

BANKING AND INSURANCE

(BCM4A14/BBA4A14)



STUDY MATERIAL

**COMMON COURSE
IV SEMESTER**

**B.Com. / BBA
(2019 Admission)**

**UNIVERSITY OF CALICUT
SCHOOL OF DISTANCE EDUCATION
CALICUT UNIVERSITY P.O.
MALAPPURAM - 673 635, KERALA**

19609

School of Distance Education University of Calicut

Study Material (IV Semester)

**B.Com. / BBA
(2019 Admission)**

Common Course

BCM4A14/BBA4A14: BANKING AND INSURANCE

Prepared by:

Sri. VIJESH VENUGOPAL

Asst. Professor in Commerce

**Post Graduate Department of Commerce
and Management Studies**

NSS College, Nenmara, Palakkad 678508

Sri. RAJAN P

Asst. Professor of Commerce

School of Distance Education

University of Calicut

Scrutinized by:

Sri. MUHAMMED FAISAL. T

Assistant Professor of Commerce

EMEA College of Arts and Science, Kondotty.

DISCLAIMER

"The author(s) shall be solely responsible
for the content and views
expressed in this book".

CONTENTS

MODULE - 1	ORIGIN AND DEVELOPMENT OF BANKING	1 - 85
MODULE - 2	NEGOTIABLE INSTRUMENTS	86 - 158
MODULE - 3	E-BANKING	159 - 186
MODULE - 4	INTRODUCTION TO INSURANCE	187 - 214
MODULE - 5	LIFE INSURANCE CONCEPT	215 - 279

MODULE - 1

ORIGIN AND DEVELOPMENT OF BANKING

The banking history is interesting and reflects evolution in trade and commerce. It also throws light on living style, political and cultural aspects of civilized mankind. The strongest faith of people has always been religion and God. The seat of religion and place of worship were considered safe place for money and valuables. The history of banking begins with the first prototype banks of merchants of the ancient world, which made grain loans to farmers and traders who carried goods between cities. This began around 2000 BC in Assyria and Babylonia. In olden times people deposited their money and valuables at temples, as they are the safest place available at that time. The practice of storing precious metals at safe places and loaning money was prevalent in ancient Rome.

However modern Banking is of recent origin. The development of banking from the traditional lines to the modern structure passes through Merchant bankers, Goldsmiths, Money lenders and Private banks. Merchant Bankers were originally traders in goods. Gradually they started to finance trade and then become bankers. Goldsmiths are considered as the men of honesty, integrity and reliability. They provided strong iron safe for keeping valuables and money. They issued deposit receipts (Promissory notes) to people when they deposit money and valuables with them. The

goldsmith paid interest on these deposits. Apart from accepting deposits, Goldsmiths began to lend a part of money deposited with them. Then they became bankers who perform both the basic banking functions such as accepting deposit and lending money. Money lenders were gradually replaced by private banks. Private banks were established in a more organised manner. The growth of Joint stock commercial banking was started only after the enactment of Banking Act 1833 in England.

India has a long history of financial intermediation. The first bank in India to be set up on modern lines was in 1770 by a British Agency House. The earliest but short-lived attempt to establish a central bank was in 1773. India was also a forerunner in terms of development of financial markets. In the beginning of 18th century, British East India Company launched a few commercial banks. Bank of Hindustan (1770) was the first Indian bank established in India. Later on, the East India Company started three presidency banks, Bank of Bengal(1806), Bank of Bombay(1840) and Bank of Madras(1843) These bank were given the right to issue notes in their respective regions. Allahabad bank was established in 1865 and Alliance Bank in 1875. The first bank of limited liability managed by Indians was Oudh Commercial Bank founded in 1881. Subsequently, the Punjab National Bank was established in 1894. In the Beginning of the 20th century, Swadeshi movement encouraged Indian entrepreneurs to start many new banks in India. Another landmark in the history of Indian banking was the formation of Imperial bank of India in

1921 by amalgamating 3 presidency banks. It is the Imperial Bank which performed some central banking functions in India. A number of banks failed during the first half of the 20th Century. It affected the people's belief and faith in Banks.

By independence, India had a fairly well developed commercial banking system in existence. In 1951, there were 566 private commercial banks in India with 4,151 branches, the overwhelming majority of which were confined to larger towns and cities. Savings in the form of bank deposits accounted for less than 1 per cent of national income, forming around 12 per cent of the estimated saving of the household sector. The Reserve Bank of India (RBI) was originally established in 1935 by an Act promulgated by the Government of India, but as a shareholder institution like the Bank of England. After India's independence, in the context of the need for close integration between its policies and those of the Government, the Reserve Bank became a state - owned institution from January 1, 1949. It was during this year that the Banking Regulation Act was enacted to provide a framework for regulation and supervision of commercial banking activity.

By independence, India had a fairly well developed commercial banking system in existence. Reserve bank of India was nationalized in the year 1949. The enactment of the Banking Companies Act 1949 (Later it was renamed as Banking Regulation Act) was a bold step in the history of banking in India. In 1955, Imperial Bank of India was nationalized and renamed as State bank of India (SBI). The

SBI started number of branches in urban and rural areas of the country.

In 1967, Govt introduced the concept of social control on banking sector. Nationalization of 14 commercial banks in 1969 was a revolution in the history of banking in India. Six more commercial banks were nationalized in 1980. Other landmarks in the history of Indian banking were the establishment of National Bank for Agricultural and Rural Development (1988), merger of New Bank of India with Punjab National Bank (1993), merger of State Bank of Sourashtra with SBI (2008) and the merger of State Bank of Indore with SBI (2010). At present, there are 27 Public sector banks, 20 private sector banks, 30 Foreign banks and 82 Regional Rural Banks in India.

MEANING AND DEFINITION OF BANK

Finance is the life blood of trade, commerce and industry. Now-a-days, banking sector acts as the backbone of modern business. Development of any country mainly depends upon the banking system. The term bank is either derived from old Italian word *banca* or from a French word *bunque* both mean a **Bench** or **money exchange table**. In olden days, European money lenders or money changers used to display (show) coins of different countries in big heaps (quantity) on benches or tables for the purpose of lending or exchanging. A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it.

Definition of a Bank

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

According to H. L. Hart, a banker is "one who in the ordinary course of his business honours cheques drawn upon him by person from and for whom he receives money on current accounts".

Banking Regulation Act of 1949 defines banking as "accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise".

Characteristics / Features of a Bank

1. Dealing in Money

Bank is a financial institution which deals with other people's money i.e. money given by depositors.

2. Individual / Firm / Company

A bank may be a person, firm or a company. A banking company means a company which is in the business of banking.

3. Acceptance of Deposit

A bank accepts money from the people in the form of deposits which are usually repayable on demand or after the expiry of a fixed period. It gives safety to the deposits of its customers. It also acts as a custodian of funds of its customers.

4. Giving Advances

A bank lends out money in the form of loans to those who require it for different purposes.

5. Payment and Withdrawal

A bank provides easy payment and withdrawal facility to its customers in the form of cheques and drafts, It also brings bank money in circulation. This money is in the form of cheques, drafts, etc.

6. Agency and Utility Services

A bank provides various banking facilities to its customers. They include general utility services and agency services.

7. Profit and Service Orientation

A bank is a profit seeking institution having service oriented approach.

8. Ever increasing Functions

Banking is an evolutionary concept. There is continuous expansion and diversification as regards the functions, services and activities of a bank.

9. Connecting Link

Bank acts as a connecting link between borrowers and lenders of money. Banks collect money from those who have surplus money and give the same to those who are in need of money.

10. Banking Business

A bank's main activity should be to do business of banking which should not be subsidiary to any other business.

11. Name Identity

A bank should always add the word "bank" to its name to enable people to know that it is a bank and that it is dealing in money.

Importance of banks

Bankers play very important role in the economic development of the nation. The health of the economy is closely related to the growth and soundness of its banking system. Although banks create no new wealth but their fund collection, lending and related activities facilitate the process of production, distribution, exchange and consumption of wealth. In this way, they become very effective partners in the process of economic development.

1. Banks mobilise small, scattered and idle savings of the people, and make them available for productive purposes
2. By offering attractive interests, Banks promote the habit of thrift and savings
3. By accepting savings, Banks provide safety and security to the surplus money
4. Banks provide convenient and economical means of payments
5. Banks provide convenient and economical means of transfer of funds

6. Banks facilitate the movement of funds from unused regions to useful regions
7. Banking help trade, commerce, industry and agriculture by meeting their financial requirements
8. Banking connect saving people and investing people.
9. Through their control over the supply of money, Banks influence the economic activities, employment, income level and price level in the economy.

Types of banks

Functional classification

1. Commercial banks/Deposit banks

Banks accept deposits from public and lend them mainly for commercial purposes for comparatively shorter periods are called Commercial Banks. They provide services to the general public, organisations and to the corporate community. They are oldest banking institution in the organised sector. Commercial banks make their profits by taking small, short-term, relatively liquid deposits and transforming these into larger, longer maturity loans. This process of asset transformation generates net income for the commercial bank. Many commercial banks do investment banking business although the latter is not considered the main business area. The commercial banking system consists of scheduled banks (registered in the second schedule of RBI) and non scheduled banks. Features of Commercial banks are;

- They accepts deposits on various accounts.

- Lend funds to organisations, trade, commerce, industry, small business, agriculture etc by way of loans, overdrafts and cash credits.
- They are the manufacturers of money.
- They perform many subsidiary services to the customer.
- They perform many innovative services to the customers.

2. Industrial banks/Investment banks

Industrial banks are those banks which provide fixed capital to industries. They are also called investment banks, as they invest their funds in subscribing to the shares and debentures of industrial concerns. They are seen in countries like US, Canada, Japan, Finland, and Germany. In India industrial banks are not found. Instead, special industrial finance corporations like IFC and SFC have been set up to cater to the needs of industries. Features of Industrial Banks are:

- Participate in management.
- Advise industries in making right investment
- Advise govt. on matters relating to industries

3. Agricultural banks

Agricultural banks are banks which provide finance to agriculture and allied sectors. It is found in almost all the countries. They are organised generally on co-operative basis. In India, Co- operative banks are registered under the Co-operative Societies Act, 1912. They generally give credit facilities to small farmers, salaried employees, small-scale

industries, etc. Co-operative Banks are available in rural as well as in urban areas. Agricultural banks are of two types;

Agricultural co-operative banks: They provide short term finance to farmers for purchasing fertilizers, pesticides and seeds and for the payment of wages.

Land Development Banks: They provide long term finance for making permanent improvement on land. They assist to purchase machinery, equipments, installation of pump sets, construction of irrigation works etc.

4. Exchange banks

Exchange banks finances foreign exchange business (export, import business) of a country. Special exchange banks are found only in some countries. The main functions of exchange banks are remitting money from one country to another country, discounting of foreign bills, buying and selling gold and silver, helping import and export trade etc.

5. Savings bank

Savings banks are those banks which specialise in the mobilisation of small savings of the middle and low income group. In India, saving bank activities are done by commercial banks and post offices. Features of savings banks are;

- Mobilise small and scattered savings
- Promote habit of thrift & savings
- Keep only small portion in hand and invest major part in govt. securities
- They do not lend to general public.

6. Central / National banks

It is the highest banking & monetary institution in a country. It is the leader of all other banks. Since it is occupying a central position, it's known as Central Bank. It is operating under state's control and is not a profit motive organisation. Reserve Bank of India (India), Bank of Canada (Canada), Federal Reserve System(USA) etc are the examples of Central Banks. The main functions of a Central Bank are;

- Monopoly of currency issue
- Acts as banker to the govt.
- Serves as bankers' bank
- Act as controller of credit
- Custodian of nation's gold and foreign exchange reserve.

INDIAN BANKING SYSTEM

The Indian banking structure comprises both organised and unorganised banking sector. The unorganised banking sector consists of indigenous bankers and money lenders. The organised sector comprises the central bank at the top level and commercial banks, specialised banks, institutional banks and non-banking financial institutions.

1. Unorganised Sector

a. Indigenous Bankers The exact date of existence of indigenous bank is not known. But, it is certain that the old banking system has been functioning for centuries. Some people trace the presence of indigenous banks to the Vedic

times of 2000-1400 BC. It has admirably fulfilled the needs of the country in the past. However, with the coming of the British, its decline started. Despite the fast growth of modern commercial banks, however, the indigenous banks continue to hold a prominent position in the Indian money market even in the present times. It includes shroffs, seths, mahajans, chettis, etc. The indigenous bankers lend money; act as money changers and finance internal trade of India by means of hundis or internal bills of exchange.

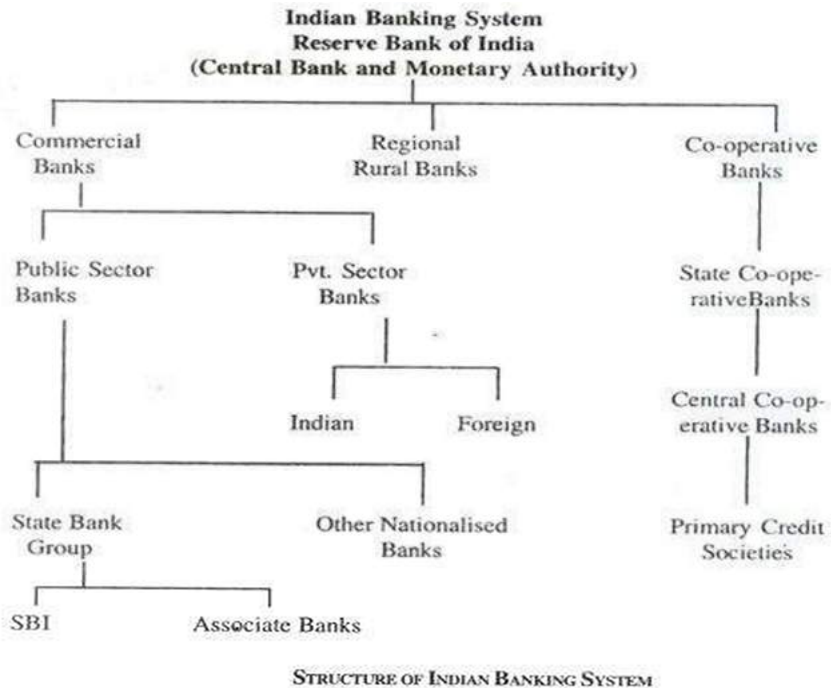
The main defects of indigenous banking are:

- (i) They are unorganised and do not have any contact with other sections of the banking world.
- (ii) They combine banking with trading and commission business and thus have introduced trade risks into their banking business.
- (iii) They do not distinguish between short term and long term finance and also between the purpose of finance.
- (iv) They follow vernacular methods of keeping accounts. They do not give receipts in most cases and interest which they charge is out of proportion to the rate of interest charged by other banking institutions in the country.

b. Moneylenders — Moneylenders are the second element of the unorganised sector. They depend entirely on their own funds for lending. They include large farmers, merchants, goldsmiths etc. They charge a very high rate of interest for their loans.

2. Organised Sector

The organised banking system in India can be classified as given below:



Reserve Bank of India (RBI)

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

Commercial Banks

There are three types of commercial banks in India

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

Public sector banks

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

Private Banks

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

Foreign Banks

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

Co-operative banks

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

Primary Credit Societies:

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

Central Co-operative Banks:

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

State Co-operative Banks:

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

Regional rural Banks

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

Regional rural banks perform the following two functions:

1. Granting of loans and advances to small and marginal farmers, agricultural workers, co - operative societies including agricultural marketing societies and primary agricultural credit societies for agricultural purposes or agricultural operations or related purposes.
2. Granting of loans and advances to artisans small entrepreneurs engaged in trade, commerce or industry or other productive activities.

Development Banks

Development Banks are banks that provide financial assistance to business that requires medium and long-term capital for purchase of machinery and equipment, for using latest technology, or for expansion and modernization. A development bank is a multipurpose institution which shares entrepreneurial risk, changes its approach in tune with industrial climate and encourages new industrial projects to bring about speedier economic growth. These banks also undertake other development measures like subscribing to the shares and debentures issued by companies, in case of under subscription of the issue by the public. There are three

important national level development banks. They are;

Industrial Development Bank of India (IDBI)

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

IDBI is an apex institution to co-ordinate, supplement and integrate the activities of all existing specialised financial institutions. It is a refinancing and re-discounting institution operating in the capital market to refinance term loans and export credits. It is in charge of conducting techno-economic studies. It was expected to fulfil the needs of rapid industrialisation. The IDBI is empowered to finance all types of concerns engaged or to be engaged in the manufacture or processing of goods, mining, transport, generation and distribution of power etc., both in the public and private sectors.

Industrial finance Corporation of India (IFCI)

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

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

Industrial Credit and Investment Corporation of India (ICICI)

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

The main objective of the ICICI was to meet the needs of the industry for long term funds in the private sector. Apart from this the Industrial Reconstruction Corporation of India (IRCI) established in 1971 with the main objective of revival and rehabilitation of viable sick units and was converted in to the Industrial Reconstruction Bank of India (IRBI) in 1985 with more powers Development banks have been established at the state level too. At present in India, 18 State Financial Corporation's (SFCs) and 26 State Industrial investment/ Development Corporations (SIDCs) are functioning to look over the development banking in respective areas /states.

Specialized Banks

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

Export Import Bank of India (EXIM Bank):

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

The main functions of the EXIM Bank are as follows:

- (i) Financing of exports and imports of goods and services, not only of India but also of the third world countries;
- (ii) Financing of exports and imports of machinery and equipment on lease basis; (iii) Financing of joint ventures in foreign countries;
- (iv) Providing loans to Indian parties to enable them to contribute to the share capital of joint ventures in foreign

countries;

- (v) to undertake limited merchant banking functions such as underwriting of stocks, shares, bonds or debentures of Indian companies engaged in export or import; and
- (vi) To provide technical, administrative and financial assistance to parties in connection with export and import.

Small Industries Development Bank of India

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

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

- (i) Initiates steps for technology adoption, technology exchange, transfer and upgradation and modernisation of existing units.
- (ii) SIDBI participates in the equity type of loans on soft terms, term loan, working capital both in rupee and

foreign currencies, venture capital support, and different forms of resource support to banks and other institutions.

- (iii) SIDBI facilitates timely flow of credit for both term loans and working capital to SSI in collaboration with commercial banks.
- (iv) SIDBI enlarges marketing capabilities of the products of SSIs in both domestic and international markets.
- (v) SIDBI directly discounts and rediscounts bills with a view to encourage bills culture and helping the SSI units to realise their sale proceeds of capital goods / equipments and components etc
- (vi) SIDBI promotes employment oriented industries especially in semi-urban areas to create more employment opportunities so that rural-urban migration of people can be checked.

National Bank for Agricultural and Rural Development

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

- a) Takes measures towards institution building for improving absorptive capacity of the credit delivery

system, including monitoring, formulation of rehabilitation schemes, restructuring of credit institutions, training of personnel, etc.

- b) Co-ordinates the rural financing activities of all institutions engaged in developmental work at the field level and maintains liaison with Government of India, State Governments, Reserve Bank of India (RBI) and other national level institutions concerned with policy formulation
- c) Undertakes monitoring and evaluation of projects refinanced by it.
- d) NABARD refinances the financial institutions which finances the rural sector.
- e) The institutions which help the rural economy, NABARD helps develop.
- f) NABARD also keeps a check on its client institutes.
- g) It regulates the institution which provides financial help to the rural economy.
- h) It provides training facilities to the institutions working the field of rural upliftment.
- i) It regulates the cooperative banks and the RRB

Indian Bank-like financial institution

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

Microfinance Institutions

Microfinance Institutions are Bank-like financial

institutions that providing financial services, such as microcredit, micro savings or micro insurance to poor people.

In addition, they also perform the following important functions:

1. provide financing facilities, with or without collateral security, in cash or in kind, for such terms and subject to such conditions as may be prescribed, to poor persons for all types of economic activities including housing, but excluding business in foreign exchange transactions
2. To buy, sell and supply on credit to poor persons industrial and agricultural inputs, livestock, machinery and industrial raw materials
3. To provide professional advice to poor persons regarding investments in small business and such cottage industries as may be prescribed.

Development financial institutions (DFIs)

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

Their functions include:

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

addition to supplying financial services not normally provided by commercial banks and finance companies

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

CUSTOMERS OF A BANK

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

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

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

Special Types of Customers

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

I. Minors:

Under the Indian law, a minor is a person who has not completed 18 years of age. The period of minority is extended to 21 years in case of guardian of this person or property is appointed by a court of law before he completes the age of 18 years. According to Indian Contract Act, a minor is recognised as a highly incompetent party to enter into legal contracts and any contract entered into with a minor is not only invalid but voidable at the option of the minor. The law has specially protected a minor merely because his mental faculty has not fully developed and as such, he is likely to commit mistakes or even blunders which will affect his interests adversely. It is for this reason; the law has come to the rescue of a minor. A banker can very well open a bank account in the name of a minor. But the banker has to be careful to ensure that he does not open a current account.

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

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

1. The minor should have attained the age of discretion, i.e., he must be about 14 years of age. He must be capable of understanding what he does.
2. The minor should be able to read and write.
3. The minor should be properly introduced. The account opening form should be signed by the minor in the presence of a bank officer who should be able to identify the minor. The date of birth of the minor should be recorded in the account opening form.
4. Banks usually stipulate limits up to which deposits in such accounts can be accepted.
5. Amount tendered by the minor should as far as possible be in cash.
6. In case of time deposits, the amount should be paid in cash on maturity. Prepayment cannot be allowed. Periodical payment of interest on deposits may be made to the minor.

Legal Provisions Regarding Guardianship of a Minor

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

- (a) Natural Guardian:

According to Section 6 of the Hindu Minority and Guardianship Act, 1956, in case of a minor boy or an

unmarried girl, his/her father and after him the mother shall be the natural guardian. In case of a married girl (minor), her husband shall be the natural guardian. The terms father or mother do not include step-father or step-mother.

(b) Testamentary Guardian:

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

(c) Guardian Appointed by Court:

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

II. Lunatics:

A lunatic or an insane person is one who, on account of mental derangement, is incapable of understanding his interests and thereby, arriving at rational judgement. Since a lunatic does not understand what is right and what is wrong, it is quite likely that the public may exploit the weakness of a lunatic to their advantage and thus deprive him of his

legitimate claims. On account of this, the Indian Contract Act recognises that a lunatic is incompetent to enter into any contract and any such contract, if entered into, is not only invalid but voidable at the option of the lunatic. Since a lunatic customer is an incompetent party, the banker has to be very careful in dealing with such customers. Bankers should not open an account in the name of a person of unsound mind. On coming to know of a customer's insanity, the banker should stop all operations on the account and await a court order appointing a receiver. It would be dangerous to rely on hearsay information. The bank should take sufficient care to verify the information and should not stop the account unless it is fully satisfied about the correctness of the information. In case a person suffers from a temporary mental disorder, the banker must obtain a Certificate from two medical officers regarding his mental soundness at the time of operation on the account.

III. Drunkards:

A drunkard is a person who on account of consumption of alcoholic drinks get himself intoxicated and thereby, loses the balance over his mental capacity and hence, is incapable of forming rational judgement. The law is quite considerable towards a person who is in drunken state. A lawful contract with such a person is invalid. This is for the simple reason that it is quite likely that the public may exploit the weakness of such a person to their advantage and thus, deprive him of his legitimate claims. A banker has to be very careful in dealing with such customers. There cannot be any objection by a

banker to open an account. In case a customer approaches the banker for encashment of his cheque especially when he is drunk, the banker should not make immediate payment. This is because the customer may afterwards argue that the banker has not made payment at all. Therefore, it is better and safer that the banker should insist upon such a customer getting a witness (who is not drunk) to countersign before making any payment against the cheque.

IV. Married Women:

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

While opening an account of a purdah lady (purdah nishin), the bank obtains her signature on the account opening form duly attested by a responsible person known to the bank. It is advisable to have withdrawals also similarly

attested. In view of practical difficulties involved, it would be better not to open accounts in the names of purdah ladies.

V. Insolvents:

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

VI. Illiterate Persons:

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

VII. Agents:

A banker may open an account in the name of a person who is acting as an agent of another person. The account should be considered as the personal account of an agent, and

the banker has no authority to question his power to deal with the funds in the account unless it becomes obvious that he is being guilty of breach of trust. However, if a person is authorised to only act on behalf of the principal, the banker should see that he is properly authorised to do the acts which he claims to do. If he has been appointed by a power of attorney, the banker should carefully pursue the letter-of-attorney to confirm the powers conferred by the document on the agent. In receiving notice of the principal's death, insanity or bankruptcy, the banker must suspend all operations on the account.

VIII. Joint Stock Company

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

(a) Memorandum of Association:

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

(b) Articles of Association:

The Articles of Association contain the rules and regulations of the company regarding its internal management. It contains in detail all matters which are concerned with the

conduct of day-to-day business of the company. The Articles of Association is also another document that a banker insists upon. It enables the banker to know the details of company's borrowing powers quantum, persons authorised to borrow etc. This will also enable the banker to understand whether the acts of the officers are within the orbit of the Company's Memorandum and Articles.

(c) *Certificate of Incorporation:*

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

(d) *Certificate to Commence Business:*

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

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

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

Secretary in addition, a copy of the specimen signatures of the officers empowered to operate the bank account has to be furnished.

(f) A Written Mandate:

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

(g) Registration of Charges:

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

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

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

IX. Clubs, Associations and Educational Institutions:

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

(a) Incorporation

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

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

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

(c) A Copy of Resolution of Managing Committee:

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

- (i) Appointing the bank concerned as the banker of the organisation.
- (ii) Mentioning the name/names of the person or persons, who are authorised to operate the account.
- (iii) Giving any other directions for the operation of the said account. A copy of the resolution must be obtained by the bank for its own record.

(d) An Application Form:

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

(e) A Written Mandate:

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

(f) Transfer of Funds:

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

(g) Death or Resignation:

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

X. Partnership Firm:

A partnership is not regarded as an entity separate from the partners. The Indian Partnership Act, 1932, defines partnership as the “relation between persons who have agreed to share the profit of the business, carried on by all or any of them acting for all.” Partnership is formed or constituted on account of agreement between the partners and with the sole

intention of earning and sharing profits in a particular ratio. Further, the business is carried on either by all the partners or some partners acting for all. The partners carry joint and several liabilities and the partnership does not possess any legal entity. A banker should take the following precautions while opening an account in the name of a partnership firm:

(a) Application Form:

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

(b) Partnership Deed:

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

(c) A Mandate:

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

(d) Transfer of Funds:

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

(e) Sanctioning of Overdraft:

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

XI. Joint Accounts:

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

- (a). The application for opening a joint account must be signed by all the persons intending to open a joint account.
- (b). A mandate containing name or names of persons authorised to operate an account.
- (c). The full name of the account must be given in all the documents furnished to the banker, even if the account is to be operated upon by one or a few of the joint account holders.
- (d). Banker must stop operating an account as soon as a notice of death, insolvency, insanity etc., of any one account holder is received.
- (e). The joint account holder, who is authorised to operate the joint account, himself alone cannot appoint an agent or attorney to operate the account on his behalf. Such attorney or agent may be appointed with the consent of

all the joint account holders.

- (f) If all the persons are operating the account, then banker must see that any cheque drawn on him is duly signed by all.
- (g) Banker must stop making payments as soon as letter of revocation is obtained. (h) Banker must see that no loan or overdraft is granted without proper security.

XII. Joint Hindu Family:

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

- (a) He must get complete information about the joint Hindu family including the names of major and minor coparceners and get a declaration from the Kartha to this effect along with specimen signatures and signatures of all coparceners.
- (b) The account should be opened either in the personal

name of the Kartha or in the name of the family business.

- (c) The documents should be signed by the Kartha and major coparceners.
- (d) The account should be operated on only by the Kartha and the authorised major coparceners.
- (e) While making advances, the banker should ascertain the purpose for which the loan is obtained and whether the loan is really needed by the joint Hindu family for business.

XIII. Trustees:

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

- (a) The banker should thoroughly examine the trust deed appointing the applicants as the trustees.
- (b) A trust deed which states the powers and functions of trustees must be obtained by the banker.

- (c) In case of two or more trustees, the banker should ask for clear instructions regarding the person or persons who shall operate the account.
- (d) In case of death or retirement of one or more trustees, banker must see the provision of the trust deed.
- (e) The banker should not allow the transfer of funds from trust account to the personal account of trustee.
- (f) The banker should take all possible precautions to safeguard the interest of the beneficiaries of a trust, failing which he shall be liable to compensate the latter for any fraud on the part of the trustee.
- (g) The insolvency of a trustee does not affect the trust property and the creditors of the trustee cannot recover their claims from trust property.
- (h) A copy of the resolution passed in the meeting of trustees open the account should be obtained.

FUNCTIONS OF COMMERCIAL BANK

Functions of a Commercial Bank can be classified into three.

1. Principal/ Primary/ Fundamental functions
2. Subsidiary/ Secondary/ Supplementary functions
3. Innovative functions.

Principal functions

Commercial banks perform many functions. They satisfy the financial needs of the sectors such as agriculture, industry, trade, communication, so they play very significant role in a

process of economic social needs. The functions performed by banks, since recently, are becoming customer-centred and are widening their functions. Generally, the functions of commercial banks are divided into two categories; primary functions and the secondary functions. Two 'acid test' functions of commercial banks are Accepting deposits and Lending loans. These functions along with credit creation, promotion of cheque system and investment in Government securities form basic functions of commercial banks. The secondary functions of commercial banks include agency services, general utility services and innovative services.

1. Receiving deposits

Most important function of a commercial bank is to accept deposit from those who can save but cannot profitably utilise this savings themselves. By making deposits in bank, savers can earn something in the form of interest and avoid the danger of theft. To attract savings from all sorts of customers, banks maintain different types of accounts such as current account, Savings bank account, Fixed Deposit account, Recurring deposit account and Derivative Deposit account.

Features of Current Accounts

- It is generally opened by trading & industrial concerns.
- It is opened not for profit or savings but for convenience in payments
- Introduction is necessary to open the account.

Any number of transactions permitted in the account. Withdrawals are generally allowed by cheque Deposit is

repayable on demand

- No interest is allowed but incidental charges claimed.
 - Minimum balance requirement varies from bank to bank.
- Features of Saving Bank (SB) accounts

- It is generally opened by middle/low income group who save a part of their income for future needs
- Introduction is necessary to open the account if cheque facility is allowed.

- There are some restrictions on number of withdrawals.
 - Fair interest (less than FD) is offered on the deposits of this account.
- Features of Fixed Deposit accounts

- o It is generally Opened by small investors who do not want to invest money in risky industrial securities like shares.

- o No introduction is necessary to open the account.

- o No maximum limit for investing.

- o Minimum period of investment is 15 days

- o Withdrawal is allowed only after the expiry of a fixed period.

- Withdrawal is generally allowed by surrendering FD Receipt

- Higher rate of interest is offered on the deposits of this account,

Features of Recurring Deposit accounts / Cumulative

Deposit account.

- This account is meant for fixed income group, who can deposit a fixed sum regularly.
- The amount is paid back along with interest after a specified period.
- High rate of interest is offered on recurring deposits.
- Passbook is the means through which deposits and withdrawals are made

2. Lending of funds

The second important function of commercial banks is to advance loans to its customers. Banks charge interest from the borrowers and this is the main source of their income. Modern banks give mostly secured loans for productive purposes. In other words, at the time of advancing loans, they demand proper security or collateral. Generally, the value of security or collateral is equal to the amount of loan. This is done mainly with a view to recover the loan money by selling the security in the event of non-refund of the loan.

