

MODERN BANKING & INSURANCE

III SEMESTER

CORE COURSE

BA ECONOMICS

(CUCBCSS - 2014 Admission onwards)



UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

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STUDY MATERIAL

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BA ECONOMICS

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MODERN BANKING & INSURANCE

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Module 1

ORIGIN AND DEVELOPMENT OF BANKING

There seem so be no uniformity amongst the economist about the origin of the word 'Bank'. It is believed that the word 'Bank' has been derived from the German word 'Bank' which means joint stock of firm or from the Italian word 'Banco' which means a heap or mound. The development of commercial banking in ancient times was closely associated with the business of money changing. In simple words, bank refers to an institution that deals in money. This institution accepts deposits from the people and gives loans to those who are in need.

Meaning of Banking

We know people earn money to meet their day to day expenses on food, clothing, education of children, etc. They also need money to meet future expenses on marriage, higher education of children housing building and social functions. These are heavy expenses, which can be met if some money is saved out of the present income. With this practice, savings were available for use whenever needed, but it also involved the risk of loss by theft, robbery and other accidents. Thus, people were in need of a place where money could be saved safely and would be available when required. Banks are such places where people can deposit their savings with the assurance that they will be able to with draw money from the deposits whenever required. Bank is a lawful organization which accepts deposits that can be withdrawn on demand. It also tends money to individuals and business houses that need it.

Definitions of Bank

Indian Banking Companies Act - "Banking Company is one which transacts the business of banking which means the accepting for the purpose of lending or investment of deposits money from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise". . **Dictionary meaning of the Word 'Bank'** -The oxford dictionary defines a bank as "an establishment for custody of money received from or on behalf of its customers. It's essential duty is to pay their drafts on it. It's profits arises from the use of the money left employed by them".

The Webster's Dictionary Defines a bank as "an institution which trades in money, establishment for the deposit, custody and issue of money, as also for making loans and discounts and facilitating the transmission of remittances from one place to another".

According to Crowther, a bank "collects money from those who have it to spare or those who are saving it out of their incomes, and it lends this money to those who require it."

The above definitions of bank reveal that bank is a Business institution which deals in money and use of money. Thus a proper and scientific definition of the bank should include various

functions performed by a bank in a proper manner. We can say that any person, institution, company or enterprise can be a bank. The business of a bank consists of acceptance of deposits, withdrawals of deposits, Making loans and advances, investments on account of which credit is exacted by banks.

A Brief History of Banking of the World

Banking activities were sufficiently important in Babylonia in the second millennium b.c. that written standards of practice were considered necessary. These standards were part of the Code of Hammurabi – the earliest known formal laws. Obviously, these primitive banking transactions were very different in many ways to their modern-day counterparts. Deposits were not of money but of cattle, grain or other crops and eventually precious metals. Nevertheless, some of the basic concepts underlying today's banking system were present in these ancient arrangements. A wide range of deposits was accepted, loans were made, and borrowers paid interest to lenders.

Similar banking type arrangements could also be found in ancient Egypt. These arrangements stemmed from the requirement that grain harvests be stored in centralized state warehouses. Depositors could use written orders for the withdrawal of a certain quantity of grain as a means of payment. This system worked so well that it continued to exist even after private banks dealing in coinage and precious metals were established.

We can trace modern-day banking to practices in the Medieval Italian cities of Florence, Venice, and Genoa. The Italian bankers made loans to princes, both to finance wars and their lavish lifestyles, and to merchants engaged in international trade. In fact, these early banks tended to be set up by trading families as a part of their more general business activities. The Bardi and Peruzzi families were dominant in Florence in the 14th century and established branches in other parts of Europe to facilitate their trading activities.. Both these banks extended substantial loans to Edward III of England to finance the 100 years war against France.

Banks became an integral part of the US economy from the beginning of the Republic. Five years after the Declaration of Independence, the first chartered bank was established in Philadelphia in 1781, and by 1794, there were seventeen more. At first, bank charters could only be obtained through an act of legislation. But, in 1838, New York adopted the Free Banking Act, which allowed anyone to engage in banking business as long as they met certain legal specifications. As free banking quickly spread to other states, problems associated with the system soon became apparent. For example, banks incorporated under these state laws had the right to issue their own bank notes. This led to a multiplicity of notes – many of which proved to be worthless in the all too common event of a bank failure. With the Civil War came legislation that provided for a federally chartered system of banks. This legislation allowed national banks to issue notes and placed a tax on state issued bank notes. These national bank

notes came with a federal guarantee, which protected the note-holder if the bank failed. This new legislation also brought all banks under federal supervision. In essence, it laid the foundations of the present-day system.

Evolution of Banking in India

From the ancient times in India, an indigenous banking system has prevailed. The businessmen called Shroffs, Seths, Sahukars, Mahajans, Chettis etc. had been carrying on the business of banking since ancient times. These indigenous bankers included very small money lenders to shroffs with huge businesses, who carried on the large and specialized business even greater than the business of banks.

- The origin of western type commercial Banking in India dates back to the 18th century. The story of banking starts from Bank of Hindustan established in 1770 and it was first bank at Calcutta under European management. It was liquidated in 1830-32. From Bank of Hindustan in 1770, the evolution of banking in India can be divided into three different periods as follows: **Phase I:** Early phase of primitive Indian banks to Nationalization of Banks in 1969 **Phase II:** From Nationalization of India banks in 1969 up to advent of liberalization and banking reforms in 1991 **Phase III**
- The foundation of Indian **Banking dates back to 1770** when the India's first bank 'Bank of Hindustan' was established in Calcutta (Kolkata) under European Management.
- The second in line was 'General Bank of India' that was established in 1786.
- . Later, three Presidential Banks were set up in India. These were – Bank of Calcutta (1806), Bank of Bombay (1840) and Bank of Madras (1843). Of all these banks, Bank of Calcutta was quite prominent because of strategic location of Calcutta as the international trade hub of British Empire in India. These Presidential Banks were set up by the East India Company.
- In 1809, Bank of Calcutta was renamed as 'Bank of Bengal'.
- In 1839, some Indian merchants in Calcutta started a new venture 'Union Bank' but the bank failed in 1848 due to economic crisis of 1848- 49.
- In 1863, India's first joint stock bank was launched. It was called 'Upper Bank of India'.
- In 1865, Allahabad Bank was established and is currently the oldest existing Joint Stock Bank in India.
- In 1881, 'Oudh Bank' was established that was entirely managed by Indians.
- In 1895, Punjab National Bank was founded that exists even today.
- In 1911, a commercial bank named Central Bank of India was established that was wholly owned and managed by Indians.
- In 1921, the three Presidential Banks were merged to form 'Imperial Bank of India'.

- In 1926, **Young Hilton committee** was set up to suggest guidelines for forming a central bank in India.
- In 1935, Reserve Bank of India was formed on recommendation of Young Hilton committee, and was regulated by RBI Act, 1934.
- Reserve Bank of India was later nationalized in 1949 following India's independence.
- In 1955, Imperial Bank was nationalized as 'State Bank of India'
 - This was the **first phase** of Indian banking which was a very slow in development. This era saw many ups and downs in the banking scenario of the country. .
- Government of India came up with the Banking Companies Act 1949. This act was later changed to Banking Regulation (Amendment) Act 1949.
- The Banking Regulation (Amendment) Act of 1965 gave extensive powers to the Reserve Bank of India. The Reserve Bank of India was made the Central Banking Authority.
- The banking sector reforms started immediately after the independence. These reforms were basically aimed at improving the confidence level of the public as most banks were not trusted by the majority of the people. Instead, the deposits with the Postal department were considered safe.
- . The first major step was Nationalization of the Imperial Bank of India in 1955 via State Bank of India Act. State Bank of India was made to act as the principal agent of RBI and handle banking transactions of the Union and State Governments.
 - ✓ **1969 Phase II:** From Nationalization of India banks, In a major process of nationalization, 7 subsidiaries of the State Bank of India were nationalized by the Indira Gandhi regime. In 1969, 14 major private commercial banks were nationalized. These 14 banks Nationalized in 1969 are as follows:
 - Central Bank of India
 - Dena Bank
 - Syndicate Bank
 - Indian Bank
 - Bank of Baroda
 - Allahabad Bank
 - UCO Bank
 - Bank of Maharastra
 - Punjab National Bank
 - Canara Bank
 - Indian Overseas Bank
 - Union Bank
 - Union Bank of India
 - Bank of India.
- The above was followed by a second phase of nationalization in 1980, when Government of India acquired the ownership of 6 more banks, thus bringing the total number of Nationalized Banks to 20. The private banks at that time were allowed to function side by side with nationalized banks and the foreign banks were allowed to work under strict regulation.
- . After the two major phases of nationalization in India, the 80% of the banking sector came under the public sector / government ownership. .

- **The third phase** of development of banking in India started in the early 1990s when India started its economic liberalization.

TYPES OF BANKS

There are various types of banks which operate in our country to meet the financial requirements of different categories of people engaged in agriculture, business, profession etc. Banks can be classified into various types on the bases of their functions, ownership, domicile, etc.

I. Classification on the Basis of functions

Central Bank:

A central bank functions as the apex controlling institution in the banking and financial system of the country. It functions as the controller of credit, banker's bank and also enjoys the monopoly of issuing currency on behalf of the government. A central bank is usually control and quite often owned, by the government of a country. The Reserve Bank of India (RBI) is such a bank within an India.

Commercial Banks.

It operates for profit. It accepts deposits from the general public and extends loans to the households, the firms and the government. The essential characteristics of commercial banking are as follows: - Acceptance of deposits from public - For the purpose of lending or investment - Repayable on demand or lending or investment. - Withdrawal by means of an instrument, whether a cheque or otherwise. Another distinguish feature of commercial bank is that a large part of their deposits are demand deposits withdrawable and transferable by cheque.

Industrial Banks:

Industrial banks also known as investment banks mainly meet the medium term and long term financial needs of the industries. The main functions of Industrial banks are:

- a. They accept long term deposits
- b. They grant long term loans to industrialists to enable them to purchase land, construct factory buildings, purchase heavy buildings, etc.
- c. They help sell or underwrite the debentures and shares of industrial firms.
- d. They can also provide information about the general economic position of the economy:
Example: Industrial Development bank of India (IDBI); Industrial Finance Corporation of India (IFCI); State Finance Corporations (SFC)

Agricultural Banks: Agricultural credit needs are different from those of Industry and Trade. The Agriculturists require:

- ✎ Short term credit to buy seeds, fertilizers and other inputs.
- ✎ Long Term credit to purchase land, to make permanent improvements on land, To purchase agricultural machinery and equipment, etc

In India Agricultural Finance is generally provided by co-operative institutions. Agricultural co-operatives provide short-term loans and Land Development banks provide Long term credit to the agriculturists

Specialized Banks:

These banks are established and controlled under the special act of parliament. These banks have got the special status. One of the major bank is 'National Bank for Agricultural and Rural development' (NABARD) established in 1982, as an apex institution in the field of agricultural and other economic activities in rural areas. In 1990 a special bank named small industries development Bank of India (SIDBI) was established. It was the subsidiary of Industrial development Bank of India. This bank was established for providing loan facilities, discounting and rediscounting of bills, direct assistance and leasing facility.

Exchange Banks:

Exchange banks Deal in foreign exchange and specialize in financing foreign Trade. They facilitate international payments through the sale and purchase of bills of exchange and thus play an important role in promoting foreign trade.

Savings Bank: The main Purpose of saving banks is to promote saving habits among the general public and mobilize their small savings. In India, postal saving banks do this job. They open accounts and issue postal cash certificates.

World Bank: World Bank refers to an institution which provides financial assistance to the member countries of the world. After the world wide depression and World War II, two institutions were founded in 1944, a) International Monetary Fund (IMF), b) International Bank of Reconstruction and development (IBRD) or popularly known as the World Bank. While the IMF was established to provide short-term loans to overcome the balance payments difficulties, the World Bank aimed at providing long term loans for the purpose of (a) reconstructing the war-damaged economies and (b) developing the less developed economies.

II. Classification on the Basis of Ownership:

On the basis of ownership, banks can be classified into three categories:

Public Sector Banks: These are owned and controlled by the government: In India, the nationalized banks and the regional rural banks come under these categories.

Private Sector Banks: These banks are owned by the private individuals or corporations and not by the government or co-operative societies.

Co-operative Banks: Cooperative banks are operated on the co-operative lines. In India, co-operative credit institutions are organized under the co-operative societies law and play an important role in meeting the financial needs in the rural areas.

III. Classification on the basis of Domicile

On the basis of domicile, the banks are divided in to two categories:

Domestic banks: These are registered and incorporated within the country

Foreign banks: These are foreign in origin and have their head offices in the country of origin.

IV. Scheduled and Non-scheduled Banks:

A Scheduled Bank is that which has been included in the Second Schedule of the Reserve Bank of India Act, 1934 and fulfills the three conditions:

It has paid-up capital and reserves of at least of Rs 5 lakhs.

It ensures the reserve bank that its operations are not detrimental to the interest of the depositor.

It is a corporation or a cooperative society and not a partnership for single owner firm. The banks which are not included in the Second schedule of the Reserve Bank of India Act are non-scheduled banks.

COMMERCIAL BANKING STRUCTURE

The structure of banking is also called organization of banking. It differs from country to another country, depending upon economic and political conditions. Over the years, the structure of banking also has undergone tremendous changes. The following are the several systems of banking.

Unit Banking: Unit banking is a system in which a bank operates in a special area, which is smaller and limited. It operates through a single office and functions within limited resource. Unit banking is often referred to as localized banking. Unit banks may have link with a correspondent bank in the city, this arrangement helps each bank to make remittances through the correspondent banks.

Branch Banking: Branch banking is a system in which every bank work is a legal entity, having one board of directors and one of shareholders and operates through a network of branches spread throughout the country. The head office of the bank is located in a big city or state capital and the branches operate throughout the country.

Group Banking: In this system, two or three separately incorporated banks are brought under the control of a holding company. The holding company controls effectively all the units in the group but each bank has a separate entity. The holding company coordinates the activities of the banks of the group. The banks so brought together may be unit banks or branch banks or both.

Chain Banks: In this system, separately incorporated banks are brought under the common control by a device other than the holding company. For example, some group of persons may own three / four banks or some persons may be directors of several banks. Though a number of banks are brought under common control, each bank in the chain retains the separate entity and carries out the functions without the interference of any body.

Correspondent Banking System: It is a system in which unit bank in small towns are linked with big banks in big cities and they act as correspondent banks to several unit banks. It means that the unit banks maintain some deposits with big banks in the metropolitan cities. The correspondent banks provide number of special services to unit banks such as accepting the surplus reserves, remittances facilities to other banks collection of cheques, draft and bills for the unit banks and so on.

UNIT BANKING

Unit banking is a system in which a bank operates in a special area, which is smaller and limited. It operates through a single office and functions within limited resource. Unit banking is often referred to as localized banking. Unit banks may have link with a correspondent bank in

the city. This arrangement helps each bank to make remittances through the correspondent banks.

Advantages of Unit banking

- i) **Local interest:** The unit bank serves the locality much better than the branch bank. It is because the management board of the unit bank can take up the decision on the spot itself. The local officers, who are permanent officers, can take necessary action without waiting for information from the head office.
- ii) **Convenience of management, supervision and control:** The size of the bank is very small, its management, supervision and control are very easy. Along with this, wastage and delay, which are inherent weakness of branch banking, can be overcome in unit banking
- iii) **Check on the formation of monopolies:** There is a bank for each locality. In this system, there is scope for competition only. Hence, there is no possibility of the growth of monopolies.
- iv) **Quick banking services:** The services in unit banking are always quick, because the unit bank need not wait for directions from the central office. There is no delay in taking any decision regarding banking problems.
- v) **Initiative in business:** The responsibility of development of banking lies with the bank itself. Therefore, the bank officer takes personal initiative on improving the business of the bank. Since the officers are well acquainted with the local problems, they can take the initiative in solving problems and taking decisions on various issues confronting the bank. This makes the banking system more elastic than what it is under the branch banking system.
- vi) **Upholding the local interest:** The unit banks, in principle, are interested in upholding the local interest. The unit banks are mainly interested in the development of industries and agriculture keeping in view the local requirements.
- vii) **Other advantages:** Since the unit banks are small when compared to the branch bank, any loss does not cause serious havoc to the credit structure of the country. Since the affairs of the banks are less scattered, there cannot be much of fraud and irregularities. Unit banking is free from diseconomies of large scale operations which are generally associated with branch banking.

