BASICS OF BANKING AND INSURANCE

V SEMESTER

CORE COURSE

B Com

(2011 Admission)

UNIVERSITY OF CALICUT

SCHOOL OF DISTANCE EDUCATION

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SCHOOL OF DISTANCE EDUCATION

STUDY MATERIAL

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BASICS OF BANKING AND INSURANCE

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MODULE 1

ORIGIN AND DEVELOPMENT OF BANKING

Banking: Meaning and definition

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

Definition of a Bank

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

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

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

Prof. Kent defines a bank as, "an organization whose principal operations are concerned with the accumulation of the temporarily idle money of the general public for the purpose of advancing to others for expenditure".

1.1 Evolution of Banking

The term bank is either derived from Old Italian word *banca* or from a French word *banque* both mean a Bench or money exchange table. In olden days, European money lenders or money changers used to display (show) coins of different countries in big heaps (quantity) on benches or tables for the purpose of lending or exchanging. According to some authorities, the work "Bank" itself is derived from the words "bancus" or "banqee," that is, a bench. The early bankers, the Jews in Lombardy, transacted their business on benches in the market place. There are others, who are of the opinion that the word "bank" is originally

derived from the German word "back" meaning a joint stock fund, which was Italianized into "banco" when the Germans were masters of a great part of Italy. This appears to be more possible. But whatever is the origin of the word 'bank', "It would trace the history of banking in Europe from the Middle Ages."

Early History of Banking

As early as 2000 B.C., the Babylonians had developed a banking system. There is evidence to show that the temples of Babylon were used as banks and such great temples as those of Ephesus and of Delbhi were the most powerful of the Greek banking institutions. But the spread of irreligion soon destroyed the public sense of security in depositing money and valuables in temples, and the priests were no longer acting as financial agents. The Romans did not organize State Banks as did the Greeks, but their minute regulations, as to the conduct of private banking, were calculated to create the utmost confidence in it. With the end of the civilization of antiquity, and as a result of administrative decentralization and demoralization of the Government authority, with its inevitable counterpart of commercial insecurity, banking degenerated for a period of some centuries into a system of financial make shifts. But that was not the only cause. Old prejudices die hard, and Aristotle's dictum, that the charging of interest was unnatural and consequently immoral was adhered to fanatically. Even now some Mohammedans, in obedience to the commands contained in that behalf in their religious books, refuse to accept interest on money loans. The followers of Aristotle's dictum forgot that the ancient world, the Hebres included, although it had to system of banks that would be considered adequate from the modern point of view, and maintained moneylenders and made no sin of interest, but only of usury. However, upon the revival of civilization, growing necessity forced the issue in the middle of the 12th century, and banks were established at Venice and Genoa, though in fact they did not become banks as we understood them today, till long after. Again the origin of modern banking may be traced to the money dealers in Florence, who received money on deposit, and were lenders of money in the 14th century, and the names of the Bardi, Acciajuoli, Peruzzi, Pitti and Medici soon became famous throughout Europe, as bankers. At one time, Florence is said to have had eighty bankers, though it could boast of no public bank.

Some experts briefed the history of modern banking as: The first public banking institution was The Bank of Venice, founded in 1157. The Bank of Barcelona and the bank of Genoa were established in 1401 and 1407 respectively. These are the recognized forerunners of modern commercial banks. Exchange banking was developed after the installation of the Bank of Amsterdam in 1609 and Bank of Hamburg in 1690. The credit for laying the foundation of modern banking in England goes to the Lombard's of Italy who had migrated to other European countries and England. The bankers of Lombardy developed the money lending business in England. The Bank of England was established in 1694. The development of joint stock commercial banking started functioning in 1833. The modern banking system actually developed only in the nineteenth century.

1.2 Growth and developments of banks in India

We cannot have a healthy economy without a sound and effective banking system. The banking system should be hassle free and able to meet the new challenges posed by technology and other factors, both internal and external.

In the past three decades, India's banking system has earned several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to metropolises or cities in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main aspects of India's growth story.

The government's regulation policy for banks has paid rich dividends with the nationalization of 14 major private banks in 1969. Banking today has become convenient and instant, with the account holder not having to wait for hours at the bank counter for getting a draft or for withdrawing money from his account.

History of Banking in India

The first bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases:

Phase 1 (1786 to 1969)

The first bank in India, the General Bank of India, was set up in 1786. Bank of Hindustan and Bengal Bank followed. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840), and Bank of Madras (1843) as independent units and called them Presidency banks. These three banks were amalgamated in 1920 and the Imperial Bank of India, a bank of private shareholders, mostly Europeans, was established. Allahabad Bank was established, exclusively by Indians, in 1865. Punjab National Bank was set up in 1894 with headquarters in Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. The Reserve Bank of India came in 1935.

During the first phase, the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1,100 banks, mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with the Banking Companies Act, 1949, which was later changed to the Banking Regulation Act, 1949 as per amending Act of 1965 (Act No. 23 of 1965). The Reserve Bank of India (RBI) was vested with extensive powers for the supervision of banking in India as the Central banking authority. During those days, the general public had lesser confidence in banks. As an aftermath, deposit mobilization was slow. Moreover, the savings bank facility provided by the Postal department was comparatively safer, and funds were largely given to traders.

Phase 2 (1969 to 1991)

The government took major initiatives in banking sector reforms after Independence. In 1955, it nationalized the Imperial Bank of India and started offering extensive banking facilities, especially in rural and semi-urban areas. The government constituted the State Bank of India to act as the principal agent of the RBI and to handle banking transactions of the Union government and state governments all over the country. Seven banks owned by the Princely states were nationalized in 1959 and they became subsidiaries of the State Bank of India. In 1969, 14 commercial banks in the country were nationalized. In the second phase of banking sector reforms, seven more banks were nationalized in 1980. With this, 80 percent of the banking sector in India came under the government ownership.

Phase 3 (1991 onwards)

This phase has introduced many more products and facilities in the banking sector as part of the reforms process. In 1991, under the chairmanship of M Narasimham, a committee was set up, which worked for the liberalization of banking practices. Now, the country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking are introduced. The entire system became more convenient and swift. Time is given importance in all money transactions.

The financial system of India has shown a great deal of resilience. It is sheltered from crises triggered by external macroeconomic shocks, which other East Asian countries often suffered. This is all due to a flexible exchange rate regime, the high foreign exchange reserve, the not-yet fully convertible capital account, and the limited foreign exchange exposure of banks and their customers.

Banking Activities

- Retail banking, dealing directly with individuals and small businesses
- Business banking, providing services to mid-market businesses
- Corporate banking, directed at large business entities
- Private banking, providing wealth management services to high networth individuals
- Investment banking, activities in the financial markets, such as "underwrite" (guarantee the sale of) stock and bond issues, trade for their own accounts, make markets, and advise corporations on capital market activities like mergers and acquisitions
- Merchant banking is the private equity activity of investment banks
- Financial services, global financial institutions that engage in multiple activities such as banking and insurance

1.3. Indian Banking Structure

The structure of banking in India consists of following components:

1. Central Bank – Reserve Bank of India (RBI)

2. Commercial Banks

   a. Public sector Banks
   b. Private Banks
   c. Foreign Banks

3. Co-operative Banks

   a. Primary Credit Societies
   b. Central Co-operative Banks
   c. State Co-operative Banks

4. Regional Rural Banks

5. Development Banks

6. Specialized Banks

   a. Export Import Bank of India
   b. Small Industries Development Bank of India
   c. National Bank for Agricultural and Rural Development

7. Microfinance institutions

8. Development financial institutions

Indian Banking system

Reserve bank of India, commercial banks, co-operative banks and regional rural banks broadly make up the banking system in India. There are two more types of banks, namely development banks and specialized banks for some particular purposes.

Central Bank – Reserve Bank of India (RBI)

The Reserve Bank of India (RBI), the central bank of India, which was established in 1935, has been fully owned by the government of India since nationalization in 1949. Like the central bank in most countries, Reserve Bank of India is entrusted with the functions of guiding and regulating the banking system of a country. (The main functions of RBI and related details are given in following pages)

Commercial Banks

There are three types of commercial banks in India

1. Public sector banks
2. Private Banks
3. Foreign banks

Currently, there are 88 scheduled commercial banks, including 28 public sector banks, 29 private banks and 31 foreign banks.

Public sector banks

These are banks where majority stake is held by the Government of India or Reserve Bank of India. In 2012, the largest public sector bank is the State Bank of India. This consists of 14 banks which are nationalised in the year 1969 and 6 banks which are nationalised in the year 1980.

- Allahabad Bank
- Andhra Bank
- Bank of Baroda
- Bank of India
- Bank of Maharashtra
- Canara Bank
- Central Bank of India
- Corporation Bank
- Dena Bank
- Indian Bank
- Indian Overseas Bank
- Oriental Bank of Commerce
- Punjab & Sind Bank
- Punjab National Bank
- Syndicate Bank
- UCO Bank
- Union Bank of India
- United Bank of India
- Vijaya Bank
- State bank and its associates

Private Banks

Private Banks are banks that the majority of share capital is held by private individuals. In Private sector small scheduled commercial banks and newly established banks with a network of 8,965 branches are operating. To encourage competitive efficiency, the setting up of new private bank is now encouraged.

Examples of old private sector banks are:

- Bank of Rajasthan
- Catholic Syrian Bank
- Dhanalakshmi Bank
- Federal Bank
- ING Vysya Bank
- Karnataka Bank
- Karur Vysya Bank
- Lakshmi Vilas Bank
- Lord Krishna Bank
- South Indian Bank
- Tamilnad Mercantile Bank
- Examples on new generation private sector banks are:
- Bank of Punjab
- Centurion Bank
- HDFC Bank
- ICICI Bank
- IDBI Bank Ltd.
- IndusInd Bank
- Kotak Mahindra Bank
- UTI Bank
- Yes Bank

Foreign Banks

Foreign banks are registered and have their headquarters in a foreign country but operate their branches in India. Apart from financing of foreign trade, these banks have performed all functions of commercial banks and they have an advantage over Indian banks because of their vast resources and superior management. At the end of September, 2010, 34 foreign banks were operating in India.

Examples of foreign bank functioning in India are:

- ABM Amro Bank
- Bank of America
- Bank of Bahrain & Kuwait
- Bank of Ceylon
- Barclays Bank
- BNP Paribas
- Ceylon Bank
- Citibank
- Hongkong & Shanghai Banking Corporation.(HSBC)
- JP Morgan Chase Bank
- Sonali Bank
- Standard Chartered Bank

Though there are three types of commercial banks, their functions as commercial banks are very similar. (Details of commercial banks are given in following pages)

Co-operative banks

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

There are three types of co-operatives banks with different functions:

Primary Credit Societies:

Primary Credit Societies are formed at the village or town level with borrower and non-borrower members residing in one locality. The operations of each society are restricted to a small area so that the members know each other and are able to watch over the activities of all members to prevent frauds.

Central Co-operative Banks:

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

State Co-operative Banks:

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

Regional rural Banks

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

Regional rural banks perform the following two functions:

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

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

Development Banks

Development Banks are banks that provide financial assistance to business that requires medium and long-term capital for purchase of machinery and equipment, for using latest technology, or for expansion and modernization. A development bank is a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with industrial climate and encourages new industrial projects to bring about speedier economic growth.

These banks also undertake other development measures like subscribing to the shares and debentures issued by companies, in case of under subscription of the issue by the public.

There are three important national level development banks. They are;

Industrial Development Bank of India (IDBI)

The IDBI was established on July 1, 1964 under an Act of Parliament. It was set up as the central co-ordinating agency, leader of development banks and principal financing institution for industrial finance in the country. Originally, IDBI was a wholly owned subsidiary of RBI. But it was delinked from RBI w.e.f. Feb. 16, 1976.

IDBI is an apex institution to co-ordinate, supplement and integrate the activities of all existing specialised financial institutions. It is a refinancing and re-discounting institution operating in the capital market to refinance term loans and export credits. It is in charge of conducting techno-economic studies. It was expected to fulfil the needs of rapid industrialisation.

The IDBI is empowered to finance all types of concerns engaged or to be engaged in the manufacture or processing of goods, mining, transport, generation and distribution of power etc., both in the public and private sectors.

Industrial finance Corporation of India (IFCI)

The IFCI is the first Development Financial Institution in India. It is a pioneer in development banking in India. It was established in 1948 under an Act of Parliament. The main objective of IFCI is to render financial assistance to large scale industrial units, particularly at a time when the ordinary banks are not forth coming to assist these concerns. Its activities include project financing, financial services, merchant banking and investment.

Till 1993, IFCI continued to be Developmental Financial Institution. After 1993, it was changed from a statutory corporation to a company under the Indian Companies Act, 1956 and was named as IFCI Ltd with effect from October 1999.

Industrial Credit and Investment Corporation of India (ICICI)

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

The main objective of the ICICI was to meet the needs of the industry for long term funds in the private sector.

Apart from this the Industrial Reconstruction Corporation of India (IRCI) established in 1971 with the main objective of revival and rehabilitation of viable sick units and was converted in to the Industrial Reconstruction Bank of India (IRBI) in 1985 with more powers

Development banks have been established at the state level too. At present in India, 18 State Financial Corporation's (SFCs) and 26 State Industrial investment/Development Corporations (SIDCs) are functioning to look over the development banking in respective areas /states.

Specialized Banks

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

Export Import Bank of India (EXIM Bank):

The Export-Import (EXIM) Bank of India is the principal financial institution in India for coordinating the working of institutions engaged in financing export and import trade. It is a statutory corporation wholly owned by the Government of India. It was established on January 1, 1982 for the purpose of financing, facilitating and promoting foreign trade of India. This specialized bank grants loans to exporters and importers and also provides information about the international market. It also gives guidance about the opportunities for export or import, the risks involved in it and the competition to be faced, etc.

The main functions of the EXIM Bank are as follows:

(i) Financing of exports and imports of goods and services, not only of India but also of the third world countries;

(ii) Financing of exports and imports of machinery and equipment on lease basis;

(iii) Financing of joint ventures in foreign countries;

(iv) Providing loans to Indian parties to enable them to contribute to the share capital of joint ventures in foreign countries;

(v) to undertake limited merchant banking functions such as underwriting of stocks, shares, bonds or debentures of Indian companies engaged in export or import; and

(vi) To provide technical, administrative and financial assistance to parties in connection with export and import.

Small Industries Development Bank of India

This specialized bank grant loan to those who want to establish a small-scale business unit or industry. Small Industries Development Bank of India (SIDBI) was established in October 1989 and commenced its operation from April 1990 with its Head Office at Lucknow as a development bank, exclusively for the small scale industries. It is a central government undertaking. The prime aim of SIDBI is to promote and develop small industries by providing them the valuable factor of production finance. Many institutions and commercial banks supply finance, both long-term and short-term, to small entrepreneurs. SIDBI coordinates the work of all of them.

Functions of Small Industries Development Bank of India (SIDBI):

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

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

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

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

(v) SIDB1 directly discounts and rediscounts bills with a view to encourage bills culture and helping the SSI units to realise their sale proceeds of capital goods / equipments and components etc.

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

National Bank for Agricultural and Rural Development

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

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

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

c) Undertakes monitoring and evaluation of projects refinanced by it.

d) NABARD refinances the financial institutions which finances the rural sector.

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

f) NABARD also keeps a check on its client institutes.

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

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

i) It regulates the cooperative banks and the RRB

Indian Bank-like financial institutions

In India, there are some Bank-like financial institutions that provide financial services. There are two types of such institution that are important to the development on India:

Microfinance Institutions

Microfinance Institutions are Bank-like financial institutions that providing financial services, such as microcredit, micro savings or micro insurance to poor people.

In addition, they also perform the following important functions:

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

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

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

2. **Development financial institutions (DFIs)**

DFIs are specialized financial institutions the Government established to promote investments in the manufacturing and agricultural sectors.

Their functions include:

1. Extending financial assistance in the form of medium- and long-term loans, participating in equity capital, underwriting and wherever relevant, acting as issuing house for public shares issues and providing guarantees for loans

2. Specialize in medium- and long-term financing in addition to supplying financial services not normally provided by commercial banks and finance companies

3. In addition, they help in identifying new projects, participate in their promotion, and where appropriate, provide ancillary financial, technical and managerial advice

1.4. Role and importance of banks in economic development

A proper financial sector is of special importance for the economic growth of developing and underdeveloped countries. The commercial banking sector which forms one of the backbones of the financial sector should be well organized and efficient for the growth dynamics of a growing economy. No underdeveloped country can progress without first setting up a sound system of commercial banking. The importance of a sound system of banking for a developing country may be depicted as follows :

1. Capital Formation

The rate of saving is generally low in an underdeveloped economy due to the existence of deep-rooted poverty among the people. Even the potential savings of the country cannot be realized due to lack of adequate banking facilities in the country. To mobilize dormant savings and to make them available to the entrepreneurs for productive purposes, the development of a sound system of commercial banking is essential for a developing economy.

2. Monetization

An underdeveloped economy is characterized by the existence of a large non monetized sector, particularly, in the backward and inaccessible areas of the country. The existence of this non monetized sector is a hindrance in the economic development of the country. The banks, by opening branches in rural and backward areas, can promote the process of monetization in the economy.

3. Innovations

Innovations are an essential prerequisite for economic progress. These innovations are mostly financed by bank credit in the developed countries. But the entrepreneurs in underdeveloped countries cannot bring about these innovations for lack of bank credit in an adequate measure. The banks should, therefore, pay special attention to the financing of business innovations by providing adequate and cheap credit to entrepreneurs.