Commercial banks lend money to the needy people in the form of Cash credits, Term loans, Overdrafts (OD), Discounting of bills, Money at call or short notice etc.

(i) Cash Credit: In this type of credit scheme, banks advance loans to its customers on the basis of bonds, inventories and other approved securities. Under this scheme, banks enter into an agreement with its customers to which money can be withdrawn many times during a year. Under this set up banks open accounts of their customers and deposit the

loan money. With this type of loan, credit is created.

(ii) Term loans: A term loan is a monetary loan that is repaid in regular payments over a set period of time. In other words, a loan from a bank for a specific amount that has a specified repayment schedule and a floating interest rate is called Term loan. Term loans usually last between one and ten years, but may last as long as 30 years in some cases. It may be classified as short term, medium term and long term loans.

(iii) Over-Drafts: It is the extension of credit from a bank when the account balance reaches zero level. Banks advance loans to its customer's up to a certain amount through over-drafts, if there are no deposits in the current account. For this, banks demand a security from the customers and charge very high rate of interest. Overdraft facility will be allowed only for current account holders.

(iv) Discounting of Bills of Exchange: This is the most prevalent and important method of advancing loans to the traders for short-term purposes. Under this system, banks advance loans to the traders and business firms by discounting their bills. While discounting a bill, the Bank buys the bill (i.e. Bill of Exchange or Promissory Note) before it is due and credits the value of the bill after a discount charge to the customer's account. The transaction is practically an advance against the security of the bill and the discount represents the interest on the advance from the date of purchase of the bill until it is due for payment. In this way, businessmen get loans on the basis of their bills of exchange before the time of their maturity.

(v) Money at Call and Short notice: Money at call and short notice is a very short-term loan that does not have a set repayment schedule, but is payable immediately and in full upon demand. Money- at-call loans give banks a way to earn interest while retaining liquidity. These are generally lent to other institutions such as discount houses, money brokers, the stock exchange, bullion brokers, corporate customers, and increasingly to other banks. ‘At call’ means the money is repayable on demand whereas ‘At short notice’ implies the money is to be repayable on a short notice up to 14 days.

3. Investment of funds in securities

Banks invest a considerable amount of their funds in government and industrial securities. In India, commercial banks are required by statute to invest a good portion of their funds in government and other approved securities. The banks invest their funds in three types of securities—Government securities, other approved securities and other securities. Government securities include both, central and state governments, such as treasury bills, national savings certificate etc. Other securities include securities of state associated bodies like electricity boards, housing boards, debentures of Land Development Banks, units of UTI, shares of Regional Rural banks etc.

4. Credit Creation

When a bank advances a loan, it does not lend cash but opens an account in the borrower’s name and credits the amount of loan to this account. Thus a loan creates an equal

amount of deposit. Creation of such deposit is called credit creation. Banks have the ability to create credit many times more than their actual deposit.

5. Promoting cheque system

Banks also render a very useful medium of exchange in the form of cheques. Through a cheque, the depositor directs the banker to make payment to the payee. In the modern business transactions by cheques have become much more convenient method of settling debts than the use of cash. Through promoting cheque system, the banks ensure the exchange of accounted cash. At present, CTS (Cheque Truncation System) cheques are used by Indian Banks to ensure speedy settlement of transactions in between banks. In contrast to the declining importance of cheques, the use of electronic payment instruments at the retail level has been growing rapidly.

Subsidiary functions

1. Agency services : Banks act as an agent on behalf of the individual or organisations. Banks, as an agent can work for people, businesses, and other banks, providing a variety of services depending on the nature of the agreement they make with their clients. Following are the important agency services provided by commercial banks in India.

- Commercial Banks collect cheques, drafts, Bill of Exchange, interest and dividend on securities, rents etc. on behalf of customers and credit the proceeds to the customer's account.

- Pay LIC premium, rent, newspaper bills, telephone bills etc.
- Buying and selling of securities.
- Advise on right type of investment.
- Act as trustees (undertake management of money and property), executors (carry out the wishes of deceased customers according to will) & attorneys (collect interest & dividend and issue valid receipt) of their customers.
- Serve as correspondents and representatives of their customers. In this capacity, banks prepare I-Tax returns of their customers, correspond with IT authorities and pay IT of their customers.

2. General Utility Services In addition to agency services, modern banks perform many general utility services for the community. Following are the important general utility services offered by Commercial Banks

- Locker facility: Bank provide locker facility to their customers. The customers can keep their valuables such as gold, silver, important documents, securities etc. in these lockers for safe custody.
- Issue travellers' cheques: Banks issue traveller's cheques to help their customers to travel without the fear of theft or loss of money. It enable tourists to get fund in all places they visit without carrying actual cash with them.
- Issue Letter of Credits: Banks issue letter of credit for importers certifying their credit worthiness. It is a letter issued by importer's banker in favour of exporter

informing him that issuing banker undertakes to accept the bills drawn in respect of exports made to the importer specified therein.

Act as referee: Banks act as referees and supply information about the financial standing of their customers on enquiries made by other businessmen.

- **Collect information:** Banks collect information about other businessmen through the fellow bankers and supply information to their customers.
- **Collection of statistics:** Banks collect statistics for giving important information about industry, trade and commerce, money and banking. They also publish journals and bulletins containing research articles on economic and financial matters.
- **Underwriting securities:** Banks underwrite securities issued by government, public or private bodies.
- **Merchant banking:** Some bank provide merchant banking services such as capital to companies, advice on corporate matters, underwriting etc.

Innovative Functions

The adoption of Information and Communication technology enable banks to provide many innovative services to the customers such as;

1. ATM services

Automated Teller Machine (ATM) is an electronic telecommunications device that enables the clients of banks to

perform financial transactions by using a plastic card. Automated Teller Machines are established by banks to enable its customers to have anytime money. It is used to withdraw money, check balance, transfer funds, get mini statement, make payments etc. It is available at 24 hours a day and 7 days a week.

2. *Debit card and credit card facility*

Debit card is an electronic card issued by a bank which allows bank clients access to their account to withdraw cash or pay for goods and services. It can be used in ATMs, Point of Sale terminals, e-commerce sites etc. Debit card removes the need for cheques as it immediately transfers money from the client's account to the business account. Credit card is a card issued by a financial institution giving the holder an option to borrow funds, usually at point of sale. Credit cards charge interest and are primarily used for short- term financing.

3. *Tele-banking :*

Telephone banking is a service provided by a bank or other financial institution, that enables customers to perform financial transactions over the telephone, without the need to visit a bank branch or automated teller machine

4. *Internet Banking:*

Online banking (or Internet banking or E-banking) is a facility that allows customers of a financial institution to conduct financial transactions on a secured website operated by the institution. To access a financial institution's online banking facility, a customer must register with the

institution for the service, and set up some password for customer verification. Online banking can be used to check balances, transfer money, shop online, pay bills etc.

5. *Bancassurance:*

It means the delivery of insurance products through banking channels. It can be done by making an arrangement in which a bank and an insurance company form a partnership so that the insurance company can sell its products to the bank's client base. Banks can earn additional revenue by selling the insurance products, while insurance companies are able to expand their customer base without having to expand their sales forces

6. *Mobile Banking:*

Mobile banking is a system that allows customers of a financial institution to conduct a number of financial transactions through a mobile device such as a mobile phone or personal digital assistant. It allows the customers to bank anytime anywhere through their mobile phone. Customers can access their banking information and make transactions on Savings Accounts, Demat Accounts, Loan Accounts and Credit Cards at absolutely no cost.

7. *Electronic Clearing Services :*

It is a mode of electronic funds transfer from one bank account to another bank account using the services of a Clearing House. This is normally for bulk transfers from one account to many accounts or vice-versa. This can be used both for making payments like distribution of dividend, interest,

salary, pension, etc. by institutions or for collection of amounts for purposes such as payments to utility companies like telephone, electricity, or charges such as house tax, water tax etc

8. *Electronic Fund Transfer/National Electronic Fund Transfer (NEFT):*

National Electronic Funds Transfer (NEFT) is a nation-wide payment system facilitating one-to-one funds transfer. Under this Scheme, individuals, firms and corporate can electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country participating in the Scheme. In NEFT, the funds are transferred based on a deferred net settlement in which there are 11 settlements in week days and 5 settlements in Saturdays.

9. *Real Time Gross Settlement System (RTGS):*

It can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis . 'Real Time' means the processing of instructions at the time they are received rather than at some later time. It is the fastest possible money transfer system in the country.

NEFT	RTGS
<ul style="list-style-type: none">• Based on Demand Net Settlement (DNS)• Fastest method of money transfer	<ul style="list-style-type: none">• Based on Gross Settlement• Slower than RTGS transfer

<ul style="list-style-type: none">• Complete transactions in batches• There is no minimum limit of transactions• Settlement on hour basis (11 settlements from 9 am to 7 pm)	<ul style="list-style-type: none">• Complete transactions individually• Minimum amount to be remitted• Settlement in real time (at the transfer order is processed)
--	---

Role of commercial banks in a developing economy

A well developed banking system is necessary pre-condition for economic development of any economy. Apart from providing resources for growth of industrialisation, banks also influence direction in which these resources are utilised. In underdeveloped and developing nations banking facilities are limited to few developed cities and their activities are focussed on trade & commerce paying little attention to industry & agriculture. Commercial banks contribute to a country's economic development in the following ways.

1. Capital formation

Most important determinant of economic development is capital formation. It has 3 distinctive stages

- Generation of savings
- Mobilisation of savings
- Canalisation of saving

Banks promote capital formation in all these stages. They promote habit of savings by offering attractive rate of return for savers. Banks are maintaining different types of accounts to

mobilise savings aiming different types of customers. They make widespread arrangements to collect savings by opening branches even in remote villages. Moreover, banks offer their resources for productive activities only.

2. Encouragement to entrepreneurial innovations

Entrepreneurs in developing economies, generally hesitate to invest & undertake innovations due to lack of fund. Bank loan facilities enable them to introduce innovative ideas and increase productive capacity of the economy.

3. Monetisation of economy

Monetisation means allow money to play an active role in the economy. Banks, which are creators and distributors of money, help the monetisation in two ways;

- They monetise debt i.e., buy debts (securities) which are not as acceptable as money and convert them to demand deposits which are acceptable as money.
- By spreading branches in rural areas they convert non-monetised sectors of the economy to monetised sectors.

4. Influencing economic activity

They can directly influence the economic activity & pace of economic development through its influence on

- (a) The rate of interest (reduction in rates make investment more profitable and stimulates economic activity)
- (b) Availability of credit. (Through Credit creation banks helps in increasing supply of purchasing power)

5. Implementation of monetary policy

Well developed banking system is necessary for effective implementation of monetary policy. Control and regulation of credit is not possible without active co-operation of banks.

6. Promotion of trade and industry

Economic progress of industrialised countries in last 2 centuries is mainly due to expansion in trade & industrialisation which could not have been made possible without development of a good banking system. Use of cheques, drafts and BoE as a medium of exchange has revolutionised the internal and international trade which in turn accelerated the pace of industrialisation.

7. Encouraging right type of industries

In a planned economy it is necessary that banks should formulate their loan policies in accordance with the broad objectives and strategy of industrialisation as adopted in the plan.

8. Regional development

Banks can play role in achieving balanced development in different regions of the economy. They can transfer surplus funds from developed region to less developed regions, where there is shortage of funds.

9. Development of agricultural & other neglected sectors

Under developed economies primarily agricultural economies and majority of the population live in rural areas. So far banks were paying more attention to trade and

commerce and have almost neglected agriculture and industry. Banks must diversify their activities not only to extend credit to trade, but also to provide medium and long term loans to industry and agriculture.

ROLE OF BANKS IN ECONOMIC DEVELOPMENT

Besides performing the usual commercial banking functions, banks in developing countries play an effective role in their economic development. The majority of people in such countries are poor, unemployed and engaged in traditional agriculture. There is acute shortage of capital. People lack initiative and enterprise. Means of transport are undeveloped. Industry is depressed. The commercial banks help in overcoming these obstacles and promoting economic development. The role of a commercial bank in a developing country is discussed as under.

1. Mobilising Saving for Capital Formation:

The commercial banks help in mobilising savings through network of branch banking. People in developing countries have low incomes but the banks induce them to save by introducing variety of deposit schemes to suit the needs of individual depositors. They also mobilise idle savings of the few rich. By mobilising savings, the banks channelize them into productive investments. Thus they help in the capital formation of a developing country.

2. Financing Industry:

The commercial banks finance the industrial sector in a number of ways. They provide short-term, medium-term and

long-term loans to industry. In India they provide short-term loans. Income of the Latin American countries like Guatemala, they advance medium-term loans for one to three years. But in Korea, the commercial banks also advance long-term loans to industry.

In India, the commercial banks undertake short-term and medium-term financing of small scale industries, and also provide hire- purchase finance. Besides, they underwrite the shares and debentures of large scale industries. Thus they not only provide finance for industry but also help in developing the capital market which is undeveloped in such countries.

3. Financing Trade:

The commercial banks help in financing both internal and external trade. The banks provide loans to retailers and wholesalers to stock goods in which they deal. They also help in the movement of goods from one place to another by providing all types of facilities such as discounting and accepting bills of exchange, providing overdraft facilities, issuing drafts, etc. Moreover, they finance both exports and imports of developing countries by providing foreign exchange facilities to importers and exporters of goods.

4. Financing Agriculture:

The commercial banks help the large agricultural sector in developing countries in a number of ways. They provide loans to traders in agricultural commodities. They open a network of branches in rural areas to provide agricultural credit. They provide finance directly to agriculturists for the

marketing of their produce, for the modernisation and mechanisation of their farms, for providing irrigation facilities, for developing land, etc.

They also provide financial assistance for animal husbandry, dairy farming, sheep breeding, poultry farming, pisciculture and horticulture. The small and marginal farmers and landless agricultural workers, artisans and petty shopkeepers in rural areas are provided financial assistance through the regional rural banks in India. These regional rural banks operate under a commercial bank. Thus the commercial banks meet the credit requirements of all types of rural people.

5. Financing Consumer Activities:

People in underdeveloped countries being poor and having low incomes do not possess sufficient financial resources to buy durable consumer goods. The commercial banks advance loans to consumers for the purchase of such items as houses, scooters, fans, refrigerators, etc. In this way, they also help in raising the standard of living of the people in developing countries by providing loans for consumptive activities.

6. Financing Employment Generating Activities:

The commercial banks finance employment generating activities in developing countries. They provide loans for the education of young person's studying in engineering, medical and other vocational institutes of higher learning. They advance loans to young entrepreneurs, medical and engineering graduates, and other technically trained persons in

establishing their own business. Such loan facilities are being provided by a number of commercial banks in India. Thus the banks not only help in human capital formation but also in increasing entrepreneurial activities in developing countries.

7. Help in Monetary Policy:

The commercial banks help the economic development of a country by faithfully following the monetary policy of the central bank. In fact, the central bank depends upon the commercial banks for the success of its policy of monetary management in keeping with requirements of a developing economy. Thus the commercial banks contribute much to the growth of a developing economy by granting loans to agriculture, trade and industry, by helping in physical and human capital formation and by following the monetary policy of the country.

TYPES OF BANKING

Banks can be classified into different groups either on the basis of their structure or on the basis of their function. Structurally banking can be divided into Branch banking and Unit Banking. Functionally, banking can be divided into Deposit Banking, Investment Banking and Mixed Banking.

Branch Banking:

This refers to a system under which two or more banks are opened under a single ownership. Examples are State Bank of India, Punjab National Bank, Indian Bank etc. which have several branches spread all-over India.

Unit Banking:

This refers to that system of banking in which banking operations are carried on through a single organisation, without any branches. This system used to be popular in America. One great advantage of branch banking is that the same bank can cater to several parts of a large country (through its branches situated in those parts) which a unit bank would find difficult to do. As against this, a unit bank has the advantage that its efforts are concentrated in one area so that it can serve that area well.

Group Banking:

This is a system under which two or more banks, separately incorporated, are connected by being controlled by a single holding company as trust.

Chain Banking:

This is similar to Group Banking. Here two or more banks are controlled by a single group through the ownership of shares or otherwise.

Deposit Banking:

In this category, the banks act as custodian or trustees of the depositors.

Correspondent banking system:

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

Investment Banking:

This refers to banks whose main function is to provide finance for investment to industrial concerns. They provide this by purchasing shares and debentures of newly floated companies.

Mixed Banking:

Most banks in India play both roles. Deposit Banking and Investment Banking. Such type of banking is called mixed banking.

RESERVE BANK OF INDIA (RBI)

The Reserve Bank of India is now the apex financial institution of the country which is entrusted with the task of controlling, supervising, promoting, developing and planning the financial system. RBI is the queen bee of the Indian financial system which influences the commercial banks' management in more than one way. The RBI influences the management of commercial banks through its various policies, directions and regulations. Its role in banking is quite unique. In fact, the RBI performs the four basic functions of management, viz., planning, organizing, directing and controlling in laying a strong foundation for the functioning of commercial banks.

RBI possesses special status in our country. It is the authority to regulate and control monetary system of our country. It controls money market and the entire banking system of our country.

Management

The Reserve Bank's affairs are governed by a central board of directors. The board is appointed by the Government of India in keeping with the Reserve Bank of India Act.

The organization structure of RBI consists of a **Central Board** and **Local Board**.

Central Board: The general supervision and control of the bank's affairs is vested in the Central Board of Directors which consists of 20 member team including a Governor, 4 Deputy Governors and 15 Directors (of which 4 are from local boards, and one is a finance secretary of Central Government). All these persons are appointed or nominated by Central Govt. The chairman of the Board and its Chief Executive authority is the Governor. Governors and Deputy Governors hold office for such a period as fixed by Central Government not exceeding 5 years and are eligible for reappointment. Directors hold office for 4 years and their retirement is by rotation. As a matter of practical convenience, the Board has delegated some of its functions to a committee called the Committee of the Central Board. It meets once in a week, generally Wednesdays. There are sub committees to assist committees such as building committee and staff sub-committee.

Local Board: For each regional areas of the country viz., Western, Eastern, Northern and Southern, there is a Local Board with head quarters at Bombay, Calcutta, New Delhi and Madras. Local boards consist of 5 members each appointed by the Central Government. The functions of the local boards are

to advise the central board on local matters and to represent territorial and economic interests of local cooperative and indigenous banks; advice on such matters that may generally be referred to them and perform such duties as the Central Board may delegate to them.

The Central office of the RBI, located at Mumbai is divided into several specialized departments. The main departments are:

1. Issue Department: - It arranges for the issue and distribution of currency notes among the different centers of the country.
2. Banking Department: - It deals with Government transactions and maintains the cash reserves of the commercial banks.
3. Department of Banking development:- It is concerned with the development of banking facilities in the unbanked and rural areas in the country.
4. Department of Banking operations: - This department supervises and controls the working of the banking institutions in the country.
5. Non-Banking Companies Department: - It regulates the activities of non-banking financial companies existing in the country.
6. Agricultural credit Department: - This department studies the problems connected with the agricultural credit in the country.

7. Industrial finance Department: It is concerned with the provision of finance to the industrial units in the country.
8. Exchange control Department: - The entire business of sale and purchase of foreign exchange is conducted by this department.
9. Legal Department: - The main function of this department is to give legal advices to the other departments of RBI.
10. Department of Research and Statistics: - This department is concerned with conducting research on problems relating to money, credit, finance, production etc.

Objectives of RBI

Prior to the establishment of the Reserve Bank, the Indian financial system was totally inadequate on account of the inherent weakness of the dual control of currency by the Central Government and of credit by the Imperial Bank of India.

The Preamble to the Reserve Bank of India Act, 1934 spells out the objectives of the Reserve Bank as: “to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.”

The important objectives are:

1. To act as Monetary Authority: Formulates implements and monitors the monetary policy to maintain price stability

and ensuring adequate flow of credit to productive sectors.

2. To Regulate and supervise the financial system of the country: It prescribes broad parameters of banking operations within which the country's banking and financial system functions. It helps to maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

3. To Manage the Exchange Control: Manages the Foreign Exchange Management Act, 1999 to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

4. To issue currency: Issues and exchanges or destroys currency and coins not fit for circulation to give the public adequate quantity of supplies of currency notes and coins and in good quality.

5. To undertake developmental role: RBI performs a wide range of promotional functions to support national objectives.

6. To undertake related Functions by acting as:

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.
- Owner and operator of the depository (SGL-Subsidiary General Ledger account) and exchange (NDS)

Negotiated Dealing System is an electronic platform for

facilitating dealing in Government Securities and Money Market Instruments that will facilitate electronic submission of bids/application for government bonds.

To sum up the objectives include:

1. To manage the monetary and credit system of the country.
2. To stabilizes internal and external value of rupee.
3. For balanced and systematic development of banking in the country.
4. For the development of organized money market in the country.
5. For facilitating proper arrangement of agriculture finance and be in successful for maintaining financial stability and credit in agricultural sector.
6. For proper arrangement of industrial finance.
7. For proper management of public debts.
8. To establish monetary relations with other countries of the world and international financial institutions.
9. For centralization of cash reserves of commercial banks.
10. To maintain balance between the demand and supply of currency.
11. To regulate the financial policy and develop banking facilities throughout the country.
12. T o remain free from political influence while making financial decisions

13. To assist the planned process of development of the Indian economy.

Besides the traditional central banking functions, with the launching of the five-year plans in the country, the Reserve Bank of India has been moving ahead in performing a host of developmental and promotional functions, which are normally beyond the purview of a traditional Central Bank.

Functions of RBI

RBI performs various traditional banking function as well as promotional and developmental measures to meet the dynamic requirements of the country. Main functions of RBI can be broadly classified into three. These are

- I. Monetary functions or Central banking functions
- II. Supervisory functions
- III. Promotional and Developmental functions.

I. Monetary functions include

- A. Issue of currency notes
 - B. Acting as banker to the Government
 - C. Serving as banker of other banks
 - D. Controlling credit
 - E. Controlling foreign exchange operations
- A. **Issue of currency notes: -**

Under Section 22 of the Reserve Bank of India Act of 1934, the Reserve Bank of India is given the monopoly of note issue. Now RBI is the sole authority for the issue of currency notes of all denominations except one rupee notes and coins in

the country. One rupee notes and coins are issued by Ministry of Finance of GOI. The RBI has a separate department called the Issue Department for the issue of currency notes.

Since 1956 system of Note Issue changed from **Proportional Reserve System** to minimum **reserve system**. Under Proportional reserve system of note issue, not less than 40% of the total volume of notes issued by the RBI was to be covered by gold coins, bullion and foreign securities. But under the Minimum reserve system of note issue, RBI is required to maintain a minimum reserve of gold or foreign securities or both against the notes issued. No maximum limit is fixed on the volume of notes. RBI maintains gold and foreign exchange reserves of Rs.200 crores of which 115 crores is in gold & balance in foreign securities, Govt. of India securities, eligible commercial bills, Pro-notes of NABARD for any loans etc.

This change from Proportional Reserve system to Minimum Reserve system is made because of two major reasons. Firstly, the planned economic development of the country called for an increased supply of money, which could not be had under the proportional reserve system. Secondly, the foreign exchange held as reserve by the Reserve bank had to be released for financing the five year plans. In short, this was to enable the expanding currency requirements of the economy.

B. Acting as Banker to government: -

The Reserve bank act as a banker to the Central and State

Governments. As a banker to the Government RBI acts in three capacities, viz., **(a) as a banker, (b) as a financial agent,** and (c) as a **financial advisor**

(a) As a banker: - RBI renders the following services

1. Accepts deposits from the Central and State Government.
2. Collects money on behalf of Government.
3. Makes payments on behalf of the Government, in accordance with their instructions.
4. Arranges for the transfer of funds from one place to another on behalf of the Governments
5. Makes arrangements for the supply of foreign exchange to the Central and State Governments.
6. It maintains currency chests with treasuries and other agencies in places prescribed by the Government of India. These chests are supplied with sufficient currency notes to meet the requirements for the transactions of the Government.
7. Short term advances are granted to Central and State Governments for a period not exceeding three months. These advances are granted up to a certain limit without any collateral securities.
8. In times of emergencies like war, extraordinary loans are also granted to the Governments by the RBI. (b) As a financial agent: - The services given are

1. Acts as an agent of the Central and State Governments in the matter of floatation of loans. On account of Reserve Bank's

intimate knowledge of the financial markets, it is able to obtain the best possible terms for the Government in this matter. Further by coordinating the borrowing programmers of the various Governments, it is able to minimize the adverse effects of Government borrowings on the money and securities market.

2. On behalf of Central Government RBI sells treasury bills of 90 days maturity at weekly auctions and secures short-term finance for the Central Government. Apart from that RBI also sells adhoc treasury bills of 90 day's maturity to the State Governments, Semi-Government Departments and foreign central banks on behalf of the Central Government.

3. RBI manages and keeps the accounts of the public debts of the Central and State Governments. It arranges for the payment of interest and principal amount on the public debt on the due dates.

4. As an agent RBI also represents Government of India in the International institutions like the IMF, the IBRD etc.

The Reserve Bank is agent of Central Government and of all State Governments in India except for that of Jammu and Kashmir and Sikkim.

(c) As a Financial Adviser: - renders following services

1. It advises the Central and State Government on all financial and economic matters such as the floating of loans, agricultural and industrial finance etc.

2. Advice on matters of International finance is also given to Central Government.

3. It collects the recent information on current economic and financial developments in India and abroad, with the help of its Research and Statistics Department and keeps Government informed periodically.

C. Banker's bank: -

RBI acts as banker to Scheduled banks. Scheduled Banks include commercial banks, foreign exchange banks, public sector banks, state co-operative banks and the regional rural banks. As a bankers' bank it renders the following services:

1. **It holds a part of the cash balances of the commercial banks:-** Every commercial bank in India is required to keep with the Reserve Bank a cash balance of not less than 6% of its demand and time liabilities. This rate can be increased up to 20%. The two main purposes of maintaining cash reserve by commercial banks are as follows. Firstly to protect the interest of the depositors, secondly to enable the Reserve Bank to accommodate the commercial banks on times of difficulties and thirdly the Reserve Bank can control the credit created by the commercial banks by varying the statutory cash reserve requirements.
2. **It acts as the clearing house: -** By acting as clearing house the Reserve bank helps the member banks in the settlement of the mutual indebtedness without physical transfer of cash.
3. It provides **cheap remittance facilities** to the commercial banks

4. It provides financial accommodation to the commercial banks: - At times of financial crisis the RBI is **the lender of last resort** for the commercial banks. Financial assistance is given by The Reserve bank either by rediscounting eligible bills or by granting loans against approved securities.

D. Control of Credit: -

RBI undertakes the responsibility of controlling credit in order to ensure internal price stability and promote sufficient credit for the economic growth of the country. Price stability is essential for economic development. To control credit, RBI makes use of both quantitative and qualitative weapons by virtue of the powers given to it by Reserve Bank of India Act of 1934 and the Indian Banking Regulation Act of 1949. These weapons are listed below.

(a) Quantitative weapons

1. Bank rate policy:

Bank rate is the lending rate of central bank. It is the official minimum rate at which central bank of a country rediscounts the eligible bills of exchange of the commercial banks and other financial institutions or grants short term loans to them. By increasing bank rate, RBI can make bank credit costlier.

2. Open Market Operations:

RBI Act authorizes the RBI to engage in the purchase of securities of central and State Government and such other securities as specified by Central Govt. But by and large, its

open market operations are confined to Central Government Securities and to a very limited extend to State Government Securities. RBI uses this weapon to offset the seasonal fluctuations in money market. When there is an excessive supply of money, RBI sells the securities in the open market. In that way RBI is able to withdraw the excess money from circulation. But when there is shortage of money supply in the market, it purchases securities from the open market and as a result, more money is arrived at for circulation

3. Variable Cash reserve ratio:

Under the RBI Act of 1934, every scheduled and non-scheduled bank is required to maintain a fixed percentage of total time and demand liabilities as cash reserve with RBI. It is called statutory Cash Reserve Ratio (CRR). An increase in CRR reduces lending capacity of the bank and a decrease in CRR increases the lending capacity. RBI can prescribe a CRR ranging up to 15% which is at present 4% (as on April '2016).

4. Variable Statutory Liquidity Ratio

According to sec 24 of BRA 1949, every commercial bank is required to maintain a certain percentage of its total deposits in liquid assets such as cash in hand, excess reserve with RBI, balances with other banks, gold and approved Government and other securities. This proportion of liquid assets to total deposits is called SLR. BRA empowers RBI to fix the SLR up to 40%. The variation of the SLR is intended to reduce the lendable funds in the hands of the commercial banks and to check the expansion of bank credit. An increase

in SLR will decrease the lendable funds in the hands of commercial banks and vice versa. Present rate of SLR is 21.25%. (As on April 2016).

5. Repo Rate and Reverse Repo Rate

Repo rate is the rate at which RBI lends to commercial banks generally against government securities. Reduction in Repo rate helps the commercial banks to get money at a cheaper rate and increase in Repo rate discourages the commercial banks to get money as the rate increases and becomes expensive. Reverse Repo rate is the rate at which RBI borrows money from the commercial banks. The increase in the Repo rate will increase the cost of borrowing and lending of the banks which will discourage the public to borrow money and will encourage them to deposit. As the rates are high the availability of credit and demand decreases resulting to decrease in inflation. This increase in Repo Rate and Reverse Repo Rate is a symbol of tightening of the policy. As of April 2016, the repo rate is 6.50 % and reverse repo rate is 6%.

b. Selective credit controls (Qualitative weapons)

1. Credit Ceiling

In this operation RBI issues prior information or direction that loans to the commercial banks will be given up to a certain limit. In this case commercial bank will be tight in advancing loans to the public. They will allocate loans to limited sectors. Few example of ceiling are agriculture sector advances, priority sector lending.

2. Credit Authorization Scheme

Credit Authorization Scheme was introduced in November, 1965 when P C Bhattacharya was the chairman of RBI. Under this instrument of credit the commercial banks are required to obtain the RBI's prior authorization for sanctioning any fresh credit beyond the authorized limits.

3. Moral Suasion

Moral Suasion is just as a request by the RBI to the commercial banks to follow a particular line of action. RBI may request commercial banks not to give loans for unproductive purpose which does not add to economic growth but increases inflation.

4. Regulation of margin requirements:

Margin refers to the difference between loan amount and the market value of collateral placed to raise the loan. RBI fixes a lower margin to borrowers whose need is urgent. For e.g. if RBI believes that farmers should be financed urgently, RBI would direct to lower the margin requirement on agricultural commodities. RBI has used this weapon for a number of times.

5. Issuing of directives:

BRA empowers RBI to issue directives to banks and banks are bound to comply with such directives. RBI directives may relate to:

- Purpose for which advance may or may not be made
- Margins requirement

- Maximum amount of loan that can be sanctioned to any company, firm or individual
- Rate of interest and other terms and conditions on which loans may be given

E Control of foreign Exchange operations

One of the central banking functions of the RBI is the control of foreign exchange operations. For the control of foreign exchange business, the RBI has set up a separate department called the Exchange Control Department in September, 1939. This Department has been granted wide powers to regulate the foreign exchange business of the country. As the central bank of India, it is the responsibility of the RBI to maintain the external value of the Indian rupee stable. India being member of the IMF, the RBI is required to maintain stable exchange rates between the Indian rupee and the currencies of all other member countries of the I.M.F. Besides maintaining stable exchange rates, RBI also acts as the custodian of the foreign exchange reserves of the country. The foreign exchange reserves of the country held by RBI includes Euro, U.S. dollars, Japanese yen etc.

