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MODERN BANKING AND INSURANCE
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MODERN BANKING AND INSURANCE

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BANKING

1.1. Introduction

The term 'bank' refers to any institution regulated by RBI, to accept deposits, pay interest, clear cheques, make loans and provide large range of financial services to customers. Banks act as an intermediary for savers of funds and users of funds. Money stored or deposited by public, can be accessed by banks to lend this money to individuals or organizations. Depositors earn interest on the money deposit and that can be made to grow. In this way, the banking system acts to channelize society's surplus funds into productive use. Wealth is used for variety of purposes like infrastructure development, generation of economic assets etc. which help society as a whole. Banks are therefore essential for economic growth of an economy.

1.1. History and Origin of Banking

The General Bank of India came in to existence in 1786. After that Bank of Hindustan and Bengal Bank were set up and were liquidated after few years of operations. Bank of Bengal (1806), Bank of Bombay (1840) and Bank of Madras (1843) were established by East India Company called them as Presidency Banks. In 1865 Allahabad Bank was established and first time exclusively by Indians, Punjab National Bank Ltd. was set up in 1894 with headquarters at Lahore. Between 1885 and 1913, Bank of India Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. Reserve Bank of India came into existence in 1935.

❖ **First phase**

Government took major steps in the Indian Banking Sector Reform after independence. Before independence, growth was very slow and some of the banks failed as public had poor confidence in the banks. In 1955, Imperial Bank of India was nationalized which has major banking facilities not only in urban areas but also rural areas. State bank of India was formed as an agent of RBI and to handle banking transactions of the Union and State Governments all over the country.

Seven banks forming subsidiary of State Bank of India were nationalized in July, 1959. With the effort of Prime Minister of India, Mrs. Indira Gandhi, 14 major commercial banks in the country were nationalized. In order to regulate bank, there was a need for enactment of act, so government came up with Banking Regulation Act 1949 which acts as a guideline for streamlining functioning of banking. Reserve Bank of India became the Central Banking Authority and was vested with extensive powers. The duty of central bank is to maintain financial stability in the economy. It acts as lender of last resort and controls money supply in the economy by administering interest rates.

❖ **Second Phase**

The following were the steps taken by the Government of India to Regulate Banking Institutions in the country.

- ✓ 1949: Enactment of Banking Regulation Act.
- ✓ 1955: Nationalisation of State Bank of India.
- ✓ 1959: Nationalisation of SBI subsidiaries.
- ✓ 1961: Insurance cover extended to depositors.
- ✓ 1969: Nationalisation of 14 major banks.
- ✓ 1971: Creation of credit guarantee corporation.
- ✓ 1975: Creation of regional rural banks.
- ✓ 1980: Nationalisation of 6 banks with deposits over 200 crores.

❖ **Third Phase**

Third phase was the phase of introduction of various products and facilities in the banking sector. Liberalisation of banking practices was introduced in 1991. A committee was setup under the chairmanship of M Narasimham. Various foreign banks came up and established their innovative practices like Phone banking and net banking has been introduced. Features which could give more ease and satisfaction to customer were introduced. The Indian banking sector is majorly dominated by public sector banks. Top 10 players control 60 percent of total industry. Banking sector is dominated by public sector banks. This industry has huge growth potential.

1.2. What is Banking?

As per Banking Regulation Act (1949), Banking is defined as the acceptance of deposits for the purpose of investment of deposits, money from the public, repayable on demand or otherwise and with drawable by cheque, draft, and order or otherwise for the purpose of lending. If the institution uses the deposits for its own purpose, such institutions cannot be regarded as banks.

Post office though opens savings accounts but it is not classified as a bank, because it accepts chequable deposits but do not sanction loans. Some of the non-banking financial institutions are IFCI, LIC, IDBI etc.

Indian banking system can be classified into two categories:

I. Organized and Unorganized Banking:

a) Organized banking: Organized banking system refers to banks which are under the control of the Reserve Bank of India. For example, Commercial Banks, Industrial Banks, Agricultural Banks.

b) Unorganized banking: Indigenous banks which are not under direct control of our central bank are a part of un-organized banking. There are ancient bankers like Mahajans, Sahukars, etc.

II. Scheduled and Non-Scheduled Banks:

Scheduled banks are those which are listed under the second schedule of Reserve Bank of India Act, 1939. Banks which have a paid-up capital and reserves of aggregate value of not less than Rs 5 lakhs are scheduled banks. On the other hand, non-scheduled banks are the banks which do not come under purview of RBI and their paid-up capital is less than Rs 5 lakh. All Commercial Banks, Regional Rural Banks, State Cooperative Banks are scheduled banks.

(a) Commercial Banks: Commercial banks create credit in economy through the process of accepting deposits. These banks deal with general public, accept deposits and provide loans to firms and households. Commercial banks in India are State Bank India (SBI), Bank of India, Punjab National Bank etc.

(b) Development Banks: Development banks are specialized financial institutions which assist in promoting economic development by providing medium- and long-term loans to industry at reasonable low rate of interests. Development banks in India are Industrial Financial Corporation of India (IFCI), State Financial Corporations, State Industrial Development Corporations etc.

(c) Co-Operative Banks: Co-operative banks come under cooperative society's law. They have been established to provide loan assistance to rural areas or farmers at low rate of interest.

(d) Land Mortgage Banks: Farmers get long term loans at low rate of interest through land mortgage banks.
e) Regional Rural Banks: Regional Rural Banks (RRBs) are established in the rural areas to meet the needs of the weaker section of the rural population.

1.3. Commercial Banks

An institution that provides its customers with services like accepting deposits, providing loans, and making investments, with the objective of earning profits is known as a Commercial Bank**.** The two main characteristics of commercial banks are lending and borrowing. They make money from a variety of fees and by earning interest income from loans. For this, the bank charges interest on lending and borrowing. The two main types of rates are the Borrowing Rate and Lending Rate. The rate offered by commercial banks to depositors for depositing money is called the borrowing rate. The rate charged by commercial banks for lending money to investors is known as the lending rate. The difference between the borrowing rate and the lending rate is known as Spread. It is the profit earned by commercial banks. Commercial Banks are important for an economy because they create capital, credit, and liquidity in the market. Commercial banks have traditionally been located in physical locations, but nowadays a number of banks also operate online.

1.3.1. Functions of Commercial Banks

The functions of commercial banks are classified into two main divisions.

(a). Primary functions

• Accepts deposit – The bank takes deposits in the form of saving, current and fixed deposits. The surplus balances collected from the firm and individuals are lent to the temporary required of commercial transactions.

• Provides Loan and Advances – Another critical function of this bank is to offer loans and advances to the entrepreneurs and businesspeople and collect interest. For every bank, it is the primary source of making profits. In this process, a bank retains a small number of deposits as a reserve and offers (lends) the remaining amount to the borrowers in demand loans, overdraft, cash credit and short-run loans, etc.

• Credit Cash- When a customer is provided with credit or loan, they are not provided with liquid cash. First, a bank account is opened for the customer and then the money is transferred to the account. This process allows a bank to create money.

(b). Secondary functions

• Discounting bills of exchange – It is a written agreement acknowledging the amount of money to be paid against the goods purchased at a given point of time in the future. The amount can also be cleared before the quoted time through a discounting method of a commercial bank.

• Overdraft Facility – It is an advance given to a customer by keeping the current account to overdraw up to the given limit.

• Purchasing and Selling of the Securities – The bank offers you with the facility of selling and buying the securities.

• Locker Facilities – Bank provides lockers facility to the customers to keep their valuable belonging or documents safely. Banks charge a minimum of an annual fee for this service.

• Paying and Gather the Credit – It uses different instruments like a promissory note, cheques and bill of exchange.

1.3.2. Types of Commercial Banks:

There are three different types of commercial banks.

• Private Bank – It is one type of commercial banks where private individuals and businesses own a majority of the share capital. All private banks are recorded as companies with limited liability. Such as Housing Development Finance Corporation (HDFC) Bank, Industrial Credit and Investment Corporation of India (ICICI) Bank and Yes Bank, etc.

• Public Bank – It is that type of bank that is nationalized, and the government holds a significant stake. For example, Bank of Baroda, State Bank of India (SBI), Dena Bank, Corporation Bank and Punjab National Bank.

• Foreign Bank – These banks are established in foreign countries and have branches in other countries. For instance, American Express Bank, Hong Kong and Shanghai Banking Corporation (HSBC), Standard & Chartered Bank and Citibank, etc. Examples of Commercial Banks Few examples of commercial banks in India are.

- State Bank of India (SBI)
- Housing Development Finance Corporation (HDFC) Bank
- Industrial Credit and Investment Corporation of India (ICICI) Bank
- Dena Bank
- Corporation Bank

1.4. Private and Public Sector Banks

The banking industry has been the backbone of our country's financial sector. Banks play an important role in the overall economic growth of the country. Public Sector Banks and Private Sector Banks are two of the three types of Commercial Banks (the third being Foreign Banks).

Public Sector Banks

Public Sector Banks are the banks whose majority of stakes are held by the state or central government. The government is responsible for formulating all the financial guidelines for these banks. These banks work under the government and thus they are trustworthy. Public sector banks work for the benefit of people by introducing new schemes from time to time and also charge less for their services. The charges on loans are also less as compared to private sector banks. The biggest public sector bank in India is the State Bank of India.

Some of the advantages of public sector banks include:

- Low-interest charges on loans
- High-interest rate on deposits
- Full job security for employees
- Offers its services to a large customer base
- Offers financial services through multiple branches
- Offers its services to the rural areas too.

Private Sector Banks

Private Sector Banks and the banks whose stakes are held by private companies or maybe by an individual. Despite being owned by private companies or individuals, these banks have to follow the rules and regulations of the central bank. These banks provide good services and are efficient.

Private sector banks provide numerous excellent services but at an additional cost.

Some of the benefits of private sector banks include:

- Offers quick services to the customers
- Offers customized services according to the financial needs of the customers
- Quick financial decision-making
- Have a streamlined management system

Private banks were set up in India after 1990 when the Government of India gave permission to establish them. Before 1990, the major stakeholders were the public sector banks. As of today, both the public sector and private sector contribute largely to the Indian economy. People choose between public sector banks and private sector banks based on their requirements and the type of service they want. At present, there are 12 public sector banks and 21 private sector banks in India.

1.5. Credit Creation

Creation of credit is one of the most outstanding functions of a modern bank. A bank has sometimes been called a factory for the manufacture of credit. How credit is created? It is an open secret that the banks do not keep cent per cent reserves against deposits in order to meet the demands of depositors.

The bank is not a cloak room where you can keep your currency notes or coins and claim those very notes or coins back when you desire. It is generally understood that money received by the bank is meant to be advanced to others.

A depositor has to be content simply with the bank's promise or undertaking to pay him whenever he makes a demand. Thus, the banks are able to do with a very small reserve, because all the depositors do not come to withdraw money simultaneously; some withdraw, while others deposit at the same time. The bank is thus enabled to erect a vast superstructure of credit on the basis of a small cash reserve. The bank is able to lend money and charge interest without parting with cash, as the bank loan creates simply a deposit or it creates a credit for the borrower. This is what is meant by creation of credit. Similarly, the bank buys securities and pays the seller with its own cheque which again is no cash; it is just a promise to pay cash. The cheque is deposited in some bank and a deposit is created or credit is created for the seller of the securities. This is credit creation.

The term 'credit creation' implies a situation, to use Benham's words, when "a bank may receive interest simply by permitting a customer to overdraw their accounts or by purchasing securities and paying for them with its own cheques, thus increasing the total bank deposits."