Disadvantages of Unit banking

- i) **Inability to finance large-scale development:** One of the most glaring disadvantages of unit banking is the limited financial resources. Consequently, it cannot undertake large scale investment on development activities.
- ii) **Absence of division of labour:** The unit banks are so small in size that division of labour is impossible. Consequently, it cannot maintain efficiency. It cannot afford to adopt the latest and the most up-to-date methods of banking.
- iii) **Inability to face a financial crisis:** The financial resources of the unit banks are limited. As such, in times of crisis, it fails to face the problem.

- iv) **Failure to provide protection to small units:** The unit banks being small are unable to provide full and adequate banking facilities to small units because its area of operations is restricted and does not command adequate resources.
- v) **Inconvenience in remittance of funds:** Since the unit bank has no branches elsewhere, remittance of funds becomes very difficult. It therefore depends upon correspondent banks for effecting transfer of funds from one place to another. This makes movement of funds more expensive and inconvenient for businessmen.
- vi) **Inequality in interest rates:** Interest rates charged by unit banks are higher than big banks. The interest rates are generally high in backward areas as a matter of great concern. This is due to limited financial resources on one hand and difficulty in the transfer of funds on the other.
- vii) **Yielding to influence and pressure:** Many times, the unit bank is forced to ignore economic principle while granting loans. It may be difficult for the bank to refuse an influential local businessman, who may not be so creditworthy. Under unit banking, often loans are given not on pure merit but on consideration of influence and pressures.

BRANCH BANKING

Branch banking is a system in which every bank work is a legal entity, having one board of directors and one of shareholders and operates through a network of branches spread throughout the country. The head office of the bank is located in a big city or state capital and the branches operate throughout the country. Branch banking has gone through significant changes since the 1980s in response to a more competitive nationwide financial services market. Financial innovation such as internet banking will greatly influence the future of branch banking by potentially reducing the need to maintain extensive branch networks to service consumers

Advantages of Branch Banking:

- i) **Large scale operations:** A big bank possessing large financial resources and having a number of branches can specialise in several operations. Huge financial resources enable a bank to provide agriculture and industrial loans to large number of people. It can employ and train officers to carry on increasing responsibilities in the field of financial management, bank can extend its activities allover the country with the presence of efficient staff.
- ii) **Geographical spreading of risks:** In the branch banking system, the banks can distribute risks geographically. The banks operating through several branches diversify both deposits and assets. Deposits are mobilized from places where savings are in plenty. At the same time, loans and advances are made to those areas where there is scarcity of capital and interest rates are high. Diversification implies distribution of bank loans to different industries in different areas. There by any risk of loss can be reduced.

Even, deposits of small amounts can enjoy the advantage of the services provided by big banks. Branch banking is convenient to operate, since transfer of funds is easy from one branch of a bank to another branch. Again, the financial resources of branch banks are large and can withstand any kind of financial chock and meet any emergency.

- iii) **Remittances Facilities:** In the branch banking system, the branches of banks are spread all over the country .As such; it is easier to transfer funds from one branch to another at a lesser cost. This facility is not available in the unit banking system. The unit banks provide the facility of transfer of funds through correspondent banks. But the cost of transfer of funds is high.
- iv) **Economy in cash reserves:** A large bank with a number of branches can carry on its lending operations with a small amount of cash reserves. The reason is that the requirements of anyone branch for extra cash can be easily met by transferring cash from some other branch, which happens to possess excess cash reserve. This advantage is deprived to unit banks.
- v) **Equality in interest rates:** By mans of transfer of funds from the surplus areas to the deficit areas, uniformity in the interest rates can be maintained.
- vi) **Profitable use of funds:** Capital can be profitably employed by means of transferring funds to profitable industries located in port towns/industrial cities. Branch banking ensures greater mobility of funds and profitability of investments.
- vii) **Large financial resources:** The great merit of branch banking system ties in mobilizing deposits from all parts of the country .Loans and advances can be made more liberally on a large scale in this system. It is because of the huge deposits branch banks raise that they can diversify their activities.
- viii) **Loans and advances and investments on securities:** The branch banks enjoy greater scope in the distribution of assets and thus compromise the twin conflicting principles of liquidity and profitability. The banks can invest in various securities depending on the time of maturity and the interest rates. The branches can also provide loans and advances by discounting trade bills on better terms. The selection of different types of securities imparts a higher degree of safety to the bank.
- ix) **Increase in banking facilities:** Since a bank has a number of branches spread all over the country, it can provide increasing banking facilities to the customers, even in remote parts of the country.
- x) **Greater public confidence:**A bank with huge financial resources and branches with a wide national network can command greater public confidence than small unit banks.
- xi) **Mobilization of deposits:** The success of banking depends upon the facilities to mobilize deposits from different sections of people. Branch banking can not only raise more deposits, but also diversify deposits.

- xii) **Efficiency in Management:** Branch banking can ensure maximum efficiency in management. The bank can appoint best men for top management. By providing periodical training, the officers can be made more efficient.
- xiii) **High banking standards:** Branch banking can render diversified services to all sorts of customers. Since branch banking has enormous resource, it can introduce advanced banking techniques and thereby maintain high standard of operations.
- xiv) **More effective credit control:** Branch banking makes central banking credit control measures more effective and easier than is possible with unit banks.
- xv) **Greater contacts:** Under branch banking, the bank can have wide contact with the customers. This helps the bank to acquire correct and reliable knowledge are regards the credit requirements of several segments of the economy. This knowledge helps the bank to plan for profitable investments of surplus funds.

Disadvantages of Branch banking

- i) **Difficulty in management, supervision and control:** If the expansion of the branches go beyond a limit, the administration of branches, supervision of the activities of the branches become difficult. Under expansion results in inefficient management. This also creates red tape, undue delay in decision and in action. For each and everything the branch managers seek direction from the superior officers. Ultimately, the board of management is troubled with not only decision-taking but also its day-to-day administration.
- ii) **Possibility of monopoly:** Under branch banking, there is always the possibility of large banks to become monopolies. Emergence of monopoly in banks proves detrimental to the larger interest of the country.
- iii) **Unnecessary competition:** The branches of competing banks tempt customers by offering special services and some concession. This naturally increases the expenditure of banks. Unhealthy competition may also result in the lowering of profitability.
- iv) **Expensiveness:** Branch banking is highly expensive. Maintenance of branches with several officers and supervisors for control is very expensive. They also nave spend considerable sums of money for advertisement. All these lead more expenses. The cost of control also becomes prohibitive.
- v) **Continuance of non-profitable branches:** The branches in many business places may work profitably, but the branches in residential localities and rural places may not get sufficient profitable business. As a result, the head office of the bank has to run non-profitable branches forcibly.
- vi) **Savings of rural places are transferred to urban places for investments:** Normally, the excess of deposits mobilized in rural branches are transferred to branches in big cities for investment. Investment opportunities are denied in the rural areas. Banks consider that investment of funds in bigger cities and towns are more

profitable than in smaller places and backward areas. This hinders economic development of backward areas.

Conclusion

However, the above disadvantages of branch banking are not impossible by careful planning, management and supervision. Hence, we may conclude that, "the advantages are thus overwhelmingly in favour of the branch banking system" and it is no wonder, therefore, that the banking system of most countries is tending towards branch banking.

MIXED BANKING

Mixed banking is that system of banking under which the commercial banks perform the dual function of commercial banking and investment banking, i.e., it combines deposit and lending activity with investment banking. Commercial banks usually offer both short-term as well as medium term loans. The German banking system is the best example of mixed Banking where banks are permitted besides, lending activity, investment functioning also. In India, Banks are permitted to undertake limited investment activity. In USA commercial or credit banks are not permitted to undertake investment activity. Banks in Switzerland, Denmark, Japan also provide long-term loans.

The need for mixed banking

- ✎ The need for industrial revival was felt both by the government and the banks. Many industrial units to which the banks had supplied short-term loans were not in a position to repay. So the bank took a wise step to take debentures of such companies in view of short-term loans instead of writing them off
- ✎ The deposits of commercial banks were fast increasing it was advisable for the banks to advance loans for long periods
- ✎ The growth of big industries led to a decrease in the dependence of bank finance as they built up their own surplus funds to supplement their working capital. Thus banks were deprived of their best customers. So they were compelled to grant long-term loans to big industries and gradually start holding industrial securities
- ✎ The government policy was for quick industrialization in countries like Germany and Japan. Bank undertook the responsibility of supplying long-term finance to industries for speedy industrialization
- ✎ Stock exchange was increased for the marketability of securities of joint stock companies. The bank companies as they could sell them in the stock exchange at any time and convert them into cash.

Merits:

- ✎ By providing both short term and long term finance to Industries mixed banking leads to rapid Industrialization of a country.

- ✘ Industry concerns have the advantage of receiving the expert advice and guidance of the banks on various financial matters.
- ✘ Mixed banking enables the commercial banks to utilize their funds more profitably as they have two lines of business viz 1. Commercial banking business 2. Industrial Banking business.
- ✘ Participation of commercial banks in the financing of Industries concerns creates greater confidence among the investing public and thereby industrial concerns can secure large finance from the public.

Demerits:

- ✘ It reduces the liquidity of funds of commercial banks and thereby reduces the ability of commercial banks to repay the debt of their customers on demand.
- ✘ If the industry to which a bank has lent large amount fails the profitability of the bank also will be adversely affected.
- ✘ In times of depression, the value of industrial sector falls down considerably. As a result, the commercial banks invested their funds on shares and debentures of industries concern have to suffer huge losses.
- ✘ In times of boom, commercial banking is tempted to invest their funds in Industrial sector beyond safe limits.
- ✘ Through their rep on the boards of management of Industrial concerns financed by them, commercial banks exercise direct and considerable influence on the industries. As a result industrial concerns find their freedom of action restricted.

COMMERCIAL BANKS

The Banks which perform all kinds of banking business and generally finance trade and commerce are called commercial banks. Since, their deposits are for a short period, these banks normally advance short term loans to businessmen and traders and avoid medium and long term and long term lending. However, recently. Commercial banks have also extended their areas of operation to medium term and long term finance

- ✘ A commercial bank is a financial intermediary.
- ✘ Its central objective is commercial that is, profit making.
- ✘ It takes money from a surplus unit by paying a low rate of interest and lends the same fund to a deficit unit at a higher rate of interest and thus makes profit.
- ✘ It is said to be a dealer in credit.
- ✘ It may be organized privately or by the Government.

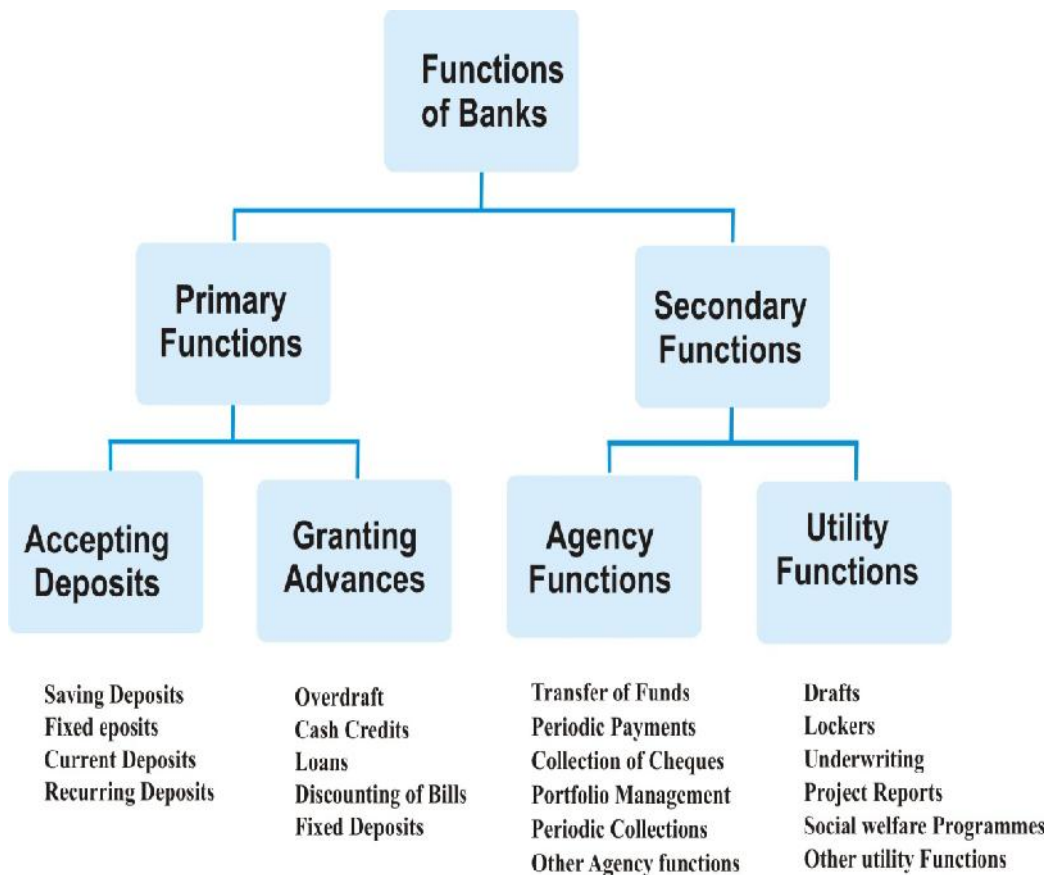
Functions of Commercial Banks:

I. Primary Functions:

1. Accepting of deposits

The following are the types of deposits:

- a) **Current deposits account:** They are, generally opened by trading and industrial concerns, public authorities, etc. Current accounts are active or running accounts which are continuously in operation. Customers can deposit any amount of money and any number of times and there is no restriction on the number of withdrawals. Current deposits are repayable on demand. It is for this reason, they are also called demand deposits or demand liabilities. So, banks are required to keep the major portion of the current deposits in liquid form. Generally no interest is allowed on current deposits.
- b) **Fixed deposit account:** They are opened by small investors who do not want invest their money in risky industrial securities, but wish to deposit their money in banks and earn good and steady income. No introduction is necessary for opening the fixed deposit accounts, as they are not operated by cheques. Fixed amounts are deposited by customers for fixed periods at fixed rate of interest. The fixed deposits can be withdrawn, not on demand, but only after the expiry of fixed periods. It is for this reason known as time deposits.



- c) **Savings deposit account:** They are opened by middle and low income groups who wish to save a part of their current incomes for their future needs and earn fair interest on their deposits. Customers can deposit any amount of money and any number of times. There are restrictions on the number as well as the amount of withdrawals from these accounts.
- d) **Recurring deposit:** It is meant for people who have regular monthly incomes. They are intended to encourage the habit of saving among the depositors on a regular basis. The depositor deposits a fixed sum of money every month for an agreed period, and at the end of the specified period, he gets back the amount deposited together with the interest accrued thereon.

2. Forms of advances

- a) **Loans:** The banker advances a lump sum for a certain period at an agreed rate of interest. The entire amount is credited to loan a/c, interest is charged on entire amount whether the borrower withdraws in full or part. The loan may be repaid in installments or at the expiry of a certain period. The loan may be made with or without security.

Loan may be a demand loan or a terms loan. Demand loan is payable on demand, it is for meeting the working capital needs of the borrower.

Term loans may be medium term or long term loan. Medium term loans are granted for a period of one year to 5 years for the purchase of vehicles, tools and equipments. Long term loans are granted for a period of more than 5 years for capital expenditure such as purchase of land, building, new machinery etc.

- b) **Cash credit:** This a permanent arrangement by which the customer is allowed to borrow money upto a certain limit, here the borrower withdraws the money as and which he requires and interest is charged only on the amount actually withdrawn. Cash credit arrangements are usually against pledge or hypothecation of goods. Cash credits are the most favourite mode of borrowing by large commercial and industrial concerns.
- c) **Overdrafts:** Overdraft is an arrangement between a banker and his customer by which the latter is allowed to withdraw over and above his credit balance in the current account upto on agreed limit. This is only a temporary accommodation/arrangements usually granted against securities. Interest is charged on the amount overdrawn.
- d) **Bills discounted and purchased:** While the traders opt for credit transaction the debtors accepts the bill drawn upon him to pay certain sum money on certain specified date by the credit-BOE. The banker discounts the BOE and credits the customer a/c, here the banker receives the interest in advance. Sometimes banks purchase the bill instead discounting them. But in almost all cases the bank holds the bill only as a security for the advance.