RBI also acts as the administrator of exchange control. It ensures that the foreign exchange reserves of the country are utilized only for approved purposes and the limited foreign exchange reserves of the country are conserved for the future.

II. Supervisory functions

RBI has been given several supervisory powers over the different banking institutions in the country. The supervisory

functions relate to licensing and establishment, branch expansion, liquidity of assets, amalgamation, reconstruction and liquidation of commercial banks and co-operative banks

III. Promotional and developmental functions

RBI is also performing promotional and developmental functions. These functions includes the following

a) Provision of Agricultural Credit: For the promotion of agricultural credit RBI has set up a separate department called the Agricultural Credit Department. It. has also set up two funds namely – 1. The National Agricultural Credit (Long term operations) and 2. The National Agricultural credit (stabilization) fund for facilitating Long term, Medium term and Short term finance for agricultural purposes.

b) Provision for Industrial finance: - RBI has played a very significant role in the field of industrial finance by helping the setting up of a number of public sector industrial finance corporations that provide short term, medium term, and long term finance for industrial purpose. These industrial finance corporations include 1. Industrial finance Corporation of India (IFCI), 2. State Finance Corporations (SFC), Industrial Development Bank of India (IDBI), 3. Industrial Reconstruction Corporation of India (IRCI), 4. Refinance Corporation of India, and 5. Unit Trust of India (UTI).

Besides the above RBI also renders the Credit Guarantee Scheme which intends to give protection to banks against possible losses in respect of their advances to small scale industrial units.

c.) Development of Bill Market: - A bill market is a place where short term bill of 3 month duration are generally discounted or rediscounted. RBI plays a very important role in the promotion of Bill Market as a well-developed bill market is essential for the smooth functioning of the credit system.

d.) Collection and publication of statistics on financial and economic matters: - These functions of RBI are extremely useful to the Government in knowing and solving the various economic problems. They are also of immense help to financial institutions, business and industry and for general public.

e.) Miscellaneous functions:- RBI has established training centers for staff for its own staff and other banks. Bankers' training college Mumbai, National Institute of Bank Management Mumbai, Staff Training College Madras, and College of Agricultural Banking at Pune are the institutions run by RBI.

EMERGING TRENDS IN BANKING

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

E-Banking

E-banking involves information technology based banking. Under this I.T system, the banking services are

delivered by way of a Computer-Controlled System. This system does involve direct interface with the customers. The customers do not have to visit the bank's premises.

Advantages of E-Banking

1. The operating cost per unit services is lower for the banks.
2. It offers convenience to customers as they are not required to go to the bank's premises. There is very low incidence of errors.
3. The customer can obtain funds at any time from ATM machines.
4. The credit cards and debit cards enables the Customers to obtain discounts from retail outlets.
5. The customer can easily transfer the funds from one place to another place electronically.

Popular services covered under E-Banking

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

1. Automated Teller Machine:

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

1. ATM provides 24 hours service: ATMs provide service round the clock. The customer can withdraw cash up to a certain limit during any time of the day or night.
2. ATM gives convenience to bank's customers : ATMs provide convenience to the customers. Now- a-days, ATMs are located at convenient places, such as at the air ports, railway stations, etc. and not necessarily at the Bank's premises.
3. ATM reduces the workload of bank's staff.: ATMs reduce the work pressure on bank's staff and avoids queues in bank premises.
4. ATM provide service without any error: ATMs provide service without error. The customer can obtain exact amount. There is no human error as far as ATMs are concerned.
5. ATM is very beneficial for travellers: ATMs are of great help to travellers. They need not carry large amount of cash with them.
6. ATM may give customers new currency notes: The customer also gets brand new currency notes from ATMs. In other words, customers do not get soiled notes from ATMs.

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

2. Electronic Transfer of Funds:

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

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

3. Tele-Banking:

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

4. Mobile Banking:

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

5. Home Banking:

It is another important innovation took place in Indian

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

6. Internet Banking:

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

7. Demate Banking:

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

8. Credit Cards

A credit card is a small plastic card issued to users as a system of payment. It allows its holder to buy goods and services based on the holder's promise to pay for these goods and services. The issuer of the card creates a revolving account and grants a line of credit to the consumer (or the user) from which the user can borrow money for payment to a merchant

or as a cash advance to the user. A credit card is different from a charge card: a charge card requires the balance to be paid in full each month. In contrast, credit cards allow the consumers a continuing balance of debt, subject to interest being charged. A credit card also differs from a cash card, which can be used like currency by the owner of the card. Most credit cards are issued by banks or credit unions.

9. Debit Card

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

Credit Card Vs Debit Card

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

10. Smart Card

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

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

The most common smart card applications are:

- Credit cards

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

11. Cheques Truncation Payment system (CTPS)

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

12. Social Banking

Social banking means banking policy to meet the socio-economic obligations of the country. It includes allocation of credit according to the requirements of the planned economic development of the country.

13. No frills Account

Now a day, RBI has advised the banks to allow people to open no-frills accounts, i.e., accounts with nil balance or very

low minimum balance.

14. Off-shore Banking

Off-shore bank is a bank located outside the country of residence of the depositor , typically in a low tax area that provides financial and legal advantages.

15. Banking Ombudsman Scheme

16. Capital Adequacy Norms

MODULE 2

NEGOTIABLE INSTRUMENTS

Definition of a Negotiable Instrument

The law relating to negotiable instruments is contained in the Negotiable Instruments Act, 1881. It is an Act to define and amend the law relating to promissory notes, bills of exchange and cheques.

The Act does not affect the custom or local usage relating to an instrument in oriental language i.e., a Hundi.

The term "*negotiable instrument*" means a document transferable from one person to another. However the Act has not defined the term. It merely says that "A .negotiable instrument" means a promissory note, bill of exchange or cheque payable either to order or to bearer. [Section 13(1)]

A negotiable instrument may be defined as "an instrument, the property in which is acquired by anyone who takes it *bona fide*, and for value, notwithstanding any defect of title in the person from whom he took it, from which it follows that an instrument cannot be negotiable unless it is such and in such a state that the true owner could transfer the contract or engagement contained therein by simple delivery of instrument"

The Act recognizes only three types of instruments viz., a Promissory Note, a Bill of Exchange and a Cheque as negotiable instruments. However, it does not mean that other

instruments are not negotiable instruments provided that they satisfy the following conditions of negotiability:

1. The instrument should be freely transferable by the custom of trade. Transferability may be by (i) delivery or (ii) endorsement and delivery.
2. The person who obtains it in good faith and for consideration gets it free from all defects and can sue upon it in his own name.
3. The holder has the right to transfer. The negotiability continues till the maturity.

Important Characteristics of Negotiable Instruments

Following are the important characteristics of negotiable instruments:

- (1) The holder of the instrument is presumed to be the owner of the property contained in it.
- (2) They are freely transferable.
- (3) A holder in due course gets the instrument free from all defects of title of any previous holder. (4) The holder in due course is entitled to sue on the instrument in his own name.
- (5) The instrument is transferable till maturity and in case of cheques till it becomes stale (on the expiry of 6 months from the date of issue).
- (6) Certain equal presumptions are applicable to all negotiable instruments unless the contrary is proved.

Classification of Negotiable Instruments

The negotiable instruments may be classified as under:

(1) Bearer Instruments

A promissory note, bill of exchange or cheque is payable to bearer when (i) it is expressed to be so payable, or (ii) the only or last endorsement on the instrument is an endorsement in blank, A person who is a holder of a bearer instrument can obtain the payment of the instrument.

(2) Order Instruments

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

(3) Inland Instruments (Section 11)

A promissory note, bill of exchange or cheque drawn or made in India, and made payable, or drawn upon any person, resident in India shall be deemed to be an inland instrument. Since a promissory note is not drawn on any person, an inland promissory note is one which is made payable in India. Subject to this exception, an inland instrument is one which is either:

- a. drawn and made payable in India, or
- b. drawn in India upon some persons resident therein, even though it is made payable in a foreign country.

(4) Foreign Instruments

An instrument which is not an inland instrument, is

deemed to be a foreign instrument. The essentials of a foreign instrument include that:

- (i) it must be drawn outside India and made payable outside or inside India; or
- (ii) it must be drawn in India and made payable outside India and drawn on a person resident outside India.

(5) Demand Instruments (Section 19)

A promissory note or a bill of exchange in which no time for payment is specified is an instrument payable on demand.

(6) Time Instruments

Time instruments are those which are payable at sometime in the future. Therefore, a promissory note or a bill of exchange payable after a fixed period, or after sight, or on specified day, or on the happening of an event which is certain to happen, is known as a time instrument. The expression "after sight" in a promissory note means that the payment cannot be demanded on it unless it has been shown to the maker. In the case of bill of exchange, the expression "after sight" means after acceptance, or after noting for non-acceptance or after protest for non-acceptance.

Ambiguous Instruments (Section 17)

An instrument, which in form is such that it may either be treated by the holder as a bill or as a note, is an ambiguous instrument. Section 5(2) of the English Bills of Exchange Act provides that where in a bill, the drawer and the drawee are the same person or where the drawee is a fictitious person or a

person incompetent to contract, the holder may treat the instrument, at his option, either as a bill of exchange or as a promissory note.

Bill drawn to or to the order of the drawee or by an agent on his principal, or by one branch of a bank on another or by the direction of a company or their cashier are also ambiguous instruments. A promissory note addressed to a third person may be treated as a bill by such person by accepting it, while a bill not addressed to anyone may be treated as a note. But where the drawer and payee are the *same e.g.*, where A draws a bill payable to A's order, it is not an ambiguous instrument and cannot be treated as a promissory note. Once an instrument has been treated either as a bill or as a note, it cannot be treated differently afterwards.

Inchoate or Incomplete Instrument (Section 20)

When one person signs and delivers to another a paper stamped in accordance with the law relating to negotiable instruments, and either wholly blank or having written thereon an incomplete negotiable instrument, he thereby gives *prima facie* authority to the holder thereof to make or complete, as the case may be, upon it a negotiable instrument, for any amount specified therein, and not exceeding the amount, covered by the stamp. Such an instrument is called an inchoate instrument. The person so signing shall be liable upon such instrument, in the capacity in which he signs the same, to any holder in due course for such amount. provided that no person other than a holder in due course shall recover from the person delivering the instrument anything in excess of the amount

intended by him to be paid thereon.

The authority to fill up a blank or incomplete instrument may be exercised by any "holder" and not only the first holder to whom the instrument was delivered. The person signing and delivering the paper is liable both to a "holder" and a "holder-in-due-course". But there is a difference in their respective rights. A "holder" can recover only what the person signing and delivering the paper agreed to pay under the instrument, while a "holder-in- due-course" can recover the whole amount made payable by the instrument provided that it is covered by the stamp, even though the amount authorised was smaller.

Kinds of Negotiable Instruments

The Act recognises only three kinds of negotiable instruments under Section 13 but it does not exclude any other negotiable instrument provided the instrument entitles a person to a sum of money and is transferable by delivery. Instruments written in oriental languages *i.e.* hundis are also negotiable instruments. These instruments are discussed below:

(I) Promissory Notes

A "promissory note" is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking, signed by the maker to pay a certain sum of money to, or to the order of, a certain person, or only to bearer of the instrument. (Section 4)

Parties to a Promissory Note:

A promissory note has the following parties:

- (a) *The maker:* the person who makes or executes the note promising to pay the amount stated therein.
- (b) *The payee:* one to whom the note is payable.
- (c) *The holder:* is either the payee or some other person to whom he may have endorsed the note.
- (d) *The endorser.*
- (e) *The endorsee.*

Essentials of a Promissory Note:

To be a promissory note, an instrument must possess the following essentials:

- (a) It must be in writing. An oral promise to pay will not do.
- (b) It must contain an express promise or clear undertaking to pay. A promise to pay cannot be inferred. A mere acknowledgement of debt is not sufficient. If A writes to B "I owe you (I.O.U.) Rs. 500", there is no promise to pay and the instrument is not a promissory note.
- (c) The promise or undertaking to pay must be unconditional. A promise to pay "when able", or "as soon as possible", or "after your marriage to I?", is conditional. But a promise to pay after a specific time or on the happening of an event which must happen, is not conditional, e.g. "I promise to pay Rs. 1,000 ten days after the death of B", is unconditional.
- (d) The maker must sign the promissory note in token of an undertaking to pay to the payee or his order.
- (e) The maker must be a certain person, i.e., the note must

show clearly who is the person engaging himself to pay.

(f) The payee must be certain. The promissory note must contain a promise to pay to some person or persons ascertained by name or designation or to their order.

(g) The sum payable must be certain and the amount must not be capable of contingent additions or subtractions. If A promises to pay Rs. 100 and all other sums which shall become due to him, the instrument is not a promissory note.

(h) Payment must be in legal money of the country. Thus, a promise to pay Rs. 500 and deliver 10 quintals of rice is not a promissory note.

(i) It must be properly stamped in accordance with the provisions of the Indian Stamp Act. Each stamp must be duly cancelled by maker's signature or initials.

(j) It must contain the name of place, number and the date on which it is made.

However, their omission will not render the instrument invalid, e.g. if it is undated, it is deemed to be dated on the date of delivery.

Note: A promissory note cannot be made payable or issued to bearer, no matter whether it is payable on demand or after a certain time

(Section 31 of the RBI Act).

(ii) Bills of Exchange

A "bill of exchange" is an instrument in writing containing an unconditional order, signed by the maker,

directing a certain person *to pay a certain sum of money only to* or to the order of, a certain person or to the bearer of the instrument. (Section 5)

The definition of a bill of exchange is very similar to that of a promissory note and for most of the cases the rules which apply to promissory notes are in general applicable to bills. There are however, certain important points of distinction between the two.

Parties to bills of exchange

The following are parties to a bill of exchange:

- (a) *The Drawer*: the person who draws the bill.
- (b) *The Drawee*: the person on whom the bill is drawn.
- (c) *The Acceptor*: one who accepts the bill. Generally, the drawee is the acceptor but a stranger may accept it on behalf of the drawee.
- (d) *The payee*: one to whom the sum stated in the bill is payable, either the drawer or any other person may be the payee.
- (e) *The holder*: is either the original payee or any other person to whom, the payee has endorsed the bill. In case of a bearer bill, the bearer is the holder.
- (f) *The endorser*: when the holder endorses the bill to anyone else he becomes the endorser.
- (g) *The endorsee*: is the person to whom the bill is endorsed.
- (h) *Drawee in case of need*: Besides the above parties.

another person called the "drawee in case of need", may be introduced at the option of the drawer. The name of such a person may be inserted either by the drawer or by any endorser in order that resort may be had to him in case of need, i.e., when the bill is dishonoured by either non-acceptance or non-payment.

(i) *Acceptor for honour*: Further, any person may voluntarily become a party to a bill as acceptor. A person, who on the refusal by the original drawee to accept the bill or to furnish better security, when demanded by the notary, accept the bill *supra protest* in order to safeguard the honour of the drawer or any endorser, is called the acceptor for honour.

Essentials of a Bill of Exchange:

- (1) It must be in writing.
- (2) It must contain an unconditional order to pay money only and not merely a request
- (3) It must be signed by the drawer.
- (4) The parties must be certain.
- (5) The sum payable must also be certain.
- (6) It must comply with other formalities e.g. stamps, date, etc.

Distinction between Bill of Exchange and Promissory Note

The following are the important points of distinction between a bill of exchange and a promissory note:

- (a) A promissory note is a two-party instrument, with a

maker (debtor) and a payee (creditor). In a bill, there are three parties-drawer, drawee and payee, though any two out of the three capacities may be filled by one and the same person. In a bill; the drawer is the maker who orders the drawee to pay the bill to a person called the payee or to his order. When the drawee accepts the bill he is called the acceptor,

(b) A note cannot be made payable to the maker himself, while in a bill, the drawer and payee may be the same person.

(c) A note contains an unconditional promise by the maker to pay to the payee

or his order; in a bill there is an unconditional order to the drawee to pay according to the directions of the drawer.

(d) A note is presented for payment without any prior acceptance by the maker. A bill payable after sight must be accepted by the drawee or someone else on his behalf before it can be presented for payment.

(e) The liability of the maker of a pro-note is primary and absolute, but the liability of the drawer of a bill is secondary and conditional.

(f) Foreign bill must be protested for dishonour but no such protest is necessary in the case of a note.

(g) When a bill is dishonoured, due notice of dishonour is to be given by the holder to the drawer and the intermediate endorsee, but no such notice need to be given in the case of a note.

(h) A bill can be drawn payable to bearer provided it is not

payable on demand. A promissory note cannot be made payable to bearer, even if it is made payable otherwise than on demand.

How Bill of Exchange Originates - Forms of Bills of Exchange

Bills of exchange were originally used for payment of debts by traders residing in one country to another country with a view to avoid transmission of coin. Now-a-days they are used more as trade bills both in connection with domestic trade and foreign trade and are called inland bills and foreign bills respectively.

Inland Bills (Sections 11 and 12)

A bill of exchange is an inland instrument if it is (i) drawn or made and payable in India, or (ii) drawn in India upon any person who is a resident in India, even though it is made payable in a foreign country. But a promissory note to be an inland should be drawn and payable in India, as it has no drawee.

Two essential conditions to make an inland instrument are:

- (1) the instrument must have been drawn or made in India; and
- (2) the instrument must be payable in India or the drawee must be in India.

Examples: A bill drawn in India, payable in USA, upon a person in India is an

inland instrument. A bill drawn in India and payable in India but drawn on a person in USA is also an inland instrument or made in India

Foreign Bills

All bills which are not inland are deemed to be foreign bills. Normally foreign bills are drawn in sets of three copies.

Trade Bill

A bill drawn and accepted for a genuine trade transaction is termed as a trade bill. When a trader sells goods on credit, he may make use of a bill of exchange. Suppose A sells goods worth Rs. 1,000 to B and allows him 90 days time to pay the price, A will draw a bill of exchange on B, in the following terms: "Ninety days after date pay A or order, the sum of one thousand rupees only for value received". A will sign the bill and then present it to B for acceptance. This is necessary because, until a bill is accepted by the drawee, nobody has either rights or obligations. If B agrees to obey the order of A, he will accept the bill by writing across its face the word "accepted" and signing his name underneath and then delivering the bill to the holder. B, the drawee, now becomes the acceptor of the bill and liable to its holders. Such a bill is a genuine trade bill.

Accommodation Bill

All bills are not genuine trade bills, as they are often drawn for accommodating a party. An accommodation bill is a bill in which a person lends or gives his name to oblige a friend or some person whom he knows or otherwise. In other

words, a bill which is drawn, accepted or endorsed without consideration is called an accommodation bill. The party lending his name to oblige the other party is known as the accommodating or accommodation party, and the party so obliged is called the party accommodated. An accommodation party is not liable on the instrument to the party accommodated because as between them there was no consideration and the instrument was merely to help, But the accommodation party is liable to a holder for value, who takes the accommodation bill for value, though such holder may not be a holder in due course. Thus, A may be in need of money and approach his friends B and C who, instead of lending the money directly, propose to draw an "Accommodation Bill" in his favour in the following form:

"Three months after date pay A or order, the sum of Rupees one thousand only'

B

To

C

If the credit of Band C is .good, this device enables A to get an advance of Rs. 1,000 from his banker at the commercial rate of discount. The real debtor in this case is not C, but A the payee who promises to reimburse C before the period of three months only. A is here the principal debtor and Band C are mere sureties. This inversion of liability affords a good definition of an accommodation bill "If as between the original parties to - the bill the one who should *prima facie* be principal

is in. fact the surety whether he be drawer, acceptor, or endorser, that bill is an accommodation bill".

Bank Draft

A bill of exchange is also sometimes spoken of as a draft. It is called as a bank draft when a bill of exchange drawn by one bank on another bank, or by itself on its own branch, and is a negotiable instrument. It is very much like the cheque with three points of distinction between the two. A bank draft can be drawn only by a bank on another bank, usually its own branch. It cannot so easily be counter-manded. It cannot be made payable to bearer.

Specimen of a Bank Draft

A.B.C. Bank

X.Y.Z. Branch

No.....

Date.....

On demand pay 'A' or order the sum of rupees one thousand five hundred only for value received.

Rs. 1,5007-

Sd./

Manager

To

'B' Branch, (Place)

In the above demand draft the drawer is X.Y.Z. Branch, the drawee is 'B' branch and the payee is 'A'.

Cheques

Section 6 of the Act provides that a cheque is a bill of exchange drawn on a specified banker, and not expressed to be *payable otherwise than on demand*. Simply stated, a cheque is a bill of exchange drawn on a bank payable always on demand. Thus, a cheque is a bill of exchange with two additional qualifications, namely: (i) it is always drawn on a banker, and (ii) it is always payable on demand. A cheque being a species of a bill of exchange, must satisfy all the requirements of a bill; it does not, *however, require acceptance*.

Note: By virtue of Section 31 of the Reserve Bank of India Act, no bill of exchange or hundi can be made *payable to bearer on demand* and no promissory note or a *bank draft can be made payable to bearer at all, whether on demand or after a specified time. Only a cheque can be payable to bearer on demand*.

Parties to a cheque

The following are the parties to a cheque:

- (a) *The drawer*: The person who draws the cheque.
- (b) *The drawee*: The banker of the drawer on whom the cheque is drawn.
- (c) (d), (e) and (f) The payee, holder, endorser and endorsee: same as in the case of a bill.

Essentials of a Cheque

- (1) It is always drawn on a banker.
- (2) It is always payable on demand.

- (3) It does not require acceptance. There is, however, a custom among banks to mark cheques as good for purposes of clearance.
- (4) A cheque can be drawn on bank where the drawer has an account.
- (5) Cheques may be payable to the drawer himself. It may be made payable to bearer on demand unlike a bill or a note.
- (6) The banker is liable only to the drawer. A holder -has no remedy against the banker if a cheque is dishonoured.
- (7) A cheque is usually valid for fix months. However, it is not invalid if it is post dated or ante- dated.
- (8) No Stamp is required to be affixed on cheques.

Distinction between Cheques and Bills of Exchange

As a general rule, the provisions applicable to bills payable on demand apply to cheques, yet there are few points of distinction between the two, namely:

- (a) A cheque is a bill of exchange and always drawn on a banker, while a bill may be drawn on anyone, including banker.
- (b) A cheque can only be drawn payable on demand, a bill may be drawn payable on demand, or on the expiry of a specified' period after sight or date.
- (c) A bill payable after sight must be accepted before payment can be demanded, a cheque does not require acceptance and is intended for immediate payment.

- (d) A grace of 3 days is allowed in the case of time bills, while no grace is given. in the case of a cheque, for payment.
- (e) The drawer of a bill is discharged, if it is not presented for payment, but the drawer of a cheque is discharged only if he suffers any damage by delay in presentment for payment.
- (f) Notice of the dishonour of a bill is necessary, but not in the case of a cheque.
- (g) The cheque being a revocable mandate, the authority may be revoked by countermanding payment, and is determined by notice of the customer's death or insolvency. This is not so in the case of bill
- (h) *A cheque may be crossed, but not a bill*

A cheque is a bill of exchange drawn on a specified banker and always payable on demand. A cheque is always drawn on a particular banker and is always payable on demand. Consequently, all cheques are bills of exchange but all bills are not cheques.

Specimen of a Cheque

ABC Bank	
Date _____	
Pay 'A';-----or the bearer	
sum of rupees-----only.	
A/c No-----LF-----	RS-----/-
Sd/-	
No-----	

Comparison Chart

Basis for Comparison	Cheque	Demand Draft
Meaning	Cheque is a negotiable instrument which contains an order to the bank, signed by the drawer, to pay a certain sum of money to a specified person.	Demand Draft is a negotiable instrument used for the transfer of money from one place to another.
Payment	Payable either to order or to bearer.	Always payable to order of a certain person.
Issuance	Cheque is issued by an individual.	Demand Draft is issued by a bank.
Bank Charges	No	Yes
Drawer	Customer of the bank.	Bank itself.
Parties Involved	Three Parties- Drawer, Drawee, Payee.	Two Parties- Drawer, Payee.
Dishonour	Yes, due to insufficient balance or other similar reasons.	No

Banker

A banker is one who does banking business. Section 5(b) of the Banking Regulation Act, 1949 defines banking as, "accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft or otherwise." This definition emphasises two points: (1) that the primary function of a banker consists of accepting of deposits for the purpose of lending or investing the same; (2) that the amount deposited is repayable to the depositor on demand or according to the agreement. The demand for repayment can be made through a cheque, draft or otherwise, and not merely by verbal order.

Customer

The term "customer" is neither defined in Indian nor in English statutes. The general opinion is that a customer is one who has an account with the bank or who utilises the services of the bank.

The special features of the legal relationship between the banker and the customer may be termed as the obligations and rights of the banker. These are:

1. Obligation to honour cheques of the customers.
2. Obligation to collect cheques and drafts on behalf of the customers.
3. Obligation to keep proper record of transactions with the customer.
4. Obligation to comply with the express standing instructions of the customer.
5. Obligation not to disclose the state of customer's account to anyone else.
6. Obligation to give reasonable notice to the customer, if the banker wishes to close the account.
7. Right of lien over any goods and securities bailed to him for a general balance *of account*.
8. Right of set off and right of appropriation.
9. Right to claim incidental charges and interest as per rules and regulations of the bank as communicated to the customer at the time of opening the account.

Liability of a Banker

By opening a current account of a customer, the banker becomes liable to his debtor to the extent of the amount so received in the said account and undertakes to honour the cheques drawn by the customer so long as he holds sufficient funds to the customer's credit. If a banker, without justification, fails to honour this customer's cheques, he is liable to compensate the drawer for any loss or damage suffered by him. But the payee or holder of the cheque has no cause of action against the banker as the obligation to honour a cheque is only towards the drawer.

The banker must also maintain proper and accurate accounts of credits and debits. He must honour a cheque presented in due course. But in the following circumstances, he *must* refuse to honour a cheque and in some others he may do so.

8. *When Banker must Refuse Payment*

In the following cases the authority of the banker to honour customer's cheque comes to an end, he *must* refuse to honour cheques issued by the customer:

- (a) When a customer countermands payment Le., where or when a customer, after issuing a cheque issues instructions not to honour it, the banker must not pay it.
- (b) *When the banker receives notice of customer's death.*
- (c) When customer has been adjudged an insolvent.
- (d) When the banker receives notice of customer's insanity.

- (e) *When an order (e.g., Garnishee Order) of the Court, prohibits payment.*
- (f) *When the customer has given notice of assignment of the credit balance of his account.*
- (g) When the holder's title is defective and the banker comes to know of it.
- (h) *When the customer has given notice for closing his account.*

When Banker may Refuse Payment

In the following cases the banker may refuse to pay a customer's cheque:

- (a) When the cheque is post-dated.
- (b) When the banker has not sufficient funds of the drawer with him and there is no communication between the bank and the customer to honour the cheque.
- (c) When the cheque is of doubtful legality.
- (d) When the cheque is not duly presented, e.g., it is presented after banking hours.
- (e) When the cheque on the face of it is irregular, ambiguous or otherwise materially *altered*.
- (f) When the cheque is presented at a branch where the customer has no account.
- (g) When some persons have joint account and the cheque is not signed jointly by all or by the survivors of them.
- (h) When the cheque has been allowed to become stale, i.e.,

it has not been *presented within six months of the date mentioned on it.*

Protection of Paying Banker (Sections 10, 85 and 128)

Section 85 lays down that where a cheque payable to order purports to be endorsed by or on behalf - of the payee the banker is discharged by payment in due course. He can debit the account of the customer with the amount even though the endorsement turns out subsequently to have been forged, or the agent of the payee without authority endorsed it on behalf of the payee. It would be seen that the payee includes endorsee. This protection is granted because a banker cannot be expected to know the signatures of all the persons in the world. He is only bound to know the signatures of his own customers.

Therefore, the forgery of drawer's signature will not ordinarily protect the banker but even in this case, the banker may debit the account of the customer, if it can show that the forgery was intimately connected with the negligence of the customer and was the proximate cause of loss.

In the case of bearer cheques, the rule is that once a bearer cheque, always a bearer cheque. Where, therefore, a cheque originally expressed by the drawer himself to be payable to bearer, the banker may ignore any endorsement on the cheque. He will be discharged by payment in due course. But a cheque which becomes bearer by a subsequent endorsement in blank is not covered by this Section. A banker is discharged from liability on a crossed cheque if he makes payment in due course.

Payment in due Course (Section 10)

Any person liable to make payment under a negotiable instrument, must make the payment of the amount due thereunder in due course in order to obtain a valid discharge against the holder.

A payment in due course means a payment in accordance with the apparent tenor of the instrument, in good faith and without negligence to any person in possession thereof. .

A payment will be a payment in due course if:

(a) it is in accordance with the apparent tenor of the instrument, i.e. according to what appears on the face of the instrument to be the intention of the parties;

(b) it is made in good faith and without negligence, and under circumstances

which do not afford a ground for believing that the person to whom it is made is not entitled to receive the amount;

(c) it is made to the person in possession of the instrument who is entitled as holder to receive payment;

(d) payment is made under circumstances which do not afford a reasonable ground believing that he is not entitled to receive payment of the amount mentioned in the instrument; and

(e) payment is made in money and money only.

Under Sections 10 and 128, a paying banker making payment in due course is protected.

Collecting Banker

Collecting Banker is one who collects the proceeds of a cheque for a customer. Although a banker collects the proceeds of a cheque for a customer purely as a matter of service, yet the Negotiable Instruments Act, 1881 indirectly imposes statutory obligation, statutory in nature. This is evident from Section 126 of the Act which provides that a cheque bearing a "general crossing" shall not be paid to anyone other than banker and a cheque which is "specially crossed" shall not be paid to a person other than the banker to whom it is crossed. Thus, a paying banker must pay a generally crossed cheque only to a banker thereby meaning that it should be collected by another banker. While so collecting the cheques for a customer, it is quite possible that the banker collects for a customer, proceeds of a cheque to which the customer had no title in fact. In such cases, the true owner may sue the collecting banker for "conversion". At the same time, it cannot be expected of a banker to know or to ensure that all the signatures appearing in endorsements on the reverse of the cheque are genuine. The banker is expected to be conversant only with the signatures of his customer. A customer to whom a cheque has been endorsed, would request his banker to collect a cheque. In the event of the endorser's signature being proved to be forged at later date, the banker who collected the proceeds should not be held liable for the simple reason that he has merely collected the proceeds of a cheque. Section 131 of the Negotiable Instruments Act affords statutory protection in such a case where the customer's title to the cheque which the banker has

collected has been questioned. It reads as follows:

"A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specifically 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 of only having received such payment.

Explanation: A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer's account with the amount of-the cheque before receiving payment thereof."

The requisites of claiming protection under Section 131 are as follows:

- (i) The collecting banker should have acted in good faith and without negligence. An act is done in good faith when it is done honestly. The plea of good faith can be rebutted on the ground of recklessness indicative of want of proper care and attention. Therefore, much depends upon the facts of the case. The burden of proving that the cheque was collected in good faith and without negligence is upon the banker claiming protection. Failure to verify the regularity of endorsements, collecting a cheque payable to the account of the company to the credit of the director, etc. are examples of negligence.
- (ii) The banker should have collected a crossed cheque, i.e., the cheque should have been crossed before it came to him for collection.
- (iii) The proceeds should have been collected for a customer, i.e., a person who has an account with him.