Let us see the actual process. Let us assume that there is only one bank in the country. Suppose a customer deposits Rs. 1,000 in the bank. The bank has to pay him interest. Therefore, the bank must seek a safe and profitable investment for this amount. It must lend it to somebody. But this amount is not actually paid out to the borrower; it is retained by the bank to meet its obligations, i.e., to pay to those of its depositors who need cash and draw cheques for the purpose.

The bank's experience tells him that for this purpose only a certain percentage of cash reserves to total liabilities need be kept. In countries like England, they keep nearly 10 per cent. The ratio of cash reserves to liabilities is much higher in countries like India, where banking habit has yet to develop.

Suppose the bank, in which a depositor has deposited Rs. 1,000, keeps 20 per cent cash reserve to meet the demand of depositors. This means that, as soon as the bank has received 1,000 it will make up its mind to advance loans up to the amount of Rs. 5,000 (only one-fifth reserve is kept). When, therefore, a businessman comes to the bank with a request for a loan of Rs. 5,000, he may be sure of being granted accommodation to this extent, provided of course, his credit is good. The bank lends Rs. 5,000, although it has only Rs. 1,000 in cash. It is here that credit comes in.

This transaction is rendered possible because the borrower is not given the loan in cash; only an account is opened in his name and the amount is credited to his account. He is simply given the cheque book, i.e., the right to draw cheques as and when he needs money. Even when he withdraws cash, it will be deposited in the bank by the recipients, because businessmen do not raise funds to keep them locked up in a cash box but to run their business and to make payments to their creditors.

When this particular businessman draws cheques on this bank to pay his creditors, these cheques are passed on by them to their own banks, where the amount is deposited in their account. Cash is seldom withdrawn. The banks adjust their mutual obligations through a system of bank clearing. Thus, the bank has succeeded in creating a credit of Rs. 5,000 against a cash reserve of Rs. 1,000.

The bank also creates credit when it purchases securities. The bank can purchase securities without paying any cash. It issues its own cheque to pay the purchase price. The cheque is deposited in this bank or some other bank and the small cash reserve which the bank keeps is sufficient to meet an obligation arising from this transaction too. It is thus that, on a small cash foundation, a vast superstructure of credit is built up.

Let us now understand the process of credit creation when there are several banks in the country, as they are in the real world. In the case of several commercial banks in the country, one individual bank cannot create all the credit as described above. But what no single bank can do individually, the banking system as a whole can do, i.e., create credit.

We shall explain the process of credit creation or the expansion of money supply in the country by the banking system collectively with the help of balance sheets of the banks. We shall illustrate how deposit of Rs. 1,00,000 of currency in a commercial bank enables the banking system as a whole to expand deposits by another Rs. 4,00,000, that is, deposits of Rs. 1,00,000 in currency leads to a total deposit of Rs. 5,00,000 in the banking system.

Banks, as other business firms, show their financial condition on a balance sheet. A simple balance sheet has two columns, its left column represents all the assets of a bank and its right column represents all the liabilities of a bank. Assets are all the things or claims a bank owns, liabilities, on the other hand, are claims against those assets; some of the claims are of creditors and some of them are of owners of the banks themselves. Because assets show everything that a bank owns and because liabilities represent claims against those assets, the two sides of the balance sheet, that is, assets and liabilities must equal each other.

Limitations on the Credit Creating Power of the Banks:

From the foregoing account of credit or deposits creation by the banks, it would seem that the banks reap where they have not sown. They advance loans or buy securities without actually paying cash. But they earn interest on the loans they give or earn dividends on the securities they purchase all the same.

This is very tempting. They make profits without investing cash. They would, of course, like to make as much profit like this as they can. But they cannot go on expanding credit indefinitely. In their own interest, they have to apply the brake, and they do actually apply it, for it is well-known that the profits made by the banks are not very high. The overriding limitation arises from the obligation of the banks to meet the demands of their depositors.

Benham has mentioned three limitations on the powers of the banks to create credit:

(i) The amount of cash in the country;

(ii) The amount of cash which the public wishes to hold; and

(iii) The minimum percentage of cash to deposits, called cash revenue ratio which the banks have to maintain.

(iv) The amount of money which the public wants to hold as deposits in the banks.

As for (i), it may be said that credit can be created on the basis of cash. The larger the cash (i.e., legal tender money) the larger the amount of credit that can be created. But the amount of cash that a bank may have is subject to the control of the central bank. The central bank has the monopoly of issue of cash. It may increase it or decrease it, and credit will expand or contract accordingly. The power of the central bank to control currency helps it to control the extent of credit that the banks have the power to create.

The second limitation arises from the habit of the people regarding the use of cash i.e. currency. If people are in the habit of using cash and not cheques, as in India, then as soon as credit is granted by the bank to a borrower, he will draw the cheque and get cash. When the bank’s cash reserves are thus reduced, its power to create credit is correspondingly reduced.

On the other hand. If people use cash only for very small and odd transactions, then the cash reserve of the banks is not much drawn upon and their power of creating credit remains unimpaired. This is the case in advanced countries like the U.S.A., England and other European countries. There the banks hardly keep 10 per cent cash reserve.

The third limitation is the most important. It arises from the cash reserve ratio cash, which the banks must maintain to ensure the safety of the bank and to retain the degree of liquidity that is considered desirable. It is clear that when a bank creates a credit or grants a loan, it undertakes a liability. There is an increase in its liabilities and there is correspondingly a fall in cash reserve ratio. The bank will not let the cash reserve ratio fall below a certain minimum.

When that minimum is reached, the power of the bank to create credit comes to an end. To grant any further credit will be risky unless the bank's experience is reassuring enough to permit the adoption of a lower percentage. Then that would be the limit.

The other important limitation on the credit creating power of banks is the amount of money which the public choose to hold as deposits in banks. The more money which the public deposits with the banks, the more reserves banks would have and therefore more credit they will be able to create and vice versa.

It may note that public can use their saved money in more than one way. The public can buy shares or debenture of the companies, it can invest in mutual funds of both public and private sectors. But the credit creation by the banks depends on the money the public deposits in them. It is important to note than rate of interest paid by the banks on deposits determines to a good extent the amount of money deposits with them by the public. Other things being equal, the higher the rate of interest, the greater the amount of money the public will deposit money with the banks.

To these may be added the fourth limitation. The bank cannot create credit without acquiring some asset. An asset is a form of wealth. Thus, the bank only turns immobile wealth into mobile wealth. Hence, as Crowther observes, "the bank does not create money out of thin air, it transmutes other forms of wealth into money.” However, banking system today has become quite advanced. These days banks give credit on the basis of personal goodwill rather than on the basis of any form of wealth.

1.6. Role of Commercial Banks

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 channelise 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 inhuman 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.

1.7. Payment Banks

The Reserve Bank of India (RBI) has formed a new type of bank called a payments bank. Payments banks are permitted to accept a maximum deposit of Rs100,000 per customer, which may be increased in the future. These banks are unable to lend money or issue credit cards, but they can provide services like net banking, ATM cards, debit cards, and mobile banking.

History of Payment Banks in India

- The RBI established the Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households, led by Nachiket Mor, in September 2013.
- On January 7th, 2014, the committee published its final report, which expounded on the development of a new type of bank known as a payment bank.
- The RBI released a draft of rules for payments banks in July of that year, asking for views from significant stakeholders and the general public. On November 27th, 2014, the final guidelines were released.
- The RBI published a list of firms that had applied for a payment bank license in February 2015. There were 41 people who applied.

- ❖ It was also announced that the license applications will be evaluated by an external advisory committee (EAC) led by Nachiket Mor.
- ❖ On the 28th of February 2015, during the presentation of the Budget, it was stated that India Post would establish a payment bank using its extensive network.
- ❖ On July 6, 2015, the external advisory committee led by Nachiket Mor submitted its conclusions.
- ❖ The Reserve Bank of India granted eleven businesses "in-principle" permission to establish payment banks on August 19, 2015.
- ❖ The "in-principle" license was valid for 18 months, during which time the businesses had to meet the conditions and were prohibited from engaging in banking activities.
- ❖ After the RBI is satisfied that the prerequisites have been met, it will give full licenses under Section 22 of the Banking Regulation Act, 1949.

Features of Payment banks in India

- ❖ A payment bank is a special sort of bank that solely performs the limited banking tasks that the Banking Regulation Act of 1949 allows.
- ❖ Some of the activities include deposit acceptance, payments and remittance services, internet banking, and acting as a business correspondent for other banks.
- ❖ They are allowed to take deposits of up to Rs 1 lakh per person at first.
- ❖ They can assist with money transfers and insurance and mutual fund sales.
- ❖ They can also only issue ATM/debit cards and not credit cards.
- ❖ They are prohibited from forming subsidiaries to provide non-banking financial services.
- ❖ They are not permitted to engage in any lending activity.
- ❖ Payment Banks are not allowed to issue Loans and cannot accept NRI Deposits.
- ❖ A person with a payment bank account might deposit and take money from any ATM or other service provider.

- ❖ To cater to individuals and small enterprises, licensing would be granted to mobile companies, grocery chains, and others.
- ❖ They are only allowed to invest the money received from customers' deposits into government securities.

Regulations Under Payment Bank

- ❖ The required minimum capital is Rs. 100 crores. For the first five years, the promoter's interest should stay at least 40%.
- ❖ Payment banks are required to maintain a Cash reserve Ratio (CRR).
- ❖ Foreign ownership of these institutions will be permitted under Indian FDI guidelines for private banks.
- ❖ The Payment Banks are required to invest a minimum of 75% of its "demand deposit balances" in approved Government securities/treasury bills having a maturity of up to one year under the Statutory Liquidity Ratio (SLR).
- ❖ The Banking Regulation Act of 1949 will govern voting rights. Any shareholder's voting power is limited to 10%, which can be increased to 26% by the Reserve Bank of India.
- ❖ It must have 25% of its branches in unbanked rural areas. To distinguish itself from other types of banks, the bank must use the term "payment bank" in its name.
- ❖ Under Section 22 of the Banking Regulation Act of 1949, the banks will be licensed as payment banks and will be regulated as such.

Eligible Promoters of Payments Bank

- ➢ Non-bank financial institutions that already exist other entities such as individuals/professionals; Non-Banking Finance Companies (NBFCs), Corporate Business Correspondents (BCs), mobile telephone companies, supermarket chains, companies, real sector cooperatives; and public sector entities that are owned and controlled by residents may apply to set up payments banks.
- ➢ To establish a payments bank, a promoter/promoter group can form a joint venture with an existing scheduled commercial bank.

- To the extent permissible by the Banking Regulation Act of 1949, scheduled commercial banks can take an equity position in a payments bank.
- The financial system in which small banks and payment banks are used to meet the needs of a specific demographic sector of the population. It is known as Differentiated banking.
- In India, 19 crore individuals do not have access to banking as of 2019. The Prime Minister's Jan Dhan Yojana is an important step toward financial inclusion.
- To qualify as a differentiated bank, the following criteria must be met:
- Maintaining higher levels of capitalization
- Access to cutting-edge technology
- Maintaining a balance between technology and customer service for underserved customers.

1.8. Digital Banking

Digital banking refers to the use of online and mobile technology to perform various banking activities and transactions. It allows customers to access and manage their bank accounts, make payments, transfer funds, check balances, and even apply for loans or open new accounts, all through digital channels such as websites and mobile apps, without the need to visit a physical bank branch. Digital banking has become increasingly popular due to its convenience and accessibility, allowing people to conduct any banking services from anywhere with an Internet connection. This post covers information on types of digital banking in India, its advantages and disadvantages.

