

UNIT-1 - Indian Financial System

Unit Objective

After reading through the Unit, one must be in a position to understand

- Indian financial system
- Role of Government & Reserve Bank of India As Regulators of Banks
- Function of banks
- Recent Developments in Indian Financial System

Unit structure

- Introduction to Indian Financial System
- Role of Reserve Bank of India
- Role & Functions of Banks
- Various Committees on Banking & Their Impact
- Recent Developments in Indian Financial System
- SHG
- NBFCs
- Unit Summary
- Glossary
- Self – Assessment Questions
- Activities / Exercises / Case Studies
- Answers for check your progress
- Suggested Readings
- Open Source
- Reference

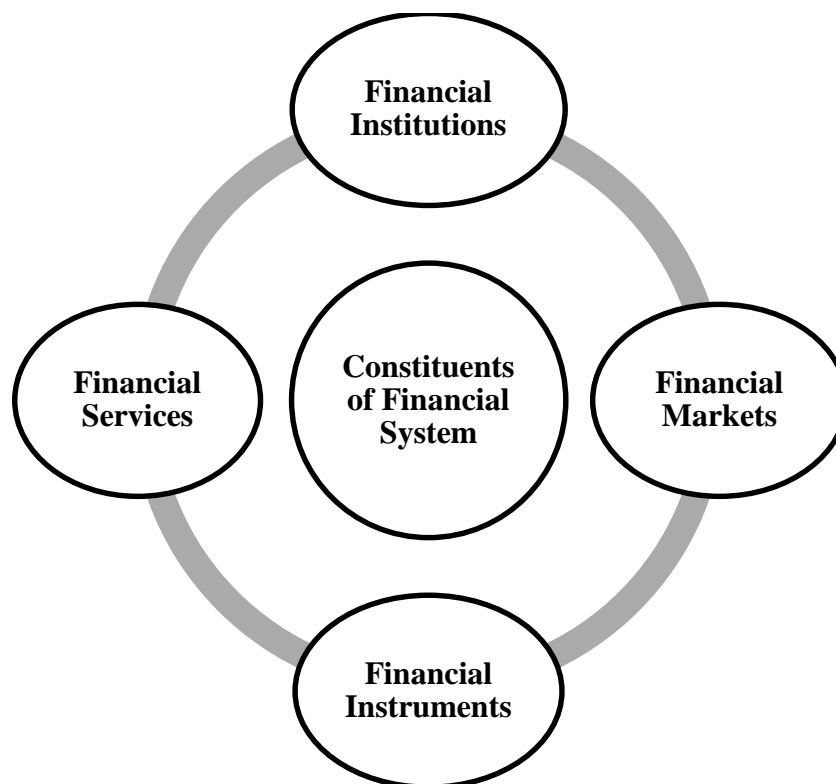
Introduction to Indian Financial System

Channelization of funds is an important task to be performed in any economy to encourage growth. Financial system performs the role of integration of the source and seeders of funds in the system there by making sure that there is a consistent flow of funds in the system and uninterrupted growth is established. The term “financial system” consists of two words “finance” and “system is a set of inter-linked institutions, agents, practices, markets, transactions and claims and liabilities. In simple the financial system means a system consist of institutions, markets, instruments and services related to finance. The Indian financial system has undergone many changes during the last five decades. But it has a commendable position in 1990’s after introduction of new economic policy in India.

Indian Financial System:

The Indian Financial system is broadly divided into organizes and unorganized sectors

- **Organized Sector:** It includes:
 - Commercial Banks (Public Sector, Private Sector, Foreign Banks, Regional Rural Banks)
 - Cooperative Banks
 - Development Financial Institutions (e.g., NABARD, SIDBI)
 - Non-Banking Financial Companies (NBFCs)
 - Insurance Companies
 - Mutual Funds
 - Pension Funds
 - Stock Exchanges
- **Unorganized Sector:** This includes informal financial channels that often operate without formal legal recognition, such as money lenders and chit funds, predominantly in rural areas.



Constituents of Financial System

Constituents of Financial System

Indian Financial System constitutes the following

- **Financial Institutions:** These help in, mobilizing savings and channeling them into productive investments. They include:
 - **Banks:** The most prominent financial institutions, accepting deposits and providing loans (e.g., commercial banks, cooperative banks, payment banks, small finance banks).
 - **Non-Banking Financial Companies (NBFCs):** Institutions that provide financial services but do not hold a banking license (e.g., housing finance companies, investment companies, microfinance institutions).
 - **Insurance Companies:** Provide financial protection against various risks (life, health, property).
 - **Mutual Funds:** Pool money from investors to invest in a diversified portfolio of securities.
 - **Pension Funds:** Manage contributions to provide retirement benefits.

- **Financial Markets:** These are platforms where financial instruments are traded, enabling the exchange of funds between buyers and sellers. They are broadly divided into:
 - **Money Market:** Deals with short-term debt instruments (maturity less than one year), providing quick liquidity. Examples include treasury bills, commercial paper, certificates of deposit, and call money. The Reserve Bank of India (RBI) plays a significant role in regulating the money market.
 - **Capital Market:** Deals with long-term financial instruments (maturity more than one year) for long-term investments. It includes:
 - **Primary Market:** Where new securities (shares, bonds) are issued for the first time (e.g., Initial Public Offerings - IPOs).
 - **Secondary Market:** Where existing securities are traded among investors (e.g., stock exchanges like BSE and NSE).
 - **Foreign Exchange Market:** Facilitates the trading of different currencies.
 - **Derivatives Market:** Deals with financial instruments (like futures and options) whose value is derived from an underlying asset.
 - **Debt Market:** Facilitates trading of debt instruments like bonds.
 - **Commodity Market:** Deals with trading in physical goods (spot market) or their futures/options.



Types of Financial Markets

- **Financial Instruments:** These are documents or contracts that represent a financial asset for one party and a liability for another. Examples include:
 - Deposits (savings, fixed deposits)
 - Loans
 - Bonds (government and corporate)
 - Shares (equities)
 - Mutual Fund Units
 - Derivatives (futures, options)
 - Insurance Policies
 - Treasury Bills, Commercial Paper, Certificates of Deposit



Types of Financial Instruments

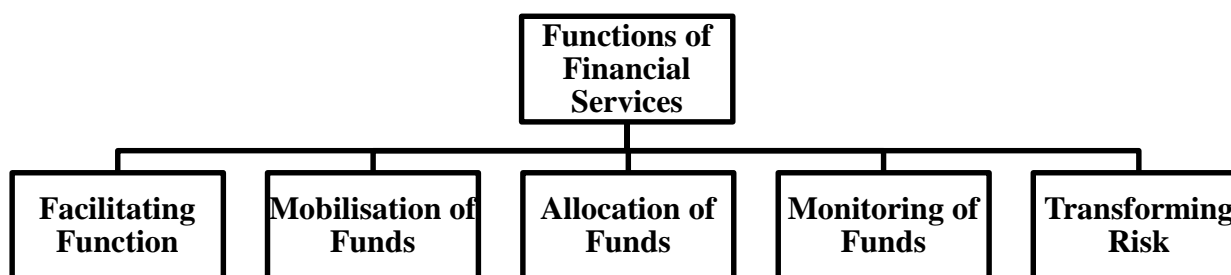
- **Financial Services:**

Financial service an important element in financial system. Financial services perform the activity of integrating the remaining three components of financial system. Financial services are very much essential to mobilize the funds in the economy and ensure that smooth functioning of the financial system happens.

Two important components such as Asset Management companies and Liability Management companies constitutes financial services. Services such as Leasing, Merchant banking, Mutual fund are performed by Asset Management Companies. Services such as Bill discounting, acceptance etc are performed by Liability Management Companies.

FUNCTIONS OF FINANCIAL SERVICES

1. **Facilitating Function:** Financial services perform the activity of a facilitator. It helps in exchange of goods and services in the economy.
2. **Mobilizing of Funds:** Financial Services plays a vital role in mobilization of funds from the sources to the seekers of funds. The flow of savings from the house hold to the industry happens in a channelized manner through various financial services.
3. **Allocation of Funds:** The financial services play an active role in allocation of funds to various section of the industry where it is most needed.



Functions of Financial Services

4. **Monitoring of Funds:** The financial services helps in managing the available funds in the best possible manner. The funds are allocated, employed and properly managed by financial service player.
5. **Transforming risk:** The Financial Services perform the function of transferring risk from one section of the market to the other where it can be bared the most.

IMPORTANCE OF FINANCIAL SERVICES:

Financial services are so vital in growth of an economy. It has the following importance.

- a. **Financing:** Financial services perform the much needed function of financing a business. It provides funds to the entrepreneurs in case of start up business through venture capital services, to the business houses in purchase of capital assets through hire purchase Financing etc.

- b. **Market growth:** Financial Services play an vital role in growth of the financial markets. Capital and money market instruments can be transacted only with the funding provided by the financial services providers.
- c. **Risk Management:** Financial Services are so important in risk management. Since risk is an element which is something uncertain and which can only be anticipated, happening of which is dependent on some other factors.
- d. **Economic Growth and Development:** Financial Services are so important to the economic growth and development. A proper integration of all section of the society is highly essential for healthy growth in the economy; this can be achieved only through financial services.



Importance of Financial Services

- e. **Foreign Investment:** Financial Services help in bring in the much needed foreign capital and thereby encouraging foreign investment. Foreign Venture capitalist is encouraged to fund Indian business.

- f. **Trade:** Financial services are helpful in encouraging both domestic and foreign trade. Adequate funding and management of funds by the financial service providers enables faster growth of trade in the country.
- g. **Return on Investment:** Financial Services ensures that the lender of the money is paid with maximum return on investment. Mutual fund managers come out with various funds with most optimal return to the unit holders.

TYPES OF FINANCIAL SERVICES:

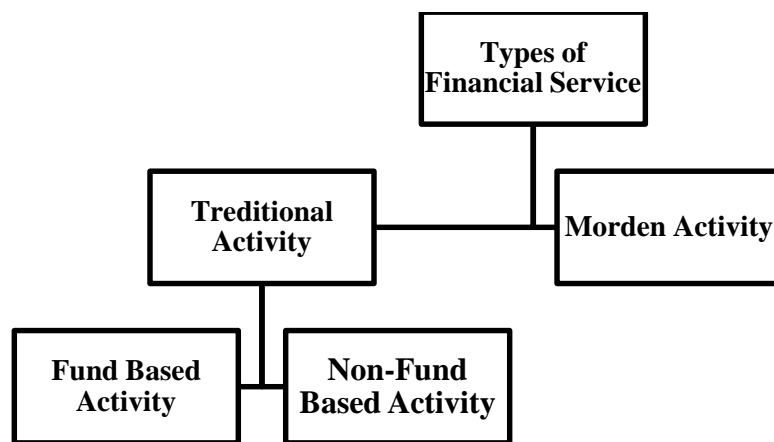
Financial services provide a wide range of activities. They can be classified into two, namely:

- a. Traditional. Activities
- b. Modern Activity

Traditional Activities

The Financial Service players traditionally provide wide range of service They can be grouped under two heads, namely.

1. Fund based activities and
2. Non-fund based activities.



Types of Financial services

I. Fund based activities:

The traditional services which come under fund based activities are the following:

Underwriting

Underwrite is a person one who makes the success of the issue a certain one the

underwriter makes it possible for the issuing company to be sure about the minimum subscription to be reached. The underwriter on his part should make good assessment of the companies' standings, competence of the records; object of the issue etc. underwriting agreement is a contract between the underwriter who is usually a merchant banker or a financial institution and the issuing company. Under this agreement the underwriter agrees to subscribe to a portion of the capital to be issued in case the issue does not fully Subscribed. This type of assistance in case of public issue is known as underwriting assistance and in respect of rights issue stand by assistance.



Illustrate 1.5 –Fund Based Activities of Financial Services

Merchant Banking

According to **Charles. P. Kindleberger** “Merchant Banking is the development of banking from commerce which frequently encountered a prolonged intermediate state known in England originally as merchant banking”

The merchant banking services are all non-funded non-banking business.

Merchant banker is one who underwrites corporate securities and advises clients on issues like corporate mergers. The merchant banker underwrites the requirements of the business concerns and arranges finance with the help of financial institutions, banks, stock exchanges, and money market.

Venture Capitalist

Higher the risk higher the return' venture is something which involves higher risk. Risky business tend to find it very difficult to raise capital that's where the role of venture capital kicks in .Venture refers to an undertaking involving more than normal business risk. The venture capital, therefore, refers to investment of capital in high risk enterprises. The need for venture capital has risen in recent years due to the need of more funds by new entrepreneurs and emergence of various business opportunities. Basically venture capitalists are involved financing of start-ups and funding risky and unproven.

Hire Purchase Financing

A hire purchase is an agreement between a lender and a borrower, or purchaser. A hire purchase is generally the same as an installment agreement or contract. It is found in nearly all industries, including car dealers, furniture stores, rental centers, and home appliances and computers. Hire purchases function as legal documents for which the lender can legally hold the title until the item is paid in full. A hire purchase can be an installment or deferred payment plan. In the former, a set monthly payment is paid on a certain day each month for a specified length of time. After the last payment, the item becomes the purchaser's property. In the latter, the property immediately belongs to the purchaser while payments are regularly made. A hire purchase can be for a few months up to many years. The interest rate can vary from low to high, depending on the institution granting the agreement. Usually, a more expensive item will be set up for 10, 15, or more years.

Factoring

Factoring is a financial service provided by specialised agents to help manufacturers and traders etc. to manage their receivables. It is a process of selling receivables to a third party on a discount. The supplier (exporter) assigns his accounts receivables in favour of the factor and gives notice of assignment to the debtor. It has been popular in developed countries. The factors undertake collection/accounting and

management of debts of their clients. Factor may either lend against accounts receivables or by purchasing invoices. He will take responsibility of collecting debt. The factoring service may be offered with or without recourse. Factoring with recourse refers to right of the factor to claim bad debts from his client, whereas in without recourse factoring, the risk of bad debt will be borne by the factoring agent himself.

According to Coleman the factoring is defined as “A continuous commercial arrangement between a factoring concern and the seller of business goods or services on credit, whereby the factor purchases accounts receivable for immediate cash and may depending on the exact nature of the arrangement”

Consumer Financing

Consumer finance companies engage primarily in making personal loans to consumers and are identified and defined by their operations under state small-loan laws. Although these laws differ in detail from state to state, they are similar in content and scope. They provide for the licensing and supervision of small-loan operations and specify many of the terms and conditions of the loans. Consumer finance is the segment of the financial services industry that lends money to individual consumers. Although banks and credit unions are among the lenders in the consumer finance industry, alternative lenders include finance companies, pay day loan services and establishments specializing in lending to borrowers with poor credit. As a whole, the broad range of services in consumer finance provides the financing to purchase vehicles, remodel a home or obtain secured and unsecured lines of credit from banks.

Mutual Fund

According to the Mutual Fund Fact Book (Published by the Investment Company Institute of the U.S.) “A Mutual Fund is a Financial Service Organization that receives money from shareholders invests it, earns returns on it, attempts to make it grow and agrees to pay the shareholder the cash on demand for the current value of its investment”.

A trust that pools the savings of investors who share a common financial goal is known as a ‘Mutual Fund’. The money thus collected is then invested in financial market instrument. The income earned through these investments, and the capital appreciation realized, are shared by its unit holder in proportion to the number of units owned by them.

II. Non fund based activities

Financial intermediaries provide services on the basis of non-fund activities. This can be called '**fee based**' activity. A wide variety of services, are being provided under this head.

They include:

- Management of **pre-issue and post-issue** activities relating to the capital issue in accordance with the SEBI guidelines and thus enabling the promoters to market their issue.
- Making arrangements for the **placement of capital** and debt instruments with investment institutions.
- Arrangement of funds from **financial institutions** for the clients' project cost or his working capital requirements.
- Assisting in the process of getting all Government and other clearances.

a. Modern Activities

The financial intermediaries render innumerable services in recent times. Most of them are in the nature of non-fund based activity. In view of the importance, these activities have been in brief under the head 'New financial products and services'.

- Rendering **project advisory services** right from the preparation of the project report till the raising of funds for starting the project with necessary Government approvals.
- Planning for **M&A** and assisting for their smooth carry out.
- Guiding corporate customers in capital restructuring.
- Acting as **trustees** to the debenture holders.
- Structuring the **financial collaborations / joint ventures** by identifying suitable joint venture partners and preparing joint venture agreements.
- **Hedging of risks** due to exchange rate risk, interest rate risk, economic risk, and political risk by using swaps and other derivative products.
- Managing **In- portfolio** of large Public Sector Corporations.
- Undertaking **risk management** services like insurance services, buy-back options etc.
- Guiding the clients in the minimization of the cost of debt and in the determination of the optimum debt-equity mix.

- Promoting **credit rating** agencies for the purpose of rating companies which want to go public by the issue of debt instrument.
- Undertaking services relating to the capital market, such as
 - ✓ Clearing services,
 - ✓ Registration and transfers,
 - ✓ Safe custody of securities,
 - ✓ Collection of income on securities.

Functions of the Indian Financial System:

The Indian financial system performs several crucial functions:

- **Mobilization of Savings:** Channels savings from households and businesses into productive investments.
- **Allocation of Credit:** Directs funds to various sectors of the economy for growth and development.
- **Facilitating Payments:** Provides efficient and secure payment and settlement systems (e.g., cheques, credit cards, digital payments).
- **Risk Management:** Offers mechanisms for individuals and businesses to manage financial risks (e.g., insurance, derivatives).
- **Price Discovery:** Helps in determining fair prices for financial assets through market interactions.
- **Capital Formation:** Contributes to the accumulation of capital, essential for economic expansion.

In essence, the Indian financial system plays a vital role in the country's economic stability and growth by efficiently transforming savings into investments, facilitating transactions, and managing financial risks.

Let Us Sum Up

Financial system performs the role of integration of the source and seeders of funds in the system there by making sure that there is a consistent flow of funds in the system and uninterrupted growth is established. The Indian Financial system is broadly divided into organized and unorganized sectors. These are documents or contracts that represent a financial asset for one party and a liability for another. Financial services are very much essential to mobilize the funds in the economy and ensure that smooth functioning of the

financial system happens. Financial services provide a wide range of activities. They can be classified into two, namely: traditional. activities and modern activity.

Check Your Progress

- 1. The Indian financial system acts as an intermediary between:** a) Importers and Exporters b) Savers and Investors c) Government and Public Sector Units d) Urban and Rural populations
- 2. The primary role of the financial system in an economy is to:** a) Increase government revenue b) Facilitate the flow of funds from surplus units to deficit units c) Control inflation directly d) Manage international trade balances
- 3. Which of the following is an example of a financial instrument?** a) A bank branch b) The Bombay Stock Exchange (BSE) c) A company's share (equity) d) The Securities and Exchange Board of India (SEBI)
- 4. The Securities and Exchange Board of India (SEBI) is the regulator for:** a) Banking sector b) Insurance sector c) Capital market (securities market) d) Microfinance institutions
- 5. In the context of the Indian financial system, "dematerialization" refers to:** a) Converting physical share certificates into electronic form b) Closing down stock exchanges c) Reducing the number of banks d) Printing new currency notes

Role of Reserve Bank of India

The Reserve Bank of India is supervising Indian economy and other banks. The RBI is the central bank of India. The main function performed by RBI is to regulate the monetary mechanism comprising of the currency, banking and credit systems of the country. The RBI has the monopoly to issue notes and has a lot of other powers over the banking system.

In 1926, the Royal Commission on Indian Currency and Finance (Hilton Young Commission) recommended that dichotomy of functions and division of responsibilities for control of currency and credit should be ended. The Commission suggested the establishment of a central bank to be called the Reserve Bank of India, whose separate existence was considered necessary for augmenting banking facilities throughout the country. The Notes Bill to establish the Reserve Bank of India (RBI) was introduced in

January 1927 in the Legislative Assembly, but it was dropped due to differences in views regarding ownership, constitution and composition of its Board of Directors. The White Paper on Indian Constitutional Reforms (1933) proposed the setting up of the RBI free from political influences. The Indian Central Banking Enquiry Committee (1931) had also strongly recommended the establishment of a Reserve Bank. These events led to the introduction of a fresh Bill in 1933. The Bill was passed in 1934 and the RBI Act came into force on January 1, 1935. The Reserve Bank was inaugurated on April 1, 1935. Central banks occupy a pivotal position in the institutional fabric of an economy.

OBJECTIVES OF RESERVE BANK OF INDIA: The preamble to the Reserve Bank of India Act, 1934, lays down the object of the RBI to be ‘to regulate the issue of bank notes and the keeping of reserve with a view to securing monetary stability and generally to operate the currency and credit system of the country to its advantage’. The financial system of India, before the establishment of the RBI, had been utterly inadequate mainly because of the dual control of currency by the government and of credit by the Imperial Bank. The Hilton Young Commission pointed out the inherent weakness of a system in which the control of currency and credit is in the hands of two distinct authorities, whose policies may be widely divergent and in which the currency and banking services are controlled and managed separately from one another. Under the circumstances, the necessity of a single institution regulating the financial policy from the point of view of the economic development of the nation as a whole was keenly felt, and the RBI was constituted mainly with this object in view.

Secondly, according to the introduction to White Paper on Indian Constitutional Reforms, the proposal for transfer of responsibility at the Centre from British to Indian hands was made dependent on the condition that a Reserve Bank, free from political influence, be established and be in successful operations. It was a ‘fundamental condition of the success of the constitution that no room should be left for doubts as to the ability of India to maintain her financial stability and credit, both at home and abroad’.

Thirdly, the inadequacy of the Imperial Bank of India in controlling the money market was patent, because of the lack of confidence of other joint-stock banks on the Imperial Bank. The success of a central banking institution depends on the confidence

which it inspires on the member banks and the influence which it exercises on them. But the Imperial Bank, which was acting as the central bank, was for all practical purposes a commercial bank competing with other joint stock banks. Under these circumstances, it was decided to establish a Reserve Bank with the object of discharging purely central banking functions and thereby initiating a fresh start in the field of Indian central banking.

- To remain free from political influence and be in successful operation for maintaining financial stability and credit.
- To discharge purely central banking functions in the Indian money market, such as acting as the note-issuing authority, bankers' bank and banker to Government, and to promote the growth of the economy.
- To assist the planned process of development of the Indian economy.

FUNCTIONS OF THE RESERVE BANK OF INDIA: The RBI performs all the typical functions of a central bank. Its main function is to regulate the monetary mechanism comprising of the currency, banking and credit systems of the country. For this, the Bank is given the monopoly of note issue and has wide powers over the banking system. Another important function of the Bank is to conduct the banking and financial operations of the government. The Bank discharges certain other functions like maintaining the external value of the rupee, collection and publication of monetary and financial information, etc. The range of functions of the Bank has come to be steadily enlarged with the task of economic development assuming new urgency and dimensions. Implementation of appropriate monetary policies, no doubt, remains its most important function. At the same time, the Bank is taking an active part in fostering an adequate banking structure capable of meeting the needs of trade, industry, agriculture and commerce.

1. Issuer of Currency Notes : It is responsible for issuing currency notes. It brings uniformity in notes issue thus making it easier to control and regulate credit in accordance with the requirements in the economy. This also helps in keeping the faith of the public in the paper currency.

2. Banker to the Government: As banker to the government the Reserve Bank manages the banking needs of the government. It maintains and operates the government's deposit

accounts. It collects receipts of funds and makes payments on behalf of the government. It represents the Government of India as the member of the IMF and the World Bank.

3. Custodian of Cash Reserves of Commercial Banks: The commercial banks hold deposits in the Reserve Bank and the latter has the custody of the cash reserves of the commercial banks. The institution is also the regulator and supervisor of the financial system and prescribes broad parameters of banking operations within which the country's banking and financial system functions. Its objectives are to maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public. It decides policy rates and reserve ratios.

4. Custodian of Country's Foreign Currency Reserves: The Reserve Bank has the custody of the country's reserves of international currency, and this enables the Reserve Bank to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

5. Lender of Last Resort: The commercial banks approach the Reserve Bank in times of emergency to tide over financial difficulties, and the Reserve bank comes to their rescue though it might charge a higher rate of interest.

6. Central Clearance and Accounts Settlement: Since commercial banks have their surplus cash reserves deposited in the Reserve Bank, it is easier to deal with each other and settle the claim of each on the other through book keeping entries in the books of the Reserve Bank. The clearing of accounts has now become an essential function of the Reserve Bank

7. Controller of Credit: Since credit money forms the most important part of supply of money, and since the supply of money has important implications for economic stability, the importance of control of credit becomes obvious. Credit is controlled by the Reserve Bank in accordance with the economic priorities of the government.

8. Detection of Fake Currency: Reserve Bank is expected to unearth black money held in cash. As the new currency notes (demonetization) have added security features, they would help in curbing the menace of fake currency.

METHODS OF CREDIT CONTROL EMPLOYED BY RBI : Credit control is one of the most important functions of the Reserve Bank of India. The Reserve Bank controls the credit in the country with the twin objectives of checking inflation and facilitating economic

development. Credit control weapons used by the Reserve Bank may be either quantitative or qualitative.

The Reserve Bank has been employing both types of weapons to control the credit by

virtue of powers given to it by the Reserve Bank of India Act, 1934 and the Banking Regulation

Act, 1949. The Reserve Bank of India Act confers on the Reserve Bank powers to control credit

quantitatively. These include bank rates or discount rates, open market operations and variable reserve requirements. The Banking Regulation Act confers on the Reserve Bank vast powers to control and regulate the entire banking system of the country. The Reserve Bank controls credit qualitatively by virtue of these powers. The Reserve Bank has the power to issue directions regarding the rate of interest that they should pay on fixed and savings deposits, the rate of interest they may charge on types of advances, the types of securities they can accept as collaterals, the branch expansion programme of the banks and many other matters.

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securities they can accept as collaterals, the branch expansion programme of the banks and many other matters.

The various methods employed by the RBI to control credit creation power of the commercial banks can be classified in two groups, viz., quantitative controls and qualitative controls. Quantitative controls are designed to regulate the volume of credit created by the banking system qualitative measures or selective methods are designed to regulate the flow of credit in specific uses.

QUANTITATIVE METHOD: Quantitative or traditional methods of credit control include banks rate policy, open market operations and variable reserve ratio.

(i) Bank Rate: The bank rate, also known as the discount rate, is the rate payable by commercial banks on the loans from or rediscounts of the Central Bank. A change in bank rate affects other market rates of interest. An increase in bank rate leads to an increase in other rates of interest and conversely, a decrease in bank rate results in a fall in other rates of interest.

A deliberate manipulation of the bank rate by the Central Bank to influence the flow of credit created by the commercial banks is known as bank rate policy. It does so by affecting the demand for credit the cost of the credit and the availability of the credit.

An increase in bank rate results in an increase in the cost of credit; this is expected to lead to a contraction in demand for credit. In as much as bank credit is an important component of aggregate money supply in the economy, a contraction in demand for credit consequent on an increase in the cost of credit restricts the total availability of money in the economy, and hence may prove an anti-inflationary measure of control.

Likewise, a fall in the bank rate causes other rates of interest to come down. The cost of credit falls, i. e., and credit becomes cheaper. Cheap credit may induce a higher demand both for investment and consumption purposes. More money, through increased flow of credit, comes into circulation. A fall in bank rate may, thus, prove an anti-deflationary instrument of control. The effectiveness of bank rate as an instrument of control is, however, restricted primarily by the fact that both in inflationary and recessionary conditions, the cost of credit may not be a very significant factor influencing the investment decisions of the firms.

(ii) Open Market Operations: Open market operations refer to the sale and purchase of securities by the Central bank to the commercial banks. A sale of securities by the Central Bank, i.e., the purchase of securities by the commercial banks, results in a fall in the total cash reserves of the latter.

A fall in the total cash reserves leads to a cut in the credit creation power of the commercial banks. With reduced cash reserves at their command the commercial banks can only create lower volume of credit. Thus, a sale of securities by the Central Bank serves as an anti-inflationary measure of control.

Likewise, a purchase of securities by the Central Bank results in more cash flowing to the commercial banks. With increased cash in their hands, the commercial banks can create more credit, and make more finance available. Thus, purchase of securities may work as an anti-deflationary measure of control.

The Reserve Bank of India has frequently resorted to the sale of government securities to which the commercial banks have been generously contributing. Thus, open market operations in India have served, on the one hand as an instrument to make available more budgetary resources and on the other as an instrument to siphon off the excess liquidity in the system.

(iii) Variable Reserve Ratios: Variable reserve ratios refer to that proportion of bank deposits that the commercial banks are required to keep in the form of cash to ensure liquidity for the credit created by them.

A rise in the cash reserve ratio results in a fall in the value of the deposit multiplier. Conversely, a fall in the cash reserve ratio leads to a rise in the value of the deposit multiplier.

A fall in the value of deposit multiplier amounts to a contraction in the availability of credit, and, thus, it may serve as an anti-inflationary measure. A rise in the value of deposit multiplier, on the other hand, amounts to the fact that the commercial banks can create more credit, and make available more finance for consumption and investment expenditure. A fall in the reserve ratios may, thus, work as anti-deflationary method of monetary control.

The Reserve Bank of India is empowered to change the reserve requirements of the commercial banks. The Reserve Bank employs two types of reserve ratio for this

purpose, viz. the Statutory Liquidity Ratio (SLR) and the Cash Reserve Ratio (CRR). The statutory liquidity ratio refers to that proportion of aggregate deposits which the commercial banks are required to keep with themselves in a liquid form. The commercial banks generally make use of this money

to purchase the government securities. Thus, the statutory liquidity ratio, on the one hand is used to siphon off the excess liquidity of the banking system, and on the other it is used to mobilise revenue for the government.

The Reserve Bank of India is empowered to raise this ratio up to 40 per cent of aggregate deposits of commercial banks. Presently, this ratio stands at 25 per cent. The cash reserve ratio refers to that proportion of the aggregate deposits which the commercial banks are required to keep with the Reserve Bank of India. Presently, this ratio stands at 9 percent.

QUALITATIVE METHOD: The qualitative or selective methods of credit control are adopted by the Central Bank in its pursuit of economic stabilisation and as part of credit management. Qualitative or selective methods of credit control include regulation of margin requirement, credit rationing, regulation of consumer credit and direct action.

(i) Margin Requirements: Changes in margin requirements are designed to influence the flow of credit against specific commodities. The commercial banks generally advance loans to their customers against some security or securities offered by the borrower and acceptable to banks.

More generally, the commercial banks do not lend up to the full amount of the security but lend an amount less than its value. The margin requirements against specific securities are determined by the Central Bank. A change in margin requirements will influence the flow of credit. A rise in the margin requirement results in a contraction in the borrowing value of the security and similarly, a fall in the margin requirement results in expansion in the borrowing value of the security.

(ii) Credit Rationing: Rationing of credit is a method by which the Central Bank seeks to limit the maximum amount of loans and advances and, also in certain cases, fix ceiling for specific categories of loans and advances.

(iii) Regulation of Consumer Credit: Regulation of consumer credit is designed to check the flow of credit for consumer durable goods. This can be done by regulating the total

volume of credit that may be extended for purchasing specific durable goods and regulating the number of installments through which such loan can be spread. Central Bank uses this method to restrict or liberalise loan conditions accordingly to stabilise the economy.

(iv) Moral Suasion: Moral suasion and credit monitoring arrangement are other methods of credit control. The policy of moral suasion will succeed only if the Central Bank is strong enough to influence the commercial banks. In India, from 1949 onwards, the Reserve Bank has been successful in using the method of moral suasion to bring the commercial banks to fall in line with its policies regarding credit. Publicity is another method, whereby the Reserve Bank makes direct appeal to the public and publishes data which will have sobering effect on other banks and the commercial circles.

Let Us Sum Up

The Reserve Bank of India is supervising Indian economy and other banks. The RBI is the central bank of India. The main function performed by RBI is to regulate the monetary mechanism comprising of the currency, banking and credit systems of the country. The RBI performs all the typical functions of a central bank. Its main function is to regulate the monetary mechanism comprising of the currency, banking and credit systems of the country. Credit control is one of the most important functions of the Reserve Bank of India. The Reserve Bank controls the credit in the country with the twin objectives of checking inflation and facilitating economic development.

Check Your Progress

1. Which of the following is NOT a primary function of the Reserve Bank of India? a) Issuer of currency b) Banker to the Government c) Regulating the stock market d) Controller of Credit.
2. The Reserve Bank of India acts as the "Lender of Last Resort" to: a) State Governments b) Public Sector Undertakings c) Commercial Banks d) Foreign Banks operating in India

3. The objective of the Monetary Policy Committee (MPC) in India is primarily to: a) Regulate foreign trade b) Control inflation within a target c) Oversee government borrowing d) Manage public debt

ROLE OF BANKS

The banking services play an important role in the economic development of a country. A well-structured banking system in a country will provide necessary power for the economy to face any given situation. A good example is India even during the world economic slowdown India managed to maintain a good healthy GDP growth, this was possible because India had a well-organized and structured banking system in place. Thus, banking plays an important role in the economic development of the country.

1. Role in Agricultural Sector

The banks play a vital role in providing financial assistance to the farmers to buy healthy seed, fertilizers and other agricultural related products. The banks provide both short and long term loans to the farmers in this aspect. In certain situations the banks have gone to extent of writing off the loans to encourage economic stability in the country. Thus banks enable the farmers to earn more income and improve their standard of living. The savings of the farmer are also mobilized by offering them an attractive interest rate. In this process, the farmers are weaned away from the clutches of moneylenders. NABARD (National Bank for Agriculture and Rural Development) has been set-up as an apex bank to meet the agricultural finance. The bank is refinancing commercial banks, cooperative banks which are involved in financing agricultural operations.

2. Role in Industrial Sector

Banks also encourage industrial production by extending loans to the industrialist. The investors are given loans for purchase of heavy machines on long-term basis. For this purpose there are Development banks such as IDBI, ICICI, etc., which provide even *soft loans*, which are not only long-term but carry lower rate of interest. For the purpose of developing backward areas the banks provide grants and loans so that more industries are attracted to backward areas. For promoting infrastructure industries such as steel,

petrol, cement etc., banks provide infrastructure finance by mobilizing resources from abroad in terms of foreign exchange.

For the purpose of improving foreign trade, especially exports, we have EXIM bank which finances for the promotion of exports as well as imports. The exporters are given various types of export finance. (Pre-shipment, post-shipment finance). Small-scale industries play a vital role in supporting large-scale industries and also in generating more employment opportunities. SIDBI (Small Industries Development Bank of India) has been set-up to provide refinancing facilities to all the banks, which are engaged in financing small-scale industries.

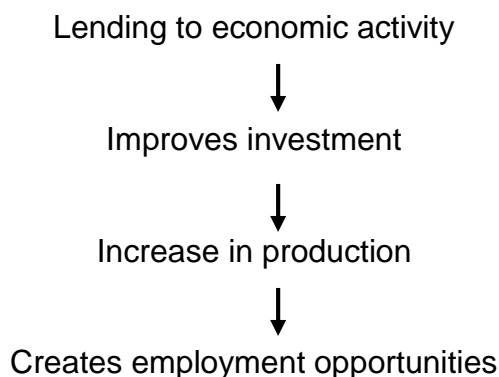
3. Service Sector

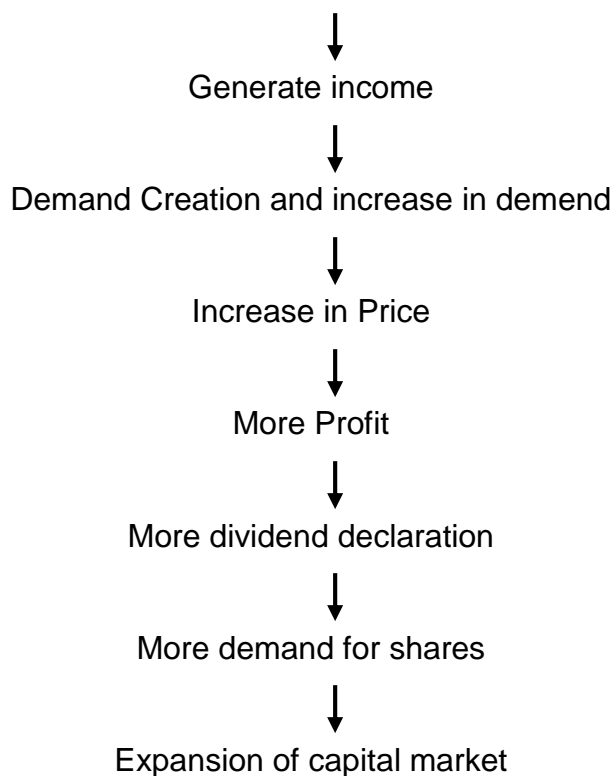
The Service sector, which consists of service such as (warehousing, insurance, marketing, advertisement, etc. It participates in growth of the economy as it provides more employment. Economic development of a country depends on this role of the banks that finance for trade, which include foreign. Banks also finance transport industry.

4. Economic Growth

So far we have seen the role of banks in the primary, secondary, tertiary sectors. In addition to these, banks play a vital role in the economy by promoting both money market and capital market. Money market provides short-term funds and the banks are the biggest players in the money market. They attract deposit from the customers and provide them as loan to industries. This trigger in a chain of activities. We can show this by way of a diagram.

ROLE OF BANKS IN ECONOMIC DEVELOPMENT





From the above diagram, we are able to see the role of banks in developing both money and capital market.

MODERN FUNCTIONS OF BANKS

Apart from the traditional function of lending and accepting deposits the modern banking functions includes the following.

1. **Portfolio Investment:** Banks are undertaking portfolio investment, which is investing the customers' funds in various securities for providing better return to the customer. This helps in the capital market getting more funds.
2. **Mutual Fund:** Banks are also enabling customers in taking part in capital market by promoting mutual funds. Here banks employ experts who could invest the customer's funds in various types of securities and provide reasonable return. They also ensure the safety of funds.
3. **Venture Capital:** Banks are providing venture capital for promoting new risky and adventurous investments. There are merchant banks promoted by banks, which

undertake the issue, allotment and collection of share capital. Thus, the corporate sector is strengthened by commercial banks.

4. **Others:** Extending of credit cards and debit card services have also brought in cumulative effect on the economy. Banks promote more self-employment opportunities by extending loans for various activities. A loan for higher education also promotes self-employment.

Various Committees on Banking & Their Impact

India has seen numerous committees that have significantly reshaped its banking landscape, particularly after economic liberalization in the early 1990s. The following are some of the committee and their impact.

1. **Narasimham Committee I (1991) and II (1998):** These were watershed committees for Indian banking reforms. Was formed to examine the structure, organization, and functioning of India's financial system and proposing reforms to enhance efficiency and competitiveness.
 - **Impact:**
 - **Liberalization and Deregulation:** Recommended reducing government interference, increasing the role of the RBI in supervision, and enhancing transparency.
 - **Capital Adequacy Norms:** Advocated for increasing the Capital Adequacy Ratio (CAR) for Indian banks to strengthen their financial health and risk-taking ability.
 - **Non-Performing Assets (NPAs):** Highlighted the issue of NPAs and recommended measures like the establishment of Asset Reconstruction Companies (ARCs) to handle bad loans. This led to legislation like the SARFAESI Act (2002).
 - **Autonomy for Public Sector Banks (PSBs):** Recommended greater operational autonomy for PSBs and reducing government equity in them.
 - **RBI's Role:** Suggested that the RBI should primarily focus on its role as a regulator and divest its ownership in banks and financial institutions.