4. Finance for Priority Sectors

The commercial banks in underdeveloped countries generally hesitate in extending financial accommodation to such sectors as agriculture and small scale industries, on account of the risks involved there in. They mostly extend credit to trade and commerce where the risk involved is far less. But for the development of these countries it is essential that the banks take risk in extending credit facilities to the priority sectors, such as agriculture and small scale industries.

5. Provision for Medium and Long term Finance

The commercial banks in under developed countries invariably give loans and advances for a short period of time. They generally hesitate to extend medium and long term loans to businessmen. As is well known, the new business need medium and long term loans for their proper establishment. The commercial banks should, therefore, change their policies in favour of granting medium and long term accommodation to business and industry.

Role of Banks in Indian Economy

In India, as in many developing countries, the commercial banking sector has been the dominant element in the country’s financial system. The sector has performed the key functions of providing liquidity and payment services to the real sector and has accounted for the Bulk of the financial intermediation process. Besides institutionalizing savings, the banking sector has contributed to the process of economic development by serving as a major source of credit to households, government, and business and to weaker sectors of the economy like village and small scale industries and agriculture. Over the years, over 30-40% of gross household savings have been in the form of bank deposits and around 60% of the assets of all financial institutions accounted for by commercial banks. An important landmark in the development of banking sector in recent years has been the initiation if reforms following the recommendations of the first Narasimham Committee on Financial System. In reviewing the strengths and weaknesses of these banks, the Committee suggested several measures to transform the Indian banking sector from a highly regulated to amore market oriented system and to enable it to compete effectively in an increasingly globalised environment. Many of the recommendations of the Committee especially those pertaining to Interest rate, an institution of prudential regulation and transparent accounting norms were in line with banking policy reforms implemented by a host of developing countries since 1970s.

Types of Banking System

A bank is an institution which deals with money and credit. It accepts the deposits from public and makes the funds available to those who need them. A modern bank performs a variety of functions and they purview is different from each other. Depending upon their functions, size etc... We can classify the banking system into the following categories:

1. Unit banking system
2. Branch banking system
3. Group banking system123
4. Chain banking system
5. Deposit banking system
6. Investment banking system
7. Correspondent banking system
8. Mixed banking system

Different countries adopt different types of banking system depending upon their economic structure.

1. Unit banking system

Under this type of banking system an individual bank operates through an single office. The size and area of operation is much smaller than in other types of banking system. It wasoriginated and grew in USA. The main reason for the development of unit banking system in America is the fear of emergence of monopoly in banking business.

2. Branch banking system

In this type of banking system a big bank as a single owner ship operates through a network of branches spread all over the country. This type of banking system was initially developed in England. Later on it become popular in other countries like Canada, India and Australia etc.

3. Group banking system

This banking system refers to the system of banking in which two or more banks are directly controlled by a corporation or an association or a business trust. The holding company may or may not be a banking company. In this system each bank maintains its separate identity. Its business is managed by the holding company. This type of banking system was popular in USA.

4. Chain banking system

It is another form of group of banking. It refers to the system in which two or more banks are brought under common control by a device other than the holding company. They have common management and policies. The management may consist of group of persons through stock ownership or otherwise.

5. Deposit banking system:

Commercial banks are the best examples for deposit banking. Deposit bank will have to maintain liquidity i.e. enough cash reserve to meet withdrawals. Deposits bank is those banks which accept deposits of short term and loans will also be for short term periods. The business in this type of banking system is less risky. The loans provided by deposit bank are in the form of overdraft, cash credit and discounting bills of exchange.

6. Investment banking system:

These banks are those financial institutions which provide long term finance to business. They invest in capital market i.e. stocks & shares of different companies. These banks act as intermediaries between savers and investors. These investment bankers are classified into various categories such as underwriters and retailers. An investment banker performs highly useful services to the co-operative bodies by supplying long term capitals. They also provide services to small investors. They mobilize the investment through shares, stocks and mutual funds.

7. Correspondent banking system:

It is another important type of banking system. A correspondent bank is one which connects the two banks under unit banking system. The best examples of correspondent bank in India are RBI or central bank.

8. Mixed banking system:

If the banks provide both short term and long term loans to the industries it is called as mixed banking system. German banks are the best examples of this type of banking system. These banks accept both short term and long term deposits. Therefore they are able to provide both short and long term loans required by the industry. The banks were facilitated to invest the surplus funds for the industrial development of the country in this type of banking system.

1.6 Commercial Banks

A bank is a financial institution engaged in banking business. A bank is a financial intermediary. It deals in money and credit. It deals with other people's money. It collects the savings of some people and gives the money to those who are in need of it. Thus a bank is a reservoir of money. It is a manufacturer of money. It manufactures credit and sells it. That is why a bank is called as a "factory of credit".

Commercial banks are profit making organizations that accept deposits and use these funds to make loans. They are playing the most important role in modern economic organisation. It performs an important economic organization. They perform an important economic function by mobilising the savings of the community and channelise the savings to productive purposes. "The tiny streams of capital flowing into the bank vaults become rives and these in turn fall into ocean of National Finance to drive the wheels of industry and to float the vessels of commerce."

There are mainly two types of commercial banking institutions in India such as public sector banks and private sector banks. The commercial banking group consists of 27 Public sector banks, 29 private sector banks, 36 Foreign Banks operating in India, 196 Regional Rural Banks and 4 Local Area Banks.

Functions of Commercial Banks

Commercial banks perform a variety of functions. All functions of commercial banks may be broadly classified into two -primary functions and secondary functions.

Primary Functions

Primary functions consist of accepting deposits, lending money and investment of funds.

1. **Accepting deposits**: Bank receives idle savings of people in the form of deposits. It borrows money in the form of deposits. These deposits may be of any of the following types:

(a) *Current or demand deposit*: In the case of current deposits money can be deposited and withdrawn at any time. Money can be withdrawn only by means of cheques. Usually a bank does not allow any interest on this kind of deposit because, bank cannot utilize these short term deposits. This type of deposits is generally opened by business people for their convenience. Current account holders should keep a minimum balance of Rs. 2000, to keep the account running.

(b) *Fixed or time deposits*: These deposits are made for a fixed period. These can be withdrawn only after the expiry of the fixed period for which the deposits have been made. The bank gives higher rate of interest on this deposit. The rate of interest depends upon the duration of deposit. The longer the period the higher will be the rate of interest. For the evidence of the deposit, the banker issues a 'Fixed Deposit Receipt'.

(c) *Savings Deposits*: As the name suggests, this deposit is meant for promotion of savings and thrift among the people. In the case of savings deposits there are certain restrictions on the number of withdrawals or on the amount that can be withdrawn per week. A minimum balance of Rs. 100 should be maintained and if cheque book facility is allowed, the minimum balance should be Rs. 1000. On the savings deposit, the rate of interest is less than that on the fixed deposit.

(d) *Recurring deposits*: This is one form of savings deposit. In this type of deposit, at the end of every week or month, a fixed amount is deposited regularly. The amount can be withdrawn only after the expiry of the specified period. This deposit works on the maxim 'little drops of water make a big ocean'. It may be opened for monthly installments in sums of Rs. 100 or in multiples of Rs. 100 with a maximum of Rs. 1000.

2. **Lending Money**: Lending constitutes the second function f a commercial bank. Out of the deposits received, a bank lends money to the traders and businessmen. Money is lent usually for short periods only. A commercial bank lends in any one of the following ways:

(a) *Loans*: In case of loan, the banker advances a lump sum for a certain period at an agreed rate of interest. The amount granted as loan is first credited in the borrower's account. He can withdraw this amount at any time. The interest is charged for the full amount sanctioned whether he withdraws the money from this account or not. Loan is granted with or without security.

(b) *Cash credit*: Cash credit is an arrangement by which the customer is allowed to borrow money up to a certain limit. The customer can withdraw the amount as and when required. Interest is charged only for the amount withdrawn and not for the whole amount as in the case of loan.

(c) *Overdraft*: overdraft is an arrangement between a banker and his customer by which the customer is allowed to withdraw over and above the credit balance in the current account up to an agreed limit. The interest is charged only for the amount sanctioned. This is a temporary financial assistance. It is given either on personal security or on the security of assets.

(d) *Discounting of bills*: Bank grants advances to their customers by discounting bills of exchange or pronote. In other words, money is lent on the security of bill of exchange or pronote. The amount after deducting the interest (discount) from the amount of the bill is credited in the account of the customer. Thus in this form of lending, the interest is received by the banker in advance. Bank, sometimes, purchases the bills instead of discounting them.

3. **Investment of funds**: Another function is investing the funds in some securities. While making investment a bank is required to observe three principles, namely liquidity, profitability and safety. A bank invests its funds in government securities issued by central

government as well as state government. It also invests in other approved securities like the units of UTI, shares of GIC and LIC, securities of State Electricity Board etc.

4. Credit Creation: -It is a unique function of Commercial Banks. When a bank advances loan to its customer if doesn't lend cash but opens an account in the borrowers name and credits the amount of loan to that account. Thus, whenever a bank grants loan, it creates an equal amount of bank deposits. Creation of deposits is called Credit Creation. In simple words we can define Credit creation as multiple expansions of deposits. Creation of such deposits will results an increase in the stock deposits. Creation of such deposits will results an increase in the stock of money in an economy.

Secondary Functions

Secondary functions include agency services and general utility services

Agency Services: Modern commercial banks render a number of services to its customers. It acts as an agent to its customers. The following are the important agency services rendered by a commercial bank:

1. It collects the cheques. bills and pronotes for and on behalf of its customers

2. It collects certain incomes like dividend on shares, interest on securities etc., on behalf of its customers.

3. It undertakes to purchase or sell securities for its customers.

4. It accepts bill of exchange on behalf of its customers.

5. It acts as a referee by supplying information regarding the financial position of its customers when inquiries made by other business people and vice versa. It supplies this information confidently.

6. It acts as an executor, administrator and trustee.

General Utility Services: General utility services are rendered not only to its costumers but also to the general public. The following are the important general utility services rendered by a commercial bank.

1. It facilitates easy and quick transfer of funds from one place to another place by means of cheques, drafts, MT, TT etc.

2. It issues letter of credit, traveler's cheques, gift cheques etc.

3. It deals with foreign exchange transactions thereby helping the importers and exporters.

4. It undertakes the safe custody of valuables. For this purpose safe deposit vaults are maintained. Vault is a strong room for keeping the valuables safe.

5. Bank makes arrangements for transport, insurance and warehousing of goods.

6. It underwrites the shares and debentures of the newly promoted joint stock companies.

7. Some commercial banks undertake merchant banking business equipment leasing business.

8. It provides tax consultancy services. It gives advice on income tax and other personal taxes. It prepares customers annual statement, files appeals etc.,

9. It provides consultancy services on technical, financial, and managerial and economic aspects for the benefit of micro and small enterprises.

Modern Functions of a Commercial Bank

1. Changing cash for bank deposits and bank deposits for cash.

2. Transferring bank deposits between individuals and/or companies.

3. Exchanging deposits for bills of exchange, government bonds, secured and unsecured promises of trade and industrial units.

4. Underwriting capital issues.

5. Providing 24 hours facility of payments through ATMs.

6. It issues credit cards, smart cards etc.

Role of Commercial Banks in the Economic Development

Commercial Banks play an important role in the growth and development of economy in general and enterprise sector in particular. Commercial Bank in India comprises the State Bank of India (SBI) and its subsidiaries, nationalized banks, foreign banks and other scheduled commercial banks, regional rural banks and non-scheduled commercial banks. The total numbers of branches of commercial banks are more than 50,000 and the regional rural banks are approximately 8,000 covering 280 districts in the country. Commercial banks mostly provide short term loans and in some cases medium term financial assistance also to small scale units. According to the Data compiled by RBI, of all the advances given to small scale industries by the commercial banks, the share of ' term loan' is nearly 30%. The lead in this regard was taken by the State Bank of India (SBI) in 1956 when a pilot scheme for guaranteed credit to small scale units was started. Initially, the scheme was confined to the branches of the SBI in the country. Subsequently, some of the other commercial banks also adopted the scheme. Under this scheme, the banks provide to the SSIs the medium term and installment credit for acquiring fixed asset for the purpose of establishment and extension of

their units, and term credit for meeting their working capital needs. The borrower is required to make a down payment of 20 to 33 1/3% of cost of equipment to be purchased from one's own resources while the rest is financed out of the loan. The rate of interest charged on these loans varies from time to time as per the directive of the Reserve Bank of India (RBI). The period for which this loan is granted varies from 7 to 10 years. These loans are repayable in half yearly or yearly instalments.

Most of the commercial banks have got specialized units in their administrative structure to take care of the financial needs of the small scale industrial units. The fixed capital needs or the long and medium term needs of the small scale industrial units are presently being taken care of by the banks under their integrated scheme of credit for the small entrepreneurs. New units apart from the existing units are also eligible to avail of the advances financed to meet their medium and long-term credit needs for replacement of machinery, addition of the machinery, modernisation etc. The rate of interest charged normally from the small scale industrial units is between 12% and 15% against 18 % from the large scale units.

The commercial banks also establish letter of credit on behalf of their clients for favoring supplies of raw materials/ machinery (both Indian and foreign) which extend the bankers assurance for payment and thus help their delivery.

Most of the commercial banks are now geared to provide counseling services to prospective and existing entrepreneurs. Some of the banks have even established consultancy cells to provide guidance to entrepreneurs at the time of project report preparation. Such consultancy cells undertake detailed studies in established units also for improving their functioning.

1.7. Central Bank

Central Bank - meaning

A modern central bank performs so many functions of different nature that it is very difficult to give any brief but accurate definition of a central bank. Any definition of a central bank is derived from its functions and these functions have varied from time to time and from country to country. In other words, the functions of central banks have grown over time making it more difficult to give any brief and unchanging definition of a central bank. We may say that a central bank is one which acts as the banker to the governments and the commercial banks, has the monopoly of note issue, operates the currency and credit system of the country and does not perform the ordinary commercial banking function.

Economists have defined central bank differently, emphasizing its one function or the other. According to Vera Smith, “the primary definition of Central banking is a banking system in which a single bank has either complete or a residuary monopoly of note issue”. In the statutes of the Bank for International Settlements, a central bank is the bank in any country to

which has been entrusted the duty of regulating the volume of currency and credit in the country". The fact that several banks have been named reserve banks appears to show that in the opinion of some authorities the custody of bank reserves is the characteristic function of a central bank.

Reserve Bank of India (RBI)

The RBI is the Central Bank of our country. It is the open Institution of India Financial and monetary system. RBI came into existence on 1st April, 1935 as per the RBI act 1935. But the bank was nationalised by the government after Independence. It became the public sector bank from 1st January, 1949. Thus, RBI was established as per the Act 1935 and empowerment took place in banking regulation Act 1949. RBI has 4 local boards basically in North, South, East and West – Delhi, Chennai, Calcutta, and Mumbai.

Functions of Reserve Bank of India (RBI)

I. Traditional Functions

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

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

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

3. **Banker to the Government**: The RBI being the apex monitory body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains

government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.

4. **Exchange Rate Management**: It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.

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

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

II. Developmental / Promotional Functions of RBI

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

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

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

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

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

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

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

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

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

8. **Promotion of Export through Refinance**: The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

III. Supervisory Functions of RBI

RBI has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

1. **Granting license to banks**: The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.
2. **Bank Inspection:** The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.
3. **Control over NBFIs:** The Non-Bank Financial Institutions are not influenced by the working of a monitory policy. However RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.
4. **Implementation of the Deposit Insurance Scheme**: The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.

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

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

I) **General / Quantitative Credit Control Methods:-**

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

1. Bank Rate Policy:-

Bank rate is the rate at which the Central bank lends money to the commercial banks for their liquidity requirements. Bank rate is also called discount rate. In other words bank rate is the rate at which the central bank rediscounts eligible papers (like approved securities, bills of exchange, commercial papers etc) held by commercial banks. Bank rate is important because it is the pace setter to other market rates of interest. Bank rates have been changed several times by RBI to control inflation and recession. Bank rate is 8.25% w.e.f. 03/05/2013.

2. Open market operations:-

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

3. Cash Reserve Ratio (CRR)

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

4. Statutory Liquidity Ratio (SLR)

Under SLR, the government has imposed an obligation on the banks to; maintain a certain ratio to its total deposits with RBI in the form of liquid assets like cash, gold and other securities. The RBI has power to fix SLR in the range of 25% and 40% between 1990 and 1992 SLR was as high as 38.5%. Narasimham Committee did not favour maintenance of high SLR. The SLR was lowered down to 25% from 10th October 1997. It was further reduced to 24% on November 2008. At present it is 23% w.e.f.11/08/2012.

5. Repo and Reverse Repo Rates

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

Reverse repo rate is the rate that banks get from RBI for parking their short term excess funds with RBI. Repo and reverse repo operations are used by RBI in its Liquidity Adjustment Facility. RBI contracts credit by increasing the repo and reverse repo rates and by decreasing them it expands credit. Repo rate was 6.75% in March 2011 and Reverse repo rate was 5.75% for the same period. On May 2011 RBI announced Monetary Policy for 2011-12. To reduce inflation it hiked repo rate to 7.25% and Reverse repo to 6.25% w.e.f 03/05/2013

II) **Selective / Qualitative Credit Control Methods:-**

Under Selective Credit Control, credit is provided to selected borrowers for selected purpose, depending upon the use to which the control tries to regulate the quality of credit - the direction towards the credit flows. The Selective Controls are:-

1. Ceiling on Credit

The Ceiling on level of credit restricts the lending capacity of a bank to grant advances against certain controlled securities.