1.8.1. **Types of Digital Banking**

In India, several types of digital banking services and platforms are available for customers to cater to their various financial needs. Here are some common types of digital banking services in India:

1. Internet Banking: Internet banking is an important and major part of digital banking, allowing customers to access their accounts, check balances, transfer funds, pay bills, and more through a secure online portal.

2. Mobile Banking: Mobile banking apps and services provided by several banks enable customers to perform banking transactions using their smartphones. This includes services like mobile payments, account management, and fund transfers.
3. UPI (Unified Payments Interface): UPI is a real-time payment system that allows users to transfer money between bank accounts instantly through mobile apps. It has gained widespread popularity in India and is used for various transactions, including peer-to-peer transfers and online shopping.
4. Mobile Wallets: Mobile wallet apps like Paytm, Google Pay, and PhonePe allow users to store money digitally and make payments for various services and products, including mobile recharges, utility bills, and online shopping.
5. Digital Lending Platforms: Several Fintech companies in India offer digital lending services, including personal loans, business loans, and instant credit through online platforms. These services often provide quick approvals and disbursements.
6. Digital Payment Banks: These banks primarily focus on providing digital financial services and payments. They offer services like savings accounts, mobile banking, and digital wallets.
7. Neo-banks: Some banks operate entirely online, offering all banking services through digital platforms.
8. Stock Trading Apps: Various stock trading apps enable users to trade stocks and securities online, providing real-time market data and analysis tools.

Services Offered by Digital Banking

Digital banking offers a wide range of services to meet the financial needs of customers. Given below are the various types of digital banking products and services:

1. Account Management: One can view account balances, transaction history, and account statements online or through mobile apps with the help of digital banking.

2. Fund Transfers: Transfer money between accounts, including peer-to-peer transfers and payments to other banks.
3. Bill Payments: Pay utility bills, credit card bills, loans, and other regular expenses electronically.
4. Mobile Wallets: Digital Banking also allows individuals to store money digitally and make payments for various services and products using a mobile wallet app.
5. Fixed Deposits: Through digital banking, one can also open and manage fixed deposit accounts with their bank.
6. Savings and Current Accounts: Open, manage, and close savings and current accounts through digital banking platforms.
7. ATM Services: It also allows customers to locate nearby ATMs, check ATM balances, and set ATM withdrawal limits.
8. Credit Card Management: One can also view their credit card transactions, pay bills, and manage rewards using the digital banking platform.

Advantages of Digital Banking

Digital banking in India offers several advantages to customers. Here are some key advantages of digital banking in India:

1. Convenience: Customers can access their accounts, make transactions, and manage finances 24/7 from the comfort of their homes or on the go through smartphones or computers.
2. Accessibility: Digital banking eliminates the need for physical bank visits, making banking services accessible to people in remote areas, including rural India.
3. Cost-Efficiency: Digital transactions are often more cost-effective for customers and banks, reducing the risk of financial errors and the need for paper-based processes.
4. Time-Saving: Transactions are processed faster, reducing wait times and the need for manual paperwork, leading to quicker fund transfers and approvals.

5. Ease of Payments: Services like UPI have simplified peer-to-peer payments and merchant transactions, making it easy to pay for goods and services digitally.
6. Cost Comparison: Digital banking platforms often provide tools to compare interest rates, fees, and charges, helping customers make informed financial decisions.
7. Investment Opportunities: Customers can easily access and invest in various financial products such as mutual funds, stocks, and fixed deposits with the help of digital banking.
8. Financial Management: Access to account statements and transaction history helps users better manage their finances and track expenses.
9. Customer Support: Many digital banks offer chat support and 24x7 customer service through digital channels to provide quick solutions to your queries.

Overall, digital banking has revolutionized the banking sector in India, offering convenience, accessibility, and enhanced financial services to a wide range of customers.

Disadvantages of Digital Banking

While digital banking in India offers numerous benefits, it also comes with certain risks and disadvantages. Here are some of the disadvantages of digital banking that must be considered:

1. Cyber security Threats: The increasing use of digital channels exposes customers to cyber-attacks, such as phishing, malware, and data breaches.
2. Fraudulent Activities: The use of digital banking can also be vulnerable to fraud, including unauthorised transactions, identity theft, and account hacking. Customers may suffer financial losses if they fall victim to scams.
3. Technical Glitches: Technical issues, system outages, or maintenance downtime can disrupt digital banking services, causing inconvenience to customers and affecting their access to online transactions or fund transfers.

4. Regulatory Challenges: The regulatory environment for digital banking is evolving, and changes in regulations can impact the services and protections available to customers.
5. Privacy Concerns: Customers may have concerns about how their personal and financial data is collected, used, and shared by digital banks and third-party service providers.
6. Account Lockout: Account lockouts due to forgotten passwords or security measures can result in temporary loss of access to digital banking services and online transactions.
7. Both customers and financial institutions must prioritize cyber security and adopt best practices for safe online banking.

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UNIT – II

CENTRAL BANKS

2.1. Introduction

The regulatory frame work or device for the financial sector mainly comprises of the Ministry of Finance of the Govt. of India which administers the Companies Act, 1956, and the Securities Contracts (Regulation) Act, 1956; the RBI and the Board of Financial Supervision (BFS) in its aegis; the SEBI, Insurance Regulatory Authority; the Governing Boards of various stock exchanges and the apex financial institutions like the IDBI, SIDBI, NHB, NCB. Among these, the RBI and SEBI have special role and responsibility.

Central banks use monetary policy to manage economic fluctuations and achieve price stability, which means that inflation is low and stable. Central banks in many advanced economies set explicit inflation targets. Many developing countries also are moving to inflation targeting. Central banks conduct monetary policy by adjusting the supply of money, usually through buying or selling securities in the open market. Open market operations affect short-term interest rates, which in turn influence longer-term rates and economic activity. When central banks lower interest rates, monetary policy is easing. When they raise interest rates, monetary policy is tightening.

2.2. Organization & Management

The Reserve Bank of India, as the central bank of the country, is the Centre of the Indian financial and monetary system. Like a prominent institution, it has been guiding, monitoring, regulating, controlling & promoting the purpose of the Indian Financial System from the beginning. It is quite new in comparison to central banks such as the Bank of England, Riksbank of Sweden and the Federal Reserve Board of U.S. It is perhaps the oldest between the central bank in the developing countries. It began its operation from April 1, 1935 on the terms of the RBI Act 1934. It has been a private shareholder institution up to Jan 1949, later on which became a State-owned institution under the RBI (Transfer to Public Ownership) Act 1948. This Act empowers the Central Govt, in consultation with the Governor of the Bank, to provide such guidelines to it as they might consider it mandatory in the public interest. Further, the Governor and all the Deputy Governors of the Bank are employed by the Central Government. The ultimate control of the Bank confers in the central board that consists of the Governor, 4 Deputy Governors, & 15 Directors chosen by the Central Government. The internal organizational set up of the Bank has been modified and expanded from time to time in order to cope with the increasing volume and range of the Banks activities.

2.3. Functions of the RBI

The RBI functions inside the structure of a mixed economic system. With respect to setting of various policies, it is necessary to continue close & uninterrupted collaboration between the government and RBI. In the event of a difference of opinion or conflict, the government view or position can always be expected to prevail.

Main Functions of Central Bank

1. To maintain monetary stability so that the business and economic life can deliver welfare gains of a properly functioning mixed economy.
2. To maintain financial stability and sound financial institutions so that monetary stability can be safely pursued.
3. To maintain stable payment systems so that financial transactions can be safely and efficiently executed.
4. To promote the development of financial infrastructure of markets and systems and to enable it to operate efficiently.
5. To ensure that credit allocation by the financial system broadly reflects the national economic priorities and societal concerns.
6. To regulate the overall volume of money and credit in the economy with a view to ensure a reasonable degree of price stability.

2.4. Role of RBI

Note issuing Authority/ Issuer of Currency. From the commencement of the RBI the single right or authority or monopoly of issuing currency notes other than one-rupee notes or coins, and coins of smaller denominations. The fundamental purpose of RBI is issue of currency notes. Though one-rupee coins & notes, and coins of smaller denominations are issued by the GOI, which are put into flow only by the RBI. These currency notes issued are a legal tender universally in India without any limit. Currently, the Bank issue notes in the mentioned denominations: Rs.2, 5, 10, 20, 50, 100 and 500. The responsibility of the Bank is to put currency into or withdraw it from circulation and also to exchange notes & coins of one denomination into those of other denominations as required by the public. The Issue Department conducts all affairs of the Bank concerning to note issue. The notes can be issued by the Bank against the security of gold coins & gold bullion, foreign securities, rupee coins, Govt. of India securities, & such bills of exchange & promissory notes as are appropriate for buying from the Bank. Until 1956, minimum 40% of the assets were to comprise of gold coin & bullion & sterling/foreign securities. In other words, the proportionate reserve system of note issue existed in India till 1956. Afterwards this system was abolished and a minimum value of gold coin & bullion & foreign securities as a portion of total approved assets came to be adopted as a cover for note issue.

Government Banker

The banker to the Central & State Governments is the RBI. It provides to the government all banking services such as acceptance of deposits, withdrawal of funds by cheques, making payments & receipts and collection of payments on behalf of the govt. RBI manages its deficit or surplus in the Central Government account by the creation & cancellation of treasury bills (known as ad hoc treasury bills).

Ways and Means Advances

As a banker to the government, the Bank can make "ways & means advances" (WMA) (these are short term loans made in order to reduce the temporary gap between receipts & payments) to both the Central & State Governments. The maximum maturity duration of these loans is three months. However, in practice, the gap between receipts & payments in context of the Central Governments is usually met by the issue of ad hoc treasury bills, while the one in respect of the State

Governments are met by the ways and means advances. This has changed in recent times and there is a greater amount of independence with the Central Bank. The agreements signed on September 9, 1994 and March 6, 1997 between the GOI and the Reserve Bank of India with regard to elimination of the ad hoc treasury bills and the introduction of the scheme of WMA by the Reserve Bank of India to the GOI, have been projected as indicators of the RBI having become more independent now. The system of WMA in the place of that of issuing ad hoc treasury bills has been regarded as a significant development in the direction of a desirable and better fiscal policy – monetary policy synchronization. The consensus between RBI and the government reached in 1994 eliminated the automatic monetization of the Central Government fiscal deficit through the issue of ad hoc Treasury Bills by April'97. Under WMA, the RBI gives ways & means advances to the Central Government in mutually agreed amounts at market linked interest rates. Under this system, since the RBI has the right to generate floatation of new government loans when the actual utilization of WMA crosses 75% of the limit, the WMA does not attain the cumulative character of the ad hoc. Thus, the RBI can now direct the government at its will, and can impose market discipline on fiscal profligacy. However, the new system notwithstanding, the fiscal dominance has continued to persist as reflected in the growing volume of government borrowings.

Overdrafts

Apart from the Ways and Means Advances, the State Govts have made heavy use of overdrafts from the RBI in excess of the credit (Ways & Means Advances) limits granted by the RBI. In other words, overdrafts are unauthorized WMA drawn by the State Government on the RBI. At present, overdrafts up to & inclusive of the seventh day are charged at the Bank rate and from the eighth day onwards at 3% more than the Bank rate. The management of the States overdraft has progressively become one of the main accountabilities of the RBI on account of the existence of large amounts of those overdrafts. The main role of RBI as the banker to the government is the issue, management & administration of the public (Central & State Governments) debt. The Bank charges a commission from the governments for rendering this service.