- **Structural Reforms:** Proposed a three-tier structure for the banking system (a few large international banks, several national banks, and regional banks) and suggested merging stronger banks while addressing weaker ones.
 - **Entry of Foreign Banks:** Recommended raising the minimum startup capital for foreign banks and allowing them to establish subsidiaries.
 - **Overall Impact:** The recommendations of the Narasimham Committees laid the groundwork for a more liberalized, competitive, and robust Indian banking sector, helping it weather global financial crises better.
2. **R. H. Khan Committee (1997 & 2015):** was formed to examine the effectiveness of the financial system for the small-scale sector and the role of primary dealers (1997). Later, in 2015, it made recommendations on issues like inflation targeting and monetary policy transmission.
 - **Impact:** Contributed to improving credit delivery to critical sectors and enhancing the functioning of money markets.
 3. **Raghuram Rajan Committee (2008):** Appointed to examine financial sector reforms in India, particularly in the context of the global financial crisis.
 - **Impact:** Provided recommendations to strengthen the banking system, enhance financial inclusion, and promote financial stability.
 4. **P. J. Nayak Committee (2014):** : Focused on governance reforms in public sector banks.
 - **Impact:** Recommended reducing government interference in PSBs, enhancing the role of their boards in key decisions, and improving corporate governance standards.
 5. **Nachiket Mor Committee (2014):**
 - **Role:** Focused on financial inclusion.
 - **Impact:** Recommended policies to expand access to financial services for all segments of the population, including through payment banks.

Let Us Sum Up

The banking services play an important role in the economic development of a country. A well-structured banking system in a country will provide necessary power for the economy to face any given situation. NABARD (National Bank for Agriculture and Rural Development) has been set-up as an apex bank to meet the agricultural finance. Banks also encourage industrial production by extending loans to the industrialist. The investors are given loans for purchase of heavy machines on long-term basics. modern banking functions includes portfolio investment, mutual fund, venture capital and Extending of credit cards and debit card services.

Check Your Progress

1. Which of the following is considered the primary, traditional function of a bank? a) Providing locker facilities b) Accepting deposits c) Issuing credit cards d) Underwriting shares.
2. How do banks primarily contribute to capital formation in an economy? a) By directly manufacturing goods and services. b) By discouraging savings and promoting consumption. c) By mobilizing scattered savings and directing them into productive investments. d) By providing only short-term loans to consumers.
3. Which of the following is a key role of banks in the payment system of an economy? a) Issuing government bonds b) Facilitating cashless transactions through various channels (e.g., NEFT, RTGS, UPI). c) Regulating insurance companies. d) Printing physical currency notes.
4. How do banks contribute to employment generation in an economy? a) By directly hiring millions of people in their operations. b) By financing various sectors like industry, agriculture, and services, which then create jobs. c) By imposing high taxes on businesses. d) By solely focusing on automation.

Self Help Group (SHG)

A Self-Help Group (SHG) is a small, informal association of individuals, typically from similar socio-economic backgrounds, who voluntarily come together to achieve collective objectives, primarily economic and social empowerment.

Key characteristics of SHGs include:

- Usually SHG small number of members which comprises of 10 to 20 members, which facilitates cohesion and effective participation.
- Members generally share similar socio-economic conditions, ensuring mutual understanding and trust.
- Members join willingly, driven by a common desire to improve their lives.
- Members commit to saving small, fixed amounts regularly (e.g., weekly or monthly) and pooling these savings into a common fund.
- The pooled savings are then used to provide small loans to members for various needs (consumption, emergencies, micro-enterprises) at reasonable interest rates, decided by the group.
- Decisions regarding savings, loans, interest rates, and other group activities are made democratically by all members.
- SHGs operate on principles of self-help and mutual support, where members assist each other in overcoming challenges and achieving goals.
- While they may have basic rules and elected leaders, they are often not formally registered under any specific law, though some may choose to register for various benefits.

Need for Self-Help Groups

The need for SHGs arises primarily from the challenges faced by marginalized and low-income populations, particularly in rural areas, in accessing formal financial services and achieving overall socio-economic well-being. Some key reasons include:

1. Lack of Access to Formal Credit:

- **No Collateral:** The poor often lack the collateral required by traditional banks, making it difficult for them to secure loans.
- **High Transaction Costs for Banks:** Banks find it uneconomical to lend small amounts to a large number of scattered, low-income borrowers due to high administrative costs.

- **Weak Community Networks:** In many traditional settings, community networks were informal but insufficient to provide consistent credit. SHGs formalize and strengthen these networks.
- **"Last-Mile" Connectivity:** Formal financial institutions often have limited reach in remote or rural areas. SHGs fill this gap.

2. Poverty and Economic Vulnerability:

- **Limited Savings Capacity:** Individually, poor households may struggle to save consistently. SHGs encourage and facilitate regular, even small, savings.
- **Income Instability:** Many informal sector workers face fluctuating incomes. SHGs provide a buffer and a source of emergency funds.
- **Lack of Entrepreneurial Capital:** Small loans from SHGs enable members to start or expand micro-enterprises, creating self-employment opportunities.

3. Social Exclusion and Disempowerment:

- **Marginalization:** Vulnerable groups, especially women, often face social barriers and lack a collective voice.
- **Low Financial Literacy:** Many poor individuals lack basic financial knowledge, making them susceptible to exploitation by informal moneylenders.
- **Dependence on Moneylenders:** High-interest rates charged by informal moneylenders can trap the poor in cycles of debt. SHGs offer an affordable alternative.

4. Limited Skill Development and Awareness:

- Individually, members may lack access to training, market information, or awareness about government schemes. SHGs can facilitate collective access to such resources.

Objectives of Self-Help Groups

The objectives of SHGs are multi-faceted, encompassing both economic and social dimensions:

1. Economic Objectives:

- **Promote Savings Habits:** To instill and reinforce a habit of regular savings among members, enabling them to build a collective corpus.
- **Facilitate Access to Credit:** To provide timely and affordable microcredit to members for consumption needs, emergencies, and income-generating activities, without collateral.
- **Reduce Indebtedness:** To free members from the clutches of exploitative informal moneylenders by offering a cheaper and more accessible alternative.
- **Foster Entrepreneurship and Livelihood Generation:** To enable members to start or expand micro-enterprises, leading to increased income and self-employment.
- **Improve Financial Literacy:** To educate members on basic financial management, budgeting, and the responsible use of credit.
- **Link with Formal Financial Institutions:** To act as a bridge between the unbanked poor and formal banks (e.g., through the SHG-Bank Linkage Programme), allowing them to access larger loans and other banking services.

2. Social Objectives:

- **Empowerment:**
 - **Women's Empowerment:** A significant objective, especially in India, is to empower women by increasing their economic independence, confidence, and decision-making power within their households and communities.
 - **Voice to the Marginalized:** To provide a platform for marginalized communities to collectively articulate their needs and participate in local governance and development processes.
- **Building Social Capital:** To foster a sense of solidarity, cooperation, trust, and mutual support among members, leading to stronger community networks.
- **Poverty Alleviation:** By facilitating economic activities and improving financial management, SHGs directly contribute to lifting households out of poverty.
- **Addressing Social Issues:** To act as a forum for collective action against social ills like dowry, child marriage, alcoholism, domestic violence, and to promote health, hygiene, and education.

- **Skill Development and Capacity Building:** To facilitate training and capacity-building programs for members in areas like vocational skills, business development, and leadership.
- **Community Development:** To participate in broader community development initiatives, often acting as effective channels for implementing government welfare schemes.

FINANCIAL INCLUSION

Financial inclusion is the **process of ensuring that individuals and businesses have access to and can effectively use a range of affordable, useful, and responsible financial products and services.** In essence, financial inclusion integrates the "unbanked" and "underbanked" into the formal financial system, empowering them to manage their finances, build assets, mitigate risks, and participate more fully in economic life.

Objectives of Financial Inclusion

The objectives of financial inclusion are broad and multifaceted, aiming to achieve both economic and social empowerment:

1. **Universal Access to Banking Services:** To ensure every household or individual has at least one basic bank account for savings and transactional purposes.
2. **Affordable Credit Availability:** To provide timely and adequate credit at reasonable interest rates for productive purposes (e.g., starting businesses, agriculture) and personal needs, especially to vulnerable groups.
3. **Promotion of Savings and Investment:** To instill a savings habit and provide safe avenues for low-income individuals to save, accumulate assets, and invest for their future.
4. **Risk Mitigation through Insurance:** To offer accessible and affordable insurance products (life, health, accidental, crop) to provide a safety net against unforeseen events and financial shocks.
5. **Efficient Payment and Remittance Systems:** To facilitate secure, fast, and low-cost methods for sending and receiving money, reducing reliance on informal and often expensive channels.

6. **Enhance Financial Literacy and Capability:** To educate and empower individuals with the knowledge and skills to understand and effectively use various financial products and services, making informed financial decisions.
7. **Foster Entrepreneurship and Livelihood Creation:** By providing access to credit, financial inclusion enables individuals to start or expand micro-enterprises, leading to self-employment and income generation.
8. **Promote Digital Financial Services:** To encourage the adoption and usage of digital payment platforms and mobile banking to enhance convenience, efficiency, and reach.
9. **Reduce Disparities and Promote Equity:** To bridge the gap between different sections of society, ensuring that economic opportunities are available to all, regardless of income, gender, or location.
10. **Strengthen Consumer Protection:** To establish robust frameworks that protect consumers from unfair practices, ensure transparency, and provide effective grievance redressal mechanisms.

Need for Financial Inclusion

The need for financial inclusion stems from its profound impact on individuals, economies, and societies:

1. **Poverty Alleviation:** Access to financial services allows the poor to manage their money better, save for future needs, access credit for income-generating activities, and cope with financial shocks, thus helping them escape the cycle of poverty.
2. **Inclusive Economic Growth:** When a larger segment of the population can participate in the formal financial system, it mobilizes domestic savings, which can be channeled into productive investments, stimulating overall economic growth that benefits a wider population.
3. **Reduction of Inequality:** Financial exclusion often exacerbates economic and social inequalities. By providing access to finance, financial inclusion helps bridge the gap between the rich and the poor, urban and rural populations, and different genders.
4. **Empowerment of Vulnerable Sections:**

- **Women:** Financial inclusion empowers women by giving them greater control over their finances, enhancing their bargaining power within households, and enabling them to pursue entrepreneurial activities.
 - **Farmers & MSMEs:** Access to credit and insurance is crucial for farmers to invest in agriculture and for Micro, Small, and Medium Enterprises (MSMEs) to grow, contributing significantly to employment and economic output.
5. **Enhanced Financial Stability:** A well-banked population means more stable deposits for banks and a reduced reliance on informal, unregulated financial channels, contributing to the overall stability and resilience of the financial system.
 6. **Efficient Delivery of Social Welfare:** Financial inclusion facilitates Direct Benefit Transfers (DBT) of government subsidies and welfare payments directly into beneficiaries' bank accounts, reducing leakages, corruption, and improving the effectiveness of social programs.
 7. **Increased Formalization of the Economy:** Bringing more individuals and businesses into the formal financial system increases tax bases, improves data collection for policymaking, and reduces the size of the informal economy.
 8. **Protection Against Exploitation:** Access to affordable formal credit protects vulnerable populations from predatory informal moneylenders who charge exorbitant interest rates.
 9. **Building Financial Resilience:** Savings and insurance products provide a safety net, enabling individuals and businesses to withstand unexpected events like illness, job loss, or natural disasters without falling deeper into poverty.
 10. **Leveraging Technology:** The push for financial inclusion drives innovation in financial technology (FinTech), leading to more efficient, accessible, and user-friendly financial services.

Advantages of Financial Inclusion:

1. **Poverty Reduction and Economic Upliftment:**
 - **Increased Savings:** Provides safe and secure avenues for low-income individuals
 - to save, accumulate assets, and build a financial cushion.

- **Access to Productive Capital:** Enables entrepreneurs, small farmers, and micro-enterprises to access credit for investments, leading to income generation, job creation, and poverty reduction.
- **Risk Management:** Offers affordable insurance products (life, health, crop) that protect vulnerable populations from financial shocks due to unforeseen events.

2. Inclusive Economic Growth:

- **Resource Mobilization:** Draws savings from the informal sector into the formal financial system, increasing the overall pool of investable funds for the economy.
- **Increased Productivity:** Businesses with access to credit can invest in better technology, expand operations, and improve efficiency, contributing to higher GDP.
- **Broader Participation:** Brings more people into the formal economy, leading to increased demand for goods and services, and fostering overall economic activity.

3. Social Empowerment and Equity:

- **Women's Empowerment:** Crucially empowers women by giving them financial independence, decision-making power, and opportunities to start businesses.
- **Reduced Inequality:** Helps bridge the gap between the rich and poor, urban and rural populations, and different genders by providing equal access to financial tools.
- **Improved Livelihoods:** Enhances the ability of marginalized communities to improve their living standards, education, and health outcomes.

4. Enhanced Financial Stability and Governance:

- **Reduced Informal Lending:** Lessens reliance on exploitative informal moneylenders, making the financial system more regulated and transparent.

- **Better Data for Policymaking:** Increased formal transactions provide valuable data for governments and central banks to formulate more effective economic policies.
- **Efficient Social Welfare Delivery:** Facilitates direct benefit transfers (DBT) of government subsidies, reducing leakages and ensuring that benefits reach the intended beneficiaries directly.

5. Innovation and Digital Transformation:

- **** mendorong FinTech:**** The push for inclusion drives innovation in financial technology, leading to the development of more efficient, accessible, and user-friendly digital financial services (e.g., mobile banking, UPI).
- **Cost Reduction:** Digitalization can lower the cost of delivering financial services, making them more affordable for low-income segments.

Disadvantages and Challenges of Financial Inclusion:

1. Risk of Over-indebtedness and Financial Stress:

- **Lack of Financial Literacy:** Individuals new to formal credit may not fully understand terms, interest rates, or repayment obligations, leading to excessive borrowing or inability to repay.
- **Predatory Lending:** Some unscrupulous lenders or products might target financially illiterate individuals with high-interest loans, pushing them into a debt trap.
- **Unintended Use of Loans:** Loans meant for productive purposes might be diverted for consumption, leading to non-performing assets (NPAs) for lenders and financial stress for borrowers.

2. Operational and Implementation Challenges for Providers:

- **High Costs of Servicing the Poor:** While digital means help, the "last mile" connectivity, customer support, and financial literacy efforts in remote areas can still be costly for banks and MFIs.
- **Lack of Infrastructure:** Remote and rural areas may lack reliable internet connectivity, electricity, and physical banking infrastructure (branches, ATMs), hindering digital and physical access.

- **Difficulty in Credit Assessment:** Lack of traditional credit history for low-income borrowers makes credit risk assessment challenging, potentially leading to higher default rates for lenders.
- **Regulatory and Supervisory Burden:** Ensuring responsible lending and consumer protection for a vast, diverse, and often vulnerable population requires robust and adaptable regulatory oversight, which can be complex to implement.

3. Customer-Side Barriers:

- **Low Financial Literacy:** Many individuals, especially in rural areas, lack awareness of basic financial concepts, the benefits of formal services, and how to use them safely.
- **Trust Deficit:** Past negative experiences with informal lenders or a general mistrust of formal institutions can deter people from engaging fully.
- **Cultural and Social Norms:** Certain cultural beliefs, gender roles, or traditions might restrict women's access to or control over financial resources.
- **Documentation Requirements:** Even with simplified KYC norms, some marginalized individuals may struggle to provide necessary identity documents.
- **Digital Divide:** Lack of access to smartphones, digital literacy, or reliable internet can exclude those who are unable to use digital financial services.

4. Potential for Misuse and Frauds:

- **Cybersecurity Risks:** As more transactions go digital, the risk of cyber frauds, identity theft, and data breaches increases, especially for new users who may not be digitally savvy.
- **Money Laundering/Terrorism Financing:** While formal systems aid in tracking, the rapid onboarding of millions could, if not properly monitored, create new avenues for illicit financial flows.

5. Sustainability Concerns for Institutions:

- **Dormant Accounts:** A significant number of accounts opened under financial inclusion drives might remain dormant, incurring maintenance costs for banks without generating much revenue.
- **Limited Profitability:** Servicing small-value transactions and loans to low-income segments can be less profitable than traditional banking, requiring institutions to balance social objectives with financial viability.

Self Help Groups and Financial Inclusion

SHGs contribute to financial inclusion through several key mechanisms:

1. Promoting Savings and Financial Discipline:

- **Regular Thrift:** SHGs encourage members to save small, regular amounts. This instills a discipline of savings, which is often difficult for low-income individuals on their own.
- **Pooled Capital:** These pooled savings form a common fund, which is the group's initial capital. This collective fund acts as a foundational financial resource.
- **Building Financial Habits:** The act of regular saving and managing a group fund helps members understand the importance of financial planning and responsible money management.

2. Providing Access to Microcredit:

- **Internal Lending:** The most immediate benefit is that SHGs provide members with access to small, collateral-free loans from their common fund for various needs (consumption, emergencies, or starting micro-enterprises). These loans are typically at reasonable interest rates set by the group, far lower than informal moneylenders.
- **Reduced Transaction Costs:** For banks, lending to an SHG as a group (instead of individual small borrowers) significantly reduces transaction costs and administrative overhead.
- **"Social Collateral":** The peer pressure and mutual trust within the group act as "social collateral," ensuring high repayment rates, which makes SHGs attractive to formal financial institutions.

3. Facilitating Linkage with Formal Financial Institutions (The SHG-Bank Linkage Programme):

- **NABARD's Pioneering Role:** In India, the **SHG-Bank Linkage Programme (SBLP)**, pioneered by NABARD (National Bank for Agriculture and Rural Development) in 1992, has been a game-changer. It's now the world's largest microfinance program.
- **Gradual Integration:** Once an SHG demonstrates financial discipline (regular meetings, savings, and internal lending), banks are encouraged to open savings accounts for them. Over time, banks extend credit to the SHG itself, which then on-lends to its members.
- **Overcoming Barriers:** This linkage overcomes major barriers like lack of collateral, high transaction costs, and limited financial literacy that traditionally excluded the poor from formal credit. It formalizes the financial transactions of millions.

4. Enhancing Financial Literacy and Capability:

- **Practical Learning:** Through managing their group's finances, members gain practical experience in budgeting, record-keeping, and loan management.
- **Awareness Programs:** Many SHGs, often supported by NGOs or government programs (like National Rural Livelihoods Mission - NRLM), conduct financial literacy sessions, educating members about formal banking products, interest rates, insurance, and responsible borrowing.
- **Informed Decision-Making:** Improved financial literacy empowers members to make better financial decisions for their households and businesses.

5. Empowerment and Social Capital Building:

- **Women's Empowerment:** The vast majority of SHGs are women-centric. Financial independence gained through SHGs significantly boosts women's self-confidence, decision-making power within their families, and social standing in the community.

- **Collective Bargaining:** SHGs provide a platform for members to collectively address common issues, whether financial or social, giving a voice to the marginalized.
- **Social Cohesion:** The regular meetings and shared goals foster strong bonds of solidarity, trust, and mutual support among members, creating valuable social capital.

Jan Dhan Yojana Accounts

The **Pradhan Mantri Jan Dhan Yojana (PMJDY)** is a flagship national mission for financial inclusion launched by the Government of India in August 2014. Its primary objective is to ensure universal access to financial services in an affordable manner, specifically for the unbanked and underserved segments of society.

Key Features of Jan Dhan Yojana Accounts:

PMJDY accounts are designed to remove barriers to banking access and encourage financial participation. Here are their main features:

1. **Zero-Balance Accounts:** The most significant feature is that these accounts can be opened with **zero minimum balance** requirement. This addresses a major barrier for low-income individuals who may not be able to maintain a specific balance in traditional bank accounts.
2. **Basic Savings Bank Deposit Account (BSBDA):** PMJDY accounts are typically opened as BSBDA, which are simplified accounts designed for accessibility.
3. **RuPay Debit Card:** Every PMJDY account holder receives a **RuPay debit card**. This card enables cashless transactions, ATM withdrawals, and access to basic digital payment infrastructure.
4. **Accidental Insurance Cover:** For RuPay PMJDY cardholders, there is an inbuilt **accidental insurance cover of ₹2 lakh** (for accounts opened after August 28, 2018). This provides a crucial safety net against unforeseen events.
5. **Overdraft (OD) Facility:** Eligible account holders can avail an overdraft facility of up to **₹10,000**. This acts as a micro-credit facility, providing immediate liquidity for emergencies or small business needs, especially for those with no prior credit history. The age limit for availing OD was revised from 18-60 years to 18-65 years. An overdraft of ₹2,000 is hassle-free.

6. **Direct Benefit Transfer (DBT):** PMJDY accounts are crucial for facilitating the **Direct Benefit Transfer (DBT)** of government subsidies and welfare scheme payments. This ensures that benefits reach the intended beneficiaries directly, reducing leakages and corruption.
7. **Access to Pension and Insurance Products:** PMJDY accounts serve as a gateway to other social security schemes like Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), and Atal Pension Yojana (APY), further enhancing financial security.
8. **Easy Money Transfer:** The accounts allow for easy transfer of money across India, promoting convenience and reducing reliance on informal channels.
9. **Mobile Banking (USSD facility):** The scheme supports mobile banking even on basic feature phones through the USSD (Unstructured Supplementary Service Data) facility, further expanding access to digital services in areas with limited internet connectivity.
10. **Extensive Network:** Accounts can be opened at any bank branch or through a Business Correspondent (BC) outlet (Bank Mitras), ensuring widespread reach, particularly in rural and remote areas.

Impact on Financial Inclusion:

PMJDY has had a transformative impact on financial inclusion in India:

- **Massive Account Penetration:** It has dramatically increased banking penetration across the country, bringing millions of previously unbanked individuals into the formal banking system.
- **Reduced Reliance on Cash:** The RuPay debit cards and the underlying digital payment infrastructure have encouraged cashless transactions, contributing to a more digitally-driven economy.
- **Leakage Reduction in Subsidies:** The DBT mechanism through PMJDY accounts has streamlined the delivery of government benefits, making the process more efficient and transparent.
- **Inculcation of Savings Habit:** While initially many accounts were zero-balance, over time, the average deposit balance in PMJDY accounts has significantly increased, indicating a growing savings habit among account holders.

- **Foundation for Other Schemes:** PMJDY has laid the groundwork for other financial and social security schemes, providing a robust platform for their implementation.
- **Financial Literacy Push:** The scheme has been accompanied by financial literacy efforts to educate beneficiaries on how to use their accounts and various financial products.

Non-Banking Financial Companies (NBFCs)

Non-Banking Financial Companies (NBFCs) are financial institutions that provide banking services without holding a banking license. In India, they are companies registered under the Companies Act (1956 or 2013) and are primarily regulated by the Reserve Bank of India (RBI).

Key Characteristics of NBFCs:

- **Do NOT accept demand deposits:** Unlike commercial banks, NBFCs cannot accept deposits that are repayable on demand (like current or savings accounts). They can, however, accept time deposits (like fixed deposits), but these are generally subject to different regulations and are not covered by deposit insurance (DICGC) like bank deposits.
- **Do NOT form part of the payment and settlement system:** They cannot issue cheques drawn on themselves.
- **Engage in diverse financial activities:** Their primary business involves loans and advances, acquisition of shares/stocks/bonds/debentures/securities, leasing, hire-purchase, insurance business, chit funds, etc.
- **Regulation:** While regulated by the RBI, certain types of NBFCs may also be regulated by other sectoral regulators (e.g., Housing Finance Companies by the National Housing Bank, now under RBI; Insurance Companies by IRDAI).

Role of NBFCs in the Economy and Financial Inclusion: NBFCs play a crucial and complementary role to commercial banks in India's financial system:

- **Last-Mile Credit Delivery:** They are often more agile and have a wider reach, especially in semi-urban and rural areas, catering to segments that traditional banks might find difficult or less profitable to serve. This makes them critical for last-mile credit delivery.

- **Specialized Lending:** NBFCs specialize in various niches, such as:
 - **Vehicle finance:** Financing commercial vehicles, two-wheelers, cars.
 - **Housing finance:** Providing home loans, especially for affordable housing segments.
 - **Gold loans:** Lending against gold ornaments.
 - **SME and MSME loans:** Catering to the credit needs of small and medium enterprises.
 - **Infrastructure finance:** Funding large-scale infrastructure projects.
- **Flexibility and Speed:** NBFCs often have more flexible lending norms, quicker processing times, and tailored products, making them attractive to borrowers with urgent financial needs or non-traditional credit profiles.
- **Digital Adoption:** Many NBFCs, particularly those with a fintech focus, are at the forefront of leveraging technology (AI, data analytics, mobile apps) to streamline operations, assess risk, and reach customers efficiently.
- **Bridging Credit Gaps:** They fill critical credit gaps in the economy, supporting sectors and individuals often underserved by mainstream banks, thereby directly contributing to financial inclusion.

Micro Finance Institutions (MFIs)

Micro Finance Institutions (MFIs) are organizations that provide financial services, primarily small loans (microcredit), to low-income individuals or groups who lack access to conventional banking and related services. Their core mission is to empower the poor, especially women, by enabling them to undertake income-generating activities.

Evolution of MFIs in India: MFIs in India operate under various legal structures:

1. **Trusts and Societies:** Often started as NGOs, focused on social development.
2. **Section 8 Companies (formerly Section 25 Companies):** Non-profit companies registered under the Companies Act.
3. **Co-operative Societies:** Governed by Co-operative Societies Acts.
4. **Non-Banking Financial Company - Micro Finance Institutions (NBFC-MFIs):**

This is the most significant and regulated category.

Role of NBFC-MFIs in Financial Inclusion: NBFC-MFIs are vital for financial inclusion because:

- **Deep Rural Penetration:** They have extensive networks and field officers who reach remote villages and urban slums, providing doorstep financial services.
- **Targeting the Poorest:** Their specific focus on low-income households and individuals (especially women) directly addresses the needs of the financially excluded.
- **Microcredit for Livelihoods:** They are primary providers of small loans that enable the poor to start or expand micro-enterprises, secure employment, and generate income.
- **Financial Literacy:** Many NBFC-MFIs integrate financial literacy training with their loan disbursement, helping clients understand financial concepts and manage their money effectively.
- **Building Credit History:** By providing formal credit, they help clients build a credit history, potentially enabling them to access larger loans from mainstream banks in the future.
- **Social Impact:** Beyond finance, they often foster social empowerment, particularly among women, by promoting group solidarity and collective action.

Let Us Sum Up

A Self-Help Group (SHG) is a small, informal association of individuals, typically from similar socio-economic backgrounds, who voluntarily come together to achieve collective objectives, primarily economic and social empowerment. The need for SHGs arises primarily from the challenges faced by marginalized and low-income populations, particularly in rural areas, in accessing formal financial services and achieving overall socio-economic well-being. Financial inclusion is the process of ensuring that individuals and businesses have access to and can effectively use a range of affordable, useful, and responsible financial products and services. The need for financial inclusion stems from its profound impact on individuals, economies, and societies poverty alleviation, empowerment of vulnerable sections and enhanced financial stability. The **Pradhan Mantri Jan Dhan Yojana (PMJDY)** is a flagship national mission for financial inclusion launched by the Government of India in August 2014. Its primary objective is to ensure universal access to financial services in an affordable manner, specifically for the

unbanked and underserved segments of society. Micro Finance Institutions (MFIs) are organizations that provide financial services, primarily small loans (microcredit), to low-income individuals or groups who lack access to conventional banking and related services.

Check Your Progress

1. What is the core concept behind the formation of Self-Help Groups (SHGs) a) To provide large-scale government subsidies to rural industries. b) To enable a group of people to pool their savings and provide micro-credit to each other. c) To form a political lobby group for local governance. d) To manage foreign exchange reserves at the grassroots level.
2. The concept of 'Financial Inclusion' primarily seeks to: a) Increase the number of luxury banking products available. b) Ensure that all sections of society, especially the vulnerable, have access to affordable and appropriate financial services. c) Mandate minimum balance requirements for all bank accounts. d) Promote only digital payment methods, eliminating cash.
3. How do SHGs contribute to 'financial inclusion'? a) By acting as direct regulators of commercial banks. b) By providing a platform for the unbanked to access formal credit through bank linkages. c) By solely distributing government welfare schemes. d) By competing directly with large commercial banks for corporate clients.
4. What is the primary target group for Microfinance Institutions (MFIs)? a) Large corporations and industrial houses b) High-net-worth individuals c) Low-income individuals, households, and small businesses lacking access to conventional banking d) Government agencies and public sector undertakings.
5. Which of the following is a common characteristic of microfinance loans? a) Very large loan amounts (e.g., millions of rupees) b) Loans primarily for purchasing luxury goods c) Small loan amounts, often for income-generating activities d) Loans requiring substantial collateral

Unit Summary

Financial system performs the role of integration of the source and seeders of funds in the system there by making sure that there is a consistent flow of funds in the system and uninterrupted growth is established. The Indian Financial system is broadly

divided into organized and unorganized sectors. The RBI performs all the typical functions of a central bank. Its main function is to regulate the monetary mechanism comprising of the currency, banking and credit systems of the country. Credit control is one of the most important functions of the Reserve Bank of India. The Reserve Bank controls the credit in the country with the twin objectives of checking inflation and facilitating economic development. The investors are given loans for purchase of heavy machines on long-term basis. Modern banking functions include portfolio investment, mutual fund, venture capital and extending of credit cards and debit card services. A Self-Help Group (SHG) is a small, informal association of individuals, typically from similar socio-economic backgrounds, who voluntarily come together to achieve collective objectives, primarily economic and social empowerment. The **Pradhan Mantri Jan Dhan Yojana (PMJDY)** is a flagship national mission for financial inclusion launched by the Government of India in August 2014.

Glossary

- **Financial Institutions:** Organizations that act as intermediaries in the financial system, such as banks, non-banking financial companies (NBFCs), insurance companies, and mutual funds.
- **Financial Markets:** Platforms where financial instruments are traded. They can be broadly categorized into:
 - **Money Market:** Deals with short-term funds (maturity generally up to one year) like Treasury Bills, Commercial Paper, Certificates of Deposit.
 - **Capital Market:** Deals with long-term funds (maturity more than one year) like shares, debentures, bonds.
- **Reserve Bank of India (RBI):** The central bank of India, responsible for monetary policy, regulation of banks, currency issuance, and management of foreign exchange reserves.
- **Securities and Exchange Board of India (SEBI):** The regulator for the Indian securities market (stock market), protecting investor interests and promoting market development.

- **Non-Banking Financial Company (NBFC):** A financial institution that provides banking services without holding a banking license, such as loan companies, investment companies, etc. They are regulated by the RBI.
- **Deposits:** Money placed by individuals or entities into bank accounts (e.g., Savings Accounts, Current Accounts, Fixed Deposits, Recurring Deposits).
- **Loans/Advances:** Funds provided by banks to borrowers, creating debt. These can be short-term (e.g., cash credit, overdraft) or long-term (e.g., term loans, home loans).
- **Credit Creation:** The unique ability of commercial banks to expand the money supply in the economy by multiplying initial deposits through the lending process.
- **Self-Help Group (SHG):** A small, informal association of people, typically from similar socio-economic backgrounds, who come together to pool their savings and provide small loans (microcredit) to each other, fostering mutual help and financial discipline.
- **Federation of SHGs:** A higher-level body formed by several SHGs, providing support, capacity building, and advocacy for member SHGs.
- **Pradhan Mantri Jan Dhan Yojana (PMJDY):** A national mission for financial inclusion launched in India, aiming to provide universal access to banking facilities with a focus on 'no-frills' accounts.
- **Business Correspondent (BC) Model:** A model where banks use individuals or organizations (BCs) as agents to provide basic banking services in remote or unbanked areas, extending their reach.
- **Digital Financial Services:** Financial services delivered through digital channels like mobile phones, internet, or payment banks, reducing transaction costs and improving accessibility.

Self – Assessment Questions

1. What are the four main components that make up the Indian Financial System? Briefly explain each.
2. Differentiate between the Money Market and the Capital Market
3. What are the two most fundamental (primary) functions of a bank?

4. Who is known as the "Lender of Last Resort" in the Indian financial system, and what does this function entail?
5. Define a Self-Help Group (SHG) and explain its core purpose.
6. What is 'microcredit' in the context of SHGs?
7. Bring out the significance of SHGs on women's empowerment.
8. What is the main objective of 'Financial Inclusion'?
9. How does the Business Correspondent (BC) model contribute to financial inclusion in remote areas?
10. What was the primary goal of the Pradhan Mantri Jan Dhan Yojana (PMJDY)?

Activities / Exercises / Case Studies

- Draw a flowchart or diagram illustrating the flow of funds in the Indian financial system.
- Make a case study on Digital Financial Inclusion in Rural India

Answers for check your progress

Introduction to Indian Financial System

6. b) Savers and Investors

Reason: - The core function of any financial system is to channel funds from those who have surplus money (savers) to those who need money for productive investments (investors). This facilitates economic growth.

7. b) Facilitate the flow of funds from surplus units to deficit units

Reason: - This is the fundamental purpose of any financial system. It ensures that available capital is efficiently allocated for investment and consumption.

8. c) A company's share (equity)

Reason: - Financial instruments are contracts that represent a monetary value, such as shares, bonds, debentures, etc. Bank branches are institutions, BSE is a market, and SEBI is a regulator.

9. c) Capital market (securities market)

Reason: - SEBI was established to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

10.a) Converting physical share certificates into electronic form

Reason: - Dematerialization was a significant reform in the Indian capital market, making share trading more efficient, secure, and reducing the risks associated with physical certificates.

Role of Reserve Bank of India

1. c) Regulating the stock market

Reason: - The RBI's primary functions include issuing currency, acting as a banker to the government, and controlling credit. The regulation of the stock market falls under the purview of the Securities and Exchange Board of India (SEBI).

2. c) Commercial Banks

Reason:- When commercial banks face a severe liquidity crisis and cannot obtain funds from other sources, the RBI provides them with emergency loans to prevent a systemic collapse, thus acting as the "Lender of Last Resort."

3. b) Control inflation within a target

Reason:- The MPC is mandated to set the policy interest rate (repo rate) to achieve the inflation target set by the Government of India.

Role of Banks

1. b) Accepting deposits

Reason:- The fundamental role of a commercial bank begins with mobilizing funds from the public by accepting various types of deposits (savings, current, fixed). This forms the basis for all other banking activities, especially lending.

2. c) By mobilizing scattered savings and directing them into productive investments.

Reason:- Banks act as crucial financial intermediaries. They gather small, dispersed savings from individuals and businesses and then aggregate these funds to provide larger sums for long-term investments in industries, infrastructure, and other productive sectors, which is essential for capital formation.

3. b) Facilitating cashless transactions through various channels (e.g., NEFT, RTGS, UPI)

Reason:- Banks are central to the modern payment system. They provide the infrastructure and services that enable individuals and businesses to make and receive payments efficiently, moving funds electronically rather than relying solely on cash.

4. b) By financing various sectors like industry, agriculture, and services, which then create jobs

Reason: - While banks themselves employ a significant workforce, their larger contribution to employment comes indirectly. By providing credit to businesses across all sectors of the economy, they enable these businesses to expand, invest, and hire more people, thereby fostering widespread employment generation.

Self Help Groups and Financial Inclusion

1. b) To enable a group of people to pool their savings and provide micro-credit to each other.

Reason: - The fundamental principle of an SHG is mutual self-help, where members (typically women) regularly save small amounts, and this pooled fund is then used to provide internal loans to members for various needs, fostering financial discipline and access to credit.

2. b) Ensure that all sections of society, especially the vulnerable, have access to affordable and appropriate financial services.

Reason: - Financial inclusion is a broad strategy to bring the unbanked and underbanked into the formal financial system, providing them with access to basic banking (savings, payments), credit, insurance, and other financial products at a reasonable cost.

3. b) By providing a platform for the unbanked to access formal credit through bank linkages.

Reason: - SHGs serve as a bridge between the informal financial practices of the poor and the formal banking sector. Banks often find it viable to lend to an SHG as a group, rather than individually to many small borrowers, leveraging the group's social collateral and repayment discipline.

4. c) Low-income individuals, households, and small businesses lacking access to conventional banking

Reason - MFIs are specifically designed to serve those segments of the population that are typically excluded from traditional financial services due to their low income, lack of collateral, or remote location.

5. c) Small loan amounts, often for income-generating activities

Reason:- Microfinance is characterized by small-value loans (microcredit) tailored to the needs of the poor, typically used for starting or expanding micro-enterprises, buying inputs, or meeting essential household needs, with a strong focus on productive use.

Suggested Readings

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- **Ozili, P. K.** "Financial inclusion in banking: A literature review and future research directions" March 2025, *Modern Finance*, 3(1):91-109.
- **Sarkar, Kaustav K., & Chavan, Pallavi.** "Digital Financial Inclusion" April 19, 2025, *Economic and Political Weekly*, Vol. 60, Issue No. 16, Special Articles.

Open Source E-Content Links

- <https://www.rbi.org.in/financialeducation/>
- <https://www.nabard.org/Publication-search.aspx?cid=50&id=24&AID=425&Key=internship>
- <https://www.youtube.com/watch?v=m0En0xQkreg>
- <https://www.youtube.com/watch?v=x8BmbUQoB54>
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- **Bhole, L.M., & Mahakud, Jitendra** - *Financial Institutions and Markets: Structure, Growth and Innovations* - McGraw Hill Education (Latest Edition)
- **Gupta, Om Prakash** - *Central Banking In India 1773-1934 Year1934* The Hindustan Times Press
- **Morduch, Jonathan, & Ogden, Timothy.** *Financial Inclusion: What Everyone Needs to Know 2022*, Oxford University Press
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UNIT – II - Basics of Banking**Unit Objective**

After going through the Unit one must be able to understand the

- Concept of banking
- Banker's duty
- Types of customers
- Priority in lending

Unit Structure

- Basic Concepts in Banking
- KYC and Anti Money Laundering Guidelines
- Negotiable instruments
- Types of Customers
- Principles of Lending
- Priority Sector Lending in Banks
- Unit Summary
- Glossary
- Self – Assessment Questions
- Activities / Exercises / Case Studies
- Answers for check your progress
- Suggested Readings
- Open Source
- Reference

Basic Concepts in Banking

Definition of Bank

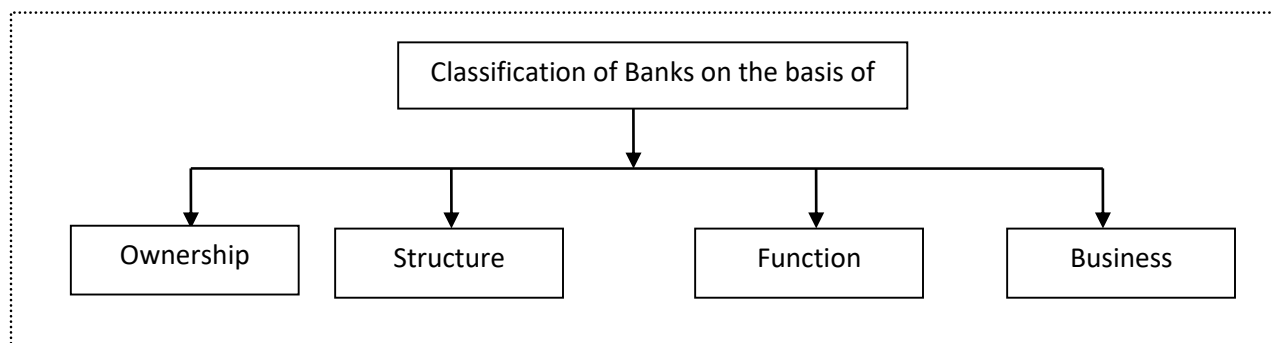
The Banking Regulation Act, 1949 (which governs banking companies in India), defines "banking" in Section 5(b) as "accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise."

This definition highlights the key characteristics:

- **Accepting deposits from the public:** This distinguishes banks from other financial institutions that may raise funds from limited sources.
- **Purpose of lending or investment:** The funds are not just held but are actively deployed.
- **Repayable on demand or otherwise:** Deposits can be accessed immediately (like current accounts) or after a certain period (like fixed deposits).
- **Withdrawal by cheque, draft, order or otherwise:** This emphasizes the role of banks in the payment system, allowing funds to be easily transferred.