3. **Creation of credit:** Credit creation is an important function of commercial banks. When a commercial bank advances a loan to its customers, liquid cash will not be lent. Instead it opens an account in the borrower's name and credits his account with the amount of loan. Such a deposit is indeed credit creation and this deposit is called secondary or derivative deposit. Thus credit creation helps to increase the money supply so as to promote economic development in the country.
4. **Use of cheque system:** Commercial banks perform the unique function of issuing and collecting cheques. Deposits can be withdrawn with the help of a cheque as it is a negotiable instrument. It can be transferred easily from one person to another. It becomes the most developed credit instrument. In modern business world the use of cheques to settle debts is found to be more convenient form than the use of liquid cash.
5. **Remittance of funds:** Banks help their customers in transferring funds from one place to another by issuing bank drafts, mail transfers, telegraphic transfers and electronics transfers on nominal commission charges.

II. Secondary Functions:

The secondary functions of a modern banker may be classified into:

1. **Agency functions**
2. **Miscellaneous functions /General utility functions.**

1. Agency functions:

The banker acts as an agent to his customers.

- i) **Payment and collection of dividends, salaries, pensions, telephone bills, insurance premium etc...:** Customers can leave standing instructions with the banker for various periodic payments ensuring the regular payments and avoiding the trouble of performing it themselves.

ii) **Purchase and sales of securities:** They simply perform the function of a broker and undertake the purchase and sale of various securities like shares, stocks, debentures etc., on behalf of their customers.

iii) **Acting as executor, administrator and trustee:** An executor is a person appointed by a testator by a will to execute his will. When no will is prepared by the testator or when no executor is named in the will or when the executor named in the will is not available or willing to act as such, the court appoints a person called as administrator. A trustee is a person who is entrusted with some property by the settler of the trust for the benefit of another person called the beneficiary. A modern bank serves as a trustee of its customer.

iv) **Acting as attorney:** An attorney is a person appointed by another person by a power of attorney to act on his behalf. As an attorney of a customer, the banker is empowered to sign transfer forms in respect of sales and purchases of securities made by him on behalf of his customers.

2. Miscellaneous functions:

- i) **Safe custody of valuables:** There are 2 ways through which a banker ensures safety of its customer's valuables.

- a. By accepting valuable for safe custody.
- b. By hiring out safe deposit lockers to the customers.

ii) Letter of credit: Letter of credit assumes great importance in international trade. Letter of credit assures payment to an exporter soon after he parts with the goods and enables the importer to make payment only after he receives the goods or the document title to goods. Thus, letters of credit facilitate foreign trade.

iii) Traveler's Cheques: A traveler's cheque can be purchased by anyone, are issued in different denominations. No commission is charged on the sale of traveler's cheque, the purchaser has to deposit the money in the issuing bank equivalent to the amount of traveler's cheque, at the time of purchase as well as at the time of encashment he has to sign in the cheque. There is no expiry period, refundable, issued in single name only and not in joint names, clubs, Societies etc.

iv) Merchant Banking: It covers a wide range of activities such as management of customers services, portfolio management, credit syndication, counseling, assisting companies in matters relating to restructuring, amalgations, mergers and take over etc., preparation of project reports, project counseling, corporate counseling, issue management, pre-investment and feasibility.

v) Dealing in foreign exchange business: It includes, export finance, forward contract, issue of solvency certificates, banks get trade information and disseminate.

- vii) Leasing Finance:** The banking laws (Amendment) act, 198, enables commercial banks to carry on equipment leasing business and set up subsidiaries for carrying on such business.
- viii) Factoring:** Factoring is a 'continuing arrangement between a financial institution say, a commercial bank (called the factor) and the business concern (called the customer) selling goods and services to trade customers in which the factor purchases the book debts of his client and immediately pay the client either the full value or a substantial part of the book debts, and thereafter collects the book debts from the debtors of the client on the due dates.
- ix) Housing Finance:**
- x) Tax Consultancy:** Banks advices on income tax and other taxes, preparing customers annual statements, claiming allowances file appeals etc.,
- xi) Underwriting of securities:** Every modern banker underwrite the shares and debentures of trading companies. He also underwrites the securities of government and semi government institutions.
- xii) Credit cards:** Credit cards are issued to customers having current / saving stock. It enables a customer to purchase the goods and services upto a certain limit without making immediate payment.

- xiii) **Gift cheques:** The purchaser of the cheque need not be an account holder, it has no negotiability and its payment is made only to the payee, gifted on occasions such as wedding, birthday etc.,
- xiv) **Consultancy Function:** The consultancy service covers technical, financial, managerial and economic aspects. This service is provided small scale industries.
- xv) **Teller System:** Under this system, the teller is authorized to receive cash and make payments upto limited amounts without reference to the ledger balance or the specimen signature. Now it is automated teller system.

RESERVE BANK OF INDIA

The Reserve Bank of India Act, 1934, confers upon it the powers to act as note-issuing authority, banker's bank to the Government. As the Central Bank of the country, the Reserve Bank of India performs both the Traditional Functions of a central bank and a variety of developmental and promotional functions. The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated. Though originally privately owned, since nationalisation in 1949, the Reserve Bank is fully owned by the Government of India.

Preamble The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as: "...to regulate the issue of Bank Notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of." **Central Board** The Reserve Bank's affairs are governed by a central board of directors. The board is appointed by the Government of India in keeping with the Reserve Bank of India Act.

Functions of RBI

The functions of Reserve Bank of India (RBI) can be broadly classified into two as follows:

1) Monetary Functions

- a) Bank of Note Issue
- b) Currency Chest
- c) Banker to Government
- d) Bankers Bank
- e) Lender of the Last Resort
- f) Banker, Agent & Adviser to the Government
- g) Custodian of the Cash Reserves of Commercial Banks
- h) Custodian of Foreign Balances of the Country
- i) Controller of Credit

2) Non-Monetary Functions

- a) Supervisory Functions
- b) Promotional Functions

Monetary Functions

a) Bank of Note Issue:

Under section 22 of the Reserve Bank of India Act, the bank has the sole right to issue bank notes of all denominations. The distribution of one rupee notes and coins and small coins all over the country is undertaken by the Reserve Bank as agent of the Government. The Reserve Bank has a separate Issue Department which is entrusted with the issue of currency notes. The assets and liabilities of the Issue Department are kept separate from those of the Banking Department. Originally, the assets of the Issue Department were to consist of not less than two-fifths of gold coin, gold bullion or sterling securities provided the amount of gold was not less than Rs. 40 crores in value. The remaining three-fifths of the assets might be held in rupee coins, Government of India rupee securities, eligible bills of exchange and promissory notes payable in India. Due to the exigencies of the Second World War and the post-war period, these provisions were considerably modified. Since 1957, the Reserve Bank of India is required to maintain gold and foreign exchange reserves of Rs. 200 crores, of which at least Rs. 115 crores should be in gold. The system as it exists today is known, as the minimum reserve system.

b) **Currency Chest:** RBI has made adequate administrative arrangements for undertaking the function of distribution of currency notes & coins. The Issue department has opened its offices in 10 leading cities for this purpose. Moreover, currency chests have been maintained all over the country to facilitate the expansion and contraction of currency in the country.

c) **Banker and agent to Government:** The Reserve Bank of India is to act as Government banker, agent and adviser. The Reserve Bank has the obligation to transact Government business, via to keep the cash balances as deposits free of interest, to receive and to make payments on behalf of the Government and to carry out their exchange remittances and other banking operations. The Reserve Bank of India helps the Government—both the Union and the States to float new loans and to manage public debt. The Bank makes ways and means advances to the Governments for 90 days. It makes loans and advances to the States and local authorities. It acts as adviser to the Government on all monetary and banking matters.

d) Bankers' Bank and Lender of the Last Resort or Father of Banks:

The Reserve Bank of India acts as the bankers' bank. The RBI controls the volume of reserves of the banks and determines their deposit credit creation ability. The banks hold all/ a part of their reserves with the RBI and in times of need, they borrow from the RBI. According to the provisions of the Banking Companies Act of 1949, every scheduled bank was required to maintain with the Reserve Bank a cash balance equivalent to 5% of its demand liabilities and 2 per cent of its time liabilities in India. By an amendment of 1962, the distinction between demand and time liabilities was abolished and banks have been asked to keep cash reserves equal to 3 per cent of their aggregate deposit liabilities. The minimum cash requirements can be

changed by the Reserve Bank of India. The scheduled banks can borrow from the Reserve Bank of India on the basis of eligible securities or get financial accommodation in times of need or stringency by rediscounting bills of exchange. Since commercial banks can always expect the Reserve Bank of India to come to their help in times of banking crisis the Reserve Bank becomes not only the banker's bank but also the lender of the last resort.

e) Loans & Advances: Section 17(4) enables RBI to grant loans, & advances to the scheduled banks, repayable on demand or on the expiry of fixed periods not exceeding 90 days against the security.

f) Custodian of the Cash Reserves of Commercial Banks: All commercial banks kept part of their cash balances as deposit with the central banks of the country, either because of convention or because of legal compulsion. They regularly draw currency from the central bank during the busy season and pay in surplus currency during slack season. Parts of these balances are meant for clearing purposes. That is all commercial banks keep deposit accounts with central bank, payment by one bank to the RBI will be simple book entry adjustment in the books of the central bank. The deposit balances with central bank are considered as cash reserves for general purposes.

g) Custodian of Foreign Balances of the Country:

The Reserve Bank of India has the responsibility to maintain the official rate of exchange. According to the Reserve Bank of India Act of 1934, the Bank was required to buy and sell at fixed rates any quantity of sterling in lots of not less than Rs. 10,000. The rate of exchange fixed was Re. 1 = sh. 6d. Since 1935 the Bank was able to maintain the exchange rate fixed at 1sh. 6d though there were periods for extreme pressure in favour of or against the rupee. After India becomes a member of the International Monetary Fund in 1945, the Reserve Bank has the responsibility of maintaining fixed exchange rates with all other member countries of the International Monetary Fund (I.M.F.)

Besides maintaining the rate of exchange of the rupee, the Reserve Bank has to act as the custodian of India's reserve of international currencies. The vast sterling balances were acquired and managed by the Bank. Further, the RBI has the responsibility of administering the exchange controls of the country.

h) Controller of Credit:

The Reserve Bank of India is the controller of credit i.e. it has the power to influence the volume of credit created by banks in India. It can do so through changing the Bank rate or through open market operations. According to the Banking Regulation Act of 1949, the Reserve Bank of India can ask any particular bank or the whole banking system not to lend to particular groups or persons on the basis of certain types of securities. Since 1956, selective controls of credit are increasingly being used by the Reserve Bank.

The Reserve Bank of India is armed with many more powers to control the Indian money

market. Every bank has to get licence from the Reserve Bank of India to do banking business within India. The licence can be cancelled by the Reserve Bank if certain stipulated conditions are not fulfilled. Every bank will have to get the permission of the Reserve Bank before it can

open a new branch. Each scheduled bank must send a weekly return to the Reserve Bank showing in detail, its assets and liabilities. This power of the Reserve Bank to call for information is also intended to give it effective control of the credit system. The Reserve Bank has also the power to inspect the accounts of any commercial bank.

Non-Monetary Functions

a). **Supervisory Functions:** In addition to its traditional central banking functions, RBI has certain non-monetary functions of the nature of supervision of banks and promotion of sound banking in India. The RBI Act, 1934, and the Banking Regulation Act, 1949, have given RBI wide powers of supervision and control over commercial and co-operative banks relating to licensing and establishment, branch expansion, liquidity of their assets, management and methods of working, amalgamation, re-construction and liquidation. RBI is authorised to carry out periodical inspections of the banks and a call for returns and necessary information from them. The nationalization of 14 major Indian scheduled banks in July 1969 has imposed new responsibilities on RBI for redirecting the growth of banking and credit policies towards more rapid development of the economy and realization of certain desired social objectives. The supervisory functions of RBI have helped a great deal in improving the standard banking in India to develop on sound lines and to improve the methods of their operation.

b) Promotional Functions:

i) By encouraging the commercial banks to expand their branches in the semi-urban and rural areas, the Reserve Bank helps (i) to reduce the dependence of the people in these areas on the defective unorganized sector of indigenous bankers and money lenders, and (ii) to develop the banking habits of the people

ii) By establishing the Deposit Insurance Corporation, the Reserve Bank helps to develop the banking system of the country, instills confidence of the depositors and avoids bank failures,

iii) Through the institutions like Unit Trust of India, the (Reserve Bank helps to mobilize savings in the country,

iv) Since its inception, the Reserve Bank has been making efforts to promote institutional agricultural credit by developing cooperative credit institutions.

v) The Reserve Bank also helps to promote the process of industrialization in the country by setting up specialized institutions for industrial finance,

vi) it also undertakes measures for developing bill market in the country

Conclusion

The Central Bank is the apex monetary institution in the money market which acts as the monetary authority of the country, and serves as the government bank as well as the banker's bank. It undertakes the major financial operations of the government; by its conduct of these operations and by other means, it influences the behaviour of financial institutions to ensure that

they support the economic policy of the government. The primary focus of the RBI in conduct of money market operations is on ensuring that the liquidity and short term interest rates are maintained at levels consistent with the monetary policy objectives of maintaining price stability, ensuring adequate flow of credit to productive sectors of the economy and bringing about orderly conditions in the foreign exchange market.

DEVELOPMENT BANKS: FUNCTIONS AND STRUCTURE

Development banks or development financial institutions (DFIs) are established mainly to provide long-term capital for industry and agriculture. It has been found that commercial banks, by the short-term nature of their deposits which they mobilize, are in a position to grant only short-term credit to industry and agriculture to meet their working capital requirements. An attempt was made, initially" in Germany, to start industrial banks -or mixed banks as they were commonly called -to give long-term credit to industry; and these banks had a fair amount of success in the industrialization of Germany. But in developing countries like India it was not possible to mixed banking, even though there was a great demand for such institutions to finance economic growth. The basic reason for this was that banking habit was not fully developed and that commercial banks could not take heavy risks by freezing short-term depositors money in long-term and medium-term loans to industry and agriculture.

It was in this context that the Government of India started a series of institutions since Independence to provide term finance to industry, trade and agriculture. The Government of India along with RBI and the banking system set up the IFCI, the SFCs, the ICICI, the IDBI, the Unit Trust of India, the LIC and the GIC. All these institutions provide finance for industries. Then we have the Export - Import Bank (EXIM Bank) which specializes in international trade. We have also development banks to promote the growth of agriculture; we call them land development banks and the National Bank for Agriculture and Rural Development (NABARD). These institutions were called development banks or public sector financial institutions. However, they are now referred to as development financial institutions.

- ✎ They are development-oriented banks.
- ✎ Chief role is the promotion of economic development by way of promoting investment and enterprise.
- ✎ Specialized financial institutions which perform the twin functions of providing medium- and long-term finance to private entrepreneurs and of performing various promotional roles.
- ✎ Financial resources of development banks rose not directly from the public but from the Government of India, the RBI, other financial institutions and foreign sources (WB, IFC, IDA).
- ✎ Bonds issued by the IDBI, and the IFCI are guaranteed by the Government of India in respect of both principal and interest.

- ✎ ICICI bonds though not guaranteed by the government are treated as trustee securities.
- ✎ Rate of interest on these bonds is also the same as that on the Government of India
- ✎ bonds. As banks, they provide finance.

Development-oriented bank, its primary object is to promote economic development by promoting investment and entrepreneurial activity in a developing economy. It encourages new and small entrepreneurs and seeks balanced regional growth.

INDUSTRIAL FINANCE CORPORATION OF INDIA (IFCI)

At the time of independence in 1947, India's capital market was relatively under-developed. Although there was significant demand for new capital, there was a dearth of providers. Merchant bankers and underwriting firms were almost non-existent and commercial banks were not equipped to provide long-term industrial finance in any significant manner. It is against this backdrop that the government established The Industrial Finance Corporation of India (IFCI) on July 1, 1948, as the first Development Financial Institution in the country to cater to the long-term finance needs of the industrial sector. The newly-established DFI was provided access to low-cost funds through the central bank's Statutory Liquidity Ratio or SLR which in turn enabled it to provide loans and advances to corporate borrowers at concessional rates. By the early 1990s, it was recognized that there was need for greater flexibility to respond to the changing financial system. It was also felt that IFCI should directly access the capital markets for its funds needs. It is with this objective that the constitution of IFCI was changed in 1993 from a statutory corporation to a company under the Indian Companies Act, 1956. Subsequently, the name of the company was also changed to "IFCI Limited" with effect from October 1999.