Bankers' Bank

The Reserve Bank of India, like all central banks, can be named as bankers' bank as it has a very distinct association with commercial and cooperative banks. The volume of reserves of commercial banks is controlled by the Bank and thus determines the deposits/credit generating ability of the banks. The banks hold a share or all of their reserves with the RBI. Likewise, in times of need, the banks borrow funds from the RBI. It is thus known as the bank of last resort or the lender of last resort. On the whole, in India, the ultimate source of money & credit is the RBI.

Supervising Authority

The RBI has huge powers to supervise & control commercial and cooperative banks with a vision to develop an adequate and sound banking system in India. It has, in this field, the following powers:

(a) to issue licenses for the establishment of new banks;
(b) to issue licenses for the setting up a bank branches;
(c) to prescribe minimum requirement regarding paid up capital and reserves, transfer to reserve fund, and maintenance of cash reserves and other liquid assets;
(d) to inspect the working of banks in India as well as abroad in respect of their organizational set up, branch expansion, mobilization of deposits, investments, and credit portfolio management, credit appraisal, region-wise performance, profit planning, man power planning and training and so on;
(e) to conduct ad hoc investigations from time to time, look into complaints, irregularities and frauds in respects of banks;
(f) to control methods of operations of banks so that they do not fritter away funds in improper investments and injudicious advances;

In keeping with the recommendations of Narasimham Committee (1991), the RBI function of bank supervision was alienated from its customary central banking function by the formation of a distinct Department of Supervision (DOS) from 22nd November 1993. The Board of Financial Supervision (BFS) was set up on 16th November 1994 under the aegis of the RBI to supervise the Indian Financial System (IFS). But it has been found that quite often the Department of Supervision (DOS) does not take action on inspection reports, that banks continue to repeat their mistakes, and that they continue to lend to defaulting parties even when they are blacklisted.

Exchange Control (EC) Authority

The crucial function of the RBI is to retain the stability of the external value of the rupee. It follows this objective by its domestic policies & the regulation of the foreign exchange market. When the external sector is considered, the job of the RBI has the following dimensions:

(a) to administer the 'foreign exchange control';

(b) to choose the exchange rate system and fix or manage the exchange rate between the rupee and other currencies;

(c) to manage exchange reserves; and

(d) to interact or negotiate with the monetary authorities of the Sterling Area, Asian Clearing Union, and other countries, and with international financial institutions such as the IMF, World Bank and Asian Development Bank.

EC (Exchange Control) in terms of FERA and FEMA

The RBI administers the 'exchange control' in terms of the Foreign Exchange Regulation Act (FERA), 1973, which has been substituted by the Foreign Exchange Management Act (FEMA). The role of the RBI is to improve & regulate the foreign exchange market. Its role is to simplify external trade & payment & provide or orderly development & maintenance of foreign exchange market within the framework of the FEMA. The custodian of the country's foreign exchange reserves is the RBI. It is consigned with the obligation of managing the investment & deployment of the reserves in the maximum beneficial manner. Its role as the stabilizer of the foreign exchange market has become all the more important with the introduction of the floating exchange rate system and convertibility of the rupee on trade and current accounts.

The RBI has the power to enter into foreign exchange transactions, both on its own as well as on behalf of the government. It deals in foreign exchange transactions on its own account and on behalf of the govt. It deals in foreign exchange with the public via the authorized dealers (Ads). It supervises, monitors and controls the foreign exchange market with a view to creating an active market with wide participation by the Ads and the exporters/importers so that the various currencies are actively traded, facilitating customers to obtain fine quotations, with rate variations being kept to the minimum. The objective of the RBI in respect of the foreign exchange forward market is to make it a useful tool for covering all exchange risks of the importers/exporters. Its regulations aim at ensuring that the forward market facilities are need based and are not used for speculative purposes.

2.5. Monetary Policy

Monetary policy is the policy used by the central bank to regulate the supply of money in the economy. The central bank of India that is Reserve bank of India plays the controlling authority here. This is a tool used to control even the inflation and the interest rates to ensure price stability and trust in the currency of a nation. The goals of monetary policy also include the contribution to the economic growth and stability, to lower unemployment rates and to maintain stability in the exchange rates with the currencies of other nations. The best monetary policy is termed as the optimal monetary policy for which optimal inflation rate should be applicable in a nation. Monetary policies are generally of two types:

1) Expansionary Policy - This type of policy increases the total supply of money in the economy. This was traditionally used to remove unemployment during recessionary period by lowering the interest rates having the belief that easy credit will help business expand.
2) Contractionary Policy- This policy increases or expands the money supply but at a pace less even less than the normal and in certain cases even shrinks it. It is intended to slow inflation and to avoid the resulting distortion of asset values.

Monetary Policy uses the following tactical approaches to maintain financial stability:

- ❖ Money Supply - This practice involves the money supply by buying and selling government bonds. These are also known as open market operations as the central bank make purchases and sales of government bonds in public markets. These involve generally the short-term bonds.
- ❖ Money demand - This practice plays on the rule that the demand is dependent on the price. The price is the interest rate to be paid by the borrower. Therefore, through this rule the central bank keeps on altering the interest rates to regulate the economy and bring in stability.
- ❖ Banking risk - This practice manages the risk within the banking system. In this it specifies the reserve requirements of the banks than those reserves may be with the central bank or with the commercial banks only. They regulate the economy under this approach through the reserve ratios. To primary tools are Cash reserve ratio and statutory reserve ratio.

The following three approaches namely open market operations, regulating interest rate and reserve ratios are the normal methods used by the reserve bank of India to ensure adequate supply of money in the economy with price stability.

2.5.1. Meaning and Objectives of Monetary Policy

Monetary Policy refers to the mechanism through which the monetary authority regulates the supply of money in the economy by using instruments such as that of interest rates to maintain the price stability and achieve better economic growth. This monetary authority is generally the central bank of the country. RBI (Reserve Bank of India) is the central bank of India.

2.5.2. Objectives of Monetary Policy

Beside price stability monetary policy accomplish the following tasks as well:

1) Full employment - Full employment is a situation favorable for any economy not only because it increases output but also for the credit standing of a nation. Monetary policy helps achieving this target.

2) Price stability - Another main objective of monetary policy is the price stability. Price stability is promoted to reduce the fluctuations in prices as

these fluctuations in prices bring uncertainty and instability in the economy. The focus of monetary policy is to facilitate the environment which is favorable to the economic development to run the projects swiftly along with maintaining the stability.

3) Economic Growth - Economic growth is a situation where real GDP of a nation that is the per capita income of the nation increases over a period of time. Monetary policy aims at it.

4) Balance of Payment - This objective of monetary policy tries to achieve the equilibrium between the exports and the imports.

5) Expansion of bank credit - One another important function of RBI is the controlled expansion of credit to commercial banks according to their seasonal requirements without affecting the output.

6) Fixed Investment - This objective of RBI focuses on the productivity of investments by having a control on non-essential fixed investment.

7) Promote Efficiency - RBI tries to increase the efficiency in the financial system by regulating and deregulating interest rates, ease operational constraints, introduce money market instruments, etc.

8) Restriction of inventories and stocks - Excess stocking of inventories is not beneficial for any economy as it may make the stock outdated over a period of time and hence may lead to a loss. To avoid this kind of problem the central bank carries out this special function of regulating the economic inventories.

9) Reducing the rigidity - RBI bring flexibility in the operations which provide autonomy. It maintains its control on all the areas where prudence is required in the financial system.

2.5.3. Instruments of Monetary Policy

The instruments of monetary policy are of two types:

1) Quantitative or general or indirect - They are meant to regulate the quantity of credit in the economy through commercial banks. The various instruments used under this are bank ate operations, open market operations and changing reserve requirements.

2) Qualitative or selective or direct - They are meant to regulate the type of credit from the central bank to the commercial banks. They include changing margin requirements and regulation of consumer credit.

Both these methods are discussed here forth:

A. Bank rate Policy:

Bank rate is the rate at which the central bank rediscounts the government securities such as that of bills of exchange and other government securities held by the commercial banks. This goes this way when the central bank wants to control the inflationary situation in the economy it raises the bank rate. This way the demand of credit from the commercial banks reduces which reduces the spare money in the hands of general public, which corrects the inflationary pressure. Similarly, when deflationary pressure is corrected by reducing the bank rates, economy is brought back to the equilibrium.

B. Open Market Operations:

It refers to sale and purchase of securities from the commercial banks by the central bank to regulate the economy. The reserve bank starts selling the securities held for the same to commercial banks, when the prices start rising, this way money is extracted from circulating in the economy and kept with the central bank as reserves. Similarly, when recessionary forces start in the economy, the central bank starts purchasing securities from the commercial banks to induce more money in the economy.

C. Changes in Reserve Ratios:

This is suggested by Keynes. This method says that every bank is required to keep certain reserves with them as well as with the central bank from the total deposits in the form of reserve fund. When prices rise, the central bank raise the reserve ratios as well, now as more money is in the form it reduces the money in circulation and hence economy moves towards the equilibrium. In the opposite, when the reserve ratio is lowered, the reserve with the commercial banks is reduced but their lending ratio increases which in turn bring more money in circulation. Equilibrium is achieved.

D. Selective Credit Controls:

Selective credit controls are used to regulate certain specific types of credit for particular purposes. They can be in the form of margin requirements as if there is specific speculative activity in the economy in particular sector in certain commodities, the RBI raise the margin requirement on them to reduce the investment in that particular commodity. Similarly, it reduces the margin on commodities which it wants to encourage investment in.

2.5.4. Limitation of Monetary Policy

The importance of monetary policy is realized in the fact it tries to promote economic development by supervising inflationary and deflationary gaps, disequilibrium in balance of Payments, stability in exchange rate, infusion of capital formation yet monetary policy faces certain barriers which are highlighted as under:

1. Money market is not organized: There is a huge size of money market in our country which is unorganized such as indigenous bankers like money lenders etc. they do not come under the control of the RBI. Thus, any tool of the Monetary Policy does not affect the unorganized money market making Monetary Policy less effective.
2. Large Non-monetized Sector: Large non-monetized sector which hinders the success of monetary policy since all the transactions conducted therein are mere barter exchanges. People do not deposit money with banks rather than use them for conspicuous consumption, etc. Such activities encourage inflationary pressures because they lie outside the control of the monetary authority.
3. Large Number of NBFLs: Coverage area of Monetary Policy is limited since Monetary Policy covers only commercial banking sector. Other non-banking institutions remain untouched. NBFI which do not come under the purview of monetary policy greatly hampers to achieve the objectives of monetary policy in the less developed country.
4. Existence of Parallel Economy: The existence of parallel economy limits the working of the monetary policy. The black money is not recorded since the borrowers and lenders keep their transactions secret and hidden. Consequently, the supply and demand of money gap arises and also doesn't remain as desired by the monetary policy.
5. Deficit Financing: A monitory authority wants to check the supply of money while deficit financing helps to increase the supply. In today's scenario deficit financing is the main source of financing development activities and thereof with deficit financing objectives of monetary policy becomes inoperative.

6. Only a Persuasive Policy: In underdeveloped economies monetary policy is soft, persuasive and lenient which sometimes leave a scope of tax evasion, antisocial elements, black money etc. in the economy which limits the effectiveness of monetary policy
7. Time lag: Monetary Policy works judiously only after series of time lags. The time gap between the formulation of the plan and implementation of it is known as time lag.

   These lags can be further divided into two phases: Inside Lag and Outside Lag.

   Inside Lag: the inside lag is the amount of time taken to enforce a policy and its effect in the economic activities. There are of further divided into two types:

   a. Recognition lag is the time taken to recognize the requited changes after adoption of the policy.

   b. Action lag is the effect that demonstrates itself after a long-time lag is known as action lag.