2. Margin Requirements

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

3. Discriminatory Interest Rate (DIR)

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

4. Directives

The RBI issues directives to banks regarding advances. Directives are regarding the purpose for which loans may or may not be given.

5. Direct Action

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

6. Moral Suasion

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

1.8. Emerging Trends in Banking

In 1990's Indian banking sector saw a great emphasis on the replacement of technolog y with the new innovations. Banks began to use these new technologies to provide better and quick services to the customers at a great speed. Some of the innovations techniqu es introduced in Indian banking sector in post reform era are as follows:

E-Banking

E-banking involves information technology based banking. Under this I.T system, the banking services are delivered by way of a Computer-Controlled System. This system does involve direct interface with the customers. The customers do not have to visit the bank's premises.

Advantages of E-Banking

The operating cost per unit services is lower for the banks.

It offers convenience to customers as they are not required to go to the bank's premises.

There is very low incidence of errors.

The customer can obtain funds at any time from ATM machines.

The credit cards and debit cards enables the Customers to obtain discounts from retail outlets.

The customer can easily transfer the funds from one place to another place electronically.

Popular services covered under E-Banking

1. Automated Teller Machines,
2. Credit Cards,
3. Debit Cards,
4. Smart Cards,
5. Electronic Funds Transfer (EFT) System,
6. Mobile Banking,
7. Internet Banking,
8. Tele-banking
9. Home banking
10. Demat facility
11. Cheques Truncation Payment System

1. Automated Teller Machine:

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

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

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

3. ATM reduces the workload of bank's staff.: ATMs reduce the work pressure on bank's staff and avoids queues in bank premises.

4. ATM provide service without any error: ATMs provide service without error. The customer can obtain exact amount. There is no human error as far as ATMs are concerned.

5. ATM is very beneficial for travellers: ATMs are of great help to travellers. They need not carry large amount of cash with them.

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

7. ATM provides privacy in banking transactions: Most of all, ATMs provide privacy in banking transactions of the customer.

2. **Electronic Transfer of Funds:**

This is an electronic debit or credit of customers account. Bank customers can buy goods and services without caring cash by using credit or debit cards. There cards are issued to thecustomers by the bankers. This system works on a pin (personal identification number).

TheCustomer swipes the card by using the card reader device to make the transactions. The development of electronic banking and internet banking helped the customers to utilize their services.

3. Tele-Banking:

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

4. Mobile Banking:

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

5. Home Banking:

It is another important innovation took place in Indian banking sector. The customers can perform a no. of transactions from their home or office. They can check the balance and transfer the funds with the help of a telephone. But it is not that popularly utilized in our country.

6. Internet Banking:

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

7. Demate Banking:

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

8. Credit Cards

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

9. Debit Card

A debit card (also known as a bank card or check card) is a plastic card that provides the cardholder electronic access to his or her bank account/s at a financial institution. Some cards have a stored value against which a payment is made, while most relay a message to the cardholder's bank to withdraw funds from a designated account in favour of the payee's designated bank account. The card can be used as an alternative payment method to cash when making purchases. In some cases, the cards are designed exclusively for use on the Internet, and so there is no physical card. In many countries the use of debit cards has become so widespread that their volume of use has overtaken or entirely replaced the check and, in some instances, cash transactions. Like credit cards, debit cards are used widely for telephone and Internet purchases. However, unlike credit cards, the funds paid using a debit card are transferred immediately from the bearer's bank account, instead of having the bearer pay back the money at a later date.

Credit Card Vs Debit Card

	Credit card	**Debit card**
1	It is a “pay later product”	It is “pay now product”
2	The card holder can avail of credit for 30-45 days	Customers account is debited immediately
3	No sophisticated communication system is required for credit card operation	sophisticated communication network/ system is required for debit card operation (eg.ATM)
4	Opening bank account and maintaining required amount are not essential	Opening bank account and maintaining required amount are essential
5	Possibility of risk of fraud is high	Risk is minimised through using PIN

10. Smart Card

A smart card resembles a credit card in size and shape, but inside it is completely different. First of all, it has an inside -- a normal credit card is a simple piece of plastic. The inside of a smart card usually contains an embedded microprocessor. The microprocessor is under a gold contact pad on one side of the card.

Smarts cards may have up to 8 kilobytes of RAM, 346 kilobytes of ROM, 256 kilobytes of programmable ROM, and a 16-bit microprocessor.

The most common smart card applications are:

- Credit cards
- Electronic cash
- Computer security systems
- Wireless communication
- Loyalty systems (like frequent flyer points)
- Banking
- Satellite TV
- Government identification

11. Cheques Truncation Payment system (CTPS)

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

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MODULE 2

TYPES OF CUSTOMERS OF BANKS

In the ordinary language, a person who has an account in a bank is considered its customer. The term customer also presents some difficulty in the matter of definition. There is no statutory definition of the term either in India or in England. However, the legal decisions on the matter throw some light on the meaning of the term.

According to Dr. Hart ***"a customer is one who has an account with a banker or for whom a banker habitually undertakes to act as such."***

"Broadly speaking, a customer is a person who has the habit of resorting to the same place or person to do business. So far as banking transactions are concerned he is a person whose money has been accepted on the footing that the banker will honour up to the amount standing to his credit, irrespective of his connection being of short or long standing." Thus, a person who has a bank account in his name and for whom the banker undertakes to provide the facilities as a banker is considered to be a customer. It is not essential that the account must have been operated upon for some time.

Thus, in order to constitute a person as a customer, he must satisfy the following conditions:

1. He must have an account with the bank – i.e., saving bank account, current deposit account, or fixed deposit account.
2. The transactions between the banker and the customer should be of banking nature i.e., a person who approaches the banker for operating Safe Deposit Locker or purchasing travellers cheques is not a customer of the bank since such transactions do not come under the orbit of banking transactions.
3. Frequency of transactions is not quite necessary though anticipated.

Special Types of Customers

Special types of customers are those who are distinguished from other types of ordinary customers by some special features. Hence, they are called special types of customers. They are to be dealt with carefully while operating and opening the accounts. They are:

I. Minors:

Under the Indian law, a minor is a person who has not completed 18 years of age. The period of minority is extended to 21 years in case of guardian of this person or property is appointed by a court of law before he completes the age of 18years.According to Indian Contract Act, a minor is recognised as a highly incompetent party to enter into legal contracts

and any contract entered into with a minor is not only invalid but voidable at the option of the minor. The law has specially protected a minor merely because his mental faculty has not fully developed and as such, he is likely to commit mistakes or even blunders which will affect his interests adversely. It is for this reason; the law has come to the rescue of a minor. A banker can very well open a bank account in the name of a minor. But the banker has to be careful to ensure that he does not open a current account.

If a current account is opened and stands overdrawn inadvertently, the banker has no remedy against a minor, as he cannot be taken to a court of law. It is for this reason that the banker should be careful to see that he invariably opens a savings bank account.

The conditions for opening and maintaining accounts in the names of the minors are:

1. The minor should have attained the age of discretion, i.e., he must be about 14years of age. He must be capable of understanding what he does.

2. The minor should be able to read and write.

3. The minor should be properly introduced. The account opening form should be signed by the minor in the presence of a bank officer who should be able to identify the minor. The date of birth of the minor should be recorded in the account opening form.

4. Banks usually stipulate limits up to which deposits in such accounts can be accepted.

5. Amount tendered by the minor should as far as possible be in cash.

6. In case of time deposits, the amount should be paid in cash on maturity. Prepayment cannot be allowed. Periodical payment of interest on deposits may be made to the minor.

Legal Provisions Regarding Guardianship of a Minor

According to Hindu Minority and Guardianship Act, 1956, a Guardian is one who is recognised by law to be one of the following:

(a) Natural Guardian:

According to Section 6 of the Hindu Minority and Guardianship Act, 1956, in case of a minor boy or an unmarried girl, his/her father and after him the mother shall be the natural guardian. In case of a married girl (minor), her husband shall be the natural guardian. The terms father or mother do not include step-father or step-mother.

(b) Testamentary Guardian:

A Hindu father, who is entitle to act as the natural guardian of his minor legitimate children may, by will, appoint a guardian for any of them in respect of the minor's person or property. Such guardian acts after the death of the father or the mother

(c)Guardian Appointed by Court:

A guardian may be appointed by the court under the Guardians and Wards Act, 1890, but the court shall not be authorised to appoint or declare a guardian of the person of a minor, if his father is alive and is not, in the opinion of the court, unfit to be guardian of the person of the minor. Similar is the case of a minor girl, whose husband is not, in the opinion of the court, unfit to be guardian of her person. Thus the father (or the husband in case of a married girl) is exclusively entitled to be the guardian.

II. Lunatics:

A lunatic or an insane person is one who, on account of mental derangement, is incapable of understanding his interests and thereby, arriving at rational judgement. Since a lunatic does not understand what is right and what is wrong, it is quite likely that the public may exploit the weakness of a lunatic to their advantage and thus deprive him of his legitimate claims. On account of this, the Indian Contract Act recognises that a lunatic is incompetent to enter into any contract and any such contract, if entered into, is not only invalid but voidable at the option of the lunatic. Since a lunatic customer is an incompetent party, the banker has to be very careful in dealing with such customers. Bankers should not open an account in the name of a person of unsound mind. On coming to know of a customer's insanity, the banker should stop all operations on the account and await a court order appointing a receiver. It would be dangerous to rely on hearsay information. The bank should take sufficient care to verify the information and should not stop the account unless it is fully satisfied about the correctness of the information. In case a person suffers from a temporary mental disorder, the banker must obtain a Certificate from two medical officers regarding his mental soundness at the time of operation on the account.

III. Drunkards:

A drunkard is a person who on account of consumption of alcoholic drinks get himself intoxicated and thereby, loses the balance over his mental capacity and hence, is incapable of forming rational judgement. The law is quite considerable towards a person who is in drunken state. A lawful contract with such a person is invalid. This is for the simple reason that it is quite likely that the public may exploit the weakness of such a person to their advantage and thus, deprive him of his legitimate claims. A banker has to be very careful in dealing with such customers. There cannot be any objection by a banker to open an account. In case a customer approaches the banker for encashment of his cheque especially when he is drunk, the banker should not make immediate payment. This is because the customer may afterwards argue that the banker has not made payment at all. Therefore, it is better and safer that the banker should insist upon such a customer getting a witness (who is not drunk) to countersign before making any payment against the cheque.

IV. Married Women:

An account may be opened by the bank in the name of a married woman as she has the power to draw cheques and give valid discharge. At the time of opening an account in the name of a married woman, it is advisable to obtain the name and occupation of her husband and name of her employer, if any, and record the same to enable detection if the account is misused by the husband for crediting there in cheques drawn in favour of her employer. In case of an unmarried lady, the occupation of her father and name and address of her employer, if any, may be obtained and noted in the account opening form. If a lady customer requests the bankers to change the name of her account opened in her maiden name to her married name, the banker may do so after obtaining a written request from her. A fresh specimen signature has also to be obtained for records.

While opening an account of a purdah lady (purdah nishin), the bank obtains her signature on the account opening form duly attested by a responsible person known to the bank. It is advisable to have withdrawals also similarly attested. In view of practical difficulties involved, it would be better not to open accounts in the names of purdah ladies.

V. Insolvents:

When a person is unable to pay his debts in full, his property in certain circumstances is taken possession of by official receiver or official assignee, under orders of the court. He realises the debtor's property and rateably distributes the proceeds amongst his creditors. Such a proceeding is called 'insolvency' and the debtor is known as an 'insolvent'. If an account holder becomes insolvent, his authority to the bank to pay cheques drawn by him is revoked and the balance in the account vests in the official receiver or official assignee.

VI. Illiterate Persons:

A person is said to be illiterate when he does not know to read and write. No current account should be opened in the name of an illiterate person. However, a savings bank account may be opened in the name of such a person. On the account opening form the bank should obtain his thumb mark in the presence of two persons known to the bank and the depositor. Withdrawal from the account by the account holder should be permitted after proper identification every time. The person who identifies the drawer must be known to the bank and he should preferably not be a member of the bank's staff.

VII. Agents:

A banker may open an account in the name of a person who is acting as an agent of another person. The account should be considered as the personal account of an agent, and the banker has no authority to question his power to deal with the funds in the account unless it becomes obvious that he is being guilty of breach of trust. However, if a person is authorised to only act

on behalf of the principal, the banker should see that he is properly authorised to do the acts which he claims to do. If he has been appointed by a power of attorney, the banker should carefully pursue the letter-of-attorney to confirm the powers conferred by the document on the agent. In receiving notice of the principal's death, insanity or bankruptcy, the banker must suspend all operations on the account.

VIII. Joint Stock Company

A joint stock company has been defined as an artificial person, invisible, intangible and existing only in contemplation of law. It has separate legal existence and it has a perpetual succession. The banker must satisfy himself about the following while opening an account in the name of a company:

(a) Memorandum of Association:

Memorandum of Association is the main document of the company, which embodies its constitution and is called the charter of the company. It gives details, especially regarding objects and capital of the company's copy of this document should be insisted upon while opening an account.

(b) Articles of Association:

The Articles of Association contain the rules and regulations of the company regarding its internal management. It contains in detail all matters which are concerned with the conduct of day-to-day business of the company. The Articles of Association is also another document that a banker insists upon. It enables the banker to know the details of company's borrowing powers quantum, persons authorised to borrow etc. This will also enable the banker to understand whether the acts of the officers are within the orbit of the Company's Memorandum and Articles.

(c) Certificate of Incorporation:

This is another vital document the banker has to verify and insist upon receiving a copy. This document signifies that the company can commence its business activities as soon as it gets this Certificate which is not the case with a public company.

(d)Certificate to Commence Business:

Only for public companies, the banker insists upon this document for verification. This document gives the clearance to public companies to commence their business activities. A company can borrow funds provided it has obtained this certificate.

(e) Application Form and Copy of the Board's Resolution:

A copy of the prescribed application form duly completed in all respects has to be submitted in the beginning and that too duly signed by the company's authorised officers. Along with this, a copy of the resolution passed at the meeting of the board regarding appointment of company's bankers is quite necessary to make everything lawful. The resolution copy should be signed by the company's Chairman and Secretary in addition, a copy of the specimen signatures of the officers empowered to operate the bank account has to be furnished.

(f) A Written Mandate:

This is also another document that a banker insists upon. It contains all the details regarding operation, overdrawing of the account and giving security to the bank by the officers of the company. This document is useful to the bank for opening as well as for operating the account of the company.

(g) Registration of Charges:

Whenever a company borrows, it has to give certain assets by way of security and in case the banker accepts them as security, it has to be properly recorded in the company's books, register of charges and duly registered.

(h) Any Change in the Company's Constitution or Offices:

Whenever there is any change in the constitution like Memorandum or in respect of company's offices, it has to be communicated in writing to the bank and it should not in any way affect the earlier contracts entered into by the company with the bank. To this effect, the bankers usually take an undertaking from the company.

IX. Clubs, Associations and Educational Institutions:

Clubs, Associations and Educational Institutions are non-trading institutions interested in serving noble courses of education, sports etc. The banker should observe the following precautions in dealing with them:

(a) Incorporation:

A sports club, an association or an educational institution must be registered or incorporated according to the Indian Companies Act, 1956, or the Co-operative Societies Acts. If it is not registered, the organisations will not have any legal existence and it has no right to contact with the outside parties.

(b) Rules and by-laws of the Organisation:

A registered association or organisation is governed by the provisions of the Act under which it has been registered. It may have its own Constitution, Charter or Memorandum of Association and rules and by-laws, etc., to carry on its activities. A copy of the same should be furnished by the organisation to the banker to acquaint the latter with the powers and functions of the persons managing its affairs. The banker should ensure that these rules are observed by the persons responsible for managing the organisation.

(c) A Copy of Resolution of Managing Committee:

For opening a bank account, the managing committee of the organisation must pass a resolution—

(i) Appointing the bank concerned as the banker of the organisation.

(ii) Mentioning the name/names of the person or persons, who are authorised to operate the account.

(iii) Giving any other directions for the operation of the said account. A copy of the resolution must be obtained by the bank for its own record.

(d) An Application Form:

An application form duly completed in all respects along with specimen signatures of the office bearers of the institution is quite essential for operation of the account.

(e) A Written Mandate:

It is an important document which contains specific instructions given to the banker regarding operations, over drawing etc.

(f) Transfer of Funds:

All funds and cheques which are in the name of the Institution should be invariably credited to the Institution account and not to the personal or private accounts of the office bearers of the institution.

(g) Death or Resignation:

In case the person authorised to operate the account on behalf of a organisation or association dies or resigns, the banker should stop the operations of the organisation's account till the organisation nominates another person to operate its account.10.

X. Partnership Firm:

A partnership is not regarded as an entity separate from the partners. The Indian Partnership Act, 1932, defines partnership as the "relation between persons who have agreed to share the profit of the business, carried on by all or any of them acting for all."Partnership is formed or constituted on account of agreement between the partners and with the sole intention of earning and sharing profits in a particular ratio. Further, the business is carried on either by all the partners or some partners acting for all. The partners carry joint and several liabilities and the partnership does not possess any legal entity. A banker should take the following precautions while opening an account in the name of a partnership firm:

(a) Application Form:

A prescribed application form duly completed in all respects along with specimen signatures of the partners of firm is quite essential for operation of the account.

(b) Partnership Deed:

The banker should, very carefully examine the partnership deed, which is the charter of the firm, to acquaint himself with the constitution and business of the firm. This will help him to know his position while advancing funds to the firm.

(c) A Mandate:

A mandate giving specific instructions to the banker regarding operations, over-drawing etc., is quite necessary. It will enable the banker to handle the accounts according to the needs of the firm.