(iv) That the collecting banker has only acted as an agent of the customer. If he had become the holder for value, the protection available under Section 131 is forfeited. Where for instance, the banker allows the customer to withdraw the amount of the cheque before the cheque is collected or where the cheque has been accepted in specific reduction of an overdraft, the banker is *deemed to have become the holder for value and the protection is lost*. But the explanation to Section 131 says that the mere crediting of the amount to the account does not imply that the banker has become a holder for value because due to accounting conveniences the banker may credit the account of the cheque to the customer's account even before proceeds thereof are realised.

Overdue, Stale or Out-of-date Cheques

A cheque is overdue or becomes statute-barred after three years from its due date of issue. A holder cannot sue on the cheque after that time. Apart from this provision, the holder of a cheque is required to present it for payment within a reasonable time, as a cheque is not meant for indefinite circulation. In India, a cheque, which has been in circulation for more than six months, is regarded by bankers as stale. If, as a result of any delay in presenting a cheque, the drawer suffers any loss, as by the failure of the bank, the drawer is discharged from liability to the holder to the extent of the damage.

Liability of Endorser

In order to charge an endorser, it is necessary to present the cheque for payment within a reasonable time of its delivery

by such endorser. 'A' endorses and delivers a cheque to B, and B keeps it for an unreasonable length of time, and then endorses and delivers it to C. C presents it for payment within a reasonable time after its receipt by him, and it is dishonoured. C can enforce payment against B but not against A, as *qua* A, the cheque has become stale.

Rights of Holder against Banker

A banker is liable to his customer for wrongful dishonour of his cheque but it is not liable to the payee or holder of the cheque. The holder has no right to enforce payment from the banker except in two cases, namely, (i) where the holder does not present the cheque within a reasonable time after issue, and as a result the drawer suffers damage by the failure of the banker in liquidation proceedings; and (ii) where banker pays a crossed cheque by mistake over the counter, he is liable to the owner for any loss occasioned by it.

Crossing of Cheques

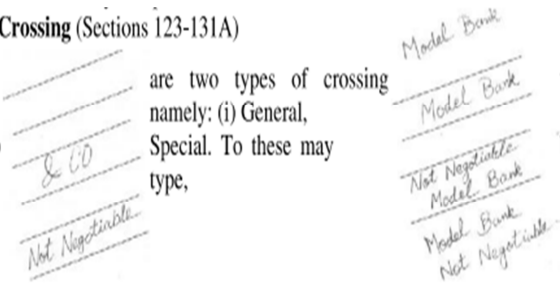
A cheque is either "open" or "crossed". An open cheque can be presented by the payee to the paying banker and is paid over the counter. A crossed cheque cannot be paid across the counter but must be collected through a banker.

A *crossing* is a direction to the paying banker to pay the money generally to a banker or to a particular banker, and not to pay otherwise. The object of crossing is to secure payment to a banker so that it could be traced to the person receiving the amount of the cheque. Crossing is a direction to the paying banker that the cheque should be paid only to a banker or a

specified banker. To restrain negotiability, addition of words "Not Negotiable" or "Account Payee Only" is necessary. A crossed bearer cheque can be negotiated by delivery and crossed order cheque by endorsement and delivery. Crossing affords security and protection to the holder of the cheque.

Modes of Crossing (Sections 123-131A)

There are two types of crossing which may be used on
cheque, namely: (i) General, be added
and (ii) Special. To these may
another type,



Specimen of a general crossing

Specimen of a special crossing

Le. Restrictive crossing.

It is general crossing where a cheque bears across its face an addition of two parallel transverse lines and/or the addition of the words "and Co." between them, or addition of "not negotiable". As stated earlier, where a cheque is crossed generally, the paying banker will pay to any banker. Two transverse parallel lines are essential for a general crossing (Sections 123-126).

In case of general crossing, the holder or payee cannot get the payment over the counter of the bank but through a bank only. The addition of the words "and Co." do not have any significance but the addition of the words "not negotiable" restrict the negotiability of the cheque and in case of transfer, the transferee will not give a better title than that of a transferor.

Where a cheque bears across its face an addition of the name of a banker, either with or without the words "not negotiable" that addition constitutes a *crossing* and the cheque is *crossed specially* and to that banker. The paying banker will pay only to the banker whose name appears across the cheque, or to his collecting agent. Parallel transverse lines are not essential but the name of the banker is the insignia of a special crossing.

In case of special crossing, the paying, banker is to honour the cheque only when it is prescribed through the bank mentioned in the crossing or it's agent bank.

Account Payee's Crossing: Such crossing does, in practice, restrict negotiability of a cheque. It warns the *collecting bunker* that the proceeds are to be credited only to the account of the payee, or the party named, or his agent. If the collecting banker allows the proceeds of a cheque bearing such crossing to be credited to any other account, he will be guilty of negligence and will not be entitled to the protection given to collecting banker under Section 131. Such crossing does not affect the paying banker, who is under no duty to ascertain that the cheque is in fact collected for the account of the person named as payee.

Not Negotiable Crossing

A cheque may be crossed not negotiable by writing across the face of the cheque the words "Not Negotiable" within two transverse parallel lines in the case of a general crossing or along with the name of a banker in the case of a

special crossing. Section 130 of the Negotiable Instruments Act provides "A person taking a cheque crossed generally or specially bearing in either case with the words "not negotiable" shall not have and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had". The crossing of cheque "not negotiable" does not mean that it is non-transferable. It only deprives the instrument of the incident of negotiability. Normally speaking, the essential feature of a negotiable instrument as opposed to chattels is that a person who takes the instrument in good faith, without negligence, for value, before maturity and without knowledge of the defect in the title of the transferor, gets a good title to the instrument. In other words, he is called a holder in due course who acquires an indisputable title to the cheque. (When the instrument passes through a holder-in-due course, it is purged of all defects and the subsequent holders also get good title). It is exactly this important feature which is taken away by crossing the cheque "not negotiable". In other words, a cheque crossed "not negotiable" is like any other chattel and therefore the transferee gets same title to the cheque which his transferor had. That is to say that the transferee cannot claim the rights of a holder-in-due-course. So long as the title of the transferors is good, the title of the transferees is also good but if there is a taint in the title to the cheque of one of the endorsers, then all the subsequent transferees' title also become tainted with the same defect-they cannot claim to be holders-in-due-course.

The object of this Section is to afford protection to the drawer or holder of a cheque who is desirous of transmitting it

to another person, as much protection as can reasonably be afforded to him against dishonestly or actual miscarriage in the course of transit. For example, a cheque payable to bearer is crossed generally and is marked "not negotiable". It is lost or stolen and comes into the possession of X who takes it in good faith and gives value for it, X collects the cheque through his bank and paying banker also pays. In this case, both the paying and the collecting bankers are protected under Sections 128 and 131 respectively. But X cannot claim that he is a holder-in-due course which he could have under the normal circumstances claimed. The reason is that cheque is crossed "not negotiable" and hence the true owner's (holder's) right supercedes the rights of the holder-in-due-course. Since X obtained the cheque from a person who had no title to the cheque (Le. from one whose title was defective) X can claim no better title solely because the cheque was crossed "not negotiable" and not for any other reason. Thus "not negotiable" crossing not only protects the rights of the true owner of the cheque but also serves as a warning to the endorsees' to enquire thoroughly before taking the cheque as they may have to be answerable to the true owner thereof if the endorser's title is found to be defective.

"Not negotiable" restricts the negotiability of the cheque and in case of transfer, the transferee will not get a better title than that of a transferor.

If the cheque becomes "not negotiable" it lacks negotiability. A cheque crossed specially or generally bearing the words "not negotiable" lacks negotiability and therefore is

not a negotiable instrument in the true sense. It does not restrict transferability but restricts negotiability only.

Maturity

Cheques are always payable on demand but other instruments like bills, notes, etc. may be made payable on a specified date or after the specified period of time. The date on which payment of an instrument falls due is called its maturity. According to Section 22 of the Act, "the maturity of a promissory note or a bill of exchange is the date at which it falls due". According to Section 21 a promissory note or bill of exchange payable "at sight" or "on presentment" is payable on demand. It is due for payment as soon as it is issued. The question of maturity, therefore, arises only in the case of a promissory note or a bill of exchange payable "after date" or "after sight" or at a certain period after the happening of an event which is certain to happen.

Maturity is the date on which the payment of an instrument falls due. Every instrument payable at a specified period after date or after sight is entitled to three days of grace. Such a bill or note matures or falls due on the last day of the grace period, and must be presented for payment on that day and if dishonoured, suit can be instituted on the next day after maturity. If an instrument is payable by instalments, each instalment is entitled to three days of grace. No days of grace are allowed for cheques, as they are payable on demand.

Where a note or bill is expressed to be payable on the expiry of specified number of months after sight, or after date,

the period of payment terminates on the day of the month which corresponds with the date of instrument, or with the date of acceptance if the bill be accepted or presented for sight, or noted or protested for non-acceptance. If the month in which the period would terminate has no corresponding day, the period shall be held to terminate on the last day of such month.

Illustration

- (i) A negotiable instrument dated 31 st January, 2001, is made payable at one months after date. The instrument is at maturity on the third day after the 28th February, 2001, Le. on 3rd March, 2001.
- (ii) A negotiable instrument dated 30th August, 2001, is made payable three months after date. The instrument is at maturity on 3rd December, 2001.
- (iii) A negotiable instrument. dated the 31 st August, 2001, is made payable three months after date. The instrument is at maturity on 3rd December, 2001.

If the day of maturity falls on a public holiday, the instrument is payable on the *preceeding* business day. Thus if a bill is at maturity on a Sunday. It will be deemed due on Saturday and *pot* on Monday.

The ascertainment of the date of maturity becomes important because all these instruments must be presented for payment on the last day of grace and their payment cannot be demanded before that date. Where an instrument is payable by instalments, it must be presented for payment on the third day after the day fixed for the payment of each instalment.

Holder

According to Section 8 of the Act a person is a holder of a negotiable instrument who is entitled in his own name (i) to the possession of the instrument, and (ii) to recover or receive its amount from the parties thereto. It is not every person in possession of the instrument who is called a holder. To be a holder, the person must be named in the instrument as the payee, or the endorsee, or he must be the bearer thereof. A person who has obtained possession of an instrument by theft, or under a forged endorsement, is not a holder. as he is not entitled to recover the instrument. The holder implies *de jure* (holder in law) holder and not *de facto* (holder in fact) holder. An agent holding an instrument for his principal is not a holder although he may receive its payment.

Holder in Due Course

Section 9 states that a holder in due course is (i) a person who for consideration, obtains possession of a negotiable instrument if payable to bearer, or (ii) the payee or endorsee thereof, if payable to order, before its maturity and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

In order to be a holder in due course, a person must satisfy the following conditions:

- (i) He must be the holder of the instrument.
- (ii) He should have obtained the instrument for value or consideration.
- (iii) He must have obtained the negotiable instrument before

maturity.

(iv) The instrument should be complete and regular on the face of it.

(v) The holder should take the instrument in good faith.

A holder in due course is in a privileged position. He is not only himself protected against all defects of the persons from whom he received the instrument as current coin, but also serves as a channel to protect all subsequent holders. A holder in due course can recover the amount of the instrument from all previous parties, although, as a matter of fact, no consideration was paid by some of the previous parties to the instrument or there was a defect of title in the party from whom he took it. *Once an instrument passes through the hands of a holder in due course, it is purged of all defects.* It is like current coin. Whoever takes it can recover the amount from all parties previous to such holder.

Capacity of Parties

Capacity to incur liability as a party to a negotiable instrument is co-extensive with capacity to contract. According to Section 26, every person capable of contracting according to law to which he is subject, may bind himself and be bound by making, drawing, acceptance, endorsement, delivery and negotiation of a promissory note, bill of exchange or cheque.

Negatively, minors, lunatics, idiots, drunken person and persons otherwise disqualified by their personal law, do not incur any liability as parties to negotiable instruments. But incapacity. of one or more of the parties to a negotiable

instrument in no way, diminishes the abilities and the liabilities of the competent parties. Where a minor is the endorser or payee of an instrument which has been endorsed all the parties accepting the minor are liable in the event of its dishonour.

Liability of Parties

The provisions regarding the liability of parties to negotiable instruments are laid down in Sections 30 to 32 and 35 to 42 of the Negotiable Instruments Act. These provisions are as follows:

1. *Liability of Drawer (Section 30)*

The drawer of a bill of exchange or cheque is bound, in case of dishonour by the drawee or acceptor thereof, to compensate the holder, provided due notice of dishonour has been given to or received by the drawer. The nature of drawer's liability is that by drawing a bill, he undertakes that (i) on due presentation, it shall be accepted and paid according to its tenor, and (ii) in case of dishonour, he will compensate the holder or any endorser, provided notice of dishonour has been duly given. However, in case of accommodation bill no notice of dishonour to the drawer is required.

The liability of a drawer of a bill of exchange is secondary and arises only on default of the drawee, who is primarily liable to make payment of the negotiable instrument.

2. *Liability of the Drawee of Cheque (Section 31)*

The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required to do so and,

or in default of such payment, he shall compensate the drawer for any loss or damage caused by such default.

As a cheque is a bill of exchange, drawn on a specified banker, the drawee of a cheque must always be a banker. The banker, therefore, is bound to pay the cheque of the drawer, i.e., customer, if the following conditions are satisfied:

- (i) The banker has sufficient funds to the credit of customer's account.
- (ii) The funds are properly applicable to the payment of such cheque, e.g., the funds are not under any kind of lien etc.
- (iii) The cheque is duly required to be paid, during banking hours and on or after the date on which it is made payable.

If the banker is unjustified in refusing to honour the cheque of its customer, it shall be liable for damages.

3. Liability of "Maker" of Note and "Acceptor" of Bill (Section 32)

In the absence of a contract to the contrary, the maker of a promissory note and the acceptor before maturity of a bill of exchange are bound to pay the amount thereof at maturity, according to the apparent tenor of the note or acceptance respectively. The acceptor of a bill of exchange at or after maturity is bound to pay the amount thereof to the holder on demand:

It follows that the liability of the acceptor of a bill corresponds to that of the maker of a note and is absolute and unconditional but the liability under this Section is subject to

the contract to the contrary (e.g., as in the case of accommodation bills) and may be excluded or modified by a collateral agreement. Further, the payment must be made to the party named in the instrument and not to any-one else, and it must be made at maturity and not before.

4. *Liability of endorser (Section 35)*

Every endorser incurs liability to the parties that are subsequent to him. Whoever endorses and delivers a negotiable instrument before maturity is bound thereby to every subsequent holder in case of dishonour of the instrument by the drawee, acceptor or maker, to compensate such holder of any loss or damage caused to him by such dishonour provided (i) there is no contract to the contrary; (ii) he (endorser) has not expressly excluded, limited or made conditional his own liability; and (iii) due notice of dishonour has been given to, or received by, such endorser. Every endorser after dishonour, is liable upon the instrument as if it is payable on demand.

He is bound by his endorsement notwithstanding any previous alteration of the instrument. (Section 88)

5. *Liability of Prior Parties (Section 36)*

Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied. Prior parties may include the maker or drawer, the acceptor and all the intervening endorsers to a negotiable instrument. The liability of the prior parties to a holder in due course is joint and several. The holder in due course may hold

any or all prior parties liable for the amount of the dishonoured instrument.

6. *Liability interse*

Various parties to a negotiable instrument who are liable thereon stand on a different footing with respect to the nature of liability of each one of them.

7. *Liability of Acceptor of Forged Endorsement (Section 41)*

An acceptor of a bill of exchange already endorsed is not relieved from liability by reason that such endorsement is forged. if he knew or had reason to believe the endorsement to be forged when he accepted the bill.

8. *Acceptor's Liability on a Bill drawn in a Fictitious Name*

An acceptor of a bill of exchange drawn in a fictitious name and payable to the drawer's order is not, by reason that such name is fictitious, relieved from liability to any holder In due course claiming under an endorsement by the same hand as the drawer's signature, and purporting to be made by the drawer.

Negotiation (Section 14)

A negotiable instrument may be transferred by negotiation or assignment. *Negotiation* is the transfer of an instrument (a note, bill or cheque) for one person to another in such a manner as to convey title and to constitute the transferee the holder thereof. When a negotiable instrument is transferred

by negotiation, the rights of the transferee may rise higher than those of the transferor, depending upon the circumstances attending the negotiation. When the transfer is made by assignment, the assignee has only those rights which the assignor possessed. In case of assignment, there is a transfer of ownership by means of a written and registered document.

Negotiability and Assignability Distinguished

A transfer by negotiation differs from transfer by assignment in the following respects:

- (a) Negotiation requires mere delivery of a bearer instrument and endorsement and delivery of an order instrument to effectuate a transfer. Assignment requires a written document signed by the transferor.
- (b) Notice of transfer of debt (actionable claim) must be given by the assignee to the debtor in order to complete his title; no such notice is necessary in a transfer by negotiation.
- (c) On assignment, the transferee of an actionable claim takes it subject to all the defects in the title of, and subject to all the equities and defences available against the assignor, even though he took the assignment for value and in good faith. In case of negotiation the transferee, as holder- in-due course, "takes the instrument free from any defects in the title of the transferor.

Importance of Delivery

Negotiation is effected by mere delivery of a bearer instrument and by endorsement and delivery of an order instrument. This shows that "delivery" is essential in

negotiable instruments. Section 46 expressly provides that making acceptance or endorsement of negotiable instrument is not complete until delivery, a dual or constructive, of the instrument. Delivery made voluntarily with the intention of passing property in the instrument to the person to whom it is given is essential.

Negotiation by Mere Delivery

A bill or cheque payable to bearer is negotiated by mere delivery of the instrument.

An instrument is payable to bearer:

- (i) Where it is made so payable, or
- (ii) Where it is originally made payable to order but the only or the last endorsement is in blank.
- (iii) Where the payee is a fictitious or a non-existing person
- (iv) These Instruments do not require signature of the transferor. The person who takes them is a holder, and can sue in his own name on them. Where a bearer negotiates an instrument by mere delivery, and does not put his signature thereon,-he is not liable to any party to the instrument in case the instrument is dishonoured, as he has not lent his credit to it. His obligations are only towards his immediate transferee and to no other holders.

A cheque, originally drawn payable to bearer remains bearer, even though it is subsequently endorsed in full. The rule is *once a bearer cheque alWays a bearer cheque*.

Negotiation by Endorsement and Delivery

An instrument payable to a specified person or to the order of a specified person or to a specified person or order is an instrument payable to order. Such an instrument can be negotiated only by endorsement and delivery. Unless the holder signs his endorsement on the instrument, the transferee does not become a holder. Where an instrument payable to order is delivered without endorsement, it is merely assigned and not negotiated and the holder thereof is not entitled to the rights of a holder in due course, and he cannot negotiate it to a third person.

Endorsement (Sections 15 and 16)

Where the maker or holder of a negotiable instrument signs the same otherwise than as such maker for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto (called Allonge), or so, signs for the same purpose, a stamped paper intended to be completed as a negotiable instrument, he is said to endorse the same (Section 15), the person to whom the instrument is endorsed is called the endorsee.

In other words, 'endorsement' means and involves the writing of something on the back of an instrument for the purpose of transferring the right, title and interest therein to some other person.

Classes of endorsement

An endorsement may be (a) Blank or General, (b) Special or Full, (c) Restrictive, or (d) Partial, and (e) Conditional or Qualified.

(a) *Blank or General:* An endorsement is to be blank or general where the endorser merely writes his signature on the back of the instrument, and the instrument so endorsed becomes payable to bearer, even though originally it was payable to order. Thus, where bill is payable to "Mohan or order", and he writes on its back "Mohan", it is an endorsement in blank by Mohan and the property in the bill can pass by mere delivery, as long as the endorsement continues to be a/blank. But a holder of an instrument endorsed in blank may convert the endorsement in blank into an endorsement in full, by writing above the endorser's signature, a direction to pay the instrument to another person or his order.

(b) *Special or Full:* If the endorser signs his name and adds a direction to pay the amount mentioned in the instrument to, or to the order of a specified person, the endorsement is said to be special or in full. A bill made payable to Mohan or Mohan or order, and endorsed "pay to the order of Sohan" would be specially endorsed and Sohan endorses it further. A blank endorsement can be turned into a special one by the addition of an order making the bill payable to the transferee.

(c) *Restrictive:* An endorsement is restrictive which prohibits or restricts the further negotiation of an instrument. Examples of restrictive endorsement: "Pay A only" or "Pay A for my use" or "Pay A on account of B" or "Pay A or order for collection".

(d) *Partial:* An endorsement partial is one which purports to transfer to the endorsee a part only of the amount payable on the instrument. A partial endorsement does not operate as

negotiation of the instrument. A holds a bill for Rs. 1,000 and endorses it as "Pay B or order Rs. 500". The endorsement is partial and invalid.

(e) *Conditional or qualified:* An endorsement is conditional or qualified which limits or negatives the liability of the endorser. An endorser may limit his liability in any of the following ways:

(i) *By sans recourse endorsement,* Le. by making it clear that he does not incur the liability of an endorser to the endorsee or subsequent holders and they should not look to him in case of dishonour of instrument. The endorser excludes his liability by adding the words "sans recourse" or "without recourse", e.g., "pay A or order same recourse".

(ii) By making his liability depending upon happening of a specified event which may never happen, e.g., the holder of a bill may endorse it thus: "Pay A-or order on his marrying B". In such a case, the endorser will not be liable until A marries B.

It is pertinent to refer to Section 52 of the Negotiable Instruments Act, 1881 here. It reads "The endorser of a negotiable instrument may, by express words in the endorsement exclude his own liability thereon, or make such liability or the right of the endorsee to receive the amount due thereon depend upon the happening of a specified event, although such event may never happen.

Negotiation Back

Where an endorser negotiates an instrument and again

becomes its holder, the instrument is said to be negotiated back to that endorser and none of the intermediary endorsees are then liable to him. The rule prevents a circuitry of action. For example, A, the holder of a bill endorses it to a, B endorses to C, and C to D, and endorses it again to A. A, being a holder in due course of the bill by second endorsement by, D, can recover the amount thereof from B, C, or D and himself being a prior party is liable to all of them. Therefore, A having been relegated by the second endorsement to his original position, cannot sue B, C and D.

Where on endorser so excludes his liability and afterwards becomes the holder of the instrument, all the intermediate endorsers are liable to him. the italicised portion of the above Section is important. An illustration will make the point clear. A is the payee of a negotiable instrument. He endorses the instrument 'sans recourse' to B, B endorses to C, C to D, and D again endorses it to A. In this case, A is not only reinstated in his former rights but has the right of an endorsee against B, C and D.

Negotiation of Lost Instrument or that Obtained by Unlawful Means

When a negotiable instrument has been lost or has been obtained from any maker, acceptor or holder thereof by means of an offence or fraud, or for an unlawful consideration, no possessor or endorsee, who claims through the person who found or obtained the instrument is entitled to receive the amount due thereon from such maker, acceptor, or holder from any party prior to such holder *unless* such possessor or

endorsee is, or some person through whom he claims was, a holder in due course.

Forged Endorsement

The case of a forged endorsement is worth special notice. if an instrument is endorsed in full, it cannot be negotiated except by an endorsement signed by the person to whom or to whose order the instrument is payable, for the endorsee obtains title only through his endorsement. Thus, if an instrument be negotiated by means of a forged endorsement, the endorsee acquires no title even though he be a purchaser for value and in good faith, for the endorsement is a nullity. Forgery conveys no title. *But where the instrument is a bearer instrument or has been endorsed in blank, it can be negotiated by mere delivery, and the holder derives his title independent of the forged endorsement and can claim the amount from any of the parties to to the instrument.* For example, a bill is endorsed, "Pay A or order". A endorses it in blank, and it comes into the hands of B, who simply delivers it to C, C forges B's endorsement and transfer it to D. Here, D, as the holder does not derive his title through the forged endorsement of B, but through the genuine endorsement of A and can claim payment from any of the parties to the instrument in spite of the intervening forged endorsement.

Acceptance of a Bill of Exchange

The drawee of a bill of exchange, as such, has no liability on any bill addressed to him for acceptance or payment. A refusal to accept or to pay such bill gives the holder no rights

against him. The drawee becomes liable only after he accepts the bill. The acceptor has to write the word 'accepted' on the bill and sign his name below it.. Thus, it is the acceptor who is primarily liable on a bill.

The acceptance of a bill is the indication by the drawee of his assent to the order of the drawer. Thus, when the drawee writes across the face of the bill the word "accepted" and signs his name underneath he becomes the acceptor of the bill.

An acceptance may be either general or qualified. A general acceptance is absolute and as a rule, an acceptance has to be general. . Where an acceptance is made subject to some condition or qualification, thereby varying the effect of the bill, it is a qualified acceptance. The holder of the bill may either refuse to take a qualified acceptance or non-acquiescence in it. Where he refuses to take it, he can treat the bill as dishonoured by non-acceptance, and sue the drawer accordingly.

Acceptance for Honour

When a bill has been noted or protested for non-acceptance or for better security, any person not being a party already liable thereon may, with the consent of the holder, by writing on the bill, accept the same for the honour of any party thereto. The stranger so accepting, will declare under his hand that he accepts the protested bill for the honour of the drawer or any particular endorser whom he names.

The acceptor for honour is liable to pay only when the bill has been duly presented at maturity to the drawee for payment and the drawee has refused to pay and the bill has

been noted and protested for non- payment. Where a bill has been protested for non-payment after having been duly accepted, any person may intervene and pay it *supra protest* for the honour of any party liable on the bill. When a bill is paid *supra' protest*, it ceases to be negotiable. The stranger, on paying for honour, acquires all the right of holder for whom he pays.

Presentment for Acceptance

It is only bills of exchange that require presentment for acceptance and even these of certain kinds only. Bills payable on demand or on a fixed date need not be presented. Thus, a bill payable 60 days after due date on the happening of a certain event may or may not be presented for acceptance. But the following bills must be presented for acceptance otherwise, the parties to the bill will not be liable on it:

- (a) A bill payable *after sight*. Presentment is necessary in order to fix maturity of the bills; and
- (b) A bill in which there is an express stipulation that it shall be presented for acceptance before it is presented for payment.

Section 15 provides that the presentment for acceptance must be made to the drawee or his duly authorised agent. If the drawee is dead, the bill should be presented to his legal representative, or if he has been declared an insolvent, to the official receiver or assigner.

The following are the persons to whom a bill of exchange should be presented:

- (i) The drawee or his duly authorised agent.

- (ii) If there are many drawees, bill must be presented to all of them.
- (iii) The legal representatives of the drawee if drawee is dead.
- (iv) The official receiver or assignee of insolvent drawee.
- (v) To a drawee in case of need, if there is any. This is necessary when the original drawee refuses to accept the bill.
- (vi) The acceptor for honour. In case the bill is not accepted and is noted or protested for non- acceptance, the bill may be accepted by the acceptor for honour. He IS a person who comes forward to accept the bill when it is dishonoured by non-acceptance.

The presentment must be made before maturity, within a reasonable time after it is drawn, or within the stipulated period, if any, on a business day within business hours and at the place of business or residence of the drawee. The presentment must be made by exhibiting the bill to the drawee; mere notice of its existence in the possession of holder will not be sufficient.

When presentment is compulsory and the holder fails to present for acceptance, the drawer and all the endorser are discharged from liability to him.

Presentment for Acceptance when Excused

Compulsory presentment for acceptance is excused and the bill may be treated as dishonoured in the following cases:

- (a) Where the drawee cannot be found after reasonable search.

- (b) Where drawee is a fictitious person or one incapable of contracting.
- (c) Where although the presentment is irregular, acceptance has been refused on some other ground.

Presentment for Payment

All notes bills and cheques must be presented for payment to the maker, acceptor or drawee thereof respectively by or on behalf of the holder during the usual hours of business, and if at banker's within banking hours.

Presentment for Payment when Excused

No presentment is necessary and the instrument may be treated as dishonoured in the following cases:

- (a) Where the maker, drawer or acceptor actively does something so as to intentionally obstruct the presentment of the instrument, e.g., deprives the holder of the instrument and keeps it after maturity.
- (b) Where his business place is closed on the due date.
- (c) Where no person is present to make payment at the place specified for payment.
- (d) Where he cannot, after due search be found. (Section 61)
- (e) Where there is a promise to pay notwithstanding non-presentment.
- (f) Where the presentment is express or impliedly waived by the party entitled to presentment.
- (g) Where the drawer could not possibly have suffered any

damage by non-presentment.

(h) Where the drawer is a fictitious person, or one incompetent to contract.

(i) Where the drawer and the drawee are the same person. m
Where the bill is dishonoured by non-acceptance.

(k) Where presentment has become impossible, e.g., the declaration of war between the countries of the holder and drawee.

(I) Where though the presentment is irregular, acceptance has been refused on some other grounds.

Dishonour by Non-Acceptance

Section 91 provides that a bill is said to be dishonoured by non-acceptance:

(a) When the drawee does not accept it within 48 hours from the time of presentment for acceptance.

(b) When presentment for acceptance is excused and the bill remains unaccepted.

(c) When the drawee is incompetent to contract.

(d) When the drawee is a fictitious person or after reasonable search can not be found.

(e) Where the acceptance is a qualified one.

Dishonour by Non-payment (Section 92)

A promissory note, bill of exchange or cheque is said to be dishonoured by non-payment when the maker of the note, acceptor of the bill or drawee of the cheque makes default in

payment upon being duly required to pay the same. Also, a negotiable instrument is dishonoured by non- payment when presentment for payment is excused and the instrument when overdue remains unpaid.

If the bill is dishonoured either by non-acceptance or by non- payment, the drawer and all the endorsers of the bill are liable to the holder, provided he gives notice of such dishonour. The drawee is liable only when there is dishonour by non-payment.

Notice of Dishonour (Sections 91-98 and Sections 105-107)

When a negotiable instrument is dishonoured either by non-acceptance or by non-payment, the holder or some party liable thereon must give notice of dishonour to all other parties whom he seeks to make liable. Each party receiving notice of dishonour must in order to render any prior party liable to himself, give notice of dishonour to such party within a reasonable time after he has received it. The object of giving notice is not to demand payment but to whom the party notified of his liability and in case of drawer to enable him to protect himself as against the drawee or acceptor who has dishonoured the instrument issued by him. Notice of dishonour is so necessary that an omission to give 'it discharges all parties other than the maker or acceptor. These parties are discharged not only on the bill or note, but also in respect of the original consideration.

Notice may be oral or in writing, but it must be actual formal notice. It must be given within a responsible' time of dishonour.

Notice of Dishonour Unnecessary

No notice of dishonour is necessary:

- (a) When it is dispensed with or waived by the party entitled thereto, e.g. where an endorser writes on the instrument such words as "notice of dishonor waived" ,
- (b) When the drawer has countermanded payment.
- (c) When the party charged would not suffer damage for want of notice. (d) When the party entitled to notice cannot after due search be found.
- (e) When the omission to give notice is caused by unavoidable circumstances, e.g., death or dangerous illness of the holder.
- (f) Where the acceptor is also a drawer, e.g., where a firm draws on its branch.
- (g) Where the promissory note is not negotiable. Such a note cannot be endorsed.
- (h) Where the party entitled to notice promises to pay unconditionally.