   Outside Lag: Outside lag is a lag which needed by the consumers, firms, government and the outside stakeholders to have an impact in their economic activities due to change in monetary policy. Outside lag is the reaction of the external stakeholders towards the adoption of the policy.
8. Poor banking Habits: Lack of awareness and poor banking habits of individuals such as preference to use cash rather than cheque leads to circulation of money in the economy only without coming back to banks for deposits which ultimately leads to reduction in credit creation in the economy.

2.6. Narasimhan Committee Report

Narasimham committee is a committee that was formulated by the Government of India in August 1991 for reviewing the financial system of the country. The government considers the inefficiency and low returns of the banking sector decided to remodel them for improving their performance. A committee of 9 members under the chairmanship of former RBI governor, M. Narasimham was constituted for analyzing different aspects of the Indian financial system. The committee submitted its report in November 1991 providing various comprehensive recommendations for bringing reforms in financial sectors.

Recommendations of Narasimham Committee - 1991

1. **Reduction in SLR and CRR:** The committee recommended the reduction in Statutory reserve ratio and Cash reserve ratio that were very high at that time. High proportion of these ratio was reducing the productivity of banks as it leads to locking up of large resources of banks with government. Narasimham committee suggested of bringing down the SLR to 25% and CRR to 10%.
2. **Interest rate deregulation:** It recommended deregulation of interest rate and providing banks an autonomy to decide interest rate themselves as per the market forces. Interest rates should be decided as per the demand and supply of funds in market.
3. **Removal of Dual control:** Banking division of the ministry of Finance and RBI were the two authorities governing the banking institutions at that time. Committee recommended that RBI should only be the authority for regulating the activities of baking sector.
4. **4-tier banking structure:** Narasimham committee recommended construction of a 4-tier hierarchy for banking structure. At top, there should be 3-4 large banks including SBI, then 8-10 national banks, local banks and rural banks at bottom.
5. **Phasing out Directed credit programme:** It suggested phasing out of Directed credit programme under which banks are required to deploy their funds under the government direction to poor sectors at lower rates. Banks should themselves decides the allocation of their funds freely. Setting up ARF Tribunal: Non-performing assets and bad debts were the alarming issues which were adversely affecting the performance of banks at that time. Committee suggested the establishment of ARF (Asset Reconstruction Fund) which will assist banks in recovering their debts.
6. **Banking autonomy:** This committee recommended that Government should provide autonomy to banks for taking their decisions freely. Bank

must take all decisions regarding upgradation of their technology and work culture themselves which will help them in raising their efficiency.

Narasimham committee - 1998

In 1998, Government of Indian constituted yet another committee under the leadership of M. Narasimham. The committee was formulated with aim of further strengthening of financial institutions of the country. This committee is termed as "Banking sector reforms Committee". It submitted its report in April 1998.

Recommendations of Narasimham Committee - 1998

1. **Strengthening Banking sector:** In context of Capital account convertibility (CAC), Narasimham committee considered a strong banking system in country. Handling issues related to management of exchange rate and domestic liquidity must be in capability of Indian banks in light of CAC. Therefore, committee recommended merger of strong banks resulting in "multiplier effect" on industry.
2. **Narrow borrowing:** NPAs (non-performing assets) were very high at that time which were equal to 20% of bank assets. It was influencing the profitability of banking institutions. Committee recommended concept of narrow borrowing for easy rehabilitation of Indian banks. As per this, banks will be permitted to deploy their funds in risk free assets and for a short term.
3. **Bank ownership:** Banks should be provided freedom regarding its working and management. Autonomy of banks and government interference in management of banks cannot go hand in hand. Therefore, committee recommended that functions of board should be reviewed and allowed to implement a professional corporate strategy.
4. **Capital adequacy norms:** This committee suggested the reviewing of capital adequacy norms for strengthening of Indian financial system. The prescribed capital adequacy norms should be raised which will increase the absorption capacity of banks. Currently, 9% is the capital adequacy ratio which need to be increased.

5. **Transparency and credibility:** Banks should maintain transparency in its reporting and avoid any manipulation which would otherwise lead to penalty. They are required to publish half yearly reports disclosing performance details, profitability, NPA and adequacy ratio. It will ensure better credibility and transparency regarding the soundness of institution in market.
6. **Amendment of Banking laws:** Narasimham committee II suggested to review the present banking laws in light of current needs of banking industry. All main laws governing banking sector such as RBI act, Bank Nationalization Act, State bank of India act, Banking regulation act etc. need to be amended for bringing the required upgradation.

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UNIT - III

INTRODUCTION TO INSURANCE

3.1. Introduction

Insurance is very important industry in India. Insurance industry is relevant from both economic and social point of view. Since liberalization insurance industry has gone through so many transformational changes. Liberalization has allowed foreign insurance companies to enter in India. These Foreign insurance companies see India as potential market. There have been several operational innovation and product innovations. Insurance industry manages risk of the society and also works as financial intermediary and provides long term funds for infrastructural development of the nation.

Insurance is transfer of risk or loss, of one entity to another entity in exchange of money known as premium. Insurance companies are into the business of insurance. Insurance companies work as a financial intermediary. These companies collect funds from society as premium and invest these large amounts of premiums in large development projects. Through insurance these companies manage risk of the investor, provide means for accumulating savings and reduces investor's income tax liability also. On the other hand, these insurance companies provide funds to the government and other sectors for long term projects. Insurance companies receive steady and periodical payments of premium as inflows. Moreover, liability of these companies is long term in nature. Hence, they are having ample amount of funds with them. Mostly insurance companies invest their funds in government bonds, state and local government projects, mortgages and corporate bonds.

3.2. Meaning of Insurance:

It is a form of contract or agreement which one party agrees in return of a consideration to pay an agreed amount of money to another party to make good for a loss, damage, injury to something of value in which the insured has to pay as a result of some uncertain event. Thus, insurance is a method of securing protection against future calamities and uncertainties. It refers to an insurance contract between two or more insurance companies. Every insurer undertakes to bear the risk according to his capacity. In order to safe guard his interest. They may insure the same risk undertaken by him along with another insurer. Hence it is a contract between two insurance companies. i.e. first insurer and reinsurer.

3.3. Types of Insurance:

Insurance is mainly of two types: a. Life insurance and b. General insurance. Under life insurance, insurer pays certain amount of money to the insured or his beneficiary upon occurring of a certain event such as death. On the other hand, any insurance policy other than life insurance, are covered under general insurance. General insurance includes health insurance, fire insurance, marine insurance, property insurance, rural insurance, vehicle insurance and travel insurance etc.

a. Life Insurance Policy Categorization:

i. Whole Life Plan: A policy which covers entire duration of insured's life is known as whole life policy. In this type of policy annual premium is paid throughout policy term period.

ii. Endowment: Under endowment plans lump sum amount is provided when the policy matures or when the policy holder dies. There are few endowments plans which provide payment in case of critical illness also.

iii. Money Back Policy: Under money back plan instead of getting lump sum amount at the end of the term, insured person gets a fixed percentage of sums assured at regular intervals. There is benefit of liquidity in money back policy.

iv. Term Plan: Term plans are the most simple and cheapest type of life insurance policy, which provides coverage for a specified period known as "term" or until a certain age of the insured. If the insured person dies within the coverage period, then this policy pays the face amount of the policy, but nothing is paid if insured outlives the term of policy. After the end of term period policyholder has an option to discontinue the policy or to extend it.

v. Unit Linked Insurance Plan (ULIP): Unit linked insurance plan is a combination of risk cover and investment both. These policies are flexible and protective both at the same time. Premium paid under these policies are used to purchase investment asset units. These asset units are selected by policyholder.

b. General Insurance Policy Categorization: Under general insurance or non-life insurance following types of insurance are covered.

i. Health Insurance: Health insurance covers all the medical and surgical expenses incurred by the insured person. These plans are created after assessing the insured persons current health position, then estimation is made for future healthcare expenses for the insured person and after all this approximation premiums are decided for the policy.

ii. Accidental Insurance: An accidental insurance policy covers both any sort of disability arising from accident and death due to accident. Accident should not arise due to the usage of alcohol or drugs.

iii. Property Insurance: Risk to property arising out of fire, theft, burglary and weather damage are covered under property insurance. Property insurance are further sub divided into earthquake insurance, flood insurance and fire insurance etc.

iv. Vehicle Insurance: Vehicle insurance is also known as motor insurance and auto insurance. It is a mandatory policy which should be taken by every vehicle owner. In case of auto accident this policy mitigates the costs associated with accident. Vehicle owner has to pay annual premiums to insurer, and then insurer pays full or part of costs arising out of auto accident.

v. Rural Insurance: Rural insurance is a policy which covers the risk of agriculture and rural businesses. These policies cover natural calamities, livestock, crop, health and life. One can take policy according to his needs.

vi. Home Insurance: Home insurance covers private homes from any kind of risk and losses.

vii. Travel Insurance: Travel insurance policies cover both, domestic and international as well as short and long-distance travel. These policies cover trip cancellation, medical expenses, flight accident, lost luggage and any other kind of loss incurred while travelling

viii. Group Insurance: An insurance policy which covers a particular group of people is known as group insurance. This group can be a society, employees of an organization or members of a professional association.

ix. Retirement Insurance: Retirement insurance is also known as Pension policies. Pension policies provide stable retirement income and give financial security to the policy holders. The main difference between life insurance and general insurance is that, under life insurance the claim is certain and fixed, but in case of general insurance, claim is uncertain i.e. amount of claim is variable and is ascertained after the happening of the event.

3.4. Role of Insurance in Economic Development

1. Saving and Insurance:

Saving involves refraining from present consumption. The investment can take place only when there are savings. The relationship between saving, investment and growth of GDP can be explained as:

$$G = S / K$$

Where G - Rate of GDP growth, S - Saving Ratio and K - Capital output ratio. Insurance companies lead to economic development by mobilizing savings and investing them into productive activities. Indian insurance companies are able to mobilize long-term savings to support economic growth and also facilitate economic development by providing insurance cover to a large segment of our people as well as to business enterprise throughout India.

2. Capital Formation and Insurance:

Capital formation maybe defined as increase in capital stock of the country consisting of plant, equipment, machinery, tools, building, means of transport, communication, etc. The process of capital formation envisages three essential steps. These are:

a) Real saving: Mobilization of saving through financial and non-financial intermediaries to be placed at the disposal of investor.

b) The act of investment: The contribution of insurance companies in the process of capital formation appears at all these stages. Insurance services act as a tool to mobilize saving, function as financial intermediary and at times also indulge in direct investment. Also govt. has made regulations under which every insurer carrying on business of life insurance shall invest 25% of funds in Govt. securities and not less than 15% in infrastructure and social sector. The importance of Indian insurance industry is gauged by the fact that annual amount of investible funds of LIC and GIC and its subsidiaries amounted to over Rs. 20,000 crore and Rs. 10,000 crores are invested in nation building activities, housing and other infrastructural areas.

c) Increased Employment:

Prior to the liberalization of insurance sector in India, the opportunities for employment were limited with the LIC of India as sole employer. While some of the professionals left the country looking for opportunities elsewhere, those who remained worked within the confines and constraints of public sector monopoly. This has further constrained the opportunities for exposure to the development in rest of the world. Liberalization and the opening up of sector to private players has now created a vast opportunity for employment.

3. Obligation to Rural and Social Sector:

The insurer is required to fulfill their obligation towards rural and social sector. For this, Life insurers are required to have 5%, 7%, 10%, 12%, and 15% of total policies in first five years respectively in rural sector. Likewise General Insurers are required to have 2% 3% and 5% thereafter of total gross premium income written in first five financial years respectively in rural sector.