(d) Transfer of Funds:

The banker has to be very careful to see that the funds belonging to the firm should not be credited to the personal or private accounts of the partners.

(e) Sanctioning of Overdraft:

While sanctioning funds by way of overdraft, the banker has to check up the partnership deed and examine the borrowing powers of the partners empowered to borrow and he can even ask for the financial statements of the previous years for information and perusal.

XI. Joint Accounts:

When two or more persons open an account jointly, it is called a joint account. The banker should take the following precautions in opening and dealing with a joint account:

(a). The application for opening a joint account must be signed by all the persons intending to open a joint account.

(b). A mandate containing name or names of persons authorised to operate an account.

(c). The full name of the account must be given in all the documents furnished to the banker, even if the account is to be operated upon by one or a few of the joint account holders.

(d) Banker must stop operating an account as soon as a notice of death, insolvency, insanity etc., of any one account holder is received.

(e) The joint account holder, who is authorised to operate the joint account, himself alone cannot appoint an agent or attorney to operate the account on his behalf. Such attorney or agent may be appointed with the consent of all the joint account holders.

(f) If all the persons are operating the account, then banker must see that any cheque drawn on him is duly signed by all.

(g) Banker must stop making payments as soon as letter of revocation is obtained.

(h) Banker must see that no loan or overdraft is granted without proper security.

XII. Joint Hindu Family:

Joint Hindu family is an undivided Hindu family which comprises of all male members descended from a common ancestor. They may be sons, grandsons and great grandsons, their wives and unmarried daughters. “A joint, Hindu family is a family which consists of more than one male member, possesses ancestral property and carries on family business.” Therefore, joint Hindu family is a legal institution. It is managed and represented in its dealings and transactions with others by the Kartha who is the head of the family. Other members of the family do not have this right to manage unless a particular member is given certain rights and responsibilities with common consent of the Kartha. The banker has to exercise greater care in dealing with this account.

(a) He must get complete information about the joint Hindu family including the names of major and minor coparceners and get a declaration from the Kartha to this effect along with specimen signatures and signatures of all coparceners.

(b) The account should be opened either in the personal name of the Kartha or in the name of the family business.

(c) The documents should be signed by the Kartha and major coparceners.

(d) The account should be operated on only by the Kartha and the authorised major coparceners.

(e) While making advances, the banker should ascertain the purpose for which the loan is obtained and whether the loan is really needed by the joint Hindu family for business.

XIII. Trustees:

According to the Indian Trusts Act, 1882, "a trust is an obligation annexed to the ownership of property and arising out of a confidence reposed in an accepted by the owner, or declared and accepted by him, for the benefit of another, or of another and the owner." As per this definition, a trustee is a person in whom the author or settler reposes confidence and entrusts the management of his property for the benefit of a person or an organisation who is called beneficiaries. A trust is usually formed by means of document called the "Trust Deed." While opening an account in the names of persons in their capacity as trustees the banker should take the following precautions:

(a) The banker should thoroughly examine the trust deed appointing the applicants as the trustees.

(b) A trust deed which states the powers and functions of trustees must be obtained by the banker.

(c) In case of two or more trustees, the banker should ask for clear instructions regarding the person or persons who shall operate the account.

(d) In case of death or retirement of one or more trustees, banker must see the provision of the trust deed.

(e) The banker should not allow the transfer of funds from trust account to the personal account of trustee.

(f) The banker should take all possible precautions to safeguard the interest of the beneficiaries of a trust, failing which he shall be liable to compensate the latter for any fraud on the part of the trustee.

(g) The insolvency of a trustee does not affect the trust property and the creditors of the trustee cannot recover their claims from trust property.

(h) A copy of the resolution passed in the meeting of trustees open the account should be obtained.

A banking institution solicits deposits of money from the members of the public. An account in a bank for this purpose may be opened by any person who (i) is legally capable of entering into a valid contract, (ii) applies to the banker in the proper manner, i.e., he follows the procedure laid down by the banker and accepts the terms and conditions stipulated by the latter. The banker, however, possesses the right to reject an application for opening an account, if he is not satisfied with the identity of the applicant, i.e., if the latter is deemed to be an undesirable person. Some persons like the minors, lunatics and drunkards are not competent to enter into valid contracts. Some persons who act on behalf of others have limitations on their power to contract, e.g., the agents, trustees; executors etc., Institutions like schools, colleges, clubs, societies, and corporate bodies are the impersonal customers of a banker. The authority power and functions of the persons managing these institutions are embodied in their respective constitutions. The banker should, therefore, take special care and precautions to ensure that the accounts of these institutes are being conducted in accordance with the provisions of their respective charters. A banker should know the legal position of the special classes of customers and the necessary precautions to be taken while dealing with them.

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MODULE 3

INTRODUCTION TO INSURANCE

It is a generally acknowledged phenomenon that there are enormous risks in every sphere of life. For property, there are fire risks; for shipment of goods, there are perils of sea; for human life, there are risks of death or disability; and so on. The chances of occurrences of the events causing losses are quite uncertain because these may or may not take place. In other words, our life and property are not safe and there is always a risk of losing it. A simple way to cover this risk of loss money-wise is to get life and property insured. In this business, people facing common risks come together and make their small contributions to the common fund. While it may not be possible to tell in advance, which person will suffer the losses, it is possible to work out how many persons on an average out of the group may suffer the losses.

When risk occurs, the loss is made good out of the common fund. In this way, each and everyone share the risk. In fact, insurance companies bear risk in return for a payment of premium, which is calculated on the likelihood of loss.

Insurance- Meaning and definition

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

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

According to Mc Gill, “Insurance is a process in which uncertainties are made certain”.

In the words of Jon Megi, “Insurance is a plan wherein persons collectively share the losses of risks”.

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

Brief History of Insurance

The growth of insurance industry is associated with the general growth of industry, trade and commerce. The origin of insurance services may be traced back to 14th Century in Italy when ships carrying goods were covered under different perils. Thus marine insurance become oldest insurance practice. The systematic and orderly beginning of the insurance industry took place in UK at Lloyds coffee house in Tower Street in London. In developing countries, insurance sector has assumed special significance as it has the potential to speed up the rate of growth of the economy. Insurance Industry assists the development process of an economy in several ways. Primarily, it acts as mobiliser of savings, financial intermediary promoter of investment activity, stabilizer of financial market, risk manager and an agent to allocate capital resources efficiently. Although the insurance industry has grown rapidly in the industrialized countries. Its growth in developing countries has neither been satisfactory nor in tandem with the growth of other sectors of the economy. The most industrialized countries in the world still account for 88% of global premium volume. The share of developing countries is extremely low. The slow growth insurance services in developing countries calls for an in-depth analysis of the nature and pattern of the evolution of these services policies pursued to develop the insurance industry and constraints thereof also need close examination.

The Indian History of Insurance

Regrettably, the Indian insurance industry has lagged behind even amongst the developing countries of the world. Although general insurance services started in India about 150 years ago, their growth has been dilatory, as reflected by low insurance penetration and density. Several factors are responsible for this state of affairs, the chief being the monopoly status of the industry till recently. The life insurance business was nationalized in 1956 and the general insurance industry in 1973. The lack of competition has impeded the development of insurance industry in India, resulting in low productivity and poor quality of customer services. The process of liberalization and globalization of the Indian economy started in right earnest in mid-1980s. The market mechanism was the motivating factor underlying the new economic policy. In consonance with the new economic policy, insurance sector was opened up for the private sector in 1999. The new competitive environment is expected to benefit the consumers, industry and the economy at large. The consumer will have a greater choice in terms of number and quality of products, low premium rates, efficient after sales services while the economy will benefit in terms of larger flow of savings, increased availability of investible funds for long term projects, enhanced productivity and growth of multiple debt instruments.

Life Insurance had its beginning in ancient Rome, where citizens formed burial clubs that would meet the funeral expenses of its members as well as help survivals by making its payments. The first stock company to get into the business of insurance was chartered in

England in 1720. In the year 1735 saw the birth of the first insurance company in American Colonies in Charleston. In 1759, the Presbyterian Synod of Philadelphia sponsored the first Life Insurance Corporation in America. However, it was after 1840 that Life Insurance really took off in a big way.

The 19th century saw huge developments in the field of insurance with the newer products being devised to meet growing needs. The history of insurance in our country is somewhat darken. The earliest reference of life insurance was available in the days of East India Company, when the policies were taken only by the British officers. The policy was issued by British officers in sterling currency. Oriental was the first foreign insurance company established in India in 1818. Foreigners, orphans and widows were become subject matter for the oriental company. The company started accepting the Indians in 1934 due to the efforts of Babu Muttylai seal. 'Bombay Life', a company had issued short term policies for 2-3 years in 1823. Raja Ram Mohan Roy, the man who pleaded for protecting widows through government insurance 'Bombay Mutual Life Assurance Society was established by some prominent citizens of Bombay in 1871. European merchant also started 'Bombay Insurance Society' in 1893 by voluntary efforts. Mr. Curstjee Furdoonju was the first insured person of India. This policy was insured in 1848 by royal Insurance which started in 1845. It was the beginning of the Indian insurance venture.

Basic terms used in insurance

Different terms are used in the insurance. Important among them are given below

Insured

The party or the individual who seeks protection against a specified task and entitled to receive payment from the insurer in the event of happening of stated event is known as insured. An insured is normally in insurance policy holder.

Insurer

The party who promises to pay indemnity the insured on the happening of contingency is known as insurer. The insurer is an insurance company.

Beneficiaries

The person or the party to whom the policy proceeds will be paid in the event of the death or happening of any contingency is called beneficiary.

Contract

An agreement binding at law between two or more parties is called contract.

Premium

The amount which is paid to the insurer by the insured in consideration to insurance contract is known as premium. It may be paid on monthly, quarterly, half yearly, yearly or as agreed upon it is the price for an insurance policy.

Insured sum

The sum for which the risk is insured is called the insured sum, or the policy money or the face value of the policy. This is the maximum liability of the insurer towards the insured.

Peril

A peril is an event that causes a personal or property loss by fire, windstorm, explosion, collision premature death, sickness, floods, dishonesty etc.

Hazard

Hazard is a condition that may create, increase or decrease the chances of loss from a given peril.

Exposure

An exposure is a measure of physical extent of the risk. An individual who owns a business house may be subjected to economic loss and individual loss because of his business and personal exposure.

Cover note

An unstamped document issued by or on behalf of insurers as evidence of insurance pending issue of policy.

Damages

Monetary compensation award at law for a civil wrong or breach of contract.

Indemnity

Compensation for actual loss suffered is call indemnity.

Reinsurance

Reinsurance is a method where by the original insurer transfer all or part of risk he has assumed to another company or companies with the object of reducing his own commitment to an reducing his own commitment to an amount that he can bear for his own account commensurate with his financial resources in the event of loss. It was originally confined to offers and acceptances on individual risk known as facultative reinsurance transactions.

Double Insurance

Double insurance implies that subject matter is insured in two or more insurance companies (insurers) and the total sum insured exceeds the actual value of subject matter. In other words, the same subject matter is insured in more than one insurer.

No claim bonus

The bonus is getting under the policy, if the claim is not reported during the policy period and after that the time renewal (in time) then as per the policy term no claim bonus is avail for the vehicle insurance policy and the rate of bonus is different in different general insurance companies, and the maximum rate should be up to 50% as per the norms.

Nature and Characteristics of Insurance

Insurance follows important characteristics – These are follows

1. **Sharing of risk**

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

2. **co-operative device**

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

3. **Large number of insured persons**

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

4. **Evaluation of risk**

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

5. **Payment of happening of specified event**

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

6. Transfer of risk

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

7. Spreading of risk

Insurance is a plan which spread the risk & losses of few people among a large number of people. John Magee writes, "Insurance is a plan by which large number of people associates themselves and transfers to the shoulders of all, risk attached to Individuals".

8. Protection against risks

Insurance provides protection against risk involved in life, materials and property. It is a device to avoid or reduce risks.

9. Insurance is not charity

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

10. Insurance is not a gambling

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

11. A contract

Insurance is a legal contract between the insurer and insured under which the Insurer promises to compensate the insured financially within the scope of insurance Policy, the insured promises to pay a fixed rate of premium to the insurer.

12. Social device

Insurance is a plan of social welfare and protection of interest of the people. Rieged and miller observe "insurance is of social nature".

13. Based upon certain principle

Insurance is a contract based upon certain fundamental principles of insurance, which includes utmost good faith, insurable interest, contribution, indemnity, causa Proxima, subrogation etc, which are operating in the various fields of insurance.

14. Regulation under the law

The government of every country enacts the law governing insurance business So as to regulate, and control its activities for the interest of the people. In India General insurance act 1972 and the life insurance act 1956 are the major enactment in this direction.

15. Insurance is for pure risk only

Pure risks give only losses to the insured, and no profits. Examples of pure Risks are accident, misfortune, death, fire, injury, etc., which are all the sided risks and the ultimate results in loss. Insurance companies issue policies against pure risk only, not against speculative risks.

16. Based on mutual goodwill

Insurance is a contract based on good faith between the parties. Therefore, both the parties are bound to disclose the important facts affecting to the contract before each other. Utmost good faith is one of the important principles of insurance.

Importance of insurance

Insurance plays significant role for not only an individual or for not only an individual or for a family but it has spread over the entire nervous system of the nation. Not only does is serve the ends of individuals, it tends more and more both to pervade and transform our modern social order.

According to the author, Dins dale, ***"No one in modern world can afford to be without insurance."***

Insurance provides various advantages to various fields. We can classify the importance as under

I individual aspects:

For an individual, the importance of insurance is laying in the following points:

1. Security for health and property
2. Encourage savings
3. Encourage the habit of forced thrift
4. Provide mental peace
5. Increase efficiency
6. Provision for the future
7. Awareness for the future

8. Credit Facility
9. Tax exemption
10. Contribution to the conservation of health
11. Cover for legal liability
12. Security to the mortgaged property
13. Poster economic independence

II Economic aspects

1. Safety against risk
2. Protection to employees
3. Basis of Credit
4. Protection from the loss of key man
5. Encourage loss prevention methods
6. Reduction of cost
7. Promote foreign trade
8. Development of big industries
9. Increase in efficiency

III Social aspects

1. Stability in family life
2. Development of employment opportunity
3. Encourage alertness
4. Contributes to the development of basic facilities

IV National aspects

1. Increase the national savings
2. Helps in development opportunities
3. Develops the money market
4. Earns foreign exchange
5. Capitalizes the savings

Function of insurance

Insurance becomes very useful in today's life. It plays significant role in this competitive era. According to Sir William Beveridge the functions of insurance can be divided into three categories.

1) Primary functions

2) Secondary functions

3) Indirect functions

Primary function

1. **To provide protection**

The most important function of insurance is to provide protection against risk of loss. It is one check the reality of the misfortune happening, and pays the cost of damages of losses.

2. **To provide certainty**

The future is totally uncertain. Any misfortune happening may occur at any stage of life. The amount of loss and time of losses both are uncertain. Insurance provides certainly towards the losses. The policy holders pay the premium to get certainty

3. **Distribution of risk**

It is a co-operative effort where the risk is distributed among the group of People. Thus, no one have to bear the losses occurred due to uncertainty.

Secondary function

1. **Helps in economic progress**

Insurance plays an important role in economic progress. It gives fully certainty to the industrialists towards the risks. The entrepreneurs can more concentrate on Innovative and profitable techniques of the production. They should not require Thinking over the risks. The industrialists can establish new industries in environment. Thus, industries have got development in economic and commerce of the nation.

2. **Insurance prevents losses**

Insurance plays vital role in preventing the losses. The amount of premium is minimized by using such appliances like the fire extinguisher. If one uses interior Machinery which may be caused for misfortune, the amount of premium will be high. Thus, indirectly, insurance provides help to minimize the chances of risks.

Indirect function

1. **A forced savings**

Life insurance is also a method of savings in India. Income tax act gives relief in payment of income tax because government wants to habituate general public to save money. It encourages the habit of thrift and savings among the people. Thus, it becomes compulsory savings to people of nation.

2. **Promote foreign trade**

It is compulsory to take marine insurance policy in foreign trade in India. Foreigners can't issue the foreign trade bill unless the cargo is fully insured. Thus Foreign trade is totally depends upon the insurance sector of the nation. It gives relief to entrepreneurs from the uncertainty of foreign trade.

3. **Others**

Insurance provides certainties towards risks in entrepreneurship. It gives Confidence in general public. It is one of the important source of investment which develops the trade and commerce of the nation.

Advantages/benefits/uses of insurance

a. **Risk transfer-** individual or businessman can easily and conveniently transfer the risk of loss

b. **Protection-** insurance give protection to the property of insured and life insurance provides financial protection

c. **Assured profit-** a policy holders can enjoy a normal expected profit say up to 15 to 20% on their investment

d. **Effect on prices (benefit to consumers)-**Manufacturers passes on the consumer, the cost of insurance along with other Production cost. Still it is beneficial to the consumers because without insurance the Cost would have been much more.

e. **Basis of credit-** policies act as valuable assets and the policy holders can avail credit or emergency loan against it

f. **Investment-** a life insurance contract provides not only protection but also investment, or a pension in old age.

g. **Capital formation-** insurance companies as institutional investors can mobilise small national savings in the form of premium and ensure capital for productive sectors.

h. **Insurance encourage saving-** life insurance is like a compulsory saving. For people have limited means of income there is no other better alternative than LIC.

i. **Invisible export-** Providing insurance service overseas is our invisible export, like export of material goods and the profit brought in is contribution to the favourable balance of Trade.

j. **Reducing cost of social services-** No victim or heirs of a deceased victim of motor accidents now a day's goes Without compensation from insurance funds built out of compulsory insurance of Motor vehicles.

