B.Com. 6th Sem. General) Banking & Insurance(CBCS)'2021

UNIT-1
INTRODUCTION

ORIGIN OF BANKING

Banking is as old as the authentic history. The banking has its origin as early as 2000 B.C., when Babylonians developed the system of banking using their temples as banks. One finds a reference to the money changers in the New Testament. The 'rudimentary bank practices' found in the Egyptian and Phoenician history. In ancient Rome also, banking was developed on the lines of Greek system. When Romans conquered the Greeks, the Temple Priests no longer acted as financial agents. The Romans introduced the rules and regulations for the conduct of private banking. The growth of banking was seen only in 12th Century A.D in Venice and Geneva. Some people opined that the word 'banking' is originated from the German word meaning 'a mound or heap of money'. Some other opined that the word "Bank" is derived from the French word 'banque' which means a 'Bench' where business is transacted. Thus, it is understood that there is no unanimity among the economists about the origin of the word 'Banking'.

In general there are plenty of evidences to show that even prior to the advent of accidental ideas, the concept of banking was practiced in India and well understood in those days. Its origin can be traced to a time as early as 500 B.C. in one or another form. Sir. Richard Temple testified to the fact that banking business was carried on in ancient India. The Vedas, Manusmiriti and Kautilya's Arthashastra bear testimony to the existence and efficient working of a banking system in India by a section of people early in the history. Banking in India has also been referred to Manu, the great Hindu Jurist and others in the early Vedic literatures. The banking was carried on by the members of the Vaish community and Manu speaks of earning through interest as the business of Vaishyas. During the Buddhist period, business of banking was further refined and decentralized. Till the Buddhist period, banking was practiced only by 'Vaishyas'. Then, Brahmins and Kshatriyas entered in to the lucrative business of banking. Thus, the transition from money-lending to banking must have occurred before Manu developed a special section to the subject of deposits and Pledges . During Ramayana and Mahabharat eras, banking was a part-time business. Whereas, during the Vedic period it became a full-time business and banking remained the crudest form.

During the Moghul period, in the reign of Jahangir and Shah Jahan Hundies came into existence and large banking houses came to be established. The indigenous bankers had great opportunities for developing the very profitable business of money changing. By the arrival of Britishers in India, revolutionary changes took place in the Indian banking system. The first joint stock bank was established at Calcutta known as "the Bank in Hindustan" in 1770 under the European management promoted by an Agency House M/S Alexander & Co. However, the need was felt for the modem banking system. Thus, the seed of modern banking on British pattern were sown during the last decade of 18th century. In the beginning of 19th century, special efforts were made to develop modern banking institutions. The bank of Calcutta' the first presidency bank was established in 1806 marked the beginning of modern banking era in India and it was renamed as the 'The Bank of Bengal' in 1809. Then two more Presidency banks namely, The Bank of Bombay' in 1840 and the bank of Madras' in 1843 were set-up through a Charter of East India Company with the financial Participation of government. Towards the end of 19th Century, the early phase of 20th century, the 'Swadeshi Movement' gave a great stimulus to the establishment of a number of banks with Indian management. The first purely Indian bank was "The Oudh commercial bank", established in 1881, followed by 'The Punjab National Bank' in 1894, and The People's Bank of India' in 1901 . The Hilton Young Currency Commission' had suggested and strongly recommended for the establishment of a Central bank to be called 'the Reserve Bank of India' (RBI) in 1926. The government of India decided to establish a separate Central bank with the task of controlling the issue of money and regulating all other banks in the country on the recommendations of 'Central Banking Enquiry Committee' in 1929-31. The year 1935 opened a new era in the history of Indian banking, when the Reserve Bank of

India was established under the Reserve Bank of India Act, 1934 to act as a central bank of the country. It started functioning from 1st April, 1935. Thus, further liberalization of Reserve bank of India's licensing policy led to expand the banking activities in rural and semi- urban areas with a view to fulfill the requirements of a developing economy in conformity with a national priorities and objectives.

Definition of a Bank

A bank is a financial institution which performs the deposit and lending function. A bank allows a person with excess money (Saver) to deposit his money in the bank and earns an interest rate. Similarly, the bank lends to a person who needs money (investor/borrower) at an interest rate. Thus, the banks act as an intermediary between the saver and the borrower.

The bank usually takes a deposit from the public at a much lower rate called deposit rate and lends the money to the borrower at a higher interest rate called lending rate.

The difference between the deposit and lending rate is called 'net interest spread', and the interest spread constitutes the banks income.

Features or function of Bank :

1) Deals with money: The Main Features of a bank is that it deals with all the money-related transactions. For example, you can deposit your money in a bank account to save it securely, and you will also get interested in the money that you will save in the account.

However, you are supposed to pay the money back to the bank with interest.

2) Provide loans : Banks make extra money by providing loans for different products to the loan. The bank makes the extra money by lending money to the eligible person at certain rates.

Nowadays, banks provide loans for various requirements such as study loan, car loan, home loan, personal loans, etc. Different banks provide different loans at different interest rates.

3) Identity : There are various banks which provide loans at different interest rates. Therefore, each bank has a different name which helps the people to identify it easily and to differentiate with other banks. Even though the basic services provided by all banks are the same, but each bank tries to provide different interest rates and better services to attract more and more customers. Therefore, each bank uses a unique bank name and unique tag line to sell their services.

4) *Withdrawal and payment facilities :* A Bank provides various payment and withdrawal services to customers so that they can receive their money hassle-free. Customers can withdraw money using cheques and drafts and also from the ATMs installed by the banks at different locations in the city.

5) *Internet services :* Another feature of a Bank is that modern banks are also providing internet services. The development of the internet and its inclusion in the banking sector has made it even more easy for people to carry out various transactions.

6) Business: The only work of banking is not to provide banking services to customers. All banks are involved in the subsidiary businesses to make more money. Their sole responsibility to provide maximum satisfaction to their customers and to provide them maximum interest rates so that more customers do banking with them.

7) *Increasing functionality:* Like other industries banking sector is also focused on enhancing their functionality. Banks have developed from just providing money lending and cash deposit and withdrawal services to providing loans and credit to cashless bank services to internet and mobile banking.

8) *Branches at different locations:* Also, the features of a bank include services to its customers wherever they live in the whole world. Most banks are opening their branches the rural part of the country to connect people with the banks and to gain more profit.

Meaning of Banker :

A banker is an employee of a bank or financial institution who services the financial needs of clients. These clients can be individuals or institutions, both with different needs. A banker tries to maximize the profit of a bank while maintaining appropriate risk levels.

Meaning of Customer of a Bank

A customer is someone who has an account with a bank or who is in such a relationship with the bank that the relationship of a banker and customer exists. The legal position implies that opening an account is the crucial element in establishing the banker-customer relationship.

Relationship between Banker and Customer

The relationship between a banker and a customer depends on the type of transaction. The following are the relations:

a) Relationship of Debtor and Creditor: Banker accepts deposits of money from his customers for the purpose of lending and investment and repays it on demand as per the terms of the contract of deposit. In fact, deposit accepted by the bank is technically money loaned out to the bank from the depositors. Therefore, the general relationship between a depositor and the banker is a relation of the debtor and the creditor. The depositors are creditors and the bank is the debtor. However, the relationship between the banker and customer is directly opposite when the bank lends money to its customer. The bank becomes the creditor and the customer becomes the debtor.

b) Relationship of Trustee and Beneficiary: When a banker accepts items like securities or documents for safe custody or maintains escrow accounts of the customers, the relation between the banker and customer is a Trustee and the Beneficiary (Trustier). The bank is the Trustee and the customer is the beneficiary.

c) Relationship of Lessor and Lessee: When a customer hires a safe deposit locker from the bank, the relation between the bank and the customer is lessor and lessee. The bank is the lessor (licensor) and the hirer of safe deposit locker is the lessee (licensee/tenant).

d) Relationship of Principal and Agent: When a bank collects cheques, bills and other instruments for customers, the relation between the bank and customer is that of Principal and Agent. The bank also makes regular payments of insurance premium rent etc. as per standing instruction received from the customer. In the above cases also the relation between the bank and the customer is of Principal and agent. The bank act as the agent and customer the principal.

e) Relationship of Assigner and Assignee: An assignor is a person who transfers his security rights to a lender as collateral to the money borrowed by him. The transfer of Life Insurance Policies, National Saving Certificates, Supply bills etc. in the name of the bank is examples of assignment. The bank on whose name security rights are transferred by the assignor is called as assignee. On full payment of dues to the assignee, the assignor can get the security re-assigned in his name.

f) Relationship of Bailor and Bailee: Bailment refers to delivery of goods by one person to another for some purpose under a condition that the goods to be returned to depositor when the purpose is accomplished or otherwise disposed of according to the directions of the person while delivering the goods (Sec 148 of contract act). The person delivering the goods is known as bailor and the person to whom goods are delivered is called bailee.

Types of Customers in Bank: A banker deals with different types of customers like Individuals, Partnership firms, Companies, co- operative societies etc. While opening and in the conduct of accounts of these persons, the banker has to comply with the law application to each of them. Bankers also open current accounts for proprietory concerns, partnership firms, Companies, limited liability partnership firm etc. The following are the types of customer:

a) Accounts of Individual : An individual can be a person holding a bank account for personal use. Such customers must comply with existing regulations and bankers must ensure that they do not open and use bank accounts for illegal purposes. The customer should be properly introduced to the bank. The introduction is necessary for terms of banking practice and also for the purpose of protection.

b) Joint Account Holder: A joint account is an account opened by two or more persons. Instruction for opening the account may be any one of the following:

- Either or Survivor
- Both Jointly

- Former or Survivor
- Anyone or Survivor

c) Accounts of Minor : A minor is a person who has not completed eighteen years of age. Any contract entered by minor is void and is not enforceable by law. As per section 11 of the Indian Contract Act 1872, "when the age of maturity has been provided by law to be 18 years, any person less than that age, even by a day, would be a minor in law". This prevents minor to acquire property, dispose property or enter into any type of agreement.

d) Non-resident individuals (NRIs): Non-Resident Indian means, a person, being a citizen of India or a person of Indian origin residing outside India. A person is considered Indian Origin when he or his parents or any of his grandparents were Indian National. Non-resident falls generally into the following two categories:

a. A person who stay abroad for the purpose of employment or to carry on business activities or vocation or for any other purpose for an indefinite period of stay outside India and

b. Indian National working abroad for a specific period.

Various Types of NRI Accounts

- Ordinary Non-resident Rupee Accounts (NRO Accounts);
- Non-Resident (External) Rupee Accounts (NRE Accounts);
- Non-resident (Non-Repatriable) Rupee Deposits (NRNR Accounts); and
- Foreign Currency (Non-Resident) Accounts (Banks) Scheme (FCNR (B) Accounts).

e) Hindu Undivided Family (HUF): Hindu Undivided Family (HUF) is **not defined under the Income Tax Act** but is covered **under the Hindu Law.** By definition, HUF consists of **all individuals** who are lineally descended from a common ancestor and also comprises of unmarried daughters. HUF is not formed by a contract but by the status of a family i.e., it is created automatically in any Hindu Family. Having a common ancestor is a pre-requisite to form a HUF.

f) Partnership firms: A partnership is not a legal entity independent of partners. It is an association of persons. Registration of a partnership is not compulsory under Partnership Act. However, many banks insist on registration of a partnership. In any case, ie stamped partnership deed or Partnership letter should be taken when an account is opened for a partnership. The partnership deed will contain names of the partners, objective of the partnership, and other operational details, which should be taken note of by the bank in its dealings.

g) Joint stock companies (Limited Liability Companies): A company is registered under companies Act has a legal status independent of that of the share-holders. A company is an artificial person which has perpetual existence with limited liability and common seal.

h) Clubs, Societies and Associations: The clubs, societies, association etc., may be unregistered or registered. Account may be opened only if persons of high standing and reliability are in the managing committee or governing body..

i). Trust Account: Trusts are created by the settler by executing a Trust Deed. A trust account can be opened only after obtaining and scrutinizing the trust deed. The Trust account has to be operated by all the trustees jointly unless provided otherwise in the trust deed.