4. Insurance as Financial Intermediary:

Financial intermediaries perform the function of channelizing saving into domestic investment. They facilitate efficient allocation of capital resources, which in turn improve productivity and economic efficiency which result in reduced capital output ratio. The insurance companies perform extremely useful function in economy as financial intermediaries. These are as follows:

a) Reduction in transaction cost: Insurers help in reducing transaction cost in economy by collecting funds from policyholders and investing the same in different projects scattered over different regions. It is a specialized and time-consuming job.

b) Creating liability: The policyholders, in case of loss, are not required to wait for a long period for the amount of claim. It improves their liquidity.

c) Facilitates Economies of scale in Investment: Insurers are in the position of financing large projects, railways power projects, etc. These large projects create economies of scale, facilitate technological innovation and specialization and thus promote economic efficiency and productivity.

5. Promotes Trade and Commerce:

The increase in GDP is positively correlated to growth of trade and commerce in economy. Whether it is production of goods and services, domestic or international trade or venture capital projects, insurance dominates everywhere. Even banks demand insurance cover of assets while granting loans for purchase of assets. Thus, insurance covers, promotes specialization and flexibility in the economic system that play contributory role in healthy and smooth growth of trade and commerce.

6. Facilitates efficient capital allocation:

Insurance provides cover to large number of firms, enterprises and businesses and also deploy their funds in number of investment projects. The vast pool of knowledge and expertise so gained enable them to distinguish between productive and high return projects. Therefore, they promote efficient and productive allocation of capital resources, which in turn lead to increased productivity and efficiency in the system.

7. Encouraging Financial Stability and Reducing Anxiety:

Insurer promotes financial stability in economy by insuring the risks and losses of individuals, firm and organizations. Because of uninsured large losses, firm may not be able to compensate for it leading to its insolvency which may cause loss of employment, revenue to supplier & Govt., loss of products to customer, etc. Moreover, it relieves the tensions and anxiety of individuals by securing the loss of their lives and assets.

8. Reducing Burden on Govt. Exchequer:

Insurance companies, particularly life insurers provide a variety of insurance products covering needs of children, women and aged etc. under social security network and thereby reduce the burden on Govt. exchequer in providing these services. This Govt., saves expenditure on these items and amount can be utilized for more productive projects. Insurance companies play an important role in economic development of country.

3.5. Saving and Investment Aspects of Insurance

In today's world, managing personal finances is crucial for achieving financial security and future goals. Three key aspects of financial planning are savings, investments, and insurance. While these terms are often used interchangeably, it is important to understand their fundamental differences and how they contribute to an individual's financial well-being. In this article, we will delve into the dissimilarities between savings, investments, and insurance, highlighting their unique characteristics and purposes.

Savings

Savings are the foundation of financial planning. They involve setting aside a portion of one's income for future use. Savings typically refer to funds deposited in traditional bank accounts, such as savings accounts or certificates of deposit (CDs). The primary purpose of savings is to establish an emergency fund and cover short-term expenses. These funds are easily accessible and generally earn a low rate of interest, making them highly liquid. Savings accounts are ideal for storing money that will be needed within a short timeframe, such as for unexpected medical expenses or car repairs. They provide stability and security, ensuring that individuals have readily available funds to meet immediate financial needs without resorting to debt.

While savings accounts offer convenience and ease of access, they may not offer significant growth potential in terms of wealth creation or beating inflation over the long term. The interest rates on savings accounts are often lower than the rate of inflation, which means that the purchasing power of the saved funds may decrease over time. Nevertheless, savings accounts play a vital role in financial planning by providing individuals with a financial cushion and flexibility for short-term financial requirements.

Investments

Investments, on the other hand, are financial instruments aimed at growing wealth over the long term through asset appreciation. Appreciation refers to an increase in the value of an asset over time. Investing involves allocating funds into assets such as stocks, bonds, mutual funds, real estate, or businesses, with the expectation of generating returns. Unlike savings, investments carry a degree of risk and are subject to market fluctuations.

The primary goal of investing is to achieve capital appreciation and generate income through dividends, interest, or rental yields. Investments often offer higher potential returns compared to savings accounts. However, they also come with a higher level of risk. Diversification and understanding one's risk tolerance are essential when investing to mitigate potential losses.

Investing is suitable for long-term financial goals, such as retirement planning, purchasing a home, or funding higher education. It allows individuals to grow their wealth over time and outpace inflation, thereby preserving purchasing power. Historical data suggests that, over the long term, well-diversified investment portfolios tend to outperform savings accounts and provide opportunities for substantial growth.

When it comes to investing, there are various options available. Stocks represent ownership in companies and can offer significant returns over time. Bonds are debt instruments issued by governments or corporations and provide fixed interest payments. Mutual funds pool money from multiple investors to invest in a diversified portfolio. Real estate investments involve purchasing properties for rental income or capital appreciation. Each investment option comes with its own risk profile, potential returns, and suitability based on an individual's financial goals and risk tolerance.

It is important to note that investing is not a guaranteed way to make money, and there is always a possibility of losses. Market volatility, economic conditions, and other factors can impact the value of investments. Therefore, individuals should conduct through research, seek professional advice if necessary, and diversify their investments to manage risk effectively.

3.6. Social Vs Private Insurance

Social insurance and private insurance differ primarily in their nature and purpose. Social insurance is a mandatory system, often run by the government, designed to provide benefits to a broad population based on contribution and social need, rather than individual risk. Private insurance, on the other hand, is voluntary and based on individual contracts, with premiums reflecting individual risk profiles.

Differences between social vs private insurance:

Mandatory vs. Voluntary:

Social insurance is typically compulsory, meaning individuals are required to participate, while private insurance is voluntary, individuals choose whether or not to purchase coverage.

Coverage:

Social insurance aims to cover a wide range of risks and populations (e.g., unemployment, disability, retirement), while private insurance focuses on specific risks (e.g., healthcare, life, and property) and can be tailored to individual needs.

Contribution:

Social insurance contributions are often based on income or employment, and may be funded by both the employee and employer, while private insurance premiums are based on risk and may be subsidized by an employer.

Benefit Structure:

Social insurance benefits are often tied to social need and may be adjusted for cost-of-living changes, while private insurance benefits are typically based on the premium paid and the terms of the policy.

Financing:

Social insurance is often financed by a dedicated fund, with contributions used to cover benefits, while private insurance relies on insurance companies investing premiums and managing risk pools.

Purpose:

Social insurance aims to provide a safety net and promote social welfare, while private insurance focuses on individual financial protection and risk management.

3.7. Life Vs Non-Life Insurance

3.7.1. History of Life Insurance:

First insurance company in India was Oriental Life insurance company which came into existence in Calcutta in the year 1818. This company failed in 1834. In the year 1829, the Madras Equitable started its life insurance business in Madras Presidency. In 1870 British Insurance Act was enacted. After its enactment in 1871 the Bombay Mutual, in 1874 Oriental and in1897 Empire of India were started in the Bombay Residency. In this era mostly foreign insurance offices namely Albert Life Assurance Royal insurance, London Globe Insurance and Liverpool were doing good business in India. Indian insurance offices were facing hard competition with these foreign insurance offices. In order to regulate life insurance business in India, the first statutory measure was taken as, Indian Life Assurance Companies Act, 1912. Further in 1928, the Indian Insurance Companies Act was passed. This act helped government to collect all the statistical data on the life and general insurance business being conducted in India by Indian and foreigner insurers. This included provident insurance societies also. In order to effectively control the activities of all the insurers, Insurance Act 1938 was passed. All the earlier legislations were amended and merged in Insurance Act 1938. Principal agencies were closed down by the Insurance Amendment Act, 1950. At this time there were large number of insurance companies which gave rise to high level of competition and few unfair trade practices. Hence government decided to nationalize insurance sector. On 19th January 1956, life insurance sector was nationalized by passing an ordinance. In 1956, 154 Indian, 16 foreign life insurers and 75 provident societies were nationalized and a new single entity was created namely Life Insurance Corporation (LIC), by passing the LIC Act, 1956, LIC enjoyed full monopoly till late 1990's. After this insurance sector was reopened to the private sector.

3.7.2. Types of Insurance

Insurance is mainly of two types: Life insurance and General insurance. Under life insurance, insurer pays certain amount of money to the insured or his beneficiary upon occurring of a certain event such as death. On the other hand any insurance policy other than life insurance, are covered under general insurance. General insurance includes health insurance, fire insurance, marine insurance, property insurance, rural insurance, vehicle insurance and travel insurance etc.

Life Insurance policy categorization:

1. Whole Life Plan: A policy which covers entire duration of insured's life is known as whole life policy. In this type of policy annual premium is paid throughout policy term period.
2. Endowment: Under endowment plans lump sum amount is provided when the policy matures or when the policy holder dies. There are few endowments plans which provide payment in case of critical illness also.

3. Money Back Policy: Under money back plan instead of getting lump sum amount at the end of the term, insured person gets a fixed percentage of sums assured at regular intervals. There is benefit of liquidity in money back policy.
4. Term Plan: Term plans are the most simple and cheapest type of life insurance policy, which provides coverage for a specified period known as "term" or until a certain age of the insured. If the insured person dies within the coverage period, then this policy pays the face amount of the policy, but nothing is paid if insured outlives the term of policy. After the end of term period policyholder has an option to discontinue the policy or to extend it.
5. Unit Linked Insurance Plan (ULIP): Unit linked insurance plan is a combination of risk cover and investment both. These policies are flexible and protective both at the same time. Premium paid under these policies are used to purchase investment asset units. These asset units are selected by policyholder.

General insurance policy categorization:

Under general insurance or non-life insurance following types of insurance are covered.

1. Health Insurance: Health insurance covers all the medical and surgical expenses incurred by the insured person. These plans are created after assessing the insured persons current health position, then estimation is made for future healthcare expenses for the insured person and after all this approximation premiums are decided for the policy.
2. Accidental Insurance: An accidental insurance policy covers both any sort of disability arising from accident and death due to accident. Accident should not arise due to the usage of alcohol or drugs.
3. Property Insurance: Risk to property arising out of fire, theft, burglary and weather damage are covered under property insurance. Property insurance is further sub divided into earthquake insurance, flood insurance and fire insurance etc.
4. Vehicle Insurance: Vehicle insurance is also known as motor insurance and auto insurance. It is a mandatory policy which should be taken by

every vehicle owner. In case of auto accident this policy mitigates the costs associated with accident. Vehicle owner has to pay annual premiums to insurer, and then insurer pays full or part of costs arising out of auto accident.

5. Rural Insurance: Rural insurance is a policy which covers the risk of agriculture and rural businesses. These policies cover natural calamities, livestock, crop, health and life. One can take policy according to his needs.
6. Home Insurance: Home insurance covers private homes from any kind of risk and losses.
7. Travel Insurance: Travel insurance policies cover both, domestic and international as well as short and long-distance travel. These policies cover trip cancellation, medical expenses, flight accident, lost luggage and any other kind of loss incurred while travelling.
8. Group Insurance: An insurance policy which covers a particular group of people is known as group insurance. This group can be a society, employees of an organization or members of a professional association.
9. Retirement Insurance: Retirement insurance is also known as Pension policies. Pension policies provide stable retirement income and give financial security to the policy holders. The main difference between life insurance and general insurance is that, under life insurance the claim is certain and fixed, but in case of general insurance, claim is uncertain i.e. amount of claim is variable and is ascertained after the happening of the event.