Noting and Protest (Sections 99-104 A) *Noting*

Where a note or bill is dishonoured, the holder is entitled after giving due notice of dishonour, to sue the drawer and the endorsers. Section 99 provides a convenient method of authenticating the fact of dishonour by means of "Noting". Where a bill or note is dishonoured, the holder may, if he so desires, cause such dishonour to be noted by a notary public on the instrument, or on a paper attached thereto or partly on each.

The noting or minute must be recorded by the notary public within a reasonable time after dishonour and must contain the fact of dishonour, the date of dishonour, the reason, if any, assigned for such dishonour if the instrument has not been expressly dishonoured the reasons why the holder treats it dishonoured and notary's charges.

Protest

The protest is the formal notarial certificate attesting the dishonour of the bill, and based upon the noting which has been effected on the dishonour of the bill. After the noting has been made, the formal protest is drawn up by the notary and when it is drawn up it relates back to the date of noting.

Where the acceptor of a bill has become insolvent, or has suspended payment, or his credit has been publicly impeached, before the maturity of the bill, the holder may have the bill protested for better security. The notary public demands better security and on its refusal makes a protest known as "protest for better security".

Foreign bills must be protested for dishonour when such protest is required by the law of the place where they are drawn. Foreign promissory notes need not be so protested. Where a bill is required by law to be protested, then instead of a notice of dishonour, notice of protest must be given by the notary public.

A protest to be valid must contain on the instrument itself or a literal transcript thereof, the names of the parties for and against whom protest is made, the fact and reasons for

dishonour together with the place and time of dishonour and the signature of the notary public. Protest affords an authentic evidence of dishonour to the drawer and the endorsee.

Discharge

The discharge in relation to negotiable instrument may be either (i) Discharge of the instrument or (ii) Discharge of one or more parties to the instrument from liability.

Discharge of the Instrument

A negotiable instrument is discharged:

- (a) by payment in due course;
- (b) when the principal debtor becomes the holder;
- (c) by an act that would discharge simple contract;
- (d) by renunciation; and
- (e) by cancellation.

Discharge of a Party or Parties

When any particular party or parties are discharged, the instrument continues to be negotiable and the undischarged parties remain liable on it. For example, the non-presentment of a bill on the due date discharges the endorsers from their liability, but the acceptor remains liable on it.

A party may be discharged in the following ways

- (a) *By cancellation* by the holder of the name of any party to it with the intention of discharging him.
- (b) *By release*, when the holder releases any party to the instrument

- (c) *Discharge of secondary parties*, Le., endorser.
- (d) *By the operation of the law*, Le., by insolvency of the debtor.
- (e) *By allowing* drawee more than 48 hours to accept the bill, all previous parties are discharged.
- (f) *By non-presentment* of cheque promptly the drawer is discharged.
- (g) *By taking qualified acceptance*, all the previous parties are discharged.
- (h) *By material alteration*.

44. Material Alteration (Section 87)

An alteration is material which in any way alters the operation of the Instrument and the liabilities of the parties thereto. Therefore, any change in an instrument which causes it to speak a different language in legal effect from that which it originally spoke, or which changes legal character of the instrument is a material alteration.

A material alteration renders the instrument void, but it affects only those persons who have already become parties at the date of the alteration. Those who take the altered instrument cannot complain. Section 88 provides that an acceptor or endorser of a negotiable instrument is bound by his acceptance or endorsement notwithstanding any previous alteration of the instrument.

Examples of material alteration are:

Alteration (i) of the date of the instrument (ii) of the sum

payable, (iii) in the time of payment, (iv) of the place of payment, (v) of the rate of interest, (vi) by addition of a new party, (vii) tearing the instrument. in a material part.

There is no material alteration and the instrument is not vitiated in the following cases :

(i) correction of a mistake, (ii) to carry out the common Intention of the parties, (iii) an alteration made before the instrument is issued and made with the consent of the parties, (iv) crossing a cheque, (v) addition of the words "on demand" in an instrument where no time of payment is stated.

Retirement of a Bill under Rebate

An acceptor of a bill may make payment before maturity, and the bill is then said to be retired, but it is not discharged and must not be cancelled except by the acceptor when it comes into his hands. It is customary in such a case to make allowance of interest on the money to the acceptor for the remainder of the time which the bill has to run. The interest allowance is known as rebate.

Hundis

Hundis are negotiable instruments written in an oriental language. They are sometimes bills of exchange and sometimes promissory notes, and are not covered under the Negotiable Instruments Act, 1881. Generally, they are governed by the customs and usages in the locality but if custom is silent on the point in dispute before the Court, this Act applies to the hundis. The term "hundi" was formerly applicable to native bills of exchange. The promissory notes

were then called "teap". The hundis were in circulation in India even before the present Negotiable Instrument Act, 1881 came into operation. The usages attached to these hundis varied with the locality in which they were in circulation.

Generally understood, the term "hundi" includes all indigenous negotiable instruments whether they are bills of exchange or promissory notes. An instrument in order to be a hundi must be capable of being sued by the holder in his own name, and must by the custom of trade be transferred like cash by delivery.

Obviously the customs relating to hundis were many. In certain parts of the country even oral acceptance was in vogue. The following types of hundis are worth mentioning

1. Shah Jog Hundi

"Shah" means a respectable and responsible person or a man of worth in the bazar. Shah Jog Hundi means a hundi which is payable only to a respectable holder, as opposed to a hundi payable to bearer. In other words the drawee before paying the same has to satisfy himself that the payee is a 'SHAH'.

2. Jokhmi Hundi

A "jokhmi" hundi is always drawn on or against goods shipped on the vessel mentioned in the hundi. It implies a condition that money will be paid only in the event of arrival of the goods against which the hundi is drawn. It is in the nature of policy of insurance. The difference, however, is that the money is paid before hand and is to be recovered if the ship

arrives safely.

3. *Jawabee Hundi*

According to Macpherson, "A person desirous of making a remittance writes to the payee and delivers the letter to a banker, who either endorses it on to any of his correspondents near the payee's place of residence, or negotiates its transfer. On the arrival, the letter is forwarded to the payee, who attends and gives his receipt in the form of an answer to the letter which is forwarded by the same channel of the drawer or the order." Therefore, this is a form of hundi which is used for remitting money from one place to another.

4. *Nam jog Hundi*

It is a hundi payable to the party named in the bill or his order. The name of the payee is specifically inserted in the hundi. It can also be negotiated like a bill of exchange. Its alteration into a *Shah Jog* hundi is a material alteration and renders it void.

5. *Darsharii Hundi*

This is a hundi payable at sight. It is freely negotiable and the price is regulated by demand and supply. They are payable on demand and must be presented for payment within a reasonable time after they are received by the holder.

6. *Miadi Hundi*

This is otherwise called *muddati* hundi, that is, a hundi payable after a specified period of time. Usually money is advanced against these hundis by shroffs after deducting the

advance for the period in advance. There are other forms of hundis also like.

Dhani Jog Hundi - A hundi which is payable to "dhani" Le., the owner.

Fimian Jog Hundi - which is payable to order if can be negotiated by endorsement and delivery.

Presumptions of Law

A negotiable instrument is subject to certain presumptions. These have been recognised by the Negotiable Instruments Act under Sections 118 and 119 with a view to facilitate the business transactions. These are described below:

It shall be presumed that:

- (1) Every negotiable instrument was made or drawn for consideration irrespective of the consideration mentioned in the instrument or not.
- (2) Every negotiable instrument having a date was made on such date.
- (3) Every accepted bill of exchange was accepted within a reasonable time before its maturity.
- (4) Every negotiable instrument was transferred before its maturity.
- (5) The instruments were endorsed in the order in which they appear on it.
- (6) A lost or destroyed instrument was duly signed and stamped.

- (7) The holder of the instrument is a holder in due course.
- (8) In a suit upon an instrument which has been dishonoured, the Court shall presume the fact of dishonour, or proof of the protest.

However these legal presumptions are rebuttable by evidence to the contrary. The burden to prove to the contrary lies upon the defendant to the suit and not upon the plaintiff.

Payment of Interest in case of dishonour

The Negotiable Instruments Act, 1881 was amended in the year 1988, revising the rate of interest as contained in Sections 80 and 117, from 6 per cent to 18 per cent per annum payable on negotiable instruments from the due date in case no rate of interest is specified, or payable to an endorser from the date of payment on a negotiable instrument on its dishonour with a view to discourage the withholding of payment on negotiable instruments on due dates.

Penalties in case of dishonour of cheques

Chapter XVII of the Negotiable Instruments Act provides for penalties in case of dishonour of certain cheques for insufficiencies of funds in the accounts. Sections 138 to 142 deal with these aspects.

The provisions contained in this Chapter provide that where any cheque drawn by a person for discharge of any liability is returned by the bank unpaid for the reason of insufficiency of the amount of money standing to the credit of the account on which the cheque was drawn or for the reason that it exceeds the arrangement made by the drawer of the

cheque with the banker for that account, the drawer of such cheque shall be deemed to have committed an offence. In that case, the drawer, without prejudice to the other provisions of the Act, shall be punishable with imprisonment for a term which may extend to one year, or with fine which may extend to twice the amount of the cheque, or with both.

In order to constitute the said offence

- (a) such cheque should have been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier; and
- (b) the payee or holder in due course of such cheque should have made a demand for the payment of the said amount of money by giving notice, in writing, to the drawer of the cheque within fifteen days of the receipt of information by him from the bank regarding the return of the cheque unpaid; and
- (c) the drawer of such cheque should have failed to make the payment of the said amount of money to the payee or the holder in due course of the cheque within fifteen days of the receipt of the said notice.

It has also been provided that it shall be presumed, unless the contrary is proved, that the holder of such cheque received the cheque in the discharge of a liability. Defences which may or may not be allowed in any prosecution for such offence have also been provided to make the provisions effective. The Supreme Court in *Modi Cements Ltd. v. K.K. Nandi*, (1988) 28 CLA 491, held that merely because the drawer issued a notice

to the drawee or to the Bank for 'stop payment', it would not preclude an action under Section 138 by the drawee or holder in due course. Usual provisions relating to offences by companies have also been included in the said new Chapter. In order to ensure that genuine and honest bank customers are not harassed or put to inconvenience, sufficient safeguards have also been provided in the new Chapter, as under:

- (a) that no Court shall take cognizance of such offence except on a complaint in writing, made by the payee or the holder in due course of the cheque;
- (b) that such complaint is made within one month or the date on which the cause of action arises;
- (c) that the Court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any such offence.

Electronic Payments

A payment system is any system used to settle financial transactions through the transfer of monetary value, and includes the institutions, instruments, people, rules, procedures, standards, and technologies that make such an exchange possible. A common type of payment system is the operational network that links bank accounts and provides for monetary exchange using bank deposits.

What makes a payment system a system is the use of cash-substitutes; traditional payment systems are negotiable instruments such as drafts (e.g., checks) and documentary credits such as letters of credit. With the advent of computers

and electronic communications a large number of alternative electronic payment systems have emerged. These include debit cards, credit cards, electronic funds transfers, direct credits, direct debits, internet banking and e-commerce payment systems. Some payment systems include credit mechanisms, but that is essentially a different aspect of payment. Payment systems are used in lieu of tendering cash in domestic and international transactions and consist of a major service provided by banks and other financial institutions.

Payment systems may be physical or electronic and each has its own procedures and protocols. Standardization has allowed some of these systems and networks to grow to a global scale, but there are still many country- and product-specific systems. Examples of payment systems that have become globally available are credit card and automated teller machine networks. Specific forms of payment systems are also used to settle financial transactions for products in the equity markets, bond markets, currency markets, futures markets, derivatives markets, options markets and to transfer funds between financial institutions both domestically using clearing and real-time gross settlement (RTGS) systems and internationally using the SWIFT network. The term **electronic payment** can refer narrowly to e-commerce—a payment for buying and selling goods or services offered through the Internet, or broadly to any type of electronic funds transfer.

Requirements for E-payments

1. Security

Since payments involve actual money, payment systems

will be a prime target for criminals. Since Internet services are provided today on networks that are relatively open, the infrastructure supporting electronic commerce must be usable and resistant to attack in an environment where eavesdropping and modification of messages is easy.

2. Reliability

As more commerce is conducted over the Internet, the smooth running of the economy will come to depend on the availability of the payment infrastructure, making it a target of attack for vandals. Whether the result of an attack by vandals or simply poor design, an interruption in the availability of the infrastructure would be catastrophic. For this reason, the infrastructure must be highly available and should avoid presenting a single point of failure.

3. Scalability

As commercial use of the Internet grows, the demands placed on payment servers will grow too. The payment infrastructure as a whole must be able to handle the addition of users and merchants without suffering a noticeable loss of performance. The existence of central servers through which all transactions must be processed will limit the scale of the system. The payment infrastructure must support multiple servers, distributed across the network.

4. Anonymity

For some transactions, the identity of the parties to the transaction should be protected; it should not be possible to monitor an individual's spending patterns, nor determine one's

source of income. An individual is traceable in traditional payment systems such as checks and credit cards. Where anonymity is important, the cost of tracking a transaction should outweigh the value of the information that can be obtained by doing so.

5. Acceptability

The usefulness of a payment mechanisms is dependent upon what one can buy with it. Thus, a payment instrument must be accepted widely. Where payment mechanisms are supported by multiple servers, users of one server must be able to transact business with users of other servers.

6. Customer base

The acceptability of a payment mechanism is affected by the size of the customer base, i.e. the number of users able to make payments using the mechanism. Merchants want to sell products, and without a large enough base of customers using a payment mechanism, it is often not worth the extra effort for a merchant to accept the mechanism.

7. Flexibility

Alternative forms of payment are needed, depending on the guarantees needed by the parties to a transaction, the timing of the payment itself, requirements for auditability, performance requirements, and the amount of the payment. The payment infrastructure should support several payment methods including instruments analogous to credit cards, personal checks, cashier's checks, and even anonymous electronic cash. These instruments should be integrated into a common framework.

8. Convertibility

Users of the Internet will select financial instruments that best suit their needs for a given transaction. It is likely that several forms of payment will emerge, providing different tradeoffs with respect to the characteristics just described. In such an environment it is important that funds represented by one mechanism be easily convertible into funds represented by others.

9. Efficiency

Royalties for access to information may generate frequent payments for small amounts. Applications must be able to make these "micropayments" without noticeable performance degradation. The cost per transaction of using the infrastructure must be small enough that it is insignificant even for transaction amounts on the order of pennies.

10. Ease of integration

Applications must be modified to use the payment infrastructure in order to make a payment service available to users. Ideally, a common API should be used so that the integration is not specific to one kind of payment instrument. Support for payment should be integrated into request-response protocols on which applications are built so that a basic level of service is available to higher level applications without significant modification.

11. Ease of use

Users should not be constantly interrupted to provide payment information and most payments should occur

automatically. However, users should be able to limit their losses. Payments beyond a certain threshold should require approval. Users should be able to monitor their spending without going out of their way to do so.

Types of E-payments

The following types of electronic payments are most common today. That said, it is important to realize that new payment types are continual being discovered and there are additional methods that exist or are being developed continuously.

Cards

Credit cards, debit cards and prepaid cards currently represent the most common form of electronic payments. For all 3 types of cards the consumer or the business most often uses a plastic card, commonly with a magnetic stripe. The cardholder gives his or her card or card number to a merchant who swipes the card through a terminal or enters the data to a PC. The terminal transmits data to his or her bank, the acquirer. The acquirer transmits the data through a card association to the card issuer who makes a decision on the transaction and relays it back to the merchant, who gives goods or services to the cardholder. Funds flow later for settlement with credit cards and are debited immediately for debit or pre-paid cards.

Along with magnetic stripe cards, smart cards are and will increasingly be used for payments. Smart cards are at present overwhelmingly plastic credit cards with an embedded

computer chip. Until recently, many smart cards operated using proprietary rather than common standards. A standard set of specifications, EMV, has been developed and is being used increasingly so that the chips on smart cards are interoperable. Korea and Japan are among the most advanced countries in Asia for smart card payments, with Malaysia catching up fast due to government mandates for banks to issue smart cards. Most credit and debit cards are expected to be issued or reissued as smart cards by 2008 or earlier.

Over time, the chip for payment can be expected to move onto other devices. A smart card might then become the computer chip in a phone, PDA or other device that can perform the same function as chip in a plastic card, eliminating the need for the actual plastic card. Smart cards could thus evolve into smart phones, smart PDAs or other smart devices.

Internet

Online payments involve the customer transferring money or making a purchase online via the internet. Consumers and businesses can transfer money to third parties from the bank or other account, and they can also use credit, debit and prepaid cards to make purchases online.

Current estimates are that over 80% of payments for online purchases are made using a credit card or debit card. At present, most online transactions involve payment with a credit card. While other forms of payment such as direct debits to accounts or pre-paid accounts and cards are increasing, they currently represent a less developed transaction methodology.

Mobile Payments

Mobile phones are currently used for a limited number of electronic transactions. However, the percentage seems likely to increase as mobile phone manufacturers enable the chip and software in the phone for easier electronic commerce.

Consumers can use their mobile phone to pay for transactions in several ways. Consumers may send an SMS message, transmit a PIN number, use WAP to make online payments, or perform other segments of their transaction with the phone. As phones develop further, consumers are likely to be able to use infrared, Bluetooth and other means more frequently to transmit full account data in order to make payments securely and easily from their phone.

Additionally, merchants can obtain an authorization for a credit or debit card transaction by attaching a device to their mobile phone. A consortium in the US also recently announced Power Swipe, for example, which physically connects to a Nextel phone, weighs 3.1 ounces, and incorporates a magnetic stripe reader, infrared printing port, and pass-through connector for charging the handset battery.

Financial Service Kiosks

Companies and service providers in several countries, including Singapore and the US, have set up kiosks to enable financial and non-financial transactions. These kiosks are fixed stations with phone connections where the customer usually uses a keyboard and television-like screen to transact or to access information. At AXS stations in Singapore, for

example, consumers can make electronic bill payments, send email or SMS message and make phone calls. Kiosks in the United States enable the customer to send money via wire transfers, cash checks, make purchases using cash, and make phone calls.

Located at convenient public locations such as bus or subway stations, convenience stores or shopping malls, these kiosks enable electronic payments by individuals who may not have regular access to the internet or mobile phones.

Television Set-Top Boxes and Satellite Receiver

Specialized boxes attached to a television can also be used for payments in some locations. The set-top box attaches to the television and a keyboard or other device, and customers can make purchases by viewing items on the television. Payment is made electronically using a credit card or other account. While usage is presently low, it could grow substantially in countries with a strong cable or satellite television network.

Biometric Payments

Electronic payments using biometrics are still largely in their infancy. Trials are underway in the United States, Australia and a limited number of other countries. Most biometric payments involve using fingerprints as the identification and access tool, though companies like Visa International are piloting voice recognition technology and retina scans are also under consideration. Essentially, a biometric identifier such as a fingerprint or voice could replace

the plastic card and more securely identifies the person undertaking the transaction. The electronic payment is still charged to a credit card or other account, with the biometric identifier replacing the card, check or other transaction mechanism.

Electronic Payments Networks

Various countries have electronic payments networks that consumer can use to make payments electronically. ACH (Automated Clearing House) in the US, domestic EFTPOS networks in Australia and Singapore, and other networks enable electronic payments between businesses and between individuals. The consumer can go online, to a financial service kiosk or use other front-end devices to access their account and make payments to businesses or other individuals.

Person-to-Person (P2P) Payments

P2P payments enable one individual to pay another using an account, a prepaid card or another mechanism that stores value. PayPal in the US, which was recently purchased by Ebay, is one of the most frequently used P2P mechanisms. The Tower Group estimates that the volume of P2P payments will grow from 105 million transactions in 2002 to 1.4 billion transactions by 2005. P2P payments can be made through a variety of means, including services like PayPal, transfers using card readers, or other. In the future other devices, such as mobile phones or PDAs, could also be used to enable P2P electronic payments.

MODULE 3

E-BANKING

Online banking, also known as **internet banking**, **e-banking** or **virtual banking**, is an electronic payment system that enables customers of a bank or other financial institution to conduct a range of financial transactions through the financial institution's website. The online banking system will typically connect to or be part of the core banking system operated by a bank and is in contrast to branch banking which was the traditional way customers accessed banking services. Fundamentally and in mechanism, online banking, internet banking and e-banking are the same thing.

To access a financial institution's online banking facility, a customer with internet access would need to register with the institution for the service, and set up a password and other credentials for customer verification. The credentials for online banking is normally not the same as for telephone or mobile banking. Financial institutions now routinely allocate customers numbers, whether or not customers have indicated an intention to access their online banking facility. Customers' numbers are normally not the same as account numbers, because a number of customer accounts can be linked to the one customer number. The customer number can be linked to any account that the customer controls, such as cheque, savings, loan, credit card and other accounts.

The customer visits the financial institution's secure

website, and enters the online banking facility using the customer number and credentials previously set up. The types of financial transactions which a customer may transact through online banking usually includes obtaining account balances, lists of the latest transactions, electronic bill payments and funds transfers between a customer's or another's accounts. Most banks also enable a customer to download copies of bank statements, which can be printed at the customer's premises (some banks charge a fee for mailing hardcopies of bank statements). Some banks also enable customers to download transactions directly into the customer's accounting software. The facility may also enable the customer to order cheque-books, statements, report loss of credit cards, stop payment on a cheque, advise change of address and other routine actions.

Features of E-Banking

Online banking facilities typically have many features and capabilities in common, but also have some that are application specific.

The common features fall broadly into several categories:

- A bank customer can perform non-transactional tasks through online banking, including —
 - o Viewing account balances
 - o Viewing recent transactions
 - o Downloading bank statements, for example in PDF format

- o Viewing images of paid cheques
 - o Ordering cheque books
 - o Download periodic account statements
 - o Downloading applications for M-banking, E-banking etc.
- Bank customers can transact banking tasks through online banking, including —
 - o Funds transfers between the customer's linked accounts
 - o Paying third parties, including bill payments (see, e.g., BPAY) and third party fund transfers (see, e.g., FAST)
 - o Investment purchase or sale
 - o Loan applications and transactions, such as repayments of enrollments
 - o Credit card applications
 - o Register utility billers and make bill payments
- Financial institution administration
- Management of multiple users having varying levels of authority
- Transaction approval process

Some financial institutions offer special internet banking services, for example:

- Personal financial management support, such as importing data into personal accounting software. Some online banking platforms support account aggregation to

allow the customers to monitor all of their accounts in one place whether they are with their main bank or with other institutions.

Advantages of E-Banking

There are some advantages on using e-banking both for banks and customers:

- Permanent access to the bank
- Lower transaction costs / general cost reductions
- Access anywhere

Security aspects of E-Banking

Security of a customer's financial information is very important, without which online banking could not operate. Similarly the reputational risks to the banks themselves are important. Financial institutions have set up various security processes to reduce the risk of unauthorized online access to a customer's records, but there is no consistency to the various approaches adopted. The use of a secure website has been almost universally embraced. Though single password authentication is still in use, it by itself is not considered secure enough for online banking in some countries. Basically there are two different security methods in use for online banking:

- The PIN/TAN system where the PIN represents a password, used for the login and TANs representing one-time passwords to authenticate transactions. TANs can be distributed in different ways, the most popular one is to send a list of TANs to the online banking user by postal letter. Another way of using TANs is to generate them by

need using a security token. These token generated TANs depend on the time and a unique secret, stored in the security token (two-factor authentication or 2FA).

- More advanced TAN generators (chip TAN) also include the transaction data into the TAN generation process after displaying it on their own screen to allow the user to discover man-in-the-middle attacks carried out by Trojans trying to secretly manipulate the transaction data in the background of the PC.
- Another way to provide TANs to an online banking user is to send the TAN of the current bank transaction to the user's (GSM) mobile phone via SMS. The SMS text usually quotes the transaction amount and details, the TAN is only valid for a short period of time. Especially in Germany, Austria and the Netherlands many banks have adopted this "SMS TAN" service.
- Usually online banking with PIN/TAN is done via a web browser using SSL secured connections, so that there is no additional encryption needed.
- Signature based online banking where all transactions are signed and encrypted digitally. The Keys for the signature generation and encryption can be stored on smartcards or any memory medium, depending on the concrete implementation (see, e.g., the Spanish ID card *DNI electrónico*).

Automated Teller Machine (ATM):

ATM is designed to perform the most important function

of bank. It is operated by plastic card with its special features. The plastic card is replacing cheque, personal attendance of the customer, banking hours restrictions and paper based verification. There are debit cards. ATMs used as spring board for Electronic Fund Transfer. ATM itself can provide information about customers account and also receive instructions from customers - ATM cardholders. An ATM is an Electronic Fund Transfer terminal capable of handling cash deposits, transfer between accounts, balance enquiries, cash withdrawals and pay bills. It may be on-line or off-line. The on-line ATN enables the customer to avail banking facilities from anywhere. In off-line the facilities are confined to that particular ATM assigned. Any customer possessing ATM card issued by the Shared Payment Network System can go to any ATM linked to Shared Payment Networks and perform his transactions.

Cards/Debit Cards:

The Credit Card holder is empowered to spend wherever and whenever he wants with his Credit Card within the limits fixed by his bank. Credit Card is a post paid card. Debit Card, on the other hand, is a prepaid card with some stored value. Every time a person uses this card, the Internet Banking house gets money transferred to its account from the bank of the buyer. The buyers account is debited with the exact amount of purchases. An individual has to open an account with the issuing bank which gives debit card with a Personal Identification Number (PIN). When he makes a purchase, he enters his PIN on shops PIN pad. When the card is slurped

through the electronic terminal, it dials the acquiring bank system - either Master Card or VISA that validates the PIN and finds out from the issuing bank whether to accept or decline the transactions. The customer can never overspend because the system rejects any transaction which exceeds the balance in his account. The bank never faces a default because the amount spent is debited immediately from the customers account.

Smart Card:

Banks are adding chips to their current magnetic stripe cards to enhance security and offer new service, called Smart Cards. Smart Cards allow thousands of times of information storable on magnetic stripe cards. In addition, these cards are highly secure, more reliable and perform multiple functions. They hold a large amount of personal information, from medical and health history to personal banking and personal preferences.

Tele Banking:

Undertaking a host of banking related services including financial transactions from the convenience of customers chosen place anywhere across the GLOBE and any time of date and night has now been made possible by introducing on-line Telebanking services. By dialing the given Telebanking number through a landline or a mobile from anywhere, the customer can access his account and by following the user-friendly menu, entire banking can be done through Interactive Voice Response (IVR) system. With sufficient numbers of

hunting lines made available, customer call will hardly fail. The system is bi-lingual and has following facilities offered

- Automatic balance voice out for the default account. Balance inquiry and transaction inquiry
- All Inquiry of all term deposit account
- Statement of account by Fax, e-mail or ordinary mail.
- Cheque book request
- Stop payment which is on-line and instantaneous
- Transfer of funds with CBS which is automatic and instantaneous
- Utility Bill Payments
- Renewal of term deposit which is automatic and instantaneous
- Voice out of last five transactions.

E-Cheque:

An e-Cheque is the electronic version or representation of paper cheque. The Information and Legal Framework on the E-Cheque is the same as that of the paper cheque's. It can now be used in place of paper cheques to do any and all remote transactions. An E-cheque work the same way a cheque does, the cheque writer "writes" the e-Cheque using one of many types of electronic devices and "gives" the e-Cheque to the payee electronically. The payee "deposits" the Electronic Cheque receives credit, and the payee's bank "clears" the e-Cheque to the paying bank. The paying bank validates the e-Cheque and then "charges" the check writer's account for the check.

Electronic Clearing Service (ECS)

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

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

ECS Debit is used by an institution for raising debits to a large number of accounts (for instance, consumers of utility services, borrowers, investors in mutual funds etc.) maintained with bank branches at various locations within the jurisdiction of a ECS Centre for single credit to the bank account of the user institution. ECS Debit is useful for payment of telephone / electricity / water bills, cess / tax collections, loan installment

repayments, periodic investments in mutual funds, insurance premium etc., that are periodic or repetitive in nature and payable to the user institution by large number of customers etc.

Based on the geographical location of branches covered, there are three broad categories of ECS Schemes — Local ECS, Regional ECS and National ECS. These schemes are either operated by RBI or by the designated commercial banks. NACH is also one of the form of ECS system operated by NPCI and further details about NACH is available at NPCI web site under the link http://www.npci.org.in/clearing_faq.aspx.

Local ECS — this is operating at 81 centres / locations across the country. At each of these ECS centres, the branch coverage is restricted to the geographical coverage of the clearing house, generally covering one city and/or satellite towns and suburbs adjoining the city.

Regional ECS — this is operating at 9 centres / locations at various parts of the country. RECS facilitates the coverage all core-banking-enabled branches in a State or group of States and can be used by institutions desirous of reaching beneficiaries within the State / group of States. The system takes advantage of the core banking system in banks. Accordingly, even though the inter-bank settlement takes place centrally at one location in the State, the actual customers under the Scheme may have their accounts at various bank branches across the length and breadth of the State / group of States.

National ECS — this is the centralized version of ECS Credit which was launched in October 2008. The Scheme is operated at Mumbai and facilitates the coverage of all core-banking enabled branches located anywhere in the country. This system too takes advantage of the core banking system in banks. Accordingly, even though the inter-bank settlement takes place centrally at one location at Mumbai, the actual customers under the Scheme may have their accounts at various bank branches across the length and breadth of the country. Banks are free to add any of their core-banking-enabled branches in NECS irrespective of their location. Details of NECS Scheme are available on the website of Reserve Bank of India. The list of centres where the ECS facility is available has been placed on the website of Reserve Bank of India. Similarly, the centre-wise list of bank branches participating at each location is available on the website of Reserve Bank of India.

ECS (CREDIT)

ECS Credit payments can be initiated by any institution (called ECS Credit User) which needs to make bulk or repetitive payments to a number of beneficiaries. The institutional User has to first register with an ECS Centre. The User has to also obtain the consent of beneficiaries (i.e., the recipients of salary, pension, dividend, interest etc.) and get their bank account particulars prior to participation in the ECS Credit scheme. ECS Credit payments can be put through by the ECS User only through his / her bank (known as the Sponsor bank). ECS Credits are afforded to the beneficiary account

holders (known as destination account holders) through the beneficiary account holders' bank (known as the destination bank). The beneficiary account holders are required to give mandates to the user institutions to enable them to afford credit to their bank accounts through the ECS Credit mechanism. The User intending to effect payments through ECS Credit has to submit details of the beneficiaries (like name, bank / branch / account number of the beneficiary, MICR code of the destination bank branch, etc.), date on which credit is to be afforded to the beneficiaries, etc., in a specified format (called the input file) through its sponsor bank to one of the ECS Centres where it is registered as a User. The bank managing the ECS Centre then debits the account of the sponsor bank on the scheduled settlement day and credits the accounts of the destination banks, for onward credit to the accounts of the ultimate beneficiaries with the destination bank branches. Further details about the ECS Credit scheme are contained in the Procedural Guidelines and available on the website of Reserve Bank of India.

ECS (DEBIT)

ECS Debit transaction can be initiated by any institution (called ECS Debit User) which has to receive / collect amounts towards telephone / electricity / water dues, cess / tax collections, loan installment repayments, periodic investments in mutual funds, insurance premium etc. It is a Scheme under which an account holder with a bank branch can authorise an ECS User to recover an amount at a prescribed frequency by raising a debit to his / her bank account.