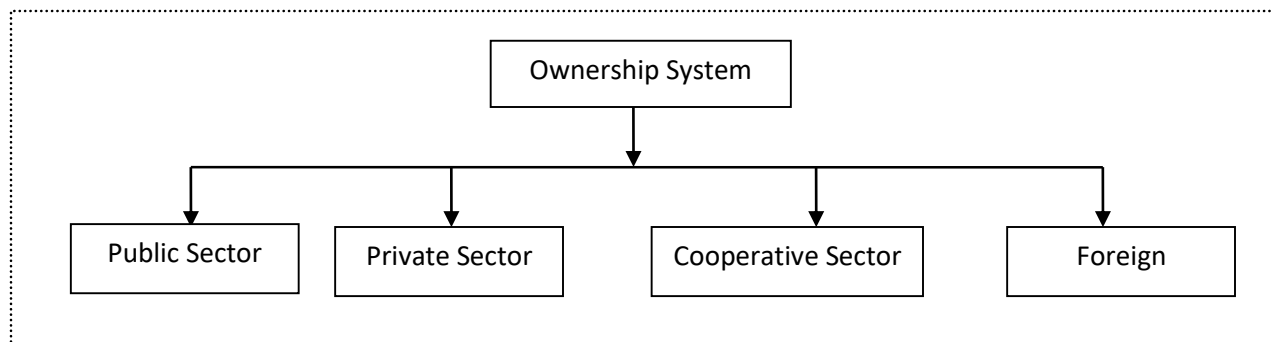
Classification of banks

Banks can be classified on the basis of ownership, types, kinds and business. A detailed discussion of Classification of banks is as under.



On the basis of ownership:

On the basis of ownership banks may be classified in to four categories. The key indicator in this classification is the ownership pater. The party holding the major stock determines the kind of bank.



Public sector Banks:

In case of these banks the majority of the ownership and the management of the operation is with the government. The majority stake (more than 50%) is held by the **Government** (Central Government of India or the State Government or both). While they operate commercially and aim for profit, their primary objective often aligns with government policies, such as financial inclusion, supporting priority sectors (agriculture, MSMEs), and ensuring stability in the financial system. The word "The" and "Limited" will not feature in their names. These banks often have a vast branch network, extending to rural and semi-urban areas.

Examples in India: State Bank of India (SBI), Punjab National Bank (PNB), Bank of Baroda, Canara Bank, Indian Bank, Union Bank of India, etc. (Currently, there are 12 Public Sector Banks in India after recent mergers).

Private sector Banks :

The majority of the ownership is held by private shareholders (individuals, corporations, or groups of investors), not the government. Their primary objective is to maximize profit for their shareholders. They are generally known for adopting modern technology and innovative banking practices.

Examples in India: HDFC Bank, ICICI Bank, Axis Bank, Kotak Mahindra Bank, IndusInd Bank, Federal Bank, etc.

Cooperative banks:

Members own and organize these banks, who are also their customers. They function on the principle of cooperation and mutual help. The Objective is To provide credit and banking facilities to the members, often at affordable rates, and to promote the economic

upliftment of their community or specific groups (e.g., farmers, small traders). Social welfare is a key aspect. They follow the "one person, one vote" principle, regardless of the shareholding. These banks are regulated by both the State Co-operative Societies Act and the Reserve Bank of India (RBI).

Examples in India: Urban Co-operative Banks (UCBs), State Co-operative Banks (SCBs), District Central Co-operative Banks (DCCBs).

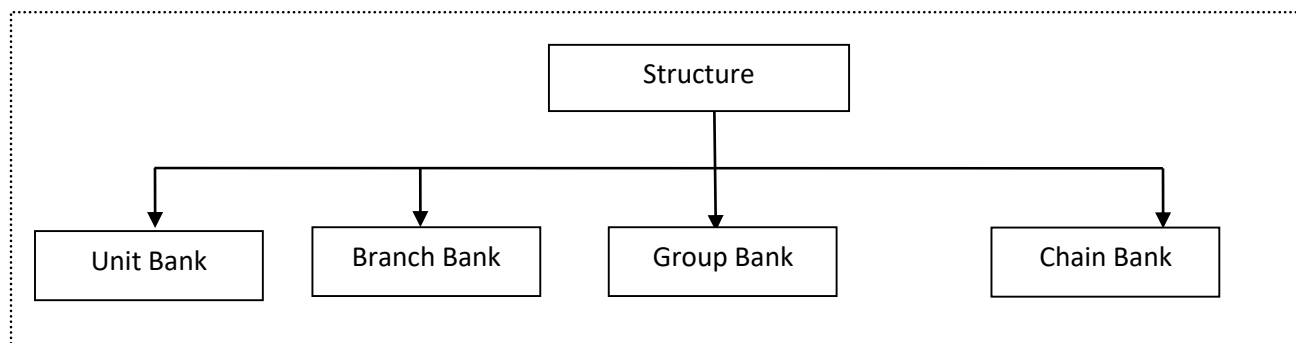
Foreign Banks:

These banks are headquartered in a **foreign country**, but they operate branches or subsidiaries in India. Their majority ownership lies with the parent bank in their home country. Foreign banks bring international banking practices and technology to the Indian market. Often focus on niche segments or specialized financial products. They are regulated by the RBI in India, but also by their home country's financial authorities.

Examples in India: Citibank, Standard Chartered Bank, HSBC Bank, Deutsche Bank, DBS Bank India Limited, etc.

On the Basis of Structure:

On the basis of structure and operational and functionality banks may be classified as unit bank, branch bank, group bank, chain bank and Correspondent Bank.



Unit Bank: The most unique feature of unit bank is that they don't have any branch. Their operations are restricted to a single geographical location. Unit bank operates as a single, independent entity with no branches. It typically serves a limited geographical area, often a single city or town. Management and decision-making are highly centralized within that single office. It has highly localized focus, closer relationship with local customers, potentially less diversified risk (dependent on the local economy) and less efficient in terms of scale economies. Historically common in the early banking history of the United

States, but less prevalent today as branch banking has become dominant. Some very small, local community banks might still operate on a unit-like basis.

Branch bank:

Branch bank is a type of bank where the management of the bank is at the head office and the operations are spread across geographical areas. Branch banking structure is most popular now y. A single bank company operates through a network of multiple branches spread across various locations (cities, regions, or even internationally). All branches are controlled and supervised by a central head office. This kind of banks are more prevalent in UK. The following are some of the features of branch bank

- It has a wide geographical reach and customer base.
- Customer have the benefit of banking at various branches of the bank
- As one of the key feature of branch business the risk is diversification
- Economies of scale and scope
- It leads to standardization of services.

Group Bank

The concept of holding and subsidiary concern is the key to formation fo group banking. A bank holding company (BHC), which may or may not be a bank itself, owns and controls the majority of stock in two or more separate banks. The BHC acts as a parent company, providing strategic direction and sometimes shared services, while the individual banks operate as subsidiaries. This type of banks allows for diversification into non-banking financial services (e.g., insurance, securities firms) under the same umbrella, depending on regulations. Group bank structure enhances financial strength and access to capital markets.

These banks are more common in United States. In India, we have State Bank of India which is a very good example for Group banking. State bank of India has a number of subsidiary companies which are not only banks but also merchant banks, leasing companies, etc (State of Bank of Partiala. State bank of Indore, State bank of Saurashtra, State bank of Mysore, State Bank of Hyderabad, State Bank of Trivancore, State Bank of Rajasthan and Bikaner). In addition to these, is State Bank of India for Housing, State Bank of India for Leasing and State Bank of India for Factoring.

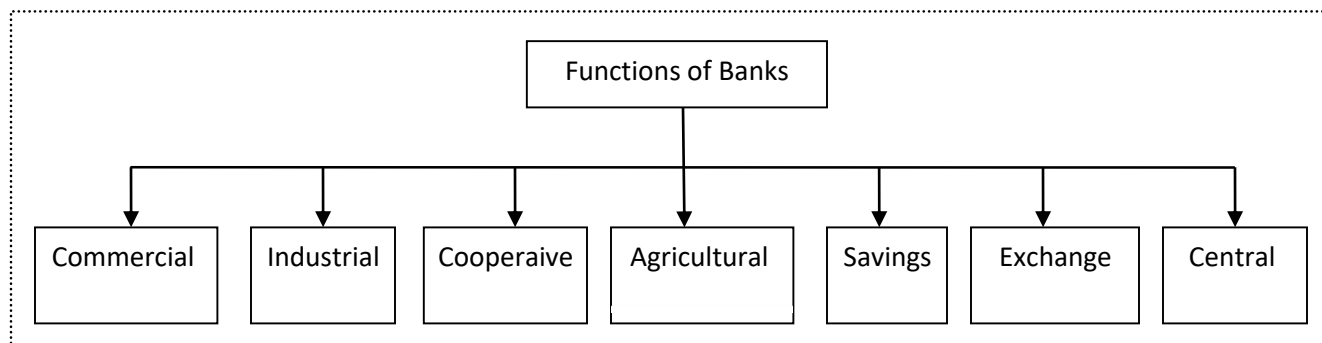
Chain Bank

This structure involves an individual, a family, or a small group of individuals gaining controlling interest (through stock ownership) in two or more legally independent banks. While the banks maintain separate charters and legal identities, they are effectively managed and controlled by the same common ownership group. The following are some of its features

- Informal control, often through common shareholders.
- Each bank retains its separate legal identity.
- Can allow for some level of coordinated policies without formal mergers.
- Less transparent in terms of control compared to holding companies.

On the Basis of Functions

As mentioned earlier, the classification of banks based on functions are brought under kinds of banks.



Commercial Banks

They are financial institutions that act as intermediaries between savers and borrowers with a profit motive. They facilitate commercial transactions and provide a wide range of services to the general public, businesses, and organizations. Collecting savings from individuals and businesses through various types of accounts (savings, current, fixed, recurring deposits) is the primary function of commercial banks. To provide loans and advances (cash credit, overdraft, term loans, consumer loans, mortgages) for various purposes to individuals, industries, trade, and agriculture is the next primary function of the commercial banks. Payment and remittance services (cheque clearing, NEFT, RTGS, UPI, demand drafts, internet banking, mobile banking) is also performed by commercial banks. It acts as agents for customers (e.g., collection of bills, dividends, paying insurance premiums, portfolio management). The commercial activities in the country such as trade,

warehousing, transport, etc., are financed by tin commercial banks. When there are more commercial activities in the country, the economic growth takes place. Thus, commercial banks play a vital role for the economic growth of the country.

Industrial or Investment Bank

Investment banks are largely created to assist the function of the industries. They do not typically accept deposits from the general public. They involve in helping companies and governments raise capital by issuing and selling securities. It Advises companies on strategic transactions like mergers, acquisitions, and divestitures. It also Provides financial and strategic advice on various corporate finance matters. It Facilitates the buying and selling of securities for clients and engaging in proprietary trading.

Examples: Goldman Sachs, Morgan Stanley, JP Morgan Chase (many large commercial banks also have robust investment banking divisions).

Co-operative bank

It operate on the principle of mutual cooperation and are owned and managed by their members. They aim to provide financial services to their members, often from specific communities, professions, or regions, with a focus on mutual welfare rather than maximizing profit. Some of its features are

- **Mobilizing Savings:** Accepting deposits from members (and sometimes non-members).
- **Providing Credit:** Offering loans and advances to members for various purposes like agriculture, small businesses, housing, and personal needs, often at lower interest rates.
- **Promoting Rural Development:** Especially in India, a significant portion of cooperative banks focuses on agricultural credit and rural development.

The structure of cooperative banks in India is as under

- **State Co-operative Banks (SCBs):** At the state level.
- **Central/District Co-operative Banks (DCCBs):** At the district level.
- **Primary Agricultural Credit Societies (PACS):** At the village level, directly dealing with farmers.
- **Urban Co-operative Banks (UCBs):** Serve urban and semi-urban areas.

(4) Agricultural Development Bank

These banks assist the agriculture sector by providing long-term loan for agriculture which will enable the borrower

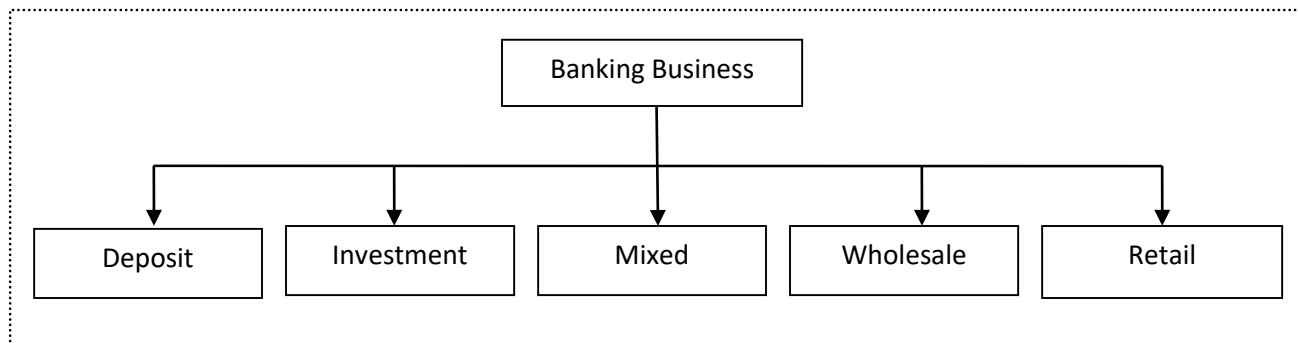
- (i) To purchase new land,
- (ii) To purchase heavy agricultural machinery such as tractor
- (iii) In repayment of old debt,
- (iv) In soil conservation and land reclamation.

Central Banks

It is the apex monetary authority of a country. It does not deal directly with the public but controls and regulates the entire banking and financial system. It is involved in monetary policy implementation and currency issuance, it is also the banker to government and banker's bank (Lender of Last Resort). It is the custodian of foreign exchange reserves and regulator and supervisor of the financial system

On the Basis of Business:

The banks can be classified on the basis of functions they perform. Such classification are deposit, investment, mixed, wholesale and retail functions.



Mixed banking combines both deposit and investment banking. Wholesale banking is a kind of banking business in which the banker concentrates on corporate customers, consisting of different types of companies. Retail banking is quite opposite to wholesale banking. The bank concentrates on individual customers and has its business operations in residential areas and gives more consumer loans to improve their standard of living.

Let Us Sum Up

The key characteristics features of banks are Accepting deposits from the public, lending or investment, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise. Banks can be classified on the basis of ownership, structure, business and function of the banks. These classifications help to reach various sections of the economy, society and various segments of the country.

Check Your Progress

1. Which institution is typically responsible for regulating and supervising the banking system in a country? a) Ministry of Finance b) Stock Exchange c) Central Bank d) International Monetary Fund (IMF)
2. When a bank lends money to a customer, it is essentially creating: a) Liabilities for the bank b) Assets for the bank c) Equity for the bank d) Reserves for the central bank
3. Which of the following is NOT a primary criterion for the classification of banks? a) Ownership b) Function c) Domicile d) Number of employees
4. Based on ownership, a bank primarily funded by private shareholders is classified as a: a) Public sector bank b) Cooperative bank c) Private sector bank d) Regional Rural Bank
5. Commercial banks primarily focus on: a) Providing long-term industrial finance b) Accepting deposits and lending for short-term needs c) Promoting agricultural development d) Managing foreign exchange reserves

Banker-Customer Relationships

Banker:

The relationship between a banker and his customer depends upon the nature of service provided by a banker the following are some of the definitions of bankers

Section 3 of the Negotiable Instruments Act says that the term 'banker' includes any person acting as a banker.

The **bill of exchange Act of 1882** defines the banker “Banker includes a body of persons whether incorporated or not who carry on the business of banking”.

Hahbury's (Laws of England) defines a banker as "an individual, partnership or corporation whose sole predominating business is banking, that is the receipt of money

on current account or deposit account and the payment of cheques drawn by and the collection of cheques paid in by a customer."

Customer:

The term 'customer' of a bank is not defined by law. Ordinarily, a person who has an account in a bank is considered as customer. According to Sir John Paget's view "To constitute a customer there must be some recognizable course or habit of dealing in the nature of regular banking business".

For the purpose of KYC policy, a 'Customer' is defined as :

- a person or entity that maintains an account and/or has a business relationship with the bank;
- one on whose behalf the account is maintained (i.e. the beneficial owner);
- beneficiaries of transactions conducted by professional intermediaries, such as Stock Brokers, Chartered Accountants, Solicitors etc. as permitted under the law, and
- Any person or entity connected with a financial transaction which can pose significant reputational or other risks to the bank, say, a wire transfer or issue of a high value demand draft as a single transaction.

Thus, to constitute a customer the following essential requisites must be fulfilled:

- A bank account – savings, current or fixed deposit – must be opened in his name by making necessary deposit of money, and
- The dealing between the banker and the customer must be of the nature of banking business.

Special Types of Customers:**Minor:**

A person below the age of 18 years is called minor. According to section-3 of the Indian minority act 1875, a minor is a person who has not attained the age of 18 and in case a guardian is appointed till he is 21. Even if a minor borrows money by falsely representing himself as an adult, he cannot be compelled to repay the loan since the contract is void one. A minor has the right to get back the securities pledged even without repaying the loan. A minor can never be appointed as a trustee. A minor cannot be adjudged as an insolvent either on his own petition or of others. As a banker runs risks in dealing with a

minor under certain circumstances, he should be very careful in opening and maintaining an account with minor. A minor can act as an agent, sometimes, he may be appointed as an agent by another person to operate his bank account. As an agent, the minor can not only draw and endorse cheques on behalf of the principal. An account can be opened in the joint names of a minor and an adult. Such account can be operated in the casual manner. However, the minor cannot be made liable for any loan given on that joint account.

Joint Accounts

A joint account is an account opened in the names of two or more persons, who are not partners, trustees, executors or administrators. These persons may be husband and wife, father and sons, friends, etc.

Partnership Firm:

A partnership firm is an association of two or more persons called partners who undertake a venture for a mutual benefit.

According to section-4 of the Indian partnership act 1932, "A relationship between the persons who have agreed to share the profits of a business carried on by all or any one of them acting for all of them."

Illiterate persons

Any person who cannot read or write is known as an illiterate person. The banker could open a bank account in favour of an illiterate person by considering the following steps

- As they are unable to sign their names their thumb impressions are taken. These are attested by a person known to the bank.
- They are not given cheque books. To withdraw money the account holder is expected to come in person and affix his thumb impression in the presence of the bank official for identification.
- There is no legal bar for two illiterate persons having a joint account.
- Two account opening forms should ideally have a clause wherein it is stated that the terms of account opening and banking have been explained to the account holder. The account holder should affix his thumbprint in the presence of a witness/official.

Relationship between Banker and Customer

The relationship between a banker and a customer is a multifaceted legal and contractual

one, primarily governed by the principles of contract law, agency, and banking practice. It's not a single, static relationship but rather a dynamic one that changes depending on the specific services availed by the customer.

Relationship as Debtor and Creditor

- **Banker as Debtor, Customer as Creditor:** This is the most fundamental relationship when a customer deposits money into their account (savings, current, fixed deposit, etc.). The customer lends money to the bank, and the bank is obligated to repay it on demand (for current/savings accounts) or at maturity (for fixed deposits). The money deposited becomes the property of the bank, and the bank can use it as it pleases, subject to its obligation to repay the customer.
- **Banker as Creditor, Customer as Debtor:** This relationship reverses when the customer borrows money from the bank, such as through a loan, overdraft, or cash credit facility. In this scenario, the bank is the lender (creditor), and the customer is the borrower (debtor), obligated to repay the loan with interest.

Relationship as Agent and Principal: The bank acts as an agent for the customer when performing services like collecting cheques, paying bills (insurance premiums, utility bills), executing standing instructions, or buying/selling securities on the customer's behalf. The customer is the principal.

Relationship as Trustee and Beneficiary: This arises when a customer entrusts valuable items, securities, or money to the bank for a specific purpose (e.g., safe custody of a will, specific investments, or escrow accounts). The bank holds these assets in trust for the customer, who is the beneficiary, and cannot use them for its own benefit.

Relationship as Bailor and Bailee: When a customer deposits valuables like jewelry, documents, or other articles for safe custody in a bank's locker, the bank becomes the bailee (responsible for safekeeping), and the customer is the bailor (owner of the goods). The bank is obligated to return these specific articles.

Relationship as Lessor and Lessee: When a bank provides a safe deposit locker facility, the bank is the lessor (owner of the locker), and the customer is the lessee (renting the locker space).

Relationship as Pledger and Pledgee: If a customer pledges assets (like shares or gold) as collateral for a loan, the customer is the pledger, and the bank is the pledgee.

The bank holds the pledged assets as security until the loan is repaid.

Relationship as Mortgagor and Mortgagee: When a customer takes a loan against immovable property (like a house or land), the customer is the mortgagor, and the bank is the mortgagee. The property is offered as security for the loan.

Relationship as Hypothecator and Hypothecatee: Similar to a pledge, but often for movable property where possession remains with the customer, but the bank has a charge on the asset. The customer is the hypothecator, and the bank is the hypothecatee.

Relationship as Advisor and Client: In situations where the bank offers financial advice, investment guidance, or wealth management services, it acts as an advisor, and the customer is the client.

Rights and Obligations of Banker

The banker-customer relationship entails specific rights and obligations for both parties:

Banker's Obligations:

- **To Honour Cheques:** The bank must honour cheques drawn by the customer if there are sufficient funds in the account and the cheque is properly drawn and presented.
- **To Maintain Secrecy:** Banks have a strict duty to keep customer account details and financial information confidential, unless disclosure is required by law or the customer's express/implied consent.
- **To Follow Instructions:** The bank must diligently follow the customer's instructions regarding their account.
- **To Maintain Proper Records:** Accurate and up-to-date records of all transactions must be maintained.
- **To Give Notice Before Closing Account:** A bank cannot unilaterally close a customer's account without giving reasonable notice.

Banker's Rights:

- **Right of General Lien:** The bank can retain goods and securities belonging to the debtor until all claims against the customer are satisfied, except for items deposited for safe custody or a specific purpose.
- **Right of Set-off:** The bank can combine multiple accounts of the same customer (in the same name and capacity) and set off a debit balance in one account against

a credit balance in another.

- **Right of Appropriation:** If a customer has multiple debts and makes a payment without specific instructions, the bank has the right to appropriate the payment towards any of the debts.
- **Right to Charge Interest and Commission:** Banks can charge interest on loans and advances and levy commissions/service charges for services rendered.
- **Right to Close the Account:** Under certain circumstances, such as improper account maintenance or fraudulent activities, the bank can close an account after providing due notice.

Obligations of Customers:

- **To Exercise Care in Drawing Cheques:** Customers must draw cheques carefully to prevent fraud or alteration.
- **To Ensure Sufficient Funds:** It is the customer's duty to ensure sufficient funds are available to honour cheques.
- **To Inform of Forgery/Loss:** The customer must promptly inform the bank of any forged cheques, lost chequebooks, or unauthorized transactions.
- **To Repay Overdrafts/Loans:** Customers are obligated to repay any overdrawn amounts or loans promptly.
- **To Pay Reasonable Charges:** Customers are liable to pay reasonable fees and charges for services provided by the bank.
- **To Provide Accurate Information:** Customers must provide accurate and up-to-date personal and financial information to the bank.
- **To Maintain Account Security:** Customers are responsible for protecting their account details, passwords, and PINs.
- **To Verify Transactions:** Customers should regularly review their account statements and report any discrepancies.

Deposit Insurance and Credit Guarantee Corporation (DICGC)

The Deposit Insurance and Credit Guarantee Corporation (DICGC) is a wholly-owned subsidiary of the Reserve Bank of India (RBI). Its primary objective is to provide a safety net for small depositors in India, safeguarding their funds in case of a bank failure or liquidation. It plays a crucial role in maintaining public confidence in the banking system.

The following are the role of DICGC

- It protects depositors from losing their money if a bank faces financial distress, such as liquidation or being placed under "All Inclusive Directions" by the RBI with restrictions on withdrawals.
- It is a wholly-owned subsidiary of RBI:
- Its functions and operations are laid out in this DICGC Act, 1961.
- By assuring depositors that their money is safe up to a certain limit, DICGC prevents panic withdrawals during times of financial instability, thereby contributing to the overall stability of the banking system.
- It enhances public confidence

DICGC insures almost all types of deposits kept with insured banks, including:

- Savings accounts
- Fixed deposits (FDs)
- Current accounts
- Recurring deposits (RDs)

The following Banks are Insured by DICGC

- Commercial Banks
- Co-operative Banks
- Primary cooperative societies are generally not insured by DICGC.

The DICGC Claim Process

In the unfortunate event of a bank failure (liquidation or imposition of "All Inclusive Directions" by RBI):

1. **Liquidator Appointed:** A liquidator is appointed for the failed bank.
2. **Claim List Submission:** The liquidator prepares a list of depositors and their claim amounts and submits it to DICGC. Depositors may be required to submit a "claim willingness form" to their bank.
3. **Verification by DICGC:** DICGC verifies the authenticity and genuineness of the claims submitted by the bank.
4. **Payment:** DICGC then makes payment to the liquidator or directly to depositors. The aim is to ensure that payment is made within a specified timeframe (e.g., 90 days from the date of imposition of restrictions by RBI).

Let Us Sum Up

The relationship between a banker and a customer is a multifaceted legal and contractual one, primarily governed by the principles of contract law, agency, and banking practice. The following are some of the relationship between banker and customer Relationship as Debtor and Creditor, Relationship as Agent and Principal, Relationship as Bailor and Bailee etc. Right of banker include right to General Lien, right of Set-off, right of Appropriation, etc.

Check Your Progress

1. What is the primary relationship between a banker and a customer when the customer deposits money into their account? a) Debtor and Creditor b) Creditor and Debtor c) Agent and Principal d) Trustee and Beneficiary
2. When a customer instructs the bank to collect a cheque on their behalf, what secondary relationship emerges? a) Debtor and Creditor b) Agent and Principal c) Lessor and Lessee d) Pledger and Pledgee
3. Which of the following situations typically TERMINATES the banker-customer relationship? a) Customer opening a new account at the same bank. b) Bank increasing interest rates on loans. c) Death or insolvency of the customer. d) Customer making a large deposit.
4. Which of the following is a primary *right* of a banker? a) Obligation to honor cheques b) Duty to maintain secrecy c) Right of General Lien d) Obligation to provide statements
5. A banker's obligation to 'render statements of account' to a customer primarily serves to: a) Generate additional revenue for the bank. b) Keep the customer informed about their transactions and balance. c) Allow the bank to track customer spending habits for marketing. d) Fulfill a regulatory requirement only for large accounts.
6. The banker's right to 'close an account' is subject to: a) Getting permission from the central bank. b) Giving reasonable notice to the customer. c) The customer having zero balance in the account. d) The customer's express agreement.

Know Your Customer, Anti Money Laundering - Guidelines

Know Your Customer (KYC) and Anti-Money Laundering (AML) guidelines are very important to monitor the flow of funds and track any illegal transaction in fund transfer. These guidelines are primarily governed by the Prevention of Money Laundering Act (PMLA), 2002, and are regulated by various authorities like the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI), and overseen by the Financial Intelligence Unit - India (FIU-IND).

The following are some of the key points of KYC norms:

- To establish and verify the true identity of the customer.
- To understand the nature of the customer's financial activities and their source of funds.
- To assess and manage the potential risks associated with the customer (e.g., money laundering risk).
- To prevent the misuse of financial systems for illegal activities.

Key Elements of KYC:

1. **Customer Acceptance Policy (CAP):** Regulated Entities (REs) must have a clear policy on customer acceptance, ensuring no anonymous or fictitious accounts are opened. They cannot open accounts if they are unable to apply appropriate Customer Due Diligence (CDD) measures.
2. **Customer Identification Procedures (CIP):** This involves identifying and verifying the customer and the beneficial owner.
 - **Officially Valid Documents (OVDs):** For individuals, these include Aadhaar card, passport, voter ID, driving license, PAN card, and NREGA card.
 - **Digital KYC:** Includes paperless Aadhaar-based eKYC, Digital KYC with physical presence of a representative, and Video KYC (V-CIP) for remote verification.
 - **Central KYC Records Registry (CKYCR):** A centralized repository for KYC records, aiming to reduce the burden of submitting documents multiple times. REs are mandated to update CKYCR within 7 days of receiving new customer information.
 - **Beneficial Ownership:** Thresholds for identifying beneficial owners have been

lowered (e.g., to 10% for partnership firms, companies, and trusts).

3. **Monitoring of Transactions:** REs are required to continuously monitor transactions to ensure they are consistent with the customer's profile and source of funds. Enhanced monitoring is required for high-risk accounts (e.g., multiple cheque book requests, frequent small cash deposits).
4. **Risk Management:**
 - **Risk Categorization:** Customers are categorized as low, medium, or high-risk based on factors like identity, financial status, nature of business, geographical location, and products/services used.
 - **Periodic Updation (Re-KYC):** KYC information needs to be updated periodically based on the risk category:
 - ✓ **High-risk customers:** At least once every two years.
 - ✓ **Medium-risk customers:** Once every eight years.
 - ✓ **Low-risk customers:** Once every ten years.
 - Self-declaration through registered email/mobile or digital channels is often sufficient for minor updates or no changes.

Anti-Money Laundering (AML) Guidelines

AML refers to a set of procedures, laws, and regulations designed to stop the practice of generating income through illegal actions. The PMLA and its rules form the backbone of AML in India. "Anti-Money Laundering (AML) guidelines" in India are a comprehensive set of rules and procedures designed to prevent, detect, and report activities related to money laundering and the financing of terrorism (AML/CFT).

Key Aspects of AML Compliance:

1. Client Due Diligence (CDD) and Enhanced Due Diligence (EDD)
2. Record Maintenance
3. Appointment of Key Officers such as Principal Officer and Designated Director
4. Establishing clear internal responsibilities and reporting chains.
5. Creating procedures for flagging suspicious activity.
6. Conducting regular internal audits.
7. Technological Integration

Important Regulatory Bodies:

- **Reserve Bank of India (RBI):** Issues Master Directions and circulars for banks and other financial institutions.
- **Securities and Exchange Board of India (SEBI):** Regulates capital market intermediaries.
- **Insurance Regulatory and Development Authority of India (IRDAI):** Oversees insurance entities.
- **Financial Intelligence Unit - India (FIU-IND):** The central national agency for receiving, processing, analyzing, and disseminating information related to suspicious financial transactions. It directly reports to the Economic Intelligence Council (EIC) headed by the Finance Minister.

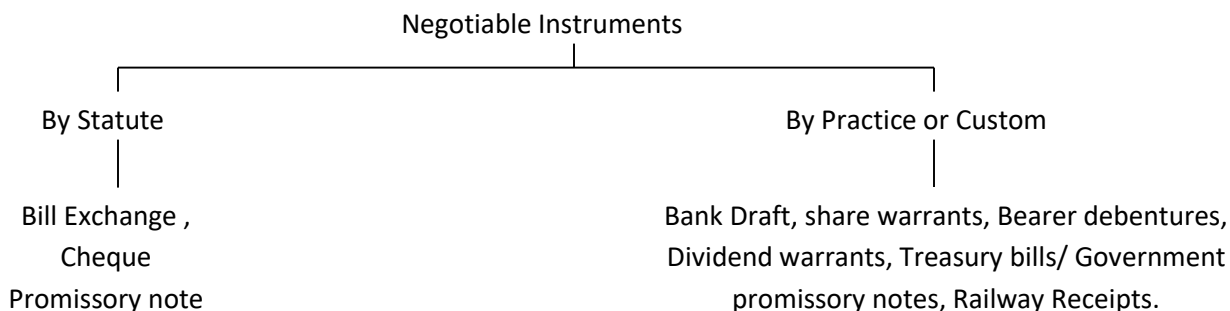
Negotiable Instruments

According to Section 13 of the Negotiable Instruments Act 1881, "negotiable instrument means promissory notes, bills of exchange or cheque, payable either to order or to bearer". A negotiable instrument is a signed document that guarantees the payment of a specific amount of money, either on demand or at a set time, to a specified person or to the bearer. The following are the features of negotiable instruments,

- They must be in a written format (can be handwritten, printed, etc.).
- They must be signed by the maker or drawer.
- The payment must be unconditional.
- The amount to be paid must be certain and clearly specified.
- The payment must be due either immediately upon presentation (on demand) or at a clearly ascertainable future date.
- They are payable to bearer or to order
- The instrument can be transferred from one person to another.

Types of Negotiable Instruments:

Negotiable instruments can be classified on the basis of Status and practice,



Let us now look into some of the negotiable instruments in detail,

Bill of exchange:

The Negotiable Instruments Act, 1881, governs Bills of Exchange. Section 5 of the Act defines it as:

"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." The following are some of its features,

1. It must be in writing.
2. It must contain an explicit and unconditional order to pay..
3. The person issuing the order (the drawer) must sign it.
4. The amount of money to be paid must be clearly specified and certain.
5. It involves three main parties who must be ascertainable:
 - **Drawer:** The person who writes or "draws" the bill,
 - **Drawee:** The person who is ordered to pay the money.
 - **Payee:** The person to whom the payment is to be made.
6. Payable on Demand or at a Definite Future Time
7. Payable to Order or Bearer:
8. Acceptance is usually done by the drawee signing the bill, indicating their agreement to honor the order.

Types of Bills of Exchange: The following are some of the types of bills of exchange,

- a) Inland Bill
- b) Foreign Bill
- c) Sight Bill (Demand Bill)
- d) Usance Bill (Time Bill)
- e) Trade Bill
- f) Clean Bill

Importance and Advantages: Negotiable Instruments Provide following advantages,

- It facilitates credit

- It is a good source of finance
- It is legal evidence of debt
- It can be transferred easily

PROMISSORY NOTE

Section 4 of the Negotiable Instruments Act defines a promissory note as "an instrument in writing containing an unconditional promise or 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".

Main Features of a Promissory note

1. It is an instrument in writing drawn by the debtor.
2. It must contain a promise or an undertaking to pay.
3. The undertaking or the promise should be an unconditional one.
4. The undertaking or the promise must be to pay a certain sum of money.
5. It may be payable on demand or after a particular date.
6. It cannot be made payable on demand to bearer.
7. It cannot be crossed.
8. Number, place, date, etc., are not essential for a promissory note.
9. The amount on it may be made payable by instalments.
10. It must be stamped.
11. It does not require acceptance as it is made by the debtor himself.
12. The following are the parties to a promissory note *Drawer, Drawee, Payee, Holder: Endorser and Endorsee.*

CHEQUES

According to Section 6 of the Negotiable Instruments Act, a cheque is "a Bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand".

A cheque is a negotiable instrument which is supplied by a banker to the customer who opens a savings or current account in a bank.

The customer who draws the cheque on the bank is called *capital drawer*. The bank on whom the cheque is drawn is called the *drawee*. The person who receives payment on the cheque is called the *payee*.

Key Features of a Cheque:

1. A cheque must be a physical or electronic document.
2. It contains an unconditional order to the bank to pay.
3. The person issuing the cheque (the account holder) must sign it.
4. A cheque can only be drawn on a bank where the drawer maintains an account (savings, current, or overdraft account).
5. Unlike some bills of exchange, a cheque is always payable immediately upon presentation to the bank.
6. The amount to be paid must be definite and clearly stated in both figures and words.
7. a cheque is generally valid for three months from the date of issue.

Crossing of a Cheque

A cheque can be crossed by four persons: drawer, holder and holder in due course, Crossing a cheque involves drawing **two parallel transverse lines** across the face of the cheque. These lines are typically drawn on the top left-hand corner, but can also be drawn across the entire cheque.

Sections 123 to 131 (A) of the Negotiable Instruments Act deal about crossing of a cheque. There are two types of crossing. They are (1) General crossing, and (2) special crossing.

Section 123 defines general crossing of cheque while Section 124 defines special crossing. **General Crossing:** According to Section 123 "where a cheque bears across its face an addition of the words 'And Company' or any abbreviation thereof, between two parallel transverse lines, or 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". **Special Crossing:** According to Section 124 "where a cheque bears across its face an addition of the name of the 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".

Let Us Sum Up

KYC guidelines are primarily governed by the Prevention of Money Laundering Act (PMLA), 2002, and are regulated by various authorities like the Reserve Bank of India

(RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI), and overseen by the Financial Intelligence Unit - India (FIU-IND). The PMLA and its rules form the backbone of AML in India. "Anti-Money Laundering (AML) guidelines" A negotiable instrument is a signed document that guarantees the payment of a specific amount of money, either on demand or at a set time, to a specified person or to the bearer. Bills of exchange involve three main parties who must be ascertainable drawer, drawee and payee. Promissory note is an instrument in writing drawn by the debtor. A cheque can be crossed by four persons: drawer, holder and holder in due course, Crossing a cheque involves drawing two parallel transverse lines across the face of the cheque. These lines are typically drawn on the top left-hand corner, but can also be drawn across the entire cheque. There are two types of crossing general crossing and special crossing.

Check Your Progress

1. Which of the following is NOT a key element of a bank's KYC policy? a) Customer Acceptance Policy (CAP) b) Customer Identification Procedures (CIP) c) Marketing Strategies for New Products d) Monitoring of Transactions
2. What is the primary purpose of KYC guidelines for financial institutions? a) To increase the bank's profitability b) To prevent the use of financial systems by criminal elements for money laundering and terrorist financing c) To attract new customers through simplified processes d) To reduce operational costs for the bank.
3. For what type of customers is enhanced due diligence (EDD) generally required? a) Low-risk customers b) Medium-risk customers c) High-risk customers (e.g., Politically Exposed Persons) d) All customers, irrespective of risk
4. A Promissory Note must contain: a) An unconditional order to pay a certain sum of money. b) An unconditional undertaking to pay a certain sum of money. c) An order to pay a certain sum of money on a future contingency. d) A conditional promise to deliver goods.
5. Which of the following is a key characteristic of a negotiable instrument? a) It must be payable only to a specific person. b) The title is transferable by mere delivery or by endorsement and delivery. c) It requires registration with a government

authority. d) Its validity depends on the underlying consideration being mentioned on the instrument.

Types of Customers

1. Individuals

Accounts maintained by individuals is the major number of accounts maintained by the banks. Individuals who are major and with unsound mind can open a bank account. The following are some of the kinds of individuals those maintain accounts in special cases,

- Minors
- Joint Account Holders:
- *Illiterate Persons*

2. Hindu Undivided Family (HUF)

- The following special requirements are to be fulfilled by the banks for opening and conducting HUF accounts:
- The account is opened in the name of the Karta or in the name of the HUF business.
- A declaration signed by Karta and all coparceners, affirms the composition of the HUF
- The account is operated only by the Karta or the authorized coparceners.
- On the death of a coparcener, his share may be handed over to his wife, daughters and other female relatives as per the Hindu Succession Act, 1956.

3. Companies

- The following requirements are to be met while opening an account in the name of a company:
- The account opening form meant for company accounts should be filled and specimen signatures of the authorized directors of the company should be obtained.
- Certified up-to-date copies of the Memorandum and Articles of Association should be obtained.
- Certificate of Incorporation (in original) should be perused and its copy retained on record.

- In the case of Public company, certificate of commencement of business should be obtained
- Certified copy of the resolution of the Board of Directors of the company regarding the opening, execution of the documents and conduct of the account should be obtained and recorded.

4. Trusts

A trust is a relationship where a person (trustee) holds property for the benefit of another person (beneficiary) or some object in such a way that the real benefit of the property accrues to the beneficiary or serves the object of the trust. A trust is generally created by a trust deed and all concerned matters are governed by the Indian Trusts Act, 1882.

- The trust deed is carefully examined and its relevant provisions, noted. A banker should exercise extreme care while conducting the trust accounts, to avoid committing breach of trust:
- A trustee cannot delegate his powers to other trustees, nor can all trustees by common consent delegate their powers to outsiders.
- The funds in the name of the trust cannot be used for crediting in the trustee's account, nor for liquidating the debts standing in the name of the trustee.
- The trustee cannot raise loan without the permission of the court, unless permitted by the trust deed.

Various types of deposit

Deposits - General

Deposits of banks are classified into three categories:

(1) Demand deposits are repayable on customers' demand. These comprise of:

- Current account deposits
- Savings bank deposits
- Call deposits

(2) Term deposits are repayable on maturity dates as agreed between the customers and the banker. These comprise of:

- Fixed deposits
- Recurring deposits
- Hybrid deposits or flexi deposits combine the features of demand and term

deposits.