Resources of IFCI

The shareholder of Industrial Finance Corporation of India are the IDBI (formerly these share were held by the Reserve Bank and the Central Government) and banking and other financial institutions, the resources of the corporations consist of its share capital and reserve, public deposits, advances from Reserve Bank of India, the world Bank and other international agencies and bonds and debentures issued in the open market.

Functions of IFCI

The corporation performs three important functions;

- ✎ It grants loans and advances to industrial concerns. It grants both rupee loans and foreign currency loans.
- ✎ It guarantees loans raised by the industrial concerns in the market.
- ✎ It underwrites the issue of stocks, shares, bonds, debentures of industrial concerns provided such stocks, shares etc., are disposed of by the corporation within a period of seven years from the time of acquisition. It also subscribes to the equity and preference shares and

debentures of companies. In recent years, IFCI assists industrial units under the equipment-leasing scheme.

The corporation is now permitted to subscribe directly to the shares of any concern. It can grant loans only to public limited companies. Industrial Finance Corporation: of India is authorized to give long and medium-term finance to public limited companies and co-operative societies engaged in manufacturing, mining, shipping, and generation and distribution of electricity. By an amendment to IFCI Act, Pvt. Ltd. Companies became eligible for financial assistance from IFCI

Working of IFCI

In recent years, IFCI has shown increasing concern over the development of backward districts - nearly 49% of IFCI sanctions were to assist projects in these districts.

In recent years, IFCI has stated new promotional schemes such as:

- ✎ Interest subsidy scheme for women entrepreneurs
- ✎ Consultancy fee subsidy schemes for providing marketing assistance to small-scale units;
- ✎ Encouraging the modernization of tiny, small-scale and ancillary units; and
- ✎ Control of pollution in the small and medium-scale units.

Since 1988-89, IFCI introduced two new schemes of financial assistance, viz., a scheme for equipment leasing and a scheme for equipment procurement. Under the Equipment Leasing Scheme, IFCI provides equipment (imported or indigenous) to the existing industrial concerns by financial lease. Under the equipment Procurement scheme, IFCI agrees to procure equipment and then to resell the same, by endorsement of documents, to the eligible existing industrial concerns the corporate or co-operative sectors. IFCI is also diversify its activities in the field of merchant banking to encompass other financial services, particularly project counseling, syndicate of gammadions and mergers etc.,

STATE FINANCE CORPORATIONS (SFC)

The scope of assistance provided by the Industrial Finance Corporation of India is limited since it deals with large public limited companies and co-operate societies which are engaged in manufacturing, mining, shipping and generations and distribution of electricity. But there are both small-scale and medium-size industries, which require financial assistance, and for his purpose the state governments desired to set up SFCs. The government of India passed the SFCs Act in 1951 and made it applicable to all the state except Jammu and Kashmir.

The authorized capital of a SFCs are fixed by the state government within the minimum and maximum limits of Rs.50 lakhs and Rs.5 crores and is divided into share of equal value which are taken by the respective state Government, the Reserve Bank of India, scheduled banks, co-operative banks, other financial institutions such as insurance companies, investment trusts and private parties. The shares are guaranteed by the State Governments. A SFCs can raise additional funds through issue and sale of bonds and debentures, receive public deposits, get refinance facilities from the Industrial Development Bank of India (IDBI) and borrow from the Reserve Bank of India. The management of the SFCs is similar to that of Industrial Finance Corporation of India; it has a Board of Directors, a Managing Director and Executive Committee. The Corporation can open offices at different places within the state.

Functions of the SFC

All types of industrial concerns can get accommodation from SFCs and in this sense the scope of activities of state corporations is wider than that of (IFCI). SFCs can:

- ✎ Guarantee loans raised by industrial concerns which are repayable within a period not exceeding 20 years and which are floated in the market.
- ✎ Underwrite the issue of stocks, shares, bonds or debentures of industrial concerns;
- ✎ Grant loans or advances to industrial concerns repayable within a period not exceeding 20 year; and
- ✎ Subscribe to debenture floated by industrial concerns.

A State Finance Corporation is however, prohibited from subscribing directly to the shares or stocks of any company having limited liability except for underwriting purpose any loans or advances on the security of its own shares. Some State Finance Corporations act as agents for their respective state governments for sanctioning and disbursing loans to small-scale industries.

MONEY MARKET

Introduction:

Money market is a segment of financial market. The term 'Money Market' does not refer to any particular place or office where money is bought and sold. It refers to any activity, i.e., the 'borrowing and lending of short-term funds against short-term credit instruments, such as treasury bills, bills of exchange, bankers' acceptances, short-term government securities, etc.

. It is a market for short term funds. It deals with all transactions in short term securities. These transactions have a maturity period of one year or less. Examples are bills of exchange, treasury bills etc. These short term instruments can be converted into money at low transaction cost and without much loss. Thus, money market is a market for short term financial securities that are equal to money.

Definition of Money Market:

According to Crowther, "Money market is a collective name given to various firms and institutions that deal in the various grades of near money".

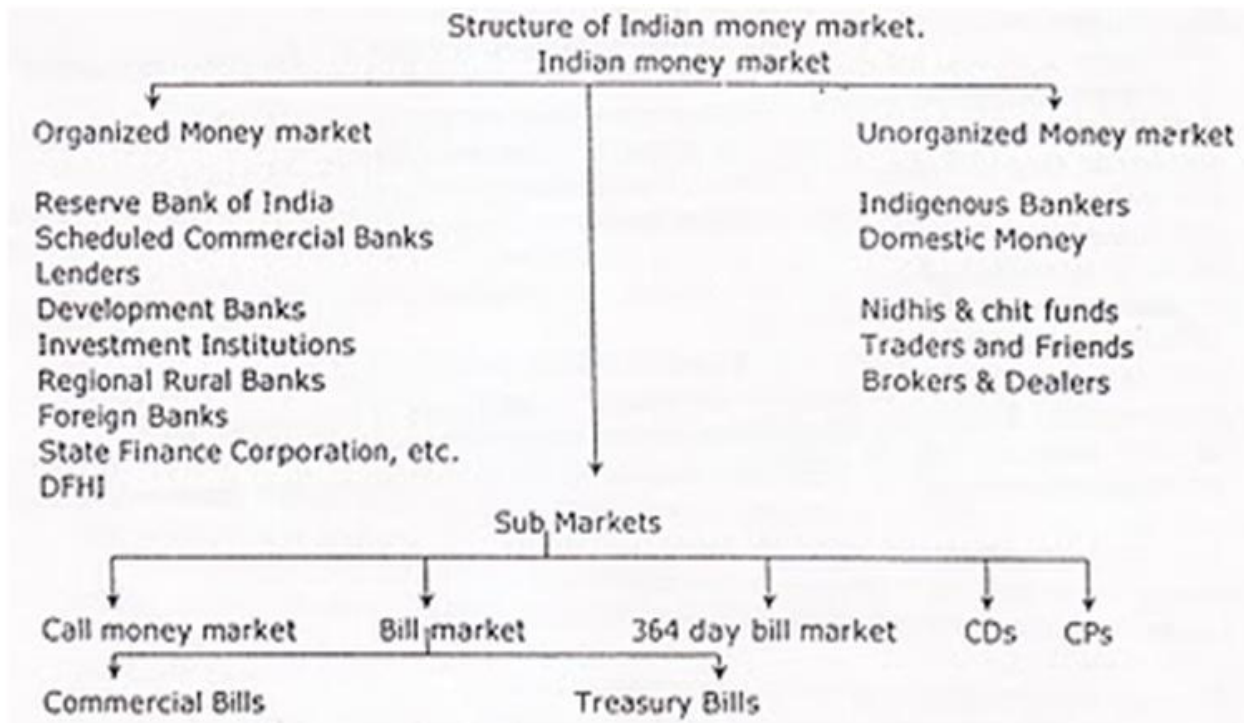
Features of Money Market

- ✎ Money market is concerned with the borrowing and lending of short-term funds only.
- ✎ For the borrowing and lending funds, it is not necessary that the borrower and the lender should meet each other face to face at a particular place. They can carry on negotiations and effect their financial transactions through telephone, telegram, mail or any other means of communication.
- ✎ A money market is not a single homogeneous market. It is composed of several specialized sub-markets, such as call market, treasury bill market, discount market, collateral loan market, etc.
- ✎ As in any other market, in the money market also, there is a price for the money borrowed and lent. That price is called interest.

- ✘ There are a large number of borrowers and lenders in the money market.
- ✘ A large volume of short-term funds is traded in money market.
- ✘ Money market is the source of working capital finance. It is the major of working capital finance.

Structure and components of Indian Money Market

The entire money market in India can be divided into two parts. They are organized money market and the unorganized money market. The unorganized money market can also be known as an unauthorized money market. Both of these components comprise several constituents. The following chart will help you in understanding the organizational structure of the Indian money market.



Organized Sector of Money Market:-

Organized Money Market is not a single market, it consist of number of markets. The most important feature of money market instrument is that it is liquid. It is characterised by high degree of safety of principal. Following are the instruments which are traded in money market

Call and Notice Money Market:-

It an important sub market of the Indian money market. It is also known as money at call and money at short notice. It is also called inter bank loan market. In this market money is demanded for extremely short period. The duration of such transactions is from few hours to 14 days. It is basically located in the industrial and commercial locations such as Mumbai, Delhi, Calcutta, etc. These transactions help stock brokers and dealers to fulfill their financial requirements. The

rate at which money is made available is called as a call rate. Thus rate is fixed by the market forces such as the demand for and supply of money.

Call money markets are located in big commercial centers like Mumbai, Kolkata, Chennai, Delhi etc. Call money market is the indicator of liquidity position of money market. RBI intervenes in call money market as there is close link between the call money market and other segments of money market.

Treasury bill Market (T - Bills):-

This market deals in Treasury Bills of short term duration issued by RBI on behalf of Government of India. At present three types of treasury bills are issued through auctions, namely 91 day, 182 day and 364 day treasury bills. State government does not issue any treasury bills. Interest is determined by market forces. Treasury bills are available for a minimum amount of Rs. 25,000 and in multiples of Rs. 25,000. Periodic auctions are held for their Issue.

T-bills are highly liquid, readily available; there is absence of risk of default. In India T-bills have narrow market and are undeveloped. Commercial Banks, Primary Dealers, Mutual Funds, Corporates, Financial Institutions, Provident or Pension Funds and Insurance Companies can participate in T-bills market.

Commercial Bills :-

Commercial bills are short term, negotiable and self liquidating money market instruments with low risk. A bill of exchange is drawn by a seller on the buyer to make payment within a certain period of time. Generally, the maturity period is of three months. Commercial bill can be resold a number of times during the nuance period of bill. The commercial bills are purchased and discounted by commercial banks and are rediscounted by financial institutions like EXIM banks, SIDBI, IDBI etc.

In India, the commercial bill market is very much underdeveloped. RBI is trying to develop the bill market in our country. RBI have introduced an innovative instrument known as "Derivative .Usance Promissory Notes, with a view to eliminate movement of papers and to facilitate multiple rediscounting.

Certificate of Deposits (CDs) :-

CDs are issued by Commercial banks and development financial institutions. CDs are unsecured, negotiable promissory notes issued at a discount to the face value. The scheme of CDs was introduced in 1989 by RBI. The main purpose was to enable the commercial banks to raise funds from market. At present, the maturity period of CDs ranges from 3 months to 1 year. They are issued in multiples of Rs. 25 lakh subject to a minimum size of Rs. 1 crore. CDs can be issued at discount to face value. They are freely transferable but only after the lock-in-period of 45 days after the date of issue. In India the size of CDs market is quite small.

In 1992, RBI allowed four financial institutions ICICI, IDBI, IFCI and IRBI to issue CDs with a maturity period of. one year to three years.

Commercial Papers (CP):-

Commercial Papers were introduced in January 1990. The Commercial Papers can be issued by listed companies which have working capital of not less than Rs. 5 crores. They could be issued in multiple of Rs. 25 lakhs. The minimum size of issue being Rs. 1 crore. At present the

maturity period of CPs ranges between 7 days to 1 year. CPs are issued at a discount to its face value and redeemed at its face value.

Money Market Mutual Funds (MMMFs):-

A Scheme of MMMFs was introduced by RBI in 1992. The goal was to provide an additional short-term avenue to individual investors. In November 1995 RBI made the scheme more flexible. The existing guidelines allow banks, public financial institutions and also private sector institutions to set up MMMFs. The ceiling of Rs. 50 crores on the size of MMMFs stipulated earlier, has been withdrawn. MMMFs are allowed to issue units to corporate enterprises and others on par with other mutual funds. Resources mobilised by MMMFs are now required to be invested in call money, CD, CPs, Commercial Bills arising out of genuine trade transactions, treasury bills and government dated securities having an unexpired maturity upto one year. Since March 7, 2000 MMMFs have been brought under the purview of SEBI regulations. At present there are 3 MMMFs in operation.

The Repo Market

Repo was introduced in December 1992. Repo is a repurchase agreement. It means selling a security under an agreement to repurchase it at a predetermined date and rate. Repo transactions are affected between banks and financial institutions and among bank themselves, RBI also undertake Repo.

In November 1996, RBI introduced Reverse Repo. It means buying a security on a spot basis with a commitment to resell on a forward basis. Reverse Repo transactions are affected with scheduled commercial banks and primary dealers.

In March 2003, to broaden the Repo market, RBI allowed NBFCs, Mutual Funds, Housing Finance and Companies and Insurance Companies to undertake REPO transactions.

Discount and Finance House of India (DFHI)

In 1988, DFHI was set up by RBI. It is jointly owned by RBI, public sector banks and all India financial institutions which have contributed to its paid up capital. It is playing an important role in developing an active secondary market in Money Market Instruments. In February 1996, it was accredited as a Primary Dealer (PD). The DFHI deals in treasury bills, commercial bills, CDs, CPs, short term deposits, call money market and government securities.

II. Unorganized Sector of Money Market:-

The economy on one hand performs through organized sector and on other hand in rural areas there is continuance of unorganized, informal and indigenous sector. The unorganized money market mostly finances short-term financial needs of farmers and small businessmen. The main constituents of unorganized money market are:-

Indigenous Bankers (IBs)

Indigenous bankers are individuals or private firms who receive deposits and give loans and thereby operate as banks. IBs accept deposits as well as lend money. They mostly operate in urban areas, especially in western and southern regions of the country. The volume of their credit operations is however not known. Further their lending operations are completely unsupervised and unregulated. Over the years, the significance of IBs has declined due to growing organised banking sector.

Money Lenders (MLs)

They are those whose primary business is money lending. Money lending in India is very popular both in urban and rural areas. Interest rates are generally high. Large amount of loans are given for unproductive purposes. The operations of money lenders are prompt, informal and flexible. The borrowers are mostly poor farmers, artisans, petty traders and manual workers. Over the years the role of money lenders has declined due to the growing importance of organized banking sector.

Non - Banking Financial Companies (NBFCs)

Non Banking Financial Companies consist of:-

Chit Funds

Chit funds are savings institutions. It has regular members who make periodic subscriptions to the fund. The beneficiary may be selected by drawing of lots. Chit fund is more popular in Kerala and Tamilnadu. RBI has no control over the lending activities of chit funds.

Nidhis

Nidhis operate as a kind of mutual benefit for their members only. The loans are given to members at a reasonable rate of interest. Nidhis operate particularly in South India.

Loan or Finance Companies

Loan companies are found in all parts of the country. Their total capital consists of borrowings, deposits and owned funds. They give loans to retailers, wholesalers, artisans and self employed persons. They offer a high rate of interest along with other incentives to attract deposits. They charge high rate of interest varying from 36% to 48% p.a.

Finance Brokers

They are found in all major urban markets specially in cloth, grain and commodity markets. They act as middlemen between lenders and borrowers. They charge commission for their services.