TYPES OF DEPOSITS:

Bank deposits serve different purposes for different people. Some people cannot save regularly; they deposit money in the bank only when they have extra income. The purpose of deposit then is to keep money safe for future needs. Some may want to deposit money in a bank for as long as possible to earn interest or to accumulate savings with interest so as to buy a flat, or to meet hospital expenses in old age, etc. Some, mostly businessmen, deposit all their income from sales in a bank account and pay all business expenses out of the deposits. Keeping in view these differences, banks offer the facility of opening different types of deposit accounts by people to suit their purpose and convenience. On the basis of purpose they serve, bank deposit accounts may be classified as follows:

a. Savings Bank Account b. Current Deposit Account c. Fixed Deposit Account d.Recurring

Deposit Account.

Let us briefly note the nature of the above accounts.

a. Savings Bank Account: If a person has limited income and wants to save money for future needs, the Saving Bank Account is most suited for his purpose. This type of account can be opened with a minimum initial deposit that varies from bank to bank. Money can be deposited any time in this account. Withdrawals can be made either by signing a withdrawal form or by issuing a cheque or by using ATM card. Normally banks put some restriction on the number of withdrawal from this account. Interest is allowed on the balance of deposit in the account. The rate of interest on savings bank account varies from bank to bank and also changes from time to time. A minimum balance has to be maintained in the account as prescribed by the bank.

b. Current Deposit Account: Big businessmen, companies and institutions such as schools, colleges, and hospitals have to make payment through their bank accounts. Since there are restriction on number of withdrawals from savings bank account, that type of account is not suitable for them. They need to have an account from which withdrawal can be made any number of times. Banks open current account for them. Like savings bank account, this account also requires certain minimum amount of deposit while opening the account. On this deposit bank does not pay any interest on the balances. Rather the accountholder pays certain amount each year as operational charge. For the convenience of the accountholders banks also allow withdrawal of amounts in excess of the balance of deposit. This facility is known as overdraft facility. It is allowed to some specific customers and upto a certain limit subject to previous agreement with the bank concerned.

c. Fixed Deposit Account (also known as Term Deposit Account): Many a time people want to save money for long period. If money is deposited in savings bank account, banks allow a lower rate of interest. Therefore, money is deposited in a fixed deposit account to earn a interest at a higher rate. Bank Deposit Account 17 This type of deposit account allows deposit to be made of an amount for a specified period. This period of deposit may range from 15 days to three years or more during which no withdrawal is allowed. However, on request, the depositors can encash the amount before its maturity. In that case banks give lower interest than what was agreed upon. The interest on fixed deposit account can be withdrawn at certain intervals of time. At the end of the period, the deposit may be withdrawn or renewed for a further period. Banks also grant loan on the security of fixed deposit receipt.

d. Recurring Deposit Account: This type of account is suitable for those who can save regularly and expect to earn a fair return on the deposits over a period of time. While opening the account a person has to agree to deposit a fixed amount once in a month for a certain period. The total deposit along with the interest therein is payable on maturity. However, the depositor can also be allowed to close the account before its maturity and get back the money along with the interest till that period. The account can be opened by a person individually or jointly with another, or by the guardian in the name of a minor. The rate of interest allowed on the deposits is higher than that on a savings bank deposit but lower than the rate allowed on a fixed deposit for the same period. Recurring Deposit Accounts may be of different types depending on the purpose underlying the deposit.

Origin and Growth of commercial Banking in India

Banking industry in India has a long history. It has travelled a long path to assume its present form. The banking industry in Indian started with small money lenders and has now large joint stock world class banks in its fold. The growth of banks in India is discussed below over two eras:

1. Pre-Independence Period
2. Post-Independence Period

1. Pre-Independence Period: Banking in its crude from is as old as authentic history. All throughout the period of India history, indigenous bankers and money lenders are recorded to have existed and carried on the business of banking and money lending on a large scale. Between 2000 and 1400 BC

during the Vedic Period records of deposits and lending are found. Renowned Hindu Law giver Manu has dealt with the matter of deposits and pledges in section of his work. The Indian banks enjoyed considerable public confidence and this can be gauged from fact that hundis were used from the days of Mahabharata. During the Moghul Period, the indigenous bankers were most prominent in connection with the financing of trade and use of instruments of trade.

Agency House: The indigenous bankers lost their importance to a certain with the advent of the English traders in India. The starting of modern banking in India can be traced to the beginning of the East India Company’s trade relation with our country. The growing trade Interest of the English merchants and non-existence of any organised banks in India, many English Agency Houses which were essentially trading company started to add banking business to their activities. The bank of Hindustan was the earliest bank started under European direction in India. The banking business of Agency House could not continue for long. Most of these Houses failed because of their complete disregard towards the principle of banking business. The Bank of Hindustan could not withstand the failure of its parent from and was closed down in 1832.

Presidency Banks: The banking business of Agency House which survived and continued to carry on trade and banking together was progressively taken over by the Presidency Banks. The three Presidency Banks viz.:

i. The Bank of Bengal (1809);
ii. The Bank of Mumbai (1840); and
iii. The Bank of Chennai (1843)

The Swadeshi Movement: Swadeshi movement prompted Indians to start many new institutions. The number of joint stock banks increased remarkably during 1906-1913. The peoples Bank of India Limited, the Bank of India Limited, the Central Bank of India Limited, Indian Bank Limited and the Bank of Baroda Limited were setup during that period.

Imperial Bank of India: The three Presidency Banks were amalgamated into the Imperial Bank of India which was brought into existence on 27th January, 1921, by the Imperial Bank of India Act, 1920. The liability of shareholders of the Imperial Bank was limited like that of shareholders of other banks registered under the Company Act. However the word “limited” did not from a part of the name of the Bank.

2. Post-Independence Period: After independence, Government has taken most important steps in regard of Indian Banking Sector reforms. In 1955, the Imperial Bank of India was nationalized and was given the name “State Bank of India”, to act as the principal agent of RBI and to handle banking transactions all over the country. It was established under State Bank of India Act, 1955.

In 1959, the 'State Bank of India' (Subsidiary Banks) Act was passed by which the public sector banking was further extended. The following banks were made the subsidiaries of State Bank of India:

i. The State Bank of Bikaner
ii. The State Bank of Jaipur
iii. The State Bank of Indore
iv. The State Bank of Mysore
v. The State Bank of Patiala
vi. The State Bank of Hyderabad
vii. The State Bank of Saurashtra
viii. The State Bank of Travancore

These banks forming subsidiary of State Bank of India was nationalized in1960. In 1963, the first two banks were amalgamated under the name of "The State Bank of Bikaner and Jaipur".

On 19th July, 1969, 14 major Indian commercial banks of the country were nationalized. In 1980, another six banks were nationalized, and thus raising the number of nationalized banks to20. Seven more banks were nationalized with deposits over 200 Crores. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalized banks from 20 to 19. Till the year1980 approximately 80% of the banking segment in India was under government's ownership. On the suggestions of Narsimhan Committee, the Banking Regulation Act was amended in 1993 and hence, the gateways for the new private sector banks were opened.

Financial Services Rendered by Banks

These financial services are explained below:

1. Banking

The banking industry is the backbone of India's financial services industry. The country has several public sector (27), private sector (21), foreign (49), regional rural (56) and urban/rural cooperative (95,000+) banks. The financial services offered in this segment include:

i. Individual Banking (checking accounts, savings accounts, debit/credit cards, etc.)

ii.Business banking (merchant services, checking accounts and savings accounts for businesses, treasury services, etc.)

iii.Loans (business loans, personal loans, home loans, automobile loans, working-capital loans, etc.)

The banking sector is regulated by the Reserve Bank of India (RBI), which monitors and maintains the segment's liquidity, capitalization, and financial health.

2. Professional Advisory

India has a strong presence of professional financial advisory service providers, which offer individuals and businesses a wide portfolio of services, including investment due diligence, M&A advisory, valuation, real-estate consulting, risk consulting, taxation consulting. These offerings are made by a range of providers, including individual domestic consultants to large multi-national organizations.

3. Wealth Management

Financial services offered within this segment include managing and investing customers' wealth across various financial instruments- including debt, equity, mutual funds, insurance products, derivatives, structured products, commodities, and real estate, based on the clients' financial goals, risk profile and time horizons.

4. Mutual Funds

Mutual fund service providers offer professional investment services across funds that are composed of different asset classes, primarily debt and equity-linked assets. The buy-in for mutual fund solutions is generally lower compared to the stock market and debt products. These products are very popular in India as they generally have lower risks, tax benefits, stable returns and properties of diversification. The mutual funds segment has witnessed double-digit growth in assets under management over the last five years, owing to its popularity as a low-risk wealth multiplier.

5. Insurance

Financial services offerings in this segment are primarily offered across two categories:

- General Insurance (automotive, home, medical, fire, travel, etc.)
- Life Insurance (term-life, money-back, unit-linked, pension plans, etc.)

Insurance solutions enable individuals and organizations to safeguard against unforeseen circumstances and accidents. Payouts for these products vary across the nature of the product, time horizons, customer risk assessment, premiums, and several other key qualitative and quantitative aspects. In India, there is a strong presence of insurance providers across life insurance (24) and general insurance (39) categories. The insurance market is regulated by the Insurance Regulatory and Development Authority of India (IRDAI).

6. Stock Market

The stock market segment includes investment solutions for customers in Indian stock markets (National Stock Exchange and Bombay Stock Exchange), across various equity-linked products. The returns for customers are based on capital appreciation – growth in the value of the equity solution and/or dividends – and payouts made by companies to its investors.

7. Treasury/Debt Instruments

Services offered in this segment include investments into government and private organization bonds (debt). The issuer of the bonds (borrower) offers fixed payments (interest) and principal repayment to the investor at the end of the investment period. The types of instruments in this segment include listed bonds, non-convertible debentures, capital-gain bonds, GoI savings bonds, tax-free bonds, etc.

8. Tax/Audit Consulting

This segment includes a large portfolio of financial services within the tax and auditing domain. This services domain can be segmented based on individual and business clients. They include:

- Tax – Individual (determining tax liability, filing tax-returns, tax-savings advisory, etc.)
- Tax – Business (determining tax liability, transfer pricing analysis and structuring, GST registrations, tax compliance advisory, etc.)

In the auditing segment, service providers offer solutions including statutory audits, internal audits, service tax audits, tax audits, process/transaction audits, risk audits, stock audits, etc. These services are essential to ensure the smooth operation of business entities from a qualitative and quantitative perspective, as well as to mitigate risk.

CHANGING ROLE OF COMMERCIAL BANKS IN INDIA

Banking industry is a very important tool in the construction of economic structure of any country and it plays a significant role in the economic development of a developing country. Economic development involves investment in various sectors of economy.

The major function of a financial institution is to provide the maximum financial convenience to the public. First, they are responsible for promoting overall savings by making banks more accessible to the public.

Second, they distribute savings in a more efficient manner to those who need it more, from an economic and social perspective.

Third, banks are responsible for creating credit and facilitating the transaction of business and trade which ultimately affect the growth of the economy.

Thus the banks collect savings from the people and mobilize saving for investment in industrial projects. The investors borrow from banks to finance the projects. Special funds are provided to the investors for the completion of projects. The banks provide a guarantee for industrial loan from international agencies. The foreign capital flows to developing countries for investment in projects.

Besides normal banking, the banks perform agency services for the client. The banks buy and sell securities, make rent payments, receive subscription funds and collect utility bills for the Government departments. Thus these banks save the time and energy of busy people.

Banks arrange foreign exchange for the business transactions with other countries. The facility of foreign currency account has resulted in an increase of foreign exchange reserves. By opening a letter of credit the banks promote foreign trade.