Demand Deposits

Current account:

An individuals, business entities (firms, company), institutions, Government bodies / departments, societies, liquidators, receivers, trusts, etc can open current account. A current account is a running and active account that may be operated upon any number of times during a working day. There is no restriction on the number and the amount of withdrawals from a current account. The other features of current account are as under:

- Current accounts are non-interest bearing
- Overdraft facility for a short period or on a regular basis up to specified limits – are permitted in current accounts.
- Cheques / bills collection and purchase facilities may also be granted to the current account holders.
- The account holder periodically receives statement of accounts from the Bank.
- Normally, banks levy charges for handling such account in the shape of “Ledger Folio charges”.
- Third party cheques and cheques with endorsements may be deposited in the current account for collection and credit.

Savings Account

Savings bank accounts are meant for individuals and a group of persons like Clubs, Trusts, Associations, Self Help Groups (SHGs) to keep their savings for meeting their future monetary needs and intend to earn income from their savings. Banks give interest on these accounts with a view to encourage saving habits. Everyone wants to save for something in the future and their savings should be safe and accessible anytime, anyplace to help meet their needs. In this account savings are completely liquid.

Features of savings bank accounts are as follows:

- Number of withdrawals are restricted
- The Bank pays interest on the products of balances outstanding on daily basis.
- Overdraft facility is not available.
- Most banks provide a passbook to the account-holder wherein date-wise debit credit transactions and credit balances are shown as per the customer’s ledger

account maintained by the Bank.

- Cheque Book Facility Accounts in which withdrawals are permitted by cheques drawn in favour of self or other parties.
- Almost all banks which provide ATM facility, give ATM cards to their accounts holder, so that they avail withdrawal facility 24 hours and all days at any place.

Term Deposits

Recurring Deposits or Cumulative Deposits :

In Recurring Deposits accounts, a certain amount of savings are required to be compulsorily deposited at specified intervals for a specific period. The main features of these deposits are:

- The customer deposits a fixed sum in the account at pre-fixed frequency (generally monthly/quarterly) for a specific period (12 months to 120 months).
- The interest rate payable on recurring deposit is normally the applicable rate of fixed deposits for the same period.
- The total amount deposited is repaid along with interest on the date of maturity.

Monthly-Plus Deposit Scheme / Recurring Deposit Premium account

It is a recurring deposit scheme with flexibility of “Step-up and Step-down” options of monthly instalments. The scheme is available to individuals, institutions, corporate, proprietorship or partnership firms, trusts, HUF, etc. Under the scheme, the customer selects the “core amount” at the time of opening the account and deposits the same initially.

Fixed Deposits

Fixed deposits are repayable on the fixed maturity date along with the principal and agreed interest rate for the period and no operations are allowed to be performed by the customer against the deposit, as is permitted in demand deposits. The depositor foregoes liquidity on the deposit and the bank can freely deploy such funds for loans/advances and earn interest.

Features of Fixed Deposits are as follows:

- The interest rates on fixed deposits, which were earlier regulated by the RBI, have been deregulated and banks offer varying interest rates for different maturities as

decided by their boards.

- Minimum period of fixed deposit is 7 days, as per the directive of the RBI. The maximum term and band of term maturities are determined by each bank along with the respective interest rates for each band.
- On maturity of a deposit, the principal and interest can be renewed for another term at an interest rate prevalent at that time and a fresh deposit receipt is issued to the customer, evidencing a fresh contract. Alternatively, the deposit can be paid up by obtaining the discharge of the depositor on the reverse of the receipt.

Certificate of Deposit:

Banks also offer deposits to attract funds from corporate companies and banks and other institutions. One such important deposit product offered by banks is called as Certificate of Deposit (CD) . Special features of a Certificate of Deposit (CD):

- Certificate of Deposit is issued at a discount to mature for the face value at maturity
- Minimum and maximum period a CD with banks are 7 days and 365 days respectively
- CDs differs from Banks' Fixed Deposits (FDs) in respect of (i) prepayment and (ii) loans.

Let Us Sum Up

The following are some of the kinds of individuals those maintain accounts in special cases, Minors, joint Account Holders and Illiterate Persons. The account is opened in the name of the Karta or in the name of the HUF business. A trust is generally created by a trust deed and all concerned matters are governed by the Indian. Deposits of banks are classified as under (1) Demand deposits are repayable on customers' demand. These comprise of: Current account deposits, Savings bank deposits and Call deposits (2) Term deposits are repayable on maturity dates as agreed between the customers and the banker. These comprise of: Fixed deposits, Recurring deposits and Hybrid deposits or flexi deposits combine the features of demand and term deposits.

Check Your Progress

1. Which of the following is NOT considered a banking transaction? a. Depositing money b. Withdrawing money c. Purchasing a house d. Transferring funds

between accounts

2. Who are considered special types of bank customers? a. Minors b. Illiterate persons c. Joint account holders d. All of the above
3. Which of the following is a demand deposit? a) Fixed Deposit b) Recurring Deposit c) Savings Account d) Time Deposit
4. A time deposit differs from a demand deposit because a) Funds are accessible anytime b) It has a fixed maturity period c) It's only for businesses d) It's not interest-bearing

Principles of Lending

Lending is one of the primary functions of banks. Therefore a clear understand of principles of lending is essential. Principles aim to minimize risk for the lender while facilitating a mutually beneficial transaction for both borrower and lender. The following are some of the principles of lending,

Principle of Safety of Funds:

The bank should ensure that they properly recover their lending. The principle of safety of fund gives importance for the need for safety of the lending. banks want to be reasonably assured that the money they lend will be repaid in full, along with any accrued interest. This principle relates to the borrower's ability to repay the loan, along with interest, according to the terms of the loan contract. The repayment of the loan depends upon the borrower's capacity and willingness to pay.

Principle of Profitability:

Banks earn profit out of their lending. This profit comes primarily from the interest charged on the loan. The interest rate charged reflects the risk associated with the loan, the cost of funds for the lender, operational expenses, and a desired profit margin. Banks must employ their funds profitably so as to earn sufficient income out of which to pay interest to the depositors, salaries to the staff and to meet various other establishment expenses and distribute dividends to the shareholders. The sound principle of lending is not to sacrifice safety or liquidity for the sake of higher profitability.

Principle of Liquidity:

The banker regards liquidity as important as safety of the funds and grants loans on the security of assets which are easily marketable without much loss. As per the RBI

regulations banks need to maintain a certain level of liquidity. Banks are essentially intermediaries for short term funds. Therefore, they lend funds for short periods and mainly for working capital purposes. The loans are, therefore, largely payable on demand. The banker must ensure that the borrower is able to repay the loan on demand or within a short period. This depends upon the nature of assets owned by the borrower and pledged to the banker.

Principle of Purpose

The purpose of the lending is very essential elements for banks. Banks do not grant loans for each and every purpose—they ensure the safety and liquidity of their funds by granting loans for *productive purposes only, viz.*, for meeting working capital needs of a business enterprise. Lenders generally prefer to understand how the borrowed funds will be utilized. This helps them assess the viability of the project or need, and thus the likelihood of repayment. Loans are often categorized (e.g., housing loans, business loans, education loans, personal loans) based on their purpose, and lending criteria may vary accordingly.

Principle of Risk Spread:

This is also a cardinal principle of sound lending. A prudent banker always tries to select the borrower very carefully and takes tangible assets as securities to safeguard his interests. Tangible assets are no doubt valuable and the banker feels safe while granting advances on the security of such assets, yet some risk is always involved therein. An industry or trade may face recessionary conditions and the price of the goods and commodities may sharply fall. Natural calamities like floods and earthquakes, and political disturbances in certain parts of the country may ruin even a prosperous business. To safeguard his interest against such unforeseen contingencies, the banker follows the principle of diversification of risks based on the famous maxim “do not keep all the eggs in one basket.” It means that the banker should not grant advances to a few big firms only or to concentrate them in a few industries or in a few cities or regions of the country only. The advances, on the other hand, should be over a reasonably wide area, distributed amongst a good number of customers belonging to different trades and industries. The banker, thus, diversifies the risk involved in lending.

If a big customer meets misfortune, or certain trades or industries are affected adversely,

the overall position of the bank will not be in jeopardy.

Approach to Lending

Risk management, profitability, and customer service are the key principles based on which approaches to lending is developed.

Banks must assess and mitigate various risks, such as credit risk, interest rate risk, liquidity risk, operational risk and regulatory risk. Banks must frame good credit policy and underwriting standards. This enables the banks to decide on target market, loan products, eligibility criteria, pricing strategy and documentation requirements. Utilizing advanced tools for credit scoring, fraud detection, portfolio management, and customer relationship management. This allows for more efficient and accurate decision-making. Regulatory Compliance is very important Adhering to all relevant laws and regulations (e.g., consumer protection laws, anti-money laundering regulations). Continuous tracking the performance of existing loans and the overall loan portfolio, identifying potential problems early, and taking corrective action is key to good lending.

Steps in Lending

The lending process typically follows a structured series of steps:

1. Loan Application:

- The potential borrower submits a formal application, providing personal and financial information.
- For individuals, this includes income, employment history, assets, liabilities, and credit history.
- For businesses, it includes financial statements (profit and loss, balance sheet, cash flow), business plan, tax returns, and details of management.

2. Credit Assessment (Underwriting):

- This is the critical phase where the lender evaluates the borrower's creditworthiness and the risk associated with the loan.
- **Character:** Assessing the borrower's willingness to repay (e.g., credit history, past payment behavior).
- **Capacity:** Evaluating the borrower's ability to repay (e.g., debt-to-income ratio for individuals, cash flow analysis for businesses).
- **Capital:** The borrower's financial stake in the venture or asset (e.g., down

payment on a house, equity in a business).

- **Collateral:** Assets pledged to secure the loan, providing a secondary source of repayment if the borrower defaults.

3. **Loan Decision:**

- Based on the credit assessment, the lender decides whether to approve or deny the loan.
- If approved, the terms and conditions are determined, including the loan amount, interest rate, repayment schedule, collateral requirements, and any covenants (conditions that the borrower must or must not meet).

4. **Loan Documentation and Closing:**

- If the loan is approved, legal documents are prepared.
- These documents outline the rights and obligations of both the borrower and the lender.
- The loan is disbursed (funds are provided to the borrower) upon signing of all necessary documents.

5. **Loan Servicing:**

- This involves managing the loan after it has been disbursed.
- **Payment Processing:** Collecting principal and interest payments.
- **Escrow Management:** For mortgages, managing property taxes and insurance payments.
- **Customer Service:** Addressing borrower inquiries and issues.
- **Reporting:** Providing statements and tax forms to borrowers.

6. **Loan Monitoring and Collections:**

- Ongoing monitoring of the borrower's financial health and payment performance.
- Identifying early warning signs of potential default.
- If payments are missed, the collections process is initiated, which can involve reminders, negotiation of payment plans, or ultimately, legal action (foreclosure, repossession) if efforts to recover the debt are unsuccessful.

7. **Loan Repayment or Resolution:**

- The loan is fully repaid according to the terms.

- In cases of default, the loan is resolved through collection efforts, restructuring, or collateral liquidation.

Let Us Sum Up

The following are the principles of lending Principle of Safety of Funds, Principle of Profitability, Principle of Liquidity, Principle of Purpose and Principle of Risk Spread. Steps in lending include the following receipt of loan application, credit assessment (Underwriting), decision on loan, loan documentation, loan monitoring and collections and loan repayment

Check Your Progress

1. What is considered the primary principle of lending? a) Liquidity b) Profitability c) Safety d) Diversification
2. Under which principle should loans be extended only for productive and lawful purposes? a) Purpose b) Liquidity c) Profitability d) Security
3. What is the first formal step in loan origination? a) Underwriting b) Application c) Disbursal d) Appraisal
4. When are mortgage appraisals and collateral value assessments conducted? a) During processing b) During underwriting c) During disbursal d) After disbursal

Priority sector Advances:

Priority sector advances are a crucial policy initiative by central banks, particularly in countries like India, to ensure that certain vital sectors of the economy receive timely and adequate credit. These sectors are deemed important for the overall development of the country and may otherwise struggle to access formal credit. The RBI has constituted many committees and sub committees to monitor and provide guidelines on prioritizing sectors for lending. The following are the Categories under priority sector

- (i) Agriculture
- (ii) Micro and Small Enterprises
- (iii) Education
- (iv) Housing
- (v) Export Credit
- (vi) Others

Agriculture

- Loans to individual farmers [including Self Help Groups (SHGs) or Joint Liability Groups (JLGs) directly engaged in Agriculture and Allied Activities,
- Short-term loans to farmers for raising crops, i.e. for crop loans.
- Medium & long-term loans to farmers for agriculture and allied activities
- Loans to farmers for pre and post-harvest activities,.
- Loans to small and marginal farmers for purchase of land for agricultural purposes.
- Loans to distressed farmers indebted to non-institutional lenders.
- Loans to farmers under Kisan Credit Card Scheme.
- Loans to corporates including farmers' producer companies of individual farmers, partnership firms and co-operatives of farmers directly engaged in Agriculture and Allied Activities,
- Bank loans to Primary Agricultural Credit Societies (PACS), Farmers' Service Societies (FSS) and Largesized Adivasi Multi- Purpose Societies (LAMPS)
- Loans for construction and running of storage facilities (warehouse, market yards, godowns and silos), including cold storage units designed to store agriculture produce/products, irrespective of their location.
- Loans to MFIs for on-lending to farmers for agricultural and allied activities as per the conditions specified.

Micro and Small Enterprises

- The Micro and Small enterprises engaged in the manufacture or production of goods to any industry specified in the first schedule to the Industries (Development and regulation) Act, 1951 and as notified by the Government from time to time..
- Bank loans up to `5 crore per unit to Micro and Small Enterprises engaged in providing or rendering of services and defined in terms of investment in equipment under MSMED Act, 2006.
- Export credit to MSE units (both manufacturing and services) for exporting of goods/services produced/rendered by them.
- All loans sanctioned to units in the Khadi and Village Industries Sector sector, irrespective of their size of operations, location and amount of original investment in plant and machinery.

- Loans to persons involved in assisting the decentralized sector in the supply of inputs to and marketing of outputs of artisans, village and cottage industries.
- Loans to cooperatives of producers in the decentralized sector viz. artisans village and cottage industries.
- Loans sanctioned by banks to MFIs for on-lending to MSE

Education

Loans to individuals for educational purposes including vocational courses up to `10 lakh for studies in India and `20 lakh for studies abroad.

Housing

Lending for housing finance, including loans for purchase, construction, or renovation of residential properties, particularly for low and moderate-income groups. **E. Export Credit** Export Credit extended by foreign banks with less than 20 branches will be reckoned for priority sector target achievement. As regards the domestic banks and foreign banks with 20 and above branches, export credit is not a separate category under priority sector. Export credit will count towards the respective categories of priority sector, i.e. Agriculture and MSE sector.

Others

- Loans outstanding under loans for general purposes under General Credit Cards (GCC). If the loans under GCC are sanctioned to Micro and Small Enterprises, such loans should be classified under respective categories of Micro and Small Enterprises.
- Loans sanctioned to State Sponsored Organizations for Scheduled Castes/ Scheduled Tribes for the specific purpose of purchase and supply of inputs to and/or the marketing of the outputs of the beneficiaries of these organizations.
- Loans sanctioned by banks directly to individuals for setting up off-grid solar and other off-grid renewable energy solutions for households.

G. Weaker Sections

Priority sector loans to the following borrowers will be considered under Weaker Sections category:-

(a) Small and marginal farmers;

(c) Beneficiaries of Swarnjayanti Gram Swarozgar Yojana (SGSY), now National Rural

Livelihood Mission (NRLM);

(d) Scheduled Castes and Scheduled Tribes;

(e) Beneficiaries of Differential Rate of Interest (DRI) scheme;

(f) Beneficiaries under Swarna Jayanti Shahari Rozgar Yojana (SJSRY);

(g) Beneficiaries under the Scheme for Rehabilitation of Manual Scavengers (SRMS);

(h) Loans to Self Help Groups;

(i) Loans to distressed farmers indebted to non-institutional lenders;

(j) Loans to distressed persons other than farmers not exceeding `50,000 per borrower to prepay their debt to non-institutional lenders;

Common guidelines for priority sector loans

- Banks should comply with the following common guidelines for all categories of advances under the priority sector.
- The rates of interest on various categories of priority sector loans will be as per DBOD directives issued from time to time.
- No loan related and adhoc service charges/inspection charges should be levied on priority sector loans up to ` 25,000.
- A register/ electronic record should be maintained by the bank, wherein the date of receipt, sanction/rejection/ disbursement with reasons thereof, etc., should be recorded. The register/electronic record should be made available to all inspecting agencies.
- Banks should provide acknowledgement for loan applications received under priority sector loans. Bank Boards should prescribe a time limit within which the bank communicates its decision in writing to the applicants.

Let Us Sum Up

Priority sector advances are a crucial policy initiative by central banks, particularly in countries like India, to ensure that certain vital sectors of the economy receive timely and adequate credit. Lending by banks are made to the priority sectors as follows The following are the Categories under priority sector Agriculture sector, Micro and Small Enterprises sector, Education sector, Housing sector, Export Credit and Others

Check Your Progress

1. Which of the following is *not* a category under PSL? a) Agriculture b) MSMEs c)

Renewable Energy d) Large corporate loans.

2. Which among the following is included in the “Weaker Sections” category? a) Urban corporate borrowers b) Individual women borrowers up to ₹1 lakh c) Large exporters d) IT startups.
3. What is the purpose of Priority Sector Lending Certificates (PSLCs)? a) They transfer credit risk to investors b) They enable banks to trade compliance with PSL obligations c) They are long-term fixed-interest instruments d) They are used to securitize corporate loans.
4. Which of these does NOT qualify as a PSL category? a) Agriculture b) MSMEs c) Large corporate loans d) Renewable energy

Unit Summary

The key characteristics features of banks are Accepting deposits from the public, lending or investment, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise. Banks can be classified on the basis of ownership, structure, business and function of the banks. These classifications help to reach various sections of the economy, society and various segments of the country. The relationship between a banker and a customer is a multifaceted legal and contractual one, primarily governed by the principles of contract law, agency, and banking practice. KYC and PML guidelines are primarily governed by the Prevention of Money Laundering Act (PMLA), 2002, and are regulated by various authorities like the Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI), Insurance Regulatory and Development Authority of India (IRDAI), and overseen by the Financial Intelligence Unit - India (FIU-IND). The following are some of the kinds of individuals those maintain accounts in special cases, Minors, joint Account Holders and Illiterate Persons. The following are the principles of lending Principle of Safety of Funds, Principle of Profitability, Principle of Liquidity, Principle of Purpose and Principle of Risk Spread. Priority sector advances are a crucial policy initiative by central banks, particularly in countries like India, to ensure that certain vital sectors of the economy receive timely and adequate credit.

Glossary

- **Know Your Customer (KYC)** – A bank’s process of confirming customer identity and understanding their financial history to prevent financial crime.
- **Anti-Money-Laundering (AML)** – A framework of policies and procedures designed to detect, prevent, and report money laundering and terrorist financing activities.
- **Negotiable Instrument** – A signed, transferable document guaranteeing payment (e.g., cheques, promissory notes, bills of exchange); must contain an unconditional promise/order and can be endorsed to another party.
- **Promissory Note** – A written promise by one party to pay a specified sum to another at a future date; a type of negotiable instrument.
- **Bill of Exchange** – A written order from one party directing another to pay a third person a fixed amount, either on demand or later; includes cheques, sight and time drafts.
- **General / Ordinary Customer** – Standard adult with full legal capacity.
- **Minor** – Under 18 in India; cannot enter contractual obligations (e.g., loan agreements) and requires guardian for account operations.
- **Special Categories** – Including joint accounts, illiterate persons, non-resident Indians, senior citizens, PEPs, etc. (not individually defined here due to length).
- **Safety** – Primary consideration to protect loaned funds and prevent borrower default.
- **Liquidity** – Ensuring loans don’t impede the bank’s ability to meet withdrawal demands.
- **Purpose** – Loans should be for lawful and productive use.
- **Diversification** – Reduce portfolio risk by spreading exposure.
- **Profitability** – Loans must cover the bank’s costs and yield adequate returns.

Self – Assessment Questions

1. How does Call Money differ from Fixed Deposits?
2. List four key components of a robust KYC program.

3. How many years must banks retain customer identification and transaction records?
4. Why must cheques be presented within 3 months from issue date?
5. What special steps are required when opening an account for a minor or an illiterate person?
6. Which principle ensures the bank can meet withdrawal demands? Explain why.
7. What are PSLCs and how do they work?
8. What are various types of crossing explain them in detail?
9. What are classifications of banks based on its operation?
10. Explain the steps involved in lending.

Activities / Exercises / Case Studies

- Present mock loan applications. Learners evaluate against 5 Ps — safety, liquidity, purpose, diversification, profitability — and decide to approve or reject..
- Make a case study on KYC guidelines and its relevance in today's world

Answers for check your progress

Basic Concepts in Banking

1. Answer: c) Central Bank

Reason: Central banks (like the Reserve Bank of India, RBI) are primarily responsible for monetary policy, financial stability, and the regulation and supervision of commercial banks to ensure their soundness and protect depositors.

2. Answer: b) Assets for the bank

Reason: A loan represents a promise from the borrower to repay the bank. From the bank's perspective, this promise is an asset because it's something the bank owns and

expects to generate future economic benefits (interest payments and principal repayment). Deposits, on the other hand, are liabilities for the bank.

3. Answer: d) Number of employees.

Reason: Banks are primarily classified based on fundamental structural and operational aspects such as who owns them (ownership - public, private, cooperative), what services they provide (function - commercial, development, specialized), and where their headquarters are located (domicile - domestic or foreign). The number of employees is an internal staffing detail and not a broad criterion for bank classification.

4. Answer: c) Private sector bank.

Reason: Private sector banks are financial institutions where the majority of the shares are owned by private individuals or corporate entities. Their management and operations are typically driven by profit motives for their private shareholders.

5. Answer: b) Accepting deposits and lending for short-term needs.

Reason: Commercial banks are the most common type of bank, and their core activities revolve around accepting various types of deposits (like savings, current, and fixed deposits) from the public and providing short-term loans and advances to individuals and businesses for their working capital and other immediate needs.

Banker-Customer Relationships

1. Answer: a) Debtor and Creditor

Reason: When a customer deposits money into their account, the bank receives the money and promises to repay it on demand or as per the terms of the deposit. Therefore, the bank owes the money to the customer, making the bank the debtor and the customer the creditor.

2. Answer: b) Agent and Principal

Reason: In this situation, the customer (principal) instructs the bank (agent) to perform a specific task, which is the collection of a cheque. The bank acts as a representative of the customer in this transaction.

3. Answer: c) Death or insolvency of the customer.

Reason: The banker-customer relationship, being contractual, generally terminates upon the death, insolvency, or mental incapacity of the customer. Other scenarios like closing an account or mutual agreement can also terminate it.

4. Answer: c) Right of General Lien

Reason: The right of general lien is a powerful right of a banker to retain securities belonging to a customer until all debts due to the bank are paid. The other options listed (a, b, d) are fundamental obligations of a banker.

5. Answer: b) Keep the customer informed about their transactions and balance.

Reason: Providing periodic statements (physical or electronic) is a key obligation of the banker. It ensures transparency and allows the customer to verify transactions, reconcile their records, and keep track of their account balance and activities.

6. Answer: b) Giving reasonable notice to the customer.

Reason: While a banker has the right to close an account, they are generally obligated to give the customer reasonable notice before doing so. This allows the customer to make alternative banking arrangements and ensures a smooth transition. Unilateral and immediate closure without notice can lead to legal issues.

Know Your Customer, Anti Money Laundering - Guidelines

1. Answer: c) Marketing Strategies for New Products

Reason: The four key elements of a KYC policy are Customer Acceptance Policy, Customer Identification Procedures, Monitoring of Transactions, and Risk Management. Marketing strategies, while important for a bank's business, are not a core component of its KYC framework.

2. **Answer:** b) To prevent the use of financial systems by criminal elements for money laundering and terrorist financing

Reason: The fundamental objective of KYC is to combat financial crime by ensuring that financial institutions know who their customers are and can detect and report suspicious activities.

3. **Answer:** c) High-risk customers (e.g., Politically Exposed Persons)

Reason: Enhanced due diligence involves more rigorous checks and ongoing monitoring for customers categorized as high-risk, such as Politically Exposed Persons (PEPs), non-face-to-face customers, or those from high-risk jurisdictions, due to their increased potential for involvement in money laundering or terrorist financing activities.

4. **Answer:** b) An unconditional undertaking to pay a certain sum of money.

Reason: Section 4 of the Negotiable Instruments Act defines a promissory note as an instrument in writing (not being a banknote 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. The key is an 'unconditional undertaking' by the maker.

5. **Answer:** b) The title is transferable by mere delivery or by endorsement and delivery.

Reason: This is a fundamental feature of negotiability. The holder in due course gets a good title, irrespective of any defect in the title of the transferor.

Types of Customers

1. **Answer:** C. Purchasing a house

Reason: Banking transactions typically involve activities like deposits, withdrawals, and fund transfers. Purchasing a house is a financial transaction but not a banking transaction unless it involves a mortgage or loan facilitated by the bank.

2. **Answer:** D. All of the above

Reason: Special types of bank customers include minors, illiterate persons, and joint account holders, among others. These customers require special considerations and precautions due to their unique legal and operational circumstances.

3. Answer: C) Savings Account

Reason: Demand deposits allow withdrawal at any time without notice or penalty. Savings accounts (and current/checking accounts) fall under this category

4. Answer: B) It has a fixed maturity period

Reason: Time deposits, also known as term or fixed deposits, are held for a fixed period and penalized for early withdrawal

Principles of Lending

1. Answer: c) Safety

Reason: Since banks lend out depositors' money, ensuring the safety of funds (i.e., reducing the risk of loss) is paramount

2. Answer: a) Purpose

Reason: Lending should finance productive, legal activities so that the borrower is likelier to repay and the bank's funds are used effectively.

3. Answer: b) Application

Reason: It all begins when the borrower submits an application detailing loan specifics and necessary documents.

4. Answer: b) During underwriting

Reason: Appraisal and LTV evaluation are integral to underwriting to ensure the collateral is adequate and acceptable as per policy

Priority sector Advances:

1. Answer: d) Large corporate loans

Reason: PSL categories include agriculture, micro/small enterprises, export credit, education, housing, social infrastructure, renewable energy, and “others” (e.g., weaker sections) — but exclude large corporate lending.

2. **Answer:** b) Individual women borrowers up to ₹1 lakh

Reason: Weaker Sections include small/marginal farmers, SC/ST, SHGs, distressed borrowers, women borrowers (\leq ₹1 lakh), persons with disabilities, etc.

3. **Answer:** b) They enable banks to trade compliance with PSL obligations

Reason: PSLCs allow banks meeting targets to sell credits, while those that haven't can purchase them — facilitating flexibility without shifting credit risk.

4. **Answer:** C) Large corporate loans

Reason: PSL focuses on underserved sectors — agriculture, MSMEs, housing, education, renewable energy, weaker sections — and excludes large corporate lending

Suggested Readings

- *Anti-Money Laundering & Know Your Customer (IIBF)* by Indian Institute of Banking & Finance (2023) – Practical coverage of AML/KYC frameworks and compliance measures.
- Moorad Choudhry, *The Principles of Banking*, 2nd Edition (2022)
A comprehensive and highly practical guide covering lending principles, liquidity, asset-liability management, bank regulation, and customer business
- S. P. Tyagi, *Commentary on The Negotiable Instruments Act, 1881*, 4th Edition Reprint 2024
In-depth legal commentary with current precedents on dishonour of cheques and digital banking implications
- D. Muraleedharan, *Modern Banking: Theory and Practice* (2nd Ed, ~2014)
Contains historical context and commentary on PSL including emerging categories like renewable energy

Open Source E-Content Links

- https://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=8093
- [https://en.wikipedia.org/wiki/Scheduled_Banks_\(India\)](https://en.wikipedia.org/wiki/Scheduled_Banks_(India))
- https://www.rbi.org.in/commonperson/English/Scripts/Notification.aspx?Id=1036&utm_source=chatgpt.com
- https://www.pragatiprakashan.co.in/book-detail/198?utm_source=chatgpt.com
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- **Indian Institute of Banking & Finance (IIBF)**, *Anti-Money Laundering & Know Your Customer* (2023) – Practical guide frequently used for certification and training regarding compliance protocols.
- **D. Muraleedharan**, *Modern Banking: Theory and Practice*, 2nd Edition (~2014) – Offers contextual commentary on PSL evolution and its place in modern Indian banking
- **Covered within Moorad Choudhry et al.**, *The Principles of Banking*, 2nd Ed (2022), in sections discussing customer management and operational frameworks.
- **S. P. Tyagi**, *Commentary on The Negotiable Instruments Act, 1881*, 4th Edition (Vinod Publications, 2022/2024) – Comprehensive legal commentary with analysis of cheques, notes, bills, and dishonor-related judgments.
- **Reserve Bank of India**, *Master Direction – KYC / AML / CFT & PMLA* (latest revision 2024–25) – The primary regulatory framework covering customer identification, due diligence, monitoring, and anti-financial crime measures.

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UNIT – III - Electronic Banking**Unit Objective**

After going through the Unit one must be able to understand the

- Basics of Electronic banking
- UPI transfer
- Marketing of Banking Services
- Third Party Products in Banking

Unit Structure

- Introduction to E- Banking
- Role of IT in Banking
- Banking Technology
- Cheque Truncation System
- Electronic Funds Transfers
- Global Trends in Banking Technology
- Marketing of Banking Services
- Unit Summary
- Glossary
- Self – Assessment Questions
- Activities / Exercises / Case Studies
- Answers for check your progress
- Suggested Readings
- Open Source
- Reference

Introduction to E- Banking

E-banking, short for electronic banking, represents a fundamental shift in how individuals and businesses interact with financial institutions. It leverages technology to deliver banking services and conduct financial transactions remotely, moving beyond the traditional brick-and-mortar branch model. E-banking encompasses various methods that allow customers to manage their accounts and perform financial operations electronically. This includes internet banking (net banking), mobile banking, ATM services, electronic funds transfers (EFTs), direct deposits, and electronic bill payments.

The usage of e banking by the enterprises came into existence in mid 90's. E-banking came into existence in greater numbers because of low operating costs. First it is in the form of ATM's and phone transactions. Recently it transformed to internet a new channel between customers and banks which benefits both. The main aim of e-banking services is to provide the customers a much faster services with low cost. From the last twenty years, banking sector has chosen a new method of banking based on the progress of information technology. In addition to these customers, transaction and communication abilities are fastened based on information technology.

E-banking made its debut in UK and USA 1920s. It becomes prominently popular during 1960, through electronic funds transfer and credit cards. The concept of web-based banking came into existence in Europe and USA in the beginning of 1980.

In India e-banking is of recent origin. The traditional model for growth has been through branch banking. The e-banking has made the customer say good-bye to huge account registers and large paper bank accounts. The e-banks, which may includes

- Credit Cards/Debit Cards
- ATM
- E-Cheques
- EFT (Electronic Funds Transfer)
- DeMAT Accounts
- Mobile Banking
- Telephone Banking
- Internet Banking
- EDI (Electronic Data Interchange)

One of the most significant advantages of e-banking is its 24/7 availability. Customers can access their accounts, check balances, transfer funds, pay bills, and even apply for loans anytime, anywhere, using a computer, smartphone, or other digital device with an internet connection. This eliminates the need for physical visits to bank branches, saving time and effort.

Core Services: E-banking platforms typically offer a wide range of services, such as:

- Account Management: Viewing account statements, transaction history, and managing multiple accounts (savings, current, credit cards, loans).
- Fund Transfers: Sending money between accounts, to other individuals, or to different banks using services like NEFT (National Electronic Funds Transfer), RTGS (Real-Time Gross Settlement), IMPS (Immediate Payment Service), and UPI (Unified Payments Interface).
- Bill Payments: Paying utility bills (electricity, water, phone), credit card bills, and loan repayments electronically.
- Online Investments: Facilitating investments in mutual funds, stocks, and other financial products.
- Service Requests: Ordering chequebooks, blocking/reissuing debit/credit cards, and updating contact details.

E-banking has revolutionized the financial landscape by making banking more efficient, cost-effective (for both banks and customers), and inclusive, extending financial services to a broader population. It has paved the way for online-only banks (neobanks) that operate entirely digitally. The different methods of e-banking are

- Online banking
- Short Message Service banking
- Telephone banking
- Mobile banking

Online banking:

Online banking also called as internet banking, allows the customers to use all the banking services from a computer which has internet access. The customer can perform financial transactions on a secure website operated by the bank.

Telephone Banking:

Telephone banking is a service provided by the banks which provides customers to perform transactions on phone. All the telephone banking systems uses automated answering system with keypad response or voice recognition capability. In telephone banking customer can't withdraws and deposits cash but can do all the other transactions.

SMS Banking:

SMS banking is a service permitting banks to do select banking services from the users mobile by the SMS messaging. SMS banking services have push and pull messages. Push messages are sent by the banks for alerting customer about new offers, marketing messages, alerts to events happening in customers account such as large amount of withdrawals from ATM or credit card etc.

Features of E-banking

E-banking provides many advantages for banks and customer's. E-banking has made life much easier and banking much faster for both customers and banks.

- It saves time spent in banks
- It provides ways for international banking.
- It provides banking throughout the year 24/7 days from any place have internet access.
- It provides well-organized cash management for internet optimization
- It provides convenience in terms of capital, labour, time all the resources needed to make a transaction.
- Taking advantage of integrated banking services, banks may compete in new markets can get new customers and grow their market share.
- It provides some security and privacy to customers, by using state-of-the-art encryption and security technologies.

Benefits of E-banking:**To the Customer:**

- Anywhere Banking no matter wherever the customer is in the world. Balance enquiry, request for services, issuing instructions etc., from anywhere in the world is possible.
- Anytime Banking – Managing funds in real time and most importantly, 24 hours a day, 7days a week.
- Convenience acts as a tremendous psychological benefit all the time.
- Brings down “Cost of Banking” to the customer over a period a period of time.
- Cash withdrawal from any branch / ATM
- On-line purchase of goods and services including online payment for the same.

To the Bank:

- Innovative, scheme, addresses competition and present the bank as technology driven in the banking sector market
- Reduces customer visits to the branch and thereby human intervention
- Inter-branch reconciliation is immediate thereby reducing chances of fraud and misappropriation
- On-line banking is an effective medium of promotion of various schemes of the bank, a marketing tool indeed.
- Integrated customer data paves way for individualized and customized services.

Role of information & Communication Technology in Banking

ICT plays an important role in the modern banking system. It has enhanced the banking services and has taken the service to all the section of the society. The Software Packages for Banking Applications in India had their beginnings in the middle of 80s, when the Banks started computerising the branches in a limited manner. The early 90s saw the plummeting hardware prices and advent of cheap and inexpensive but high powered PC's and Services and banks went in for what was called Total Branch Automation (TBA) packages. The middle and late 90s witnessed the tornado of financial reforms, deregulation globalisation etc. coupled with rapid revolution in communication technologies and evolution of novel concept of convergence of communication technologies, like internet, mobile/cell phones etc. Technology has continuously played on important role in the working of banking institutions and the services provided by them.

Safe keeping the public money, transfer of money, issuing drafts, exploring investment opportunities and lending drafts, and exploring investment being provided.

Information Technology enables sophisticated product development, better market infrastructure, implementation of reliable techniques for control of risks and helps the financial intermediaries to reach geographically distant and diversified markets. Internet has significantly influenced delivery channels of the banks. Internet has emerged as an important medium for delivery of banking products and services.

The customers can view the accounts; get account statements, transfer funds and purchase drafts by just punching on few keys. The smart card's i.e., cards with microprocessor chip have added new dimension to the scenario. The shift from traditional banking to e-banking is changing customer's expectations.

Impact of IT on the Service Quality:

- With automation, service no longer remains a marketing edge with the large banks only. Small and relatively new banks with limited network of branches become better placed to compete with the established banks, by integrating IT in their operations.
- The technology has commoditising some of the financial services.
- The technology on one hand serves as a powerful tool for customer servicing, on the other hand, it itself results in depersonalising of the banking services.
- In order to reduce service delivery cost, banks need to automate routine customer inquiries through self-service channels.

Impact of IT on Privacy and Confidentiality of Data:

Data being stored in the computers is now being displayed when required on through internet banking mobile banking, ATM's etc. all this has given rise to the issues of privacy and confidentiality of data are:

- The data processing capabilities of the computer, particularly the rapid throughput, integration, and retrieval capabilities, give rise to doubts in the minds of individuals as to whether the privacy of the individuals is being eroded.

- So long as the individual data items are available only to those directly concerned, everything seems to be in proper place, but the incidence of data being cross referenced to create detailed individual dossiers gives rise to privacy problems.
- Customers feel threatened about the inadequacy of privacy being maintained by the banks with regard to their transactions and link at computerised systems with suspicion.

Let Us Sum Up

Online banking also called as internet banking, allows the customers to use all the banking services from a computer which has internet access. One of the most significant advantages of e-banking is its 24/7 availability. In telephone banking customer can't withdraws and deposits cash but can do all the other transactions. SMS banking services have push and pull messages. E banking saves time spent in banks and provides ways for international banking. Information Technology enables sophisticated product development, better market infrastructure, implementation of reliable techniques.

Check Your Progress

1. What does ATM stand for in the context of banking? a) Automated Transaction Machine b) Automatic Teller Machine c) Any Time Money d) Advanced Technology Module
2. Which of the following is a primary advantage of E-banking for customers? a) Requirement to visit the bank during specific hours. b) Limited access to account information. c) 24/7 access to banking services from anywhere. d) Higher transaction fees compared to traditional banking.
3. IMPS stands for: a) Indian Mobile Payment System b) Immediate Money Payment Service c) Interbank Mobile Payment Service d) Instant Money Transfer Protocol
4. What is a key benefit of E-banking for banks themselves? a) Increased need for physical branches. b) Higher operational costs. c) Reduced transaction costs and improved efficiency. d) Limited reach to a global customer base.
5. What is a "Debit Card"? a) A card that allows you to borrow money up to a certain credit limit. b) A card that directly deducts money from your linked bank account for

purchases or withdrawals. c) A card that stores a pre-paid amount and can be recharged. d) A card exclusively used for online shopping.

Banking Technology

Automated Teller Machines (ATM's)

An automated teller machine (ATM) is an electronic banking outlet that allows customers to complete basic transactions without the aid of a branch representative or teller. Anyone with a credit card or debit card can access most ATMs. The first ATM appeared in London in 1967, and in less than 50 years, ATMs had spread around the globe, Automatic teller machines have transformed the concept of banking in India. It has eliminated the requirement of to stand in long queue and filling of forms for routine banking transaction. Now customers of banks can access their money with the scratch of a ATM card. An automated teller machine (ATM) is an electronic computerized device that allows banks customers to directly use a secured method of communication to access their bank accounts. Entry of Automated teller machines (ATM's) has changed the office atmosphere of the branches of banks. There is no need for a customer to visit branches for their day today banking transaction like cash deposits, cash withdrawals, balance enquiry, dropping cheque etc. Electronic channels have opened new avenues for banks. ATM's are electronic machines which are operated by customer himself to withdraw or deposit cash.

ATM delivers multiple services 24x7, which is major cause of making it a success in he history of banking industry. In fact, e-banking services became profitable and successful due to various services delivered through ATM's. The management of ATM's involves loading of cash, arrangement of money with bank service of car that delivers cash, providing insurance for all areas such as theft of cash from ATM's. ATM's helps customers in withdrawing cash at anytime, from anyplace. Along with these services, many more services are also provided by ATM's that includes checking their account balances, recharging prepaid mobile phone credit, transfer of money, making bill payments.

Features of Automated Teller Machine:

- Transfer funds between linked bank accounts

- Receive account balance
- Prints recent transactions list
- Change your pin
- Deposit your cash
- Prepaid mobile recharge
- Bill payments
- Cash withdrawal
- Perform a range of feature in your foreign language.