FEATURES Or DEFICIENCIES OF INDIAN MONEY MARKET

Indian money market is relatively underdeveloped when compared with advanced markets like New York and London Money Markets. Its' main features / defects are as follows

i) Dichotomy:-

A major feature of Indian Money Market is the existence of dichotomy i.e. existence of two markets: -Organized Money Market and Unorganized Money Market. Organized Sector consist of RBI, Commercial Banks, Financial Institutions etc. The Unorganized Sector consists of IBs, MLs, Chit Funds, Nidhis etc. It is difficult for RBI to integrate the Organized and Unorganized Money Markets. Several segments are loosely connected with each other. Thus there is dichotomy in Indian Money Market.

ii) Lack of Co-ordination and Integration :-

It is difficult for RBI to integrate the organized and unorganized sector of money market. RBT is fully effective in organized sector but unorganized market is out of RBI's control. Thus

there is lack of integration between various sub-markets as well as various institutions and agencies. There is less co-ordination between co-operative and commercial banks as well as State and Foreign banks. The indigenous bankers have their own ways of doing business.

iii) Diversity in Interest Rates :-

There are different rates of interest existing in different segments of money market. In rural unorganized sectors the rate of interest are high and they differ with the purpose and borrower. There are differences in the interest rates within the organized sector also. Although wide differences have been narrowed down, yet the existing differences do hamper the efficiency of money market.

iv) Seasonality of Money Market :-

Indian agriculture is busy during the period November to June resulting in heavy demand for funds. During this period money market suffers from Monetary Shortage resulting in high rate of interest. During slack season rate of interest falls & there are plenty of funds available. RBI has taken steps to reduce the seasonal fluctuations, but still the variations exist.

v) Shortage of Funds :-

In Indian Money Market demand for funds exceeds the supply. There is shortage of funds in Indian Money Market an account of various factors like inadequate banking facilities, low savings, lack of banking habits, existence of parallel economy etc. There is also vast amount of black money in the country which have caused shortage of funds. However, in recent years development of banking has improved the mobilization of funds to some extent.

vi) Absence of Organized Bill Market :-

A bill market refers to a mechanism where bills of exchange are purchased and discounted by banks in India. A bill market provides short term funds to businessmen. The bill market in India is not popular due to overdependence of cash transactions, high discounting rates, problem of dishonour of bills etc.

vii) Inadequate Banking Facilities :-

Though the commercial banks, have been opened on a large scale, yet banking facilities are inadequate in our country. The rural areas are not covered due to poverty. Their savings are very small and mobilisation of small savings is difficult. The involvement of banking system in different scams and the failure of RBI to prevent these abuses of banking system shows that Indian banking system is not yet a well organized sector.

viii) Inefficient And Corrupt Management :-

One of the major problems of Indian Money Market is its inefficient and corrupt management. Inefficiency is due to faulty selection, lack of training, poor performance appraisal, faulty promotions etc. For the growth and success of money market, there is need for well trained and dedicated workforce in banks. However, in India some of the bank officials are inefficient and corrupt.

Conclusion:-

The above features / defects of Indian Money Market clearly indicate that it is relatively less developed and has yet to acquire sufficient depth and width. The deficiencies are slowly and steadily overcome by policy measures undertaken by RBI from time to time.

Module II

Recent Trends in Banking:

Today, banking business is becoming more a cross-border game. The banking sector has experienced a process of significant structural transformations in the last few decades. With the potential to become the fifth largest banking industry in the world by 2020 and third largest by 2025, India's banking and financial sector is expanding rapidly. Great changes have taken place in the banking industry such as deregulation of financial institutions with regard to their pricing decisions, financial innovation involving the development of new processes and financial instruments, and globalization so that most major banks operate throughout the world rather than in one country. Indian banking sector has made rapid strides in reforming itself to the new competitive business environment which changed its approach from "conventional banking to convenience banking" and "mass banking to class banking." Banking is re-defined and re-engineered with the development of sophisticated instruments and innovations in market practices. The major innovations and practices in the banking industry may be listed as follows:

- Electronic Banking (E-Banking)
- Tele Banking
- Mobile Banking (M-Banking)
- Consortium Banking
- Social Banking
- Debit Cards
- Credit Cards
- Automated Teller Machine (ATM)
- E-Purse
- Electronic Fund Transfer System (EFTS)
- Real Time Gross Settlement (RTGS)
- Cheque Truncation System (CTS)
- Non Performing Assets (NPA)
- Capital Adequacy Ratio
- Banking Ombudsman
- Banking Sector Reforms in India

E-Banking:

Electronic banking (E-banking) is a method of banking in which the customer conducts transactions electronically via the Internet. It is a system that allows the individuals to [perform banking activities](#) at their convenient place, via the internet. It is the automated delivery of banking products and services directly to customers through electronic, interactive communication channels. Online banking enables the [customers](#) to perform all routine [transactions](#) anytime, day or night, and can be done from anywhere. E-banking is also referred as online banking, internet banking, virtual banking etc.

To access a financial institution's online banking facility, a customer would need to register with the institution for the service, and set up some password for customer verification. The online banking facilities offered by various financial institutions have many features and capabilities in common. The common features include:

1. Bank customers can perform non-transactional tasks through online banking including: (a) viewing account balances, (b) viewing recent transactions, (c) ordering cheque books, and (d) download periodic account statements.
2. Bank customers can transact banking tasks through online banking including: (a) [fund transfers](#) between the customer's linked accounts, (b) paying third parties, including [bill payments](#), (c) investment purchase or sale, (d) loan applications and transactions, (e) credit card applications, and (f) register utility billers and make bill payments.

Today, many banks are internet only banks. Unlike their predecessors, these internet only banks do not maintain brick and mortar bank branches. Instead, they typically differentiate themselves by offering better and more extensive online banking features. Security of customers' financial information is very important without which, online banking could not operate. The use of a [secure website](#) has become almost universally adopted to reduce the risk of unauthorised online access to a customer's records.

Tele Banking:

Telephone banking (Tele banking) is a service provided by a [bank](#) or other [financial institution](#) that enables the [customers](#) to perform their [financial transactions](#) over the telephone, without the need to visit a [bank branch](#). It refers to the use of a system to allow customers of a bank to process various banking procedures over the telephone. All the transactions can be done in the comfort of one's home using only a touch-tone telephone. The ease of access for services is one of the major advantages that telephone banking can provide for customers.

From the bank's point of view, telephone banking reduces the cost of handling transactions by reducing the need for customers to visit a bank branch for non-cash withdrawal or deposit transactions. To use a financial institution's telephone banking facility, a customer must first register with the institution for the service, and set up some password for customer verification. Most telephone banking services use an automated phone answering system with phone keypad response or [voice recognition capability](#). To access telephone banking, the customer would call the special phone number set up by the financial institution. The service can be provided using an automated system, using speech recognition or by live [customer service](#) representatives.

The types of financial transactions which a customer may transact through telephone banking include obtaining account balances and list of latest transactions, [electronic bill payments](#), and [funds transfers](#) between a customer's or another's [accounts](#). Cash withdrawals and deposits require the customer to visit a bank branch or an Automated Teller Machine (ATM). Banking

over a telephone system can often be more convenient than banking in person, since some functions can be accessed even when a bank is closed.

M-Banking:

Mobile banking (M-banking) is a system that allows customers of a [financial institution](#) to conduct a number of financial transactions through a mobile device such as a [mobile phone](#) or [tablet](#) through specifically designed Mobile Banking Apps. It is the most convenient and easy way to stay connected with the bank. It refers to provision and availing of banking and financial services with the help of mobile telecommunication devices. The scope of offered services may include facilities to conduct bank and stock market transactions, to administer accounts and to access customised information. Mobile banking has until 2010 most often been performed via SMS, known as SMS Banking.

The typical mobile banking services may include: (1) Mini-statements and checking of account history, (2) [Funds transfers](#) between the customer's linked accounts, (3) Paying third parties, including [bill payments](#) and third party [fund transfers](#), (4) Alerts on account activity or passing of set thresholds, (5) Cheque book and card requests, (6) Access to loan statements, (7) Access to card statements, (8) Status of requests for credit, including mortgage approval, and insurance coverage, (9) [Mutual funds](#)/equity statements, (10) Real-time stock quotes, (11) Personalised alerts and notifications on security prices, (12) Monitoring of term deposits (13) Portfolio management services, (14) ATM Location etc.

With the advent of technology and increasing use of smart phone and tablet based devices, the use of mobile banking functionality would enable customers connect across various services. The rapid growth of smart phones based on [Google's Android Operating System](#) have led to the increasing use of special client programs, called 'Apps' downloaded to the mobile devices. With further advancements in web technologies, more and more banks are launching mobile web based services. But, mobile banking is attractive and popular mainly among the younger and 'tech-savvy' customers.

Consortium Banking:

Consortium is an association or group of independent members with the objective of participating in a common activity or joint venture by pooling their resources for achieving a common goal and mutual benefit. *Consortium* is a [Latin](#) word, meaning '[partnership](#)' or 'association' where the members co-operate with one another and conduct the operations that they would not be able to do individually. Consortium banking implies the collaboration of a group of banks to make a loan. It is created to fund a specific project or to execute a specific deal. It is also known as 'loan syndication' where two or more banks come together to finance big projects requiring huge amount of money.

The consortium leverages individual banks' assets to achieve its objectives. All member banks have equal ownership shares – no one member has a controlling interest. It shares the

security interest in common. After the bank's objective is met the consortium typically dissolves. Consortium lending is usually done by smaller banks to reap an opportunity to be a part of a big project financing by distributing the risks among the collaborator banks. By resorting to consortium lending, the banks not only saves their prospective customers but also builds good relations with other banks.

There is little bit difference between consortium banking and multiple banking. Under consortium banking, several banks or financial institutions finance a single borrower with common appraisal, common documentation, joint supervision and follow-up exercise. But in multiple banking, different banks provide finance and different banking facilities to a single borrower without having a common arrangement and understanding between the lenders.

Social Banking:

Social banking is rightly defined by Roland Benediktar as “banking with a conscience.” It calls for a move towards a more social and environmental responsibility in the financial sector beyond the principles of conventional business management. It is also known as ethical/alternative/civic/ sustainable banking. Social banking policies were made to shift the focus of commercial banks from ‘selective banking’ to ‘mass banking.’ In their financing, it deals with sustainable and socially responsible projects which have particular dimensions of environmental assumptions and notions like justice and equality. Social or ethical banks do share a common set of principles, the most prominent being [transparency](#) and social or environmental aims of the projects they finance.

Social Banking describes the provision of banking and financial services that consequently pursue, as their main objective, a positive contribution to the potential of all human beings to develop, today and in the future. In Social Banking, the focus is on satisfying existing needs in the real economy and the society whilst simultaneously taking into account their social, cultural, ecological and economic sustainability. Social banking focuses on investing in community, providing opportunities for the disadvantaged, and supporting social, environmental and ethical concerns.

Social Banking describes a process, not a steady state. It is about jointly identifying and testing creative new ways to create social and environmental screens. The kind of analysis that conventional banks generally partake is a ‘single [bottom line](#) analysis’ which only considers the financial performance. But, social or sustainable banks consider a ‘[triple bottom line](#) analysis’ that takes into account the environmental, social, and financial performance.

Debit Cards:

A debit card is a [plastic payment card](#) that provides the cardholder electronic access to their [bank account](#) at a financial institution. Most cards relay a message to the cardholder's bank to withdraw funds from a payer's designated bank account. Debit cards usually allow for instant

withdrawal of cash, acting as the [ATM card](#) for withdrawing cash. The card, where accepted, can be used instead of [cash](#) when making purchases. Unlike credit and charge cards, payments using a debit card are immediately transferred from the cardholder's designated bank account, instead of them paying the money back at a later date.

There are currently three ways that debit card transactions are processed, namely, (i) *Online debit* or *PIN debit*, (ii) *Offline debit* or *signature debit*, and (iii) The Electronic Purse System. One physical card can include the functions of all three types, so that it can be used in a number of different circumstances. In many countries, the use of debit cards has become so widespread that their volume has overtaken or entirely replaced [cheques](#) and, in some instances, cash transactions. Although many debit cards are of the [Visa](#) or [Master Card](#) brand, there are many other types of debit card, each accepted only within a particular country or region. The [National Payments Corporation of India](#) (NPCI) has launched a new card called [RuPay](#).

Debit cards may also be used on the Internet. Internet purchases can be authenticated by the consumer entering their PIN. The online debit cards require electronic authorization of every transaction and the debits are reflected in the user's account immediately. The transaction may be additionally secured with the [personal identification number](#) (PIN) [authentication](#) system.

Credit Cards:

A credit card is a [payment card](#) issued to users as a system of [payment](#). It allows the cardholder to pay for goods and services based on the holder's promise to pay for them. The issuer of the card creates a [revolving account](#) and grants a [line of credit](#) to the user from which he can borrow money for payment to a [merchant](#) or as a [cash advance](#) to the user. Credit cards may be treated as 'convenient credit' that allow the consumers a continuing balance of debt, subject to [interest](#) being charged. It can be used like currency by the owner of the card. It typically involves a third-party entity that pays the seller and is reimbursed by the buyer.

Credit cards may simply serve as a form of [revolving credit](#). The main benefit to the cardholder is convenience. Compared to debit cards and checks, a credit card allows small short-term loans to be quickly made to a cardholder who need not calculate a balance remaining before every transaction, provided the total charges do not exceed the maximum credit line for the card. A credit card issuing company, such as a bank or credit union, would enter into agreements with merchants for them to accept their credit cards. Each month, the cardholder is sent a statement indicating the purchases made with the card, any outstanding fees, and the total amount owed.

[Electronic verification](#) systems allow merchants to verify in a few seconds that the card is valid and the cardholder has sufficient credit to cover the purchase, allowing the verification to happen at time of purchase. The verification is performed using a [credit card payment terminal](#) or [point-of-sale](#) (POS) system with a communications link to the merchant's acquiring bank. Credit card issuers usually waive interest charges if the balance is paid in full each month, but typically

will charge full interest on the entire outstanding balance from the date of each purchase if the total balance is not paid.

Credit cards are accepted in larger establishments in almost all countries, and are available with a variety of credit limits and repayment arrangements. Many credit cards offer rewards and benefits packages, such as enhanced product warranties at no cost, free loss/damage coverage on new purchases and various insurance protections. Credit cards can also offer a [loyalty program](#), where each purchase is rewarded with points, which may be redeemed for further [goods](#) and [services](#) or [cash back](#).

ATM:

An Automated Teller Machine (ATM) is an electronic telecommunication device that enables the customers of a [financial institution](#) to perform [financial transactions](#) without the need for a human [cashier](#), clerk or [bank teller](#). It is also known as Automated Banking Machine (ABM). Using an ATM, customers can access their bank deposit or credit accounts in order to make a variety of transactions such as withdrawals, check balances, getting mini statements, etc. Most ATMs are connected to [interbank networks](#), enabling people to withdraw and deposit money from machines not belonging to the bank where they have their accounts or in the countries where their accounts are held (enabling cash withdrawals in local currency).

On most modern ATMs, the customer is identified by inserting a plastic [ATM card](#) with a [magnetic stripe](#) or a plastic [smart card](#) with a [chip](#) that contains a unique card number and some security information. An ATM card is any [payment card](#) issued by a [financial institution](#) that enables a customer to access an [Automated Teller Machine](#) (ATM) in order to perform transactions such as deposits, cash withdrawals, obtaining account information, etc. It is also known as Bank Card, Money Access Card, Key Card or Cash Card. Most ATM cards today are [Bank Cards](#) such as [debit](#) or [credit cards](#) that have been ATM-enabled. Unlike an offline [bank card](#) that is signature based, an ATM card require authentication through a [personal identification number](#) (PIN).

[Interbank networks](#) allow the use of ATM cards at ATMs of financial institutions other than those of the institution that issued the cards. In some banking networks, the two functions of ATM cards and debit cards are combined into a single card called simply as a Debit Card or also commonly called as Bank Card. These are able to perform banking tasks at ATMs and also make point-of-sale transactions, with both features using a PIN. ATM cards can also be used on merchants' card terminals that deliver ATM features without any [cash drawer](#). These terminals can also be used as cashless [scrip](#) ATMs by cashing the receipts they issue at the merchant's [point of sale](#).

E-Purse:

An electronic purse is the store of value on a card, which can be used in a manner similar to cash to pay for travel or for other small-scale transactions. Electronic purse is the secure

information stored in a dedicated area or file of a smart-card. The value is placed on the card in one of three ways: (i) Preloaded on to the card (in the same manner as telephone cards), without the possibility to add further value. The intention is that the card is discarded when the value is expired, (ii) Added to the card at the time the card is issued, or when the e-purse application is added to an existing card, and (iii) Additional value added to an existing e-purse or top-up.

There are different concepts for electronic purse, which centre on the nature of the value. The main types are:

1. **Tokens:** The purse consists of units that have no monetary value. The units can be equivalent to individual journeys, or to money units. When the card is presented for travel, the number of units required for the applicable fare is deducted. Eventually, when all of the units have been deducted, the card is no longer usable for travel.

2. **Transport money:** The purse consists of units equivalent to money, but it can only be used for passenger transport fares. Depending on the context, this could include multiple modes, park and ride, and car parking. Although presented to the user in terms of cash equivalent, it does not have any monetary validity outside the immediate transport environment.