The banks not only collect funds from the customers but also serve as a guide to them in investing their funds. The policy of banks is an instrument in wide dispersal of credit in the country. Banking sector plays a positive role in augmenting the progress of a country as repositories of community's savings and as purveyors of credit. It is the heart of financial structure since it has the ability to add to the money supply of the nation and thus creates additional purchasing power.

Lending, investing and related activities of banks facilitate the economic processes of production, distribution and consumption. In a developing country like India banks also have social responsibilities like uplifting the weaker sections and financing the social projects. Banking industry in India has been playing a pivotal role in rebuilding the Indian economy by extending its network to the backward and rural areas, small industries and weaker sections of the society etc., in addition to providing finance to industry and business. In a way commercial banks have emerged as the key financial agencies of rapid economic development today than ever before.

Types of bank in India

Some important types of banks in countries like India are discussed below:
(a) Organized and unorganized banking:
Indian banking system can broadly be classified into two categories:
(i) Organized banking and
(ii) Unorganized banking.
That part of Indian banking system which does not fall under the control of our central bank (i.e. Reserve Bank of India) is called as un-organised banking. For example, Indigenous banks. Whereas, organized banking system refers to that part of the Indian banking system which is under the influence and control of the Reserve Bank of India. For example. Commercial Banks, Industrial Banks, Agricultural Banks.
(b) Scheduled and Non-scheduled banks: Under the Reserve Bank of India Act, 1939, banks were classified as scheduled banks and non scheduled banks.. The scheduled banks are those which are entered in the second schedule of RBI Act, 1939. Scheduled banks are those banks an which have a paid up capital and reserves of aggregate value of not less than Rs 5 lakhs and which satisfy RBI.
All Commercial Banks, Regional Rural Banks, State Cooperative Banks are scheduled banks. On the other hand, non-schedule banks are those banks whose total paid up capital is less than Rs 5 lakh and RBI has no specific control over these banks. These banks are not included in the second schedule of RBI Act, 1934.
(c) Indigenous Bankers: From very ancient days indigenous banking as different from the modern western banking has been organized in the form of family or individual business. They have been called by various names in different parts of the country as Shroffs, Sethus, Sahukars, Mahajans, Chettis and so on. They vary in their size from petty money lenders substantial shroffs.
(d) Central Bank: In each country there exists central bank which controls a country's money supply and monetary policy. It acts as a bank to other banks, and a lender of last resort. India Reserve Bank of India (RBI) is the Central Bank.
(e) Commercial Bank: A bank dealing with general public, accepting deposits from making loans to large numbers of households and firms. Through the process of accepting deposits and lending, commercial banks create credit in the economy. Some examples (commercial banks in India are State Bank India (SBI), Punjab National Bank (PNB) etc.
(f) Development Banks: Development banks are specialised financial institutions. To promote economic development, development banks provide medium term and long term loans the entrepreneurs at relatively low rate o interest rates. Some examples of development banks in India are Industrial Development Bank of India (IDBI), Industrial Financial Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI) etc.
(g) Co-Operative Banks: Co-operative banks are organised under the provisions of the Co- operative societies law of the state. These banks were originally set up in India to provide credit to the farmers at cheaper rates. However, the co-operative banks function also in the urban sectors.
(h) Land Mortgage Banks: The primary objective of these banks is to provide long-term loans to farmers at low rates in matters related to land, The land mortgage banks are also known as the Land Development Banks.
(i) Regional Rural Banks: Regional Rural Banks (RRBs) are established in the rural areas to meet the needs of the weaker section of the rural population.
(j) National Bank for Agricultural and Rural Development (NABARD): This bank was established in 1982 in India in view of providing the rural credit to the farmers. Actually, it is an apex institution which co¬ordinates the functioning of different financial institutions working in the field of rural credit. NABARD has been making continuous efforts through its micro-finance programme or improving the access of the rural poor to formal institutional credit. The self help group (SHG) – Bank linkage programme was introduced in 1992 as a mechanism to provide financial services to the rural poor people on a sustainable basis.
(k) Exchange Banks: These banks are engaged in buying and selling foreign exchange. These banks

help the growth of international trade.
(i) Exim Bank: It is popularly known as 'Export Import Bank'. Such banks provide long term financial assistance to the exporters and importers.

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UNIT-2
CHEQUES AND PAYING BANKER

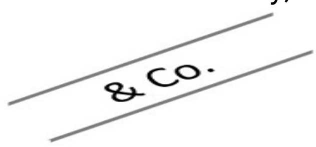
Meaning of crossing

Ans: A crossed cheque is basically any cheque which is crossed with two parallel lines. The lines can be drawn either across the whole cheque or through the top left-hand corner. It simply means that the specific cheque can only be deposited straightway into a bank account and cannot be instantly cashed by a bank or any credit institution. This ensures a level of security to the payer since it requires the funds to be handled through a collecting bank.

Types of Crossing

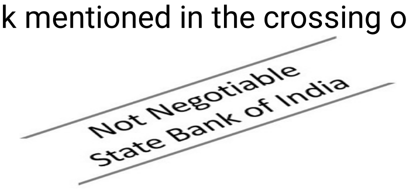
The way a cheque is crossed specified the banker on how the funds are to be handled, to protect it from fraud and forgery. Primarily, it ensures that the funds must be transferred to the bank account only and not to encash it right away upon the receipt of the cheque. There are several types of crossing

1. **General Crossing**: When across the face of a cheque two transverse parallel lines are drawn at the top left corner, along with the words & Co., between the two lines, with or without using the words not negotiable. When a cheque is crossed in this way, it is called a general crossing.



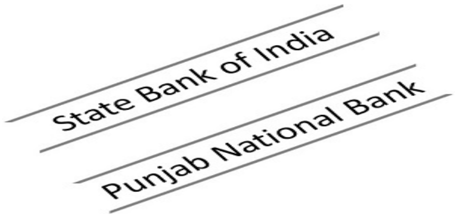
2. **Restrictive Crossing**: When in between the two transverse parallel lines, the words 'A/c payee' is written across the face of the cheque, then such a crossing is called restrictive crossing or account payee crossing. In this case, the cheque can be credited to the account of the stated person only, making it a non-negotiable instrument.

3. **Special Crossing**: A cheque in which the name of the banker is written, across the face of the cheque in between the two transverse parallel lines, with or without using the word 'not negotiable'. This type of crossing is called a special crossing. In a special crossing, the paying banker will pay the sum only to the banker whose name is stated in the cheque or to his agent. Hence, the cheque will be honoured only when the bank mentioned in the crossing orders the same.



4. **Not Negotiable Crossing**: When the words not negotiable is mentioned in between the two transverse parallel lines, indicating that the cheque can be transferred but the transferee will not be able to have a better title to the cheque.

5. **Double Crossing**: Double crossing is when a bank to whom the cheque crossed specially, further submits the same to another bank, for the purpose of collection as its agent, in this situation the second crossing should indicate that it is serving as an agent of the prior banker, to whom the cheque was specially crossed.



The crossing of a cheque is done to ensure the safety of payment. It is a well-known mechanism used to protect the parties to the cheque, by making sure that the payment is made to the right payee. Hence, it reduces fraud and wrong payments, as well as it protects the instrument from getting stolen or encashed by any unscrupulous individual.

Rules of Crossing of Cheque

Negotiable Cheques are generally crossed as a measure of safety.

- A cheque can be crossed generally, may be crossed specially by the holder.
- The Cheque holder has the right to add the words "not negotiable" to it.
- When an uncrossed cheque or a crossed cheque generally is sent to a banker for the collection, the person may cross it specially to himself. In this case, he does not enjoy the Statutory protection against being sued for conversion.

What is an Endorsement?

Endorsement means, **"**the writing of one's name on the back of the instrument or any paper attached to it with the intention of transferring the rights therein**"**. – Negotiable Instruments Act

Thus, an endorsement is signing a negotiable instrument for the purpose of negotiation.

- Person who effects an endorsement is called an **"endorser"**
- Person to whom the negotiable instrument is transferred by endorsement is called the "**endorse**d"

Types of Endorsement

Different types of endorsement are discussed below:

1. Blank or general endorsement
2. Special or full endorsement [Sec. 16]
3. Partial endorsement [Sec. 56]
4. Restrictive endorsement [Sec. 50]
5. Conditional or qualified endorsement
   - Sans recourse
   - Facultative
   - Contingent

1. **Blank or general endorsement :** It is a type of endorsement when the **endorser just signs on the instrument without mentioning the name** of the person in whose favour the endorsement is made.

Endorsement in blank specifies no endorsee. It simply consists of the signature of the endorser on the endorsement.

Example: A bill is payable to X. X endorses the bill by simply affixing his signature. This is an endorsement in blank by X. In this case the bill becomes payable to bearer.

There is no difference between a bill or note endorsed in blank and one payable to bearer. They can both be negotiated by delivery.

2. Special or full endorsement : In this type of endorsement contains not only the signature of the endorser but also the name of the person in whose favour the endorsement is made, then it is an endorsement in full. In such an endorsement, it is only the endorsee who can transfer the instrument.

Example: A is the holder of a bill endorsed by B in the blank. A writes over B's signature the words "Pay to C or order." A is not liable as an endorser but the writing operates as an endorsement in full from B to C.

3. Partial endorsement : A partial endorsement is a type of endorsement in which purports to transfer to the endorsee a part only of the amount payable on the instrument. Such an endorsement does not operate as a negotiation of the instrument.

Example: A is the holder of a bill for Rs.1000. He endorses it "pay to B or order Rs.500." This is a partial endorsement and invalid for the purpose of negotiation.

4. Restrictive endorsement : A restrictive endorsement is one which either by express words restricts or prohibits the further negotiation of a bill or which expresses that it is not a complete and unconditional transfer of the instrument but is a mere authority to the endorsee to deal with bill as directed by such endorsement.

Example: "Pay C," "Pay C for my use," "Pay C for the account of B" are instances of restrictive endorsement. The endorsee under a restrictive endorsement acquires all the rights of the endorser except the right of negotiation.

5. Conditional or qualified endorsement : A type of endorsement where the endorsee limits or negatives his liability by putting some condition in the instrument is called a conditional endorsement. A conditional endorsement, unlike the restrictive endorsement, does not affect the negotiability of the instrument. It is also sometimes called a qualified endorsement.
    a) Sans recourse: Endorser relieves himself from the liability to all subsequent endorsees.
    b) Facultative : The endorser waives any of his rights
    c) Contingent : The endorser makes his liability dependent upon happening of some event.

General Rules regarding the Form of Endorsements :

An endorsement must be regular and valid in order to be effective. The appropriateness or otherwise of a particular form of endorsement depends upon the practice amongst the bankers. The following rules are usually followed in this regard.

1. Signature of the endorser: The signature on the document for the purpose of endorsement must be that of the endorser or any other person who is duly authorized to endorse on his behalf. If a cheque is payable to two persons, both of them should sign their names in their own handwriting. If the endorser signs in block letters, it will not be considered a regular endorsement.

2. Spelling: The endorser should spell his name in the same way as his name appears on the cheque or bill as its payee or endorsee. If his name is mis-spelt or his designation has been given incorrectly, he should sign the instrument in the same manner as given in the instrument. Thereafter, he may also put his proper signature in the same handwriting, if he likes to do so. For example, if the payee's name is wrongly spelt as 'Virendra Perkash' instead of 'Virendra Prakash' regular endorsement will be as follows:

Merely writing the correct name will not be regular endorsement.

3. No addition or omission of initial of the name. An initial name should neither be an added nor omitted from the name of the payee or endorsee as given in the cheque. For example, a cheque is payable to S.C. Gupta should not be endorsed as S. Gupta or vice versa. Similarly, a cheque payable to Harish Saxena should not be endorsed as H. Saxena because it will be doubtful for the paying banker to ascertain that H. Saxena is Harish Saxena and nobody else. It is possible that some Hari Saxena has signed on the cheque as H. Saxena.