3.7.3. Life Insurance

Life insurance is a special agreement between a company and someone who buys the insurance. When people buy life insurance, they pay monthly or yearly premiums. If that person passes away, the insurance company gives a sum of money to the person or people they chose to get the money. The agreement says how much money will be given and how long the insurance will be valid.

Non-Life Insurance

Non-life insurance, also known as general insurance, is all about protecting the things you own. It covers property, businesses, and people. Some people call it Property and Casualty (P&C) insurance. Non-life insurance is unlike life insurance because it helps when things get damaged. It gives money to help with accidents. Non-life insurance is all about keeping things safe. It doesn't insure people's lives. When buildings or belongings get destroyed. It can be a big problem. That's why people can get insurance for their things.

To sum it up, life insurance takes care of your family when you're not there, while non-life insurance helps protect your belongings from unexpected things that can happen.

Features of Life and Non-life Insurance

- Life insurance takes care of your family's money if something happens to you.
- There are different types of life insurance, like term life, whole life, and universal life.
- Cost of life insurance depends on many things.
- Some life insurance policies can give you extra benefits, like saving money or borrowing against the policy.
- People get life insurance to replace their income, pay for a funeral, or pay off debts.

Non-Life Insurance

- Non-life insurance covers accidents, destruction of property, and compensation for any injuries.
- Common types include auto, home, health, travel, and business insurance.
- Premiums are determined based on risk assessment, coverage limits, and deductible amounts.
- If something unexpected happens, non-life insurance can help pay for the costs or damages.
- Non-life insurance is important for individuals and businesses to protect their things and be prepared for unexpected expenses.

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UNIT - IV

INSURANCE CONTRACT AND RISK MANAGEMENT

4.1. Introduction

The fundamental principle of Insurance is mathematical; its application is financial; and its interpretation is legal. For the layman to understand the Insurance principle he should be an actuary (who design and price the insurance products); to understand its application to financial problems, he need not be a financial; and to understand its legal concepts, he need not be a lawyer. The subject of Insurance covers a vast array of topics. This and the following chapters are concerned with these topics. Insurance may be defined as a contract between two parties whereby one party called insurer undertakes in exchange for a fixed sum called premium to pay the other party called insured a fixed amount of money after happening of a certain event. Insurance policy is a legal contract & its formation is subject to the fulfilment of the requisites of a contract defined under Indian Contract Act 1872. According to the Act "A Contract may be defined as an agreement between two or more parties to do or to abstain from doing an act, with an intention to create a legally binding relationship." Since Insurance is a contract, certain sections of Indian Contract Act are applicable. Insurance contracts are a vital element of risk pooling and determine the risks covered, the premiums charged and the value of the insurance cover. Although insurance contracts are governed by the usual laws of contract, in practice there are important features of an insurance contract that fundamentally impact the relationship between the insured and the insurer. Insurance contracts are governed by the principle of 'utmost good faith'. This requires the insured to disclose all material facts which may impact the risks underwritten by the insurance company. This is an important concept in project finance because of the complex nature of the project risks and the fact that many of these risks change over time. Most insurance contracts are negotiated through a broker and brokers will thus typically play a central role in disclosing project information to the insurers.

4.2. Meaning of Contract

An insurance contract is a legally binding agreement between an insurance company (insurer) and an individual or entity (policyholder) where the insurer agrees to provide financial protection against specified risks in exchange for the payment of premiums by the policyholder. It is a contract governed by the principles of contract law and specific insurance regulations.

4.3. Concepts of Insurance Contract

1. **Insurable Interest:** The policyholder must have an insurable interest in the subject matter of the insurance contract. This means that the policyholder must suffer a financial loss or have a legal relationship with the insured property or person, such as ownership or a legal obligation.
2. **Premium:** The policyholder pays a premium as consideration for the insurance coverage provided by the insurer. Premiums can be paid in a lump sum or in periodic installment, as agreed upon in the contract.
3. **Policy Terms and Conditions:** The insurance contract outlines the terms and conditions governing the coverage. It includes details such as the scope of coverage, exclusions, deductibles, policy limits, duration of coverage, premium payment obligations, and other relevant provisions.
4. **Insured Event and Claims:** The insurance contract specifies the events or circumstances that trigger coverage and the process for filing and settling claims. The policyholder must promptly notify the insurer in case of a claim and provide the necessary documentation to support the claim.
5. **Termination and cancellation:** Insurance contracts may be terminated or cancelled based on the terms outlined in the contract or as per applicable laws and regulations. Policyholders may have the option to cancel the policy, or insurers may terminate the contract for non-payment of premiums or other reasons specified in the contract.

4.4. Nature of Insurance Contract

1. **Utmost Good Faith:** Insurance contracts are based on the principle of utmost good faith, requiring both the insurer and policyholder to

disclose all relevant information honestly and completely. This ensures a fair assessment of risks and determines the terms and conditions of the contract.

2. **Indemnity:** The fundamental principle of insurance is indemnity, aiming to restore the policyholder to the same financial position as before the occurrence of the insured event. The insurance contract intends to compensate the policyholder for the actual loss suffered, up to the policy limits.
3. **Risk Transfer:** Insurance contracts involve the transfer of risks from the policyholder to the insurer. By paying premiums, the policyholder transfers the financial responsibility of covering losses arising from specified risks to the insurer.
4. **Conditional Contract:** An insurance contract is conditional in nature. The insurer's obligation to pay a claim is triggered by the occurrence of the insured event, as specified in the policy. The policyholder must fulfil the conditions and obligations stated in the contract to be eligible for coverage.

4.5. Insurable Interest

The principle of insurable interest is a foundational, concept in the insurance industry, forming the basis for the validity and enforceability of insurance contracts. Insurable interest refers to the financial or economic interest that an individual or entity has in the subject matter of an insurance policy. This principle ensures that the party purchasing insurance stands to suffer a financial loss in the event of the insured risk, thereby aligning the purpose of insurance with the fundamental concept of indemnity.

4.5.1. Meaning of Insurable Interest

Insurable interest refers to a financial or economic interest that a person or entity has in the subject matter of an insurance policy. In the context of insurance, it is essential for the validity and enforceability of an insurance contract. Insurable interest ensures that the individual purchasing the insurance policy has a legitimate reason to obtain coverage because they would suffer a financial loss if the insured risk occurs.

4.5.2. Principle of Insurable Interest

The principle of insurable interest meaning is a foundational concept in insurance that establishes the necessity for a person or entity to have a genuine financial interest in the subject matter of an insurance policy. Insurable interest ensures that the individual purchasing the insurance stands to suffer a direct and measurable financial loss if the insured event occurs. This principle serves as a fundamental requirement for the validity and enforceability of insurance contracts.

Aspects of Principle of Insurable Interest

The key aspects of the principle of insurable interest include:

- Financial Interest: The policyholder must have a real and substantial financial interest in the property, life, or liability being insured. This interest is what creates a legitimate reason for obtaining insurance coverage.
- Prevention of Wagering: The principle of insurable interest is designed to prevent insurance contracts from being used for speculative or gambling purposes. Without an insurable interest, the insurance agreement could resemble a wager rather than a legitimate risk transfer mechanism.
- Validity of Contracts: Most jurisdictions require insurable interest for an insurance contract to be legally valid. This requirement ensures that insurance is used for its intended purpose to provide protection against genuine risks and financial losses.
- Dynamic Nature: Insurable interest is not static and may change over time. For example, a creditor's interest in a debtor's life may diminish as a loan is repaid.

Principle of Insurable Interest Example

- In life insurance, family members, business partners, or creditors may have insurable interest in an individual's life.
- In property insurance, the property owner has insurable interest as they would suffer a financial loss if the property is damaged or destroyed.

- In business insurance, a company has insurable interest in its assets, such as buildings, equipment, or inventory.

4.5.3. Conclusion

The principle of insurable interest is the bedrock of insurance contracts, establishing a direct financial connection between the insured party and the potential loss. It safeguards against moral hazard, reinforces the concept of indemnity, and ensures that insurance serves its intended purpose of providing financial protection rather than facilitating speculative practices. Understanding and adhering to the principle of insurable interest is fundamental for creating robust and ethically sound insurance agreements.

4.6. Utmost Good Faith

The Principle of Utmost Good Faith, a fundamental tenet in insurance contracts, sets the standard for a relationship built on transparency, trust, and honesty between the insurer and the insured. This principle demands full and honest disclosure of all material facts relevant to the insurance coverage, requiring both parties to act with the highest degree of good faith throughout the entire life cycle of the contract. This mutual commitment to openness forms the bedrock of insurance agreements and is pivotal in ensuring fairness, accuracy, and integrity within the insurance industry. The principle of utmost good faith is applicable to almost all industries.

4.6.1. Meaning of Utmost Good Faith

The Principle of Utmost Good Faith, also known by its Latin term "uberrimae fidei," is a fundamental concept in the insurance industry. Principle of utmost good faith means that the high standard of honesty, trust, and disclosure expected from both parties involved in an insurance contract the insurer and the insured.

Here's a breakdown of the meaning:

- Utmost Good Faith:
    - Utmost: This signifies the highest level or extreme degree.
    - Good Faith: This refers to honesty, openness, and fairness in dealings.
- Meaning of the Principle:

- Insurer's Perspective: The insurer expects the insured to provide complete and accurate information regarding all material facts relevant to the insurance coverage. This includes any information that might influence the insurer's decision to accept or reject the risk, determine the premium, or set the terms and conditions of the policy.
- Insured's Perspective: The insured, in turn, relies on the insurer to act with the same level of good faith. This includes providing clear and transparent details about the terms and conditions of the insurance contract, including coverage limitations and exclusions.

➢ Mutual Trust and Disclosure: Both parties are obligated to disclose all material information, whether asked or not, during the negotiation and execution of the insurance contract. This disclosure is essential for an accurate assessment of the risk involved and for establishing a fair and equitable insurance agreement.

➢ Throughout the Contract Period: The principle extends beyond the initial stages of the contract. Throughout the life of the policy, both parties are expected to communicate any changes in circumstances or material facts that may affect the terms and conditions of the coverage.

➢ Legal Consequences of Breach: Failure to uphold the Principle of Utmost Good Faith may have legal consequences. If either party breaches this principle by withholding important information or acting in bad faith, it can lead to the voiding of the insurance contract, denial of a claim, or legal action.

4.6.2. Exceptions to the Principle of Utmost Good Faith

The principle of utmost good faith, also known as uberrimae fidei, is a fundamental concept in insurance contracts, requiring both parties the insurer and the insured to act honestly and fairly toward each other. However, there are certain situations where this principle may not apply or where exceptions may arise. Here are some exceptions to the principle of utmost good faith:

- Non-disclosure of Material Facts: The insured is not required to disclose information that is not material to the insurance contract. Material facts are those that would influence the insurer's decision to accept the risk or determine the premium. However, if the insured knowingly withholds material information, it may lead to the nullification of the insurance contract.
- Representation vs. Warranty: In some jurisdictions, a distinction is made between representations and warranties in insurance contracts. A representation is a statement of fact made by the insured to the best of their knowledge and belief, whereas a warranty is an absolute statement of fact that must be strictly complied with. Breach of a warranty may result in the insurer avoiding the contract, while a misrepresentation may lead to remedies such as adjusting the terms or voiding the contract if it is fraudulent.
- Insurer's Conduct: If the insurer engages in fraudulent or dishonest practices, such as misrepresentation of coverage or unfair claims handling, the insured may not be bound by the principle of utmost good faith and may have grounds to challenge the validity of the contract.
- Statutory Protections: Some jurisdictions have consumer protection laws or regulations that provide certain rights and remedies to insured parties, which may override or limit the application of the principle of utmost good faith in specific circumstances.
- Implied Terms: Implied terms, whether by statute or common law, may alter or supplement the obligations of the parties in an insurance contract. These implied terms may provide additional protections to insured parties or impose obligations on insurers that are not explicitly stated in the contract.
- Uberrimae Fidei Not Applicable: In certain types of insurance contracts, such as contracts of indemnity, where the insurer relies more on risk assessment rather than the insured's representations, the principle of utmost good faith may not be as strictly applied.