3. **Transport and Micro Purchases:** The purse contains units equivalent to money. The primary usage is for payment of passenger transport services. The value can also be used for small purchases at non-transport locations like kiosks and vending machines. There is likely to be a modest upper limit on the value that can be loaded to the card at any given time.

4. **E-Cash:** The purse contains electronic money, which has full monetary value, is usable at any outlet with an accepting device, and is at any time exchangeable for cash. Transport may be just one of a number of items where the e-cash can be used, and might not even be the main usage. The e-cash is subject to banking regulations, and would have to be issued and underwritten by a bank.

Though the handling requires a substantial level of technical competence, the major benefits of electronic purse are:

- Cash handling is reduced as customers migrate to prepaid tickets.
- High degree of security.
- Innovative means of adding/renewing value can be utilized.
- Electronic purse can be offered for infrequent customers when it is desired to eliminate all cash transactions.
- Third parties can become involved in issuing value.
- Incentives such as free transfers, discounts and fare-capping can be offered to the customer in a secure and consistent way.

NEFT:

National Electronic Funds Transfer (NEFT) is a nation-wide payment system facilitating one-to-one funds transfer. Under this Scheme, individuals, firms and corporates can electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country participating in the Scheme. NEFT is a credit-push system i.e., transactions can be originated by the payer or remitter.

The NEFT system takes advantage of the core banking system in banks. Accordingly, the settlement of funds between originating and receiving banks takes place centrally at Mumbai, whereas the branches participating in NEFT can be located anywhere across the length and breadth of the country. For being part of the NEFT funds transfer network, a bank branch has to be NEFT-enabled. Indian Financial System Code (IFSC) is an alpha-numeric code that uniquely identifies a bank-branch participating in the NEFT system. This is an 11 digit code with the first 4 alpha characters representing the bank, and the last 6 characters representing the branch. The 5th character is 0 (zero). IFSC is used by the NEFT system to identify the originating/destination banks/branches and also to route the messages appropriately to the concerned banks/branches.

Presently, NEFT operates in hourly batches – there are twelve settlements from 8 am to 7 pm on week days (Monday through Friday) and six settlements from 8 am to 1 pm on Saturdays. The beneficiary can expect to get credit for the NEFT transactions within two business hours. There is no limit – either minimum or maximum – on the amount of funds that could be transferred using NEFT. However, maximum amount per transaction is limited to Rs. 200000.

NEFT offers many advantages to the customers over the other modes of funds transfer as listed below:

- 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.

Besides personal funds transfer, the NEFT system can also be used for a variety of transaction including payment of credit card dues to the card issuing banks, payment of loan EMI etc. It is necessary to quote the IFSC of the beneficiary card issuing bank to initiate the bill payment transactions using NEFT.

RTGS:

Real Time Gross Settlement (RTGS) can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting). 'Real Time' means the processing of instructions at the time they are received rather than at some later time and 'Gross Settlement' means the settlement of funds transfer instructions occurs individually (on an instruction by instruction basis). The RTGS system is primarily meant for large value transactions. The minimum amount to be remitted through RTGS is Rs. 2 lakh. There is no upper ceiling for RTGS transactions.

Under normal circumstances the beneficiary branches are expected to receive the funds in real time as soon as funds are transferred by the remitting bank. The beneficiary bank has to credit the beneficiary's account within 30 minutes of receiving the funds transfer message. The RTGS service window for customer's transactions is available to banks from 9.00 hours to 16.30 hours on week days and from 9.00 hours to 14:00 hours on Saturdays for settlement at the RBI end. However, the timings that the banks follow may vary depending on the customer timings of the bank branches.

There is a fundamental difference between NEFT and RTGS. NEFT is an electronic fund transfer system that operates on a Deferred Net Settlement (DNS) basis which settles transactions in batches. In DNS, the settlement takes place with all transactions received till the particular cut-off time. These transactions are netted (payable and receivables) in NEFT whereas in RTGS the transactions are settled individually. For example, currently, NEFT operates in hourly batches. Any transaction initiated after a designated settlement time would have to wait till the next designated settlement time. Contrary to this, in the RTGS transactions are processed continuously throughout the RTGS business hours.

Cheque Truncation System:

Cheque Truncation System (CTS) or Image-based Clearing System (ICS) in India is a project undertaken by the [Reserve Bank of India](#) (RBI) in 2008 for the faster clearing of cheques. [Cheque truncation](#) means, stopping the flow of the physical cheques issued by a drawer to the drawee branch. The physical instrument is truncated at some point enroute to the drawee branch and an electronic image of the cheque is sent to the drawee branch along with the relevant information. This would eliminate the need to move the physical instruments across branches, except in exceptional circumstances. CTS is based on online image-based cheque clearing system where cheque images and [Magnetic Ink Character Recognition \(MICR\)](#) data are captured at the collecting bank branch and transmitted electronically.

Before CTS, to settle a cheque, it has to be presented to the drawee [bank](#) for payment. Originally this was done by taking the cheque to the drawee bank, however as cheque usage increased this became cumbersome and banks arranged to meet each day at a central location to exchange cheques and settle the money. This became known as [central clearing](#). Bank customers

who received cheques could deposit them at their own bank, who would arrange for the cheque to be returned to the drawee bank and the money credited to and debited from the appropriate accounts. If a cheque was [dishonoured](#) or bounced it would be physically returned to the original bank marked as such. This process would take several days, as the cheques had to be transported to the central clearing location, from where they were taken to the payee bank. If the cheque bounced, it would be sent back to the bank where the cheque was deposited. This is known as the clearing cycle. Cheques had to be examined by hand at each stage, which required a large amount of manpower.

In 1960, machine readable codes were added to the bottom of cheques in [MICR](#) format, which allowed the clearing and sorting process to be automated. This helped to speed up the clearing process; however the law in most countries still required the cheques to be delivered to the payee bank, and so physical movement of the paper continued. Starting in the mid-1990s, some countries started to change their laws to allow "truncation": cheques would be [imaged](#) and a digital representation of the cheque would be transmitted to the drawee bank, and the original cheques were destroyed. The MICR codes and cheque details are normally encoded as text in addition to the image. The bank where the cheque was deposited would typically do the truncation and this dramatically decreased the time it took to clear a cheque. In some cases large retailers that received large volumes of cheques could also do the truncation. Once the cheque has been turned into a digital document it can be processed through the banking system just like any other [electronic payment](#).

The Reserve Bank of India first implemented CTS in [National Capital Region, New Delhi](#) from 1st February 2008. Based on the experience gained and the benefits that would accrue to the customers and banks, it was decided to operationalise CTS across the country starting 1st January 2014.

CTS have emerged as an important efficiency enhancement initiative undertaken by the Reserve Bank of India. The major benefits are:

1. Cheque truncation speeds up the process of collection of cheques resulting in better service to customers.
2. The electronic movement of images can facilitate shorter clearing cycle.
3. With the introduction of imaging and truncation, the physical movement of instruments is stopped and there is no fear of loss of instruments in transit.
4. It lowers the cost of collection of cheques, and removes the reconciliation-related and logistics-related problems.
5. It effectively eliminates the associated cost of movement of the physical cheques, reduces the time required for their collection and brings elegance to the entire activity of cheque processing.
6. It provides operational efficiency for banks and customers alike and reduces the risks associated with paper clearing.

7. Limitations of the existing clearing system in terms of geography or jurisdiction can be removed, thus enabling consolidation and integration of multiple clearing locations managed by different banks into a nation-wide standard clearing system with uniform processes and practices.

CTS bring elegance to the entire activity of Cheque processing and clearing. In addition to operational efficiency, CTS offers human resource rationalisation, cost effectiveness, business process re-engineering, adoption of latest technology and ultimately better service.

NPA:

A Non-performing asset (NPA) is defined as a [credit facility](#) in respect of which the [interest](#) and/or instalment of [principal](#) has remained 'past due' for a specified period of time. NPAs refer to the loans that are in jeopardy of default. Once the borrower has failed to make interest or principal payments for 90 days, the loan is considered to be a non-performing asset. Non-performing assets are problematic for financial institutions since they depend on interest payments for income. The account remains 'out of order' for a period of more than 90 days, in respect of an [Overdraft](#)/Cash Credit. NPAs result from defaults or the failure to meet financial obligations, say non-payment of a loan instalment.

NPAs do not just reflect badly in a bank's account books, they adversely impact the national economy. When bank do not get loan repayment or interest payments, liquidity problems may ensue. NPAs decrease profitability, reduce capital assets and lending limits, and increase the loan loss reserves. NPAs affect the credit ratings and goodwill of an organisation.

Banks classify non-performing assets further into the following three categories based on the period for which the asset has remained non-performing and the realisability of the dues:

1. **Sub-standard Assets:** A sub-standard asset is one which has been classified as NPA for a period not exceeding 12 months.
2. **Doubtful Assets:** A doubtful asset is one which has remained NPA for a period exceeding 12 months.
3. **Loss Assets:** A loss asset is one which cannot be recovered and loss has been identified by the bank. But the amount has not been written off, wholly or partly.

Capital Adequacy Ratio:

For the smooth flow of credit in an economy, it is essential that banks should be financially sound so as to meet its various requirements. Banks encounter various types of risks while carrying the business of financial intermediation as it is the highly leveraged sector of an economy. Capital adequacy ratio (CAR) is one of the measures which ensure the financial soundness of banks in absorbing a reasonable amount of loss. Regulation of capital assumes significant importance so as to reduce bank failures, to promote stability, safety and soundness of

the banking system, to prevent systemic disaster and to ultimately reduce losses to the bank depositors.

Capital Adequacy Ratio is the ratio which protects banks against excess leverage, insolvency and keeps them out of difficulty. It is defined as the ratio of banks capital in relation to its current liabilities and risk weighted assets. Risk weighted assets is a measure of amount of banks assets, adjusted for risks. $CAR = (\text{Bank's Capital} / \text{Risk Weighted Assets})$. As per RBI norms, Indian Scheduled Commercial Banks should have a CAR of 9% i.e., 1% more than stipulated Basel Norms while Public Sector Banks are emphasized to keep this ratio at 12%.

Capital adequacy is an important parameter for judging the strength and soundness of the banking system. An appropriate level of capital adequacy ensures that the bank has sufficient capital to expand its business, while at the same time its net worth is enough to absorb any financial downturns without becoming insolvent. CAR is the ratio which determines banks capacity to meet the time liabilities and other risks such as credit risk, market risk, operational risk etc.

Banking Ombudsman:

The Banking Ombudsman Scheme is introduced under Section 35 A of the Banking Regulation Act, 1949 by the Reserve Bank of India (RBI) with effect from 1995. The Banking Ombudsman Scheme enables an expeditious and inexpensive forum to bank customers for resolution of complaints relating to certain services rendered by banks. The Banking Ombudsman is a senior official appointed by the Reserve Bank of India to redress customer complaints against deficiency in certain banking services. All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are covered under the Scheme. As on date, 15 Banking Ombudsmen have been appointed with their offices located mostly in state capitals.

The major grounds of complaints that come under the purview of the Banking Ombudsman Scheme are listed below:

- Non-payment or inordinate delay in the payment or collection of cheques, drafts, bills etc.
- Non-acceptance, without sufficient cause, of small denomination notes tendered for any purpose, and for charging of commission in respect thereof.
- Non-acceptance, without sufficient cause, of coins tendered and for charging of commission in respect thereof.
- Non-payment or delay in payment of inward remittances.
- Failure to issue or delay in issue of drafts, pay orders or bankers' cheques.
- Non-adherence to prescribed working hours.
- Failure to provide or delay in providing a banking facility (other than loans and advances) promised in writing by a bank or its direct selling agents.

- Delays, non-credit of proceeds to parties accounts, non-payment of deposit or non-observance of the Reserve Bank directives, if any, applicable to rate of interest on deposits in any savings, current or other account maintained with a bank.
- Complaints from Non-Resident Indians having accounts in India in relation to their remittances from abroad, deposits and other bank-related matters.
- Refusal to open deposit accounts without any valid reason for refusal.
- Levying of charges without adequate prior notice to the customer.
- Non-adherence by the bank or its subsidiaries to the instructions of Reserve Bank on ATM/Debit card operations or credit card operations.
- Non-disbursement or delay in disbursement of pension.
- Refusal to accept or delay in accepting payment towards taxes, as required by Reserve Bank/Government.
- Refusal to issue or delay in issuing, or failure to service or delay in servicing or redemption of Government securities.
- Forced closure of deposit accounts without due notice or without sufficient reason.
- Refusal to close or delay in closing the accounts.
- Non-adherence to the fair practices code as adopted by the bank or non-adherence to the provisions of the Code of Bank s Commitments to Customers issued by Banking Codes and Standards Board of India and as adopted by the bank.
- Non-observance of Reserve Bank guidelines on engagement of recovery agents by banks.
- Any other matter relating to the violation of the directives issued by the Reserve Bank in relation to banking or other services.

A customer can lodge a complaint before the Banking Ombudsman if the reply is not received from the bank after one's representation, or the bank rejects the complaint, or if the complainant is not satisfied with the reply given by the bank. One may lodge the complaint at the office of the Banking Ombudsman under whose jurisdiction; the bank branch complained against is situated. The Banking Ombudsman does not charge any fee for filing and resolving customers' complaints. The amount, if any, to be paid by the bank to the complainant by way of compensation for any loss suffered by the complainant is limited to the amount arising directly out of the act or omission of the bank or Rs 10 lakh, whichever is lower.

Banking Sector Reforms in India:

Indian financial system, especially the banking industry has experienced a process of significant structural transformations in the last few decades. Banking today is re-defined and re-engineered with the development of sophisticated instruments and innovations in market practices. The financial sector reforms introduced as an integral part of the new economic reforms initiated in 1991 have touched upon almost all aspects of the banking sector. For a few decades preceding the onset of banking and financial sector reforms in India, banks operated in an environment that was heavily regulated and characterised by sufficient barriers to entry which protected them against much competition. The main thrust of the financial sector reforms has

been the creation of a strong, efficient, and stable financial structure for the economy with greater element of market discipline in the context of liberalisation.

In August 1991, the Government appointed a Committee under the Chairmanship of Shri. M. Narasimham (Popularly known as Narasimham Committee I) to examine all the aspects relating to the structure, organisation, functions and procedures of the financial system in the context of liberalisation of banking practices. The aim of this Committee was to bring 'operational flexibility' and 'functional autonomy' so as to enhance efficiency, productivity and profitability of the banks. The Committee submitted its report in November, 1991. Shri. M. Narasimham chaired another committee on banking sector reforms which submitted its report in April, 1998. This committee is known as Narasimham Committee II which focused on bringing about structural changes so as to strengthen the foundations of Indian banking system.

The broad objectives of the financial sector reforms contain two major thrusts, namely: (1) the thrust towards liberalisation which seeks to reduce direct controls over banks and other financial market participants, and (2) the thrust towards stronger regulation of the financial sector. The approach towards financial sector reforms in India is based on the following principles:

- Cautious and appropriate sequencing of reforms measures.
- Introduction of the norms that are mutually reinforcing.
- Introduction of complementary reforms across monetary, fiscal and external sectors.
- Development of financial institutions.
- Development of more transparent and efficient financial markets.

Considering the situation, it can be observed that the main objective of Indian banking sector reforms was 'to promote a diversified, efficient and competitive financial system with the ultimate goal of improving the allocative efficiency of resources through operational flexibility, improved financial viability and institutional strengthening.' The major highlights Indian financial sector reforms are listed below:

1. Interest rate liberalisation and disbanding of administered interest rates.
2. Enhancing the role of market forces by making sharp reduction in pre-emption through reserve requirements.
3. Conveying operational autonomy to public sector banks with focus on competition enhancing measures.
4. Market determined pricing for Government securities.
5. Enhanced transparency and disclosure norms to facilitate market discipline.
6. Introduction of pure inter-bank call money market.
7. Auction-based repos and reverse repos for short term liquidity management.
8. Facilitation of improved payments and settlement mechanism.

9. Requirement of significant advancements in dematerialisation and markets for securitised assets.
10. Establishment of uniform prudential norms of regulation and supervision.
11. Introduction and phased implementation of international best practices on risk-weighted capital adequacy requirements, accounting, income recognition, provision and exposure.
12. Suitable measures to strengthen risk management through recognition of different components of risk.
13. Application of market-to-market principle for investment portfolio and limits on deployment of funds in sensitive areas.
14. 'Know Your Customer (KYC)' and 'Anti Money Laundering' guidelines.