Limitations of Insurance

In spite of number of advantages of insurance, it has certain limitations. On account of such limitations, the benefits of insurance could not be availed in full.

a. All the risks cannot be insured. Only pure risks can be insured and speculative risks are not insurable.

b. Insurable interest (financial interest) en the subject matter of insurance either at the time of insurance or at the time of loss, or at both the times must be present, in the absence of which the contract of insurance becomes void.

c. In case the loss arises from the happening of the event cannot be valued in terms of money, such risks are not insurable.

d. Insurance against the risk of a single individual or a small group of persons are not advisable, since it is not practicable due to higher cost involved.

e. Another important limitation is that the premium rates are higher in our country & as such, certain category of people cannot avail the advantage of insurance. The main reason for the higher rate of premiums is the higher operating cost.

f. It becomes difficult to control moral hazards in insurance. There are certain people who may utilise the insurance plans for their self-interest by claiming false claims from insurance companies.

Insurance and Social Security

The path of insurance has been evolved to look after the interests of people from uncertainty by providing certainty of compensation at a given contingency. The insurance

principle comes to be more useful in modern affairs. It not only serves the ends of individuals, or of special groups of individuals, but also tends to spread through and renovate modern social order or social security. Following point explain in the role of insurance in social security empowerment.

A. Social security to individuals

1. Insurance provides security and safety

The insurance provides safety and security against the loss on a particular event. Eg. In case of life insurance, payment is made when death occurs or the term of Insurance is expired. The loss to the family at a premature, death and payment in old age are adequately provided by insurance. In other words, security against premature death and old-age sufferings are provided by life insurance. Similarly, the property of Insured is secured against loss on a fire in fire insurance.

2. Insurance offers peace of mind

The security wish is the prime motivating factor. This is the wish, which tends To stimulate to work more. If this wish is unsatisfied, it will create a tension which May manifest itself in the form of an unpleasant reaction causing reduction in "work. By means of insurance, feeling of insecurity may be eliminated.

3. Insurance protects mortgaged property

At the death of the owner of the mortgaged property, the property is taken over by the lender of money and the family is deprived of the use of the property. At The damage or destruction of the property, he will lose his right to get the loan repaid. The insurance will provide adequate amount to the dependents at the early death of the property-owner to pay-off the unpaid loans. Similarly, the mortgagee gets adequate amount at the destruction of the property.

4. Insurance eliminates dependency

What would happen at the death of the husband or father, the annihilation of family needs no elaboration. Similarly, at destruction of property and goods, the Family would suffer a lot. It brings reduced standards of living and the suffering may go to any extent of begging from the relatives, neighbours, or friends. The economic Independence of the family is reduced or, sometimes, lost totally. The insurance is here to assist them and provide adequate amount at the Time of sufferings.

5. **Life insurance encourages saving**

The elements of protection and investment are present only in case of life Insurance. In property insurance, only protection element exists. In most of the life Policies elements of saving predominates. These policies combine the programs of Insurance and savings.

6. **Life insurance fulfils the needs of a person**

The needs of a person are divided into:

a. Family needs,
b. Old-age needs,
c. Re-adjustment needs,
d. Special needs, and
e. The clean-up needs

B. Social security to business

The insurance has been useful to the business society also. Some of the uses are discussed below

1. **Uncertainty of business and losses if reduced**

In business, commerce and industry a huge number of properties are employed. With a slight slackness or negligence, the property may be turned into ashes. The accident may be fatal not only to the individual or property but to the third party also. New construction and new establishment are possible only with the help of Insurance. In absence of it, uncertainty will be to the maximum level and nobody would like to invest a huge amount in the business or industry.

2. **Business efficiency is increased with insurance**

When the owner of a business is free from the impact of losses, he will certainly devote much time to the business. The carefree owner can work better for the maximization of the profit. The new as well as old businessmen are guaranteed payment of certain amount with the insurance policies at the death of the person; at the damage, destruction, or disappearance of the property or goods. The insurance, removing the uncertainty, enable the businessmen to concentrate more in business.

3. **Key man indemnification**

Key man is that particular man whose capital, expertise, experience, energy, ability to control, goodwill and dutifulness make him the most valuable asset in the business and whose absence will reduce the income of the employer till the time such employee is not

substituted. The death or disability of such valuable lives will, in many instances, prove a more serious loss than that by fire or any other hazard. The Potential loss to be suffered and the compensation to the dependents of such employee require adequate provision, which is met by purchasing adequate life-policies.

4. **Enhancement of credit**

The business can obtain loan by pledging the policy as collateral for the loan. The insured persons are getting more loans due to certainty, of payment at their death. The amount of loan that can be obtained with such pledging a policy will not exceed the cash value of the policy. In case of death, this cash value can be utilized for settling the loan along with the interest. If the borrower is unwilling to repay the loan and interest, the lender can surrender the policy and get the amount of loan and interest thereon repaid.

5. **Business continuation**

In a business, particularly partnership business may get discontinued at the death of any partner, although the surviving partners can restart the Business. But in both the cases the business and the partners will suffer economically. The insurance policies provide adequate funds at the time of death. Each partner may be insured for the amount of his interest in the partnership and his dependents may get that amount at the death of the Partner.

Basic Principles of Contract of Insurance

Contract of insurance have all the essential elements of general contract. According to section 2(h) and section 10 of the Indian Contract Act 1872, a valid contract must have the essential elements of offer and acceptance, consideration, legal parties, sound mind and free consent of the parties. Further, Insurance transactions need be governed by special principles in order to protect the interests of the contracting parties, particularly the customer. It is in view of this that the contracts are governed by certain special basic legal principles. These make insurance contracts very unique and different from other kinds of commercial contracts. As one shall see below, there are, however, differences between life and general insurance with regard the application, of the principles.

Following are the important essential elements or principles of a valid contract of insurance

1. Nature of contract – General to all contracts

   Special principles of insurance contract
2. Insurable interest
3. Utmost good faith
4. Indemnity

5. Causa proxima
6. Contribution
7. Mitigation of loss
8. Subrogation

1. Nature of Contract

The nature of contract is a fundamental principle of a contract of insurance required for a valid contract. Essential elements of a valid contract are:

a. Agreement (offer and acceptance) –insurance is an agreement between insurer and insured. Proposal is made by one party and accepted by other.

b. Lawful consideration- premium is consideration for insurance contract

c. Lawful objects- object of insurance is lawful and not against to public policy. It is for public welfare

d. Free consent- consent of parties to contract should be free. I.e., not by means of coercion, undue influence, fraud, misrepresentation etc.

e. Competent parties (legal capacity of parties)- parties to an insurance contract should be competent to contract. Ie, they should not be idiot, lunatic, minor, insolvent etc.

f. Consensus ad idem- parties to contract should understand the subject matter of insurance in same sense.

g. Possibility and certainty of performance etc.

2. The principle of insurable interest

The existence of insurable interest is an essential ingredient of any insurance contract. Insurable interest is the pre-requisite for insurance. A general definition used for insurable interest is “The legal right to insure arising out of financial relationship, recognized under law, between the insured and the subject matter of insurance.” Therefore, just as the owner of a house or a factory has an insurable interest in the house or factory, the bank that has lent money for the construction of the house or the factory too has an insurable interest in these to the extent of the outstanding loan amount since in the event of the damage or destruction of the property, the bank stands to lose a part or the whole of the money lent. A person who wants to insure must have insurable interest in the property to be insured. The essentials of insurable interest are:

1. There must be a property capable being insured.

2. Such a property must be subject matter of interest.

3. The insured should have a legal relation to the subject matter insurable interest could arise in a number of ways such as ; Ownerships, Mortgagee, Trustee, Bailee, Lessee etc.

In fire insurance, the insurable interest must exist throughout the contract. It must exist

a. At the inception i.e. while placing the proper for insurance.

b. During the term of the policy, i.e. the interest should not cease during the period of insurance.

c. At the time of loss i.e. in the event of fire accident the insured should continue to have the interest in the property to claim insurance money.

Referring to life insurance, a person is deemed to have insurable interest on his own life to an unlimited extent, as in the event of his pre-mature death, there will be loss of his future earnings of individual. Spouses are presumed to have insurable interest in each other's life. However in case of other members of the family, insurable interest is not presumed to exist. A person cannot, therefore, insure, say his brother or sister though they may dependent on him.

3. The Principle Of Utmost Good Faith

The principle of utmost good faith is mostly discussed in the context of the duty of the insured towards the insurer, though it is equally applicable to the insurer's duty towards the insured. In insurance contract, the prosper is the only person who is deemed to have known all the facts of the subject matter of insurance and the insurer is to completely rely on what the proposer has disclosed. The proposer, should therefore, furnish all material facts concerning the property proposed insurance which would enable the insurance company to decide the appropriate rates and the terms and condition. The duty of disclosure of material facts continues throughout the contract and the insured should advice the insurance company wherever change occurs in the property insured.

4. The Principle Of Indemnity

The object of insurance is to place insured in the same financial position as was just before the loss. This principle prevents the insured from making a profit out of loss and ensures public interest at large. For example, if a machinery insured and is destroyed by fire, the insurance company will make good to loss by taking into consideration the depreciation and wear the tear of the machinery having been in use by the insured for some time. It will not be true indemnity to pay the price of new machinery as the insured has enjoyed the use of the machinery for some years. If the insurance company pays him the money to get new machinery, it may tempt him to set fire to the sofa so that he could get new machinery for old at insurance cost.

For a building damaged by fire measure of indemnity is the cost of repairing the building to its pre-fire condition. For machinery the measure of indemnity is the cost of repair, if the machinery is destroyed by fire the market value of such a machine after taking in to consideration wear and tear and depreciation. For stock in a retail shop the measure is the cost of replacement at wholesale rate. For manufacturer it is the cost of labour, fuel, and overheads. The indemnity is for the net loss suffered by the insured and therefore, if there by any salvage of the damaged property, the value of the salvage is deducted from the amount of loss.

In the case of personal accident policies it is not possible to place a value on life as such. Hence personal accident policies are called benefit policies.

There are four methods of indemnification and they are.

1) Cash payment

2) Repair

3) Replacement

4) Reinstatement

In case of life insurance, however, the economic value of a human life cannot be measured precisely before death. It could in fact be unlimited. Hence, life insurance cannot strictly be a contract of indemnity. This does not however, mean a person can be granted life insurance for an unlimited amount.

5. The Principle Of Subrogation

Subrogation is principle, which applied to all contracts of indemnity. It means that after payment of the loss the insurer gets the right of taking all steps to recover any money in compensation from a third party. Technically speaking "Subrogation is the right, which an insurer gets, after he has indemnified the loss, to step into the shoes of the insured and avail himself of all the rights against their party in respect of loss indemnified." The subrogation principle prevents the insured of collecting the twice of the same loss at first instance, and wrong doer would escape liability at second. It strengthens the areas of insurer in cases of possibility of one recovery of misdoings, stealing or damaging made by third party and recovering the goods indemnified.

6. Contribution

The contribution is the right of an insurer who has paid a loss under a policy to recover a proportionate amount from other insurer who is liable for the loss. Such situations only arise

(a) When different insurer has agreed to contribute the loss by way of collecting proportionate premium.

(b) The policies are in existence at the time of loss.

(c) The policies are legally enforceable at law.

(d) The interest covered under all the policies are same, and affected in favour of a common insured.

Indemnity is also governed by the principle of contribution. The insurer is required to contribute proportionately loss to the extent of its interest. If a property has been insured with more than one insurer, in the event of a loss the insured will get a proportionate part of the loss from each insurer, so that the insured does not make a profit out of the settled claim.

7. The Proximate Cause

The proximate cause can be defined as "the active efficient cause that sets in motion a train of events which brings about a result, without the intervention of any force started and working actively from a new independent force." In other words, it specifies the indemnification of losses concurrent with the perils specified under insurance contracts and not in general. Properties are exposed to various perils like fire, earthquake, explosion, perils of sea, war, riot, civil commotion and so on, and policies of insurance covering various combinations of such perils can be procured. Policies of insurance usually afford protection against some of these perils, expressly exclude certain perils from the cover, and by implication other perils are covered. The insurer's liability under the policy arises only if the cause of the loss is a peril insured against and not as expressly excluded or other peril.

8. Mitigation of Loss

Mitigation of loss is applied in valid insurance contract. In the event of some mishap or accident to the insured property, the insured must make necessary effort to safeguard his remaining property and minimise the loss, as much as possible. If he does make any reasonable efforts to reduce the loss, insurer will be liable for payment of all loss resulting from the peril insured against. If he is negligent to preserve the property, the insurer may avoid the payment of loss.

Classification of Insurance

We can classify the insurance as following:

I. On the basis of Risk

a. Personal insurance
b. Property insurance
c. Liability insurance
d. Fidelity guarantee insurance

On the basis of nature of business

a. Life insurance
b. General insurance -
   1. Fire insurance
   2. Marine insurance
   3. Social insurance
   4. Miscellaneous insurance

Miscellaneous insurance may includes

a) Vehicle insurance
b) Accident insurance
c) Burglary insurance
d) Crop insurance
e) Cattle insurance
f) Engineering insurance etc.

For our sake, we can classify insurance into 2 groups' i.e. life insurance and nonlife (general) insurance.

I. Life Insurance

It is governed by the LIC act 1956. It is contract in which the insurer, inconsideration of payment of premium compensate to a person on death or on the expiry of certain period whichever is earlier. (Life insurance details given in the following module)

II. General Insurance

General Insurance covers a wide range of services. Section 6(b) of the insurance act 1938 defines General Insurance. It includes all the risks except life. Its classification is:

A. Marine Insurance

Marine insurance is the oldest insurance which was introduced long back to compensate on sea and to compensate the loss due to various sea perils or loss of the ship etc. In today's context, marine insurance is an important part of trade and commerce and is a significant part of global insurance business. Marine play a key role in international trade. Law relating to Marine Insurance Act 1963.

According to section 3 of marine insurance act, 1963 defines marine insurance as, a contract where by an insurer undertakes to indemnify the assured against marine losses that is to say the losses incidental to marine adventure.

Features of marine insurance contract:

1. Features of a valid contract: marine insurance is a contract; therefore it should possess the features of a valid contract, according to Indian contract act. They are;
    - The proposal forms called slips are the offer from the merchant. The original slip is submitted along with the other material information. This is proposal from the merchant or the ship owner is the offer.
    - The master and crew of the ship have an insurable interest in respect of their wages.
    - Premium is consideration to contract.
    - The policy is prepared, stamped and signed and it will be the legal evidence of the contract
    - When slip is presented to the insurer, he checks it and satisfied he puts initial. Now the proposal is accepted. Once the slip is accepted the offer of the proposer is accepted by the insurer
2. Insurable interest in marine policy:
    - Owner of the goods has insurable interest to the extent of total value of the goods.
    - Owner of the ship can insure the ship to its full price
    - Buyer of the goods who insured them has insurable interest even he rejects the goods.
    - Insurer has an insurable interest in his risk and may reinsure in respect of it.
    - The receiver freight can insure up to the amount of freight to be received by him.
    - The policy holder has an insurable interest in the charges of any insurance which he may affect.
    - If the subject matter insured is mortgaged, the mortgager has an insurable interest
3. Disclosure by agent (utmost good faith):

When insurance policy is taken through an agent, he must disclose to the insurer every fact. The agent is deemed to know all the details of material information. If the information is false, the insurer can avoid the policy. If negligence can be held against the broker, he may be liable for breach of contract.

4. Principle of Indemnity:

Marine insurance is a contract of indemnity. It implies that the policy holder cannot make profit out of a claim. In the absence of principle of indemnity, the policy holder may make profit out of claim. The insurance contract implies that the indemnifies only to the extent agreed upon. The basis of indemnity is always a cash basis.

5. Principle of subrogation:

   This principle specifies that the policy holder should not get more than the actual loss. The insurer has a right to pay the amount of loss after reducing the money received by the policy holder from the third party. After indemnification the insurer gets all the rights of insured on the third parties. But he cannot file suit in his name. There fore he has to take the support of the support of the policy holder.

6. Average clause:

   A marine policy is invariably subject to average clause.

7. Express and implied Warranties:

   All marine insurance contracts are subject to certain express and implied warranties.

8. Principle of contribution:
   Principle of contribution also applicable in the case of marine insurance contracts.

Maritime perils

Maritime perils are also called as "Perils of the sea". It means the perils consequent on, or incidental to the navigation of the sea, that is to say, war perils, rovers, thieves, captures, seizures, restraints and detainment etc.

Following losses have been held to be perils of the sea:

a. Loss caused because of collisions against a sunken rock.
b. Loss caused because of collision with another ship
c. Loss caused because of heating due to the closure of ventilators to prevent the immersion of sea water.
d. Loss caused because rats made a hole in the bottom of a ship and sea water entered into ship through that hole and damaged the cargo.

Marine Policy

The instrument in which the contract of insurance is affected is known as marine policy or sea policy. It is a document which incorporates the details of terms and conditions of marine insurance. Contents of marine policies are:

1. Name of the insured
2. Policy number
3. Sum insured
4. Premium
5. Stamp duty
6. Steamer or other conveyance
7. Voyage or journey.
8. Number and date of bill of lading and other similar document related.
9. Interest to be insured.
10. Subject matter insured and the risk insured.
11. Place where claims are payable
12. Place and date of issue of policy.
13. Authorised signatures.