The User institution has to first register with an ECS Centre. The User institution has to also obtain the authorization (mandate) from its customers for debiting their account along with their bank account particulars prior to participation in the ECS Debit scheme. The mandate has to be duly verified by the beneficiary's bank. A copy of the mandate should be available on record with the destination bank where the customer has a bank account. The ECS Debit User intending to collect receivables through ECS Debit has to submit details of the customers (like name, bank / branch / account number of the customer, MICR code of the destination bank branch, etc.), date on which the customer's account is to be debited, etc., in a specified format (called the input file) through its sponsor bank to the ECS Centre.

The bank managing the ECS Centre then passes on the debits to the destination banks for onward debit to the customer's account with the destination bank branch and credits the sponsor bank's account for onward credit to the User institution. Destination bank branches will treat the electronic instructions received from the ECS Centre on par with the physical cheques and accordingly debit the customer accounts maintained with them. All the unsuccessful debits are returned to the sponsor bank through the ECS Centre (for onward return to the User Institution) within the specified time frame. For further details about the ECS Debit scheme, the ECS Debit Procedural Guidelines — available on the website of Reserve Bank of India

The advantages of ECS Debit to customers are many and

include,

- ECS Debit mandates will take care of automatic debit to customer accounts on the due dates without customers having to visit bank branches / collection centres of utility service providers etc.
- Customers need not keep track of due date for payments.
- The debits to customer accounts would be monitored by the ECS Users, and the customers alerted accordingly.
- Cost effective.

Core Banking (Centralised Online Real time Electronic Banking)

Core banking is a banking service provided by a group of networked bank branches where customers may access their bank account and perform basic transactions from any of the member branch offices. Core banking is often associated with retail banking and many banks treat the retail customers as their core banking customers. Businesses are usually managed via the Corporate banking division of the institution. Core banking covers basic depositing and lending of money. Normal Core Banking functions will include transaction accounts, loans, mortgages and payments. Banks make these services available across multiple channels like ATMs, Internet banking, mobile banking and branches. The core banking services rely heavily on computer and network technology to allow a bank to centralise its record keeping and allow access from any location. It has been the development of banking software that has allowed core banking solutions to be developed.

Electronic Fund Transfer (EFT)

An electronic funds transfer (EFT) is a transaction that takes place over a computerized network, either among accounts at the same bank or to different accounts at separate financial institutions. EFTs include direct-debit transactions, wire transfers, direct deposits, ATM withdrawals and online bill pay services. Transactions are processed through the Automated Clearing House (ACH) network, the secure transfer system of the Federal Reserve that connects all U.S. banks, credit unions and other financial institutions.

For example, when you use your debit card to make a purchase at a store or online, the transaction is processed using an EFT system. The transaction is very similar to an ATM withdrawal, with near-instantaneous payment to the merchant and deduction from your checking account. Direct deposit is another form of an electronic funds transfer. In this case, funds from your employer's bank account are transferred electronically to your bank account, with no need for paper-based payment systems.

The increased use of EFTs for online bill payments, purchases and pay processes is leading to a paper-free banking system, where a large number of invoices and payments take place over digital networks. EFT systems play a large role in this future, with fast, secure transactions guaranteeing a seamless transfer of funds within institutions or across banking networks. EFT transactions, also known as an online transaction or PIN-debit transaction, also offer an alternative to signature debit transactions, which take place through one of

the major credit card processing systems, such as Visa, MasterCard or Discover, and can cost as much as 3% of the total purchase price. EFT processing, on the other hand, only charges an average of 1% for debit card transactions.

Real Time Gross Settlement (RTGS)

The acronym 'RTGS' stands for Real Time Gross Settlement, which can be defined as the continuous (real-time) settlement of funds transfers individually on an order by order basis (without netting). 'Real Time' means the processing of instructions at the time they are received rather than at some later time; 'Gross Settlement' means the settlement of funds transfer instructions occurs individually (on an instruction by instruction basis). Considering that the funds settlement takes place in the books of the Reserve Bank of India, the payments are final and irrevocable.

NEFT is an electronic fund transfer system that operates on a Deferred Net Settlement (DNS) basis which settles transactions in batches. In DNS, the settlement takes place with all transactions received till the particular cut-off time. These transactions are netted (payable and receivables) in NEFT whereas in RTGS the transactions are settled individually. For example, currently, NEFT operates in hourly batches. [There are twelve settlements from 8 am to 7 pm on week days and six settlements from 8 am to 1 pm on Saturdays.] Any transaction initiated after a designated settlement time would have to wait till the next designated settlement time. Contrary to this, in the RTGS transactions are processed continuously throughout the RTGS business hours.

The RTGS system is primarily meant for large value transactions. The minimum amount to be remitted through RTGS is 2 lakh. There is no upper ceiling for RTGS transactions. Under normal circumstances the beneficiary branches are expected to receive the funds in real time as soon as funds are transferred by the remitting bank. The beneficiary bank has to credit the beneficiary's account within 30 minutes of receiving the funds transfer message.

National Electronic Fund Transfer (NEFT)

National Electronic Funds Transfer (NEFT) is a nation-wide payment system facilitating one-to-one funds transfer. Under this Scheme, individuals, firms and corporates can electronically transfer funds from any bank branch to any individual, firm or corporate having an account with any other bank branch in the country participating in the Scheme. For being part of the NEFT funds transfer network, a bank branch has to be NEFT- enabled. The list of bank-wise branches which are participating in NEFT is provided in the website of Reserve Bank of India.

Individuals, firms or corporates maintaining accounts with a bank branch can transfer funds using NEFT. Even such individuals who do not have a bank account (walk-in customers) can also deposit cash at the NEFT-enabled branches with instructions to transfer funds using NEFT. However, such cash remittances will be restricted to a maximum of Rs.50,000/- per transaction. Such customers have to furnish full details including complete address, telephone number, etc. NEFT, thus, facilitates originators or remitters to

initiate funds transfer transactions even without having a bank account. Individuals, firms or corporates maintaining accounts with a bank branch can receive funds through the NEFT system. It is, therefore, necessary for the beneficiary to have an account with the NEFT enabled destination bank branch in the country.

The NEFT system also facilitates one-way cross-border transfer of funds from India to Nepal. This is known as the Indo-Nepal Remittance Facility Scheme. A remitter can transfer funds from any of the NEFT-enabled branches in to Nepal, irrespective of whether the beneficiary in Nepal maintains an account with a bank branch in Nepal or not. The beneficiary would receive funds in Nepalese Rupees. No. There is no limit — either minimum or maximum — on the amount of funds that could be transferred using NEFT. However, maximum amount per transaction is limited to Rs.50,000/- for cash-based remittances within India and also for remittances to Nepal under the Indo-Nepal Remittance Facility Scheme. No. There is no restriction of centres or of any geographical area within the country. The NEFT system takes advantage of the core banking system in banks. Accordingly, the settlement of funds between originating and receiving banks takes places centrally at Mumbai, whereas the branches participating in NEFT can be located anywhere across the length and breadth of the country. Presently, NEFT operates in hourly batches - there are twelve settlements from 8 am to 7 pm on week days (Monday through Friday) and six settlements from 8 am to 1 pm on Saturdays.

Working of NEFT system

Step-1 : An individual / firm / corporate intending to originate transfer of funds through NEFT has to fill an application form providing details of the beneficiary (like name of the beneficiary, name of the bank branch where the beneficiary has an account, IFSC of the beneficiary bank branch, account type and account number) and the amount to be remitted. The application form will be available at the originating bank branch. The remitter authorizes his/her bank branch to debit his account and remit the specified amount to the beneficiary. Customers enjoying net banking facility offered by their bankers can also initiate the funds transfer request online. Some banks offer the NEFT facility even through the ATMs. Walk-in customers will, however, have to give their contact details (complete address and telephone number, etc.) to the branch. This will help the branch to refund the money to the customer in case credit could not be afforded to the beneficiary's bank account or the transaction is rejected / returned for any reason.

Step-2 The originating bank branch prepares a message and sends the message to its pooling centre (also called the NEFT Service Centre).

Step-3 : The pooling centre forwards the message to the NEFT Clearing Centre (operated by National Clearing Cell, Reserve Bank of India, Mumbai) to be included for the next available batch.

Step-4 : The Clearing Centre sorts the funds transfer

transactions destination bank-wise and prepares accounting entries to receive funds from the originating banks (debit) and give the funds to the destination banks(credit). Thereafter, bank-wise remittance messages are forwarded to the destination banks through their pooling centre (NEFT Service Centre).

Step-5 : The destination banks receive the inward remittance messages from the Clearing Centre and pass on the credit to the beneficiary customers' accounts.

IFSC

IFSC or Indian Financial System Code is an alphanumeric code that uniquely identifies a bank-branch participating in the NEFT system. This is an 11 digit code with the first 4 alpha characters representing the bank, and the last 6 characters representing the branch. The 5th character is 0 (zero). IFSC is used by the NEFT system to identify the originating / destination banks / branches and also to route the messages appropriately to the concerned banks / branches. Bank-wise list of IFSCs is available with all the bank-branches participating in NEFT. List of bank-wise branches participating in NEFT and their IFSCs is available on the website of Reserve Bank of India . All the banks have also been advised to print the IFSC of the branch on cheques issued to their customers. Further, banks have also been advised to ensure that their branch staff provide necessary assistance to customers in filling out the required details, including IFSC details, in the NEFT application form, and also help in ensuring that there is no mismatch between the IFSC code and

branch details of beneficiary branch as provided by the customer.

E-purse

Electronic money, or e-money, is the money balance recorded electronically on a stored-value card. These cards have microprocessors embedded which can be loaded with a monetary value. Another form of electronic money is network money, software that allows the transfer of value on computer networks, particularly the internet. Electronic money is a floating claim on a private bank or other financial institution that is not linked to any particular account. Examples of electronic money are bank deposits, electronic funds transfer, direct deposit, payment processors, and digital currencies.

Virtual Banking

A bank that offers services predominately or exclusively over the Internet. A virtual bank offers normal banking services, including access to one's checking and savings accounts and personal and business loans. Even non-virtual banks almost always offer virtual banking services. A virtual bank offers of some or all the same types of accounts and services that traditional bricks-and-mortar banks do, but virtual banks exist only online. They typically charge lower fees and pay higher interest because of low overhead. Virtual bank transactions can be checked in real time, as they happen, rather than at the end of the banking day or the end of the month -- though those services may also be available through the online branches of traditional banks. Virtual banks don't have

branches or own ATM machines, so you make deposits electronically or by mail. Your virtual bank may reimburse your ATM fees for using other banks' machines. However, there may be a limit to the number of transactions a virtual bank will cover each month.

Financial Inclusion

Financial inclusion is a method of offering banking and financial services to individuals. It aims to include everybody in society by giving them basic financial services regardless of their income or savings. It focuses on providing financial solutions to the economically underprivileged. The term is broadly used to describe the provision of savings and loan services to the poor in an inexpensive and easy-to-use form. It aims to ensure that the poor and marginalised make the best use of their money and attain financial education. With advances in financial technology and digital transactions, more and more startups are now making financial inclusion simpler to achieve.

Financial inclusion wants everybody in the society to be involved and participate in financial management judiciously. There are many poor households in India that do not have any access to financial services in the country. They are not aware of banks and their functions. Even if they are aware of banks, many of the poor people do not have the access to get services from banks. They may not meet minimum eligibility criteria laid by banks and hence, they will not be able to secure a bank's services. Banks have requirements such as minimum income, minimum credit score, age criteria, and minimum

years of work experience. A bank will provide a deposit or a loan to an applicant only if he or she meets these criteria. Many of the poor people may be unemployed without any previous employment record due to lack of education, lack of resources, lack of money, etc. These economically underprivileged people of the society may also not have proper documents to provide to the banks for verification of identity or income. Every bank has certain mandatory documents that need to be furnished during a loan application process or during a bank account creation process. Many of these people do not have knowledge about the importance of these documents. They also do not have access to apply for government- sanctioned documents.

Financial inclusion aims to eliminate these barriers and provide economically priced financial services to the less fortunate sections of the society so that they can be financially independent without depending on charity or other means of getting funds that are actually not sustainable. Financial inclusion also intends to spread awareness about financial services and financial management among people of the society. Moreover, it wants to develop formal and systematic credit avenues for the poor people.

For several years, only the middle and high classes of the society procured formal types of credit. Poor people were forced to rely on unorganised and informal forms of credit. Many of them were uneducated and did not have basic knowledge about finance and hence, they got cheated by the greedy and rich people of the society. Several poor people

have been exploited for years in the context of financial assistance.

Definition

Financial inclusion is the process of ensuring access to financial products and services needed by vulnerable groups at an affordable cost in a transparent manner by institutional players.

Objectives of Financial Inclusion

- Financial inclusion intends to help people secure financial services and products at economical prices such as deposits, fund transfer services, loans, insurance, payment services, etc.
- It aims to establish proper financial institutions to cater to the needs of the poor people. These institutions should have clear-cut regulations and should maintain high standards that are existent in the financial industry.
- Financial inclusion aims to build and maintain financial sustainability so that the less fortunate people have a certainty of funds which they struggle to have.
- Financial inclusion also intends to have numerous institutions that offer affordable financial assistance so that there is sufficient competition so that clients have a lot of options to choose from. There are traditional banking options in the market. However, the number of institutions that offer inexpensive financial products and services is very minimal.
- Financial inclusion intends to increase awareness about

the benefits of financial services among the economically underprivileged sections of the society.

- The process of financial inclusion works towards creating financial products that are suitable for the less fortunate people of the society.
- Financial inclusion intends to improve financial literacy and financial awareness in the nation.
- Financial inclusion aims to bring in digital financial solutions for the economically underprivileged people of the nation.
- It also intends to bring in mobile banking or financial services in order to reach the poorest people living in extremely remote areas of the country.
- It aims to provide tailor-made and custom-made financial solutions to poor people as per their individual financial conditions, household needs, preferences, and income levels.
- There are many governmental agencies and non-governmental organisations that are dedicated to bringing in financial inclusion. These agencies are focussed on improving the access to receiving government-approved documents. Many poor people are unable to open bank accounts or apply for a loan as they do not have any identity proof. There are so many people who live in rural areas or tribal villages who do not have knowledge about documents such as PAN, Aadhaar, Driver's License, or Electoral ID. Hence, they cannot avail many of the services offered by governmental or private

institutions. Due to lack of these documents, they are unable to avail any form of subsidies offered by the government that they are actually entitled to.

Financial Inclusion Schemes in India

The Government of India has been introducing several exclusive schemes for the purpose of financial inclusion. These schemes intend to provide social security to the less fortunate sections of the society. After a lot of planning and research by several financial experts and policymakers, the government launched schemes keeping financial inclusion in mind. These schemes have been launched over different years. Let us take a list of the financial inclusion schemes in the country:

1. PMJDY - Pradhan Mantri Jan Dhan Yojana

Pradhan Mantri Jan-Dhan Yojana is a government scheme launched by the government of India to provide easy access to financial services such as Remittance, Credit, Insurance, Pension, Savings and Deposit Accounts to poor and needy section of our society.

2. APY - Atal Pension Yojana

Atal Pension Yojana scheme was launched to help poor people working in the unorganised sector to receive regular income after retirement.

3. PMVVY - Pradhan Mantri Vaya Vandana Yojana

The Indian Government launched a pension scheme and it can be taken from 4 May 2017 to 31 March 2020. In the 2018-2019 Budget Speech, the Government of India increased

the maximum limit to Rs.15 lakh under the Pradhan Mantri Vaya Vandana Yojana scheme. The scheme can be bought via online and offline modes from Life Insurance Corporation (LIC) of India. The main aim of the scheme is to provide senior citizens with a regular pension during the time when there is a fall in interest rates.

4. Stand up India Loan Scheme

In India, challenges have always plagued entrepreneurs who are women or are members of the SC/ST community who are looking to obtain a loan to launch their own business venture. However, in a noble effort to not only acknowledge but also address these challenges, faced by members of the SC/ST communities and women, Prime Minister Narendra Modi launched the Stand Up India Scheme in April of 2016.

5. MUDRA Loan

MUDRA Loan is offered under the Pradhan Mantri Mudra Yojana (PMMY). MUDRA stands for Micro-Units Development and Refinance Agency. Under this scheme, borrowers can avail business loans ranging from Rs.50,000 to Rs.10 lakh on the basis of the Sishu, Kishor, and Tarun categories.

6. Jan Suraksha Schemes

It comprises of Pradhan Mantri Suraksha Bima Yojana which offer Rs. 1000 to Rs. 5000, Pradhan Mantri Jeevan Jyoti Bima Yojana offering Rs. 1 lakh to Rs. 2 lakh for accidents, and Atal Pension Yojana offering Rs.2 lakh insurance cover.

7. SSY - Sukanya Samriddhi Yojana

The Sukanya Samriddhi Yojana scheme is aimed at betterment of girl child in the country. Sukanya Samriddhi scheme has been launched to offer a means of saving to the girl child in every family. Tenure of SSY is 21 years from the date of opening of the account or till the marriage of the girl after she attains the age of 18 years

8. Jeevan Suraksha Bandhan Yojana**9. Credit Enhancement Guarantee Scheme (CEGS) for Scheduled Castes (SCs)****10. Venture Capital Fund for Scheduled Castes under the Social Sector Initiatives****11. Varishtha Pension Bima Yojana (VPBY)****Importance of financial inclusion**

Financial inclusion strengthens the availability of economic resources and builds the concept of savings among the poor. Financial inclusion is a major step towards inclusive growth. It helps in the overall economic development of the underprivileged population. In India, effective financial inclusion is needed for the uplift of the poor and disadvantaged people by providing them with the modified financial products and services.

MODULE 4

INTRODUCTION TO INSURANCE

Insurance is a form of risk management in which the insured transfers the cost of potential loss to another entity in exchange for monetary compensation known as the premium. Insurance allows individuals, businesses and other entities to protect themselves against significant potential losses and financial hardship at a reasonably affordable rate. We say "significant" because if the potential loss is small, then it doesn't make sense to pay a premium to protect against the loss. After all, you would not pay a monthly premium to protect against a loss because this would not be considered a financial hardship for most. Insurance is appropriate when you want to protect against a significant monetary loss. Take life insurance as an example. If you are the primary breadwinner in your home, the loss of income that your family would experience as a result of your premature death is considered a significant loss and hardship that you should protect them against. It would be very difficult for your family to replace your income, so the monthly premiums ensure that if you die, your income will be replaced by the insured amount. The same principle applies to many other forms of insurance. If the potential loss will have a detrimental effect on the person or entity, insurance makes sense. Everyone that wants to protect themselves or someone else against financial hardship should consider insurance. This may include:

- Protecting family after one's death from loss of income
- Ensuring debt repayment after death
- Covering contingent liabilities
- Protecting against the death of a key employee or person in your business
- Buying out a partner or co-shareholder after his or her death
- Protecting your business from business interruption and loss of income
- Protecting yourself against unforeseeable health expenses
- Protecting your home against theft, fire, flood and other hazards
- Protecting yourself against lawsuits
- Protecting yourself in the event of disability
- Protecting your car against theft or losses incurred because of accidents
- And many more

Insurance- Meaning and definition

Insurance is a contract between two parties. One party is the insured and the other party is the insurer. Insured is the person whose life or property is insured with the insurer. That is, the person whose risks are insured is called insured. Insurer is the insurance company to whom risk is transferred by the insured. That is, the person who insures the risk of insured is called insurer. Thus insurance is a contract between insurer and insured. It is a contract in which the insurance company

undertakes to indemnify the insured on the happening of certain event for a payment of consideration. It is a contract between the insurer and insured under which the insurer undertakes to compensate the insured for the loss arising from the risk insured against. Some definitions of insurance are given below:

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

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

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

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

History of Insurance in India

In India, insurance has a deep-rooted history. Insurance in various forms has been mentioned in the writings of Manu

(Manusmrithi), Yagnavalkya (Dharmashastra) and Kautilya (Arthashastra). The fundamental basis of the historical reference to insurance in these ancient Indian texts is the same i.e. pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. The early references to Insurance in these texts have reference to marine trade loans and carriers' contracts.

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

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

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

The Life Insurance Corporation (LIC) absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies—245 Indian and foreign insurers in all. In 1972 with the General Insurance Business (Nationalisation) Act was passed by the Indian Parliament, and consequently, General Insurance business was nationalized with effect from 1 January 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commence business on 1 January 1973.

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

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

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

Terms used in Insurance

Insured

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

Insurer

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

Beneficiaries

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

Contract

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

Premium

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

Insured sum

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

Peril

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

Hazard

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

Exposure

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

Cover note

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

Damages

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

Indemnity

Compensation for actual loss suffered is call indemnity.

Reinsurance

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

Double Insurance

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

No claim bonus

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

maximum rate should be up to 50% as per the norms.

Characteristics of Insurance

Insurance follows important characteristics — These are follows

1. Sharing of risk

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

2. Co-operative device

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

3. Large number of insured persons

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

4. Evaluation of risk

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

5. Payment of happening of specified event

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

6. Transfer of risk

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

7. Spreading of risk

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

8. Protection against risks

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

9. Insurance is not charity

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

10. Insurance is not a gambling

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

11. A contract

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

12. Social device

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

13. Based upon certain principle

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

14. Regulation under the law

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

15. Insurance is for pure risk only

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

16. Based on mutual goodwill

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

Insurance As A Social Security Tool

1. United Nations Declaration of Human Rights 1948 provides: - "Every one has a right to adequate standard of living for health and well being of himself and his family, including food, clothing, housing, medical care, necessary social services and the right to security in the event of unemployment, sickness, disability, widowhood, or other lack of livelihood in circumstances beyond his control."
2. Under a socialistic system the responsibility of full security would be placed upon the state to find resources for providing social security. In the capitalistic left to the individuals. The society provides instruments which can be used in securing this aim. Insurance is one of aim. In capitalistic society too there is a tendency to provide

some social security by the state under some schemes where members are required to contribute.

3. In India, Article 41 of our Constitution requires the State (with in limits of its economic capacity and development) to make effective provision for securing the right to work, to education and to provide public assistance in case of unemployment, old age, sickness and disablement.
4. Part of the obligations under Article 41 are met by the State through the mechanism of Life Insurance.
5. Where breadwinner of family dies, family's income stops to that extent, affecting the economic condition. Life Insurance provides such alternate arrangement as we have discussed above. Otherwise another family would have been pushed into the lower strata of society. The lower strata creates a cost on society. Poor people cost the nation by way of subsidies etc.
6. Life insurance helps in restoration of the adverse economic condition so caused.

Functions of Insurance

Insurance is defined as a co-operative device to spread the loss caused by a particular risk over a number of persons who are exposed to it and who agree to ensure themselves against that risk. Risk is uncertainty of a financial loss. It should not be confused with the chance of loss which is the probable number of losses out of a given number of exposures. It should not be confused with peril which is defined as the

cause of loss or with hazard which is a condition that may increase the chance of loss. Finally, risk must not be confused with loss itself which is the unintentional decline in or disappearance of value arising from a contingency. Wherever there is uncertainty with respect to a probable loss there is risk. Every risk involves the loss of one or other kind. The function of insurance is to spread the loss over a large number of persons who are agreed to co-operate each other at the time of loss. The risk cannot be averted but loss occurring due to a certain risk can be distributed amongst the agreed persons. They are agreed to share the loss because the chances of loss, i.e., the time, amount, to a person are not known.

Anybody of them may suffer loss to a given risk, so, the rest of the persons who are agreed will share the loss. The larger the number of such persons the easier the process of distribution of loss. In fact; the loss is shared by them by payment of premium which is calculated on the probability of loss. In olden time, the contribution by the persons was made at the time of loss. The insurance is also defined as a social device to accumulate funds to meet the uncertain losses arising through a certain risk to a person insured against the risk. The functions of insurance can be studied into two parts (i) Primary Functions, and (ii) Secondary Functions.

Primary Functions:

(i) Insurance provides certainty:

Insurance provides certainty of payment at the uncertainty of loss. The uncertainty of loss can be reduced by better planning and administration. But, the insurance relieves

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

(ii) Insurance provides protection:

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

(iii) Risk-Sharing:

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

Secondary functions:

Besides the above primary functions, the insurance works

for the following functions:

(i) Prevention of Loss:

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

(ii) It Provides Capital:

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

(iii) It Improves Efficiency:

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

(iv) It helps Economic Progress:

The insurance by protecting the society from huge losses of damage, destruction and death, provides an initiative to work hard for the betterment of the masses. The next factor of economic progress, the capital, is also immensely provided by the masses. The property, the valuable assets, the man, the machine and the society cannot lose much at the disaster.

Advantages of Insurance**1. Assures for financial compensation**

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

2. Reduction of risks

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

3. Encouragement to saving and investment

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

secured from the financial risks. Hence, it encourages persons to make regular savings.

4. Basis of credit

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

5. Maintains economic stability

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

6. Promotes business activities

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

7. Provides employment opportunities

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

Disadvantages of Insurance

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

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

Basic Principles of Insurance

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.

This is a regulatory principal. This principle is observed more strictly in property insurance than in life insurance.

The purpose of this principle is to set back the insured to the same financial position that existed before the loss or damage occurred.

5. Principal 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.

Double insurance policy is adopted where the financial position of the insurer is doubtful. The insured cannot recover more than the actual loss and cannot claim the whole amount from both the insurers.

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.

Kinds of Insurance

Business Point of View :

The insurance can be classified into three categories from

business point of view: (i) Life Insurance, (ii) General Insurance, and (iii) Social Insurance.

(i) Life Insurance:

Life Insurance is different from other insurance in the sense that, here, the subject matter of insurance is life of human being. The insurer will pay the fixed amount of insurance at the time of death or at the expiry of certain period. At present, life insurance enjoys maximum scope because the life is the most important property of the society or an individual. Each and every person requires the insurance. This insurance provides protection to the family at the premature death or gives adequate amount at the old age when earning capacities are reduced. Under personal insurance a payment is made at the accident. The insurance is not only a protection but is a sort of investment because a certain sum is returnable to the insured at the death or at the expiry of a period. The business of life insurance is wholly done by that Life insurance Corporation of India.

(ii) General Insurance :

The general insurance includes property insurance, liability insurance and other forms of insurance. Fire and marine insurances are strictly called property insurance. Motor, theft, fidelity and machine insurances include the extent of liability insurance to a certain extent. The strictest form of liability insurance is fidelity insurance, whereby the insurer compensates the loss to the insured when he is under the liability of payment to the third party.

(iii) Social Insurance:

The social insurance is to provide protection to the weaker section of the society who is unable to pay the premium for adequate insurance. Pension plans, disability benefits, unemployment benefits, sickness insurance and industrial insurance are the various forms of social insurance. With the increase of the socialistic ideas, the social insurance is an obligatory duty of the nation. The Government of a country must provide social insurance to its masses.

Risk Point of View:

Insurance is divided into property liability and other form from high point of view

A. Property Insurance:

Under the property insurance property of person/persons are insured against a certain specified risk. The risk may be fire or marine perils, theft of property or goods, damage to property at accident.

(a) Marine Insurance:

Marine insurance provides protection against loss of marine perils. The marine perils are collision with rock, or ship attacks by enemies, fire and capture by pirates, etc. These perils cause damage, destruction or disappearance of the ship and cargo and non-payment of freight. So, marine insurance insures ship (Hull), cargo and freight. Previously only certain nominal risks were insured but now the scope of marine insurance had been divided into two parts: (i) Ocean Marine Insurance and (ii) Inland Marine Insurance. The former insures

only the marine perils while the latter covers inland peril which may arise with the delivery of cargo (goods) from the godown of the insured and may extend up to the receipt of the cargo by the buyer (importer) at his godown.

(b) Fire Insurance:

Fire insurance covers risks of fire. In the absence of fire insurance, the fire waste will increase not only to the individual but to the society as well. With the help of fire insurance, the losses, arising due to fire are compensated and the society is not losing much. The individual is protected from such losses and his property or business or industry will remain approximately in the same position in which it was before the loss. The fire insurance does not protect only losses but it provides certain consequential losses also. War risk, turmoil, riots, etc., can be insured under this insurance, too.

(c) Miscellaneous Insurance:

The Property, goods, machine, furniture, automobile, valuable articles, etc., can be insured against the damage or destruction due to accident or disappearance due to theft. There are different forms of insurances for each type of the said property whereby not only property insurance exists but liability insurance and personal injuries are also insured.

B. Liability Insurance:

The general insurance also includes liability insurance thereby the insured is liable to pay the damage of property or to compensate the loss of personal injury or death. This insurance is seen in the form of fidelity insurance, automobile insurance and machine insurance, etc.

C. Other Forms:

Besides the property and liability insurances, there are certain other insurances which are included under general insurance. The examples of such insurances are export-credit insurances, State employees insurance, etc., whereby the insurer guarantees to pay certain amount at the certain events. This insurance is extending rapidly these days.

1. Personal Insurance:

The personal insurance includes insurance of human life which may suffer loss due to death, accident and disease. Therefore, the personal insurance is further sub-classified into life insurance, personal accident insurance and health insurance.

2. Property Insurance:

The property of an individual and of the society is insured against the loss of fire and marine perils, the crop is insured against unexpected decline in production, unexpected death of the animals engaged in business, break-down of machines and theft of the property and goods.

3. Liability Insurance:

The liability insurance covers the risks of third party, compensation to employees, liability of the automobile owners and reinsurances.

4. Guarantee Insurance:

The guarantee insurance covers the loss arising due to dishonesty, disappearance and disloyalty of the employers or

second. The party must be a party of the contract. His failure causes loss to the first party. For example, in export insurance, the insurer will compensate the loss at the failure of the importers to pay the amount of debt.

Life Insurance Vs General Insurance Types

Life insurance is a non-personal insurance contract. This means that the policyholder and the person being insured do not have to be the same person. General insurance is always a personal contract where the insurance company contracts with you directly for insurance protection.

Function

Both life insurance and general insurance accept premiums in exchange for insurance benefits. Insurance premiums are invested into bonds or bond-like investments that produce stable and consistent returns for the insurance company. The investments, plus premium payments, also ensure that the insurance company can pay the promised benefits that are outlined in the insurance policy. When you need to file a claim, both types of insurance require a claim form for you to fill out. The payment of benefits, and the amount of the benefit that is payable, are always spelled out in your insurance contract.

Significance

Life insurance insures your life or the life of someone that you have an economic interest in, like your spouse, children, siblings or business partners. When the insured individual dies, the life insurance policy pays a death benefit

that is fixed. This is called a valued contract. A valued contract pays a fixed sum of money, regardless of the nature of the loss insured by the contract.

General insurance insures homes, automobiles and other personal property. This type of insurance is sometimes referred to as "property and casualty" insurance. General insurance is indemnity insurance. Indemnity insurance pays just enough money to you to repair or replaced the insured property. For example, your homeowner's insurance may cover your entire home and the contents of it. However, if your roof is damaged in a storm, the policy only pays enough to repair the damage.

Benefits

The benefit of life insurance is that it pays off any financial obligations you have left after you die. It can pay more than that, however, because life insurance pays a fixed amount. Death benefits can be used to create wealth for the surviving beneficiaries, or they can be used to replace the primary income earner's salary for a surviving spouse.