Functions of Automated Teller Machine:

- The ATM provides 24 hours service
- The ATM provides privacy in banking communications
- The ATMs reduce the work load banks staff
- The ATM may give customer new currency notes
- The ATMs are convenient to banks customers
- The ATM is very beneficial for travellers
- The ATM provide services without any error

Facilities provided to the ATM customers

1. Anytime, anywhere access to cash, withdrawal of cash is available 24x7.
2. Transfer of money from one account to another account is possible with the help of ATM"s.
3. A customer with the help of ATM"s can check his/her last transactions and current balance. In addition to these, a mini statement can also be generated with the help of ATM"s.
4. Change of personal identification number of ATM/debit card can be made with ATM"s.
5. Cheque book request can be made by the customers through ATM"s.
6. Fixed deposits can be done with the help of ATM"s.
7. Utility bills can be paid by the customers with the help of ATM"s.
8. Customers can pay their credit card bill with ATM"s.
9. Mobiles can be recharged via ATM"s.

10. To get the latest updates on mobile, customers can change their mobile number through ATM's.

11. Check drop facility can also be used by customers at ATMs.

Advantages of ATM

- It helps in quick cash withdrawal
- Anyone Can Have Bank Card and transact in an ATM
- The account holder has the facility of account balance inquiry
- It provides the details of recent transactions
- Deposit cash / cheques can be made in an ATM
- Transfer funds between accounts within the same bank is possible with ATM
- The customers can pay their utility bills
- ATM provides Convenient 24x7 Banking service
- Customers can withdraw cash while in overseas

Disadvantages of ATMs

Fraud: Criminals can fit skimming devices and small cameras to ATMs. These machines record account details and personal identification numbers, which the crook uses to withdraw money from those accounts.

Fees: Banks and machine owners draw a huge source of revenue from ATM fees. Cardholders can usually withdraw cash for free from ATMs owned by their bank, but typically have to pay to use machines owned by other companies.

Theft Risk: If you go to a bank, you're likely walking into a secured area watched by multiple cameras or a life guard. Those elements encourage crooks to keep their distance from the bank.

Card Retention: ATMs give, but they can also take. They can malfunction and simply not be available when you need them. Some will also retain damaged cards, or any card if its owner fails to enter a correct PIN after three attempts. A cardholder can usually reclaim her card if it's been retained by a machine owned by her bank. However, if the card is kept by another bank's ATM, there's no guarantee she'll ever see it again.

Cash Deposit Machine

The biggest advantage about these machines installed at ATMs is that we can deposit money round the clock. However, we will also find CDMs located inside banks,

which can be used during regular banking working hours. These machines save time spent waiting in those long queues where a teller would normally assist you to deposit your money.

Debit Card

A debit card is a payment card that deducts money directly from a consumer's checking account to pay for a purchase. Debit cards eliminate the need to carry cash or physical checks to make purchases. In addition, debit cards, also called check cards, offer the convenience of credit cards and many of the same consumer protections when issued by major payment processors like Visa or MasterCard.

Unlike credit cards, they do not allow the user to go into debt, except perhaps for small negative balances that might be incurred if the account holder has signed up for overdraft protection. However, debit cards usually have daily purchase limits, meaning it may not be possible to make an especially large purchase with a debit card. See *Credit versus Debit Cards: Which Is Better?*

Debit cards serve a dual purpose: They allow the user to withdraw money from his or her checking account through an ATM or through the cash-back function many merchants offer at the point of sale. In addition they also allow the user to make purchases. ATM cards, by contrast, only allow the user to withdraw money from an ATM, while credit cards only allow purchases unless the credit card holder has a PIN-enabled cash advance feature (and the cash advance will incur interest, unlike withdrawing cash from a checking account).

Debit card purchases can usually be made with or without a personal identification number (PIN). If the card has a major payment processor's logo, it can be run as a credit card, and the cardholder won't need to take the risk of exposing their PIN number. The money will still come directly out of the cardholder's checking account, and there won't be any finance charges when the debit card is run as a credit card. Some debit cards also offer reward programs, similar to credit card reward programs, such as 1% back on all purchases.

Internet Banking

Banks have traditionally been in the forefront of harnessing technology to improve their products, services and efficiency. They have, over a long time, been using electronic and telecommunication networks for delivering a wide range of value added products and services. This form of banking is generally referred to as Internet Banking, although the range of products and services offered by different banks vary widely both in their content and sophistication.

Broadly, the levels of banking services offered through INTERNET can be categorized in to three types: (i) The Basic Level Service is the banks' websites which disseminate information on different products and services offered to customers and members of public in general. It may receive and reply to customers' queries through e-mail, (ii) In the next level are Simple Transactional Websites which allow customers to submit their instructions, applications for different services, queries on their account balances, etc, but do not permit any fund-based transactions on their accounts, (iii) The third level of Internet banking services are offered by Fully Transactional Websites which allow the customers to operate on their accounts for transfer of funds, payment of different bills, subscribing to other products of the bank and to transact purchase and sale of securities, etc.

Features of Internet banking

Some of the distinctive features of I-banking are:

- It removes the traditional geographical barriers as it could reach out to customers of different countries / legal jurisdiction. This has raised the question of jurisdiction of law / supervisory system to which such transactions should be subjected,
- It has added a new dimension to different kinds of risks traditionally associated with banking, heightening some of them and throwing new risk control challenges,
- Security of banking transactions, validity of electronic contract, customers' privacy, etc., which have all along been concerns of both bankers and supervisors have assumed different dimensions given that Internet is a public domain, not subject to control by any single authority or group of users,
- It poses a strategic risk of loss of business to those banks who do not respond in time, to this new technology, being the efficient and cost effective delivery mechanism of banking services,

- A new form of competition has emerged both from the existing players and new players of the market who are not strictly banks.

Products and services offered

Banks in India are at different stages of the web-enabled banking cycle. Initially, a bank, which is not having a web site, allows its customer to communicate with it through an e-mail address; communication is limited to a small number of branches and offices which have access to this e-mail account. As yet, many scheduled commercial banks in India are still in the first stage of Internet banking operations. With gradual adoption of Information Technology, the bank puts up a web-site that provides general information on the banks, its location, services available e.g. loan and deposits products, application forms for downloading and e-mail option for enquiries and feedback. It is largely a marketing or advertising tool. Some of the banks permit customers to interact with them and transact electronically with them. Such services include request for opening of accounts, requisition for cheque books, stop payment of cheques, viewing and printing statements of accounts, movement of funds between accounts within the same bank, querying on status of requests, instructions for opening of Letters of Credit and Bank Guarantees etc. Banks providing Internet banking services have been entering into agreements with their customers setting out the terms and conditions of the services. The terms and conditions include information on the access through user-id and secret password, minimum balance and charges, authority to the bank for carrying out transactions performed through the service, liability of the user and the bank, disclosure of personal information for statistical analysis and credit scoring also, non-transferability of the facility, notices and termination, etc.

Truncation System of cheque clearance:

The Cheque Truncation System (CTS) was introduced to eliminate the physical movement of cheques, thereby speeding up the clearing process, reducing costs, and enhancing security. Truncation, in the context of cheque clearance, means stopping the physical flow of a cheque at an early point in the clearing cycle.

Cheque Truncation System (CTS) involves following steps:

1. **Cheque Deposit and Image Capture:**

- When a customer deposits a cheque at their bank (the presenting bank), the bank uses a "Capture System" (scanner and software) to immediately capture the electronic image of the cheque.
- Simultaneously, key data from the cheque, particularly the Magnetic Ink Character Recognition (MICR) band, is extracted.

2. **Electronic Transmission to Clearing House:**

- The captured images and data are digitally signed and encrypted to ensure security and authenticity.
- This electronic information is then transmitted securely to a central processing location, often called a Clearing House (e.g., National Payments Corporation of India - NPCI in India).

3. **Processing and Settlement at Clearing House:**

- The Clearing House processes the received data and images.
- It performs the necessary matching and verification, arrives at the settlement figures between banks, and routes the images and data to the respective paying banks. This is known as "presentation clearing."

4. **Paying Bank Processing:**

- The paying bank receives the electronic images and data from the Clearing House.
- They use this information to verify the cheque and process the payment.
- If a cheque needs to be dishonored (e.g., insufficient funds, stop payment), the paying bank generates a "return file" electronically.

5. **Return Clearing:**

- The return file/data from the paying banks is processed by the Clearing House in a "return clearing" session.
- This return information is then provided to the presenting banks, allowing them to inform their customers about the unpaid instruments.

6. **Completion of Cycle:**

- The entire clearing cycle is considered complete once both the presentation clearing and the associated return clearing sessions are successfully processed.

Benefits:

- The most significant benefit is the drastic reduction in cheque clearing time,
- Eliminates the logistical costs associated with transporting physical cheques (transportation, handling, storage).
- Reduces the risk of cheques being lost, stolen, or tampered with during transit.
- Digital signatures and encryption add layers of security.
- Leads to better reconciliation and verification.
- Faster access to funds due to quicker clearing times.
- CTS enables seamless clearing across different cities within the clearing grids.

Let Us Sum Up

An automated teller machine (ATM) is an electronic computerized device that allows banks customers to directly use a secured method of communication to access their bank accounts. ATM delivers multiple services 24x7, which is major cause of making it a success in the history of banking industry. A debit card is a payment card that deducts money directly from a consumer's checking account to pay for a purchase. Unlike credit cards, they do not allow the user to go into debt, except perhaps for small negative balances that might be incurred if the account holder has signed up for overdraft protection. With gradual adoption of Information Technology, the bank puts up a web-site that provides general information on the banks, its location, services available e.g. loan and deposits products, application forms for downloading and e-mail option for enquiries and feedback. The Cheque Truncation System (CTS) was introduced to eliminate the physical movement of cheques, thereby speeding up the clearing process, reducing costs, and enhancing security.

Check Your Progress

- 1. Which of the following technologies is used for secure online banking transactions?** A. HTTP B. FTP C. HTTPS D. SMTP
- 2. NEFT in Indian banking stands for** A. National Electronic Funds Transfer B. New Electronic Fund Transfer C. National Exchange Fund Transfer D. None of the above

3. **What is the primary function of an ATM?** A. Issuing loans B. Accepting deposits only C. Providing banking services without human teller D. Issuing credit cards
4. **A debit card is linked to which of the following?** A. Credit account B. Fixed deposit account C. Savings or current account D. Loan account
5. **Internet banking requires which of the following?** A. Printed passbook B. Access to ATM only C. Internet connection and user credentials D. Cheque book

Electronic Fund Management

Banking operations over the years and decades have witnessed many changes and have been adopting from time to time new innovations. The technological revolution especially in the Information and Technology front has changed the functioning of banks. In today's globalized competitive business environment banks are trying to have the competitive edge by using the latest technology to cut down turnaround time, cut costs and increase efficiency. "E-Banking" through many innovative products and services has revolutionized banking operations.

Real Time Gross Settlement (RTGS)

One of the important IT revolutions in Indian Banking Scenario was the implementation of the Real Time Gross Settlement (RTGS) system by the Reserve Bank of India. With the changing scenario from manual environment to electronic mode, banks started to use faster, safer and efficient methods to transfer funds. In this regard, two important and popular electronic funds transfer systems are Real Time Gross System (RTGS) and National Electronic Funds Transfer System (NEFT).

RTGS is an electronic payment system, where payment instructions are processed on a 'continuous' or 'REAL TIME' basis and settled on a 'GROSS' or 'individual' basis without netting the debits against credits. In India, RBI introduced this system and the system is functioning well. The payments so effected are 'final' and 'irrevocable'. The settlement is done in the books of the central bank (RBI). The RTGS system allows transfer of funds across banks on a real time (immediate) basis. Each participant bank needs to open a dedicated settlement account for putting through its RTGS transactions. Not only does it allow transfer of funds, it also reduces the credit risk. Both customers and

banks can transfer funds monies the same day at regular intervals within the banking hours.

The following information is required for an RTGS transaction:

- The amount that needs to be transferred in rupees
- Name of the payee/beneficiary as in the bank account
- IFSC code of the payee/beneficiary
- Account number of the payee/beneficiary
- Name of beneficiary bank and bank branch

Features of RTGS

1. Real Time Gross Settlement helps banks to settle interbank and forex settlements
2. It also helps banks in handling big ticket funds transfers
3. Since RTGS it is routed through RBI platform, the credit risk is minimized (this is one of the main advantages in settlement of funds)
4. Unlike in case of cheque clearance, the drawer of the cheque cannot enjoy the float time (the date of issuance of cheque and the date on which it is received in inward clearing and debited by his banker). However, in the case of RTGS, the remitter's account is debited first and then only the funds are transferred
5. If all relevant details such as the beneficiary's name, account number, IFSC code of the receiving branch, name of the beneficiary bank, etc., are correctly furnished it would assist the remitting bank to effect the transfer quickly
6. As the name RTGS suggests, the transfer mechanism works on real time and, therefore, the beneficiary branch/bank should receive the funds immediately. The beneficiary's branch/bank should give credit to the beneficiary's account immediately or latest within 2 hours of receiving the funds transfer message.

Functions of RTGS

Here are the main features of an RTGS transaction that one should be aware of before using it:

- Realtime online fund transfer
- Used for high value transactions
- Safe and secure
- Reliable and backed by RBI

- Immediate clearing
- Funds credited on a one-on-one basis
- Transactions executed on an individual and gross basis

National Electronic Funds Transfer (NEFT)

NEFT is a system similar to RTGS with certain differences. RTGS handles big ticket transactions, whereas NEFT handles smaller size transactions. Most branches are using this facility to transfer funds in an efficient manner. Once the applicant for the transfer of funds furnishes full and correct details (correct account details means correct name of the beneficiary, the correct account number, the branch and bank of the beneficiary, and the correct IFS code, etc.) funds can be transferred to the beneficiary's account by the remitting bank. Transfer of funds through NEFT is safe, quick. It reduces the paper work and is cost effective.

Features of NEFT

1. NEFT is a funds transfer system which enables a customer of a bank to transfer funds to another customer of another bank having account with any participating bank
2. NEFT allows both intra and inter-bank funds transfer within a city and across cities
3. Since it is in the form of e transfer, without any physical movement of instruments, funds can be transferred quickly
4. The beneficiary customer gets funds in his account on the same day or at the earliest on the next day depending upon the time of settlement
5. Both the originating and destination bank branches should be on NEFT platform
6. The correct details of IFSC, beneficiary's name, account numbers, etc., should be furnished to the originating bank
7. The originating bank branch can keep track of the status of the NEFT transaction
8. In case for any reason the destination branch is not able to afford credit to the beneficiary's account, destination branch/bank have to return the funds to the originating bank within two hours of completion of the batch through which the transaction was processed

Important Points to Know about NEFT:

1. The National Electronic Funds Transfer enables electronic transfer of funds between two NEFT-enabled bank branches. It can also be used to transfer funds from or to NRE/NRO accounts in India. Remittance is not allowed to a foreign country, except Nepal.
2. The transactions are bunched up and settled in batches at specified times. There are 12 settlements from 8 am to 7 pm on weekdays, and six from 8 am to 1 pm on Saturdays. If a transaction is initiated after a batch settlement time, it's deferred to the next batch.
3. There is no minimum or maximum limit on the amount that can be transferred under NEFT. Even those who do not have a bank account with a branch can deposit cash at the NEFT-enabled branches, but such remittances can be made up to a maximum of Rs 50,000 per transaction.
4. The credit for the first 10 batches on weekdays (8 a.m. to 5 p.m.) and the first five batches on Saturdays (8 a.m. to 12 noon) takes place on the same day. For the other batches, the funds may be credited on the next working day.

NEFT offers many advantages over the other modes of funds transfer:

- The remitter need not send the physical cheque or Demand Draft to the beneficiary.
- The beneficiary need not visit his / her bank for depositing the paper instruments.
- The beneficiary need not be apprehensive of loss / theft of physical instruments or the likelihood of fraudulent encashment thereof.
- Cost effective.
- Credit confirmation of the remittances sent by SMS or email.
- Remitter can initiate the remittances from his home / place of work using the internet banking also.
- Near real time transfer of the funds to the beneficiary account in a secure manner.

Key Differences Between NEFT, RTGS

Online transfer methods are subject to availability based on the customer's eligibility and level of access granted by the bank. Additionally, the limits on fund value, timings, settlement speed, and other factors are a part of the online fund transfer method to

provide a positive experience to the customer when they choose one transfer method over the other.

NEFT - The funds transferred under this method are settled in batches (based on Deferred Net Settlement (DNS) and at a specific time of the day. If the transfer is initiative beyond the cut-off time specified by RBI, the funds are typically settled on the next working day. At present, the fund transfer requests under NEFT are processed in twelve batches between 8 a.m. to 7 p.m. on weekdays and six batches between 8 a.m. to 1 p.m. on Saturdays. Unfortunately, NEFT is not available on Sundays and bank holidays. One of the biggest advantages of NEFT is the cost-effectiveness, an individual can carry out smaller value transfers without worrying about the transaction fee and service charges. A smaller fee on the transfer enables the individual to carry out more payments which make NEFT the most popular and extensively used method for online fund transfers.

Under NEFT, the transactions can be initiated and settled from the bank account of one particular bank to another bank's account throughout India at no additional cost apart from the standard charges, provided both the banks are a part of the NEFT transfer network (NEFT-enabled). Though some banks might have their own policies concerning the NEFT service provided by them, such as restrictions on transferring funds immediately to a newly added beneficiary, fund value limits restricting the value of transfer beyond a specified limit, etc., these protocols are proven to be effective for safeguarding the customer's financials.

RTGS - This type of transfer methods is applicable and available for fund transfers between Rs.2 lakh to Rs.10 lakh, however, the biggest advantage for RTGS is the fastest/real-time settlement factor. As soon as the transfer instructions are sent, the fund gets settled almost immediately. However, in order to take advantage of the RTGS facility, both the originator's and the beneficiary's account has to be RTGS-enabled. Even though most banks are a part of the vast and popular RTGS transfer network facilitated by RBI, individuals are recommended to either get in touch with their bank directly or refer to their online banking section to discover their eligibility concerning access to RTGS payment system. The transaction fee under RTGS is higher than the other methods due to the faster settlement speed performed on an instruction by instruction basis.

RTGS comes with limits on the minimum and maximum fund value, however, it is efficiently used in situations where individuals and businesses require immediate settlement of high-value funds that are well within the specified limits. Efficiency, speed, and reliability factors are few among the many factors that make RTGS as one the most-sought medium of online fund transfers.

Indian Financial System Code (IFSC)

IFSC is an alpha-numeric code that identifies a bank-branch participating in the RTGS/NEFT system. IFSC has 11 digit code and the first four alpha characters represents the bank, the 5th code is 0 (zero), which is reserved for future use and the last six digits are numeric characters represents the branch. Correct IFSC code is essential for identifying the beneficiary's branch and bank as destination for funds transfers.

Unified Payments Interface (UPI):

UPI is a real-time payment system developed by the **National Payments Corporation of India (NPCI)**. Think of UPI as the "**highway**" or "**railroad**" that enables instant money transfers between different bank accounts using a single mobile application. It's an interoperable system that allows users to link multiple bank accounts from various banks to one UPI-enabled app.

Key Features of UPI:

- **Instant Transactions:** Enables real-time, 24/7, 365-day fund transfers.
- **Virtual Payment Address (VPA):** Users create a unique VPA (e.g., yourname@bankname or yourmobile@upi) which eliminates the need to remember complex bank account numbers and IFSC codes. This enhances privacy and reduces errors.
- **Mobile-First:** Designed for seamless transactions via smartphones.
- **Bank Agnostic:** Users can link accounts from different banks to a single UPI app.
- **Multiple Transaction Options:** Supports person-to-person (P2P) transfers, person-to-merchant (P2M) payments, utility bill payments, online shopping, QR code-based payments, and more.
- **Single-Click Authentication:** Simplifies payments with a single UPI PIN authentication.

- **Security:** Leverages multi-factor authentication, including UPI PINs and biometrics, with end-to-end encryption.
- **Interoperability:** Allows transactions between users of different banks and different UPI apps.

BHIM (Bharat Interface for Money): The Government-Backed App

BHIM is a mobile payment application developed by NPCI, built on the UPI platform. It's essentially **one of many "vehicles"** that run on the UPI highway. Launched by the Indian government in December 2016, its primary goal was to promote financial inclusion and cashless transactions, especially among segments that might be new to digital payments.

Key Products/Features of BHIM:

- **Send Money:** Users can send money using a UPI ID, mobile number, Aadhaar number, or by scanning a QR code.
- **Request Money:** Users can initiate "collect requests" to receive money from others by entering their UPI ID.
- **Scan & Pay:** Facilitates quick payments to merchants by scanning UPI QR codes. Users can also generate their own QR codes to receive payments.
- **Transaction History:** Provides a detailed view of past transactions, with options to filter and raise disputes.
- **Profile Management:** Allows users to manage their UPI ID(s), view/share their QR code, and link/switch between multiple bank accounts.
- **UPI PIN Management:** Users can set and change their UPI PIN within the app.
- **Bill Payments:** Integrates with the Bharat Bill Payment System (BBPS) for utility bill payments (electricity, gas, DTH, telecom, etc.).
- **UPI LITE:** A feature allowing small-value transactions (up to ₹200 per transaction, cumulative usage up to ₹4,000 per day) directly from an on-device wallet without requiring a UPI PIN for every transaction, making it even faster for micro-payments.
- **UPI 2.0 Features (introduced later):**
 - **Linking Overdraft (OD) Accounts:** Allows users to link their OD accounts to UPI for digital access.

- **Signed Intent & QR:** Provides additional security by reducing the risk of tampered QR codes and ensuring the authenticity of the recipient.
- **Mandate:** Enables pre-authorization of transactions to be debited later, useful for scheduled payments or subscriptions.
- **Invoice in the Inbox:** Allows users to view the invoice details from verified merchants before making a payment.

Impact of UPI and BHIM on Digital Payments in India

The combined power of UPI and BHIM has had a **transformative and profound impact** on the Indian economy and its payment ecosystem:

1. Explosive Growth in Digital Transactions:

- UPI has become the **dominant retail payment system** in India, processing billions of transactions monthly. As of late 2024, UPI was processing over 15 billion transactions per month.
- This has led to a significant **reduction in cash dependency**, fostering a more formalized economy.

2. Financial Inclusion:

- UPI's user-friendly interface and accessibility have brought millions of **unbanked and underbanked individuals** into the formal financial system, especially in rural and semi-urban areas.
- It has empowered small businesses and street vendors to accept digital payments, significantly expanding their customer base and improving cash flow.

3. Ease and Convenience:

- Payments are now instant, 24/7, and can be done from anywhere with a mobile phone, eliminating banking hours and geographical barriers.
- The simplicity of using a UPI ID or scanning a QR code has made digital payments accessible to a wide range of users, regardless of their digital literacy level.

4. Reduced Transaction Costs:

- For end-users, UPI transactions are generally **zero-cost**, making it highly attractive compared to traditional payment methods that might involve fees. This benefits both consumers and small businesses.

5. Innovation and Competition:

- UPI's open API architecture has spurred a vibrant **fintech ecosystem**, with numerous third-party payment applications (Google Pay, PhonePe, Paytm, etc.) leveraging UPI to offer innovative services.
- This competition has driven further innovation in features and user experience.

6. Government Initiatives and Transparency:

- UPI has facilitated more efficient **direct benefit transfers (DBT)** from the government to beneficiaries, reducing leakages and ensuring that subsidies and welfare schemes reach the intended recipients.
- The digital trail created by UPI transactions enhances transparency and accountability

7. Economic Growth:

- By increasing the efficiency of transactions, reducing costs, and fostering a more robust financial ecosystem, UPI has a positive impact on India's GDP.
- It has enabled small and medium-sized enterprises (SMEs) to participate more actively in the digital economy.

8. Global Recognition:

- India's UPI model is now a case study for other countries looking to build their own fast payment systems. UPI is being adopted in various countries like Sri Lanka, Nepal, Bhutan, Mauritius, France, and the UAE, highlighting its global potential.

Let Us Sum Up

“E-Banking” through many innovative products and services has revolutionized banking operations. One of the important IT revolutions in Indian Banking Scenario was

the implementation of the Real Time Gross Settlement (RTGS) system by the Reserve Bank of India. RTGS is an electronic payment system, where payment instructions are processed on a 'continuous' or 'REAL TIME' basis and settled on a 'GROSS' or 'individual' basis without netting the debits against credits. NEFT is a system similar to RTGS with certain differences. RTGS handles big ticket transactions, whereas NEFT handles smaller size transactions. IFSC is an alpha-numeric code that identifies a bank-branch participating in the RTGS/NEFT system. IFSC has 11 digit code and the first four alpha characters represents the bank, the 5th code is 0 (zero), UPI is a real-time payment system developed by the **National Payments Corporation of India (NPCI)**. BHIM is a mobile payment application developed by NPCI, built on the UPI platform. It's essentially **one of many "vehicles"**

Check Your Progress

1. **What is the primary objective of E-Fund Management in banking?** A. To generate electricity B. To manage physical cash C. To monitor and control electronic financial transactions D. To provide internet access
2. **Which platform provides instant money transfer service in India and supports E-Fund Management?** A. RTGS B. UPI C. NEFT D. ECS
3. **UPI is regulated by which of the following organizations?** A. SEBI B. RBI C. NPCI D. NABARD
4. **Which of the following is true about BHIM?** A. It is a mobile wallet like Paytm B. It is UPI-based app developed by NPCI C. It only works with one bank D. It is used for card payments only
5. **Which of the following is NOT required for using UPI services?** A. Bank account linked with mobile number B. Smartphone C. Internet access D. Cheque book

Global Trends in Banking Technology:

The global banking industry is currently undergoing a rapid and transformative shift, driven by advancements in technology. Here are some of the key global trends in banking technology:

1. AI and Machine Learning (AI/ML): AI and ML are revolutionizing nearly every aspect of banking, from back-office operations to customer-facing services.

- AI/ML analyze vast transaction patterns in real-time to detect and prevent fraudulent activities and strengthen anti-money laundering (AML) efforts.
- AI-driven chatbots and virtual assistants provide 24/7 support, answering common inquiries, and offering personalized assistance.
- ML algorithms enhance credit risk assessment by analyzing millions of data points, leading to more accurate and efficient loan underwriting.
- AI, often combined with Robotic Process Automation (RPA), automates repetitive tasks like data entry, document processing, and compliance checks, improving efficiency and reducing errors.

2. Cloud Computing: Cloud adoption is no longer just about infrastructure migration; it's a strategic imperative for banks seeking agility, scalability, and enhanced security.

- Cloud solutions provide on-demand, scalable infrastructure, allowing banks to manage resources efficiently and reduce operational costs.
- Cloud providers offer robust security stacks, including real-time threat detection, automated patching, multi-layered access controls, and encryption, often surpassing traditional on-premise security.
- Cloud solutions offer geo-redundant architecture and disaster recovery setups, ensuring business continuity and minimizing downtime.

3. Cyber security & Fraud Prevention: As banking becomes more digital, cyber security remains a paramount concern. Banks are heavily investing in advanced measures to protect sensitive data and maintain customer trust.

- AI-powered threat detection systems analyze vast amounts of data to identify suspicious activities and prevent cyber-attacks in real-time.
- These technologies provide enhanced security and convenience for user authentication, reducing fraud.
- Encrypting data at rest and in transit is crucial to protect sensitive information from unauthorized access.
- Integrations with FinTechs and other third-party vendors introduce new vulnerabilities, requiring careful risk management.

Marketing of Banking Services

Marketing of banking services has evolved significantly from traditional advertising to a comprehensive, customer-centric approach. In today's highly competitive and technologically driven financial landscape, it's no longer just about promoting products, but about building relationships, trust, and delivering value.

Meaning of Marketing of Banking Services

Marketing of banking services refers to the **sum of activities undertaken by financial institutions to understand, anticipate, create, communicate, deliver, and exchange services that satisfy the financial needs and wants of customers more efficiently and effectively than competitors, while achieving the bank's organizational goals (profitability, growth, brand reputation, etc.).**

It involves:

- **Identifying customer needs:** Understanding what individuals, businesses, and other entities require in terms of financial solutions (e.g., savings, loans, investments, digital payment options).
- **Developing tailored products and services:** Designing and innovating financial products and services that specifically address those identified needs.
- **Pricing strategies:** Setting competitive and attractive rates for various services (e.g., interest rates on loans, charges for transactions).
- **Distribution channels:** Making services accessible to customers through various channels like physical branches, ATMs, internet banking, mobile apps, and other digital platforms.
- **Promotion and communication:** Effectively communicating the value proposition of these services to target audiences through advertising, public relations, content marketing, digital campaigns, and personal selling.
- **Building relationships:** Fostering long-term relationships with customers based on trust, excellent service, and personalized experiences.

Essentially, it's about applying core marketing principles to the unique characteristics of intangible banking services.

Importance of Marketing of Banking Services

Marketing is crucial for banks due to several factors:

1. **Increased Competition:** The banking sector is highly competitive, not just from traditional banks but also from a growing number of FinTech companies, digital-only banks (neobanks), and other financial service providers. Effective marketing helps banks differentiate themselves and stand out.
2. **Customer Acquisition and Retention:** In a crowded market, marketing strategies are vital for attracting new customers and, more importantly, retaining existing ones. Loyal customers are more profitable and can become advocates for the bank.
3. **Brand Building and Trust:** Banking is built on trust. Marketing plays a critical role in building a strong brand image, reputation for reliability, security, and customer-centricity. A positive brand instills confidence in customers.
4. **Product and Service Promotion:** Banks offer a wide array of complex financial products. Marketing helps educate customers about these offerings, their benefits, and how they can meet specific financial goals (e.g., mortgages, investment plans, insurance).
5. **Adapting to Digital Transformation:** Customers today are digitally savvy and expect seamless, convenient, and personalized digital banking experiences. Marketing strategies must adapt to leverage digital channels, data analytics, and AI to meet these evolving expectations.
6. **Market Analysis and Adaptation:** Continuous market research and analysis are essential to understand changing customer behaviors, market trends, and competitive landscapes. Marketing helps banks adapt their strategies and offerings accordingly.
7. **Revenue Growth and Profitability:** Ultimately, effective marketing drives customer engagement, increased usage of services (cross-selling and up-selling), and customer loyalty, all of which contribute directly to the bank's revenue growth and long-term profitability.
8. **Compliance and Ethical Communication:** The financial industry is heavily regulated. Marketing ensures that all communications are compliant with

regulations, honest, transparent, and protect customer privacy, which is vital for maintaining trust and avoiding legal issues.

Functions of Marketing in the Banking Industry

The functions of marketing in the banking industry encompass a wide range of activities:

1. Market Research and Analysis:

- **Customer Segmentation:** Identifying and understanding different customer groups based on demographics, psychographics, financial needs, and behaviors.
- **Needs Assessment:** Researching current and future financial needs and wants of various customer segments.
- **Competitive Analysis:** Monitoring competitors' offerings, pricing, marketing strategies, and strengths/weaknesses.
- **Trend Monitoring:** Keeping track of technological advancements, economic shifts, and regulatory changes that impact the banking sector.

2. Product/Service Development and Management:

- **Innovation:** Developing new financial products and services or enhancing existing ones to meet identified customer needs and market gaps.
- **Product Lifecycle Management:** Managing products through their various stages (introduction, growth, maturity, decline) and making decisions on enhancements or discontinuation.
- **Value Proposition Design:** Clearly defining the unique benefits and value that each banking service offers to customers.

3. Pricing Strategy:

- **Cost-Plus Pricing:** Considering the costs involved in providing a service.
- **Competitive Pricing:** Setting prices in relation to competitors.
- **Value-Based Pricing:** Pricing based on the perceived value to the customer.
- **Tiered Pricing:** Offering different pricing structures based on usage or account balance.

4. Distribution and Channel Management (Place):

- **Branch Network Optimization:** Strategically locating physical branches and ensuring their accessibility.
- **Digital Channels:** Developing and optimizing internet banking, mobile apps, ATMs, and other digital platforms for service delivery.
- **Partnerships:** Collaborating with FinTechs or other businesses to extend reach and offer integrated services.

5. Promotion and Communication:

- **Advertising:** Using various media (TV, print, digital ads, social media) to create awareness and promote services.
- **Public Relations:** Managing the bank's public image and reputation through media relations, community engagement, and corporate social responsibility (CSR) initiatives.
- **Content Marketing:** Creating valuable and informative content (blogs, articles, videos, infographics) to educate customers and establish thought leadership.
- **Digital Marketing:** SEO, SEM, social media marketing, email marketing, influencer marketing, etc. to reach and engage online audiences.
- **Personal Selling/Relationship Management:** Training bank staff to effectively engage with customers, understand their needs, and cross-sell/up-sell relevant services.

6. Customer Relationship Management (CRM):

- **Building Loyalty:** Implementing strategies to foster long-term relationships, trust, and loyalty with customers.
- **Personalization:** Tailoring offers, communications, and services based on individual customer data and preferences.
- **Customer Service Excellence:** Ensuring high-quality customer support across all touchpoints (in-branch, phone, digital).
- **Feedback Collection:** Gathering customer feedback to continuously improve services and address pain points.

7. Brand Management:

- **Brand Positioning:** Defining how the bank wants to be perceived in the market.
- **Brand Identity:** Developing consistent visual and verbal branding elements (logo, messaging, tone of voice).
- **Reputation Management:** Proactively managing the bank's reputation, especially in the digital age where information spreads rapidly.

Let Us Sum Up

The global banking industry is currently undergoing a rapid and transformative shift, driven by advancements in technology. AI and ML are revolutionizing nearly every aspect of banking, from back-office operations to customer-facing services. Marketing of banking services refers to the sum of activities undertaken by financial institutions to understand, anticipate, create, communicate, deliver, and exchange services that satisfy the financial needs and wants of customers more efficiently and effectively than competitors, while achieving the bank's organizational goals (profitability, growth, brand reputation, etc.).

Check Your Progress

1. **How is Artificial Intelligence (AI) primarily used in modern banking systems?** A. Printing bank statements B. Enhancing customer service via chatbots C. Replacing ATMs D. Issuing chequebooks
2. **Which of the following is a major benefit of using Cloud Computing in banking?** A. Manual data processing B. High infrastructure cost C. Scalability and on-demand access to data D. Data kept only on local computers
3. **Which of these is a risk of using cloud computing in banking?** A. Limited scalability B. High paper usage C. Cybersecurity and data privacy concerns D. Increased cash transactions

Market Research & Product Development

Market research in banking is the systematic process of gathering, analyzing, and interpreting information about the banking industry, its customers, competitors, and

market trends. It's an indispensable tool for making informed decisions about product design, pricing, promotion, and distribution.

Aspects of Market Research for Banking Products:

1. Understanding Customer Needs and Behavior:

- Identifying distinct customer groups with unique financial needs and preferences. This allows for targeted product development.
- Determining how customers prefer to interact with the bank (e.g., mobile app, internet banking, physical branch, ATM, call center) and which channels they use for different types of transactions.
- Visualizing the entire customer experience to identify friction points and opportunities for improvement.
- Utilizing surveys, interviews, focus groups, online reviews, social media listening, and direct customer interactions to gather qualitative and quantitative data.
- Assessing the level of financial understanding among different customer segments to tailor communication and product complexity.

2. Competitive Analysis:

- Developing competitive product that is in line with the customers need.
- Understanding where the bank stands in the market relative to competitors and identifying areas for competitive advantage.
- Studying competitors' promotional activities, digital presence, and customer acquisition tactics.

3. Market Trends and Emerging Technologies:

- Tracking the increasing adoption of mobile banking, UPI, internet banking, and other digital payment methods.
- Monitoring the impact of AI/ML, blockchain, cloud computing, and IoT on financial services and customer expectations.
- Staying updated on new policies from the RBI (Reserve Bank of India) and other financial regulators that might impact product design or market entry.

Methods of Market Research:

- **Primary Research:** Surveys (online, phone, in-person), focus groups, in-depth interviews (IDIs), ethnographic studies (observing customers in their natural environment), mystery shopping.
- **Secondary Research:** Analyzing existing data from industry reports (e.g., from ICRA, Ken Research), government publications, academic studies, news articles, and internal bank data.

Product Development of Banking Products

Product development in banking is the process of creating new financial products and services or enhancing existing ones to meet identified customer needs, market opportunities, and the bank's strategic objectives. It's a continuous cycle that involves ideation, design, testing, launch, and ongoing management.

Key Stages and Considerations in Banking Product Development:

1. Idea Generation and Concept Validation:

- **Sources of Ideas:** Market research insights, customer feedback, employee suggestions, competitive analysis, regulatory changes, technological advancements, and internal innovation labs.
- **Concept Testing:** Presenting preliminary product ideas to target customers to gauge interest, understanding, and willingness to use/pay. This helps refine the concept before significant investment.

2. Feasibility Analysis and Business Case Development:

- **Market Feasibility:** Is there a sufficient market size and demand for the product?
- **Technical Feasibility:** Can the bank's existing or new technology infrastructure support the product? (Often a significant challenge due to legacy systems).
- **Financial Feasibility:** Is the product profitable? What are the projected revenues, costs, and ROI?
- **Legal & Regulatory Compliance:** Ensuring the product adheres to all relevant banking laws, RBI guidelines (e.g., KYC, AML, consumer protection), and data privacy regulations. This is paramount in banking.

- **Risk Assessment:** Identifying and mitigating potential risks associated with the new product (e.g., credit risk, operational risk, reputational risk, cyber risk).

3. Design and Development:

- **Feature Definition:** Detailing the specific functionalities, benefits, and user experience (UX) of the product. This often involves cross-functional teams (product managers, IT, legal, operations).
- **User Experience (UX) and User Interface (UI) Design:** Creating intuitive, seamless, and secure digital interfaces for mobile apps, web platforms, and other digital touchpoints. This is crucial for adoption.
- **Integration with Core Systems:** Ensuring the new product integrates smoothly with the bank's existing core banking systems, payment gateways, and other IT infrastructure.
- **Security by Design:** Building security measures into the product from the ground up, not as an afterthought.

4. Testing and Pilot Launch:

- **Internal Testing:** Rigorous testing by internal teams to identify bugs, ensure functionality, and verify compliance.
- **Beta Testing/Pilot Programs:** Launching the product to a small group of internal users or external customers to gather real-world feedback and make necessary adjustments before a full-scale launch.
- **Risk Mitigation:** Ensuring all identified risks are addressed and contingency plans are in place.

5. Full-Scale Launch and Marketing:

- **Go-to-Market Strategy:** Developing a comprehensive marketing and communication plan to introduce the product to the target audience.
- **Training:** Training bank staff (branch personnel, customer service, sales teams) on the new product's features, benefits, and how to sell/service it effectively.
- **Distribution Channels:** Making the product available through all relevant channels (digital, branches, ATMs, etc.).

6. Post-Launch Monitoring and Iteration (Product Lifecycle Management):

- **Performance Monitoring:** Tracking key performance indicators (KPIs) like adoption rates, usage, customer satisfaction, profitability, and customer feedback.
- **Continuous Improvement:** Regularly updating and enhancing the product based on customer feedback, market changes, and technological advancements. This often involves an agile development approach.
- **Decommissioning:** Deciding when to phase out or replace outdated or underperforming products.

Factors influencing Marketing of Banking Products

The marketing of banking products is influenced by various internal and external factors. In a dynamic market like India, these factors are particularly significant due to rapid economic growth, technological advancements, diverse demographics, and a stringent regulatory environment.

Here are the key factors influencing the marketing of banking products:

I. Internal Factors (Bank-Specific)

1. Product Portfolio and Features:

- **Variety and Innovation:** The range of products (savings accounts, loans, credit cards, investments, insurance) and their unique features (e.g., higher interest rates, flexible loan terms, digital-only features) directly influence marketing strategies. Innovative products that address specific customer pain points are easier to market.
- **Perceived Value:** How customers perceive the value of a bank's offerings compared to competitors. Marketing needs to clearly articulate this value.
- **Digital Integration:** The seamlessness of digital channels (mobile app, internet banking, UPI integration) directly impacts how a product is marketed, especially to tech-savvy customers.

2. Pricing Strategy:

- **Interest Rates:** On loans (EMIs) and deposits (returns). Highly competitive rates can be a major marketing hook.