The **coverage** under marine insurance policy includes the following:

a) The ship (hull and machinery).

b) The insurable goods and property exposed to maritime perils.

c) Other incidental earnings like freight, commission etc. which will be lost along with the property due to the maritime perils.

d) The third party liabilities incurred by the insurer or other person responsible for or interested in the property.

e) Expenses incurred to prevent and minimise loss

Types of marine insurance policies:

1. **Time policy:**

If the policy is to insure the subject matter for a definite period of time it iscalled time policy. For example: 6 AM of 1st July 2013 to 6 AM of 31 March 2014 or 6 Am of 1st March 2012 to 6 PM 28th February 2013. Usually time polices are taken for one year. If the policy contains a clause 'continuation clause', if the ship is till at sea, the policy will continue for some more time. But the policy holder should take a fresh policy duly stamped for the continuation period. Time policy is commonly taken for hull insurance.

2. **Mixed policy (voyage and time policy):**

If a policy contains the provision of both time policy and voyage policy, it is called mixed policy. This policy covers the risk during a particular voyage for a specified period. Example: from Bombay to London for six months.

3. **Valued policy:**

Valued policy specifies the agreed value of the subject matter insured. Therefore the value of loss to be compensated by the insurer is fixed and remains constant throughout. The insurer and the insured agree upon the value at the time of taking the policy. Thus it is also called insured value or agreed value. The insured value need not be actual value.

4. **Unvalued policy:**

Unvalued policy does not specify the agreed value of the subject matter insured at the time of taking policy. It left to be valued when the loss takes place. Thus, it is called as open policy or insurable policy.

5. **Floating policies:**

Floating policies gives the description of insurance in general terms. The policy just mentions the amounts for which the insurance is taken for each shipment. It leaves other details such as name of the ship etc., to be given in the declaration. Floating policies are popular in large scale international trade.

6. **Wagering policy:**

This policy is issued without there being any insurable interest, or a policy bearing evidence that the insured is willing to dispense with any proof of interest. This policy contains such words as "Policy proof of Interest". This is void policy as per Sec.4 of marine insurance Act.

7. Blanket policy☹open cover policy)

This policy is issued to cover several different properties or all assets fixed as well as current of the insured under one insurance. It is the policy which covers more than one type of property in one location and one more type of property at several locations.

8. Construction policy or builders risk policy

This policy is designed to cover the risks incidental to the building of a vessel, usually giving cover from the time of laying keel until the completion trials and handing over to the owners.

B. Fire Insurance:

Fire insurance is a recent developed concept in insurance sector. It is covered under the insurance act 1938. Definition:"Fire insurance is a cover against the risk of loss of property due to fire accident." Fire Insurance is a contract where by the insurer undertakes in consideration of the premium paid to make good any loss cause by the fire during a specific period. The specific amount to be assured or claimed in case of loss should be mentioned or specified in the contract.

Subject matter of Fire insurance

As per fire insurance, the following are the examples of insurable property:

1. Building
2. Electrical installation in building
3. Contents of building such as machinery, plant and equipment, accessories etc.
4. Goods (finished/WIP) and raw materials in factories and godowns
5. Contents of dwelling, shops, hotels etc.
6. Furniture, fixtures, fitting etc.
7. Pipelines located inside or outside of compound etc.

Features of Fire Insurance: (fundamental principles of fire insurance)

1. It is a General Contract: It is one of the important features of fire insurance; It contains all the features of a valid contract. This is accepted by the insurer for the consideration of the premium. The insurer issues the policy with all terms and conditions of the contract.

2. Contact of Indemnity: Fire insurance is a contract of indemnity, in the event of loss the insured can recover actual amount of loss. Insured is allowed to gain excess amount out of the loss caused due to fire.

3. Contract of Uberimae fidei: a fire insurance contract is based on absolute good faith and therefore insured must make full and adequate disclosure of all material facts of subject matter of insurance.

4. Principles of Insurable interest : insurable interest must exist at the time of effecting the policy as well as the time of loss.

5. Principles of mitigation of loss and subrogation etc. are applicable in fire insurance.

4. Period of the policy: Fire insurance policy is issued for one year. Therefore they are popular as Annual insurance

Types of fire policy:

Important fire insurance policies are:

3. **Valued policy**: under this policy, the value of the property to be insured is determined at the time of the policy is taken. In the event of loss the fixed amount is payable irrespective of the actual amount of loss.
4. **Specific policy**: This policy covers the loss up to a specified amount which is less than the real value of the property. Thus it is an under- insurance policy. The whole of the actual loss is payable provided it does not exceed the insured amount.
5. **Comprehensive policy**: Comprehensive policy as the name indicates covers losses against risks as fire, theft, burglary, riots, civil disturbances etc. Therefore this policy is popular as 'all in one policy'. It may also cover loss of profits during the period the business remains closed due to fire.
6. **Floating policy**: it is a policy which covers property at different places against loss by fire. Example: goods stored in two different warehouses. It covers goods in two or more localities under one sum assured for one premium.
7. **Average policy**: A policy with 'average clause' is called average policy. The amount of indemnity. Under this, the insured is penalised for under insurance of the property.
8. **Replacement policy:** This policy otherwise called reinstatement policy. Under this policy, the insurer undertakes to pay the cost of replacement of property instead of paying compensation to the insured for property destroyed.
9. **Adjustable policy:** this policy is nothing but an ordinary policy on the stock of the businessman with liberty to the insured to vary at his option. The premium is adjustable pro-rata according to the variation of the stock.

10. **Declaration policy:** This policy may be granted only in respect of stock of inventories of the insured. As per this, insured must declare in writing the stock covered under the policy to the insurer and at the end premium is adjusted accordingly.

C. Miscellaneous insurance:

Health, Motor, property and others come under this category.

- Health insurance provides for the payment of benefits to cover the loss due to sickness.
- Motor Insurance provides the benefits in case of, damage or loss due to accident.
- Deposit insurance provides Insurance against bank deposit. This scheme was introduced by our government in 1962.
- Postal insurance was introduced in 2006 by postal department of India. This scheme provides insurance to postal saving account holders for accidental death.
- Accident insurance policies offered by insurer are personal accident insurance; crackle core insurance, passenger flight capon insurance, suhana safer policy, kidnap & ransom insurance, Bhagya shri policy etc.
- The liability insurance policies offered by insurer are professional indemnity policy, adhikari suraksha kavach, doctor's indemnity policy etc.
- Burglary insurance policies provide insurance coverage against burglary, theft etc of valuable goods
- Baggage insurance policy provides insurance coverage for loss of baggage and luggage etc in transit.

Some of the important types of insurance are:

1. **Property Insurance**:

The home is most valuable possession for everyone. This particular policy is specially intended to cover all the risks of your house under a single policy. Property insurance also provides protection for other valuable properties and other assets that are of interest for the insured. Property insurance includes fidelity, burglary and insolvency. Property insurance covers all loss of property by burglary, theft or house breaking by any other act which is a criminal offence. Types of policies are

a. Business premises insurance policy

b. Private dwelling insurance policy

c. Jewellery and Valuable insurance policy

d. All risks insurance policy.

2. Health Insurance☹Medical insurance)

It covers all medical expenses following hospitalization from sudden illness or expenses from any kind of accident. It is an Insurance against loss by illness or bodily injury. Health insurance provides coverage for medicine, visits to the doctor or emergency room, hospital stays and other medical expenses. Policies differ in what they cover, the size of the deductible and/or co-payment, limits of coverage and the options for treatment available to the policyholder. Health insurance can be directly purchased by an individual, or it may be provided through an employer. Medicare and Medical aid are programs which provide health insurance to elderly, disabled, or un-insured individuals. There are a number of companies which provide private health insurance, including Blue Cross, United Healthcare, or Star health. Important policies are:

a. Individual Mediclaim policy

b. Group Mediclaim policy

c. Jan Arogya Bhima policy

d. Cancer policy

e. Bhavishya Arogya policy

f. Overseas medical policy

g. Videsh Yatra Mitra policy

11. **Personal Accident Insurance**:

This insurance policy allows full compensation for injury and even loss of life caused by an accident. It also includes compensation of cost of treatment and the use of hospital facilities in the process of treatment.

4. Travel Insurance:

This policy covers the insured against various events and misfortunes while travelling abroad. Travel insurance covers the insured against any kind personal accidents, medical expenses and even loss of checked luggage, passport etc.

5. Liability Insurance:

This policy indemnifies the officers or other professional employees against loss of their jobs arising from claims made against them by reason of any wrongful Act in their terms of service.

6. Fidelity guarantee insurance:

In this insurance, the insurer undertakes to indemnify the insured (employer) in consideration of certain premium,upto certain specified amount insured against for loss arising through the fraud, or embezzlement on the part of the employees. This kind of insurance frequently adopted as a precautionary measures in cases where new and untried employees are given position of trust.

Important types of policies are:

a. Individual policy
b. Collective policy
c. Floating or Floater policy
d. Positions policy
e. Blanket policy

7. Motor Vehicle Insurance:

According to Motor Vehicles Act, every motor vehicle running on the road has to be insured, if not with at least a liability policy. Generally, there are two types of motor insurance policy; one covers the act of liability while the other covers all liability and damages caused to the vehicles. As per the provisions of the MV Act1938 (amended in 1988), it was made compulsory for motorists to insure against the risk of liability to third parties. In other words, the insurance of motor vehicle against risk is not mandatory but insurance of third party liability arising out of use of motor vehicle in public places is mandatory. Important types of policies are:

a. Act liability only policy (Form A policy)
b. Third party only policy
c. Comprehensive policy
d. Garage insurance policy
e. Collision insurance policy

8. Cattle insurance

This insurance provides cover against death of animals occurring during any period and if the animal is pregnant for less than four months, the indemnity will be restricted to 50% of the sum assured or market value whichever is less. This policy is also extended to cover the risk of permanent total disability on payment of extra premium.

9. Engineering insurance

This insurance is designed to protect the interest of contractors and principals in respect of civil engineering projects, like building, bridges, tunnel etc. this policy provides an "All Risks" cover. Important policies are:

a. Boiler insurance policy
b. Engine insurance policy
c. Electrical Plant insurance policy
d. Lifting machinery insurance policy

10. Public liability insurance

Under Public liability Insurance Act, 1991, all the companies, individuals and persons owing and dealing hazardous good are required to take insurance policy satisfying the limits specified in the Act. For the purpose of insurance, public liability risk insurance is classified into;

a. Industrial risks insurance
b. Industrial All risks insurance
c. Non-industrial risk insurance

11. Crop Insurance

This insurance is designed to provide a measure of financial support to farmers in the event of crop failure due to drought, flood etc. and to restore credit eligibility for farmers after a crop failure, for the next crop season and to support and stimulate production of pulses and oil seeds. Crop insurance scheme is also known as Rashtriya Krishi Bhima Yojana

12. Social insurance

Social insurance is a government-run insurance programme operated soundly using actuarial techniques but funded primarily by current contributions while relying on the taxing power of the government to guarantee solvency. Social security is a part of social insurance system. This insurance system is not popular in india.The social insurance programmes of countries are drawn up based on their specific Needs. In the United States the following are the characteristics of social insurance:

1. Compulsory programmes
2. Floor of income- The main aim of social insurance is to provide minimum required benefit to meet the needs.
3. Social adequacy rather than individual equity
4. Benefits loosely related to earnings
5. Benefits prescribed by the law
6. No means test: These benefits are given as a right. No formal test is needed.
7. Full funding unnecessary
8. Financially self-supporting
9. Medicare support

MODULE 4

INSURANCE LAWS IN INDIA

Life insurance- concept

Life insurance is a contract under which the insurer (Insurance Company) inconsideration of a premium paid undertakes to pay a fixed sum of money on the death of the insured or on the expiry of a specified period of time whichever is earlier. In case of life insurance, the payment for life insurance policy is certain. The event insured against is sure to happen only the time of its happening is not known. So life insurance is known as 'Life Assurance'. The subject matter of insurance is life of human being. Life insurance provides risk coverage to the life of a person. On death of the person insurance offers protection against loss of income and compensate the titleholders of the policy.

Basic Principles of Life Insurance Contract.

1. **Insurable interest**

The insured must have insurable interest in the life assured. In absence of insurable interest, Contract of insurance is void. Insurable interest must be present at the time of entering into contract with insurance company for life insurance. It is not necessary that the assured should have insurable interest at the time of maturity also.

2. **Utmost good faith**

The contract of life insurance is a contract of utmost good faith. The insured should be open and truthful and should not conceal any material fact in giving information to the insurance company, while entering into a contract with insurance company. Misrepresentation or concealment of any fact will entitle the insurer to repudiate the contract if he wishes to do so.

3. **Not a contract of indemnity**

The life insurance contract is not a contract of indemnity. A Contract of life insurance is not a contract of indemnity. The loss of life cannot be compensated and only a fixed sum of money is paid in the event of death of the insured. So, the life insurance contract is not a contract of indemnity. The loss resulting from the death of life assured cannot be calculated in terms of money.

Features of life insurance

Following are the important features of valid contract of life insurance

1. Elements of a valid contract
2. Insurable interest
3. Utmost good faith
4. Warranties
5. Assignment and Nomination
6. Cause is certain
7. Premium (consideration)
8. Term of policy
9. Return of premium (surrender)

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.

i) 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.

ii) 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.

iii) 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.

iv) Initiates investments

Life Insurance Corporation encourages and mobilizes the public savings and channelizes 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.

v) Credit worthiness

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

vi) 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.

vii) Tax Benefit

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

Life insurance Policies

Life insurance policies can be grouped into the following categories:

1. **Term Policy**

In case of Term assurance plans, insurance company promises the insured for a nominal premium to pay the face value mentioned in the policy in case he is no longer alive during the term of the policy.

Term assurance policy has the following features:

• It provides a risk cover only for a prescribed period. Usually these policies are short-term plans and the term ranges from one year onwards. If the policyholder survives till the end of this period, the risk cover lapses and no insurance benefit payment is made to him.

• The amount of premium to be paid for these policies is lower than all other life insurance policies. As savings and reserves are not accumulated under this policy, it has no surrender value and loan or paid-up values are not allowed on these policies.

• This plan is most suitable for those who are initially unable to pay high premium

• when income is low as required for Whole Life or Endowment policies, but requires life cover for a high amount.

2. **Whole Life Policy**

This policy runs for the whole life of the assured. The sum assured becomes payable to the legal heir only after the death of the assured. The whole life policy can be of three types.

(1) Ordinary whole life policy – In this case premium is payable periodically throughout the life of the assured.

(2) Limited payment whole life policy – In this case premium is payable for a specified period (Say 20 Years or 25 Years) Only.

(3) Single Premium whole life policy – In this type of policy the entire premium is payable in one single payment.

3. Endowment Life Policy

In this policy the insurer agrees to pay the assured or his nominees a specified sum of money on his death or on the maturity of the policy whichever is earlier. The premium for endowment policy is comparatively higher than that of the whole life policy. The premium is payable till the maturity of the policy or until the death of the assured whichever is earlier. It provides protection to the family against the untimely death of the assured.

4. Health insurance schemes

An individual is subject to uncertainty regarding his health. He may suffer from ailments, diseases, disability caused by stroke or accident, etc. For serious cases the person may have to be hospitalized and intensive medical care has to be provided which can be very expensive. It is here that medical insurance is helpful in reducing the financial burden. These days the vulnerability to lifestyle diseases such as heart, cancer, neurotic, and pollution based, etc are on the increase. So it makes sense for an individual to go for medical insurance cover.

5. Joint Life Policy

This policy is taken on the lives of two or more persons simultaneously. Under this policy the sum assured becomes payable on the death of any one of those who have taken the joint life policy. The sum assured will be paid to the survivor(s). For example, a joint life policy may be taken on the lives of husband and wife, sum assured will be payable to the survivor on the death of the spouse.

6. With Profit And Without Profit Policy

Under with profit policy the assured is paid, in addition to the sum assured, a share in the profits of the insurer in the form of bonus. Without profit policy is a policy under which the assured does not get any share in the profits earned by the insurer and gets only the sum assured on the maturity of the policy. With profit and without profit policies are also known as participating and non–participating policies respectively.

7. Double Accident Benefit Policy

This policy provides that if the insured person dies of any accident, his beneficiaries will get double the amount of the sum assured.

8. Annuity Policy

Under this policy, the sum assured is payable not in one lump sum payment but in monthly, quarterly and half-yearly or yearly instalments after the assured attains a certain age. This policy is useful to those who want to have a regular income after the expiry of a certain period e.g. after retirement. Annuity is paid so long as the assured survives. In annuity policy medical check-up is not required. Annuity is paid so long as the assured survives.

9. Policies For Women

Women, now a days are free to take life assurance policies. However, some specially designed policies suit their needs in a unique manner; important policies for women are

A. Jeevan Sathi is also known a Life Partner plan where the husband and wife are covered under this endowment policy

B. Jeevan Sukanya

10. Group Insurance

Group life insurance is a plan of insurance under which the lives of many persons are covered under one life insurance policy. However, the insurance on each life is independent of that on the other lives. Usually, in group insurance, the employer secures a group policy for the benefit of his employees. Insurer provides coverage for many people under single contract.

10. Policies For Children

Policies for children are meant for the various needs of the children such as education, marriage, security of life etc. Some of the major children policies are:

(1) Children's deferred assurances

(2) Marriage endowment and educational annuity plans

(3) Children endowment policy

11. Money Back Policy

In this case policy money is paid to the insured in a number of separate cash payments. Insurer gives periodic payments of survival benefit at fixed intervals during the term of policy as long as the policyholder is alive.

The contract for the life insurance starts with the proposal made by the proposer in standard application form available with insurance company and then various other documents are prepared.