4. Prefixes and suffixes to be excluded: The prefixes and suffixes to the names of the payee or

endorsee need not be included in the endorsement. For example, the words "Mr., Messrs, Mrs., Miss, Shri, Shrimati, Lala, Babu, General, Dr., Major, etc." need not be given by the endorser otherwise the endorsement will not be regular. However, an endorser may indicate has title or rank, etc., after his signature. For example, a cheque payable to Mojor Raja Ram or Dr. Laxmi Chandra may be endorsed as 'Raja Ram, Major' or Laxmi Chandra, M.D.' A cheque payable to Padmashri Vishnu Kant may be endorsed as Vishnu Kant, Padmashri.

Meaning of Paying Banker :

The term paying banker refers to the drawee banker who pays the cheques of his customers. The primary relationship between a banker and his customers is that of a debtor and a creditor.

Duties of The paying banker

The paying banker has the following duties:

A) In case of sufficiency of funds in the account of the drawer which can be properly used to pay the cheque, the banker must pay the cheque when required to do so.

B) The paying banker is expected to pay the cheque to the genuine payee as per the direction of the drawer.

C) The paying banker should pay the cheque when there is no restriction imposed on the payment by the drawer or by the law.

D) The payment should be made when the cheques are presented for payment within a reasonable time after being drawn and during banking hours.

E) He has to honour the cheque drawn against the account maintained at that branch of the bank where the cheque is presented.

F) The banker should not make payment of crossed cheques over the counter of the bank. He must pay the crossed cheques through a banker.

Liabilities Of Paying Banker :

In the following ways liabilities of the paying banker may arise :

A) When there are sufficient funds in the account of the customer applies for the payment of cheques the paying banker shall be liable to pay damages if he wrongfully dishonours the cheques.

B) When the customer has been granted overdraft facility, the banker will be held liable if he dishonours cheques drawn by the customer on the basis of the overdraft.

C) When the customer is misled by the entry in the passbook and draws a cheque believing the balance shown by passbook as the actual balance, the banker shall be liable if the cheque is dishonoured.

D) When the customer is allowed by the banker to draw a cheque on the basis of cheque deposited for collection, before it is actually realised, the banker shall be liable to the customer if he subsequently dishonours the cheque.

E) The paying banker shall be liable if he pays the cheque contravening the legal provisions laid down by the Negotiable instruments act.

Statuary protection for holder in due course of collecting Bank :

Section 131 of the Negotiable Instruments Act provides protection to a collecting banker who receives payment of a crossed cheque or draft on behalf of his customers. According to Section 131 of the Act "a banker who has, in good faith and without negligence, received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment."

The protection provided by Section 131 is not absolute but qualified. A collecting banker can claim protection against conversion if the following conditions are fulfilled.

1. Good Faith and Without Negligence: Statutory protection is available to a collecting banker when he receives payment in good faith and without negligence.

The phrase in "good faith" means honestly and without notice or interest of deceit or fraud and does necessarily require carefulness. Negligence means failure to exercise reasonable care. It is not for the customer or the true owner to prove negligence on the part of the banker. The burden of proving that he collected in good faith and without negligence is on the banker. The banker should have exercised reasonable care and deligence. What constitutes negligence depends upon facts of each case.

Following are a few examples which constitute negligence:

(a) Failure to obtain reference for a new customer at the time of opening the account.
(b) Collection of cheques payable to 'trust accounts' for crediting to personal accounts of a trustee.
(c) Collecting for the private accounts of partners, cheques payable to the partnership firms.
(d) Omission to verify the correctness of endorsements on cheques payable to order.
(e) Failure to pay attention to the crossing particularly the "not negotiable crossing."

2. Collection for a Customer: Statutory protection is available to a collecting banker if he collects on behalf of his customer only. If he collects for a stranger or noncustomer, he does not get such protection. As Jones aptly puts if "duly crossed cheques are only protected in their collection, if handled for the customer". A bank cannot get protection when he collects a cheque as holder for value. In Great Western Railway Vs London and Country Bank it was held that "the bank is entitled for protection as it received collection for an employee of the customer and not for the customer."

3. Acts as an Agent: A collecting banker must act as an agent of the customer in order to get protection. He must receive the payment as an agent of the customer and not as a holder under independent title. The banker as a holder for value is not competent to claim protection from liability in conversion. In case of forgery, the holder for value is liable to the true owner of the cheque.

4. Crossed Cheques:Statutory protection is available only in case of crossed cheques. It is not available in case uncrossed or open cheques because there is no need to collect them through a banker. Cheques, therefore, must be crossed prior to their presentment to the collecting banker for clearance. In other words, the crossing must have been made before it reached the hands of the banker for collection. If the cheque is crossed after it is received by the banker, protection is not available. Even drafts are covered by this protection.

To conclude, it is necessary that the collecting banker should have acted without negligence if he wants to claim statutory protection under Section 131 of the said Act. The statutory protection is available to the banker if he collects a cheque marked "Not Negotiable" for a customer, whose name is not used as the payee there-in, provided the requirements of the said sections are duly complied with.

Concept of Negligence

Negligence occurs when someone acts in a careless, reckless, or negligent manner, causing another individual to get hurt or damages another's property.

There are four elements of negligence you must establish to recover compensation in a personal injury claim based on the theory of negligence which are

i. Duty of care
ii. Breach of duty of care,
iii. Causation
iv. The existence of damages.

Given below an explanation of above mentioned elements of negligence.

i. Duty of Care

This is a legal obligation to exercise the same level of reasonable care that another person would exercise in a similar situation.

For instance, doctors have a legal duty to provide their patients with the same level of care that a similarly-trained medical professional would provide if he or she were in a similar situation.

All drivers on the road have a duty of care to operate their vehicles safely and in accordance with all traffic laws in order to prevent chaos and injury to others on the road.

In some cases, your attorney will need to consult experts to determine the specific duty of care for the situation where your injury occurred.

ii. Breach of Duty of Care

You must also prove that the defendant breached his or her duty of care by failing to act the way that a reasonably prudent person would if he or she were in the same situation.

In other words, you must prove that an average person possessing the same knowledge as the defendant would have behaved differently because he or she would have known that his or her actions or lack of action would cause injury to the plaintiff (accident victim).

iii. Causation

This means there must be a direct link between the breach of duty of care and your injuries. You must also show that there was a reasonable expectation for the defendant to foresee that his or her actions might cause an injury to the plaintiff.

This means that, regardless of the defendant's actions, he or she will likely not be held liable for an injury that was random or unforeseeable.

iv. The existence of damages:

To receive compensation for your negligence claim, you must be able to prove that the defendant's negligence caused damages, such as medical bills for the treatment of your injury, bills to repair property damaged in the accident and other monetary expenses like loss of income from the inability to work.

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UNIT -3
BANKING LENDING

Concept of Lending

Lending (also known as "financing") occurs when someone allows another person to borrow something. Money, property, or another asset is given by the lender to the borrower, with the expectation that the borrower will either return the asset or repay the lender. In other words, the lender gives a loan, which creates a debt that the borrower must settle.

Simply put, lending allows someone else to borrow something. In terms of business and finance, lending often occurs in the context of taking out a loan. A lender gives a loan to an entity, which is then expected to repay their debt. Lending can also involve property or another asset, which is eventually returned or paid for in its entirety.

Principles of sound lending

A banker follows certain basic **principles of lending** while doing carrying out their lending and credit operations. Banks deals with public money accepting deposit and lend to their borrowers to earn profit. Banks follow some fundamental principles of lending in order to ensure safety, security and profitability on money it lend. Lending is one of the most important functions performed by the commercial banks and is major source of income of bank.

Borrower may differ in terms of their purpose of advance, activities, financial health, repayment capacity, risk so some important principles / considerations are followed by bank before taking lending decision.

Important Principles of Lending in Banking | Credit Principles

These basic principles of bank lending affect bank's loan policies, credit operations to a great extent. Here are some important principles of lending :

i. Safety
ii.Liquidity
iii.Purpose
iv.Diversity or Risk Spread
v.Profitability
vi Security

Given below an explanation of all above mentioned principles of lending:

i. Safety: Safety is the most important fundamental principle of lending. Banks deal with public money so safety of money from public is first priority of bank. When a banker lends, he must be sure about that the money is in safe hand and will definitely come back at regular interval as per repayment schedule without any default. Safety of funds depends on nature of security, character of borrower, repayment capabilities and financial health of the borrower.
ii. Liquidity: Liquidity is also an important principle of lending in banking. Bank lend public money which is repayable on demand by depositors so bank lends for a short period. A banker must ensure that money will come back on demand or as per repayment schedule. The borrower must be able to repay the loan within a reasonable time after demand for repayment is made.
'Liquidity' has as much importance as 'safety' of funds. The reason behind it is that a bulk of their deposit is repayable on demand or at a very short notice. Banker must ensure that money is locked up for a long time. If loan becomes illiquid, it may not be possible for bankers to meet their obligations vis a vis depositors.
iii. Purpose: The underlying purpose for which an applicant is seeking a loan should be productive. The purpose of loan helps in determining level of risk and also impact interest rate on loan.Purpose of loan should be productive in order to ensure safety of funds while it should be extended for short term to ensure liquidity.
iv. Diversity or Risk Spread: Bank follow this approach (principle of diversity) while creating its advances portfolio. Risk is always present while extending any kind of advance to any type of borrower. To minimize the risk, bank should lend to borrowers from different trades, industries like agriculture, education, IT, pharma, educational etc. Lending surplus to a particular sector may have adverse affect on bank in time of slump.

A banker must follow principle of diversity also while choosing its investment portfolio. He must invest the funds over different share and debentures of different industries rather than investing in particular type of security.
v. Profitability: Banks accept deposits from public and lend it to make profit. Banks also incur expenses to maintain deposits such as rent, stationary, premises rent, provision for depreciation of their fixed assets, bad loans. After incurring such expenditures, a bank must earn some profit like other financial institutions.So a banker must extend the advance in such a way that it is profitable for bank and also at competitive lending rate.
vi Security: A banker avoids lending to a borrower without any security. Security act as an insurance to lender bank in case of default by the borrower. The banker carefully scrutinizes all the different aspects of an advance before granting it. At the same time, he provides for an unexpected change in circumstances which may affect the safety and liquidity of the advance. It is only to provide against such contingencies that he takes security so that he may realize it and reimburse himself if the well-calculated and almost certain source of repayment unexpectedly fails.

Meaning of Secured Loans

Secured loans are loans that are backed by an asset, like a house in the case of a mortgage loan or a car with an auto loan. This asset is the collateral for the loan. When you agree to the loan, you agree that the lender can repossess the collateral if you don't repay the loan as agreed.
Even though lenders repossess property for defaulted secured loans, you could still end up owing money on the loan if you default. When lenders repossess property, they sell it and use the proceeds to pay off the loan. If the property doesn't sell for enough money to completely cover the loan, you will be responsible for paying the difference.

Meaning of Unsecured Loans

The same isn't true for an unsecured loan. An unsecured loan is not tied to any of your assets and the lender can't automatically seize your property as payment for the loan. Personal loans and student loans are examples of unsecured loans because these are not tied to any asset that the lender can take if you default on your loan payments.

Distinguish between secured and unsecured loan/advances.

Given below the points of distinctions between secured and unsecured loan:

i. The most important difference between a secured and unsecured loan is the collateral required to attain the loan. A secured loan requires you to provide the lender with an asset that will be used as collateral for the loan. Whereas and unsecured loan doesn't require you to provide an asset as collateral in order to attain a loan.
ii. Another key difference between a secured and unsecured loan is the rate of interest. Secured loans usually have a lower rate of interest when compared to an unsecured loan. This is because unsecured loans are considered to be riskier loans by lenders than secured loans.
iii. Secured loans are easier to obtain while unsecured loans are harder to obtain, as it is less risker for a banker to dispense a secured loan.
iv. Secured loans usually have longer repayment periods when compared to unsecured loans. In general, secured loans offer a borrower a more desirable contract that an unsecured loan would.
v. Secured loans are easier to obtain for the mere fact that they are less risky for a lender to give out, while unsecured loans are comparatively harder to obtain.