- **Fees and Charges:** Transparency in fees (e.g., ATM charges, minimum balance fees) is crucial, as hidden charges can damage trust and customer retention.
- **Promotional Offers:** Discounts, cashback, waivers, or bundled offers on various products (e.g., zero-processing fee loans for a limited period).

3. Distribution Channels:

- **Branch Network:** The accessibility and quality of physical branches still matter for certain segments (e.g., rural customers, senior citizens, complex transactions).
- **Digital Presence:** Robust mobile apps, user-friendly internet banking portals, and seamless integration with digital payment platforms (like UPI) are now non-negotiable. Marketing efforts must direct customers to these channels.
- **ATMs and Kiosks:** Self-service options are important convenience factors.
- **Agent Networks/Partnerships:** Tie-ups with financial advisors, wealth managers, or FinTechs to extend reach.

4. Promotional Mix (Communication Strategy):

- **Advertising:** Choice of media (TV, print, radio, digital, social media) and messaging to reach target audiences.
- **Public Relations:** Building a positive brand image through media relations, CSR activities, and community engagement.
- **Sales Promotion:** Short-term incentives to encourage immediate product uptake.
- **Direct Marketing:** Personalized communication through email, SMS, and direct mail.
- **Personal Selling:** The role of bank staff in branches and through direct sales teams in explaining products and building relationships.
- **Digital Content Marketing:** Providing valuable financial education and insights through blogs, videos, and social media to attract and engage customers.

5. People (Bank Staff):

- **Customer Service Quality:** The behavior, knowledge, and responsiveness of bank employees significantly influence customer experience and word-of-mouth marketing.
- **Training and Motivation:** Well-trained and motivated staff are better equipped to understand customer needs, explain complex products, and provide excellent service.
- **Internal Marketing:** Ensuring that employees understand and believe in the bank's products and values.

6. Processes:

- **Efficiency:** Streamlined and fast processes for account opening, loan sanctioning, and transaction processing. Cumbersome processes can deter customers, regardless of product features.
- **Digital Onboarding:** The ease of opening accounts or applying for loans digitally is a major marketing point.
- **Customer Feedback Mechanisms:** How effectively the bank collects and acts on customer feedback to improve services.

7. Physical Evidence (Tangibles):

- **Branch Ambiance:** Cleanliness, comfort, and technological integration (e.g., digital displays, self-service kiosks) in physical branches.
- **Website/App Design:** User-friendliness, aesthetics, and intuitiveness of digital platforms.
- **Communication Materials:** Quality of brochures, statements, and digital content.

II. External Factors (Macro Environment)

1. Economic Factors:

- **GDP Growth:** A growing economy generally leads to increased demand for loans (personal, housing, business) and investment products.
- **Inflation:** High inflation can erode purchasing power, affecting savings patterns and demand for certain loans.

- **Interest Rates:** RBI's repo rate and reverse repo rate changes directly influence lending and deposit rates, impacting product attractiveness. Banks need to adjust their marketing to reflect these changes.
- **Disposable Income:** Higher disposable income leads to more savings and investments, influencing demand for wealth management products.
- **Unemployment Rates:** High unemployment can reduce demand for loans and increase default risks, influencing lending product marketing.
- **Credit Demand:** Overall demand for credit from various sectors (retail, corporate, MSMEs) affects a bank's lending focus.

2. Regulatory and Legal Factors:

- **Reserve Bank of India (RBI) Regulations:** The RBI heavily regulates Indian banking, influencing everything from interest rates, capital adequacy, KYC norms, consumer protection, digital lending guidelines, and privacy laws (e.g., DPDP Act 2023). Marketing strategies must be compliant and transparent.
- **SEBI (Securities and Exchange Board of India):** Influences marketing of investment-related banking products.
- **IRDAI (Insurance Regulatory and Development Authority of India):** For bancassurance products.
- **Consumer Protection Laws:** Mandate fair practices, transparency in charges, and clear communication to consumers.
- **Anti-Money Laundering (AML) & KYC Norms:** While crucial for compliance, they can sometimes add friction to customer onboarding, requiring banks to market the ease of these processes (e.g., video KYC).

3. Social and Cultural Factors:

- **Demographics:** Age groups (e.g., youth, millennials, senior citizens), income levels, and urban/rural divide significantly influence financial needs and digital adoption. Marketing needs to be tailored.

- **Literacy and Financial Literacy:** Lower financial literacy in certain segments (especially rural) requires simpler product explanations and more educational marketing.
- **Cultural Values:** Trust in traditional banking, preference for physical interactions, influence of family in financial decisions, and attitudes towards debt and saving vary across regions and communities in India.
- **Lifestyle Changes:** Growing urbanization, nuclear families, and increased female workforce participation create new demands for convenient, personalized banking services.
- **Language Diversity:** India's linguistic diversity necessitates multilingual marketing campaigns.

4. Technological Factors:

- **Digital Transformation:** The rapid adoption of digital payment systems (UPI, NEFT, IMPS), mobile banking, and internet banking has revolutionized marketing. Banks must market their digital capabilities.
- **AI and Machine Learning:** Used for personalized marketing, fraud detection, predictive analytics (e.g., identifying customers likely to need a loan), and enhancing customer service (chatbots).
- **Blockchain:** While still nascent, its potential for secure and efficient cross-border payments could influence future product marketing.
- **Data Analytics:** The ability to collect and analyze vast amounts of customer data allows for hyper-personalization of marketing messages and product offerings.
- **Cybersecurity:** As digital adoption rises, marketing must also emphasize the robust security measures taken by the bank to build trust and allay fears of cyber fraud.

5. Competitive Landscape:

- **Traditional Banks:** Competition from large public and private sector banks with established branch networks and customer bases.

- **FinTech Companies:** Agile, technology-driven companies offering niche services (payments, lending, wealth management) that often have a superior digital customer experience.
- **Neobanks:** Digital-only banks that offer low-cost, convenient, and often hyper-personalized services, appealing to younger, tech-savvy demographics.
- **Non-Banking Financial Companies (NBFCs):** Offer specialized lending products (e.g., gold loans, vehicle loans) that compete with bank offerings.
- **Global Players:** Presence of international banks with global expertise and sophisticated digital platforms.
- **Market Concentration:** The level of competition in specific product categories and geographical areas.

Let Us Sum Up

Market research in banking is the systematic process of gathering, analyzing, and interpreting information about the banking industry, its customers, competitors, and market trends. Product development in banking is the process of creating new financial products and services or enhancing existing ones to meet identified customer needs, market opportunities, and the bank's strategic objectives. The marketing of banking products is influenced by various internal and external factors. In a dynamic market like India, these factors are particularly significant due to rapid economic growth, technological advancements, diverse demographics, and a stringent regulatory environment.

Check Your Progress

1. **What is the primary objective of market research in banking?** A. To recruit employees B. To study customer needs and market trends C. To calculate interest rates D. To process loans faster
2. **What does product development in banking involve?** A. Reducing staff B. Improving physical infrastructure C. Creating and customizing financial products for customer segments D. Closing existing accounts

3. **Which of the following is not an example of a banking product?** A. Savings account B. Fixed deposit C. Loan against property D. HR policy
4. **Which of the following tools is used for market segmentation in banking research?** A. Loan appraisal B. SWOT analysis C. Demographic profiling D. ATM installation.
5. **Market research helps banks to**A. Reduce interest ratesB. Forecast customer trends and plan accordingly C. Ignore competition D. Focus only on traditional banking

Third Party Products in Banking

Banks primarily focused on core banking activities like accepting deposits, providing loans, and facilitating payments. However, with increased competition, evolving customer needs, and a desire to diversify revenue streams, banks have increasingly moved towards offering a broader suite of financial services, including TPPs. In the context of banking, "third-party products" (TPP) refer to financial products and services that are not manufactured or directly underwritten by the bank itself, but are distributed or sold by the bank on behalf of other financial institutions or companies. Banks act as intermediaries, leveraging their wide customer base, distribution network, and brand trust to offer these products.

Common Examples of Third-Party Products in Indian Banking:

Some of the most prevalent third-party products offered by banks in India include:

1. **Insurance Products:** This is one of the most significant TPP categories. Banks tie up with life insurance companies and general insurance companies to sell various policies.
 - **Life Insurance:** Term plans, endowment plans, ULIPs (Unit Linked Insurance Plans), pension plans.
 - **General Insurance:** Health insurance, motor insurance, home insurance, travel insurance, fire insurance.
2. **Mutual Funds:** Banks partner with Asset Management Companies (AMCs) to distribute units of various mutual fund schemes (equity, debt, hybrid, ELSS - Equity Linked Savings Schemes, SIPs - Systematic Investment Plans).

3. **Gold Products:** Sale of gold coins, gold bars, and sometimes even digital gold, often sourced from recognized bullion dealers or government mints.
4. **Government Bonds/Securities:** Facilitating investment in government-backed securities like RBI Floating Rate Savings Bonds, Sovereign Gold Bonds, or other government-issued bonds.
5. **Portfolio Management Services (PMS) / Investment Advisory Services:** For high-net-worth individuals, banks might have tie-ups with wealth management firms to offer specialized investment advice and portfolio management.
6. **Certain Lending Products:** While banks offer their own loans, they might also act as a referral agent or co-lending partner for specialized loans offered by NBFCs (Non-Banking Financial Companies) or FinTech lenders, especially in niche segments.
7. **Online Trading Accounts / Demat Services:** Partnering with stockbrokers or depository participants to offer customers integrated trading and demat accounts.

Benefits of Third-Party Products:

For the Bank:

1. **Diversified Revenue Streams:** Banks earn commission, fees, or brokerage for selling TPPs, which is a significant source of non-interest income. This helps offset pressure on traditional interest income margins.
2. **Increased Profitability:** TPPs require less capital allocation compared to core banking activities (as they are off-balance sheet), leading to higher return on equity (ROE) for these services.
3. **Enhanced Customer Relationships & Retention:** By offering a comprehensive suite of financial products under one roof, banks become a "one-stop shop" for customers' financial needs. This deepens customer relationships and reduces the likelihood of customers going to competitors for other financial services.
4. **Customer Acquisition:** The wider product offering can attract new customers who are looking for specific investment or insurance solutions.

5. **Leveraging Existing Infrastructure:** Banks utilize their established branch network, digital platforms, and customer service teams to distribute TPPs, minimizing additional operational costs.
6. **Cross-Selling and Up-Selling Opportunities:** Having a deeper understanding of a customer's financial profile through their core banking relationship allows banks to effectively cross-sell relevant third-party products.
7. **Competitive Advantage:** Offering a broad range of products helps banks remain competitive against FinTechs and other financial service providers that specialize in niche areas.

For the Customer:

1. **Convenience and Simplicity:** Customers can access a wide array of financial products from a single, trusted entity (their bank), saving them time and effort.
2. **Trust and Familiarity:** Customers generally have a high level of trust in their banks. Purchasing products like insurance or mutual funds through their bank provides a sense of security.
3. **Integrated Financial Planning:** Banks can offer more holistic financial advice, combining their core products with TPPs to meet diverse financial goals (e.g., combining a savings account with a mutual fund SIP and a health insurance policy).
4. **Professional Guidance:** Bank relationship managers can provide guidance on various products, helping customers choose what suits their needs and risk profile.

Risks and Challenges Third-Party Products:

While beneficial, offering TPPs also comes with its own set of risks and challenges:

1. **Reputational Risk:** If the third-party product underperforms, or if there's a grievance with the third-party provider, the bank's reputation can be severely impacted, even if the bank is not directly responsible for the product's performance.
2. **Mis-selling and Customer Grievances:** This is a significant concern, particularly in India. Pressure on sales targets can lead to bank staff mis-selling complex products to customers who don't fully understand the risks involved or for whom the product is unsuitable. This can lead to complaints, regulatory fines, and loss of customer trust.

3. **Compliance Risk:** Banks must adhere to strict regulatory guidelines from the RBI, IRDAI, and SEBI regarding the sale of TPPs. Non-compliance can result in hefty penalties.
4. **Operational Risk:** Managing multiple partnerships with different third-party providers, ensuring data security, and seamless integration of systems can pose operational challenges.
5. **Product Knowledge and Training:** Bank staff need extensive training to understand the intricacies of various TPPs, their features, risks, and suitability for different customer profiles. Inadequate knowledge can lead to mis-selling.
6. **Conflict of Interest:** There can be a perception of conflict of interest if banks prioritize selling TPPs that offer higher commissions, rather than products that are best suited for the customer.
7. **Liability:** While banks are distributors, they can still face indirect liability or customer backlash for issues related to TPPs, even if the primary liability lies with the product manufacturer.

One stop shop Financial solutions in Banks

A "one-stop shop" financial solution in banks refers to a strategy where a bank aims to provide all or most of the financial products and services a customer might need, under a single roof or through an integrated platform. Instead of customers having to go to different institutions for their banking, investments, insurance, and other financial requirements, the bank strives to be their primary financial partner.

Components of One-Stop Shop Financial Solution:

A comprehensive one-stop shop typically includes:

1. **Core Banking Services:**
 - Savings Accounts (various types: basic, premium, salary, senior citizen, minor)
 - Current Accounts (for businesses)
 - Fixed Deposits (FDs) and Recurring Deposits (RDs)
 - Loans (Home Loans, Personal Loans, Car Loans, Education Loans, Gold Loans, Business Loans, Loan Against Property)

- Credit Cards and Debit Cards
 - Payment Services (UPI, NEFT, RTGS, IMPS, Bill Payments)
 - Forex Services (currency exchange, travel cards)
2. **Investment Products (Third-Party Products - TPPs):**
- **Mutual Funds:** Offering a wide range of equity, debt, and hybrid mutual fund schemes from various Asset Management Companies (AMCs) through SIPs and lump-sum investments.
 - **Stock Broking/Demat Accounts:** Facilitating investment in shares and other securities, often in partnership with a brokerage firm.
 - **Bonds/Government Securities:** Sale of government-issued bonds, corporate bonds, and other fixed-income instruments.
 - **Sovereign Gold Bonds (SGBs):** Government-backed gold bonds.
 - **National Pension System (NPS):** Retirement planning through this government-sponsored scheme.
3. **Insurance Products (Bancassurance - TPPs):**
- **Life Insurance:** Term plans, endowment plans, ULIPs (Unit Linked Insurance Plans), child plans, retirement plans from partner life insurance companies.
 - **General Insurance:** Health insurance, motor insurance, home insurance, travel insurance, fire insurance from partner general insurance companies.
4. **Wealth Management and Advisory Services:**
- **Financial Planning:** Providing guidance on budgeting, savings, investments, and retirement planning.
 - **Portfolio Management Services (PMS):** For high-net-worth individuals seeking professional management of their investment portfolios.
 - **Estate Planning:** Basic guidance on wills, trusts, and inheritance.
5. **Digital and Value-Added Services:**
- **Comprehensive Mobile App & Internet Banking:** A single, intuitive platform to manage all accounts, investments, and other services.
 - **Customer Support:** Integrated customer service channels (chatbots, call centers, dedicated relationship managers) for all products.

- **Financial Calculators:** EMIs, SIP returns, retirement planners etc.
- **Personalized Insights:** Using data analytics to offer tailored product recommendations and financial advice.
- **Buy Now, Pay Later (BNPL):** Integrating short-term credit options.

Benefits of One-Stop Shop Financial Solutions:

For the Customer:

- **Convenience:** All financial needs can be met at one place, saving time and effort. No need to visit multiple institutions.
- **Integrated View of Finances:** A consolidated view of accounts, loans, investments, and insurance helps in better financial management and planning.
- **Trust:** Customers generally have high trust in their primary bank, extending this trust to other products offered through the bank.
- **Personalized Service:** Banks can leverage customer data across all products to offer highly personalized recommendations and services.
- **Potential for Better Deals:** Banks might offer preferential rates or bundled benefits for customers utilizing multiple services.
- **Simplified Grievance Redressal:** A single point of contact for resolving issues across various financial products.

For the Bank:

- **Increased Revenue:** Diversification of revenue streams through commissions and fees from TPPs, in addition to interest income from core banking.
- **Higher Customer Lifetime Value (CLTV):** Customers who use multiple products are more loyal and generate more revenue over their lifetime.
- **Enhanced Customer Retention:** It creates "sticky" relationships, making it harder for customers to switch banks.
- **Cross-selling and Up-selling Opportunities:** A holistic view of the customer's financial life enables banks to intelligently cross-sell relevant products.
- **Reduced Customer Acquisition Cost:** It's often cheaper to sell additional products to existing customers than to acquire new ones.
- **Competitive Advantage:** Differentiates the bank from niche players and competitors, positioning it as a holistic financial partner.

- **Deeper Customer Insights:** More data points on customer behavior across various financial activities, enabling better analytics and product development.

Challenges of the One-Stop Shop Model:

Despite the numerous benefits, banks face several challenges in implementing a true one-stop shop:

- **Technological Integration:** Integrating diverse systems for core banking, mutual funds, insurance, etc., from different providers can be complex and costly, especially with legacy IT infrastructure.
- **Regulatory Compliance:** Navigating multiple regulatory frameworks (RBI, IRDAI, SEBI) for different product categories, ensuring compliance, and avoiding mis-selling is a significant challenge.
- **Product Knowledge and Training:** Training bank staff to be knowledgeable across a vast array of complex financial products (both proprietary and third-party) is critical and ongoing.
- **Mis-selling Risk:** The pressure to cross-sell can lead to mis-selling if suitability is not adequately assessed, leading to customer complaints and reputational damage.
- **Customer Experience Consistency:** Maintaining a consistent, high-quality customer experience across all product lines and channels can be difficult.
- **Brand Perception:** Ensuring that customers understand the distinction between bank's own products and third-party products to manage expectations and liabilities.
- **Competition from Specialists:** While aiming to be a one-stop shop, banks still face intense competition from specialized FinTechs (e.g., dedicated investment apps, pure-play lending platforms) that might offer a superior experience or specific feature in their niche.
- **Data Privacy and Security:** Handling a vast amount of sensitive customer data across various integrated services requires robust cyber security measures and strict adherence to data privacy laws.

Financial Advisory Services (FAS)

Financial advisory services offered by banks are becoming an important component of their overall offerings, moving beyond traditional transaction-based banking to a more holistic approach to customer financial well-being. These services aim to guide individuals, families, and even small businesses in managing their money, planning for future goals, and optimizing their financial health.

Types of Financial Advisory Services Offered by Banks:

Banks typically offer a range of financial advisory services, often segmented based on the client's wealth level and complexity of needs.

1. Financial Guidance:

- Helping customers understand their income and expenses, create budgets, and manage cash flow effectively.
- Advising on managing credit card debt, personal loans, and other liabilities, including consolidation strategies.
- Assisting customers in setting simple financial goals like buying a car, saving for a down payment, or planning for a short-term vacation.
- Providing information and explaining the features of various proprietary and third-party products (mutual funds, insurance) without necessarily providing personalized investment advice.

2. Comprehensive Financial Planning

- A detailed analysis of the client's current financial situation, including assets, liabilities, income, expenses, risk tolerance, and time horizons.
- Helping clients define and prioritize complex financial goals, such as retirement planning, children's education, marriage expenses, wealth creation, or starting a business.
- Advising on how to distribute investments across different asset classes (equity, debt, gold, real estate) based on risk profile and goals.
- Recommending specific investment products (mutual funds, direct equities, bonds, alternative investments) to build a diversified portfolio.
- Identifying potential financial risks (e.g., health issues, premature death, disability).

- Recommending suitable insurance solutions (life, health, general insurance) to mitigate these risks and protect assets.
- Advising on tax-efficient investment strategies, deductions, and optimizing tax liabilities across various income sources and investments.

3. Wealth Management Services 6

- This is often a premium segment of financial advisory, offering highly personalized and sophisticated services.
- Tailored strategies for large portfolios, including access to niche products like Alternate Investment Funds (AIFs) and Portfolio Management Services (PMS).
- Advice on international investments, if the bank has such offerings.
- Guidance on charitable giving and setting up foundations.

Advantages of Financial Advisory Services to customers:

1. **Trust and Credibility:** Banks, especially established ones, enjoy a high level of public trust, which extends to their advisory services.
2. **Convenience & One-Stop Shop:** Customers can get banking, investment, insurance, and advice all under one roof, simplifying their financial life.
3. **Holistic View of Finances:** Banks often have a complete picture of a customer's banking transactions, loans, and deposits, which can inform better financial advice.
4. **Accessibility:** Banks have extensive branch networks and digital presence, making advisory services more accessible to a wider population.
5. **Integrated Solutions:** The ability to seamlessly integrate advice with product execution (e.g., getting advice on a mutual fund and then investing through the bank's platform).
6. **Regulatory Oversight:** Banking advisory services are under the purview of the RBI and other financial regulators, providing a layer of consumer protection.

Let Us Sum Up

With increased competition, evolving customer needs, and a desire to diversify revenue streams, banks have increasingly moved towards offering a broader suite of financial services, including TPPs. In the context of banking, "third-party products" (TPP) refer to

financial products and services that are not manufactured or directly underwritten by the bank itself. A "one-stop shop" financial solution in banks refers to a strategy where a bank aims to provide all or most of the financial products and services a customer might need, under a single roof or through an integrated platform. Instead of customers having to go to different institutions for their banking, investments, insurance, and other financial requirements, the bank strives to be their primary financial partner. Financial advisory services offered by banks are becoming an important component of their overall offerings, moving beyond traditional transaction-based banking to a more holistic approach to customer financial well-being.

Check Your Progress

1. **Which of the following is a common Third Party Product (TPP) offered by banks?** A. Recurring deposit B. Savings account C. Mutual funds D. Fixed deposit
2. **What is the main benefit to a bank in selling Third Party Products?** A. Increased cost of service B. Additional revenue through commissions C. High NPA risk D. Legal ownership of the product
3. **Bancassurance refers to** A. Online banking via mobile B. Banks issuing their own insurance C. Selling insurance products through banks D. Bank audits by insurance companies
4. **Which of the following is NOT considered a Third Party Product?** A. Life Insurance B. Home Loan C. Mutual Fund D. Health Insurance
5. **What is a key risk banks face in selling TPPs?** A. Credit risk B. Interest rate fluctuation C. Reputational risk if mis-sold D. Foreign exchange risk

Unit Summary

One of the most significant advantages of e-banking is its 24/7 availability. In telephone banking customer can't withdraws and deposits cash but can do all the other transactions. SMS banking services have push and pull messages. E banking saves time spent in banks and provides ways for international banking. Information A debit card is a payment card that deducts money directly from a consumer's checking account to pay for a

purchase. The Cheque Truncation System (CTS) was introduced to eliminate the physical movement of cheques, thereby speeding up the clearing process, reducing costs, and enhancing security. “E-Banking” through many innovative products and services has revolutionized banking operations. IFSC is an alpha-numeric code that identifies a bank-branch participating in the RTGS/NEFT system. IFSC has 11 digit code and the first four alpha characters represents the bank, the 5th code is 0 (zero), Marketing of banking services refers to the sum of activities undertaken by financial institutions to understand, anticipate, create, communicate, deliver, and exchange services that satisfy the financial needs and wants of customers more efficiently and effectively than competitors, while achieving the bank's organizational goals (profitability, growth, brand reputation, etc.). The marketing of banking products is influenced by various internal and external factors. In a dynamic market like India, these factors are particularly significant due to rapid economic growth, technological advancements, diverse demographics, and a stringent regulatory environment. In the context of banking, "third-party products" (TPP) refer to financial products and services that are not manufactured or directly underwritten by the bank itself.

Glossary

- **ATM (Automated Teller Machine):** A self-service machine that enables customers to perform basic banking transactions like withdrawals, deposits, and balance inquiries without visiting a branch.
- **Core Banking:** A centralized system where banking services are delivered through a network of branches and digital channels connected to a central server.
- **Electronic Banking (E-Banking):** The use of electronic platforms such as computers, mobile phones, or ATMs to conduct banking transactions.
- **IFSC (Indian Financial System Code):** A unique code used to identify bank branches in India for electronic money transfers like NEFT, RTGS.
- **Internet Banking:** A service that allows customers to perform banking transactions over the internet using a web portal.
- **NEFT (National Electronic Funds Transfer):** A nationwide payment system for transferring funds between banks on a deferred settlement basis.

- **RTGS (Real-Time Gross Settlement):** A system where large-value fund transfers are settled in real time on an individual order basis.
- **UPI (Unified Payments Interface):** A mobile-based real-time payment system that allows instant money transfer between bank accounts using a smartphone.
- **Market Segmentation:** Dividing the customer base into distinct groups based on needs, behaviors, or demographics to target marketing effectively.

Self – Assessment Questions

1. Discuss the various types of E-Banking services available to customers.
2. What are the advantages and disadvantages of E-Banking from the customer's perspective?
3. What is UPI? How has it revolutionized digital payments in India?
4. Discuss the impact of E-Banking on the banking industry and customer behavior.
5. Explain the role of Information and Communication Technology (ICT) in modern banking.
6. How is Artificial Intelligence (AI) transforming banking operations and customer service?
7. Discuss the different types of Electronic Fund Transfer (EFT) systems used in India.
8. What is RTGS? How does it differ from NEFT in terms of features and use cases?
9. What are Third Party Products (TPPs) in banking? Explain their significance for banks and customers.
10. Compare third-party product selling with traditional banking products in terms of customer engagement and revenue models.

Activities / Exercises / Case Studies

- **Create an E-Banking User Guide (Group Project)** - Design a simple brochure or poster explaining how to use mobile banking or UPI.
- **Make a Case Study UPI Success Story** - A small vegetable vendor in a rural town starts accepting UPI payments, increasing his sales and customer base

Answers for check your progress

Introduction to E- Banking

6. **Answer: b) Automated Teller Machine.**

Reason: ATM is a widely recognized acronym for a machine that allows bank customers to perform basic transactions.

7. **Answer: c) 24/7 access to banking services from anywhere.** Rationale

Reason: Convenience and round-the-clock access are major benefits of e-banking.

8. **Answer: c) Immediate Money Payment Service.**

Reason: *IMPS is a popular real-time interbank electronic funds transfer system in India.*

9. **Answer: c) Reduced transaction costs and improved efficiency.**

Reason: Automation and self-service through e-banking significantly cut down the operational expenses for banks.

5. **Answer: b) A card that directly deducts money from your linked bank account for purchases or withdrawals.**

Reason: *Debit cards offer direct access to funds available in the linked bank account.*

Banking Technology

4. **Answer: C. HTTPS**

Reason: HTTPS (Hypertext Transfer Protocol Secure) encrypts data between the user's browser and the bank's server, ensuring secure online banking transactions.

5. **Answer: A. National Electronic Funds Transfer**

Reason: NEFT is a nationwide payment system facilitating one-to-one funds transfer from one bank account to another.

6. **Answer: C. Providing banking services without human teller**

Reason: ATMs (Automated Teller Machines) allow customers to withdraw cash, check balances, and perform basic banking functions 24/7.

7. **Answer: C. Savings or current account**

Reason: A debit card directly withdraws money from the customer's linked savings or current account.

8. Answer: C. Internet connection and user credentials

Reason: Internet banking allows customers to perform transactions using a computer or smartphone with login credentials (username and password) over the internet.

Electronic Fund Management**1. Answer: C. To monitor and control electronic financial transactions**

Reason: E-Fund Management involves the use of digital tools and systems to manage, transfer, and track funds electronically, improving efficiency and reducing manual intervention.

2. Answer: B. UPI

Reason: Unified Payments Interface (UPI) enables real-time, instant fund transfers using mobile phones and virtual payment addresses, making fund management faster and simpler.

3. Answer: C. NPCI (National Payments Corporation of India)

Reason: NPCI manages UPI as part of India's digital payment infrastructure. RBI and IBA jointly formed NPCI.

4. Answer: B. It is a UPI-based app developed by NPCI

Reason: BHIM (Bharat Interface for Money) is a mobile app that uses UPI to enable secure, fast money transfers and was launched by NPCI.

5. Answer: D. Cheque book

Reason: UPI operates digitally via mobile apps; a cheque book is not necessary.

Global trends in Banking**6. Answer: B. Enhancing customer service via chatbots**

Reason: Banks use AI-powered chatbots (like HDFC's Eva or SBI's SIA) to respond instantly to customer queries, reducing human workload and improving service efficiency.

7. Answer: C. Scalability and on-demand access to data

Reason: Cloud computing allows banks to scale operations quickly, access large data volumes anytime, and reduce dependence on physical infrastructure.

8. Answer: C. Cybersecurity and data privacy concerns

Reason: While cloud improves efficiency, storing sensitive financial data remotely increases exposure to cyber risks and regulatory scrutiny.

Market Research & Product Development

1. Answer: B. To study customer needs and market trends

Reason: Market research helps banks understand what customers want, identify market gaps, and design suitable products or services.

2. Answer: C. Creating and customizing financial products for customer segments

Reason: Product development refers to designing banking products (like loans, deposits, cards) tailored to specific market needs or segments.

3. Answer: D. HR policy

Reason: HR policy relates to internal employee management and is not a customer-facing financial product.

4. Answer: C. Demographic profiling

Reason: Demographics (age, income, occupation) help segment the market and develop targeted financial products.

5. Answer: B. Forecast customer trends and plan accordingly

Reason: Market research reveals emerging trends, helping banks anticipate future demands and stay competitive.

Third Party Products in Banking

1. Answer: C. Mutual funds

Reason: Mutual funds are TPPs because banks distribute them on behalf of Asset Management Companies (AMCs) and earn commission without taking ownership.

2. Answer: B. Additional revenue through commissions

Reason: Banks earn **fee-based income** by distributing third party products like insurance or mutual funds, without credit risk or capital requirement.

3. Answer: C. Selling insurance products through banks

Reason: Bancassurance is a model where banks distribute insurance products as third party agents on behalf of insurers.

4. Answer: B. Home Loan

Reason: Home loans are core lending products of the bank, not a third party offering. TPPs are products like insurance or investments sold on behalf of external companies.

5. Answer: C. Reputational risk if mis-sold

Reason: Since banks act as intermediaries, any mis-selling (e.g., selling a high-risk mutual fund to a senior citizen) can damage their credibility and attract penalties.

Suggested Readings

- **"Banking Theory and Practice"** *Author:* K.C. Shekhar & Lekshmy Shekhar
Publisher: Vikas Publishing
- **"E-Banking Management: Issues, Solutions, and Strategies"** *Author:* Mahmood Shah & Steve Clarke
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Open Source E-Content Links

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UNIT – IV - Insurance**Unit Objective**

After going through the Unit one must be able to understand the

- Introduction to Insurance
- Risk Management
- Insurance Regulations
- Insurance Contract

Unit Structure

- Introduction to Insurance
- Risk Management
- Diversification
- Insurance Regulation
- Insurance Contract
- Unit Summary
- Glossary
- Self – Assessment Questions
- Activities / Exercises / Case Studies
- Answers for check your progress
- Suggested Readings
- Open Source
- Reference

Introduction to Insurance

Insurance is a form of contract or an arrangement where one party agrees in return for a consideration to pay an agreed amount of money to another party to make good the loss, damage or injury to something of value in which the insured has an interest. Being a contract of indemnity, it is based on the principle of utmost good faith.

Insurance is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as the premium. Insurance allows individuals, businesses and other entities to protect themselves against significant potential losses and financial hardship at a reasonably affordable rate. We say "significant" because if the potential loss is small, then it doesn't make sense to pay a premium to protect against the loss.

The business of insurance extends to protection of the economic value of assets. The owner of an asset attaches a value to the property since it gives them some benefit in the form of income or the loss of which could cause irreparable loss to the owner. For example, owning a car for self-use may not give any monetary benefit but it is more for the pleasure of comfort it provides to the owner. If the vehicle is damaged due to say, water logging due to heavy rains, the car will have only scrap value - a need for covering this risk arises in such unforeseen situations.

The basic principle of insurance is that an entity will choose to spend small periodic amounts of money against a possibility of a huge unexpected loss. Basically, all the policyholder pool their risks together. Any loss that they suffer will be paid out of their premiums which they pay.

Alternatively, a company which is in the business of transportation may own a fleet of lorries which are given on lease for others who want to transport goods. In this scenario, there could be a reduction on the revenue if there is an accident to the lorry due to which the transportation business is affected - need for insurance as a risk management tool

arises. Therefore, insurance is a tool of risk management to cover the uncertainties – the risk of loss of assets or human life.

Insurance- Meaning and definition

Insurance is a contract between two parties. One party is the insured and the other party is the insurer. Insured is the person whose life or property is insured with the insurer. That is, the person whose risks are insured is called insured. Insurer is the insurance company to whom risk is transferred by the insured. That is, the person who insures the risk of insured is called insurer. Thus insurance is a contract between insurer and insured. It is a contract in which the insurance company undertakes to indemnify the insured on the happening of certain event for a payment of consideration. It is a contract between the insurer and insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against. Some definitions of insurance are given below:

According to Gosh and Agarwal, “insurance may be defined as a co-operative form of distributing a certain risk over a group of persons who are exposed to it’

According to Mc Gill, “Insurance is a process in which uncertainties are made certain” In the words of Jon Megi, “Insurance is a plan wherein persons collectively share the losses of risks”.

Thus, insurance is a device by which a loss likely to be caused by uncertain event is spread over a large number of persons who are exposed to it and who voluntarily join themselves against such an event. The document which contains all the terms and conditions of insurance (i.e. the written contract) is called the ‘insurance policy’. The amount for which the insurance policy is taken is called ‘sum assured’. The consideration in return for which the insurer agrees to make good the loss is known as ‘insurance premium’. This premium is to be paid regularly by the insured. It may be paid monthly, quarterly, half yearly or yearly.

History of Insurance in India

In India, insurance has a deep-rooted history. Insurance in various forms has been mentioned in the writings of Manu (Manusmriti), Yagnavalkya (Dharmashastra) and Kautilya (Arthashastra). The fundamental basis of the historical reference to insurance in these ancient Indian texts is the same, i.e. pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. The early references to insurance in these texts have reference to marine trade loans and carriers' contracts.

Insurance in its current form has its history dating back until 1818, when *Oriental Life Insurance Company* was started by Anita Bhavsar in Kolkata to cater to the needs of European community. The pre-independence era in India saw discrimination between the lives of foreigners (English) and Indians with higher premiums being charged for the latter. In 1870, *Bombay Mutual Life Assurance Society* became the first Indian insurer.

At the dawn of the twentieth century, many insurance companies were founded. In the year 1912, the Life Insurance Companies Act and the Provident Fund Act were passed to regulate the insurance business. The Life Insurance Companies Act, 1912 made it necessary that the premium-rate tables and periodical valuations of companies should be certified by an actuary. However, the disparity still existed as discrimination between Indian and foreign companies. The oldest existing insurance company in India is the National Insurance Company, which was founded in 1906, and is still in business.

The Government of India issued an Ordinance on 19 January 1956 nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The Life Insurance Corporation (LIC) absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. In 1972 with the General Insurance Business (Nationalisation) Act was passed by the Indian Parliament, and consequently, General Insurance business was nationalized with effect from 1 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 commenced business on 1 January 1973.

The LIC had monopoly till the late 90s when the insurance sector was reopened to the private sector. Before that, the industry consisted of only two state insurers: Life Insurers (Life Insurance Corporation of India, LIC) and General Insurers (General Insurance Corporation of India, GIC). GIC had four subsidiary companies. With effect from December 2000, these subsidiaries have been de-linked from the parent company and were set up as independent insurance companies: Oriental Insurance Company Limited, New India Assurance Company Limited, National Insurance Company Limited and United India Insurance Company Limited.

Insurance in India refers to the market for insurance in India which covers both the public and private sector organisations. It is listed in the Constitution of India in the Seventh Schedule as a Union List subject, meaning it can only be legislated by the Central government. The insurance sector

has gone through a number of phases by allowing private companies to solicit insurance and also allowing foreign direct investment. India allowed private companies in the insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014. However, the largest life-insurance company in India, Life Insurance Corporation of India is still owned by the government and carries a sovereign guarantee for all insurance policies issued by it.

Characteristics of Insurance

Insurance follows important characteristics — These are as follows

1. Sharing of risk

Insurance is a co-operative device to share the burden of risk, which may fall on happening of some unforeseen events, such as the death of head of family or on happening of

marine perils or loss of by fire.

2. Co-operative device

Insurance is a co-operative form of distributing a certain risk over a group of persons who are exposed to it. A large number of persons share the losses arising from a particular risk.

3. Large number of insured persons

The success of insurance business depends on the large number of persons insured against similar risk. This will enable the insurer to spread the losses of risk among large number of persons, thus keeping the premium rate at the minimum.

4. Evaluation of risk

For the purpose of ascertaining the insurance premium, the volume of risk is evaluated, which forms the basis of insurance contract.

5. Payment of happening of specified event

On happening of specified event, the insurance company is bound to make payment to the insured. Happening of specified event is certain in life insurance, but in the case of fire, marine or accidental insurance, it is not necessary. In such cases, the insurer is not liable for payment of indemnity.

6. Transfer of risk

Insurance is a plan in which the insured transfers his risk on the insurer. This may be the reason that many persons observe, that insurance is a device to transfer some economic losses which would have been borne by the insured themselves.

7. Spreading of risk

Insurance is a plan which spreads the risk & losses of few people among a large number of people. John Magee writes, "Insurance is a plan by which large number of people associate themselves and transfer to the shoulders of all, risk attached to individuals".

8. Protection against risks

Insurance provides protection against risk involved in life, materials and property. It is a

device to avoid or reduce risks.

9. Insurance is not charity

Charity pays without consideration but in the case of insurance, premium is paid by the insured to the insurer in consideration of future payment.

10. Insurance is not a gambling

Insurance is not a gambling. Gambling is illegal, which gives gain to one party and loss to other. Insurance is a valid contract to indemnify against losses. Moreover, insurable interest is present in insurance contracts it has the element of investment also.

Functions of Insurance

Primary Functions:

(i) Insurance provides certainty:

Insurance provides certainty of payment at the uncertainty of loss. The uncertainty of loss can be reduced by better planning and administration. But, the insurance relieves the person from such difficult task. Moreover, if the subject matters are not adequate, the self-provision may prove costlier. There are different types of uncertainty in a risk. The risk will occur or not, when will occur, how much loss will be there? In other words, there are uncertainty of happening of time and amount of loss. Insurance removes all these uncertainty and the assured is given certainty of payment of loss. The insurer charges premium for providing the said certainty.

(ii) Insurance provides protection:

The main function of the insurance is to provide protection against the probable chances of loss. The time and amount of loss are uncertain and at the happening of risk, the person will suffer loss in absence of insurance. The insurance guarantees the payment of loss and thus protects the assured from sufferings. The insurance cannot check the happening of risk but can provide for losses at the happening of the risk.

(iii) Risk-Sharing:

The risk is uncertain, and therefore, the loss arising from the risk is also uncertain. When

risk takes place, the loss is shared by all the persons who are exposed to the risk. The risk sharing in ancient time was done only at time of damage or death; but today, on the basis of probability of risk, the share is obtained from each and every insured in the shape of premium without which protection is not guaranteed by the insurer.

Secondary functions:

Besides the above primary functions, the insurance works for the following functions:

(i) Prevention of Loss:

The insurance joins hands with those institutions which are engaged in preventing the losses of the society because the reduction in loss causes lesser payment to the assured and some saving is possible which will assist in reducing the premium. Lesser premium invites more business and more business causes lesser share to the assured. So again premium is reduced to, which will stimulate more business and more protection to the masses. Therefore, the insurance assists financially to the health organisation, fire brigade, educational institutions and other organisations which are engaged in preventing the losses of the masses from death or damage.

(ii) It Provides Capital:

The insurance provides capital to the society. The accumulated funds are invested in productive channel. The dearth of capital of the society is minimised to a greater extent with the help of investment of insurance. The industry, the business and the individual are benefited by the investment and loans of the insurers.

(iii) It Improves Efficiency:

The insurance eliminates worries and miseries of losses at death and destruction of property. The carefree person can devote his body and soul together for better achievement. It improves not only his efficiency, but the efficiencies of the masses are also advanced.