Proposal Forms

The proposal form is a standardized form. The proposal form is a type of an application form, which a proposer has to fill all the relevant details about the life to be assured. The agent has the proposal form with him provided by the insurer. There are different types of policies and so the different types of proposal forms are there. It has the entire details regarding the duration of the policy, type of plan, mode of payment, etc. A proposal form is to be to be completed by the proposer in his own handwriting and signed in the presence of the agent. The proposal form contains a declaration at the end, to ensure the authenticity of the information given.

Usually the proposal form contains the following information to be filled by the prospective insured:

1. Name of life assured

2. Address

3. Date of Birth

4. Occupation

5. Age

6. Name of the employer (if any)

7. Sum assured of the proposed policy

8. Number and age of the family members

9. Family medical history

10. Proposer’s Medical history

Besides these there are other related forms regarding health, occupation, the agent’s confidential report and many others. In addition there is a consent letter which shows the consent of the life assured to the imposition of some clause or extra premium, duly signed by the life assured.

First Premium Receipt

The agent provides the proposal form and other related documents and the underwriter examines the form and other documents and then determines the terms on which to accept the risk or reject the same. The consent of the person assured is obtained in the form of payment of premium. After receiving the payment, the insurance company issues the First Premium Receipt, which acknowledges the proposal of the life-assured. It contains all particulars of the policy. It has the details of the next premium to be paid. The policy bond is sent within 45-50 days from the date of first premium receipt to the life assured. The First Premium Receipt is an important and powerful document on the basis of which the life-assured can ask the insurer to issue the policy bond, which is treated as Evidence of the Contract of Life assurance.

Policy Bond

After issuing the First Premium Receipt, the next step is that of the insurer of sending the policy bond to the life-assured and this document is also known as Policy Contract, which is the ultimate evidence of the life-assured. The Policy Contract contains all the terms and conditions of the contract between insurance company and the life assured, duly stamped as per the Indian Stamp Act. The policy is sent to the life assured by the insurer. The policy contract contains the details of the insurance such as duration of the policy, the type of policy, sum assured, premium amount and the date of maturity, extra premium, nominee, assignee etc.

Assignment and Nomination

The Policyholder should be advised for nomination, if no nomination was effected. When nomination or assignment is effected by a policyholder, it should be scrutinized thoroughly to see whether it was in order or not. If there is any material omission or mistake, it may be returned to the policyholder or the assignee with a covering letter giving instructions as to the corrections to be made in the assignment or nomination. When a document is sent for correction, reminders should be sent every fortnight until the requirements are complied with. The policyholder should follow the instructions printed on the back of assignment or nomination.

Nomination

Nomination is the process of identifying a person to receive the policy money in the event of the death of the Policyholder. Nomination can be done at the beginning of the Policy by giving details of nominee in the proposal form. However, if the nomination is not given at the beginning, the policyholder can give it at a later date. For that purpose a prescribed form is to be filled up and nomination can be endorsed on Policy Bond.

Change in Nomination.

Change of nomination can be done by the policy holder any time during the term of the policy and any number of times he wants to. Procedure of nomination is same every time.

Withdrawal of nomination

Nomination can be withdrawn by the policy holder without giving prior notice to the nominee. Nomination can be done only by a policyholder who has attained majority and on a policy on his life. Under Nomination, the Nominee gets only the right to receive the policy money in the event of the death of the Policyholder.

Death of the Nominee

If the nominee dies and the policyholder is still surviving then the nomination would be ineffective. If Nominee dies after the death of the Policyholder but before receiving policy money, then also Nomination becomes ineffective and only the legal heirs of the policyholder can claim money.

Nomination at a later date

After the policy is prepared and issued and if no Nomination has been given the assured can give the nomination only by an endorsement on the policy itself. A nomination is not required to be stamped. Nomination in favour of a stranger cannot be given as there is no insurable interest involved in that case. For nomination in favour of wife and children, specific names of wife and children should be given.

Successive nominee

Where it is mentioned in nomination that the policy money should be paid to "Nominee A failing him to Nominee B whom failing to Nominee C, etc.", such nomination is called successive nomination. Such nomination would be in favour of one individual in the order mentioned. All such Nomination would mean that if Nominee A were dead at the time in question the Nominee B would take the whole amount and that if both Nominees A and B were then dead then Nominee C would take the whole amount and so on.

A Minor Nominee

In view of the Insurance (Amendment Act) 1950, the Life Assured has the right, where a nominee is a minor, to appoint any person as the Appointee to receive the moneys secured by the policy in the event of the assureds' death during minority of the nominee. The person so appointed will not be a guardian of the minor Nominee's power will be limited to the right to receive the policy money in the event of the assureds' death during the minority of the Nominee. The appointment must be a major. The appointment of Appointee must be communicated to the insurance company. So his name can be registered with the company. The appointment can be cancelled or changed by the life assured any time before the maturity of the policy.

Assignment

Assignment is a means whereby the right and title under a policy gets transferred from assignor to assignee. Assignor is the policyholder who transfers the title and assignee is the person who gets the title of the policy from the assignor. Assignment can be made either by endorsement on the policy or on a separate paper duly stamped. Assignor must be a major.

Assignment must be in writing and assignor's signature along with a witness is required. Notice of assignment should be submitted to the insurer by the assignor. Assignment can be of two types:

1. Absolute Assignment: In which all the rights, title and interest of the assignor in the policy passes on to the assignee without the possibility of cancellation of the same.

2. Conditional Assignment: In which the assignor and the assignee may agree that in case specified event or events happen, the assignment would be cancelled or ineffective in part or as a whole.

Impact of assignment

In assignment, assignor gives all the rights over the policy to the assignee that becomes the owner of the policy. The assignee has the right to reassign that policy. In the event of death of the assignee, if the assignment is conditional assignment and the assignee dies, the assignment becomes ineffective and all the rights and title of the policy goes back to the life assured if he is alive. If the life assured is not surviving, the benefit goes back to the life assureds' nominee. In case of absolute assignment, if the assignee dies, all the rights entitled of the policy are given to legal heirs of the assignee.

Cancellation of assignment

An assignment once executed cannot be cancelled, however, if an assignee during the term of the policy reassigns the interest and title of the policy to the previous assignor such reassignment will result in cancellation of assignment and the benefits of the policy go back to the original assignor.

Procedures of Assignment

A standard form of Assignment is issued to the policyholder who wants to effect an assignment of his policy. Necessary instructions are there for executing the assignment which is then registered by the insurance company.

Points to be considered by the insurance company for affecting assignment:

(1) Check whether the assignment is executed on the Policy or on a separate paper and if it is executed on a separate paper that the paper is adequately stamped. If it is unstamped or inadequately stamped inform the assignor and get it corrected.

(2) Check whether notice of assignment is received from the assignor; if the notice is not received or it is defective, inform the assignor.

(3) Check the signatures of assignor affixed to the assignment and notice with the specimen of his signature in the proposal papers to see that they tally.

(4) If the assignment is executed on a separate paper, ensure that the paper should be stamped, in accordance with the stamp regulations.

(5) Check that the date and place of execution on Assignment are mentioned.

Claims and Settlement

The easy and timely settlement of a valid claim is an important function of an insurance company. The yardstick to judge insurance company's efficiency is as to how quick the claim settlement is. The speed, kindness and fairness with which an insurer handles claims show the maturity of the company and may lead to great satisfaction of the client. It is the liability of the insurance company to honour valid and legal claims. At the same time the company must identify the fraudulent and invalid claims.

A claim may arise:

i) On death of Policyholder before the maturity date.

ii) On maturity, i.e. after expiry of the endowment period specified in the policy contract when the policy money becomes payable.

Certain features are common to all life insurance claims. These are:

1. Policy must be in force at the time of claims.

2. Insured must be covered by the policy.

3. Nothing was outstanding to the insurer at the time of claim.

4. Claim is covered by the policy.

Death Claims

Following points to be considered in connection with insurance claim,

I. **Intimation of death**

The death of the life assured has to be intimated in writing to the insurer. It can be done by the Assignee or nominee under the policy or from a person representing such Assignee or Nominee or when there is no nomination or assignment by a relative of the life assured, the employer, the agent or the development officer. The intimation of the death of the life assured by the claimant should contain the following particulars:

(1) His or her relationship with the deceased,

(2) The name of the policyholder,

(3) The number/s of the policy/policies,

(4) The date of death

(5) The cause of death and

(6) Sum assured etc.

If any of these particulars are missing the claimant can be asked to furnish the same to the insurer. The intimation must satisfy two conditions

(1) It must establish properly the identity of the deceased person as the life assured under the policy,

(2) It must be from a concerned person.

I**i. Proof of death and other documents**

In case of claim by death, after the receiving the intimation of death the insurance company ensures that the insurance policy has been in force for the sum assured on the date of death and the intimation has been received from assignee, nominee or other claimant. The following documents are required:

(i) Certificate of death.

(ii) Proof of age of the life assured (if not already given).

(iii) Deeds of assignment / reassignments.

(iv) Policy document.

(v) Form of discharge.

If the claim has accrued within three years from the beginning of the policy, the following additional requirements may be called for:

(i) Statement from the hospital if the deceased had been admitted to hospital.

(ii) Certificate of medical attendant of the deceased giving details of his/her last illness.

(iii) Certificate of cremation or burial to be given by a person of known character and responsibility present at the cremation or burial of the body of the deceased.

(iv) Certificate by employer if the deceased was an employee.

Proof of death and other documents to be submitted will depend upon the cause of death and circumstances of each case.

(1) In case of an air crash the certificate from the airline authorities would be necessary certifying that the assured was a passenger on the plane.

In case of ship accident a certified extract from the logbook of the ship is required. In case of sudden cardiac arrest, murder the doctors' certificate may not be available.

(2) The insurance may waive strict evidence of title if the sum assured of the policy is small and there is no dispute among the survivors of the policy moneys.

(3) If the life assured had a death due to accident, suicide or unknown cause the police inquest report, panchanama, post mortem report, etc would be required.

Iii. Net Payable Amount of Claim

After receiving the required documents the company calculates the amount payable under the policy. For this purpose, a form is filled in which the particulars of the policy, assignment, nomination, bonus etc. should be entered by reference to the Policy Ledger Sheet. If a loan exists under the policy, then the section dealing with loan is contacted to give the details of outstanding loan and interest amount, which is deducted from the gross policy amount to calculate net payable claim amount.

The net amount of claim payable is calculated and is called payment voucher. In the case of 'in force' policy unpaid premiums if any due before the assureds' death with late fee where necessary and the premium falling due in the policy year current at the time of death should be deducted from the claim amount.

Maturity Claims

If the life insured survives to the full term, then basic sum assured is payable. This payment by the insurer to the insured on the date of maturity is called maturity payment. The amount payable at the time of the maturity includes a sum assured and bonus/incentives. The insurer sends in advance the intimation to the insured with a blank discharge form for filling various details in it. It is to be returned to the office along with

• Original Policy document

• Age proof if age is not already submitted

• Assignment /reassignment, if any. .

Legally no claim is acceptable in respect for a lapsed policy or death of the Life assured happening within 3 years from the date of beginning of the policy. However, some concessions are given and payment of claims is made:

• If the Life assured had paid at least 3 years' premiums and thereafter if premiums have not been paid, the nominees/life assured get proportionate paid up value.

• In the event of the death of' the Life assured within 3 years and the policy is under the lapsed position, nothing is payable.

Procedure of the maturity claims

Settlement procedure for maturity claim is simple after receipt of completed and stamped discharge form from the person entitled to the policy money along with policy documents, claim amount will be paid by account payee cheque.

• If the life assured is reported to have died after the date of maturity but before the receipt is discharged, the claim is to be treated as the maturity claim and paid to the legal heirs. In this case death certificate and evidence of title is required.

• Where the assured is known to be mentally deranged, a certificate from the court of law under the Indian Lunacy Act appointing a person to act as guardian to manage the properties of the lunatic should be called.

Additional benefits apart from regular claims

Double Accident Benefit: For claiming the benefits under the Double Accident Benefit the claimant has to produce the proof to the satisfaction of the Corporation that the accident is defined as per the policy conditions. Normally for claiming this benefit documents like FIR, Post-mortem Report are required.

Surrender Value

If the insured is unwilling or unable to pay the premium of the policy, he may surrender the policy and ask for its surrender value. Surrender value is the cash value payable by the insurance on voluntary termination of the policy contract by the life assured before the expiry of the term of the policy. Surrender value depends on the type of policy and number of premium paid. A policy can be surrendered only when the premium is paid for the three years.

Differences between Assurance (life insurance) and Insurance (general insurance / non-life insurances)

1. **Scope –** the term "Assurance" is used only in life insurance and therefore the scope is comparatively limited.

   The term insurance is used for all other types of risk coverage and therefore, the scope is wider.
2. **Renewal of Policy** -The life insurance contract is a continuing contract and it will not lapse unless the premium is regularly paid. It is not certain that the event insured against may happen or not.

   Most of the general insurance policies are annual policies, so renewal of policy is required.
3. **Element of investment**- the element of investment is present in assurance since there is certainly of receiving payment either on death or on maturity of the policy.

   General insurance lacks the element of investment since there is no certainty of receiving payment.
4. **Assurance** –in life insurance, the insurer gives assurance to the insured to pay the claim in any case, either on maturity or death.

   In general insurance, the insurer only promises to secure the property in case of actual loss.
5. **Amount of Claim-** In LI, the policy amount is paid to the assured in full on the maturity or on death along with bonus, etc. announced by the insurance company from time to time.

   In GI, The payment of claim is subjected to the element of actual loss but not more than the insured sum.
6. **Insurable Interest**- In a life policy, the insurable interest is one that required by law and such interest is not measurable in terms of money.

   In GIs, the insured is required to have an insurable interest in terms of money.

7. **Principle of indemnity**- Principle of indemnity does not apply in life assurance. The sum assured is payable unrespectable of any profit or loss and the full extent of the amount insured.

Principle of indemnity is the basis of general insurance contracts.

8. **Certainty of event** –in LIs, the event (death or reaching maturity) is bounded to happen sooner or later.

It is not certain that the event insured against may happen or not in the case of GIs.

9. **Insured Sum** -Insurance policy for any amount or any number of policies can be taken in LIs.

In general insurance, the policy amount is restricted to market value of assets; not more than that. This is because that indemnity cannot be more than the value of asset.

10. **Certainly of payment of claim-** in LIs, Payment of claim either on maturity of the policy or on death of the assured is certain.

There is no certainly to receive payment since it is paid only in case of loss of the property insured in GIs.

11. **Insurable interest on the date of the policy or the policy falls due-**In life insurance insurable interest is to be proved at the date of the contract and it is not necessarily be present at the time, when the policy falls due for claim.

In marine insurance, the insured must be having insurable interest on the subject matter at the time of loss, but not necessarily be present at the time of affecting the policy.

12. **Subject matter-** Human life is subject matter of life insurance.

Goods and properties are subject matter of general insurance.

13. **Principle of subrogation –** This is not applicable in life insurance.

This principle is applicable in general insurance.

14. **Surrender of policy-**in life insurance, the policy can surrender before maturity period.

In the case of fire and marine insurance, policy cannot be surrendered before maturity.

Legal Frameworks of Insurance (Law relating to insurance)

There are mainly four laws are concerned with the insurance business of India are as follows.

A. Insurance Act, 1938

B. Life Insurance Corporation Act, 1956

C. General Insurance Business (Nationalization) Act, 1972

D. Insurance Regularity and Development Authority Act, 1999 (IRDA)

A. INSURANCE ACT, 1938

The insurance act originally passed in the year 1938. however It amended for several times, It latest amendment of the insurance act was the, the IRDA itself when it became the authority to perform many tasks required to be done under the insurance act such as issuing licenses, issuing registration certificates, monitoring compliance with the provisions of the Act, issuing directives, laying down norms. The all above said functions were performed by the controller of Insurance earlier as per the Insurance Act, 1938. The provisions of the Act may be briefly described as follows.

a. Registration

To obtain the certificate of registration is compulsory to the every insurance company. The Registration should be renewed annually. The paid up capital must be of Rs. 100 crores for life insurance or general and Rs. 200 crores for re-insurance business. Every insurer has to deposit in cash or approved securities, a sum equivalent to 1 % in life insurance or 3% in general insurance of the total gross premium in-any financial year commencing after 31st March, 2000 with the Reserve Bank of India. The amount is not being exceeding Rs. 10 crores. The deposit amount is Rs. 20 crores for reinsurance businesses.

Every insurance company must keep the accounts separately of all receipts and payment in respect of each class of insurance business such as the marine or miscellaneous insurance.

Insurers must invest his assets only in those investments which approved under the provisions of the Act.

Every insurance company has to do a minimum insurance business in the rural or social sector, as may be specified in the order. The authority can be investigated the affair of the insurer at any time.

b. Licensing of agents

License is the pre requirement for becoming the agent. Person can't work as an insurance agent unless he has obtained a license from the authority. There is some disqualification as per the act for a person to be an agent, as follows:

1. Being unsound mind.

2. Being convicted of criminal misappropriation or criminal breach of trust or cheating or forgery or Abetment or Attempt to commit any such offence.