General insurance is beneficial in that the insurance ensures that, almost regardless of the damage done, that the property will be repaired or replaced. While general insurance generally has a maximum payout determined by the value of your property, it does not pay a fixed amount, so you won't have to guess at how much insurance you need to purchase.

Expert Insight

Both types of insurance are necessary to protect your life and your property. They each serve a different function and fill

specific roles in your insurance plan. When buying life insurance, only buy enough insurance to cover your current and expected future financial liabilities. When purchasing general insurance, the maximum coverage should not extend beyond the total replacement value of your property.

MODULE 5

LIFE INSURANCE — CONCEPT

Life insurance (or **life assurance**, especially in the Commonwealth), is a contract between an insurance policy holder and an insurer or assurer, where the insurer promises to pay a designated beneficiary a sum of money (the benefit) in exchange for a premium, upon the death of an insured person (often the policy holder). Depending on the contract, other events such as terminal illness or critical illness can also trigger payment. The policy holder typically pays a premium, either regularly or as one lump sum. Other expenses (such as funeral expenses) can also be included in the benefits.

Life policies are legal contracts and the terms of the contract describe the limitations of the insured events. Specific exclusions are often written into the contract to limit the liability of the insurer; common examples are claims relating to suicide, fraud, war, riot, and civil commotion.

Life-based contracts tend to fall into two major categories:

Protection policies — designed to provide a benefit, typically a lump sum payment, in the event of specified event. A common form of a protection policy design is term insurance.

Investment policies — where the main objective is to facilitate the growth of capital by regular or single premiums. Common forms (in the U.S.) are whole life, universal life, and variable life policies.

Basic Principles of Life Insurance

1. Insurable interest

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

2. Utmost good faith

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

3. Not a contract of indemnity

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

Features of Life Insurance

Since the life insurance is not an indemnity contract, the insurer, in his part, is required to pay a definite sum of money

agreed on maturity of policy at the death or an amount in instalment for a fixed period or during life. As such, contrary to other insurance policies, it has some distinct features. The essential features of life insurance are as follows:

1. Insurable interest

The insured or policyholder must have an insurable interest for a valid life insurance contract. Insurable interest arises out of pecuniary relationship which exists between the insurer and policy holder, the former or insurer stands to loose by the death of the policy holder or latter and or continuous to gain by his survival. In life insurance contract, a person may have insurable interest for his own life as well as lives of his relatives such as wife, son, daughter etc. No person can purchase life insurance policy for a third person unless he has financial interest in his life.

2. Utmost good faith

The life insurance requires that the principle of utmost good faith should be preserved by both the parties; insurer and insured. Utmost good faith between the parties is necessary in all kinds of contracts. The insured in particular, must disclose all facts accurately and completely with respect to the object of life policy.

3. Warranties

Warranties are the representations in life insurance which are embodied in the policy and expressly or impliedly forming part of the basis of the contract. Warranties are the integral part of the contract. These are the bases of the contract between

insured and insurer and if any statement or information or presentation, whether material or non-material, is untrue the contract may be void and the premium paid by insured may be forfeited by the insurance company or insurer.

4. Assignment and nomination

The life insurance policy can be assigned free for a legal consideration or love and affection. The insured may assigned to anybody on any ground. As such, the assignment shall be complete and effectual only on the execution of such endorsement either on the policy itself or by a separate deed.

5. Return of premium

Generally, the amount of premium paid cannot be refunded. however, for the reason of equity, the premium may be refunded. If it is the case of misrepresentation or breach of warranty, the insured, in the absence of any express condition to the contrary, can claim for return of premium paid. But, in case of guilty of fraud in obtaining policy, the insured cannot claim the amount of premium to be returned.

Importance of Life Insurance

The following point shows the role and importance of insurance:

Insurance has evolved as a process of safeguarding the interest of people from loss and uncertainty. It may be described as a social device to reduce or eliminate risk of loss to life and property. Insurance contributes a lot to the general economic growth of the society by provides stability to the functioning of process. The insurance industries develop

financial institutions and reduce uncertainties by improving financial resources.

1. Provide safety and security:

Insurance provide financial support and reduce uncertainties in business and human life. It provides safety and security against particular event. There is always a fear of sudden loss. Insurance provides a cover against any sudden loss. For example, in case of life insurance financial assistance is provided to the family of the insured on his death. In case of other insurance security is provided against the loss due to fire, marine, accidents etc.

2. Generates financial resources:

Insurance generate funds by collecting premium. These funds are invested in government securities and stock. These funds are gainfully employed in industrial development of a country for generating more funds and utilised for the economic development of the country. Employment opportunities are increased by big investments leading to capital formation.

3. Life insurance encourages savings:

Insurance does not only protect against risks and uncertainties, but also provides an investment channel too. Life insurance enables systematic savings due to payment of regular premium. Life insurance provides a mode of investment. It develops a habit of saving money by paying premium. The insured get the lump sum amount at the maturity of the contract. Thus life insurance encourages savings.

4. Promotes economic growth:

Insurance generates significant impact on the economy by mobilizing domestic savings. Insurance turn accumulated capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce activities those results into economic growth and development. Thus, insurance plays a crucial role in sustainable growth of an economy.

5. Medical support:

A medical insurance considered essential in managing risk in health. Anyone can be a victim of critical illness unexpectedly. And rising medical expense is of great concern. Medical Insurance is one of the insurance policies that cater for different type of health risks. The insured gets a medical support in case of medical insurance policy.

6. Spreading of risk:

Insurance facilitates spreading of risk from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large number of persons get insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of funds of the insurer.

7. Source of collecting funds:

Large funds are collected by the way of premium. These funds are utilised in the industrial development of a country, which accelerates the economic growth. Employment opportunities are increased by such big investments. Thus,

insurance has become an important source of capital formation.

Types of Life Insurance Policies

1. Term Policy

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

Term assurance policy has the following features:

- It provides a risk cover only for a prescribed period. Usually these policies are short- term plans and the term ranges from one year onwards. If the policyholder survives till the end of this period, the risk cover lapses and no insurance benefit payment is made to him.
- The amount of premium to be paid for these policies is lower than all other life insurance policies. As savings and reserves are not accumulated under this policy, it has no surrender value and loan or paid-up values are not allowed on these policies.
- This plan is most suitable for those who are initially unable to pay high premium
- When income is low as required for Whole Life or Endowment policies, but requires life cover for a high amount.

2. Whole Life Policy

This policy runs for the whole life of the assured. The

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

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

(2) Limited payment whole life policy — In this case premium is payable for a specified period

(Say 20 Years or 25 Years) Only.

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

3. Endowment Life Policy

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

4. Health insurance schemes

An individual is subject to uncertainty regarding his health. He may suffer from ailments, diseases, disability caused by stroke or accident, etc. For serious cases the person may have to be hospitalized and intensive medical care has to be provided which can be very expensive. It is here that medical insurance is helpful in reducing the financial burden.

These days the vulnerability to lifestyle diseases such as heart, cancer, neurotic, and pollution based, etc. are on the increase. So it makes sense for an individual to go for medical insurance cover.

5. Joint Life Policy

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

6. With Profit And Without Profit Policy

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

7. Double Accident Benefit Policy

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

8. Annuity Policy

Under this policy, the sum assured is payable not in one

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

9. Policies For Women

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

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

B. Jeevan Sukanya

10. Group Insurance

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

10. Policies For Children

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

- (1) Children's deferred assurances
- (2) Marriage endowment and educational annuity plans
- (3) Children endowment policy

11. Money Back Policy

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

Need for Insurance Documentation

Life insurance is a legally enforceable contract between two parties both of whom are legally qualified to contract. It is therefore, necessary that the terms and conditions of the agreement must be suitably documented in a manner that would make it clear that both parties to the contract are Ad-idem i.e., of the same mind. Ad-Idem means that both the parties understand the same thing in the same sense or are of the same mind on the same subject. There must be consensus or Ad-Idem between the parties to the contract. This is possible provided all the terms and conditions, rights and duties - privileges and obligations are properly documented in terms which can be clearly interpreted in a court of law. Between two human beings sometime silence means an acceptance. But as the insurer is a legal personality entitled to contract verbal discussion between parties to the contract is not possible and hence there is a need for documentation. Insurance is also a contract of utmost good faith and enforced only in the distant future. It is therefore necessary that the declarations made by

both the parties should be put in black and white for future reference. Any suppression, willful and material shall make the contract void. The insured, therefore, has a duty to declare all that he knows about himself, his health, his financial status in answering questions contained in the proposal form and other ancillary documents which may be required by the insurer.

Documents needed at the stage of the proposal

Proposal form is the basic format which is filled in by the proposer who wants to take an insurance policy. It can be defined as the application for insurance. A proposal form has three portions

- (1) The first gives details about the proposer, his name, address, occupation, the details about the type of insurance that he wants to take and the name of the nominee to whom the money is payable in case the policyholder does not survive to take the maturity amount.
- (2) The second portion relates to the details of the insurance policy that the proposer already possesses, the present health conditions and the personal history of his health, any sickness or accident he might have had. This is a detailed questionnaire and the proposer is expected to reply to each question truthfully and honestly. A female proposer has to reply to certain additional questions specific to her gender. The last portion of the proposal form relates to the declaration. Through this declaration, the proposer
 - (i) affirms the veracity of the statements made in the proposal form in replying to the question

(ii) affirms that he/she has not suppressed, misrepresented or concealed any fact which may be material to the risk

(iv) agrees that this declaration along with the proposal form shall form the basis of the contract and if any information is found to be false the contract will be null and void thus reinforcing the principle of “Uberimma Fides” (Utmost good faith).

(v) further agrees to take the insurance on the terms and conditions decided by the insurer. The proposer further agrees to keep the insurer informed of any changes in the position relating to his health or his occupation between now and the issuance of the first premium receipt. It is thus clear that after the insurer has issued the first premium receipt, the contract is said to have concluded and thereafter the insurer has no right to change the terms of the contract. However, the insurer has a right to offer any term and condition before the final acceptance of the insurance. For example, in case of a female proposer, the insurer may not agree to accept the risk of the childbirth. In case of certain hazardous occupation like commercial pilots, the insurer may like to exclude the risk to life due to such occupation. In case of certain deformity, the risk of accident can be excluded. These exclusions of risks are not normal terms of the policy contract and therefore have to elicit consent of the proposer. In case of a substandard health, the insurer may like to accept a reduced risk during the first one or two years of the insurance. The consent of the insured is a must for such limitations to be imposed. All such special conditions or riders are mentioned in the policy either by an

endorsement or attachment to the document. If the insurer has taken a Convertible Whole Life Plan which is to be converted to an endowment plan after 5 There are certain other documents which may be required at the proposal stage.

Age proof

Age is an important factor in deciding the quantum of premium against a policy. The document proving the age, i.e. age proof must be reliable and the insured has to undertake as to its truthfulness. An insurer accepts these documents as standard age proof -

- 1) Certified extract from municipal records, recorded at the time of birth.
- 2) Certificate of baptism or extract from Family Bible
- 3) Extract from school or college records.
- 4) Extract from service register in case of employees - Government or semi government or such other reputed institutions which insist on conclusive evidence of age at the time of recruitment.
- 5) Identity card issued by Defence department.
- 6) Marriage certificates issued by Roman Catholic Church.
- 7) Domicile certificate.
- 8) Passport.

Non-standard age proofs are those which are comparatively less reliable and therefore the insurer accepts them with a pinch of salt. In other words the insurer takes certain

precautions before accepting such age proofs as final.

Such **non-standard age proofs** are

(1) Horoscope, (2) service records of employers other than those mentioned above (3) ESI card, (4) Marriage Certificate in case of a Muslim proposer., 5) Elders Declaration, 6) Self Declaration, 7) Driving Licence, 8) Certificate issued by village panchayat, 9) Electoral role, 10) Ration card.

Age proof is insisted upon for completion of proposal if the declared age of the proposer is less than 20 or more than 50 or if the sum proposed is quite high, say above one lakh

Proof of income

This document may become necessary whenever the sum proposed is very high. Normally a sum proposed which is seven to eight times of the declared income is acceptable for insurance. But proposals do come to the insurer when the known source of income of the proposer is much less compared to the amount of insurance desired. A service holder normally does not face this problem as his sources of income are verifiable.

In case of business people, the assessed income is at times much less compared to what is a desirable income for the amount of insurance desired. In such cases the insurer at times calls for assessed income tax returns, or Chartered Accountant's certificate etc. Such precautions are necessary to eliminate the possibility of moral hazard

Documents Needed During The Continuance of The Policy:

First Premium Receipts and Renewal Premium Receipts

The First Premium Receipt (FPR) is the confirmation of insurance. This document is important as it gives the date of assumption of the risk but its value is nil once the policy document has been issued

Policy Contract

Policy document is a detailed document and it is the Evidence of the insurance contract which mentions all the terms and conditions of the insurance. The insured buys not the policy contract, but the right to the sum of money and its future delivery. The insurer on its part promises to pay a sum of money, provided of course the insured keeps its part of promise of paying the instalments of premium as scheduled. The pre-amble to the insurance contract makes the above statement clear and states that this policy is issued subject to the conditions and privileges printed on the back of the policy. The endorsements placed on the policy shall also be part of the policy and it also makes a reference to the proposal form saying that that the statements given in the proposal form are the basis of the contract. The schedule which is printed on the policy document identifies the office which has issued the policy. It states the name of the policyholder, the date of commencement of the policy, an identification number of the policy called policy number. This number is extremely useful for making any reference to the insurer relating to this policy. This shall avoid needless delay. Beneficiary's name is also mentioned along with address. It is necessary to check that it is

correct and any mistake should be immediately pointed out for correction. A mistake in the address may misdirect the premium notices and any other future correspondence. It also states the name of the nominee and the date upto which premium has to be paid. The schedule goes on to mention, the type of policy, on the happening of which, the sum assured is payable and to whom it is payable. It of course also mentions when and how long the premium is to be paid. The policy document is signed by an official of the insurer and dated and stamped as per the provision of the Stamp Act to make it a completely legally enforceable document.

Renewal Premium Receipts

Though it is the duty of the insured to pay the renewal premium on the due date the insurer sends a renewal premium notice to the insured out of courtesy and on receiving the

Nomination

Generally nomination is made at the time of taking a policy. In case it is not done, it is possible to make nomination subsequently by an endorsement on the policy. It is also possible to change a nomination subsequently by an endorsement. After marriage, such change in nomination is normally required.

Assignment

An assignment of a policy in favour of another person or institution can be effected by an endorsement on the policy. Re-assignment can also be done by a subsequent endorsement on the same policy.

Revival of policies

The insurer allows automatic revival of a lapsed policy if outstanding premiums are paid along with interest, generally within six months of the first unpaid premium. When the nominee or heir of a life assured informs the life insurance company that the life assured is missing and his whereabouts are unknown, the life insurer advises the nominee / heir to pay the premium and keep the policy in force. In such cases revivals are automatic on payment of premium and interest thereon. As the period of non-payment of premium grows longer, the arrears of premium may get accumulated to a larger sum, making it difficult for the policyholder to pay in one go. In such cases, insurers also allow instalment revival. Insurers like LIC grant loan on the lapsed policy for revival of the policy. While calculating the loan they presume outstanding premiums as paid and calculate the loan so that the loan amount will be high. If the policy lapsed in its early years when it has not yet acquired paid-up value, the insurer allows its revival by shifting of the date of commencement of the policy. The age and fresh premium is calculated from this date onwards. This difference in premium (for six quarterly instalments) is collected at the time of revival and the policyholder is asked to pay one premium (quarterly January 2013) at the revised rate.

Requirements

Conditions of revival of a life insurance policy are determined on the basis of factors such as amount of coverage, age of the life assured, period of lapse, period already run by

the policy, health and occupation of the life assured. So in cases other than automatic revival on payment of arrears of premium and interest, the insurer will insist for evidence of continued good health of the life assured. This can be accomplished through a declaration of good health and /or medical report from an authorised medical examiner.

Good faith holds

Revival of a life policy by submission of such requirements is as good as purchasing a new policy. These documents enable the insurer to decide whether to accept or decline and in the event of acceptance of risk, to determine the rates, terms and conditions of a cover to be granted' (e.g., an increase in premium, a reduction in term, accident benefit to be disallowed, table of the policy to be changed, to decline the revival itself.) They come within the definition of 'proposal' in a policy. In other words, a declaration of good health must provide all honest and truthful disclosures. Insurers carry out investigations in case of early death claim after revival to rule out the possibility of deliberate suppression of material facts.

Revival of a life insurance policy gives the policyholder some very important advantages such as continuance of life cover at a lower premium, bonus for the period during which the policy was in lapse condition and tax advantages. Keep your life insurance policy in force.

Claim Settlement Process:

Death Claim

Step One: Intimation of Claim The claimant must submit the

written intimation as soon as possible to enable the insurance company to initiate the claim processing. The claim intimation should consist of basic information such as policy number, name of the insured, date of death, cause of death, place of death, name of the claimant etc .Claim intimation form can be availed from nearest branch of the insurance company or/and by downloading it from the company website.

Step Two: Documentation The claimant will be required to provide the following documents along with a claimant's statement: I. Certificate of Death II. Proof of age of the life assured (if not already given) III. Deeds of assignment / reassignments (if required) IV. Policy document V. Any other document as per requirement of the insurer For early death Claim, (If the claim has accrued within three years from the beginning of the policy), the following additional requirements may be called for: I. Statement from the hospital if the deceased had been admitted to hospital II. Certificate of medical attendant of the deceased giving details of his/her last illness III. Certificate of cremation or burial to be given by a person of known character and responsibility present at the cremation or burial of the body of the deceased IV. Certificate by employer if the deceased was an employee In special cases as per following the poof of death will be different from the standard specification In case of an air crash the certificate from the airline authorities would be necessary certifying that the assured was a passenger on the plane. In case of ship accident a certified extract from the logbook of the ship is required. In case of death from medical causes, the doctors'

certificate and/or treatment records may be required. If the life assured had a death due to accident, murder, suicide or unknown cause the police inquest report, panchanama, post mortem report, etc would be required.

Step Three: Submission of required Documents for Claim Processing For faster claim processing, it is essential that the claimant submits complete documentation as early as possible.

Step Four: Settlement of Claim As per the regulation 8 of the IRDA (Policy holder's Interest) Regulations, 2002, the insurer is required to settle a claim within 30 days of receipt of all documents including clarification sought by the insurer. If the claim requires further investigation, the insurer has to complete its procedures within six months from receiving the written intimation of claim. After receiving the required documents the company calculates the amount payable under the policy. For this purpose, a form is filled in which the particulars of the policy, bonus, nomination, assignment etc. should be entered by reference to the Policy Ledger Sheet. If a loan exists under the policy, then the section dealing with loan is contacted to give the details of outstanding loan and interest amount, which is deducted from the gross policy amount to calculate net payable claim amount. Generally all claim payments would be made through the electronic fund transfer.

Maturity & Survival Claims: The payment by the insurer to the insured on the date of maturity is called maturity payment. The amount payable at the time of the maturity includes a sum assured and bonus/incentives, if any. The insurer sends in advance them intimation to the insured with a blank discharge

form for filling various details in it. It is to be returned to the office along with Original Policy document, ID proof, Age proof if age is not already submitted, Assignment /reassignment, if any and Copy of claimant's Bank Passbook & Cancelled Cheque. Settlement procedure for maturity claim is simple after receipt of completed and stamped discharge form from the person entitled to the policy money along with policy documents, claim amount will be paid by account payee cheque.

Regarding maturity claims certain points are to be remembered:

If the life assured is reported to have died after the date of maturity but before the receipt is discharged, the claim is to be treated as the maturity claim and paid to the legal heirs. In this case death certificate and evidence of title is required. Where the assured is known to be mentally deranged, a certificate from the court of law under the Indian Lunacy Act appointing a person to act as guardian to manage the properties of the lunatic should be called. For Survival Benefit claim, Policy bond and discharge voucher is required.

Rider Claims: The life insurance policy can be attached with different riders like accidental rider, Critical illness Rider, Hospital cash Rider, waiver of Premium Rider etc. For different Riders different proceedings can be opted for claim settlement. In some cases the claim may proceed as well as with the death Claim (Like Waiver of premium rider, accidental death Rider etc). But in some other cases different documents can be required for along with the duly filled Claim

form & Policy Copy: For Critical Illness Rider, necessary medical documents such as first investigation report, Doctor's prescription, Discharge Summery etc are required For Accidental disability rider, Attested copy of FIR, Doctor Certificate of disability, Photograph of the injured with reflecting disablement, Original Medical bills with prescriptions/ treatment papers etc are required. For Hospital cash rider medical documents are required such as Medical & Investigation report, Prescriptions, Medical and Investigation Bills, Discharge Card etc.

Importance of Proper Documentation in Claim Processing:

It is noted that in many cases the life insurance claim has been denied by the insurer because the claimant has failed to follow some step or not able to submit the necessary information to the company. So it is recommended that when you claim for life insurance, take proper steps and documentation.

Laws relating to Insurance Business

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

- A. Insurance Act, **1938**
- B. Life Insurance Corporation Act, **1956**
- C. General Insurance Business (Nationalization) Act, 1972
- D. Insurance Regularity and Development Authority Act, **1999** (IRDA)
- A. INSURANCE ACT, 1938**

The insurance act originally passed in the year 1938.

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

a. Registration

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

Every insurance company must keep the accounts separately of all receipts and payment in respect of each class of insurance business such as the marine or miscellaneous insurance. Insurers must invest his assets only in those investments which approved under the provisions of the Act. Every insurance company has to do a minimum insurance business in the rural or social sector, as may be specified in the

order. The authority can be investigated the affair of the insurer at any time.

b. Licensing of agents

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

1. Being unsound mind.
2. Being convicted of criminal misappropriation or criminal breach of trust or cheating or forgery or Abetment or Attempt to commit any such offence.
3. Being found to have been guilty of or connived at any fraud, Dishonesty or misappropriation against any insured on insurer.

c. Licensing of surveyors and loss assessors

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

d. Solvency margin

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

e. Payment of premium before assumption of risk

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

B. Life Insurance Corporation Act, 1956

Life Insurance Business in India was nationalized with effect from January 19, 1956. On the date, the Indian business of 16 non-Indian insurers operating in India and 75 Provident Societies were taken over by Government of India. Life Insurance Corporation of India, Act was passed by the Parliament on June 18, 1956 and came into effect from July 1, 1956. Life Insurance Corporation of India commenced its functioning as a corporate body from September 1, 1956. Its working is governed by the LIC Act. The LIC is a corporate having perpetual succession and a common seal with a power to acquire hold and dispose of property and can by its name sue and be sued. Important Provisions of Life Insurance Corporation Act, 1956

1. Constitution
2. Capital

3. Functions of the Corporation
4. Transfer of Services
5. Set-up of the Corporation
6. Committee of the Corporation
7. Authorities
8. Finance, Accounts and Audit
9. Miscellaneous

Life Insurance Corporation of India (LIC)

The LIC of India was set up under the LIC Act, 1956 under which the life insurance was nationalised. As a result, business of 243 insurance companies was taken over by LIC on 1-9-1956. It is basically an investment institution, in as much as the funds of policy holders are invested and dispersed over different classes of securities, industries and regions, to safeguard their maximum interest on long term basis. LIC is required to invest not less than 75% of its funds in Central and State Government securities, the government guaranteed marketable securities and in the socially-oriented sectors. At present, it is the largest institutional investor. It provides long term finance to industries. Besides, it extends resource support to other term lending institutions by way of subscription to their shares and bonds and also by way of term loans. LIC which has entered into its 57th year has emerged as the world's largest insurance co. in terms of number of policies covered. The LIC's total coverage of policies including individual, group and social schemes has crossed the 11 crore.

Objectives of LIC of India

The LIC was established with the following objectives:

1. Spread life insurance widely and in particular to the rural areas, to the socially and economically backward classes with a view to reaching all insurable persons in the country and providing them adequate financial cover against death at a reasonable cost
2. Maximisation of mobilisation of people's savings for nation building activities.
3. Provide complete security and promote efficient service to the policy-holders at economic premium rates.
4. Conduct business with utmost economy and with the full realisation that the money belong to the policy holders.
5. Act as trustees of the insured public in their individual and collective capacities.
6. Meet the various life insurance needs of the community that would arise in the changing social and economic environment
7. Involve all people working in the corporation to the best of their capability in furthering the interest of the insured public by providing efficient service with courtesy.

Role and Functions of LIC

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

1. It collects the savings of the people through life policies

and invests the fund in a variety of investments.

2. It invests the funds in profitable investments so as to get good return. Hence the policy holders get benefits in the form of lower rates of premium and increased bonus. In short, LIC is answerable to the policy holders.
3. It subscribes to the shares of companies and corporations. It is a major shareholder in a large number of blue chip companies.
4. It provides direct loans to industries at a lower rate of interest. It is giving loans to industrial enterprises to the extent of 12% of its total commitment.
5. It provides refinancing activities through SFCs in different states and other industrial loan - giving institutions.
6. It has provided indirect support to industry through subscriptions to shares and bonds of financial institutions such as IDBI, IFCI, ICICI, SFCs etc. at the time when they required initial capital. It also directly subscribed to the shares of Agricultural Refinance Corporation and SBI.
7. It gives loans to those projects which are important for national economic welfare. The socially oriented projects such as electrification, sewage and water channelising are given priority by the LIC.
8. It nominates directors on the boards of companies in which it makes its investments.

9. It gives housing loans at reasonable rates of interest.
10. It acts as a link between the saving and the investing process. It generates the savings of the small savers, middle income group and the rich through several schemes.

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

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

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

General Insurance Corporation of India (GIC)

General insurance industry in India was nationalised and a government company known as General Insurance

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

Objective of the GIC are:

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

Role and Functions of GIC

- a. Carrying on of any part of the general insurance, if it thinks it is desirable to do so.
- b. Aiding, assisting and advising the acquiring companies in the matter of setting up of standards of conduct and sound practice in general insurance business.
- c. Rendering efficient services to policy holders of general insurance.
- d. Advising the acquiring companies in the matter of controlling their expenses including the payment of commission and other expenses.
- e. Advising the acquiring companies in the matter of investing their fund.

- f. Issuing directives to the acquiring companies in relation to the conduct of general insurance business.
- g. Issuing directions and encouraging competition among the acquiring companies in order to render their services more efficiently.

Duties, Powers and Functions of IRDA

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

- Registering and regulating insurance companies
- Protecting policyholders' interests
- Licensing and establishing norms for insurance intermediaries
- Promoting professional organisations in insurance
- Regulating and overseeing premium rates and terms of non-life insurance covers
- Specifying financial reporting norms of insurance companies
- Regulating investment of policyholders' funds by insurance companies
- Ensuring the maintenance of solvency margin by insurance companies
- Ensuring insurance coverage in rural areas and of vulnerable sections of society

General Insurance Business (Nationalization) Act , 1972

The General Insurance Business (Nationalization) Act

has been incorporated on 20th September 1972. This Act has been established to provide for acquisition and transfer of shares of Indian Insurance Companies and undertakings to serve for better economy by securing the development of general insurance business by proper regulations and control over such business. Fifty five Indian Insurance Companies and fifty two other general insurance operations of other Companies were nationalized through this Act. On the day of enactment of this Act all shares in the capital of all insurance Companies in pursuance to this Act shall get transferred and vested in Central Government. Immediately after the transfer, it provides such person not more than ten shares of each insurance company to the name specified in the Official Gazette by the Central Government. This is to enable the Insurance Companies to work as a Government Companies.

The Central Government holding the vested properties and rights shall transfer the undertakings of the existing insurer who is not an Indian insurance Company to the Indian insurance Companies as notified in the Official Gazette. This transfer includes all the assets and liabilities of such Companies, including all the material particulars of such Companies, etc. In case of any liabilities or any issues arises from the date of transfer, Indian insurance Companies shall be responsible unless it is specified anything in the notifications in the Official Gazette by the Central Government. Even in case of any Suit or Appeal or any other legal proceedings initiated on such Company, Indian insurance Company shall handle that in good faith. In case of any question arises with

regard to any particulars with our general insurance Companies or such other Companies, the Central Government is responsible to answer it after reasonable opportunities of being heard have been given to such person who are interested in such matter and will decide accordingly in pursuance to this Act.

In case of matters with regard to employees of the previous insurance Company shall occupy the same position and payment in the Indian insurance Company as it deem fit unless his position has been terminated by them or his remuneration is been altered. Any question with regard to this is also answered by the Central Government after giving reasonable opportunity to hear. The General Insurance Corporation (GIC) was incorporated in pursuance to this Act under the Companies Act, 1956 as a Private Company limited by shares. This GIC was established to control and operate the General Insurance Business in India. This GIC is the only re-insurance Company having four decades of experience in the Indian insurance markets. The Government of India transferred all the assets and operations of the nationalized general insurance Companies to GIC and public-sector insurance Companies. This Corporat

The Central Government shall pay for transfer and vested shares or undertakings by Indian insurance Companies from other existing insurance Company as per schedule B and to the Central Government to vest shares and rights will get payment as per schedule A listed under this Act. This disbursement of amount by corporation is based on the requirements prescribed

under this Act and in a way it is prescribed to carry on any part of general insurance business by assisting the acquiring Companies through framing proper regulations in general insurance business. After paying all the required payment if there remains any profit, the Central Government shall distribute the profit among the acquired Companies. The Central Government shall formulate any number of schemes or regulations in pursuance to this Act as and when it is necessary. Acquiring Companies shall submit periodical accounts statements that are properly audited by Auditor-General of India and Comptroller. This statements shall intern submit before the Parliaments. This Act also contains several miscellaneous provisions with schedules attached in pursuance to this Act. This Act also got amended this Act and Insurance Act of 1938. This Act has been later amended in the year 2002. The Act along with the amendments ended the monopoly of GIC and its subsidiaries and liberalized the insurance business in India.

Fundamental Principles of General Insurance Utmost Good Faith

Utmost good faith, a principle dating back to *Carter v. Boehm* in 1766, is a principle based on precedent rather than on a set of defining codes or statutes. Utmost good faith requires honesty and full disclosure at all times, starting with the application phase. It prevents both the insured and insurer from concealing or misrepresenting facts during the application phase, prevents the insurer from ever altering the policy without full disclosure during the time the policy is in

force and, in the event of a loss, requires the insured to provide a full, honest representation of the facts surrounding the event and loss. Violating this principle can be the basis of a case for fraud.

Indemnity

The principle of indemnity refers to the payment of money for claims. It says an insured should get no more and no less money than the insurance policy permits and the extent of the loss allows. Provisions in the policy dictate whether claims are valued at cash or replacement value — taking or not taking an allowance for depreciation — or the face value a policy defines for policies that insure valuables such as artwork or antiques. Indemnity does not apply, however, to life insurance policies.

Subrogation

Subrogation is a principle of substitution and recovery. It puts an insurance company in a middleman position when a third party causes a loss and in this way helps to control insurance costs. For example, in the case of an auto accident, subrogation stops an insured from collecting payment from two insurance companies for the same loss, places responsibility for the accident on the third party and gives an insurance company the legal right to demand recovery for any payments made to the insured as a result of the accident.

Contribution

Contribution applies in a case where an insured holds more than one policy for the same thing. It allows insurance

companies to share the cost of claims and prevents an insured from collecting in full on more than one policy. The principle of contribution states that an insured can make a claim equal to the extent of a loss from one or all insurers. If one insurer pays the claim in full, the insurer can then recover a percentage of the payment from the other insurers.