(iv) It helps Economic Progress:

The insurance by protecting the society from huge losses of damage, destruction and death, provides an initiative to work hard for the betterment of the masses. The next factor of economic progress, the capital, is also immensely provided by the masses. The

property, the valuable assets, the man, the machine and the society cannot lose much at the disaster.

Advantages of Insurance

1. Assures for financial compensation

Insurance provides financial security to the insured. It gives guarantee of compensation against large financial losses in return of small premium.

2. Reduction of risks

Human beings are exposed to different kinds of financial risks, which may cause large financial losses. It is not possible to eliminate the risks but it can be forecasted and reduced by applying some precautionary measures. Insurance helps in reducing risks by suggesting for pre caution measures on one side and by sharing the losses to a group of person who has agreed to join the common pool.

3. Encouragement to saving and investment

In the insurance agreement, the insured has to pay a certain regular premium to the insurer in return to the compensation of the probable future loss or compensation at old age or compensation after his/her death. Insurance is thus a method of collecting saving from the parties willing to get secured from the financial risks. Hence, it encourages persons to make regular savings.

4. Basis of credit

An insured can easily get loan by pledging insurance policy as a security from the insurance company itself. Besides, financial institutions grant credit facilities on the pledge of the properties which are being insured.

5. Maintains economic stability

Financial risks and uncertainties push the entire economy into instability. It is a very bad sign to total business and social sectors. Insurance assures the compensation of the financial losses caused by the specified future events and considerably helps in maintaining economic stability.

6. Promotes business activities

Business sector is more risky sector. The chances of fire in the go down, loss of stocks by theft, explosion in the ship, train or plane etc. are more frequent in this sector. Insurance takes away these risks and promotes and develops business activities in consideration to a nominal charge i.e premium.

7. Provides employment opportunities

As insurance has become business in the modern day business world, hundreds of entrepreneurs and thousands of employees have been engaging in this line. Hence, by establishing and developing insurance companies, it has provided employment opportunities to thousands of people as per their qualification and calibre.

Disadvantages of Insurance

Besides a number of benefits, insurance has also some limitations.

- Insurance leads to negligence as the insured feels that he/she can be compensated for any loss or damage.
- Insurance companies do not make the compensation promptly on maturity of the policy or for the financial losses as the expectation of the insured.
- It may lead to the crimes in the society as the beneficiaries of the policy may be tempted to commit crimes to receive the insured amount.
- Although insurance encourages savings, it does not provide the facilities that are provided by bank

Let Us Sum Up

Insurance is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as the premium. Insurance allows individuals, businesses and other entities to protect themselves against significant potential losses and financial hardship at a reasonably affordable rate. Insurance is a device by which a loss likely to be caused by uncertain event is spread over a large number of persons who are exposed to it and who voluntarily join themselves against such an event. The pre-independence era in India saw discrimination between the lives of foreigners (English) and Indians with higher premiums being charged for the latter. In 1870, *Bombay Mutual Life Assurance Society* became the first Indian insurer. The

Government of India issued an Ordinance on 19 January 1956 nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year.

Check Your Progress

- 1. What is the primary purpose of insurance?** A. To earn profits for the insurer
B. To eliminate risks completely
C. To share and transfer risk
D. To increase government revenue
- 2. Which of the following is NOT a principle of insurance?** A. Principle of Indemnity
B. Principle of Contribution
C. Principle of Increasing Risk
D. Principle of Utmost Good Faith
- 3. What is the meaning of "Insurable Interest"?** A. Having an interest in getting a higher return
B. Having a legal right to insure
C. Expectation of profit from insurance
D. Being able to avoid all types of risks
- 4. The consideration paid by the insured to the insurer for covering the risk is called:** A. Claim
B. Sum assured
C. Premium
D. Bonus

Risk Management; Identification

In the context of insurance, **risk** is the possibility of an uncertain event occurring that results in a financial loss. It is the central concept around which the entire industry is built.

To put it simply, insurance is a mechanism for transferring risk. An individual or business (the policyholder) pays a known amount of money (the premium) to an insurance company to protect against the possibility of a large, unknown financial loss from a specific event. The insurer, in turn, accepts that risk and agrees to pay for the loss if the event occurs, up to the limits of the policy.

Characteristics of Risk in Insurance

For a risk to be insurable, it must meet several criteria:

- **Uncertainty:** The event must be uncertain. If a loss is guaranteed to happen, it is not a risk but a certainty, and therefore not insurable. For example, the depreciation of a car's value is not a risk; it's a certainty.
- **Fortuitousness:** The event causing the loss must be accidental and outside the policyholder's control. A loss that is intentionally caused by the insured is not covered.
- **Measurability:** The loss must be quantifiable in financial terms. This allows the insurer to determine the amount of a claim payout and to set an appropriate premium.
- **Predictability:** While the exact timing of a loss for an individual is uncertain, the insurer must be able to predict the frequency and severity of losses for a large group of similar risks. This is the basis of actuarial science, which uses statistical data to calculate premiums.
- **Homogeneity:** The insurer must be able to group a large number of similar risks together (e.g., all homeowners in a certain area, all drivers of a certain age and type of car). This is known as the "law of large numbers," and it allows the insurer to spread the risk among a large pool of policyholders.

Risk Identification

Risk identification is the foundational step in risk management. It is the systematic process of discovering and documenting potential threats that could impact an organization's objectives. In the context of insurance, this means pinpointing all the possible events that could lead to a claim and a financial loss for the insurer.

Techniques for Risk Identification:

- **Brainstorming and Workshops:** Engaging with experts, underwriters, and other stakeholders to generate a comprehensive list of potential risks. This is particularly useful for identifying new and emerging risks.

- **Historical Data Analysis:** Reviewing past claims and loss data to understand the frequency and severity of certain events. This helps in anticipating future risks and developing accurate actuarial models.
- **SWOT Analysis (Strengths, Weaknesses, Opportunities, Threats):** A tool to analyze internal and external factors that could influence the company. For example, a "weakness" could be a lack of cybersecurity, leading to a "threat" of a data breach.
- **Checklists and Templates:** Using standardized lists of risks relevant to a specific industry or policy type to ensure no common risks are overlooked.
- **Scenario Analysis:** Exploring potential future events and their impacts. This is used for stress testing and strategic planning, especially for catastrophic events like natural disasters or pandemics.

Types of Risks in Insurance:

Insurers must identify and classify risks to determine if they are insurable. A key distinction is between pure and speculative risk.

- **Pure Risk:** This involves only two possible outcomes: loss or no loss. It is the type of risk that insurance is designed to cover. Examples include natural disasters (fire, flood, earthquake), accidents, and death.
- **Speculative Risk:** This involves the possibility of a gain, a loss, or no change. Examples include investing in the stock market or starting a new business. Speculative risks are generally not insurable.

Other risk classifications include:

- **Particular Risk:** Affects an individual or a small group (e.g., a car accident).
- **Fundamental Risk:** Affects a large population or region and is often beyond individual control (e.g., a pandemic or a major hurricane).
- **Financial Risk:** Can be measured in monetary terms (e.g., property damage).

- **Non-Financial Risk:** Cannot be easily measured in money (e.g., reputational damage).

Risk Measurement

Once risks have been identified, the next step is to manage them. Risk management in insurance involves a systematic process of assessing and controlling threats to the business. For an insurance company, this means not only managing its own operational and financial risks but also managing the risks it assumes from its policyholders.

Risk Management Strategies:

- **Risk Avoidance:** Choosing not to engage in activities that carry a specific risk. For example, an insurer might choose not to offer policies in a region prone to frequent natural disasters.
- **Risk Retention:** Accepting a portion of the risk. This can be done by a policyholder through a deductible, where they agree to pay a certain amount of the loss themselves. For the insurer, this means holding a specific amount of risk on its balance sheet.
- **Loss Prevention and Reduction:** Implementing measures to minimize the frequency or severity of a loss. For example, requiring a homeowner to install a smoke detector or a security system can reduce the risk of fire or theft.
- **Risk Transfer:** The core function of insurance. It involves shifting the financial burden of a potential loss from one party (the policyholder) to another (the insurer) in exchange for a premium.
- **Risk Sharing:** The concept of an insurance pool, where many policyholders contribute premiums to a common fund. The financial burden of a loss for one member is then shared by all.

Risk Diversification

Diversification is a critical risk management strategy for insurance companies. It is the principle of "not putting all your eggs in one basket." By spreading its loss exposures

across various areas, markets, and products, an insurer can reduce the overall impact of a single catastrophic event or a localized downturn.

Methods of Diversification:

- **Geographic Diversification:** An insurer can diversify its portfolio by writing policies in different geographical areas. This helps to mitigate the impact of a large-scale disaster, like a hurricane, that affects a single region.
- **Line of Business Diversification:** An insurer can offer a variety of policy types, such as life insurance, auto insurance, and property insurance. A downturn in one line of business may be offset by strong performance in another.
- **Reinsurance:** This is a key form of risk diversification. Reinsurance is essentially "insurance for insurers." An insurance company transfers a portion of its risk portfolio to another insurer (the reinsurer). This allows the primary insurer to limit its exposure to a single large loss and frees up capital to write more policies.
- **Risk-Based Capital:** Insurers are often required to hold a certain amount of capital based on the risks they assume. Diversification can help lower these capital requirements by reducing the overall risk profile of the company.

Sum of Large Numbers Theory of Probability

Probability theory, a branch of mathematics, is a means of predicting random events by analysing large quantities of previous similar events. Probabilities in statistics are the mathematical odds that an event will occur. To obtain a probability ratio, the number of favorable results in a set is divided by the total number of possible results in the set. The probability ratio expresses the likelihood that the event will take place. This ratio is significant to insurance providers.

Risk is inherent or a facet of every human endeavour or aspect of life. From the moment we get up in the morning, drive or take public transportation to get to school or to work until we get back into our beds (and perhaps even afterwards), we are exposed to risks of different degrees. What makes the study of risk fascinating is that while some of this-

risk bearing may not be completely voluntary, we seek out some risks on our own (speeding on the highways or gambling, for instance) and enjoy them. While some of these risks may seem trivial, others make a significant difference in the way we live our lives. It can be argued that every major advance in human civilization, from the caveman's invention of tools to gene therapy, has been made possible because someone was willing to take a risk and challenge the status quo.

Risk is the potential of loss (an undesirable outcome, however not necessarily so) resulting from a given action, activity and/or inaction. The notion implies that a choice having an influence on the outcome sometimes exists (or existed). Potential losses themselves may also be called "risks". Any human endeavor carries some risk, but some are much riskier than others.

Risk can be defined in different ways

- The probability of something happening multiplied by the resulting cost or benefit if it does.
- The probability or threat of quantifiable damage, injury, liability, loss, or any other negative occurrence that is caused by external or internal vulnerabilities, and that may be avoided through pre-emptive action

Probability Theory and Statistics

Probability theory, a branch of mathematics, is a means of predicting random events by analysing large quantities of previous similar events. Probabilities in statistics are the mathematical odds that an event will occur. To obtain a probability ratio, the number of favorable results in a set is divided by the total number of possible results in the set. The probability ratio expresses the likelihood that the event will take place. This ratio is significant to insurance providers.

Relationship between Risk and Probability:

Risk versus Probability: While some definitions of risk focus only on the probability of an event occurring, more comprehensive definitions incorporate both the probability of the

event occurring and the consequences of the event. Thus, the probability of a severe earthquake may be very small but the consequences are so catastrophic that it would be categorized as a high-risk event.

Sum of Large Numbers in Probability Theory (Insurance Context)

The Sum of Large Numbers, more commonly referred to as the Law of Large Numbers (LLN) in probability theory, is a foundational concept in insurance and actuarial science.

The **Law of Large Numbers** states that as the number of independent and identically distributed (i.i.d.) trials (or exposures) increases, the **average result** of those trials converges to the **expected value (mean)**.

In insurance, the LLN justifies **risk pooling** and **premium setting**:

Concept	Application
Risk Pooling	By insuring a large number of independent policyholders, an insurer can predict overall losses more accurately .
Premium Calculation	Insurers use expected losses (from large historical data) to set fair and stable premiums .
Predictability	The larger the insured group, the less volatile the average loss per policy becomes.

Let Us Sum Up

In the context of insurance, risk is the possibility of an uncertain event occurring that results in a financial loss. It is the central concept around which the entire industry is built. Risk identification is the foundational step in risk management. It is the systematic process of discovering and documenting potential threats that could impact an organization's objectives. In the context of insurance. Once risks have been identified, the next step is to manage them. Risk management in insurance involves a systematic

process of assessing and controlling threats to the business. Diversification is a critical risk management strategy for insurance companies. It is the principle of "not putting all your eggs in one basket."

Check Your Progress

- 1. Which of the following is NOT a method used for risk identification in insurance?** A. Brainstorming B. Checklists C. Regression analysis D. Interviews
- 2. Which of the following best describes the goal of risk diversification in insurance?** A. Increase the premiums collected B. Concentrate risk for better control C. Spread risk across multiple exposures D. Avoid underwriting new policies
- 3. Which type of risk is best reduced through pooling in insurance?** A. Systematic risk B. Unsystematic risk C. Catastrophic risk D. Credit risk
- 4. What is the primary purpose of risk measurement in insurance?** A. To eliminate all risks B. To determine solvency margins only C. To quantify and evaluate the impact of risk D. To increase claim frequency

Insurance Regulation; IRDA Regulations

The IRDAI Act, 1999, established the Insurance Regulatory and Development Authority of India ("IRDAI" or "Authority") as a statutory regulator to regulate and promote the insurance industry in India and to protect the interests of policyholders. The IRDAI Act also carried out a series of amendments to the Act of 1938 and conferred the powers of the Controller of Insurance on the IRDAI.

Every Chairperson and every other whole time member of IRDAI appointed shall hold office for a term of five years and every part time member shall hold office for a term not exceeding five years. However, Chairperson shall not hold office once he or she attains 65 years while whole time members shall not hold office once he or she attained the age of 62 years.

Under Section 14 of the IRDAI Act, 1999, IRDAI has the following powers:

- Issue of Certificate of Registration to insurance companies, renew, modify, withdraw, suspend or cancel the certificate of registration.
- Protection of interests of policy holders in matters concerning assignment of policies, nomination, insurable interest, claim settlement, surrender value and other terms and conditions of insurance contract.
- Specification of requisite qualifications, practical training and code of conduct for insurance agents and intermediaries.
- Specification of code of conduct for surveyors and loss assessors.
- Promoting efficiency in the conduct of insurance businesses.
- Promoting and regulating professional organizations connected with insurance and reinsurance industry.
- Levying fees and other charges for carrying out the purposes of the Act.
- Control and regulation of rates, advantages, terms and conditions that may be offered by insurers.
- Specifying the form and manner in which books of account shall be maintained by insurance companies and intermediaries.
- Regulation of investments of funds by insurance companies.
- Regulation of maintenance of margin of solvency.
- Adjudication of disputes between insurers and insurance intermediaries.
- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations.
- Specifying the percentage of life- and general- insurance business to be undertaken by insurers in rural or social sectors.
- Such other powers as may be prescribed.

IRDAI Regulations on Insurance Contracts

The IRDAI regulations for insurance contracts are designed to ensure fairness, transparency, and clarity for policyholders. While the specific regulations can be extensive and subject to change, here are some general principles and key areas of focus:

- **Policyholder Protection:** The core of IRDAI's regulations is the protection of policyholders. This includes ensuring fair and ethical practices by insurance companies, transparency in product offerings, and a robust grievance redressal mechanism.
- **Product Filing and Approval:** Insurers are required to file all new products and any modifications to existing ones with the IRDAI for approval. This process ensures that products are designed to meet the needs of customers and that the terms and conditions are fair.
- **Clarity and Disclosure:** Insurers must provide clear and easy-to-understand information about policy terms, conditions, benefits, and exclusions. This includes providing a customized benefit illustration for all traditional products, which must be signed by both the policyholder and the intermediary.
- **Surrender Value:** Regulations specify the minimum guaranteed surrender value for policies, providing policyholders with some financial recourse if they need to terminate their policy before maturity.
- **Claim Settlement:** The IRDAI monitors claim settlements to ensure they are handled fairly and promptly. Insurers are required to have a proper grievance redressal process and cannot deny claims arbitrarily. The regulations also provide for penal interest in case of a delay in settling claims.
- **Portability:** For health insurance policies, the IRDAI has established norms for portability, allowing policyholders to switch insurers without losing the benefits of the waiting period they have already served.
- **Underwriting Policy:** Insurers must have a board-approved underwriting policy for accepting, modifying, or denying a proposal. The reasons for denying a proposal must be communicated to the applicant in writing.

IRDAI's role as Regulator of Insurance Agents

IRDAI have been vested with the following powers under the IRDAI Act, 1999 to regulate the Distributors of Insurance Policies:

1. Specification of requisite qualifications, practical training and code of conduct for insurance agents and intermediaries.
2. Specification of code of conduct for survey or sand loss assessors.
3. Promoting efficiency in the conduct of insurance business.
4. Calling for information from or undertaking inspection of insurance companies, intermediaries and other organisations connected with insurance business.
5. Control and regulation of rates, advantages, terms and conditions that may be offered by general insurance companies.
6. Specifying the form and manner in which books of account shall be maintained by insurance companies and intermediaries.

Individual Agents

As per Section 42 of the Insurance Act, 1938, an insurer may appoint any person to act as insurance agent for the purpose of soliciting and procuring insurance business.

Section 42(1) The Authority or an officer authorised by it in this behalf shall, in the manner determined by the regulations made by it and on payment of the fee determined by the regulations, which shall not be more than two hundred and fifty rupees, issue to any person making an application in the manner determined by the regulations, a licence to act as an insurance agent for the purpose of soliciting or procuring insurance business: Provided that,—

- in the case of an individual, he does not suffer from any of the disqualifications mentioned in subsection (4); and
- in the case of a company or firm, any of its directors or partners does not suffer from any of the said disqualifications

As per Section 42 of the Insurance Act, 1938, an insurer may appoint any person to act as insurance agent for the purpose of soliciting and procuring insurance business.

No person shall act as an insurance agent for more than one life insurer, one general insurer, one health insurer at a time.

Provided that the Authority shall, while framing regulations, ensure that no conflict of interest is allowed to arise for any agent in representing two or more insurers for whom he may be an agent.

Pursuant to the powers given under Section 42 of Insurance Act, 1938, IRDAI have framed Regulations for regulating the Individual Insurance Agents. Key highlights of the Regulations are given hereunder.

- Every insurer to have a Policy on Individual Agents approved by Board to be in place specifying:
 - Minimum age;
 - Qualifications - minimum X passed recommended;
 - Pre-recruitment Training requirements & Skill development training by Insurer (not less than 25 hours for Pre-recruitment Training);
 - Remuneration to Individual Agents.
- Every insurer to also have a Board approved Policy on Commission & remuneration to Agents & Intermediaries, giving broad framework on Commission & Rewards to Agents, Eligibility for Commission after Termination, Orphan Policies allocation etc.
- Interview procedure shall also specified by the Policy.
- PAN mandatory for appointment of Insurance Agents.
- All candidates to undergo 50 hours pre-recruitment training to be conducted by an Authorised body and pass an examination to be conducted by Insurance Institute of India/authorised body.
- Registration Certificate issued by IRDAI to Agents.
- Insurer to screen the names of candidates with the with prohibited lists – Centralized list of blacklisted agents, Agents working with other Companies – to ensure that there is no backdoor entry by persons who have committed fraud in the past.
- Appointment letter & ID card to be issued by the Company.

- Insurance companies may refuse to appoint an Agent. Agents may appeal against refusal to the Appellate Authority appointed within the Insurance Company.
- Procedure for Agency Performance Review, Suspension & Resignation of Agents to be laid down.
- Details of Individual Agents (as well as corporate /agents) to be published on Insurer's website.

Corporate Agents

In the case of a Corporate Agency, a Partnership firm or a Company may apply for doing insurance agency, as against individuals which we saw earlier. However, unlike Individual agent who can work for only 1 insurer in a line of business (Life/Non-Life/Standalone health), a Corporate agent is allowed to work for upto 3 insurers in each line of business. Therefore, a Corporate agent can work up to a maximum of 9 insurers, with a cap of 3 insurers in each line of business.

Insurance Brokers

These are entities that act on behalf of the client to arrange insurance business. They provide services like risk management and claims consultancy. Brokers also require a license from the IRDAI and must adhere to specific capital requirements and a code of conduct.

Generic Norms for Insurance Advisors

The generic norms of insurance advisors, encompassing all types of intermediaries, are primarily focused on maintaining a fair and stable market. These norms include:

- **Consumer-Centricity:** All advisors are required to prioritize the needs of the customer. This involves understanding the client's financial situation and risk appetite before recommending a suitable product.

- **Transparency and Disclosure:** Advisors must clearly disclose all relevant information, including the policy's features, benefits, costs, and commissions. The personalized benefit illustration, which shows guaranteed and non-guaranteed returns, is a key tool for this.
- **Training and Education:** Intermediaries must undergo continuous training and professional development to stay updated with industry changes and new regulations.
- **Ethical Practices:** The IRDAI's regulations emphasize a high standard of ethics and professionalism, aiming to eliminate misleading sales practices, mis-selling, and unfair competition among intermediaries.
- **Grievance Redressal:** Advisors are part of the overall grievance redressal mechanism and are expected to assist policyholders with their queries and complaints.

Let Us Sum Up

Every Chairperson and every other whole time member of IRDAI appointed shall hold office for a term of five years and every part time member shall hold office for a term not exceeding five years. The IRDAI regulations for insurance contracts are designed to ensure fairness, transparency, and clarity for policyholders. While the specific regulations can be extensive and subject to change. Section 42(1) The Authority or an officer authorised by it in this behalf shall, in the manner determined by the regulations made by it and on payment of the fee determined by the regulations, which shall not be more than two hundred and fifty rupees, issue to any person making an application in the manner determined by the regulations, a licence to act as an insurance agent for the purpose of soliciting or procuring insurance business. No person shall act as an insurance agent for more than one life insurer, one general insurer, one health insurer at a time. a Corporate agent is allowed to work for upto 3 insurers in each line of business. A Corporate agent can work up to a maximum of 9 insurers, with a cap of 3 insurers in each line of business. Insurance brokers provide services like risk management and claims consultancy. The generic norms of insurance advisors, encompassing all types of intermediaries, are primarily focused on maintaining a fair and stable market.

Check Your Progress

- 1. Which Act served as the legislative predecessor to the IRDA Act, 1999?** A) The Marine Insurance Act, 1963 B) The Life Insurance Corporation Act, 1956 C) The Insurance Act, 1938 D) The Public Liability Insurance Act, 1991
- 2. Which organization is officially responsible for regulating the insurance business in India?** A) RBI B) SEBI C) IRDAI D) NABARD
- 3. What does the “R” in IRDAI stand for?** A) Regulation B) Regulatory C) Research D) Rate
- 4. What is the primary objective of IRDAI?** A) To maximize profits for insurance companies B) To regulate the stock market C) To promote and protect the rights and interests of policyholders D) To increase the number of insurance agents
- 5. Which of these is *not* a typical function of IRDAI?** A) Regulating solvency margin for insurers B) Promoting professional organisations in insurance C) Issuing/suspending insurer registrations D) Setting foreign direct investment policy across all financial sectors.

Unit Summary

Insurance is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as the premium. Insurance allows individuals, businesses and other entities to protect themselves against significant potential losses and financial hardship at a reasonably affordable rate. Insurance is a device by which a loss likely to be caused by uncertain event is spread over a large number of persons who are exposed to it and who voluntarily join themselves against such an event. Once risks have been identified, the next step is to manage them. Risk management in insurance involves a systematic process of assessing and controlling threats to the business. Diversification is a critical risk management strategy for insurance companies. It is the principle of "not putting all your eggs in one basket." The IRDAI regulations for insurance contracts are designed to ensure fairness, transparency, and clarity for policyholders. Section 42(1) The Authority or an officer authorised by it in this behalf shall, in the manner determined by the regulations made by

it and on payment of the fee determined by the regulations, which shall not be more than two hundred and fifty rupees, issue to any person making an application in the manner determined by the regulations, a licence to act as an insurance agent for the purpose of soliciting or procuring insurance business. No person shall act as an insurance agent for more than one life insurer, one general insurer, one health insurer at a time. a Corporate agent is allowed to work for upto 3 insurers in each line of business.

Glossary

- **Reinsurance:** Insurance that insurers purchase from other insurers to reduce exposure to significant or catastrophic losses. Also known as "insurance for insurers."
- **Nominee / Beneficiary:** A nominee is designated by the policyholder to receive benefits from a policy; the beneficiary is the person who ultimately receives the payout.
- **Premium:** The periodic payment made by the policyholder to the insurer in exchange for coverage (could be monthly, annually, etc.).
- **Peril :** A direct cause of loss (e.g. fire, theft, flood)—the event that triggers policy coverage.
- **Hazard :** A condition or circumstance that increases the likelihood or severity of a loss—for example, faulty wiring increasing risk of fire.
- **IRDAI :** The *Insurance Regulatory and Development Authority of India*, established under the IRDA Act of 1999, is the autonomous statutory body under the Ministry of Finance responsible for licensing, regulating, and developing the insurance and reinsurance industry in India
- **Retention :** The portion of risk that an insurer assumes and does not transfer via reinsurance
- **Licensing & Registration :** Insurers, intermediaries (agents, brokers, TPAs), and surveyors must obtain IRDAI registration. Licensing criteria include capital adequacy, governance, and operational capability, periodically renewed by IRDAI

- **Corporate Agent:** Non-individual entities (firms or companies) licensed to market insurance product(s)

Self – Assessment Questions

1. Write a short note on IRDAI
2. What is the role of IRDAI as a regulator of insurance agents?
3. Who are corporate agents?
4. Explain the law of large numbers in insurance.
5. Outline fundamental principles of insurance.
6. Describe the nature and purpose of reinsurance.
7. Describe the five risk management strategies and relate them to insurance.
8. Define risk management in the context of insurance.
9. Describe the characteristics of an insurable risk.
10. Define “risk identification” in the context of insurance

Activities / Exercises / Case Studies

- Identify and describe at least four methods insurers use to detect and list risks.
- Identify different types of insurance and the risks they cover

Answers for check your progress

Introduction to Insurance

1. **Answer:** C. To share and transfer risk

Reason: Insurance is a mechanism that allows the transfer of risk from an individual or business to an insurance company. It does not eliminate risk, but helps manage financial losses by spreading the risk among a larger group.

2. **Answer:** C. Principle of Increasing Risk

Reason: Insurance is based on principles like indemnity, contribution, subrogation, and utmost good faith. Increasing risk is contrary to the objectives of insurance and is not a recognized principle.

3. Answer: B. Having a legal right to insure

Reason: Insurable interest means the policyholder must suffer a financial loss if the insured event occurs. Without this, the insurance contract is not valid.

4. Answer: C. Premium

Reason: Premium is the amount the insured pays to the insurer for the risk cover provided under the insurance contract.

Risk Identification, management and diversification

1. Answer: C. Regression analysis

Reason: Regression analysis is a **quantitative tool used for measuring and modeling risk**, not for identifying it. Risk identification typically involves qualitative tools like brainstorming, interviews, and checklists.

2. Answer: C. Spread risk across multiple exposures

Reason: Diversification reduces the overall impact of any single loss by spreading risk across multiple policyholders, geographic regions, or lines of business.

3. Answer: B. Unsystematic risk

Reason: **Unsystematic (idiosyncratic) risk** can be reduced through pooling and diversification. Systematic risk, like inflation or recession, affects all participants and is harder to diversify.

4. Answer: C. To quantify and evaluate the impact of risk

Reason: Risk measurement helps insurers understand the **financial consequences** of various risks, allowing for informed pricing, underwriting, and capital allocation.

Insurance Regulation; IRDA Regulations

1. Answer: C) The Insurance Act, 1938

Reason: The 1938 Act was the principal insurance law governing India before the IRDA Act of 1999 established a regulatory body and updated the framework.

2. Answer: C) IRDAI

Reason: The Insurance Regulatory and Development Authority of India is the statutory body established under the IRDA Act, 1999 to regulate and license insurers and intermediaries.

3. Answer: B) Regulatory

Reason: IRDAI expands to “Insurance **Regulatory** and Development Authority of India.”

4. Answer: C) To promote and protect policyholder rights

Reason: IRDAI’s core mandate is safeguarding policyholder interests while supporting healthy industry growth.

5. Answer: D) Setting FDI policy across all financial sectors

Reason: While IRDAI regulates solvency, licensing, and professionals, FDI policy across the broader economy is set by the Government of India—not IRDAI.

Suggested Readings

- **Fundamentals of Insurance** – *P.K. Gupta* Published by Himalaya Publishing House (2017).
- **General Insurance in India: Principles and Techniques** – *K.C. Sharma* Published by Regal Publications (2013).
- **Principles of Insurance and Risk Management** — *Mittal Alka & S.L. Gupta* Publisher: Sultan Chand & Sons, Revised 3rd Edition, ~2013
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- **Principles of Insurance Law** — *M.N. Srinivasan & K. Kannan*

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- ***Fundamentals of Risk and Insurance*** — Emmett J. Vaughan & Therese M. Vaughan
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Publisher: Cambridge University Press.
- **Commentary on the IRDA Act** — S.K. Sarvaria & Apoorv Sarvaria
Published by LexisNexis.
- **Law of Insurance** — B.N. Banerjee & S.K. Sarvaria

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UNIT – V - General Insurance**Unit Objective**

After going through the Unit one must be able to understand the

- Concept General Insurance
- Products of General Insurance
- Life Insurance Principles
- Employee linked insurance

Unit Structure

- Introduction to General Insurance
- Marine Insurance
- Fire Insurance
- Automobile Insurance
- Home Insurance
- Overseas Travel Insurance
- Medical Insurance
- Jewellery Insurance
- Life Insurance
- Employees Deposit Linked Insurance
- Unit Summary
- Glossary
- Self – Assessment Questions
- Activities / Exercises / Case Studies
- Answers for check your progress
- Suggested Readings
- Open Source
- Reference

Introduction to General Insurance

It is commonly understood that all insurance other than life is non-life or general insurance.

General Insurance is

- A policy or agreement between the policyholder and the insurer which is considered only after realization of the premium.
- The premium is paid by the insured who has a financial interest in the asset covered.
- The insurer will protect the insured from the financial liability in case of loss.

General Insurance comprises of insurance of property against fire, burglary and natural calamities like floods and earthquakes etc., personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities. There are also other covers such as Errors and Omissions insurance for professionals, credit insurance, agricultural insurance, etc.

The non-life insurers offer policies covering machinery against breakdown, there are policies that cover the hull of ships and so on. A marine cargo policy covers goods in transit including by sea, air and road. Further, insurance of motor vehicles against damages and theft forms a major chunk of non-life insurance business. In respect of insurance of property, it is important that the cover is taken for the actual value of the property to avoid being imposed a penalty should there be a claim.

Personal insurance covers include policies for Accident, Health etc. Products offering Personal Accident cover are benefit policies. Health insurance covers offered by non-life insurers are mainly hospitalization covers either on reimbursement or cashless basis. The cashless service is offered through Third Party Administrators who have arrangements with various service providers, i.e., hospitals. The Third Party Administrators also provide service for reimbursement claims. Sometimes the insurers themselves process reimbursement claims.

There are general insurance products that are in the nature of package policies offering a combination of the covers mentioned above. Apart from offering standard covers,

insurers also offer customized or tailor-made ones. Industries also need to protect themselves by obtaining insurance covers to protect their building, machinery, stocks, etc. and need to cover their liabilities as well. Financiers insist on insurance of property which they finance through loans. So, most industries or businesses that are financed by banks and other institutions do obtain covers.

Most general insurance covers are annual contracts. However, there are few products that are long-term.

The transactions of general insurance business in India are governed by two main statutes, namely:

- The Insurance Act, 1938
- General Insurance Business (Nationalisation) Act, 1972

Marine Insurance

A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the insured, in the manner and to the extent thereby agreed, against transit losses, that is to say losses incidental to transit.

A contract of marine insurance may by its express terms or by usage of trade be extended so as to protect the insured against losses on inland waters or any land risk which may be incidental to any sea voyage.

1. Cargo insurance which provides insurance cover in respect of loss of or damage to goods during transit by rail, road, sea or air.

Thus cargo insurance concerns the following:

- Export and import shipments by ocean-going vessels of all types,
 - Coastal shipments by steamers, sailing vessels, mechanized boats, etc.,
 - Shipments by inland vessels or country craft, and
 - Consignments by rail, road, or air and articles sent by post.
2. Hull insurance which is concerned with the insurance of ships (hull, machinery, etc.). This is a highly technical subject and is not dealt in this module.

Types of Marine Insurance

(a) Special Declaration Policy:

This is a form of floating policy issued to clients whose annual estimated dispatches (i.e. turnover) by rail / road / inland waterways exceed Rs 2 crores.

Declaration of dispatches shall be made at periodical intervals and premium is adjusted on expiry of the policy based on the total declared amount.

When the policy is issued sum insured should be based on previous year's turnover or in case of fresh proposals, on a fair estimate of annual dispatches.

A discount in the rates of premium based on turnover amount (e.g. exceeding Rs.5 crores etc.) on a slab basis and loss ratio is applicable.

(b) Special Storage Risks Insurance

This insurance is granted in conjunction with an open policy or a special declaration policy.

The purpose of this policy is to cover goods lying at the Railway premises or carrier's godowns after termination of transit cover under open or special declaration policies but pending clearance by the consignees. The cover terminates when delivery is taken by the consignee or payment is received by the consignor, whichever is earlier.

(c) Annual Policy

This policy, issued for 12 months, covers goods belonging to the insured, which are not under contract of sale, and which are in transit by rail / road from specified depots / processing units to other specified depots / processing units.

(d) "Duty" Insurance

Cargo imported into India is subject to payment of Customs Duty, as per the Customs Act. This duty can be included in the value of the cargo insured under a Marine Cargo Policy, or a separate policy can be issued in which case the Duty Insurance Clause is incorporated in the policy. Warranty provides that the claim under the Duty Policy would be payable only if the claim under the cargo policy is payable.

(e) “Increased Value” Insurance

Insurance may be ‘goods at destination port’ on the date of landing if it is higher than the CIF and Duty value of the cargo.

Procedure to Insure Under Marine Insurance

The following is the procedure to insure under marine insurance,

1. Submission of form
2. Quotation from the Insurance Company
3. Payment of Premium
4. Issue of cover note

1. Submission of form**Submission of form includes the following,**

- Name of the shipper or consignor (the insured).
- Full description of goods to be insured
- Method and type of packing: The possibility of loss or damage depends on this factor. Generally, goods are packed in bales or bags, cases or bundles, crates, drums or barrels, loose packing, paper or cardboard cartons, or in bulk etc.
- Voyage and Mode of Transit: Information will be required on the following points:
 - The name of the place from where transit will commence and the name of the place where it is to terminate.
 - Mode of conveyance to be used in transporting goods,

2. Quotation from the Insurance Company

Based on the application the rates of premium depends upon:

- (a) Nature of commodity.
- (b) Method of packing.
- (c) The Vessel.
- (d) Type of insurance policy.

3. Payment of premium:

On accepting the premium rates, the concerned person will make the payment to the insurance company. The payment can be made on the consignment basis.

4. Issue of cover note

A cover note is a document granting cover provisionally pending the issue of a regular policy. It happens frequently that all the details required for the purpose of issuing a policy are not available. For instance, the name of the steamer, the number and date of the railway receipt, the number of packages involved in transit, etc., may not be known.

Procedure of Claim Settlement

As the risk coverages are different for import/export and inland (with in India) consignments, the procedure of claim settlement is explained as under

For Import/Export consignments

Claims Documents

Claims under marine policies have to be supported by certain documents which vary according to the type of loss as also the circumstances of the claim and the mode of carriage.

The documents required for any claim are as under

(a) Intimation to the Insurance Company: As soon as the loss is discovered then it is the duty of the policyholder to inform the Insurance Company to enable it to assess the loss.

(b) Policy: The original policy or certificate of insurance is to be submitted to the company. This document establishes the claimant's title and also serves as an evidence of the subject matter being actually insured.

(c) Bill of Lading: Bill of Lading is a document which serves as evidence that the goods were actually shipped. It also gives the particulars of cargo.

(d) Invoice: An invoice evidences the terms of sale. It also contains complete description of the goods, prices, etc. The invoice enables the insurers to see that the insured value

of the cargo is not unreasonably in excess of its cost, and that there is no gross over valuation. The original invoice (or a copy thereof) is required in support of claim.

(e) Survey Report: Survey report shows the cause and extent of loss, and is absolutely necessary for the settlement of claim.

(f) Debit Note: The claimant is expected to send a debit note showing the amount claimed by him in respect of the loss or damage. This is sometimes referred to as a claim bill.

(g) Copy of Protest: If the loss or damage to cargo has been caused by a peril of the sea, the master of the vessel usually makes a protest on arrival at destination before a Notary Public.

(h) Letter of Subrogation: This is a legal document (supplied by insurers) which transfers the rights of the claimant against a third party to the insurers.

(i) Bill of entry: The other important document is bill of entry issued by the customs authorities showing therein the amount of duty paid, the date of arrival of the steamer, etc., account sales showing the proceeds of the sale of the goods if they have been disposed of; repairs or replacements bills in case of damages or breakage; and copies of correspondence exchanged between the carriers and the claimants for compensation in case of liability resting on the carriers.

Inland Transit Claims (Rail / Road)

In regard to claims relating to inland transit, the documents required to be submitted to the insurers in support of the claim are:

- (a) Original policy or certificate of insurance duly endorsed.
- (b) Invoice, in original, or copy thereof.
- (c) Certificate of loss or damage (original) issued by carriers.
- (d) If goods are totally lost or not delivered, the original railway receipt and / or non-delivery certificate / consignment note.
- (e) Copy of the claim lodged against the railways / road carriers (By Regd. A.D.)
- (f) Letter of Subrogation, duly stamped.
- (g) Special Power of Attorney duly stamped. (Railway Claims).

(h) Letter of Authority addressed to the railway authorities signed by the consignors in favour of consignees whenever loss is claimed by consignees.

(i) Letter of Authority addressed to the railway authorities signed by the consignors in favour of the insurers

(j) Letter of Undertaking from the claimant in case of non-delivery of consignment.

(k) Claim Bill, after adjusting salvage value proposed.

Fire Insurance

The term fire in a fire insurance is interpreted in the literal and popular sense. There is a fire when something burns. In other words fire means visible flames or actual ignition. Simmering/ smoldering is not considered fire in Fire Insurance. Fire produces heat and light but either of them alone is not fire. Lightening is not a fire but if it ignites something, the damage may be due to fire.

Fire Insurance is applicable to stationary assets, such as buildings, Plant and machinery, stocks etc. The items which are in normal course of work kept in one premises for purpose of manufacturing or production .

Example

The following are the items which can be burnt/ damaged through fire:

- Buildings
- Electrical installation in buildings
- Contents of buildings such as machinery, plant and equipment, accessories, etc.
- Goods (raw materials, in–process, semi–finished, finished, packing materials, etc.) in factories, godown etc.
- Goods in the open
- Furniture, fixture and fittings
- Pipelines (including contents) located inside or outside the compound, etc.

The owner of above mentioned properties can insure against fire damage through fire insurance policy which provides financial protection for property against loss or damage by fire.

Insurance of property means insurance of buildings, machinery, stocks etc against Fire and Allied Perils, Burglary Risks and so on. Goods in transit via Sea, Air, Railways, Roads and Courier can be insured under Marine Cargo Insurance. Hulls of ship and boats can be insured under Marine Hull Insurance. Further, there are specialized policies available such as Aviation Insurance Policy for insurance of planes and helicopters. Thus Property Insurance is a very vast category of General Insurance and the type of cover that you need depends upon the type of property you are seeking to cover.

FEATURES OF FIRE INSURANCE

(1) Offer & Acceptance: It is a prerequisite to any contract. Similarly, the property will be insured under fire insurance policy after the offer is accepted by the insurance company

(2) Payment of Premium: An owner must ensure that the premium is paid well in advance so that the risk can be covered. If the payment is made through cheque and it is dishonored then the coverage of risk will not exist.