3. Being found to have been guilty of or connived at any fraud, Dishonesty or misappropriation against any insured on insurer.

c. Licensing of surveyors and loss assessors

No insurer can settle any claim equal to or exceeding Rs. 20000/- without the report on the loss from a licensed surveyor. The person can act as a surveyor or loss assessor only after obtaining license from the authority. The authority can't issue the license without get satisfaction about the applicant.

d. Solvency margin

The authority for the insurer also decides the solvency margin. The act clarifies how the assets and liabilities have to be determined and the extent to which the assets are to exceed the liabilities. These provisions exist to ensure the adequacy of insurer's solvency

e. Payment of premium before assumption of risk

A risk can be assumed by the, insurance company after receiving the premium or a guarantee that the premium will be paid within the prescribe time. Sometimes agents collect the premium amount and dispatch or deposited to the insurance company. They have to deposit the money within the 24 hours except the bank and postal holiday. The agent has to deposit the premium in full without deducting his commission. If any refund of, the premium will be due, the insurer directly shall paid the amount to the insured by crossed or order cheque or by postal money order.

B. Life Insurance Corporation Act,1956

Life Insurance Business in India was nationalized with effect from January 19, 1956. On the date, the Indian business of 16 non-Indian insurers operating in India and 75 Provident Societies were taken over by Government of India. Life Insurance Corporation of India, Act was passed by the Parliament on June 18, 1956 and came into effect from July 1, 1956. Life Insurance Corporation of India commenced its functioning as a corporate body

from September 1, 1956. Its working is governed by the LIC Act. The LIC is a corporate having perpetual succession and a common seal with a power to acquire hold and dispose of property and can by its name sue and be sued.

Important Provisions of Life Insurance Corporation Act, 1956

1. Constitution

2. Capital

3. Functions of the Corporation

4. Transfer of Services

5. Set-up of the Corporation

6. Committee of the Corporation

7. Authorities

8. Finance, Accounts and Audit

9. Miscellaneous

Life Insurance Corporation of India (LIC)

The LIC of India was set up under the LIC Act, 1956 under which the life insurance was nationalised. As a result, business of 243 insurance companies was taken over by LIC on 1-9-1956.

It is basically an investment institution, in as much as the funds of policy holders are invested and dispersed over different classes of securities, industries and regions, to safeguard their maximum interest on long term basis. LIC is required to invest not less than 75% of its funds in Central and State Government securities, the government guaranteed marketable securities and in the socially-oriented sectors. At present, it is the largest institutional investor. It provides long term finance to industries. Besides, it extends resource support to other term lending institutions by way of subscription to their shares and bonds and also by way of term loans.

LIC which has entered into its 57th year has emerged as the world's largest insurance co. in terms of number of policies covered. The LIC's total coverage of policies including individual, group and social schemes has crossed the 11 crore.

Objectives of LIC of India

The LIC was established with the following objectives:

1. Spread life insurance widely and in particular to the rural areas, to the socially and economically backward claries with a view to reaching all insurable persons in the country and providing them adequate financial cover against death at a reasonable cost

2. Maximisation of mobilisation of people's savings for nation building activities.

3. Provide complete security and promote efficient service to the policy-holders at economic premium rates.

4. Conduct business with utmost economy and with the full realisation that the money belong to the policy holders.

5. Act as trustees of the insured public in their individual and collective capacities.

6. Meet the various life insurance needs of the community that would arise in the changing social and economic environment

7. Involve all people working in the corporation to the best of their capability in furthering the interest of the insured public by providing efficient service with courtesy.

Role and Functions of LIC

The role and functions of LIC may be summarised as below:

1. It collects the savings of the people through life policies and invests the fund in a variety of investments.

2. It invests the funds in profitable investments so as to get good return. Hence the policy holders get benefits in the form of lower rates of premium and increased bonus. In short, LIC is answerable to the policy holders.

3. It subscribes to the shares of companies and corporations. It is a major shareholder in a large number of blue chip companies.

4. It provides direct loans to industries at a lower rate of interest. It is giving loans to industrial enterprises to the extent of 12% of its total commitment.

5. It provides refinancing activities through SFCs in different states and other industrial loan-giving institutions.

6. It has provided indirect support to industry through subscriptions to shares and bonds of financial institutions such as IDBI, IFCI, ICICI, SFCs etc. at the time when they required initial capital. It also directly subscribed to the shares of Agricultural Refinance Corporation and SBI.

7. It gives loans to those projects which are important for national economic welfare. The socially oriented projects such as electrification, sewage and water channelising are given priority by the LIC.

8. It nominates directors on the boards of companies in which it makes its investments.

9. It gives housing loans at reasonable rates of interest.

10. It acts as a link between the saving and the investing process. It generates the savings of the small savers, middle income group and the rich through several schemes.

Formerly LIC has played a major role in the Indian capital market. To stabilise the capital market it has underwritten capital issues. But recently it has moved to other avenues of financing. Now it has become very selective in its underwriting pattern.

C. GIBNA (The General Insurance Business Nationalization Act- 1972)

The General Insurance Business Nationalization Act was passed in 1972 to set up the general insurance business. It was the nationalization of 107 insurance companies into one main company called General Insurance Corporation of India and its four subsidiary companies with exclusive privilege for transacting general insurance business. This act has been amended and the exclusive privilege ceased on and from the commencement of the insurance regulatory and development authority act 1999. General Insurance Corporation has been working as a reinsurer in India. Their subsidiaries are working as a separate entity and plays significant role in the public sector of general insurance.

G**eneral Insurance Corporation of India (GIC)**

General insurance industry in India was nationalised and a government company known as General Insurance Corporation of India was formed by the central government in November, 1972. General insurance companies have willingly catered to these increasing demands and have offered a plethora of insurance covers that almost cover anything under the sun.

Objective of the GIC are:

1. To carry on the general insurance business other than life, such as accident, fire etc.
2. To aid and achieve the subsidiaries to conduct the insurance business and,
3. To help the conduct of investment strategies of the subsidiaries in an efficient and productive manner.

Role and Functions of GIC

a. Carrying on of any part of the general insurance, if it thinks it is desirable to do so.

b. Aiding, assisting and advising the acquiring companies in the matter of setting up of standards of conduct and sound practice in general insurance business.

c. Rendering efficient services to policy holders of general insurance.

d. Advising the acquiring companies in the matter of controlling their expenses including the payment of commission and other expenses.

e. Advising the acquiring companies in the matter of investing their fund.

f. Issuing directives to the acquiring companies in relation to the conduct of general insurance business.

g. Issuing directions and encouraging competition among the acquiring companies in order to render their services more efficiently.

Classification of Indian General Insurance Industry

General Insurance is also known as Non-Life Insurance in India. There are totally 16 General Insurance (Non-Life) Companies in India. These 16 General Insurance companies have been classified into two broad categories namely:

a) PSUs (Public Sector Undertakings)

b) Private Insurance Companies

a) PSUs (Public Sector Undertakings):-

These insurance companies are wholly owned by the Government of India(subsidiaries of GIC). There are totally 4 PSUs in India namely:-

• National Insurance Company Ltd-Head Office-Kolkata

• Oriental Insurance Company Ltd- Head Office- New Delhi

• The New India Assurance Company Ltd- Head Office-Mumbai

• United India Insurance Company Ltd- Head Office-Chennai

b) Private Insurance Companies:-

There are totally 12 private General Insurance companies in India namely:-

- Apollo DKV Health Insurance Ltd
- Bajaj Allianz General Insurance Co. Ltd
- Cholamandalam MS General Insurance Co. Ltd
- Future General Insurance Company Ltd
- HDFC Ergo General Insurance Co Ltd
- ICICI Lombard General Insurance Ltd
- Iffco Tokio General Insurance Pvt Ltd
- Reliance General Insurance Ltd
- Royal Sundaram General Insurance Co Ltd
- Star Health and Allied Insurance
- Tata AIG General Insurance Co Ltd
- Universal Sompo General Insurance Pvt Ltd

C. Insurance Regulatory And Development Authority (IRDA)-1999

In 1993, Malhotra Committee headed by former Finance Secretary and RBI Governor. R. N. Malhotra was formed to evaluate the Indian Insurance Industry and recommend its future direction. The committee was set up with an objective of complementing the reforms in the Indian Financial Sector. The reforms were aimed at "Creating a mere efficient and come positive financial system suitable for the requirement of the economy keeping in mind the structural changes currently underway and recognizing that insurance is an .important part of the overall financial system where it was necessary to address the need for similar reforms."

The Insurance Regulatory and Development Authority (IRDA) is a national agency of the Government of India, based in Hyderabad. It was formed by an act of Indian Parliament known as IRDA Act 1999, which was amended in 2002 to incorporate some emerging requirements. Mission of IRDA as stated in the act is "to protect the interests of the policyholders, to regulate, promote and ensure orderly growth of the insurance industry and for matters connected therewith or incidental thereto."

Duties, Powers and Functions of IRDA

Section 14 of IRDA Act, 1999 lays down the duties, powers and functions of IRDA.

(1) Subject to the provisions of this Act and any other law for the time being in force, the authority shall have the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business.

(2) Without prejudice to the generality of the provisions contained in sub-section (1), the powers and functions of the Authority shall include,

a. Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;
b. protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
c. Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;
d. Specifying the code of conduct for surveyors and loss assessors;
e. Promoting efficiency in the conduct of insurance business;
f. Promoting and regulating professional organisations connected with the insurance and re-insurance business;
g. Levying fees and other charges for carrying out the purposes of this Act;
h. calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the insurance business;
i. control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);
j. Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
k. Regulating investment of funds by insurance companies;
l. Regulating maintenance of margin of solvency;
m. Adjudication of disputes between insurers and intermediaries or insurance intermediaries;

There are certain other acts which directly or indirectly affects the general insurance businesses which are as follows:

1. **Marine Insurance Act, 1963**

The act is specially formulated for the marine insurance business. It codifies the law relating to Marine Insurance. There are only few exception from the U.K.Marine Insurance Act, 1905 Underwriters have thorough knowledge about how to pursue rights of recovery from carries or bailees under subrogation proceedings.

2. **The Carriage of Goods by Sea Act, 1925**

The act specifies the minimum rights, liabilities and immunities of a ship owner in respect of loss or damage to cargo carried.

3. **The Merchant Shipping Act,1958**

It provides protection to ship owners. The ship owners liability arises up to certain maximum sums for certain losses, provided the incident giving rise such claims has arisen without the actual fault or priority of the ship owner, whether the claims relates to loss of life, personal injury, or damage to property on land or water. It also confers an obligation on the ship owner to send his ship to sea in a sea worthy and safe condition,

4. **The Bill Of Lading Act, 1855**

Bill of leading is an evidence of the contract of carriage of goods between the ship owner and the shipper, as an acknowledgement of the receipt of the goods on board the vessel. It is a document of title. This document requires in connection with settlement of marine cargo claims.

5. **The Indian Ports Act, 1963**

The act described the liability of port trust- authority for loss of or damage to goods whilst in their custody. It also defines the prescribed time limit for filling monetary claim on, or suit against the Port Trust Authorities.

6. **The Carriers Act, 1865**

The act defines the rights and liabilities of truck owners or operators who carry goods for public hire in respect of loss or damage to goods carried by them. It also mentions the time limit within which notice of loss or damage must be filed with the road carriers.

7. **Indian Railways Act, 1989**

The act deals with various aspects of railway administration; there are also provisions, which are relevant to marine insurance. The provisions of the relate to rights and liabilities of railways as carries of goods. The tribunals deal with claims for cargo loss, personal injuries, and refund of excess freight.

8. **The Indian Post Office Act, 1898**

The act defines the liability of the government for loss, wrong delivery, delay of or damage to any postal article in course of transmission of post.

9. **The Carriage by Air Act, 1972**

This act defines the liability of the air carrier for death of or injury to passages and for loss of or damage to registered luggage and cargo. It also prescribes the maximum limits of liability for death, Injury, damage etc., it specifies the time limits within which claims have to be filed on the air carrier. The provisions also apply to domestic carriage with some changes.

10. **Multimodal Transportation Act, 1993**

This is the act for the persons who engage in more than one mode of transportation such as rail, road, sea or air. The act specifies limits of liability of the operator, contents of documents issued by them, notice of loss etc.

11. **The Motor Vehicles Act, 1988**

The act specifies for compulsory third party insurance of motor vehicles, no fault liability, solution fund for victims of 'Hit and run' victims of motor vehicle accidents.

12. **The Inland Steam Vessels Act, 1977**

The act is in relation to the insurance of mechanically propelled vessels against third party risks. It makes the same insurance compulsory for owners or operators of inland vessels to insure against legal liability for death or bodily injury of third parties or of passengers carried for hire or reward and for damage to property of third parties. It prescribes the limits of the liability.

13. **Public Liability Insurance Act, 1991**

It deals with the immediate relief to the persons affected by accidents arising of hazardous substances. It also deals with that this liability, which is on 'no fault' basis, has to be compulsorily insured.

14. The Workman's Compensation Act, 1923

It describes the payment by employers to their employee / workmen, of compensation for injury by accident or disease, arising out of and in the course of employment.

15. Sale Of Goods Act, 1930

The act relates with the rights and obligations of sellers and buyers of goods like the merchantable quality of goods, the point or time at which ownership transfers from sellers to buyer.

16. The Indian Stamp Act, 1899

A policy of insurance must be stamped as per the schedule of rates for various classes of insurance prescribed in the act. A policy can't be enforced 'in a court of law' if it is not stamped.

17. Exchange Control Regulations

Generally, premiums and the amount of the claim are payable in Indian currency, rupees. The regulations describe the circumstances when premiums and claims can be paid in foreign currency and the procedure for obtaining permission from the reserve Bank of India.

18. Consumer Protection Act, 1986

The objective to pass this act is to provide for better protection of the interests of consumers and for the settlement of consumers disputes. It is applicable to the buyers of goods and services. Insurances have been defined as a service, for the purpose of the act. The buyer of insurance is a consumer.

Insurance Ombudsman

In India the idea of insurance ombudsman (IO) was first mooted in the year 1998. Central government by the powers conferred on it by sub section (I) section 114 of insurance act 1938, has set up an ombudsman specifically for insurance sector.

Main objective of insurance ombudsman is redressal and settlement of disputes arising between insured and insurer. Insurance ombudsman is a quasi judicial body established for speedy settlement of disputes in fair, impartial and judicial manner. The proceedings before insurance ombudsman are summary proceedings without involving any cost and they are speedy too. Thus, the main advantage of IO is its cost effectiveness and expeditious settlement of disputes. Insurance ombudsman is open to all individuals where the claim amount is less than Rs. 20 lakhs. Powers of insurance ombudsman include examining the complaints regarding:

- Partial or total repudiation of claims
- Delay in settlement of claims
- Legal construction of policy (Policy wordings)
- Premium paid or payable
- Non issue of insurance documents to customers after receipt of premium.

Insurance Business in India

As on March 31, 2010, there were 31 insurance companies operating in India. Of these 15 were general insurance companies and 16 life insurance companies. Out of the 15 general insurers, 9 were private and the remaining 6 public sector companies. Among the life insurers, there was only public sector company, viz. Life Insurance Corporation of India. The remaining 15 were private life insurers. Prior to the opening up of the insurance sector in 2000, however, there were only two players in the Market, the Life Insurance Corporation of India, writing life business and the General Insurance Corporation of India (GIC) dealing with general insurance business, operating through its four subsidiaries, viz., National Insurance Company Ltd., the New India Assurance Company Ltd., The Oriental Insurance Company Ltd., and United India Insurance Co. Ltd. The four subsidiaries have now been delinked from GIC. GIC now operates as the national reinsurer. Unlike an insurance company, a reinsurance company does not accept business from the end customer, but acts as the insurer for insurance companies, thus, helping to pool the risks that are reinsured with ii by all the companies.

(Also read the functions/objectives/roles of LIC and GIC to get complete picture of insurance business in India)

Reference Books:

1. Sheldon H.P: *Practice and Law of Banking.*
2. Dr. P. Periyaswamy: *Principles and Practice of Insurance*.
3. Bedi. H.L: *Theory and Practice of Banking.*
4. Maheshwari. S.N. : *Banking Law and Practice.*
5. Shekar. K.C: *Banking Theory Law and Practice.*
6. Pannandikar & Mithami': *Banking in India.*
7. Radhaswamy & Vasudevan: *Text Book of Banking.*
8. *IRDA website*
9. *Websites of LIC, GIC etc*

Model Question Paper. 1

FIFTH SEMESTER B.COM. DEGREE (PRIVATE/SDE)

EXAMINATION 2013

(CCSS)

BC5 B09-Banking and Insurance

	Time	Weightage
Part I- Descriptive questions	2.45 hours	27
Part II-Multiple choice questions	0.15 hours	3
Maximum	3 hours	30 weightage

Part I

Part A

Answer **all** *questions.*

Each question carries a weightage of 1

1. Define banking.
2. What do you mean by Insurance Bond?
3. Define commercial banks.
4. What is RRB?
5. What is Assurance?
6. Expand the following : a. CTPS b. GIBNA
7. Differentiate between Reinsurance and Double insurance.
8. What you mean by Credit Control?
9. What is the aim of EXIM bank? (9 x1= 9 weightage)

Part B

Answer **any 5** *questions.*

Each question carries a weightage of 2

10. Distinguish between Life insurance and Nonlife insurance.
11. Discuss the functions of IDBI.
12. Briefly explain the structure of banking system in India.
13. Briefly explain various fire insurance policies.
14. Discuss the role and functions of IRDA.
15. Explain the emerging trends in banking.
16. Discuss the role of commercial banks in economic development?

(5 x 2= 10 weightage)

Part c

Answer **any 2** *questions.*

Each question carries a weightage of 4

17. "As controller of credit, the central bank attempts to influence and control the volume of Bank credit and also to stabilize business condition in the country". Do you agree?.
18. Briefly explain the Banking System in India and also give the examples (name of Banks).
19. How do you classify insurance Business and discuss the features of different types of insurances. (2 x4 =8 weightage)

Part II

20 No's of multiple choice questions

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