India adopted Basel I guidelines in 1999 while Basel II guidelines were implemented in phases by 2009. The Basel III capital regulations have been implemented in India from April 1, 2013 in phases and will be fully implemented as on March 31, 2018. The performance of the Indian economy is one of the strongest drivers for the banking industry's growth and vice versa. A boost in the banking industry is expected from the rising per capita income in India, which along with a growth in the earning population of the country will lead to a higher number of people utilising banking services. A World Bank Survey conducted in 2011 revealed that only 35 per cent of all adults in India had a bank account with a formal banking institution, while this figure stood at 21 per cent in the poorest income quantile. This represents a massive opening that financial institutions in the country can leverage upon for future growth.

Further, the policies of the Reserve Bank have prioritised 'financial Inclusion' which broadens the resource base of the financial system by developing a banking culture among the hitherto financially excluded Indian population. Concerted efforts were initiated by the Government and RBI to promote 'financial inclusion' as one of the important national objectives of the country. Sustained government support and a careful re-evaluation of existing business strategies can set the stage for Indian banks to become bigger and stronger, thereby setting the stage for expansions into a global consumer base.

Module – III

INSURANCE

Objectives

- 1) To provide a basic awareness of the use of insurance
- 2) To make an understanding of the concepts of insurance
- 3) To make an understanding of the mechanics of insurance in life

Introduction

Man is a social animal. He contributes to society's well being and gets protection from the society in which he lives. He remained exposed to various types of risks like death, accidents, loss of health and wealth, fire, natural calamities and so on. Insurance in some form or other has been an answer to his problem of security. Insurance is a process in which losses of few are shared by many who are equally exposed to same risk. As such, Insurance is a co-operative venture.

Meaning

In the "Dictionary of Business and Finance" Insurance is stated to mean "a form of contract or agreement under which one party agrees in return for a consideration to pay an agreed amount of money to another party to make good a loss, damage, or injury to something of value in which the insured has a pecuniary interest as a result of some uncertain event. It is a device by which the loss likely to be caused by an uncertain event is spread over a number of person who are exposed to it and who proposed to insure themselves against such an event." This agreement or contract is put in writing is known as policy. The person whose risk is insured is called insured/assured and the person, who insures is known as insurer/assurer/ underwriter. The consideration is return for which the insurer agrees to make good is to be paid regularly by the insured monthly, quarterly, half yearly or annually.

Definition

The term insurance has been defined at two levels they are:

1. The functional level and
2. The legal level

Functional Definition

According to John Megi, "Insurance is a plan where in persons collectively share the loss of risk". Reigel and Milker States : Insurance is primarily to decrease the uncertainty of events.

According to William Beveridge, The collective bearing of risk is insurance

From the above definition, It can be concluded that...

1. Insurance provides security
2. Insurance is a co-operative arrangement which distributes the loss of risk among a large number of people
3. Insurance provides a fund out of which the losses of the members are compensated.

Legal Definitions.

According to Tindal, Insurance is a contract in which a sum of money is paid by the assured in consideration of the Insurer's incurring the risk by paying a large sum upon a given contingency".

According to Britannica Encyclopedia, Insurance may be described as a social device where by a large group of individual through a system of equitable contribution may reduce or eliminate certain measurable risks of economic loss common to all members of the group.

Nature and Characteristics of Insurance

- i. A contract: It is a Contract between the insurer and the insured and the terms and Conditions of the contract are contained in the policy document.
- ii. Legal aspect: It is regulated by law
- iii. Consideration: In a contract of insurance the insurer undertakes to identify the loss suffered by the insured as per terms of the contract.
- iv. Co-operative device: Insurance is a co-operative venture of bearing the risk of individuals.
- v. Protection of Financial Risk: Insurance compensates only financial or monetary loss.
- vi. It is based on Principles : It is based on certain strong principles.
- vii. Insurance contracts are contracts of indemnity: Except life insurance, all other insurance are based on principle of indemnity. In life insurance the insurer pays a fixed sum of money on maturity or in the event of the death of the insured.
- viii. Insurance is not a gambling
- ix. It is not a charity,
- x. It is a Contract of subrogation.

Evolution of insurance

The origin of insurance is unknown. Human beings have an instinct to shoulder risk and an inner urge to be protected against may exist ever since man inhabited the earth.

History of marine insurance (Bottomry Bonds)

Marine insurance is the oldest form of insurance.. Bottomry bonds were loans advances which were to be repaid with interest on the safe arrival at the ship at the destination. It is

believed that marine insurance was first started in Italy in 4th Century BC. Later it is spread to Holland, Spain, Germany and England. In 1696, a coffee house,(Lloyd's coffee house) was considered to be the main centre where the underwriters gathered together to discuss business matters of common interest. In 1774 the underwriters formed Lloyd's Association and they formed policy in 1779. Now marine insurance business is mainly conducted this association. Later most of the countries passed the marine Insurance Act. The Indian Marine Insurance Act was passed in the year 1963.

History of Fire Insurance

Fire insurance was firstly used in Germany in the beginning of 16th century. Dr Nicholas Borban opened a fire insurance company in London in 1680 due to the after effect of the Great Fire 1668 in London. After the Industrial revolution many fire Insurance companies were emerged. The Lloyd's also entered in this field. In India, first fire insurance company was established in 1850.

History of Life Insurance

The first Life Insurance policy was issued on 1653 by Richard Martin to a person name William, Gibbons. As an institution in life Insurance was established in England (1679), The Bombay Mutual Life Insurance Society was the first Life Insurance Company that was organized in India in 1912, the Insurance Act was passed to exercise control over the business life insurance .LIC was established on September 1956.

History of other Insurance

The Industrial revolution led to the birth of different types of insurance systems. The employers and employees were exposed to many risks on account of Fire, Accident, theft, motor vehicles loss, livestock insurance, crops etc... The scope of general insurance is shows fast development taking place in the modern world.

Insurance in India

In India references about insurance can be found in the codes of Manu and Rigveda. Directly or indirectly some sort of insurance did exist during the Vedic periods. Marine Insurance was started in between 1797 and 1810. Fire Insurance was started in 1825 at Madras. The first Indian Insurance company started in the year 1850. The Indian Insurance Act of 1912 was passed to exercise proper control over the life insurance business in the country. Life Insurance business was nationalized in 1956. In 1972, General Insurance business Act was passed and it came in to force from January 1973.

FUNCTIONS OF INSURANCE

Primary functions	Secondary functions	Other functions
protection	Provides capital	Encourage trade
security	Increases efficiency	Encourage saving
Distribution of risk	Helps in loss reduction	Social welfare
		Check inflation
		Basis of credit

Principles of Insurance

1. Utmost Good Faith.

It implies that the insurer and the insured must act in good faith and disclose all material facts concerning the subject matter of insurance

2. Insurable Interest:-

A person is said to have insurable interest in the subject matter, if he suffers financially, by its loss or destructions. It is very important to know the time at which the insurable interest must exist to execute a valid contract of insurance. It depends on the branch of insurance also.

3. Indemnity:-

It means that the insured will be paid only the actual amount of loss or the amount of the policy whichever is less.

4. Subrogation:-

It is an extension of indemnity-According to this principle when the insurer pays compensation to the insured for loss, the insurer will get all the rights of the insured in respect of the damaged property and against third party who is responsible for loss

5. Contribution:-

It is just another outcome of the doctrine of indemnity. Sometimes a person gets a subject matter insured with more than one insurer called the Double insurance, whereby in the event of damage, he can't claim anything more than the total loss from all the insurers together. Contribution is the right of insurer who has paid a loss under a policy to cover appropriate amount from other insurers who are liable for the loss.

6. Migration of Loss:-

This principle reminds the insured of his duty to take all necessary steps to minimize or mitigate the loss, in case of occurrence of the risk insured. The insured must be very careful and active to make every effort to minimize the loss.

7. Proximate cause:-

There are many several causes for a loss. But an insurer is liable to indemnify the insured only whom the loss is caused by the peril insured against. When there is only one causes for a loss, it is quite easy to settle the claim. When there are several causes only the proximate or nearest cause should be considered.

8. Warranties:-

Insurance contract contain conditions which many be expressed on implied. Expressed warranties are incorporated in the policy. Implied warranties are not mentioned in the policy. The warranties are to be fulfilled by the insured during the insurance contract period. If the warranty is broken the insurer is not bound to compensate the loss.

Kinds of insurance

Insurance in common practice are classified as under

Classification of Insurance

On the basis of risk	Commercial point	Developmental point
1. Personal	1. General insurance	1. Marine
2. Property	2. Life insurance	2. Fire
3. Liability	3. Social insurance	3. Life
4. Guarantee		4. Social
		5. Others

Personal insurance

The subject matter of personal insurance contracts is the life or the health of the insured. Under the contracts of personal insurance the insured is compensated financially in the event of death. Personal hard ware further divided in to -Life insurance - Accident insurance - Health insurance

Life insurance

Usually referred to as life assurance insures the insured against the happening of certain event i.e. death (it may be uncertain) it involves both the element of protection and investment as

in case the insured lives up to the materiality of the policy, the investment made by the insured in the form of periodical premium is paid back to the insured on the maturity at the policy.

Accident insurance

Here insured is provided with financial aid in case of an accident, caring loss to the insured. The amount of compensation deposes up on the extent to which the injured sustained the injuring in case of death, or loss of feet, hand, half of the policy is paid

Health Insurance provides for the expenses incurred in connection with the hospitalization and medical expenses by the insured.

Property Insurance

Property is the subject matter of this insurance. The following are the different kinds of property insurance in existence.

Marine-Fire -Crop -Live Stock -Burglary -Baggage- Pedal Cycle -Plate Glass -Television

Marine Insurance

It is the oldest form of Insurance. It is an arrangement by which the insurer agrees to indemnify the loss suffered by insured as account of the perils at sea while transporting goods. Marine Insurance further classified in to Cargo, Freight, Hull Insurance.

Cargo Insurance:- The Cargo on Ship is exposed to risk arising from an act of God or enemy, fire, and other perils of sea etc... This risk covers Cargo Insurance.

Freight Insurance:- In certain cases the owner of the Cargo may promise to undertake to pay the freight on the goods transported when the cargo is safely delivered at the port of destination.

Hull Insurance: - Sometime owner of ship suffers many risks, like ship itself is exposed to the perils at sea. The owner insured against this risk is hull insurance.

Fire Insurance

Fire Insurance is a contract of indemnity where by the insurer agrees to indemnify the insured, the actual loss or damage suffered or the amount of the policy whichever is less.

Group Insurance:-

It is a device by which the Insurer indemnifies the insured against financial losses due to the accordance of natural calamities and other risks.

Live stock insurance:-

The insured is indemnified against losses caused due to accidental or natural death of live stock.

Burglary Insurance:-

Burglary Insurance firstly developed in U.K in 1887. Under this, the company agrees to indemnify financial losses caused by theft or burglary ad house-breaking etc...during the period of contract of insurance.

Baggage Policy

Offers protection to travelers against financial loss caused by theft, robbery of the baggage during travel.

Pedal Cycle Policy

Offers to pay the loss suffered by third parties in the event of accident in which the cycle of the insured is involved.

Plate-Glass policy

Offers protection to glass materials fixed to display windows or showcase of commercial establishment.

Television Policy

Offers protection to damage of T.V or loss due to accidents.

Liability Insurance

Offers protection to the insured against financial loss arising out of legal liability through negligence or by reason of operation of common law.

Guarantee Insurance

Guarantees the honesty and faithfulness of third party and if any loss is suffered by the insured due to the dishonesty of the third party covered under the scheme. The insurer must indemnify the loss suffered by the insured.

General Insurance

Commonly involved fire insurance and Marine Insurance.

Social Insurance

It is a technique of social security and it includes all sections of society. Social Insurance can further classified in to sickness insurance, accident, disablement, maternity, old-age insurance, Unemployment Insurance.

Sickness insurance:-

The insured is provided with financial aid in addition to medical facilities during the period of sickness.

Disablement Insurance:-

The insured is given financial help for the disablement in an accident other than the industrial accident.

Maternity Insurance:-

The insured woman workers are compensated by the insurer for the expenses done on getting treatment, balanced food during the period of maturity.

Old Age Insurance:-

Insured gives pension when they become old, not being able to earn their livelihood.

Unemployment Insurance:-

Getting financial help due to some uncontrollable reason.

Other Insurance

- Agricultural Pumping set Insurance
- Rain Insurance
- Export risk Insurance
- Air Craft Insurance
- Machinery Insurance
- Bankers Indemnity Insurance
- War or Emergency Insurance
- Sports Insurance
- Motor Vehicle Insurance

Types of Insurance Organization

The Insurance organization developed in different forms with the advantages of insurance practices. Some of the forms are

Self Insurance

The plan by which an individual or concern set up a private fund out of which to pay losses is termed self-insurance. It is a merely a provision for meeting the contingency. Here the insured become his own insurer for the particular risk. But it can be successfully worked only when there is a wide distribution of risks subject to the same hazard.

Individual Insurer

An Individual like other business can perform the business of insurer provided he has sufficient resources and talent of business. It is very rare.

Partnership

A Partnership firm can also carry on insurance business for sake of profit. In the early period before the advent of joint stock companies many insurance undertakings were partnership. This form had been completely disappeared with advent of Joint Stock Companies.

Joint Stock Companies

Which are organized by share holders who subscribe the necessary Capital to start business are formed for earning profits for the stock-holders who are the real owners of the companies. The management of a company is entrusted to a Board of Directors who is elected by the share holders from among themselves. But in Life Insurance, It is the practice to share certain portion of profit among certain policy – holders.

Mutual Companies

Mutual Companies were co-operative association formed for the purpose of effecting insurance on the property of its members. The policy holders were themselves the share –holders of the companies, each member was insurer as well as insured. They had power to participate in the management.

Co-operative Insurance Organization

Co-operative Insurance Organization were those concerns which are incorporated and registered under Indian Co-operative Societies Act. They are non-profit organizations. IRDA permitted co-operative insurance organization in 2005.

Lloyd's Association

It is the greatest insurance organization in world. They are also termed as syndicates. Any insured who wants to become a member of such association has to deposit a certain fee as security for the regular payment of his liabilities. Lloyd's as a co-operation is never liable on a policy. They have done commendable work in all kinds of insurance.

State Insurance

The Government of a nation sometimes owns insurance and runs the business for the benefit of the public. It is defined as that insurance which is under public sector part; more specifically it can be stated that when government have taken over the insurance business particularly life insurance. In India Life Insurance business was nationalized in 1956 and General Insurance were nationalized in 1972.

Re insurance

Re insurance is a device where by the original insurer can minimize his risk. When an insurer transfers a part of risks on particular policy by insuring it with some others, it is called re-insurance.

Features of Reinsurance

- ◆ It is liable only to the original insurer
- ◆ It is liable only for the risk or any part of a risk mentioned in the reinsurance contract
- ◆ Insurance principles are applicable to reinsurance also
- ◆ Direct Insurer can never reinsure for larger amount than that of original insurance amount.
- ◆ The reinsurer shall never be liable to the original insured.

Objectives of Reinsurance

- ◆ Reducing the risk of the insurer by sharing it with other insurers
- ◆ Limiting the liability to an amount which is within the financial capacity of the insurers.
- ◆ Stabilising of the underwriting over a period of time
- ◆ Safe guarding against serious effect of uncertainties.

Merits of Reinsurance

- It makes possible distribution of risk and helps in minimizing the burden of loss
- Gives courage to insurance companies to undertake heavy risk
- Avoid unhealthy competition among companies
- Develop co-operation among companies
- Helps to build strong insurance system.

Terms of Reinsurance

Ceding Office - Original Insurer

Cession - The amount of insurance ceded to the re insurer by the original insurer

Reinsurer - Company which provides insurance cover to the ceding company

Re insured - The Insurer who wishes to reinsure a part of the risk insured with another insurer

Retrocession - If a reinsurer reinsures a part of the risk he has undertaken with another

Retention - Amount retained by the ceding company for itself.

Methods of Reinsurance

Facultative Method:- In this method ceding company offers each risks for reinsurance. The reinsurer may accept or decline the offer for reinsurance.

Treaty Methods:- It is an agreement between the direct insurer and the reinsurer usually for a period of one year. Under this method the ceding company agrees to give, and the reinsures agree to accept, all insurance business within the limits laid down in the treaty.

Pooling Method:- Under this method different underwriters agree to work together by giving their acceptance to a common pool.