Different types of loan/advances

Advances by commercial banks are made in different forms such as demand loan, term loan, cash credit, overdraft etc. These forms of advances are explained below.

1. Demand Loan: In a demand loan account, the entire amount is paid to the debtor at one time, either in cash or by transfer to his savings bank or current account. No subsequent debit is ordinarily allowed except by way of interest, incidental charges, insurance premiums, expenses incurred for the protection of the security etc. Repayment is provided for by installments without allowing the demand character of the loan to be affected in any way. There is usually a stipulation that in the event of any installment, remaining unpaid, the entire amount of the loan will become due. Interest is charged on the debit balance, usually with monthly rests unless there is an arrangement to the contrary. No cheque book is issued. The security may be personal or in the form of shares, Govt. paper, fixed deposit receipt, life insurance policies, goods, etc

2. Term Loan: When a loan is granted for a fixed period exceeding three years and is repayable according to the schedule of repayment, it is known as a term loan. The period of term loan may extend up to 10 years and in some cases up to 20 years. A term loan is generally granted for fixed capital requirements, e.g. investment in plant and equipment, land and building etc. These may be required for setting up new projects or expansion or modernization of the plant and equipment. Advances granted for purchasing land / building / flat (Apartment house) are term loans.

3. Overdraft: An overdraft is a fluctuating account wherein the balance sometimes may be in credit and at other times in debit. Overdraft facilities are allowed in current accounts only. Opening of an overdraft account requires that a current account will have to be formally opened, and the usual account opening form completed. Whereas in a current account cheques are honored if the balance is in credit, the overdraft arrangement enables a customer to draw over and above his own balance up to the extent of the limit stipulated

4. Cash Credit: A cash credit is essentially a drawing account against credit granted by the bank and is operated in the same way as a current account in which an overdraft limit has been sanctioned. The principal advantages of a cash credit account to a borrower are that, unlike the party borrowing on a fixed loan basis, he may operate the account within the stipulated limit as and when required and can save interest by reducing the debit balance whenever he is in a position to do so. The borrower can also provide alternative securities from time to time in conformity with the terms of the advance and according to his own requirements. Cash credits are normally granted against the security of goods e.g. raw materials, stock in process, finished goods. It is also granted against the security of book-debts. If there is good turnover both in the account and in the goods, and there are no adverse factors, a cash credit limit is allowed to continue for years together. Of course a periodical review would be necessary.

5. Bills Purchased: Bills, clean or documentary, are sometimes purchased from approved customers in whose favour regular limits are sanctioned. In the case of documentary bills, the drafts are accompanied by documents of title to goods such as railway receipts or bills of lading (BOL). Before granting a limit, the creditworthiness of the drawer is to be ascertained. Sometimes the financial standing of the drawees of the bills are verified, particularly when the bills are drawn from time to time on the same drawees and/or the amounts are by large.

6. Bills Discounted: Since bills, maturing within 90 days or so after date or sight, are discounted by banks for approved parties. In case a bill, say for Rs. 10,000 due 90 days hence, is discounted today at 20% per annum, the borrower is paid Rs. 9,500 its present worth. However the full amount is collected from the drawee on maturity. The difference between the present worth and the amount of the bill represents earning of the banker for the period for which the bill is to run. In banking terminology this item of income is called "discount".

ADVANTAGES OF advances against various security:

1. If default is committed by the borrower, the banker as secured creditor can take possession of security, sell the same and recover loan from the proceeds.
2. Charging of assets to an extent operates as control on behaviour of the borrower.
3. By specific charging of security a borrower is prevented from raising finance against the same security.
4. It ensures continuous involvement of the borrower and he cannot leave the business at his will.
5. The charging of a security exhibits confidence of borrower in business.
6. End-use of funds for the purpose of lending is also secured by the same.*

BANK ADVANCES AGAINST VARIOUS SECURITIES

A major part of bank advances are granted only for productive purposes and banks normally do not grant any advance for consumption purpose. Advances against miscellaneous securities such as bank's own fixed deposits receipts, national savings certificates, life policies, shares etc. are still granted on a restricted scale. The policies in this regard may differ from bank to bank. It may also not be possible to specify the exact terms and conditions on which the advances will be granted but at the same time it may be stated that the conditions will not be materially different than those discussed in this chapter.

1. ADVANCES AGAINST BANKS OWN DEPOSITS:

Deposits of the bank may be broadly divided in two categories as under:

i) Demand Deposits.
ii) TERM Deposits.

Demand deposits are payable on demand and as such no advance against such a deposit may normally be required. ,

Term deposits are payable after a fixed period and may generally be accepted under three different schemes:

1. Fixed deposits where a fixed amount is accepted for an agreed term and the interest is payable, every quarter.
2. Reinvestment plan where a fixed amount is accepted for an agreed term and interest accrued every quarter is further invested. The depositor is paid a lump sum amount after expiry of the agreed term.
3. Monthly recurring deposit where a monthly instalment is accepted for an agreed term and a lump sum amount is paid to the depositor after its expiry.

2. ADVANCES AGAINST LIFE INSURANCE POLICIES:

Life insurance policies are considered as one of best securities available for bank advances and are readily accepted as collateral security. Need based advance is also granted against life insurance policies on a restricted basis. A life insurance policy has three different values attached to it as under:

1. Insured value: The face value of the policy equivalent to the sum assured.

2. Paid- value : The value which has been already paid by the assured against the policy.
3. Surrender value: The value which Life Insurance Corporation will be prepared to pay should the policy be surrendered to it and the contract of insurance under the policy is cancelled.

3. ADVANCES AGAINST GOVERNMENT SECURITIES, NATIONAL SAVINGS CERTIFICATES, POST OFFICE TERM DEPOSITS, ETC.:

Government securities are generally issued in two forms as under:

- Stocks.
- Promissory notes.

For securities which are held in the form of stocks, the owner is only given a certificate to the effect that his name has been registered as an owner of certain amount of stock in a specified loan in the Public Debt Office. These stocks are transferable only by submitting a special transfer form obtainable from a public debt office. Public Debt Office will transfer the stock and issue a fresh certificate in favour of the transferee.

The security issued in the form of promissory notes are transferable by endorsement and delivery just like any other negotiable instrument and are not required to be sent to Public Debt Office at the time of each transfer unlike stocks. These securities have a stable value and are easily marketable and constitute good security for bank advances.

National Saying Certificates are freely acceptable as security for bank advances. Premature encashment of these certificates before three years has now been stopped by post office and any short-term requirement of funds against the certificates will be met by banks only. The general terms and conditions of advances against Govt. securities, National Saying Certificates etc. are given below:

(i) The bank should satisfy themselves as to the acceptability of the credit needs of the borrower and end use of funds lent and they should not be guided solely by availability of the security.

(ii) The interest rate should be as per the directives on interest rate issued by the Reserve Bank of India.

(iii) Adequate margin should be maintained to cover the defaults, if any, in repayment of the principal and interest.

(iv) They should ascertain and follow the procedure prescribed by the Public Debt Office of the RBI, postal authorities, etc., when advances against Government securities, postal certificates, etc. are granted.

4. ADVANCES AGAINST RELIEF BONDS:

Relief Bonds issued in different series in demat form are eligible for sanction of loans against them subject to the following terms:

(i) The banks will satisfy themselves as to the acceptability of the purpose, genuineness of the credit, need of the borrower and end use of funds lent.

(ii) The rate of interest will be in accordance with the directives on interest rates issued by the RBI from time to time.

(iii) Adequate margin will be kept to cover defaults, if any, in repayment of the principal and interest at the appropriate rate.

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UNIT-4
INTERNET BANKING

CONCEPT OF Home Banking

Home banking is the practice of conducting banking transactions from home rather than at branch locations. Home banking generally refers to mobile banking, web banking, banking over the telephone, or banking by mail. The first experiments with online banking started in the early 1980s. However, it did not become popular until the rise of the Internet in the mid-1990s.

The concept of virtualization play a vital role to transform banking industry from paper banking to paperless banking which will majorly benefit the customers of banking industry. Home Banking works as a milestone to achieve the customer satisfaction towards the services provided by commercial banks. Home Banking is a type of banking which allowed customers to access their financial and banking services via internet world wide web. This implies that home Banking may be cost-efficient and a convenient banking format for many customers. It can be expected to generate its main benefits from retail services such as short-term lending, deposits, cash management including card payments, pre-scheduled payments for electricity, insurance, housing, etc. In those cases, traditional manual operations within the bank are being replaced by online ones performed by the customers themselves.

Benefits of Home Banking

Benefits of home banking can be evaluated through the following points:

i. One of the frequently cited benefits of banking is its relative convenience. Borrowers can access their balances, transfer funds and set up monthly payments from their computers without ever having to leave their homes. Additionally, the majority of online banks offer mobile applications for your Smartphone, although these are also offered by many retail banks as well.

ii. Another increasingly popular feature is the ability to deposit checks through an app. Many online banks will allow you to do this, including Ally eCheck Deposit and CIT Bank's mobile app. Although this was previously limited to more tech-savvy banks, it has also been adopted by many retail banks in recent years.

iii. Rewards programs are another feature that we don't typically see offered by retail banks outside of credit cards. Discover's Cash back Checking account allows customers to earn cash rewards on qualifying debit card transactions. Certain online institutions like Memory Bank provide special promotional rates for accounts that meet direct deposit, monthly purchase or balance requirements, which stands in contrast to many retail banks that often require you to meet certain requirements just to avoid fees.

iv. Online banks are almost always open. While most retail banks will be closed on weekends or holidays, online banks allow you to access your account 24/7 and have customer service representatives available around the clock.

v. Saving time and reducing physical risks are also the benefits of home banking. Financial transactions can often be completed in minutes at home.

Dis advantages of home/online banking

No one type of bank can be the best at everything. In spite of their many advantages, there are some drawbacks to using online banks as well. Here are some of the downsides of working with an online bank:

i. Technology issues
ii. Security issues
iii. Inefficient at complex transactions
iv. No relationship with personal banker
v. Inconvenient to make deposits

Types of Home Banking

Home banking is of following types:

1. Mobile Banking: Banking via mobile phone apps has become increasingly popular. Most mobile apps are easier to use than websites, and they have some security benefits. In particular, banking apps can provide protection from phishing attacks. Mobile apps also often allow users to access features that are not available via websites. For example, it is frequently possible to scan paper checks with an app, while this feature is less common on websites.

2. Web Banking: Web banking via the Internet is still fairly common. Nearly all banks have websites that allow access to checking accounts and savings accounts. Web banking is generally available for both individuals and small businesses. Some users may be more comfortable with web banking

than new apps for mobile phones. The vast majority of web browsers is also open source and thoroughly tested, which makes them more secure than most mobile apps.

3. Banking Over the Telephone: Banking over the telephone is one of the oldest forms of home banking, and it still has some uses. Some of the earliest home banking services was automated systems for obtaining account balances over the phone. While the Internet has mostly taken over that function, banking by phone remains a useful fallback. Phone calls are a way for banks to verify if customers actually made suspicious looking transactions. Phone calls also help customers to resolve issues when errors occur.

4. Banking by Mail : Banking by mail continues to enjoy some popularity. Depositing paper checks via mail is simple and intuitive for people who usually do their banking in person. Furthermore, banking by mail does not introduce the cyber security risks associated with online banking. Banking by mail is a good alternative for customers with a temporary need for home banking.

Notes on virtual banking

Definition: The Virtual Banking is the provision of accessing the banking and related services online without actually going to the bank branch/office in person. Simply, availing the banking services through an extensive use of information technology without any requirement for the physical walk-in premises is called as virtual banking.

Any financial institution that offers the traditional banking services online is termed as a virtual bank. Virtual banking enables a customer to pay bills online, check account details, secure loans, withdraw and deposit money anytime as per the convenience.

Some common forms of virtual banking are, ATMs, use of magnetic ink character recognition code (MICR), Electronic clearing service scheme, electronic fund transfer scheme, RTGS, computerized settlement of clearing transactions, centralized fund management schemes, etc.