Insurable Interest

The principle of insurable interest states that in order for a loss to “count” an insured must have an interest in or own the item being insured. Interest can be subjective, as in life insurance, or it can be a physical thing, such as a car or home. Either way, insurable interest prevents a person from taking out a policy or an insured from making a claim or collecting payments for a person he doesn’t have a direct relationship with or an item he doesn't own.

Proximate Cause

Proximate cause — which does not apply to life insurance — addresses what perils an insured chooses to cover and identifies insurer liability when two or more perils come together to cause a loss. It states that the proximate, closest or most dominant cause determines liability. For example, if an insured has fire but no flood insurance and a fire causes water pipes to burst and flood the home, the insured is liable for damage the fire causes. However, because bursting water pipes are the dominant cause of the flood damage, the insurance company is not legally liable to pay any claims resulting from repairs.

Types of General Insurance

Basically there are four type of general insurance stated below. Beside these a number of different kinds of policies for hedging against the various kind of risk are available in the market these days.

- Fire Insurance
- Marine Insurance
- Motor Insurance
- Health Insurance
- Miscellaneous Insurance

Fire Insurance

Fire is hazardous to human life as well as property. Loss of life by fire is covered under Life insurance and loss of property by fire is covered under fire insurance. Fire causes enormous damage by physically reducing the materials to ashes. A fire insurance policy provides protection strictly against fire. There could be enormous reasons for fire. In practice certain other related perils are also covered by the fire insurance policy. The General Insurance Act (Tariff) recommends the form of the contract in which a fire insurance is to be written. The policy form contains a preamble and operative clause, general exclusions and general conditions. Fire Insurance comes under tariff class of business. All India Fire Tariff is the revised fire insurance tariff, which came into force on May 1, 2001. Now a single policy was introduced to cover all property risks called standard fire and special peril policy in the place of three standard policies i.e. A, B & C.

A contract of fire insurance can be defined as a contract under which one party (the insurer) agrees for consideration (premium) to indemnify the other party (The insured) for the financial loss which the latter may suffer due to damage to the property insured by fire during a specified period of time and up to an agreed amount. The document containing the terms and conditions of the contract is known as ‘Fire Insurance Policy’. A fire policy contains the name of the parties, description of the insured property, the sum for which the property is insured, amount of premium payable and the period insured against. The premium may be paid either in single installment or by way of installments. The insurer is liable to make good the loss only when loss is caused by actual fire. The phrase ‘loss or damage by fire’ also includes the loss or damage caused by efforts to extinguish fire.

Scope of cover

Standard Fire and special perils policy usually cover loss due to the following perils:

- 1. Fire:** Destruction or damage to the property insured by its own fermentation, natural heating or spontaneous combustion or drying process can not be treated as damage due to fire.
- 2. Lightning:** It may result in fire damage or other type of damage, such as cracks in a building due to a lightning strike.
- 3. Explosion:** An explosion is caused inside a vessel when the pressure within the vessel exceeds the atmospheric pressure acting externally on its surface. This policy, however,

does not cover destruction or damage caused to the boilers or other vessels where heat is generated.

4. Storm, cyclone, typhoon, hurricane, tornado, landslide: These are all various types of violent natural disturbances accompanied by thunder or strong winds or heavy rain fall. Loss or damage directly caused by these disturbances are covered excluding those resulting from earthquake, volcanic eruption etc.

5. Bush fire: This covers damage caused by burning of bush and jungles but excluding destruction or damage caused by forest fire.

6. Riot, strike, malicious, and terrorism damages: Any loss or physical damage to the property insured directly caused by such activity or by the action of any lawful authorities in suppressing such disturbance is covered.

7. Aircraft damage: Loss, destruction or damage caused by Aircraft, other aerial or space devices and articles dropped there from excluding those caused by pressure waves.

8. Overflowing of water tanks and pipes etc.: Loss or damage to property by water or otherwise on account of bursting or accidental overflowing of water tanks, apparatus and pipes is covered.

9. Add-on Covers: The insurer can issue the standard fire policy with added benefits at the option of the policyholders by charging additional premium. These added benefits are as follows:

1. Architects, Surveyors and Consulting engineer's

fees (in excess of 3% claim amount)

2. Debris removal (in excess of 1% of claim amount)
3. Deterioration of stocks in cold storage due to power failure
4. Forest fire
5. Spontaneous combustion
6. Earthquake as per minimum rates and excess applicable as specified in the tariff.
7. Omission to insure additions, alterations or extensions.

The following types of losses, however, are not covered by a fire policy:

- Loss by theft during and after the occurrence of fire.
- Loss caused by burning of property by order of any public authority. Loss caused by underground fire.
- Loss or damage to property occasioned by its own fermentation or spontaneous combustion.
- Loss happening by fire which is caused by earthquake, invasion, act of foreign enemy, warlike operations, civil wars, riot etc.

In all the above cases the insurer is not liable, unless specifically provided for in the fire insurance policy. The insurer can issue the standard fire policy as per the New Fire Tariff along with added benefits at the option of the policyholders by charging additional premium.

Types of Fire Policies

The important fire insurance policies are discussed below:

- (i) **Valued Policy.** They are the exception in fire insurance. Under valued policy, the value declared in the policy is the amount the insurer will have to pay to the insured in the event of a total loss irrespective of the actual value of loss. The policy violates the principle of indemnity. The insurer has to pay a specified amount quite independent of the market or actual value of the property at the time of loss. So such a policy is very rarely issued. It may be issued only on artistic work, antiques and similar rare articles whose value cannot be determined easily.
- (ii) **Specific Policy.** Under this policy, the insurer undertakes to make good the loss to the insured upto the amount specified in the policy. Supposing, a building worth Rs.2,00,000 is insured against fire for Rs.1,00,000. If the damage to the property is Rs.75,000 the insurer will get the full compensation. Even if the loss is Rs.1,00,000 the insurer will get the full amount. But if the loss is more than Rs.1,00,000 the insured will get Rs. 1,00,000 only. Hence, the value of property is not relevant in determining the amount of indemnity in case of a specific policy.
- (iii) **Average Policy.** Under a fire insurance policy containing the 'average clause' the insured is liable for such proportion of the loss as the value of the uncovered

property bears to the whole property. e.g. if a person gets his house insured for Rs. 4,00,000 though its actual value is Rs.6,00,000, if a part of the house is damaged in fire and the insured suffers a loss of Rs. 3,00,000 the amount of compensation to be paid by the insurer comes out to Rs. 2,00,000 calculated as follows:

$$\text{Amount of claim} = \frac{(\text{Insured amount} \times \text{Actual loss})}{\text{Actual value of property}}$$

$$(4,00,000 \times 3,00,000) / 6,00,000 = 2,00,000$$

- (iv) Floating policy. A floating policy is used for covering fluctuating stocks of goods held in different lots for one premium. With every transaction of sale or purchase, the quantities of goods kept at different places fluctuate. It is difficult for the owner to take a policy for a specific amount. The best way is to take out a floating policy for all the stocks of goods.
- (v) Reinstatement Policy. In such a policy, the insurer has the right to reinstate or replenish the property destroyed instead of paying compensation to the insured in cash. It may be granted on building, machinery, furniture, fixture and fittings only.
- (vi) Consequential loss Policy. Sometimes the insured has to suffer a greater financial loss on account of dislocation of business caused by fire .e.g. close down business after fire for repair, to meet fixed expenses such as rent, salaries, taxes and other expenses as usual. Such considerable loss to the insured is not covered by the

ordinary fire policy. In order to cover such loss by fire, the 'Consequential Loss Policy' has been introduced. The loss so suffered is separately calculated from the loss actually suffered.

- (vii) Comprehensive policy. This policy covers the risks of the fire arising out of any cause that is civil commotion, lightening, riots, thefts, labor disturbances and strikes etc. It is also known as 'all insurance policy'.
- (viii) A Blanket policy. This policy is issued to cover all the fixed and current assets of an enterprise by one insurance.
- (ix) Declaration policy. In this policy, trader takes out a policy for the maximum value of stock which may be expected to hold during the year. At a fixed date each month, the insured has to make a declaration regarding the actual value of stock at risk on that date. On the basis of such declaration, the average amount of stock at risk in the year is calculated and this amount becomes the sum assured.
- (x) Sprinklers leakage policy. It covers the loss arising out of water leakage from sprinklers which are setup to extinguish fire.

Claim Procedure for Fire Insurance

1. In the event of fire the insured must immediately give the insurer a notice about the loss caused by fire. A written claim should be delivered within 15 days from the date of loss. The insured is required to furnish all plans, invoices,

documents, proofs and other relevant informations required by the insurer. If the insured failed to submit these documents within 6 months from the date of loss, the insurer has the right to consider it as no claim.

2. On receipt of the claim the insurer verifies whether the essentials of a valid claim are satisfied or not. e.g. The cause of fire should be an insured peril.

3. The insured completes the form, signs the declaration given in the form as to the truthfulness and accuracy of the information and returns the same.

4. An official employed by the insurer investigates small and simple claims. For large claims, the insurance company employs independent loss surveyor.

5. On the basis of the claim form and the investigation report, the company then settles the claim.

Marine Insurance

Marine insurance covers the loss or damage of ships, cargo, terminals, and any transport or cargo by which property is transferred, acquired, or held between the points of origin and final destination. Cargo insurance discussed here is a sub-branch of marine insurance, though Marine also includes Onshore and Offshore exposed property (container terminals, ports, oil platforms, pipelines); Hull; Marine Casualty; and Marine Liability.

The general principles of marine insurance are the same as with other types of insurance in that there are two parties: the assured and assurer (or carrier). The assured or insured

agrees to pay a premium and the insurer agrees that, if certain losses or damage occurs to certain interests of the insured, the insurer will indemnify the insured. The similarities pretty much end here. The complex circumstances involved in sea voyages require very specific arrangements for the provision of marine insurance. The fixing of rates and special conditions, for example, requires a vast knowledge of the nature of vessels and cargos and of the conditions of navigation.

The marine policy may cover the risks of a single voyage, or may insure for a certain period of time. Cargo is almost always insured by voyage. Vessels are usually insured for certain duration of time, usually year by the year. Cargo policies may be on a single lot or may be open to cover cargo as shipped by the insured. Hull insurance, or vessel insurance, may cover a ship or a whole fleet.

Typical of marine insurance is the principle that no contract of marine insurance is valid unless the insured has an insurable interest in the subject matter at the time of loss. The term insurable interest has been variously defined. According to the English *Marine Insurance Act* of 1906, "every person has an insurable interest who is interested in a marine adventure.... a person is interested in a marine adventure where he stands in any legal or equitable relation to the adventure or to any insurable property at risk therein, in consequence of which he may benefit by the safety or due arrival of insurable property, or may be prejudiced by its loss, or damage thereto, or by the detention thereof, or may incur liability in respect thereof".

The nature and scope of marine insurance is determined by reference to s. 6 of the Marine Insurance Act and by the definitions of “marine adventure” and “maritime perils”. A contract of marine insurance is a contract whereby the insurer undertakes to indemnify the insured, in the manner and to the extent agreed in the contract, against losses that are incidental to a marine adventure or an adventure analogous to a marine adventure, including losses arising from a land or air peril incidental to such an adventure if they are provided for in the contract or by usage of the trade; or losses that are incidental to the building, repair or launch of a ship.

"Marine adventure" means any situation where insurable property is exposed to maritime perils, and includes any situation where the earning or acquisition of any freight, commission, profit or other pecuniary benefit, or the security for any advance, loan or disbursement, is endangered by the exposure of insurable property to maritime perils, and any liability to a third party may be incurred by the owner of, or other person interested in or responsible for, insurable property, by reason of maritime perils. "Maritime perils" means the perils consequent on or incidental to navigation, including perils of the seas, fire, war perils, acts of pirates or thieves, captures, seizures, restraints, detainments of princes and peoples, jettisons, barratry and all other perils of a like kind and, in respect of a marine policy, any peril designated by the policy.

Subject Matter of Marine Insurance

The insured may be the owner of the ship, owner of the

cargo or the person interested in freight. In case the ship carrying the cargo sinks, the ship will be lost along with the cargo. The income that the cargo would have generated would also be lost. Based on this we can classify the marine insurance into four categories:

1. **Hull Insurance:** Hull refers to the ocean going vessels (ships trawlers etc.) as well as its machinery. The hull insurance also covers the construction risk when the vessel is under construction. A vessel is exposed to many dangers or risks at sea during the voyage. An insurance effected to indemnify the insured for such losses is known as Hull insurance.
2. **Cargo Insurance:** Cargo refers to the goods and commodities carried in the ship from one place to another. The cargo transported by sea is also subject to manifold risks at the port and during the voyage. Cargo insurance covers the shipper of the goods if the goods are damaged or lost. The cargo policy covers the risks associated with the transshipment of goods. The policy can be written to cover a single shipment. If regular shipments are made, an open cargo policy can be used that insures the goods automatically when a shipment is made.
3. **Freight Insurance:** Freight refers to the fee received for the carriage of goods in the ship. Usually the ship owner and the freight receiver are the same person. Freight can be received in two ways- in advance or after the goods reach the destination. In the former case, freight is

secure. In the latter the marine laws say that the freight is payable only when the goods reach the destination port safely. Hence if the ship is destroyed on the way the ship owner will lose the freight along with the ship. That is why, the ship owners purchase freight insurance policy along with the hull policy.

4. **Liability Insurance:** It is usually written as a separate contract that provides comprehensive liability insurance for property damage or bodily injury to third parties. It is also known as protection and indemnity insurance which protects the ship owner for damage caused by the ship to docks, cargo, illness or injury to the passengers or crew, and fines and penalties.

Types of Marine Policy

There are different types of marine policies known by different names according to the manner of their execution or the risk they cover. They are:

- (i) **Voyage Policy:** Under the policy, the subject matter is insured against risk in respect of a particular voyage from a port of departure to the port of destination, e.g. Mumbai to New York. The risk starts from the departure of ship from the port and it ends on its arrival at the port of destination. This policy covers the subject matter irrespective of the time factor. This policy is not suitable for hull insurance as a ship usually does not operate over a particular route only. The policy is used mostly in case of cargo insurance.

- (ii) **Time Policy:** It is one under which the insurance is affected for a specified period of time, usually not exceeded twelve months. Time policies are generally used in connection with the insurance of ship. Thus if the voyage is not completed within the specified period, the risk shall be covered until the voyage is completed or till the arrival of the ship at the port of call.
- (iii) **Mixed Policies:** It is one under which insurance contract is entered into for a certain time period and for a certain voyage or voyages, e.g., Kolkata to New York, for a period of one year. Mixed Policies are generally issued to ships operating on particular routes. It is a mixture of voyage and time policies.
- (iv) **Valued Policies:** It is one under which the value of subject matter insured is specified on the face of the policy itself. This kind of policy specifies the settled value of the subject matter that is being provided cover for. The value which is agreed upon is called the insured value. It forms the measure of indemnity in the event of loss. Insured value is not necessarily the actual value. It includes (a) invoice price of goods (b) freight, insurance and other charges (c) ten to fifteen percent margin to cover expected profits.
- (v) **Unvalued policy:** It is the policy under which the value of subject matter insured is not fixed at the time of effecting insurance but has to be ascertained wherever the subject matter is lost or damaged.

- (vi) **Open policy:** An open policy is issued for a period of 12 months and all consignments cleared during the period are covered by the insurer. This form of insurance Policy is suitable for big companies that have regular shipments. It saves them the tedious and expensive process of acquiring an insurance policy for each shipment. The rates are fixed in advance, without taking the total value of the cargo being shipped into consideration. The assured has to declare the nature of each shipment, and the cover is provided to all the shipments. The assured also deposits a premium for the estimated value of the consignment during the policy period.
- (vii) **Floating Policy:** A merchant who is a regular shipper of goods can take out a 'floating policy' to avoid botheration and waste of time involved in taking a new policy for every shipment. This policy stands for the contract of insurance in general terms. It does not include the name of the ship and other details. The other details are required to be furnished through subsequent declarations. Thus, the insured takes a policy for a huge amount and he informs the underwriter as and when he makes shipment of goods. The underwriter goes on recording the entries in the policy. When the sum assured is exhausted, the policy is said to be "fully declared" or "run off".
- (viii) **Block Policy:** This policy covers other risks also in addition to marine risks. When goods are to be transported by ship to the place of destination, a single

policy known as block policy may be taken to cover all risks. E.g. when the goods are dispatched by rail or road transport for shipment, a single policy may cover all the risks from the point of origin to the point of destination.

Assignment of Marine Policy

A marine insurance policy may be transferred by assignment unless the terms of the policy expressly prohibit the same. The policy may be assigned either before or after loss. The assignment may be made either by endorsement on the policy itself or on a separate document. The insured need not give a notice or information to the insurer or underwriter about assignment. In case of death of the insured, a marine policy is automatically assigned to his heirs. At the time of assignment, the assignor must possess an insurable interest in the subject matter insured. An insured who has parted with or lost interest in the subject matter insured cannot make a valid assignment. After the occurrence of the loss, the policy can be assigned freely to any person. The assignor merely transfers his own right to claim to the assignee.

Clauses in a Marine Policy

A policy of marine insurance may contain several clauses. Some of the clauses are common to all marine policies while others are included to meet special requirements of the insured. Hull, cargo and freight policies have different standard clauses. There are standard clauses which are invariably used in marine insurance. Firstly, policies are constructed in general, ordinary and popular sense, and, later

on, specific clauses are added to them according to terms and conditions of the contract. Some of the important clauses in a marine policy are described below:

1. Valuation Clause. This clause states the value of the subject matter insured as agreed upon between both the parties.
2. Sue and Labour clause. This clause authorizes the insured to take all possible steps to avert or minimize the loss or to protect the subject matter insured in case of danger. The insurer is liable to pay the expenses, if any, incurred by the insured for this purpose.
3. Waiver Clause. This clause is an extension of the above clause. The clause states that any act of the insured or the insurer to protect, recover or preserve the subject matter of insurance shall not be taken to mean that the insured wants to forgo the compensation, nor will it mean that the insurer accepts the act as abandonment of the policy.
4. Touch and Stay Clause. This clause requires the ship to touch and stay at such ports and in such order as specified in the policy. Any departure from the route mentioned in the policy or the ordinary trade route followed will be considered as deviation unless such departure is essential to save the ship or the lives on board in an emergency.
5. Warehouse to warehouse clause. This clause is inserted to cover the risks to goods from the time they are dispatched from the consignor's warehouse until their

delivery at the consignee's warehouse at the port of destination.

6. In charge Clause. This clause covers the loss or damage caused to the ship or machinery by the negligence of the master of the ship as well as by explosives or latent defect in the machinery or the hull.
7. F.P.A. and F.A.A. Clause. The F.P.A. (Free of Particular Average) clause relieves the insurer from particular average liability. The F.A.A. (free of all average) clause relieves the insurer from liability arising from both particular average and general average.
8. Lost or Not Lost Clause. Under this clause, the insurer is liable even if the ship insured is found not to be lost prior to the contract of insurance, provided the insurer had no knowledge of such loss and does not commit any fraud. This clause covers the risks between the issue of the policy and the shipment of the goods.
9. Running down Clause. This clause covers the risk arising out of collision between two ships. The insurer is liable to pay compensation to the owner of the damaged ship. This clause is used in hull insurance.
10. Free of Capture and Seizure Clause. This clause relieves the insurer from the liability of making compensation for the capture and seizure of the vessel by enemy countries. The insured can insure such abnormal risks by taking an extra 'war risks' policy.
11. Continuation Clause. This clause authorizes the vessel to

continue and complete her voyage even if the time of the policy has expired. This clause is used in a time policy. The insured has to give prior notice for this and deposit a monthly prorated premium.

12. **Barratry Clause.** This clause covers losses sustained by the ship owner or the cargo owner due to willful conduct of the master or crew of the ship.
13. **Jettison Clause.** Jettison means throwing overboard a part of the ship's cargo so as to reduce her weight or to save other goods. This clause covers the loss arising out of such throwing of goods. The owner of jettisoned goods is compensated by all interested parties.
14. **At and From Clause.** This clause covers the subject matter while it is lying at the port of departure and until it reaches the port of destination. It is used in voyage policies. If the policy consists of the word 'from' only instead of 'at and from', the risk is covered only from the time of departure of the ship.

Warranties

Warranty means a promissory warranty by which the insured undertakes that some particular thing will or will not be done or that some condition will be fulfilled; or affirms or negates the existence of particular facts. A warranty may be an implied warranty and express warranty.

Express Warranties: An express warranty may be in any form of words from which the intention to warrant may be inferred.

(2) An express warranty must be included in, or written on, the

marine policy or be contained in a document incorporated by reference into the policy. It does not exclude an implied warranty, unless they are inconsistent.

An express warranty may be in any form of words from which the intention to warrant may be inferred. Unfortunately, it has proven difficult for insurers to find the exact words that will lead to the required inference. Words such as “warranted that” have been held to not necessarily delineate a warranty. Similarly, the words “warranted free from any claim...” were held not to delineate a warranty. Examples of express warranties are as follows:

The number and type of express warranties are limited only by the imagination and ingenuity of underwriters. Almost anything can be made to be an express warranty provided the proper words are used. Notwithstanding this total freedom to make almost anything a warranty most policies contain relatively few. The more common express warranties are:

- Navigation and trading warranties that limit the geographical areas in which a vessel may operate;
- Laid up and out of commission warranties that require a vessel to be laid up for a defined period or generally;
- Identity of the master warranties that require a named person to command the vessel;
- Towing warranties that prohibit the insured vessel from being towed except where customary or when the vessel is in need of assistance;

- Private pleasure use warranties that prohibit any commercial use of a yacht; and
- Warranties regarding surveys and inspections that require inspections to be conducted or recommendations by surveyors to be complied with.

Implied Warranty: these are the warranties which are not expressly mentioned in the contract but the law takes it for granted that such warranty exists. An express warranty does not exclude implied warranty unless it is inconsistent therewith. Implied warranties do not appear in the policy documents at all, but are understood without being put into words, and as such, are automatically applicable. These are included in the policy by law, general practice, long established custom or usage. There are three warranties implied by the Act. They are the warranty of legality, neutrality and seaworthiness.

- **Legality:** The warranty of legality is one which is often expressly included in policies as well as implied. The journey undertaken by the ship must be for legal purposes. Carrying prohibited or smuggled goods is illegal and therefore, the insurer shall not be liable for the loss.
- **Neutrality:** Where in any marine policy insurable property is expressly warranted to be neutral, there is an implied condition in the policy (o) that the property will have a neutral character at the commencement of the risk and that, in so far as the insured has control, that

character will be preserved during the risk; and (b) where the property is a ship, that, in so far as the insured has control, the papers necessary to establish the neutrality of the ship will be carried on the ship and will not be falsified or suppressed and no simulated papers will be used.

- **Seaworthiness:** There is an implied warranty in every voyage policy that, at the commencement of the voyage, the ship will be seaworthy for the purpose of the particular marine adventure insured.

Types of Marine Losses

A loss arising in a marine adventure due to perils of the sea is a marine loss. Marine loss may be classified into two categories:

- **Total loss:** A total loss implies that the subject matter insured is fully destroyed and is totally lost to its owner. It can be Actual total loss or Constructive total loss. In actual total loss subject matter is completely destroyed or so damaged that it ceases to be a thing of the kind insured. e.g. sinking of ship, complete destruction of cargo by fire, etc. In case of constructive total loss the ship or cargo insured is not completely destroyed but is so badly damaged that the cost of repair or recovery would be greater than the value of the property saved. e.g. a ship dashed against the rock and is stranded in a badly damaged position. If the expenses of bringing it back and repairing it would be more than the actual value

of the damaged ship, it is abandoned.

- **Partial loss:** A partial loss occurs when the subject matter is partially destroyed or damaged. Partial loss can be general average or particular average. General average refers to the sacrifice made during extreme circumstances for the safety of the ship and the cargo. This loss has to be borne by all the parties who have an interest in the marine adventure. e.g. A loss caused by throwing overboard of goods is a general average and must be shared by various parties. Particular average may be defined as a loss arising from damage accidentally caused by the perils insured against. Such a loss is borne by the underwriter who insured the object damaged. e.g. If a ship is damaged due to bad weather the loss incurred is a particular average loss.

Insurance business in India

The insurance industry of India consists of 53 insurance companies of which 24 are in life insurance business and 29 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. Apart from that, among the non-life insurers there are six public sector insurers. In addition to these, there is sole national re-insurer, namely, General Insurance Corporation of India (GIC Re). Other stakeholders in Indian Insurance market include agents (individual and corporate), brokers, surveyors and third party administrators servicing health insurance claims.

Out of 29 non-life insurance companies, five private

sector insurers are registered to underwrite policies exclusively in health, personal accident and travel insurance segments. They are Star Health and Allied Insurance Company Ltd, Apollo Munich Health Insurance Company Ltd, Max Bupa Health Insurance Company Ltd, Religare Health Insurance Company Ltd and Cigna TTK Health Insurance Company Ltd. There are two more specialised insurers belonging to public sector, namely, Export Credit Guarantee Corporation of India for Credit Insurance and Agriculture Insurance Company Ltd for crop insurance.

Market Size

During April 2015 to February 2016 period, the life insurance industry recorded a new premium income of Rs 1.072 trillion (US\$ 15.75 billion), indicating a growth rate of 18.3 per cent. The general insurance industry recorded a 14.1 per cent growth in Gross Direct Premium underwritten in FY2016 up to the month of February 2016 at Rs 864.2 billion (US\$ 12.7 billion). India's life insurance sector is the biggest in the world with about 360 million policies which are expected to increase at a Compound Annual Growth Rate (CAGR) of 12- 15 per cent over the next five years. The insurance industry plans to hike penetration levels five per cent by 2020. The country's insurance market is expected to quadruple in size over the next 10 years from its current size of US\$ 60 billion. During this period, the life insurance market is slated to cross US\$ 160 billion. The general insurance business in India is currently at Rs 78,000 crore (US\$ 11.44 billion) premium per annum industry and is growing at a healthy rate of 17 per cent.

The Indian insurance market is a huge business opportunity waiting to be harnessed. India currently accounts for less than 1.5 per cent of the world's total insurance premiums and about 2 per cent of the world's life insurance premiums despite being the second most populous nation. The country is the fifteenth largest insurance market in the world in terms of premium volume, and has the potential to grow exponentially in the coming years.

Investments

The following are some of the major investments and developments in the Indian insurance sector.

- The Insurance sector in India is expected to attract over Rs 12,000 crore (US\$ 1.76 billion) in 2016! as many foreign companies are expected to raise their stake in private sector insurance joint ventures.
- QuEST Global, a pure-play engineering and Research and Development (R&D) services provider, has raised investment of around Rs 2,396 crore (US\$ 351.54 million) from leading global investors Bain Capital, GIC and Advent International for a minority stake in the company.
- Foreign Direct Investment in the insurance sector stood at US\$ 341 million in March- September, 2015, showing a growth of 152 per cent compared to the same period last year.
- Insurance firm AIA Group Ltd has decided to increase its stake in Tata AIA Life Insurance Co Ltd, a joint venture

owned by Tata Sons Ltd and AIA Group from 26 per cent to 49 per cent.

- Canada-based Sun Life Financial Inc plans to increase its stake from 26 per cent to 49 per cent in Birla Sun Life Insurance Co Ltd, a joint venture with Aditya Birla Nuvo Ltd, through buying of shares worth Rs 1,664 crore (US\$ 244.14 million).
- Nippon Life Insurance, Japan's second largest life insurance company, has signed definitive agreements to invest Rs 2,265 crore (US\$ 332.32 million) in order to increase its stake in Reliance Life Insurance from 26 per cent to 49 per cent.
- The Central Government is planning to launch an all-in-one insurance scheme for farmers called the Unified Package Insurance Scheme (Bhartiya Krishi Bima Yojana). The proposed scheme will have various features like crop insurance, health cover, personal accident insurance, live stock insurance, insurance cover for agriculture implements like tractors and pump sets, student safety insurance and life insurance.
- Government launched a special enrolment drive, Suraksha Bandhan Drive comprising of sale of gift cheques and launch of deposit schemes in bank branches, to facilitate enrolment under Pradhan Mantri Suraksha Bima Yojana (PMSBY) and Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY).
- To increase the subscriber base and ensure wider reach,

the Central Government has eased several norms for its flagship insurance scheme Atal Pension Yojana (APY), in terms of more options for periodical contributions, voluntary and premature exits and simplified penalty for payment delays.

- Bennett Coleman and Co. Ltd (BCCL), the media conglomerate with multiple publications in several languages across India, is set to buy Religare Enterprises Ltd's entire 44 per cent stake in life insurance joint venture Aegon Religare Life Insurance Co. Ltd. The foreign partner Aegon is set to increase its stake in the joint venture from 26 per cent to 49 per cent, following government's reform measure allowing the increase in stake holding by foreign companies in the insurance sector.
- GIC Re and 11 other non-life insurers have jointly formed the India Nuclear Insurance Pool with a capacity of Rs 1,500 crore (US\$ 220.08 million) and will provide the risk transfer mechanism to the operators and suppliers under the CLND Act.
- State Bank of India has announced that BNP Paribas Cardif is keen to increase its stake in SBI Life Insurance from 26 per cent to 36 per cent. Once the foreign joint venture partner increases its stake to 36 per cent, SBI's stake in SBI Life will get diluted to 64 per cent.

Government Initiatives

The Government of India has taken a number of

initiatives to boost the insurance industry. Some of them are as follows:

- The Union Budget of 2016-17 has made the following provisions for the Insurance Sector:
- Foreign investment will be allowed through automatic route for up to 49 per cent subject to the guidelines on Indian management and control, to be verified by the regulators.
- Service tax on single premium annuity policies has been reduced from 3.5 per cent to 1.4 per cent of the premium paid in certain cases.
- Government insurance companies to be listed on the exchanges
- Service tax on service of life insurance business provided by way of annuity under the National Pension System regulated by Pension Fund Regulatory and Development Authority (PFRDA) being exempted, with effect from 1 April 2016.
- The Insurance Regulatory and Development Authority (IRDA) of India has formed two committees to explore and suggest ways to promote e-commerce in the sector in order to increase insurance penetration and bring financial inclusion.
- IRDA has formulated a draft regulation, IRDAI (Obligations of Insurers to Rural and Social Sectors) Regulations, 2015, in pursuance of the amendments brought about under section 32 B of the Insurance Laws

(Amendment) Act, 2015. These regulations impose obligations on insurers towards providing insurance cover to the rural and economically weaker sections of the population.

- The Government of India has launched two insurance schemes as announced in Union Budget 2015-16. The first is Pradhan Mantri Suraksha Bima Yojana (PMSBY), which is a Personal Accident Insurance Scheme. The second is Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), which is the government's Life Insurance Scheme. Both the schemes offer basic insurance at minimal rates and can be easily availed of through various government agencies and private sector outlets.
- The Uttar Pradesh government has launched a first of its kind banking and insurance services helpline for farmers where individuals can lodge their complaints on a toll free number.
- The select committee of the Rajya Sabha gave its approval to increase stake of foreign investors to 49 per cent equity investment in insurance companies.
- Government of India has launched an insurance pool to the tune of Rs 1,500 crore (US\$ 220.08 million) which is mandatory under the Civil Liability for Nuclear Damage Act (CLND) in a bid to offset financial burden of foreign nuclear suppliers.