(3) Contract of Indemnity: Fire insurance is a contract of indemnity wherein the insurance company promises to put the insured party in same financial condition as he was immediately prior to accident, which resulted in damage/loss of asset -- If there is no loss, there is no liability even if there is fire.

(4) Utmost Good Faith: The property owner must disclose all the relevant information to the insurance company while insuring their property. The fire policy shall be voidable in the event of misrepresentation, mis-description or non-disclosure of any material information.

(5) Insurable Interest: The fire insurance will be valid only if the person who is insuring the property is owner or having insurable interest in that property. Such interest must exist at all times during the validity of the insurance cover. It is well known that insurable interest exists not only with the ownership but also as a tenant or bailee or financier. Banks can also have the insurable interest.

(6) Contribution: If a person insured his property with two insurance companies, then in case of fire loss both the insurance companies will contribute to pay the loss to the owner proportionately.

(7) **Period of fire Insurance:** The period of insurance is to be defined in the policy. Generally the period of fire insurance policy is twelve months (365 days). The period can be less than one year but not more than one year.

(8) **Deliberate Act:** If a property is damaged or loss occurs due to fire because of deliberate act of the owner, then that damage or loss will not be covered under the policy.

TYPES OF FIRE INSURANCE POLICIES

I. Floater Policy: This policy is issued only for the stocks, not for plant & machineries. Sometime the stock is kept at various locations and it is very difficult to provide the value of stock at each location. Therefore to cover the risks of stocks at various locations under one sum insured an additional load of 10% on premium is to be paid. Example: A person is having two godowns at Delhi and the value of stock is Rs 50 lakhs and he is not having the value at each location then he can insure the stock under floating policy by paying an additional premium.

II. Declaration Policies: This type of policy is useful where there is frequent fluctuations in stocks / stock values and to avoid the under insurance (insurance of lower value) of the stock,

Declaration Policy(ies) can be granted subject to the following conditions:

- (a) The minimum sum insured shall be 1 crore.
- (b) Monthly declarations based on the average of the highest value at risk on each day or highest value on any day of the month shall be submitted by the Insured latest by the last day of the succeeding month. If declarations are not received within the specified period, the full sum insured under the policy shall be deemed to have been declared.
- (c) Reduction in sum insured shall not be allowed under any circumstances.
- (d) Refund of premium on adjustment based on the declarations / cancellations shall not exceed 50% of the total premium.
- (e) The basis of value for declaration shall be the Market Value unless otherwise agreed to between insurer and insured.
- (f) It is not permissible to issue declaration policy in respect of

- i) Insurance required for a short period
- ii) Stocks under going process
- iii) Stocks at Railway sidings

III. Floater Declaration Policy: It is combination of the above mentioned policies i.e. stock lying at different locations and the value of stock fluctuating. In this type of policies adjustment of policy is done at the end of the policy period based on actual average stock held by the insured during the year. The excess premium is refunded if the average stock during the year was lower than declared for the policy in the beginning of the year. A minimum of 80% of premium collected is however retained irrespective of average of stock values declared during the year.

Automobile Insurance

In Motor Insurance First party is the owner of property(Motor Vehicle), Second party is the Insurer and the Third party is everyone else, say person on street. Normally in insurance loss or damage to the property of insured is covered. If your car gets damaged, its repair and replacement is covered. This is commonly called First party insurance or own damage section of Insurance policy.

Third-party insurance is compulsory for all vehicle-owners as per the Motor Vehicles Act. It covers only your legal liability for the damage you may cause to a third party - bodily injury, death and damage to third party property - while using your vehicle on public spaces. Recently, pursuant to the Supreme Court decision, IRDAI has mandated all General Insurance Companies , to make it compulsory to provide long term third-party motor covers for new vehicles to curb the number of uninsured vehicles plying on the road.

Motor insurance policy is a contract between the insured and the insurer in which the insurer promises to indemnify the financial liability in event of loss to the insured. This loss to insured can arise out of:-

- Loss to insured motor vehicle due to accidental damage arising out of various perils covered under the policy.

- His incurring financial liability towards third parties due to accident of motor vehicle resulting in injury/ disability or death of the third party or damage or loss of third party property
- Personal Accident Injury to owner arising out of insured vehicle meeting with an accident

Motor third-party insurance or third-party liability cover, which is sometimes also referred to as the 'act only' cover, is a statutory requirement under the Motor Vehicles Act. It is referred to as a 'third-party' cover since the beneficiary of the policy is someone other than the two parties involved in the contract i.e. the insured and the insurance company. The policy does not provide any benefit to the insured; however it covers the insured's legal liability for death/disability of third party or damage to third party property.

What is Third Party Insurance?

There are two quite different kinds of insurance involved in the damages system. One is Third Party liability insurance, which is just called liability insurance by insurance companies and the other one is first party insurance.

A third party insurance policy is a policy under which the insurance company agrees to indemnify the insured person, if he is sued or held legally liable for injuries or damage done to a third party. The insured is one party, the insurance company is the second party, and the person you (the insured) injure who claims damages against you is the third party.

Third-party insurance is essentially a form of liability insurance purchased by an insured (first-party) from an insurer (second party) for protection against the claims of another (third party). The first party is responsible for their damages or losses, regardless of the cause of those damages.

Classification of Motor Vehicles

As per the Motor Vehicles Act for the purpose of insurance the vehicles are classified into three broad categories such as:

Private cars

(a) Private Cars - vehicles used only for social, domestic and pleasure purposes.

(b) Private vehicles - Two wheeled.

1. Motorcycle/Scooters
2. Auto cycles
3. Mechanically assisted pedal cycles

(c) Commercial vehicles

1. Goods carrying vehicles
2. Passengers carrying vehicles
3. Miscellaneous & Special types of vehicles

The risks under motor insurance are of two types:

1. Legal liability due to bodily injury, death or damage caused to the property of others.
2. Loss or damage to one's own vehicle\ injury to or death of self and other occupants of the vehicle.

PRINCIPLES OF MOTOR INSURANCE

Motor insurance being a contract like any other contract has to fulfill the requirements of a valid contract as laid down in the Indian Contract Act 1872. In addition it has certain special features common to other insurance contracts.

They are:

- Utmost good faith
- Insurable interest
- Indemnity
- Subrogation and contribution
- Proximate cause

All of these principles have already been discussed in detail in earlier chapters. But for the student's convenience, we will be discussing these here again:

Benefits of Motor Insurance Policies

Cars and bikes are increasingly more expensive with each passing day. At such a time, staying without proper insurance can lead to severe monetary losses for the owner. Listed below are some advantages of purchasing such a plan.

- Prevents Legal Hassle - Helps you avoid any traffic fines and other legalities that you would otherwise need to bear.
- Meets All Third-Party Liability - If you injure a person or damage someone's property during a vehicular accident, the insurance policy helps you meet the monetary losses, effectively.
- Financial Assistance to Repair Your own Vehicle - After accidents, you need to spend considerable sums on repairing your own vehicle. Insurance plans limit such out of pocket expenses, allowing you to undertake repairs immediately.
- Theft/loss cover - If your vehicle is stolen, your insurance policy will help you reclaim a portion of the car/bike's on-road price. You can expect similar assistance if your vehicle is damaged beyond repair due to accidents.

Additionally, individuals who own a commercial car/two-wheeler can also avail tax benefits if they pay premiums for that vehicle.

CLAIM PROCEDURE FOR MOTOR INSURANCE

(a) Vehicle Accident Claims

After the insured submit his claim form and the relevant documents, the insurer appoints a surveyor to inspect the vehicle and submit his/her report to the insurance company. Insured also get the details of the surveyor's report. In case of major damage to the vehicle, the insurer arranges for a spot survey at the site of accident.

The insured can undertake repairs only on completion of the survey. Once the vehicle is repaired, the insured should submit duly signed bills/cash memos to the insurance company. In some cases, companies have the surveyor re-inspect the vehicle after repairs. In such a scenario, the insured should pay the workshop/garage and obtain a proof of release document (this is an authenticated document signed by owner to release the vehicle from the garage after it is checked and repaired).

Once the vehicle has been released, insured should submit the original bill, proof of release, and cash receipt from the garage to the surveyor. The surveyor sends the claim file to the insurance company for settlement along with all the documents and finally, the insurance company reimburses the insured.

(b) Third Party Insurance Claim

In the event of a third party claim, the insured should notify the insurance company in writing along with a copy of the notice and the insurance certificate. The insured should not offer to make an out-of-court settlement or promise payment to any party without the written consent of the insurance company. The insurance company has a right to refuse liabilities arising out of such promises.

The insurance company will issue a claim form that has to be filled and submitted along with:

- Copy of the Registration Certificate
- Driving license
- First information report (FIR)

After verification, the insurance company will appoint a lawyer in the defense of insurer and the insured should cooperate with the insurance company, providing evidence during court proceedings. If the court orders compensation, the insurance company will then do it directly.

(c) Vehicle Theft Claims

In the event of theft of vehicle, the insured should lodge the First Information Report (FIR) with a police station

immediately, inform the insurance company and provide them with a copy of the FIR. He should also submit the Final Police Report to the insurance company as soon as it is received and extend full cooperation to the surveyor or investigator appointed by the company. After the claim is approved, the Registration Certificate of the stolen vehicle has to be transferred in the name of the company and the insured needs to submit the duplicate keys of the vehicle along with a letter of subrogation and an indemnity on stamp paper (duly notarized) to the insurance company.

Let Us Sum Up

It is commonly understood that all insurance other than life is non-life or general insurance. A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the insured, in the manner and to the extent thereby agreed, against transit losses, that is to say losses incidental to transit. The following is the procedure to insure under marine insurance, Submission of form, Quotation from the Insurance Company, Payment of Premium and Issue of cover note. The term fire in a fire insurance is interpreted in the literal and popular sense. Fire Insurance is applicable to stationary assets, such as buildings, Plant and machinery, stocks etc. In Motor Insurance First party is the owner of property(Motor Vehicle), Second party is the Insurer and the Third party is everyone else, say person on street. Normally in insurance loss or damage to the property of insured is covered. Third-party insurance is compulsory for all vehicle-owners as per the Motor Vehicles Act. Motor insurance policy is a contract between the insured and the insurer in which the insurer promises to indemnify the financial liability in event of loss to the insured.

Check Your Progress

- 1. Marine insurance covers which of the following risks?** a) Loss due to fire only
b) Loss due to theft only c) Loss due to sea perils d) Loss due to burglary
- 2. Which of the following is not covered under a standard fire insurance policy?**
a) Damage due to lightning b) Damage due to explosion c) Damage due to war d) Damage due to fire
- 3. The principle of indemnity in fire insurance ensures that:** a) Insurer pays double the loss b) Insured profits from the loss c) Insured is restored to the financial position before the loss d) Premium increases after every claim
- 4. Which of the following is mandatory under the Motor Vehicles Act in India?** a) Own Damage Cover b) Third-Party Liability Insurance c) Personal Accident Cover d) Roadside Assistance Cover
- 5. Which component of motor insurance protects against theft or damage to the insured vehicle?** a) Third-party cover b) Own damage cover c) Personal accident cover d) Comprehensive health cover

Home Insurance (House + Articles Insurance)

Home insurance provides **financial protection** against **damage or loss to a residential property** and/or its **contents** due to specified perils.

1. Types of Home Insurance:

a) Building Insurance (House Structure)

- Covers the **physical structure** of the home (walls, roof, floor, etc.).
- Also includes **fixtures and fittings** like bathroom fittings, kitchen cabinets, etc.
- Common perils covered:
 - Fire
 - Lightning
 - Earthquake
 - Floods
 - Explosion
 - Storm/Cyclone
 - Riots, strikes, and malicious damage

b) Contents Insurance (Household Articles)

- Covers **household items** like:
 - Furniture
 - Electronics (TV, fridge, etc.)
 - Appliances
 - Clothing
 - Jewelry (to a certain extent)
- Protection from:
 - Theft and burglary
 - Accidental damage
 - Fire and natural calamities

c) Comprehensive Home Insurance

- Covers both **building and contents** under a single policy.

2. Add-on Covers (Optional Extensions):

- Jewelry and valuables protection
- Portable electronic equipment
- Domestic employee accident cover
- Temporary accommodation costs

3. Exclusions:

- Willful destruction of property
- Wear and tear, depreciation
- War or nuclear risks
- Loss due to pets or termites (unless specifically covered)

4. Claim Process:

1. Inform the insurer immediately.
2. File FIR (in case of theft).
3. Submit a claim form with required documents.
4. Surveyor inspects the damage.
5. Insurer processes the claim.

5. Importance of Home Insurance:

- Safeguards against **natural and man-made disasters**.
- Provides **peace of mind**.
- Helpful in case of **mortgaged property** (banks often require insurance).

Overseas Travel Insurance

Overseas travel insurance offers **coverage for emergencies and losses** incurred while traveling outside the home country.

1. Key Features:

- Available for **individuals, families, or students** traveling abroad.
- Coverage is usually **comprehensive** and time-bound (duration of the trip).

2. Coverage Inclusions:

a) Medical Cover:

- Emergency hospitalization
- Accident/injury cover
- Medical evacuation
- Repatriation of remains
- Dental treatment (in emergencies)

b) Trip-related Cover:

- Trip cancellation or curtailment
- Flight delay or missed connection
- Loss or delay of checked-in baggage
- Loss of passport or travel documents

c) Personal Liability Cover:

- Compensation for injury/damage caused to third parties.

d) Hijack Distress Allowance:

- Daily compensation for distress caused due to hijack.

e) Accidental Death and Disability:

- Lump sum paid in case of accidental death or permanent disability abroad.

3. Special Types of Overseas Travel Insurance:

- **Student Travel Insurance:** For students pursuing education abroad.
- **Senior Citizen Travel Insurance:** Tailored for travelers above 60 years.
- **Corporate Travel Plans:** For frequent business travelers.

4. Exclusions:

- Pre-existing medical conditions (unless covered by rider)
- Traveling against medical advice
- War, terrorism, or nuclear risks
- Participation in adventure sports (can be added optionally)

5. Claim Process:

1. Contact insurer/TPA helpline (many offer 24/7 global support).
2. Notify the claim within stipulated time.
3. Submit documents: tickets, bills, hospital reports, passport copy, etc.
4. Reimbursement or cashless settlement (depending on the plan).

6. Benefits of Travel Insurance:

- Ensures **financial protection** in unfamiliar territory.
- **Mandatory for visas** to some countries (e.g., Schengen area).
- Reduces stress during emergencies while abroad.

Let Us Sum Up

Home insurance provides financial protection against damage or loss to a residential property and/or its contents due to specified perils. Types of Home Insurance Building Insurance (House Structure), Contents Insurance (Household Articles) and Comprehensive Home Insurance. Overseas travel insurance offers coverage for emergencies and losses incurred while traveling outside the home country. Features of overseas travel insurance are it is available for individuals, families, or students traveling abroad and the Coverage is usually comprehensive and time-bound (duration of the trip).

Check Your Progress

1. **What does building insurance under home insurance primarily cover?** a) Furniture and electronics b) Jewellery and personal items c) Structure of the house d) Kitchen utensils
2. **What is typically not covered under standard home insurance policies?** a) Fire damage b) Theft of contents c) War and nuclear risks d) Flood damage

3. **A home insurance claim for theft will usually require:** a) Horoscope of house owner b) Birth certificate c) FIR from police d) Utility bill
4. **Which of the following is usually covered under overseas travel insurance?**
a) Income tax payment b) Emergency medical expenses abroad
c) Domestic vehicle insurance d) Business loss due to competitors
5. **A person's luggage is delayed while traveling abroad. Which part of the policy is relevant?** a) Accidental death cover b) Trip cancellation cover
c) Baggage delay cover d) Medical evacuation cover
6. **Personal liability cover in travel insurance helps when:** a) You damage someone's property or injure someone abroad b) Your bank card is stolen
c) You miss a connecting flight d) You are hospitalized

Medical Insurance

A systematic plan for financing medical expenses is an important and integral part of a risk management plan. With rising health care costs, it was no longer possible for an individual to meet the heavy cost of treatment involving hospitalization.

The reasons for rise in health care costs are:

- (a) Increase in medical treatment costs.
- (b) Technological advancements in medical equipment.
- (c) High labour costs.

Definition

“Health insurance is an insurance, which covers the financial loss arising out of poor health condition or due to permanent disability, which results in loss of income.”

A health insurance policy is a contract between an insurer and an individual or group, in which the insurer agrees to provide specified health insurance at an agreed upon price (premium). It usually provides either direct payment or reimbursement for expenses associated with illness and injuries. The cost and range of protection provided by health insurance depends on the insurance provider and the policy purchased.

HEALTH INSURANCE POLICIES

The health insurance policies available in India are:

- Mediclaim policy (individuals and groups)
- Overseas Mediclaim policy
- Raj Rajeshwari Mahila Kalyan Yojna
- Bhagyashree Child Welfare Policy
- Cancer Insurance Policy
- Jan Arogya Bima Policy

Mediclaim Policy (individuals and groups)

Mediclaim policy is offered to individuals and groups exceeding 50 members. It covers the hospitalization for diseases or sickness and for injuries. Under group medi-claim policy, group discount is allowed to groups exceeding 101 people. The medical expenses will be reimbursed only if the insured is admitted in the hospital for a minimum duration of 24 hours. Cost of treatment includes consultation fee of doctors, cost of medicines and hospitalization charges. Health insurance in India is available at very economical rates. It is very popular among professionals like Chartered accountants, Advocates, Engineers etc. It is very suitable for self-employed persons because it covers risks against several general and serious diseases.

Overseas Mediclaim Policy

In 1984, the Overseas Mediclaim Policy was developed. This policy will reimburse the medical expenses incurred by Indians upto 70 years of age while traveling abroad. The premium will be charged based on their age, purpose of travel, duration and plan selected by the insured under the policy. This policy is provided to businessmen, people going on holiday tour, traveling for educational professional and official purposes.

Raj Rajeshwari Mahila Kalyan Yojna

It is a personal accident policy offered by an insurance company for the welfare of women. It is offered to women residing in rural and urban areas. Women between 10-75 years of age are eligible for this policy irrespective of their occupation and income level.

Bhagyashree Child Welfare Policy

It is offered to girls between 0-18 years. The age of the parents of the girls shouldn't be more than 60 years. It provides coverage to one girl child in a family who loses her father or mother in an accident.

Cancer Insurance Policy

It is designed for cancer patient's aid association members. The persons insured under this policy will pay premium to their association along with the membership fee. This policy will offer coverage to the insured in case he develops cancer. All the expenses incurred for treatment of cancer not exceeding the sum insured will be paid directly to the insured person.

Jan Arogya Bima Policy

This policy provides medical insurance to poorer section of the people. This policy covers illness like heart attack, jaundice, food poisoning, and accidents etc. that requires immediate hospitalization.

Policy Term (coverage period) of Health Insurance Policies

(a) Individual Policies – under individual health insurance policies, General insurance companies and Standalone health insurance companies can provide insurance cover for a minimum period of 1 year and maximum period of 3 years. However, Life insurance companies can provide only for a minimum Policy term of 5 years. This is because Life insurance contracts, by nature, are long-term contracts

(b) Premium guarantee – No premium can be changed during the Policy period. However, for a Life insurer, premiums cannot be changed for a minimum period of 3 years

(c) Group Policies – these are one year renewable Policies, except for Group Health policies under lender borrower groups (Group credit linked products), where the term can be extended up to 5 years. A minimum group size of 7 has been prescribed for issuing the Group policies.

(d) Personal accident and Travel covers – may be offered for a term of less than 1 year as well.

Jewellery Insurance

1. Definition:

Jewellery Insurance is a type of **specialized insurance** that provides **financial protection against loss, theft, or damage** of valuable ornaments such as gold, diamonds, platinum, and other precious items.

2. Who Needs It?

- Individuals owning high-value jewellery
- People who frequently travel with jewellery
- Families with heirloom pieces
- Professionals in the jewellery business (specialized coverage)

3. Coverage Offered:

- Theft/Burglary
- Accidental damage
- Loss due to fire
- Robbery or snatching
- Loss during travel
- Mysterious disappearance
- Normal wear and tear

4. Types of Jewellery Covered:

- Gold and silver jewellery
- Diamond and gemstone jewellery
- Antique ornaments
- Luxury watches (in some policies)

5. How It Works:

- **Valuation:** Insured must declare the value, often with a valuation certificate.
- **Policy Type:** Standalone jewellery policy or as an **add-on under home insurance**.
- **Sum Insured:** Based on **current market value** or declared value.

6. Exclusions:

- Loss due to negligence or carelessness
- Items not declared in policy schedule
- Normal wear and tear
- Manufacturing defects
- War or nuclear risks

7. Claim Process:

1. Report loss/damage to police (in case of theft).
2. Inform the insurer immediately.
3. Submit FIR, purchase invoice, and claim form.
4. Surveyor assesses the claim.
5. Insurer processes the settlement.

8. Importance:

- Jewellery is often high in **monetary and emotional value**.
- Provides **peace of mind** against loss/theft.
- Important during **festive seasons or weddings**, when jewellery is worn frequently.

Social Security Insurance

Definition:

Social Security Insurance refers to **government-administered insurance schemes** that provide **financial support and protection** to individuals against economic risks such as **illness, disability, unemployment, old age, and death**.

2. Objectives:

- Provide **financial assistance** to economically weaker sections.
- Promote **income security** in old age.
- Ensure **social equity** and protect against poverty.
- Encourage **universal social protection**.

3. Key Components of Social Security in India:

Scheme/Program	Coverage
Employees' State Insurance (ESI)	Sickness, maternity, disability, death
Employees' Provident Fund (EPF)	Retirement income
Atal Pension Yojana (APY)	Pension for informal workers
Pradhan Mantri Suraksha Bima Yojana	Accidental death/disability cover
Pradhan Mantri Jeevan Jyoti Bima Yojana	Life insurance for low premium
National Social Assistance Programme	Pensions for senior citizens, widows, disabled

4. Types of Risks Covered:

Risk/Event	Social Security Scheme Example
Old age	EPF, APY, NSAP
Sickness	ESI, Ayushman Bharat
Disability	ESI, PMSBY
Death (life risk)	PMJJBY, PMSBY, EPF EDLI Scheme
Unemployment	Atal Beemit Vyakti Kalyan Yojana (under ESI)

5. Features:

- Funded by **government, employer, and/or employee**.
- May be **contributory** or **non-contributory** (welfare-based).
- Benefits are **pre-defined** or linked to contributions.

6. Importance:

- Ensures **income stability** during crisis situations.
- Reduces **economic inequality**.
- Protects against **life uncertainties**.

- Helps maintain **human dignity and basic standard of living**.

7. Challenges in Implementation:

- Low awareness among informal workers
- Limited coverage in rural areas
- Administrative bottlenecks
- Fragmentation across multiple departments

Let Us Sum Up

A health insurance policy is a contract between an insurer and an individual or group, in which the insurer agrees to provide specified health insurance at an agreed upon price (premium). It usually provides either direct payment or reimbursement for expenses associated with illness and injuries. Health insurance in India is available at very economical rates. It is very popular among professionals like Chartered accountants, Advocates, Engineers etc. It is very suitable for self-employed persons because it covers risks against several general and serious diseases. Jewellery Insurance is a type of specialized insurance that provides financial protection against loss, theft, or damage of valuable ornaments such as gold, diamonds, platinum, and other precious items. Social Security Insurance refers to government-administered insurance schemes that provide financial support and protection to individuals against economic risks such as illness, disability, unemployment, old age, and death.

Check Your Progress

1. **Which of the following is the main objective of medical (health) insurance?**
a) To increase hospital profits b) To provide reimbursement or cashless cover for medical expenses c) To offer life cover d) To reduce government healthcare burden
2. **What is a pre-existing condition in health insurance?** a) A condition discovered after policy purchase b) A health condition that existed before buying the policy c) A condition treated under Ayurveda d) A disease caused by accident

3. **Jewellery insurance typically does not cover which of the following?** a) Theft of declared jewellery b) Fire damage to gold ornaments c) Accidental loss while travelling abroad d) Depreciation in gold price
4. **Which document is usually required while buying jewellery insurance?** a) Voter ID card b) Income certificate c) Valuation certificate or purchase invoice d) Driving license
5. **Which of the following is not a social security insurance scheme in India?** a) Employees' State Insurance Scheme (ESIS) b) Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) c) Atal Pension Yojana (APY) d) National Pension Scheme for Traders and Self-Employed (NPS Lite) e) Term Insurance from Private Insurer
6. **The main objective of social security insurance is:** a) To promote luxury lifestyle b) To encourage foreign investment c) To provide financial protection to vulnerable groups d) To offer high investment returns

Life Insurance; Principles

Life insurance is a contract between an insurer and a policyholder. In exchange for regular premium payments, the insurer provides a lump-sum payment, known as a death benefit, to a designated beneficiary upon the death of the insured person. The core principles that govern this contract are:

- **Principle of Utmost Good Faith (Uberrimae Fidei):** This is the foundational principle for all insurance contracts. It mandates that both the insurer and the insured act with complete honesty and transparency. The policyholder must disclose all relevant and material facts honestly, such as their medical history, lifestyle, and occupation. The insurer, in turn, must clearly explain the policy's terms, conditions, and exclusions. Failure to do so can make the contract void.
- **Principle of Insurable Interest:** The policyholder must have a genuine financial or emotional stake in the life of the person being insured. This principle prevents individuals from taking out policies on strangers for speculative purposes. Examples of insurable interest include a person insuring their own life, a spouse insuring their partner's life, or a business insuring the life of a key employee.

- **Principle of Indemnity (with a caveat):** While the principle of indemnity—which states that a policy should compensate for a loss without allowing for profit—is central to most insurance (like property or health insurance), it is not strictly applicable to life insurance. A human life cannot be assigned a monetary value in the same way as a car or a house. Instead, life insurance policies pay a predetermined "sum assured" or death benefit, which is an agreed-upon amount that aims to provide financial support to beneficiaries rather than simply "indemnify" for a loss.
- **Principle of Risk Pooling:** This is the fundamental concept behind how insurance works. Insurers pool the premiums of many policyholders to create a large fund. This fund is then used to pay out claims for the few policyholders who experience an insured event (e.g., death). By spreading the risk among a large group, the financial burden is reduced for any single individual.

2. Death and Survival Classifications (Types of Life Insurance)

Life insurance policies can be broadly classified based on whether they pay out upon death, survival, or a combination of both.

- **Death Classifications:** These policies are primarily designed to provide a death benefit to beneficiaries upon the insured's death.
 - **Term Life Insurance:** This is the simplest and most affordable type of life insurance. It provides coverage for a specific period or "term," such as 10, 20, or 30 years. If the insured person dies within the policy term, the death benefit is paid to the nominee. If they survive the term, the policy expires, and no benefit is paid.
 - **Whole Life Insurance:** This type of permanent life insurance provides coverage for the entire lifetime of the insured (often up to age 99 or 100). It combines a death benefit with a savings component, known as "cash value," which grows over time. Premiums are generally higher than for term insurance. Policyholders can often borrow against the cash value.

- **Universal Life Insurance:** A flexible type of whole life insurance where the policyholder can adjust their premium payments and death benefit amount within certain limits. It also features a cash value component that earns interest.
- **Survival Classifications:** These policies combine life insurance with a savings or investment component, offering benefits if the insured survives the policy term.
 - **Endowment Plans:** These are a mix of life insurance and savings. They provide a guaranteed payout to the policyholder at maturity (if they survive the term) or to the beneficiary upon their death. They are suitable for individuals seeking moderate savings and insurance.
 - **Money-Back Policies:** A variation of endowment plans, money-back policies provide periodic payouts, known as "survival benefits," to the policyholder at regular intervals throughout the policy term. The remaining sum assured, along with any bonuses, is paid at maturity.
 - **Unit-Linked Insurance Plans (ULIPs):** ULIPs are hybrid products that combine life insurance with investment options. A portion of the premium goes toward the life cover, while the rest is invested in various market-linked funds (e.g., equity or debt). The returns depend on the performance of the chosen funds.

Traditional Salary Savings Scheme

This is not a specific type of insurance but a premium payment method, often associated with group insurance plans. In a salary savings scheme, the employer deducts the insurance premium directly from the employee's salary and remits it to the insurer.

- **Key Features:**
 - **Convenience:** The deduction is automatic, ensuring premiums are paid on time without the employee's direct intervention.
 - **Discipline:** It promotes a disciplined savings habit, as the amount is set aside before the employee receives their salary.

- **Group Benefits:** These schemes are typically part of a larger group insurance policy, which can offer lower premiums compared to individual policies due to the pooled risk and administrative efficiency.
- **Employer's Role:** The employer acts as a facilitator, collecting premiums from employees and paying the insurer.

Employees Deposit Linked Insurance

The EDLI scheme is an insurance plan for employees in India. It is mandatory for organizations covered under the Employees' Provident Fund (EPF) and Miscellaneous Provisions Act of 1952.

- **Purpose:** The primary objective of EDLI is to provide a lump-sum payment to the nominee or legal heir of an employee in the event of the employee's death while still in service. It serves as a social security benefit for private-sector employees.
- **Key Features:**
 - **No Employee Contribution:** The entire premium for the EDLI scheme is paid by the employer, making it a free insurance benefit for the employee.
 - **Automatic Coverage:** All employees who have an EPF account are automatically covered under the EDLI scheme.
 - **Death Benefit Calculation:** The claim amount is a lump sum calculated based on the employee's average monthly salary over the last 12 months, along with a bonus. The maximum payout is capped at a specific limit (e.g., currently up to ₹7 lakh).
 - **Alternative Option:** Employers can opt out of the EDLI scheme if they provide a more beneficial group life insurance plan to their employees. The benefits of the alternative plan must be equal to or greater than those offered by EDLI.

Let Us Sum Up

Life insurance is a contract between an insurer and a policyholder. In exchange for regular premium payments, the insurer provides a lump-sum payment, known as a death benefit, to a designated beneficiary upon the death of the insured person. Life insurance policies can be broadly classified based on whether they pay out upon death, survival, or a combination of both. This is not a specific type of insurance but a premium payment method, often associated with group insurance plans. In a salary savings scheme, the employer deducts the insurance premium directly from the employee's salary and remits it to the insurer.

Check Your Progress

- 1. Which of the following is a primary principle of life insurance?** A. Principle of Indemnity B. Principle of Contribution C. Principle of Insurable Interest D. Principle of Subrogation
- 2. Life insurance policies can be classified as:** A. Only Death Benefit Policies B. Only Survival Benefit Policies C. Only Annuity Plans D. Death and Survival Benefit Policies
- 3. Which of the following best describes the Traditional Salary Savings Scheme?** A. A scheme where premium is paid by employer only B. A group insurance scheme with premium deducted from salary C. A pension scheme with employer contributions D. A mutual fund-based insurance policy
- 4. Under the Employees' Deposit Linked Insurance (EDLI) Scheme, the insurance benefit is linked to:** A. Monthly salary of the employee B. Total years of service C. Average balance in the Provident Fund account D. Number of dependents
- 5. Which of the following is NOT applicable under life insurance contracts?** A. Risk Coverage B. Principle of Indemnity C. Premium Payment D. Nomination
- 6. The survival benefit under life insurance is generally paid:** A. On death of the insured B. On policy maturity if the insured survives C. Only when the insured is hospitalized D. On termination of employment

Unit Summary

A contract of marine insurance is an agreement whereby the insurer undertakes to indemnify the insured, in the manner and to the extent thereby agreed, against transit losses, that is to say losses incidental to transit. The term fire in a fire insurance is interpreted in the literal and popular sense. Fire Insurance is applicable to stationary assets, such as buildings, Plant and machinery, stocks etc. Third-party insurance is compulsory for all vehicle-owners as per the Motor Vehicles Act. Motor insurance policy is a contract between the insured and the insurer in which the insurer promises to indemnify the financial liability in event of loss to the insured. Types of Home Insurance Building Insurance (House Structure), Contents Insurance (Household Articles) and Comprehensive Features of overseas travel insurance are it is available for individuals, families, or students traveling abroad and the Coverage is usually comprehensive and time-bound (duration of the trip). A health insurance policy is a contract between an insurer and an individual or group, in which the insurer agrees to provide specified health insurance at an agreed upon price (premium. Jewellery Insurance is a type of specialized insurance that provides financial protection against loss, theft, or damage of valuable ornaments such as gold, diamonds, platinum, and other precious items. Social Security Insurance refers to government-administered insurance schemes that provide financial support and protection to individuals against economic risks such as illness, disability, unemployment, old age, and death. Life insurance is a contract between an insurer and a policyholder. In exchange for regular premium payments, the insurer provides a lump-sum payment, known as a death benefit, to a designated beneficiary upon the death of the insured person. Life insurance policies can be broadly classified based on whether they pay out upon death, survival, or a combination of both.

Glossary

- **Cargo Insurance:** Covers goods being transported against loss or damage.
- **Freight Insurance:** Covers the loss of freight due to damage or loss of cargo.
- **Policyholder:** The person or entity in whose name the policy is issued.
- **Reinstatement Value:** The cost of replacing damaged property with new property of the same kind.
- **Third-Party Liability:** Mandatory cover for damages or injury caused to others.
- **Own Damage (OD):** Covers damages to the policyholder's own vehicle.

- **Burglary Cover:** Protection against theft of insured articles.
- **Valuation of Contents:** Determining the value of items to be insured in case of loss.
- **Trip Cancellation:** Coverage for losses due to cancellation of trips.
- **Baggage Loss:** Compensation for loss of checked-in luggage.
- **Health Insurance:** Covers hospitalization and medical treatment expenses.
- **Pre-existing Diseases:** Illnesses present before the inception of policy.
- **Group Mediclaim Policy:** Health cover for a group (usually employees) under one master policy.
- **Floater Cover:** A single sum insured shared by multiple members.
- **All-Risk Policy:** Comprehensive cover against various perils, including mysterious disappearance.
- **Social Security Insurance:** Government-sponsored schemes providing protection against unemployment, old age, or disability.
- **Endowment Plan:** Pays either on death or survival (policy maturity).
- **Whole Life Policy:** Covers the insured for their entire life.
- **Utmost Good Faith:** Full disclosure of all material facts by both parties.
- **Risk Coverage:** Insurance covers the financial impact of death/survival.

Self – Assessment Questions

1. Define marine insurance. What are its main types?
2. What types of properties can be covered under fire insurance?
3. Why is third-party motor insurance mandatory in India?
4. What is included in the “Householder’s Package Policy”?
5. What are the major risks covered in a travel insurance policy?
6. Explain the term “sum insured” in the context of health insurance.
7. Who typically provides group mediclaim policies?
8. What risks are generally covered under jewellery insurance?
9. Define life insurance and explain the principle of insurable interest.
10. How does a salary savings scheme operate in life insurance?

Activities / Exercises / Case Studies

- Create a mock fire insurance policy for a small business, including sum insured, perils covered, exclusions, and premium.
- Plan a mock international student trip (e.g., 3 months to Germany). Students must list travel risks and choose appropriate coverage components in a travel insurance policy.

Answers for check your progress

Introduction to General Insurance

1. **Answer:** c) Loss due to sea perils

Reason: Marine insurance specifically covers risks such as storms, shipwreck, piracy, and other perils of the sea.

2. **Answer:** c) Damage due to war

Reason: War and nuclear risks are generally excluded from standard fire insurance policies.

3. **Answer:** c) Insured is restored to the financial position before the loss

Reason: Fire insurance follows the indemnity principle — compensating only the actual loss to avoid unjust enrichment.

4. **Answer:** b) Third-Party Liability Insurance

Reason: According to Indian law, third-party insurance is compulsory for all motor vehicles.

5. **Answer:** b) Own damage cover

Reason: Own damage cover is part of comprehensive policies and covers theft, fire, and accidental damage to the insured vehicle.

Home Insurance (House + Articles Insurance) and Overseas Travel Insurance

1. **Answer:** c) Structure of the house

Reason: Building insurance covers the physical structure of the house including walls, roof, fittings, and fixtures.

2. **Answer:** c) War and nuclear risks

Reason: These are standard exclusions in most insurance policies due to their catastrophic and uninsurable nature.

3. Answer: c) FIR from police

Reason: For claims involving theft or burglary, filing an FIR is mandatory to validate the claim.

4. Answer: b) Emergency medical expenses abroad

Reason: Travel insurance is meant to cover unexpected medical costs while traveling abroad.

5. Answer: c) Baggage delay cover

Reason: Travel insurance includes compensation for delays in receiving checked-in baggage.

6. Answer: a) You damage someone's property or injure someone abroad

Reason: Personal liability protects you legally and financially if you cause harm to another person or their property.

Health Insurance, Jewellery Insurance and Social Security Insurance

1. Answer: b) To provide reimbursement or cashless cover for medical expenses

Reason: Health insurance covers hospitalization costs, treatments, and sometimes OPD, helping individuals manage high medical bills.

2. Answer: b) A health condition that existed before buying the policy

Reason: Pre-existing conditions are ailments that the insured had before taking the policy, and they may be excluded for a waiting period.

3. Answer: d) Depreciation in gold price

Reason: Jewellery insurance covers physical loss or damage, not market fluctuations in gold or diamond value.

4. Answer: c) Valuation certificate or purchase invoice

Reason: This helps establish the correct value of the item being insured and forms the basis of claim settlement.

5. **Answer:** e) Term Insurance from Private Insurer

Reason: Social security schemes are typically government-run for public welfare, while private term insurance is commercial.

6. **Answer:** c) To provide financial protection to vulnerable groups

Reason: Social security systems are designed to ensure minimum living standards and protect people from poverty, unemployment, old age, etc.

Life Insurance; Principles, Death and Survival Classifications, Traditional Salary Savings Scheme and Employees Deposit Linked Insurance

1. **Answer:** C. Principle of Insurable Interest

Reason: In life insurance, the insured must have a financial or emotional interest in the continued life of the person insured. This is known as the **Principle of Insurable Interest** and is mandatory at the time of policy inception.

2. **Answer:** D. Death and Survival Benefit Policies

Reason: Life insurance includes both **death benefit policies** (e.g., term insurance) and **survival benefit policies** (e.g., endowment or money-back plans), depending on whether benefits are paid upon death or survival.

3. **Answer:** B. A group insurance scheme with premium deducted from salary

Reason: The **Traditional Salary Savings Scheme** is a group life insurance plan where premiums are collected through payroll deductions, usually offering life cover and sometimes savings/returns.

4. **Answer:** C. Average balance in the Provident Fund account

Reason: EDLI provides a lump-sum payment to the nominee of an EPF member who dies during the service. The **benefit is linked to the average PF balance** of the employee during the last 12 months and the eligible salary, subject to certain ceilings.

5. **Answer:** B. Principle of Indemnity

Reason: Unlike general insurance, **life insurance is not a contract of indemnity**, as the loss of life cannot be measured precisely in monetary terms. The sum assured is pre-agreed and paid irrespective of actual financial loss.

6. **Answer:** B. On policy maturity if the insured survives

Reason: Survival benefits are paid when the insured **survives the policy term**. Endowment and money-back policies are examples that provide such benefits.

Suggested Readings

- *Marine Insurance: Law and Practice* - Susan Hodges - Publisher: Routledge
- *Insurance Principles and Practice* - M.N. Mishra & S.B. Mishra - Publisher: S. Chand
- *Risk Management and Insurance* - C. Arthur Williams Jr. & Richard M. Heins - Publisher: McGraw Hill
- *Principles of Insurance* - Dr. Neelam C. Gulati - Publisher: Excel Books
- *Practice of General Insurance* - P.K. Gupta - Publisher: Himalaya Publishing House
- *Principles and Practice of Life Insurance* - Dr. Neelam C. Gulati - Publisher: Excel Books

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- www.irdai.gov.in
- www.epfindia.gov.in
- www.esic.gov.in
- www.epfindia.gov.in
- <https://www.policyholder.gov.in>
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- *General Insurance for Beginners* - **K.C. Mishra** – Publisher: Cengage Learning India, **2017**
- **IRDAI Guidelines** – *Standard Fire & Special Perils Policy* Publisher: IRDAI, **Revised Circular – 2021**

- **WHO–IRDAI** – *Health Insurance in India Handbook* Publisher: WHO/IRDAI collaboration, **2016**
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