One of the advantages of virtual banking service is that the transactions can be checked in real time, i.e. as and when the transactions are made and the customer is not required to wait for the day or a month to end to check the transaction details. The cost incurred in handling the transactions is lower than the traditional form of banking, and also, it charges low fee comparatively because of less overhead expenses.

Also, the response time has increased manifold with the invent of online banking. The customer can access his account any time round the clock and indulge in the banking activities as per his convenience.

Notes on E-payments

Electronic Payment System: - It an e-commerce environment, payments take the form of money exchange in an electronic form and are therefore called electronic payments, Electronic payments (e -payments) are an integral part of e-commerce and are one of its most crucial aspects.

"Electronic payment is a form of a financial exchanger that takes place between the buyer and the seller facilitated by means of electronic communications. Electronic payment is a financial exchange that takes place in an online environment."

Electronic Payment System is a system of financial exchange that is facilitated by a digital financial instrument such as encrypted credit card numbers, electronic cheques backed by a bank.

E-payment is based on electronic financial network and communication technologies as a means to realize circulation and payment by making use of binary data stored in the bank computer systems.

Thus an e-payment has the following features:

- It is supported by computer technologies. It realizes storage, payment, and circulation.
- Multiple functions are integrated together, including deposit, loan, and non-cash settlement.
- It is widely applied to areas such as production, exchange, distribution, and consumption.
- It is simple, secure, fast and reliable.
- It is usually accomplished through an exclusive network for banks.

ADVANTAGES OF E-PAYMENTS:

Electronic payment allows your customers to make cashless payments for goods and services through cards, mobile phones or the internet. It presents a number of advantages, including cost and time savings, increased sales and reduced transaction costs.

1. Increased Speed and Convenience: E-payment is very convenient compared to traditional payment methods such as cash or check. Since you can pay for goods or services online at any time of day or night, from any part of the world, your customers don't have to spend time in a line, waiting for their turn to transact. Nor do they have to wait for a check to clear the bank so they can access the funds they need to shop. E-payment also eliminates the security risks that come with handling cash money.

2. Increased Sales: As internet banking and shopping become widespread, the number of people making cash payments is decreasing. According to Bank rate, more than two-thirds of consumers carry less than $50 a day, meaning electronic alternatives are increasingly becoming the preferred payment option. As such, e-payment enables businesses to make sales to the customers who choose to pay electronically and gain a competitive advantage over those that only accept traditional methods.

3. Reduced Transaction Costs: While there are no additional charges for making a cash payment, trips to the store typically cost money, and checks also need postage. On the other hand, there are usually no fees – or very small ones – to swipe your card or pay online. In the long run, e-payment could save both individuals and businesses hundreds to thousands of dollars in transaction fees.

Disadvantage OF E –PAYMENTS:

1. Security Concerns: Although stringent measures such as symmetric encryption are in place to make e-payment safe and secure, it is still vulnerable to hacking. Fraudsters, for instance, use phishing attacks to trick unsuspecting users into providing the log-in details of their e-wallets, which they capture and use to access the victims' personal and financial information. Inadequate authentication also ails e-payment systems. Without superior identity verification measures like biometrics and facial recognition, anyone can use another person's cards and e-wallets and get away without being caught. These security concerns may make some people reluctant to use e-payment systems.

2. Disputed Transactions: If someone uses your company's electronic money without your authorization, you would identify the unfamiliar charge and file a claim with your bank, online payment processor or Credit Card Company. Without sufficient information about the person who performed the transaction, though, it can be difficult to win the claim and receive a refund.

3. Increased Business Costs: E-payment systems come with an increased need to protect sensitive financial information stored in a business's computer systems from unauthorized access. Enterprises with in-house e-payment systems must incur additional costs in procuring, installing and maintaining sophisticated payment-security technologies.

Types of Electronic Payment System are:

- Electronic cash
- Electronic wallets
- Smart cards
- Credit cards
- Debit cards
- Charge cards

Note on ATM card

An ATM card is a payment card or dedicated payment card issued by a financial institution which enables a customer to access automated teller machines (ATMs). ATM cards are payment card size and style plastic cards with a magnetic stripe and/or a plastic smart card with a chip that contains a unique card number and some security information such as an expiration date or CVVC (CVV). ATM cards are known by a variety of names such as bank card, MAC (money access card), client card, key card or cash card, among others. Most payment cards, such as debit and credit cards can also function as ATM cards, although ATM-only cards are also available. Charge and proprietary cards cannot be used as ATM cards. The use of a credit card to withdraw cash at an ATM is treated differently to a POS transaction, usually attracting interest charges from the date of the cash withdrawal. Interbank networks allow the use of ATM cards at ATMs of private operators and financial institutions other than those of the institution that issued the cards.

Short notes on:

a) Debit Cards: A debit card is a payment card that deducts money directly from a consumer's checking account to pay for a purchase. Debit cards eliminate the need to carry cash or physical checks to make purchases directly from your savings

b) Credit Cards: Issued by a bank that allows cardholders to borrow funds with which to pay for goods and services with merchants that accept cards for payment. Credit cards impose the condition that cardholders pay back the borrowed money, plus any applicable interest, as well as any additional agreed-upon charges, either in full by the billing date or over time.

c) Biometric payment is a point of sale (POS) technology that uses biometric authentication to identify the user and authorize the deduction of funds from a bank account. Fingerprint payment, based on finger scanning, is the most common biometric payment method.

d) Smart Cards: Smart cards are generally used in applications that must deliver fast, secure transactions and protect personal information such as credit cards and other types of payment cards, corporate and government identification cards and transit fare payment cards. Smart cards are also sometimes used to function as documents such as electronic passports and visas. Smart cards are often designed to be used with a PIN, for example, when they are used as debit or ATM cards.

e) ECS (Debit/Credit): An ECS or Electronic Clearing System is a method of transaction that is generally used by organisations for bulk payments and repetitive transactions. ECS is an older system which is now being replaced by NACH (National Automated Clearing House).

f) E-Money: Money that is stored electronically, for example, on a computer or plastic card, and can be used to pay for products and services, for example, on the internet: A number of issues need to be resolved before we see e-money replace cash completely, the most important being data security.

g) Electronic purse: A plastic card with a small amount of money stored electronically on it, which can be used instead of cash to pay for things: A smart card becomes an electronic purse when money is credited to the card via an electronic reader

h) Digital Cash: Digital cash is a system of purchasing cash credits in relatively small amounts, storing the credits in your computer, and then spending them when making electronic purchases over the Internet.

i) NEFT:

National Electronic Funds Transfer (NEFT) is an electronic funds transfer system maintained by the Reserve Bank of India (RBI). Started in November 2005, the setup was established and maintained by Institute for Development and Research in Banking Technology. There is no minimum or maximum limit for fund transfer in NEFT system. The persons or parties which have bank accounts generally use this facility. This facility is open even to those, who do not have bank accounts. The persons without bank account can deposit cash at the NEFT enabled branch with instructions to transfer funds using NEFT.

J) RTGS:

Real Time Gross Settlement: It is a system to transfer funds from one bank to another bank on a real time and gross basis. The settlement in real time means payment transactions not subjected to any waiting period. The transaction is settled as soon as processed. Gross settlement means the transaction is settled on one to one basis, without bunching or netting with any other transaction. Once processed, the payment is final and irrevocable. This system of electronic transfer takes place with the help of Central Bank of the country.

Distinguish between NEFT and RTGS.

Distinction between NEFT and RTGS:

i) The main difference between the two is that RTGS is on gross settlement basis whereas NEFT is on net settlement basis.
ii) RTGS completes transactions in real time while NEFT completes transactions in cycles.
iii) The transfer in RTGS is completed on a one to one basis while NEFT is on a deferred net basis, where transfer are bundled and deferred for a specific time.
iv) RTGS is a high value transfer system, handling funds worth Rs 1,00,000 and above, while NEFT transfers smaller amounts below Rs 10,000.

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UNIT- 5
INSURANCE

Basic concept of risk

In simple terms, risk is the possibility of something bad happening. Risk involves uncertainty about the effects/implications of an activity with respect to something that humans value (such as health, well-being, wealth, property or the environment), often focusing on negative, undesirable consequences.

In simple words risk is danger, peril, hazard, chance of loss, amount covered by insurance, person or object insured. The risk is an event or happening which is not planned but eventually happens with financial consequences resulting in loss. There is saying higher the risk more the profit.

Types of Business Risk

Following are the various types of Business Risks:

1) Physical risk: Physical risks include dangers that pose a threat to physical assets, including your buildings, equipment and people. Risks could be events such as fire, flooding, or crimes like theft and vandalism. Physical damage can present a risk to your business in a number of ways, from time lost and repair costs, to legal action and reputational harm if you've failed to guard against the risks appropriately.

2. Strategic risk: How do you know you've made the right decision for your business? Decision making often involves balancing risk versus reward. On the one hand, the right decision could help you achieve your business goals, on the other, a wrong move could negatively impact your organisation. Plus of course, it's not just down to the decision itself, but also the way it's executed. A poor strategy can result in multiple challenges, from low sales and poor profits to dissatisfied customers and reputational harm.

3. Compliance (Regulatory) risk: Businesses are governed and guided by a wealth of legislation, regulation and responsibilities, both mandatory and voluntary. Some will be unique to your organisation, industry or sector, others will be more generic across business, such as health and safety and data protection law. The risks of failure to be compliant can be severe, including legal action, fines, penalties and even closure. Beyond that, failing to fulfill your responsibilities is likely to damage your reputation. In terms of rewards, compliance is a chance to show your customers how you're caring for their interests and improving how things are done.

4. Operational (Human) risk: Operational risks involve the day-to-day running of your organisation, from human error or inappropriate staff behaviour, to systems failure, fraud and embezzlement. Anything that puts a spanner in your internal works, is likely to have a knock-on impact on your business, potentially resulting in lost time and revenue and even reputational damage. It's

important to remember that staff behaviour can impact your business anytime, outside work and in, both positively and negatively.

5. **Technology (Cyber security) risk:** Doing business in an increasingly digital world naturally comes with both risks and rewards. Cyber-attacks and the reputational damage a data breach can cause are a growing concern for many businesses. On the plus side, data enriched by the in-depth understanding of artificial intelligence (AI) is helping businesses reach and connect with their customers like never before and develop new products and services. Technology risks can also be linked to events like loss of power, taking systems and equipment out of action, with many organisations choosing to generate their own power onsite.
6. **Financial risk:** Financial risk is a good example of the external pressures' businesses can face. From economic uncertainties and volatile financial markets, to the move towards sustainable finance with investors increasingly taking environmental and social factors into account. All of these things can impact an organisation financially, along with risks such as poor financial planning and projection and fraudulent activity. It's also essential to consider the part wider socio-economic risks play in customer-related credit risks such as late or non-payment. Financial risks can result in loss of income and negative cash flow, and even bankruptcy if they're not managed properly.
7. **Reputational risk:** Reputational damage is often a consequence of poorly managed business risks, from failing to meet your responsibilities to making a misjudged decision. In a world where news and opinions can be shared instantaneously via social media and organisations are often seen through the prism of wider issues such as climate change and gender equality, it's more essential than ever to understand reputational risk and how to protect yourself. Equally, it's also important to recognise the potential of good risk management to enhance your reputation, with customers increasingly valuing honesty, transparency and positive action around the issues they care about.

Evaluation and measurement of risks

There are five principal risk measures, and each measure provides a unique way to assess the risk present in investments that are under consideration. The five measures include the alpha, beta, R-squared, standard deviation, and Sharpe ratio. Risk measures can be used individually or together to perform a risk assessment. When comparing two potential investments, it is wise to compare like for like to determine which investment holds the most risk.

Alpha: Alpha measures risk relative to the market or a selected benchmark index. For example, if the S&P 500 has been deemed the benchmark for a particular fund, the activity of the fund would be compared to that experienced by the selected index. If the fund outperforms the benchmark, it is said to have a positive alpha. If the fund falls below the performance of the benchmark, it is considered to have a negative alpha.