Module IV

Risk Management

Risk and Uncertainty

The entire business process has to face number of risks and uncertainties. Uncertainty comes from changes in economic, social and political trends. In business and also in real life, those are dangers and risks of every kind. The concept of risk may be defined as the possibility of unfavourable results following any occurrence. Risk arise due to uncertainties in regard to cost, loss or damage. The loss or damage may be related to financial loss or non-financial loss. The term uncertainty used to indicate instructions where the possibility of occurrence of a result, which is not quantifiable, so that it not possible to insure against uncertainty.

Classification of Risks

The whole process of risk can be classified into:

- a) **Financial and non-financial risks:** if any risk is concerned with financial loss, it is termed as a financial risk. Any risk other than financial consequences are referred to as non-financial risks.
- b) **Static and Dynamic risks:** Static risk insole losses resulting from the destruction of an asset or change in it possession as a result of dishonesty or human failure. Such financial losses arise even if there were no changes in the economic environment.

Dynamic risks are losses resulting from the changes in the economic environment. For ex : economic losses due to change in demand, change in profit, industrial disputes etc.

- c) **Fundamental and particular risks:** Fundamental risk is also termed as group risk. It involves losses that occur as a result of the causes or problems relating to major factors such as changes of social, cultural and political environment.

Particular risks involve losses that occur resulting from individual events. Burning of a house or robbery of a bank are the examples of particular risk.

- d) **Pure risk and speculative risks:** The concept of pure risk refers to those situations that involve the chances of loss or no loss. Speculator risk means those risks which involve a situation whose there is no possibility of gain.

Pure risks can be grouped into personal risk, property risk, liability risk and risk arising from failure of others.

Other risks :- Risks other than above classification can be grouped as follows :

1. Market risks
2. Technical risks
3. Political risks
4. Physical risks
5. Business risks

Risk Management Process

Risk management is concerned with the conversion of a firm's assets and earning power against risks of accidental loss. Risk management may be defined as "the identification, analysis and economic control of those risks which can threaten the assets or earning capacity of an enterprise".

Features of Risk Management :- Risk management has the following features :

- a) Risk management is a scientific approach to the problem of dealing with only pure risks and not any other risks faced by an individual or business.
- b) Risk management gives importance to insurable and uninsurable risks and to the suitable techniques for problems dealing with all pure risks.
- c) It mainly emphasizes reducing the cost of handling risk by using appropriate methods.

Importance of Risk Management

Risk management is of vital importance in the day to day business and human activities. It is essential for not only prevention of risks but also for reduction of risks. It provides maximum social advantage. It plays a significant role in bringing about social, political and economic development of a country. The importance of risk management is given as follows.

1. To evacuate the risks of business.
2. To effective handling of pricing the risk, monitoring and insuring against risk.
3. To introduce various plans and techniques to minimise the risks.
4. To give advice and make suggestions for handling the risks, and
5. To create awareness about risks among the people.

Objective of Risk Management

Following are the important objectives of risk management :

- a) Protecting employees from accident is an important objective of risk management.
- b) Due attention given on cost of handling risks
- c) Effective utilization of resources, and
- d) Maintaining good relations with society and public

Principles of Risk Insurance Management

The principles of risk insurance management brought out by the following:

- (1) Principles of Risk Identification
- (2) Principles of Risk Analysis
- (3) Principles of Risk Assessment
- (4) Principles of Taking Corrective Decision
- (5) Principles of Evaluation
- (6) Principles of Alternative Course of Action
- (7) Principles of Risk Control
- (8) Principles of Risk Retention
- (9) Principles of Risk Transfer.

‘These principles of risk insurance management have been discussed

- 1. Principles of Risk Identification:** Proper identification of risk is essential to achieve the several objectives of risk management such as preserving the operating effectiveness of the organization, minimizing the cost of handling risk etc. Without proper identification of risk, a firm’s operations have no meaning and direction. The success of the risk insurance management depends on proper risk identification.
- 2. Principles of Risk Analysis:** The risk manager should select various statistical tools to analyze the identified risk on the basis of principles of analysis in order to achieve the objectives of risk management. Analysis of a risk is necessary not only to know the level of severity of risk, but also to determine the accuracy and relevance of risk exposure at each stage.
- 3. Principles of Risk Assessment:** Necessary steps are to be taken by the executives in order to make an assessment of cost of risk. This is essential to keep reducing the cost of risk within control.
- 4. Principles of Taking Corrective Decision:** Corrective decision is an integral part of the risk manager’s job. In risk management, decision making is a process involving information, choice of alternative actions, implementation and evaluation that is directed

to the achievement of certain stated goals.

- 5. Principles of Alternative Course of Action:** The final choice from among the several alternatives will be based on how efficiently the risk manager's chosen alternative will produce results which come up to the desired level. In some cases, the decision as regards the final alternative will be objective, but in a majority of cases it is subjective, based on the Majority of cases are subjective based on the value judgement of the risk manager concerned.
- 6. Principles of Risk Control:** Effective control provides the yardstick measure the effectiveness of performance at various levels of handling risk to achieve the risk management objectives, various financial mechanisms can be used to control risk. This is essential to keep the cost of risk within control.
- 7. Principles of Risk Retention:** This principle provides a valuable frame work within which managers may make their decisions. When the risk has been identified, the risk manager can look to the principles of risk retention, as to how the effects are to be financed. For example, loss on account of faulty production planning can be improved by developing new technologies. High production cost may be minimized by effective control system.
- 8. Principles of Risk Transfer:** Principles of risk transfer help to analyze the transfer of financial effect of risk to another party. Generally, business people are unwilling to bear such risks which create losses to the firm and so want to transfer them. Many natural risks or losses can be avoided through insurance.

Insurance and Risk Management

Generally, the insurance management function is limited to property insurance, liability insurance, workmen's compensation insurance and suretyship. However, some firms include their programs for pension, group life, hospitalization etc., with in the duties of the insurance manager. The insurance executives must understand and negotiate an almost limitless number of forms of insurance of which the following are among the most important.

- (1) Automobile Insurance:** Numerous forms of policies are available covering automobile bodily injury and property damage, automobile collision insurance, comprehensive liability, non-ownership liability against liability from operation by others etc.
- (2) Marine Insurance:** Probably, the oldest form of insurance. This covers merchandise being carried by ocean-going vessels on a per voyage basis, or an open form that covers all voyage and all shipments, blanket.
- (3) Power Plant Insurance;** This title applies to almost any type of power plant equipment or appliances including steam, electric, internal combustion, and refrigeration, and insures

against accident or breakdown.

- (4) **Workmen's Compensation Insurance:** A form to comply with compulsory Workmen's Compensation Acts. It is statutory in form and varies by state.
- (5) **Valuable Papers Insurance:** This form of insurance provides all risks coverage on valuable papers, usually on an agreed amount basis.
- (6) **Export Credit Insurance:** Covers agreed percentage of loss sustained because of insolvency of firms to whom the assured has extended credit, and based on that credit, exported merchandise or services to them.
- (7) **Fire Legal Liability Insurance:** Coverage against liability of the P* firm for damage to property of other caused by the fire, including P property in the care, custody or control of the insured.
- (8) **Employer's Liability Insurance:** Provides for the protection for the firm against liability arising out of injury to employees apart from that imposed by the Workmen's Compensation Laws.

Risk Management of Life Insurance Companies

Life insurance is generally referred to as life assurance. It insures the insured against the happening of certain event, for eg: death. The subject matter of life insurance is the life of human being. The life insurance is described as contingent contracts because the life cannot be compensated and only a specified sum can only be paid if the insured dies, this by reducing the risk of death of the insured, to the family of the insured as well as his dependants.

As we referred earlier, the subject matter of life insurance is the life of a human being. Life insurance provides risk coverage to the life of a person. On the death of the person insurance offers protection against loss of income and compensate the life holders of the policy.

Module V

Type of Insurance Policies

Life Insurance – Meaning

Life Insurance is a contract providing for payment of a sum of money to the person assured or the person entitled to receive the same on the happening of certain events, usually death life insurance is defined as a mutual agreement by which one party agrees to pay a given sum of money upon the happening of a particular event contingent upon the duration of human life, in consideration of the payment of a smaller sum immediately, or in periodical payments by the other party. Life Insurance Corporation of India was organised with the objectives of assurance of

- a) Family protection
- b) Provision for old age
- c) Tax concession
- d) Housing loans
- e) Loans advanced for educational purposes and
- f) Donation to charitable institutions

Features of Life Insurance

1. Life insurance is an outcome of offer and acceptance. The offer is made by the insured and acceptance is done by the insurer.
2. The insurance company agrees to pay a certain sum of money either on the death of the insured or on the maturity of the policy whichever is earlier.
3. The insured has an obligation to pay an amount periodically up to the date of death or expiry of the period of the policy whichever is earlier.
4. Life insurance is not a contract of indemnity. We cannot calculate the value of life in terms of money.
5. Insurable interest must be present at the time of taking policy and which may or may not be present at the time of death of the insured.
6. It is considered as the best alternative way of savings.

IMPORTANCE OF LIFE INSURANCE

Life Insurance is of great importance to individuals, groups, business community and general public. Some of the main benefits of life insurance are given below.

1. Protection against untimely death

Life insurance provides protection to the dependents of the life insured and the family of the assured in case of his untimely death. The dependents or family members get a fixed sum of money in case of death of the assured.

2. Saving for old age

After retirement the earning capacity of a person reduces. Life insurance enables a person to enjoy peace of mind and a sense of security in his/her old age.

3. Promotion of savings

Life insurance encourages people to save money compulsorily. When a life policy is taken, the assured is to pay premiums regularly to keep the policy in force and he cannot get back the premiums, only surrender value can be returned to him. In case of surrender of policy, the policyholder gets the surrendered value only after the expiry of duration of the policy.

4. Initiates investments:

Life Insurance Corporation encourages and mobilizes the public savings and channelises the same in various investments for the economic development of the country. Life insurance is an important tool for the mobilization and investment of small savings.

5. Credit worthiness:

Life insurance policy can be used as a security to raise loans. It improves the credit worthiness of business.

6. Social Security:

Life insurance is important for the society as a whole also. Life insurance enables a person to provide for education and marriage of children and for construction of house. It helps a person to make financial base for future.

7. Tax Benefit

Under the Income Tax Act, premium paid is allowed as a deduction from the total income under section 80C.

Kinds of Policies

The life insurance policies can be divided on the basis of :

1. Duration of policy
2. Methods of premium payment
3. Participation in profit
4. Number of lives covered
5. Method of payment of sum assured

Term Insurance: - Term insurance policies provide issued usually for a shorter period are treated as temporary contracts. Term assurance provide for payment only in the event of death before a certain date or age. These types of policies are frequently adopted as collateral security for a loan.

Whole Life Insurance:- Under this policy, the premium payable for 35 years or till age or whichever is more. The policies where the premium is payable thought the life of the assured is called the whole life whole term policy. This is the cheapest policy because the premium rate is lower.

Endowment:-

This is a popular policy issued by the LIC of India. The basic object is that the policy for the sum assured becomes matured on the policy holder death or on his attaining a particular age whichever is earlier. The period for which the policy is taken is called as endowment period. The premium under this policy is little higher as compared with term assurance. This policy is useful to the family in case of sudden death of the policy holder.

Annuity :- Life annuity is an insurance product that features a predetermined periodic payment of amount until the death of the annuitant or insurer. These policies are used to help retirees budget their money after retirement. The insurer pays into the annuity on a periodic basis when he or she is still working. However, annuitants may also buy the annuity policies as one large purchase. When the annuitant retires, the annuity makes periodic payments to the annuitant, providing a reliable source of income. When the death of the annuitant occurs the periodic payments from the annuity usually stop.

Surrender of policy

Surrender of policy indicates the termination of the contract of insurance. The term surrender value refers to the amount of money which the insurer agrees to pay, in case the assured decides to surrender his policy before its maturity. The policy holder wishes to surrender his policy to the insurer and gives up his claim on it. The amount of surrender value is calculated on the basis of actual premium paid and number of years the policy has been alive. Surrender value insurers with each payment of premium. According to LIC of India, a policy acquires surrender value only after payment of two or three years premium.

Revival of Lapsed Policies

When the premium is not paid within the days of grace, the policy lapses. It may be revived during the life time of the life assured. It can be revived within a period of five years from the due date of the first unpaid premium and before the date of maturity.

Loans on policies

When a policy has a surrender value, it also has a loan value, and insurance companies usually lend 95 percent of surrender value, keeping the 5 percent as margin for a year's arrears of interest. The loan may be repaid at the convenience of the borrower. In case it is not repaid it keeps on accumulating with interest, to be deducted from the policy amount. This is the best investment that an insurance company can make, as there is never any danger of the money being lost.

Claims on Policies

A person claiming money on the maturity of the policy must satisfy the insurance company that he is entitled to receive the money either :

- a) As the owner of the policy
- b) Became the actual claim is rested in him as legal representative or as a nominee or as assignee.

On the maturity of the life policy, the insurer requires a reasonable proof of age and death of the life assured. Death may be proved by direct or indirect evidence.

Motor vehicle Insurance

Motor vehicle insurance falls under General Insurance. Its importance is increasing day by day. In motor insurance, the owner's liability to compensate people who were killed or injured through the negligence of the motorists or drivers is passed on to the insurance company. Motor insurance business is the largest single section of accident insurance.

Personal Accident Insurance

This means insurance for individuals or groups of person against any personal accident or illness. In India this type of insurance is done by the GIC. The risk insured in personal accident insurance is the bodily injury resulting solely and directly from accident caused by violent, external and visible means. Under this policy the insurer pays the specified sum, if the insured sustains any bodily injury resulting solely and directly from accident caused by external violent and visible means.

Medical insurance

Medical insurance, generally known as mediclaim is a contract between the proposer and the insurance company that mentions the insurance company will pay a portion of the medical expenses if the insured is sick or injured and need medical care. The insured is required to pay the insurance company a premium in each month. Some contracts also specify that the insurance company will pay a portion of insured medical expenses to make sure that the proposer doesn't get sick, such as paying for annual physical examinations and immunization. The amount the insurance company will pay, and under what circumstances they will pay is known as 'coverage', and can differ significantly from policy to policy. Medical insurance, which offers protection from increasingly high medical costs, is offered in a variety of policy types and terms.

Burglary Insurance

Burglary insurance falls under the classification of insurance of property. In the case of burglary policy, the loss or damages of household goods and properties due to theft, burglary, house – breaking and acts of such nature are covered. The actual loss is compensated under the policy.

Fidelity Guarantee Insurance

Fidelity guarantee insurance is a type of contract of insurance and also a contract of guarantee to

which general principles of insurance apply. Fidelity guarantee does not mean the guarantee of the employee's honesty. But, it guarantees the employer for any damage or loss resulting from the employee's dishonesty or disloyalty. The insurer is liable to compensate the said loss to the employer as prescribed by the contract.

Crop Insurance

Crop insurance is a contract to provide a measurement of financial support to farmers in the event of crop failure due to drought or flood. The insurance covers all risks of loss or damage relating to production of rice, milks, wheat, oil seeds, pulses etc.

Marine Insurance

Marine insurance is a contract of insurance under which the insurer undertakes to indemnify the insured against losses incidental to marine adventures. It may cover loss or damage to the ship, cargo, freight, vessels or any other subject of marine adventures.

Fire Insurance

Fire insurance is a contract of agreement between the insurer and insured whereby the insurer undertakes to indemnify the insured for destruction or damage to property caused by fire or other specified perils during an agreed period of time. The payment of premium may be paid either in instalments or in lump sum.

Reinsurance

The term, reinsurance, also termed as insurance of insurance, means that an insurer who has assumed a large risk may arrange with another insurer to insure a portion of the insured risk. In reinsurance, one insurer insures the risk which has been undertaken by another insurer. The original insurer who transfers a part of the insurance contract is called the reinsured and the second insurer is called reinsurer. Of course, the reinsurer has to pay reinsurance premium for risk shifted.

For eg: while GIC's subsidiaries look after general insurance, GIC itself has been a major reinsurer. All insurance companies have to give 20 percent of their reinsurance business to GIC. However, GIC reinsures the amount further with international companies such as swissre (Switzerland), Munichre (Germany) and Royale (UK).

Insurance Regulatory and Development Authority (IRDA) Act

IRDA Act was passed in December 1999. This is an Act to provide for the establishment of an authority to protect the interests of holders of insurance policies, to regulate, promote and ensure the growth of insurance industry. The IRDA Act amended the Insurance Act of 1938. The Life Insurance corporation Act of 1956 and the General Insurance Act of 1972.

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