Beta: Beta measures the volatility or systemic risk of a fund in comparison to the market or the selected benchmark index. A beta of one indicates the fund is expected to move in conjunction with the benchmark. Betas below one are considered less volatile than the benchmark, while those over one are considered more volatile than the benchmark.

R-Squared: R-Squared measures the percentage of an investment's movement attributable to movements in its benchmark index. An R-squared value represents the correlation between the examined investment and its associated benchmark. For example, an R-squared value of 95 would be considered to have a high correlation, while an R-squared value of 50 may be considered low.

Standard Deviation: Standard deviation is a method of measuring data dispersion in regards to the mean value of the dataset and provides a measurement regarding an investment's volatility.

As it relates to investments, the standard deviation measures how much return on investment is deviating from the expected normal or average returns.

Sharpe Ratio: The Sharpe ratio measures performance as adjusted by the associated risks. This is done by removing the rate of return on a risk-free investment, such as a U.S. Treasury Bond, from the experienced rate of return.

Transfer of risks in Insurance business

Before we understand what is transfer of risk we must know what is meaning of the word transfer. The meaning of transfer is to move from one place to another, to covey property to another, or transfer any right/power/money/shares/liabilities or assets.

When we talk of liabilities one becomes much alert as everyone is eager to transfer the liabilities to someone else the particularly pecuniary liabilities. And what are those pecuniary liabilities. It may a debt due to a bank/others, liability of procuring health services, liability of accidental events or otherwise. Every type of liability is considered as a Risk.

The Insurance is a form of risk management. It is primarily used to transfer risks of loss in exchange for payment of certain amount known as premium. The insurer company is engaged in the business of selling the insurance, (willing to accept the risk) the person desirous of purchasing the insurance (willing to transfer the risks).

The risk that an individual or a any entity is not willing to bear is preferred to be transferred to another entity. In brief it is called insurance. In exchange for payment of an agreed amount say premium the insurer agrees to indemnify the insured for losses that result from specified perils. Options and hedges also operate to transfer risk from one party to another.

Principles of Life insurance

Principles of Life insurance are:

1. Nature of Contract: Nature of contract is a fundamental principle of insurance contract. An insurance contract comes into existence when one party makes an offer or proposal of a contract and the other party accepts the proposal.

A contract should be simple to be a valid contract. The person entering into a contract should enter with his free consent.

2. Principal of utmost good faith: Under this insurance contract both the parties should have faith over each other. As a client it is the duty of the insured to disclose all the facts to the insurance company. Any fraud or misrepresentation of facts can result into cancellation of the contract.

3. Principle of Insurable interest: Under this principle of insurance, the insured must have interest in the subject matter of the insurance. Absence of insurance makes the contract null and void. If there is no insurable interest, an insurance company will not issue a policy.

An insurable interest must exist at the time of the purchase of the insurance. For example, a creditor has an insurable interest in the life of a debtor, A person is considered to have an unlimited interest in the life of their spouse etc.

4. Principle of indemnity: Indemnity means security or compensation against loss or damage. The principle of indemnity is such principle of insurance stating that an insured may not be compensated by the insurance company in an amount exceeding the insured's economic loss.

In type of insurance the insured would be compensation with the amount equivalent to the actual loss and not the amount exceeding the loss.

5. Principle of subrogation: The principle of subrogation enables the insured to claim the amount from the third party responsible for the loss. It allows the insurer to pursue legal methods to recover the amount of loss, For example, if you get injured in a road accident, due to reckless driving of a third party, the insurance company will compensate your loss and will also sue the third party to recover the money paid as claim.

6. Double insurance: Double insurance denotes insurance of same subject matter with two different companies or with the same company under two different policies. Insurance is possible in case of indemnity contract like fire, marine and property insurance.

7. Principle of proximate cause: Proximate cause literally means the 'nearest cause' or 'direct cause'. This principle is applicable when the loss is the result of two or more causes. The proximate

cause means; the most dominant and most effective cause of loss is considered. This principle is applicable when there are series of causes of damage or loss.

Principles of General insurance

Insurance bears the cost of the unexpected type of risk among a large number of people in the same region. It is significant conditions and situation of the insurer before getting insured. As both the parties are relying on each other without any practical application. The insurer must investigate any doubtable insurance claims and accept and approve all claims of genuine insurance as soon as possible without delay and hindrance. There are 7 Basic Principles Of General Insurance applicable which make the bond of reliability stronger between the involved parties.

1.The Principle of Uberrimaefidei (Utmost Good Faith)

Is a fundamental and first primary principle of Insurance. According to this principle, the insurance agreement is signed by both parties in absolute good faith, belief or trust. The person applying for the insurance should indeed disclose and surrender to the insurer all the subject matter regarding Insurance. The insurer's liability gets void if any fact found false, hidden, omitted or present in the wrong manner by the insured. The principle of Uberrimaefidei applies to all types of insurance contracts.

2. The Principle of Insurable Interest

States that the person getting insurance should have subject matter in the interest of the insured. The person has the insurable interest when the existence of the subject matter gives him some gain, and it's non- existence will provide him with a loss. That means the insured person will have a financial loss in case of damage of insured object. Example, the factory owner, has an insurable interest in its machinery as they are making him monetary profit and if he sells it, the owner of the factory does not have any insurance left. We conclude that ownership plays a very crucial role in insurable interest.

3. The Principle of Indemnity

Means security, compensation or protection given against any loss, damage or injury of the insured object. According to this principle, the contract of insurance is only be signed to protect the object against any damage or loss due to future uncertainties. In the contract signed the amount of compensation paid should be in absolute proportion to the actual cost of the object. The compensation should not be less or more of the actual damage.

4. The Principle of Contribution

This principle is a corollary to the principles of indemnity. It applies to the principles of indemnity if the insured person has taken more than one policy on the same subject matter. In this case, insurer can claim only the extent of actual loss from one insurer on any number of the insurer. If one insurer compensates full loss than that insurer can claim the proportionate amount from other insurer or insurers.

5. The Principle of Subrogation

This principle is an extent of indemnity or corollary of the principles of indemnity. If the insured person compensated the loss or damage of property or object than the right of ownership is shifted to the insurer. This principle has its importance if the damaged property has some value after the event of damage. The insurer can benefit out of subrogation only to the extent of compensation paid to the insured person.

6. The Principle of Loss Minimization

According to this principle, the insured should try its level best to minimize the loss in case of an event such as fire or flood occur. Hence it is the responsibility of the insured to protect its property and avoid further losses.

7. The Principle of Causa Proxima (Nearest Cause)

Means if the damage has occurred by multiple causes than the closest and the nearest cause of damage should be taken into consideration. The Principles of General Insurance states that whether the insured is liable for the compensation of the losses or not. The proximate (nearest) cause of the loss should be considered and not the remote (fairest) must be looked into. For example. , and the sea water entered the ship, here the cause of the damage is both the rats and the sea water. The ship has insurance of sea water and not the rats, but the insurer will have to pay the compensation of the sea water which should be taken into account.

Finally, the conclusion is that the insured party should genuinely present its subject matter and no facts should be hidden or omitted for the covering of the risk from future uncertainties for to avoid delays in compensation approvals.

Notes on the following:

a) Principles of utmost good faith b) principles of indem,nity c) principles of contribution.
d) principles of subrogation. e)Insurable Interest. f)Proximate Cause.

a) Principles of utmost good faith: The principle of Utmost Good Faith is also known as Uberrimae Fides. It means that both the policyholder and the insurer need to disclose all material and relevant information to each other before commencement of the contract.

Under Section 45 of Insurance Act 1938 states that if within 2 years of commencement or revival of the insurance policy, the insurer get to know that there has been a non-disclosure or misrepresentation of material facts, then the insurer can call the policy null and void.

It simply means that if within 2 years the Insurance Company finds out that the policy holder has not stated the complete truth or has lied while filling up the proposal form, then it can cancel the policy and decline the claim. It is not necessary that they will definitely repudiate the claim, but it is also a possibility. The insurer may ask for the difference in premium or change the terms and conditions after the fact has been disclosed.

Thus, if an alcoholic person had mentioned that he is non-alcoholic and he dies in a heart attack within 2 years of the policy commencement, then also the Insurance Company may repudiate or decline the claim on grounds of "non-disclosure" or "misrepresentation" of "material facts", i.e. for not stating the complete truth or misstating information which is relevant for underwriting and risk assessment. His policy could have been over-rated or loaded with additional premium if the underwriters were aware of the fact.

b) Principles of indemnity: It is one of the fundamental principles of insurance

Principle of indemnity is applied only to policies belonging to non life category of insurance.

Principle of indemnity is not applied to life insurance policies as the life of a human being cannot be ascertained in terms of money

Principle of indemnity implies "To bring back the insured to the financial position where he was prior to the happening of loss"

In simple words, it ensures to make good the loss of the insured and to bring back the insured to the position where he was prior to the happening of the loss. This principle is important as it ensures that the insured doesn't make profit out of insurance policy. Insurance policies can't be used to make profits.

The claim can be made equivalent to loss when full value insurance is taken of subject matter. In cases of under insurance average clause is applied and the claim payable is less than the actual loss. Profit can't also be made in cases of over insurance.

c) Principles of contribution: Contribution is the right of an insurer to recover an equitable proportion of a paid claim on behalf of another insurer who is also liable for the claim. This happens when you're double insured. It may happen accidentally.

You may insure a car, and your son who drives it also insures it with a different company, accidentally. You may claim twice but you don't get 100% from both companies. You'll only get 50% from each because of the principle of indemnity.

Another example is a factory with a Construction or All-risk policy and a Marine Cargo policy. If your two policies are with different insurers, I say to the client, please make sure your Marine Cargo policy has a 50/50 clause on it.

Here's why. Say the cargo is air conditioning units stored on site for some time. When you open them, you realise they've been damaged somehow, somewhere. Who knows where? To make things simpler, we just say 50/50, and the insurers share the loss. That way, we prevent any fighting, and we don't have to go to court.

d) Principles of Subrogation: Subrogation refers to the practice of substituting one party for another in a legal setting. Essentially, subrogation provides a legal right to a third party to collect a debt or damages on behalf of another party. The insurance sector is considered a primary area of application of the subrogation principle. By using subrogation, an insurance company can recover the amount of the insurance claim paid to the insured client from the party that caused the damage. Note that in such situations, the insurance company represents the interests of its insured client. In other words, subrogation is a remedy to the insurance company for the paid-out insurance claim.

The subrogation right is generally specified in contracts between the insurance company and the insured party. The contracts may contain special clauses that provide the right to the insurance company to start the process of recovering the payment of the insurance claim from the party that caused the damages to the insured party.

Subrogation is one of the equitable doctrines in countries with common law legal systems.

e) Insurable Interest: Insurable interest is defined as the reasonable concern of a person to obtain insurance for any individual or property against unforeseen events such as death, losses, etc. A person is expected to have reasonable interest in a longer life for himself, his family, business and hence is in need of acquiring insurance for these. Therefore, insurable interest is often related to ownership, relationship by law or blood and possession. However, it is not an important element of life insurance contracts under modern law.

Insurable interest is simply defined as the level of hardship (financial dependency and otherwise) a person will suffer from the loss of something or someone they have insured. In the case of life insurance, it refers to the potential needs the beneficiary will require from the financial loss of the insured person. It it helps, you can think of it as a question: "Do I have a reasonable *interest* in insuring this person's life?" The term interest here refers to necessity or motivation, and has no relation to traditional banking or accruing of wealth.

f) Proximate Cause(principles of causa Proxima): The cause having the most significant impact in bringing about the loss under a first-party property insurance policy, when two or more independent perils operate at the same time (i.e., concurrently) to produce a loss. Courts employ a set of proximate cause rules to resolve causation disputes when a property policy states that it covers or excludes losses "caused by" a peril and there is more than one peril at work in a fact pattern. Under common law, whether the policy provides coverage depends on which peril is chosen as the proximate cause. If the peril selected as the proximate cause is covered, courts consider the loss to have been caused by the covered peril and will hold that the loss is covered. If the peril selected as the proximate cause is uncovered or excluded, courts consider the loss to have been caused by the uncovered or excluded peril and will hold that the loss is not covered. (2) As a principle of tort law, proximate cause refers to a doctrine by which a plaintiff must prove that the defendant's actions set in motion a relatively short chain of events that could have reasonably been anticipated to lead to the plaintiff's damages. If the defendant's actions were "proximate" or close enough in the chain of causation to have foreseeably led to the plaintiff's damages, courts will impose liability. Otherwise, if the defendant's actions set in motion a long, bizarre chain of events that could not have reasonably been foreseen to lead to the plaintiff's damages, courts will not impose liability. In tort law, multiple actions by one or more defendants that are a substantial factor in producing the loss can qualify as proximate causes.

Types of Insurance

There are two broad types of insurance:

1. Life Insurance 2. General Insurance

1) Life Insurance: Life insurance is a contract that offers financial compensation in case of death or disability. Some life insurance policies even offer financial compensation after retirement or a

certain period of time. Life insurance, thus, helps you secure your family's financial security even in your absence. You either make a lump-sum payment while purchasing a life insurance policy or make periodic payments to the insurer. These are known as premiums. In exchange, your insurer promises to pay an assured sum to your family in the event of death, disability or at a set time.

2) General insurance: A general insurance is a contract that offers financial compensation on any loss other than death. It insures everything apart from life. A general insurance compensates you for financial loss due to liabilities related to your house, car, bike, health, travel, etc. The insurance company promises to pay you a sum assured to cover damages to your vehicle, medical treatments to cure health problems, losses due to theft or fire, or even financial problems during travel.

Simply put, a general insurance offers financial protection for all your assets against loss, damage, theft, and other liabilities. It is different from life insurance. Following are the various types of General Insurance:

a. Health Insurance b. Motor Insurance c. Travel Insurance d. Home Insurance e. Fire Insurance

a. Health Insurance: This type of general insurance covers the cost of medical care. It pays for or reimburses the amount you pay towards the treatment of any injury or illness.

It usually covers:

- Hospitalisation
- The treatment of critical illnesses
- Medical bills prior to or post hospitalisation
- Day care procedures like Cataract operations

b. Motor Insurance: Motor insurance is for your car or bike what health insurance is for your health.

It is a general insurance cover that offers financial protection to your vehicles from loss due to accidents, damage, theft, fire or natural calamities

You can also get motor insurance for your commercial vehicles.

In India, you cannot drive or ride without motor insurance.

c. Travel insurance: A travel insurance compensates you or pays for any financial liabilities arising out of medical and non-medical emergencies during your travel abroad or within the country.

d. Home Insurance: Home insurance is a cover that pays or compensates you for damage to your home due to natural calamities, man-made disasters or other threats.

It covers liabilities due to fire, burglary, theft, flood, earthquakes, and sabotage. It not only offers financial protection to your home, but also takes care of the valuables inside the property.e

e. Fire Insurance: Fire insurance pays or compensates for the damages caused to your property or goods due to fire.

It covers the replacement, reconstruction or repair expenses of the insured property as well as the surrounding structures.

It also covers the damages caused to a third-party property due to fire.

In addition to these, it takes care of the expenses of those whose livelihood has been affected due to fire.

<u>Concepts of Life insurance</u>

Life Insurance is defined as a contract between the policy holder and the insurance company, where the life insurance company pays a specific sum to the insured individual's family upon his death. The life insurance sum is paid in exchange for a specific amount of premium. Life is beautiful, but also uncertain. Whatever you do, however smart and hard you work, you are never sure what life has in store for you.

<u>Characteristics OF life insurance:</u>

Following are the characteristics of Life insurance:

i) Offer and acceptance: Like other contracts of insurance the life insurance contract is also the outcom e of an offer made by the policy owner and its acceptance by the insurer. Generally the life insurance is a contract is made in writing.

2) Agreed sum of money: The insurer agrees to pay a certain sum of money either on the death of polic y owner or on the maturity of the policy whichever is earlier

3) Premium: The policy owner is liable to pay periodically the amount of the payment in the form of prem ium till the death of the policy owner or expiry of the period of policy whichever is earlier

4) Not a contract of indemnity: Life insurance contract is a note a contract of indemnity as the loss caused by the death cannot be measured in terms of money is a compensation for loss of the one's life.
5) Insurable interest: In life insurance insurable interest must exist when the claim. The person who has been assigned a life policy need not have insurable interest in it as the insurable interest was already present at time of taking policy.
6) Lending helping hand: Life insurance provides helping hand to those who are left support less and helps financially in case of the death of the insured. It is also considered to be than the best alternative for making savings.
7) Covers other risks: Life insurance covered others risks which are connected with the human life in addition to the risk of death. For example, total and permanent disability or temporary disability and medical expense compulsory retirement or the economics death risks etc., have also been covered under the purview of Life insurance these days. 8) Relief sword of damocles: Life insurance relieves the insured from the sword of damocles i.e.., various risks and uncertainties which may occur before and after the death of the insured

Meaning of Non-life insurance

Non-life insurance is any type of insurance other than life insurance. While life insurance is broken down into permanent and term life policies, non-life insurance includes many types of other insurance policies. Non-life insurance may cover people, property or legal liabilities.
General insurance or non-life insurance policies, including automobile and homeowners policies, provide payments depending on the loss from a particular financial event. General insurance is typically defined as any insurance that is not determined to be life insurance. It is called property and casualty insurance in the United States and Canada and non-life insurance in Continental Europe.

Characteristics of Non-life insurance

Following are the characteristics of General Insurance:

1. Insurable interest1.

A person can enter into a contract of insurance only when he has some insurable interest on the life or property which is insured. Insurable interest basically means that the non-existence or any injury or damage caused to a property or life should bring loss which can be estimated in terms of money. So, a person is said to have insurable interest, on the property or life of any person, provided the loss or damage caused to the property or life directly affects him. Thus, a person cannot take insurance for an unconnected property or for an individual with whom he has no connection as there is no insurable interest.

2. Contract of 'Uberrimae fidei' or Contract of Utmost good faith

Both the parties to the contract, that is the insured and the insurer have to disclose all the facts connected with the insurance contract. Non-disclosure of facts or declaration of false information will make the contract null and void. A person suffering from a major disease cannot insure under the pretext of having good health by concealing his ailment. If he does so, later when the insurer comes to know about his disease, the contract will become null and void and no compensation can be claimed from the insurance company.

3. Indemnity:

Life insurance is different from contract of indemnity. It is a contingent contract where the event death is certain to take place but it is a question of time. Hence, the insurance company cannot guarantee against death or prevent death but can agree to pay a stipulated sum in the event of death happening at an earlier date than agreed upon. When a person takes life insurance, he nominates his dependents to receive the policy amount in the event of his death, prior to the stipulated or agreed period.

4. Mitigation of Loss

Though insurance aims at minimizing the loss, it is expected that every party to the contract of insurance should take adequate steps to minimize the loss. Thus, when a fire accident takes place in a match factory, the insured should minimize the loss by taking adequate preventive measures. He cannot allow the goods to be destroyed by fire simply because he has insured them. Thus, mitigation of loss ensures that both the parties to the insurance shall undertake measures by which the risk is minimized and the loss suffered is also mitigated.

5. Causa proxima

The cause for the accident should be a direct cause for which an insurance is taken and it should not be a remote cause. In other words, the insurance company will pay compensation to the insured only when the cause of accident is directly related to the loss. If the loss is the result of two causes, one must look into the nearest cause and ascertain whether that cause is insured. Only then the insurance company will pay compensation for the loss.

6. Subrogation

Subrogation means stepping into the shoes of another person. When the insurance company pays full compensation to the insured, it takes over the ownership of the goods insured and will enjoy complete right of taking necessary legal steps to claim compensation from such persons who are responsible for the loss suffered.

7. Contribution

When an insurance company pays compensation to the insured, it puts back the insured in the same position that he was prior to the accident. If the insured has undertaken insurance with more than one insurance company, then he cannot claim compensation from every insurance company with which he has insured. Under the doctrine of contribution, when an insurance company compensates the insured, it will be indemnified by the other insurance company to the extent of the policy taken by insured.

<u>Concept of Re-insurance</u>

Reinsurance is insurance that an insurance company purchases from another insurance company to insulate itself (at least in part) from the risk of a major claims event. With reinsurance, the company passes on ("cedes") some part of its own insurance liabilities to the other insurance company. The company that purchases the reinsurance policy is called a "ceding company" or "cedent" or "cedant" under most arrangements. The company issuing the reinsurance policy is referred simply as the "reinsurer". In the classic case, reinsurance allows insurance companies to remain solvent after major claims events, such as major disasters like hurricanes and wildfires. In addition to its basic role in risk management, reinsurance is sometimes used to reduce the ceding company's capital requirements, or for tax mitigation or other purposes.

A company that purchases reinsurance pays a premium to the reinsurance company, who in exchange would pay a share of the claims incurred by the purchasing company. The reinsurer may be either a specialist reinsurance company, which only undertakes reinsurance business, or another insurance company. Insurance companies that accept reinsurance refer to the business as 'assumed reinsurance'.

<u>The powers of IRDA</u>

The following are the powers of IRDA

1. All insurance companies have to register with IRDA compulsorily.
2. Companies can undertake only insurance business.
3. The capital structure of the companies will be determined by IRDA.
4. Companies have to deposit with RBI the amount stipulated by IRDA.
5. Accounts and balance sheets of companies have to be submitted to IRDA.
6. Insurance companies have to appoint actuaries and they will value the liabilities of the insurance companies and report the same to IRDA.
7. Investment of assets will be prescribed by IRDA in the form of approved securities.
8. The nature of general insurance business will be prescribed by IRDA.
9. Statements of investment assets to be submitted to IRDA every financial year.
10. All insurance companies have to devote certain percentage of their business including insurance for crops. This should cover unorganized sector including the economically weaker sections.
11. The appointment of chief executive officer requires prior permission of the IRDA.
12. All insurance agents must obtain license from IRDA.
13. IRDA has powers for levying penalty on companies which fail to comply with the rules and regulations.

<u>The functions of IRDA</u>

1. Issuing certificate of registration.
2. Protecting the interest of policy holders.
3. Issuing license to agents.

4. Specifying code of conduct for surveyors and loss assessors.
5. Promoting efficiency in the insurance business.
6. Undertaking inspection, conducting enquiries etc., on insurance companies.
7. Control and regulations of rates, terms and conditions by insurance company to policy holders.
8. Adjudication of disputes between insurance company and others in the insurance business.
9. Fixing the percentage of insurance business to rural and social sectors.

Role of IRDA in regulating insurance business

At one point of time, some insurance companies used to deny coverage to their policyholders. The basis of the denial was either their choice of business to underwrite or was their understanding of good risk and bad risk. To regulate the market and minimize any sort of partial acts, the IRDA was established.

Like the banking system in India is regulated as per the guidelines of RBI. It restricts the bankers to not behave unruly with the account holders. The banking institutes are allowed to offer loans and interest as per the rates pre-defined by RBI. It leaves no room for the monopoly to take over which in turn works best for the masses. Financial Institutes like banks and insurance companies will be successful in our democracy until market practices are for the majority and not just for fraction of people.

IRDA on the same lines of industrial practice plays a vital role like

a. Ensures and encourages the systematic growth of the insurance industry just to benefit the common people who invest in policies to look for safety.
b. Protects the interest of the policyholders so that they trust the system.
c. Promote high standards of integrity and fair dealings in the market.
d. Resolve disputes of all kinds and speed up claim settlement.
e. Set standards and conduct vigilance to check for scams or frauds.

The Indian economy is growing which further promotes the entrance of new insurance players in the market. To keep the pace of growth even-handed, IRDA needs to maintain standards of quality. It will further contribute to strengthening the financial capacity of a country as a whole.

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