4.6.3. Conclusion

Principle of Utmost Good Faith is not merely a legal doctrine; it is the ethical core of insurance relationships. Upholding this principle is essential for the smooth functioning of insurance contracts, as it fosters an environment where both parties can rely on the veracity of the information provided. This commitment to utmost good faith not only enhances the credibility of the insurance industry but also serves as a vital safeguard against misunderstandings and disputes.

4.7. Principle of Indemnity

The principle of indemnity is a fundamental concept in insurance that governs the compensation provided to the policyholder in the event of a loss. This principle is based on the idea that insurance is designed to restore the insured to the financial position they were in before the loss occurred, and it aims to prevent the policyholder from gaining a financial advantage through the insurance contract.

4.7.1. Meaning of Indemnity

Indemnity refers to a legal or financial obligation to compensate another party for any loss, damage, or liability incurred. It is a form of protection or reimbursement against financial losses or adverse consequences. The party providing indemnity, often referred to as the indemnitor, agrees to make the other party, known as the indemnitee, whole by compensating them for specific losses or damages.

4.7.2. Principle of Indemnity

The principle of indemnity is a fundamental concept in insurance that governs the compensation provided to the policyholder in the event of a covered loss. This principle is based on the idea that the purpose of insurance is to indemnity, or compensate, the insured party for the actual financial loss suffered due to an insured event. The key elements of the principle of indemnity include:

- Financial Restoration: The primary objective of indemnity is to restore the insured to the financial position they were in before the covered loss occurred. The insurance payout is intended to cover the actual economic loss suffered, preventing the insured from making a profit from the insurance contract.

- No Overcompensation: The principle prohibits the insured from receiving more than the actual amount of the loss. The insurance company is not obligated to provide compensation exceeding the financial loss suffered by the insured.
- Insurable Interest Requirement: To claim indemnity, the insured must have an insurable interest in the subject matter of the insurance. This ensures that the insured has a legitimate financial interest in the property or person being insured.
- Practical Application in Property Insurance: The principle of indemnity is often evident in property insurance. In the case of property damage or loss, the insurer compensates the policyholder for the cost of repair, replacement, or the actual cash value of the property at the time of the loss.
- Depreciation Considerations: When calculating indemnity for property insurance, depreciation may be taken into account. This reflects the reduction in the value of property over time, ensuring that the compensation aligns with the actual value at the time of the loss.
- Prevention of Moral Hazard: The principle of indemnity helps prevent moral hazard by discouraging the insured from intentionally causing a loss to gain financially. The insured should have a genuine interest in protecting the insured property or person.
- Application in Different Types of Insurance: The principle of indemnity is applicable across various types of insurance, including property insurance, liability insurance, and health insurance. In each case, the goal is to provide compensation for actual losses without allowing for Exceptions to the Principle of Indemnity.

The exceptions have been stated below.

- Life Insurance: Life insurance is not strictly based on the principle of indemnity. The insurer pays a predetermined sum (the face amount) upon the death of the insured, regardless of the actual financial loss suffered.
- Personal Accident Insurance: Similar to life insurance, personal accident insurance may pay a predetermined sum for specific injuries

or events, deviating from the strict application of the principle of indemnity.

- Valued Policies: Some policies, such as valued policies, specify a predetermined amount of compensation irrespective of the actual loss. These are exceptions to the principle of indemnity.
- New-for-Old Policies: In certain policies, especially in marine insurance, "new-for-old" clauses may allow for the replacement of damaged or lost items with new ones, without considering depreciation.

4.7.3. Principle of Indemnity Example

Let's consider a property insurance example:

- Scenario: A policyholder insures a building for its market value of $500,000. A covered event causes damage to the building.
- Principle of Indemnity Application: The insurer, applying the principle of indemnity, assesses the actual loss. If the cost of repair is $50,000, the insured is indemnified for that amount. If the actual cash value of the damaged property is less due to depreciation, the indemnity may be adjusted accordingly.

4.7.4. Application of the Principle of Indemnity

- Property Insurance: In cases of property damage or loss, the principle of indemnity is applied to compensate the insured for the actual financial loss suffered, considering factors like repair costs and depreciation.
- Liability Insurance: While liability insurance is not based on the principle of indemnity, it still involves compensating the insured for actual financial losses resulting from covered liability claims.
- Health Insurance: In health insurance, the principle of indemnity is applied when reimbursing the insured for actual medical expenses incurred, up to the policy limits.
- Motor Insurance: Following an accident, motor insurance applies the principle of indemnity by compensating the insured for the repair costs or the actual cash value of the damaged vehicle.

4.7.5. Conclusion

The principle of indemnity serves as a cornerstone in insurance contracts, emphasizing the idea of restoring the insured to the financial state they were in before the occurrence of the insured event. While providing essential financial protection, this principle prevents the misuse of insurance as a tool for financial gain.

4.8. Risk Management

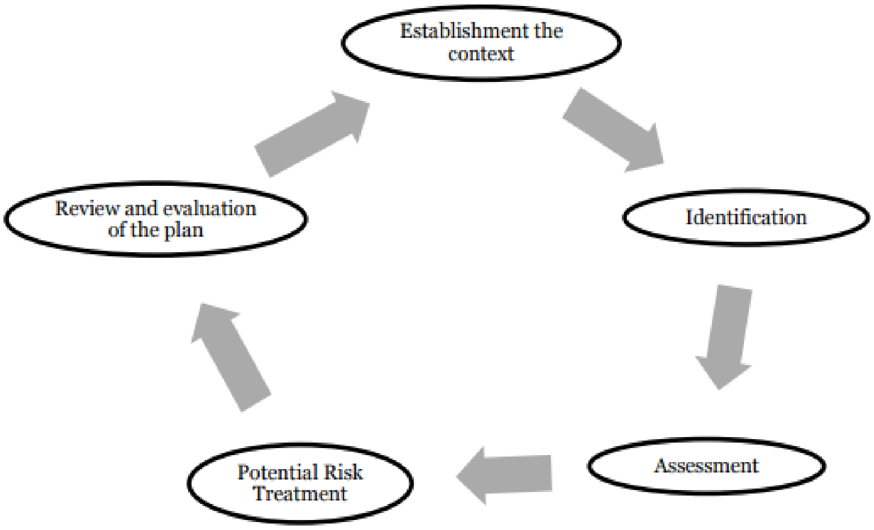
4.8.1.Introduction :

Risk can be defined as the chance of loss or an unfavorable outcome associated with an action. Uncertainty does not know what will happen in the future, the greater the uncertainty, the greater the risk. For an individual, risk management involves optimizing expected returns subject to the risks involved and risk tolerance. Risk is what makes it possible to make a profit. If there was no risk, there would be no return to the ability to successfully manage it. For each decision there is a risk return trade-off. Anytime there is a possibility of loss (risk), there should be an opportunity for profit. Risk management is the process of identifying, assessing and controlling threats to an organization's capital and earnings. These threats, or risk, could stem from a wide variety of sources, including financial uncertainty, legal liabilities, strategic management errors, accidents and natural disasters. IT security threats and data-related risks, and the risk management strategies to alleviate them have become a top priority for digitized companies. As a result, a risk management plan increasingly includes companies' processes for identifying and controlling threats to its digital assets, including proprietary corporate data, a customer's personally identifiable information and intellectual property.

4.8.2. Definition of Risk Management :

Risk management is an integrated process of delineating (define) specific areas of risk, developing a comprehensive plan, integrating the plan, and conducting the ongoing evaluation' – Dr. P.K. Gupta.

4.8.3. Risk Management Process :



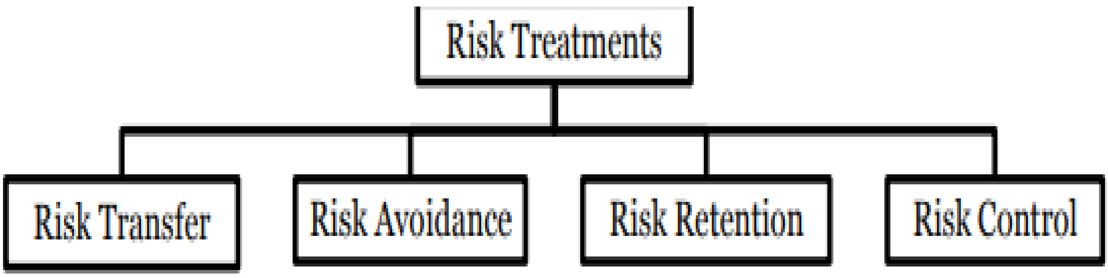
1. Establish the Context: The purpose of this stage of planning enables to understand the environment in which the respective organization operates, that means the thoroughly understand the external environment and the internal culture of the organization. You cannot resolve a risk if you do not know that it is. At the initial stage it is necessary to establish the context of risk. To establish the context there is a need to collect relevant data. There is a need to map the scope of the risks and objectives of the organization.

2. Identification: After establishing the context, the next step in the process of managing risk is to identify potential risks. Risks are about events that, when triggered, will cause problems. Hence, risk identification can start with the source of problems, or with the problem itself.

Risk identification requires knowledge of the organization, the market in which it operates, the legal, social, economic, political, and climatic environment in which it does its business, its financial strengths and weaknesses, its helplessness to unplanned losses, the manufacturing processes, and the management systems and business mechanism by which it operates. Any failure at this stage to identify risk may cause a major loss for the organization. Risk identification provides the foundation of risk management. The identification methods are formed by templates or the development of templates for identifying source, problem or event. The various methods of risk identification are - Brainstorming, interview, checklists, structured 'What-if' technique (SWIFT), scenario analysis, Fault Tree Analysis (FTA), Bow Tie Analysis, Direct observations, incident analysis, surveys, etc.

3. Assessment: Once risks have been identified, they must then be assessed as to their potential severity of loss and to the probability of occurrence. These quantities can be either simple to measure, in the case of the value of a lost building, or impossible to know for sure in the case of the probability of an unlikely event occurring. Therefore, in the assessment process it is critical to make the best educated guesses possible in order to properly prioritize the implementation of the risk management plan. The fundamental difficulty in risk assessment is determining the rate of occurrence since statistical information is not available on all kind of past incidents. Nevertheless, risk assessment should produce such information for the management of the organization that the primary risks are easy to understand and that the risk management decisions may be prioritized. Thus, there have been several theories and attempts to quantify risks. Numerous different risk formula exist but perhaps the most widely accepted formula for risk quantification is rate of occurrence multiplied by impact of the event [Rate of occurrence x Impact of the event].

4. Potential Risk Treatments: Once risks have been identified and assessed, all techniques to manage the risk fall into one or more of these four major categories.



a) Risk Transfer: Risk transfer means that the expected party transfers whole or part of the losses consequential to risk exposure to another party for a cost. The insurance contracts fundamentally involve risk transfers. Apart from the insurance device, there are certain other techniques by which the risk may be transferred.

b) Risk Avoidance: Avoid the risk or the circumstances which may lead to losses in another way, includes not performing an activity that could carry risk. Avoidance may seem the answer to all risks but avoiding risks also means losing out on the potential gain that accepting (retaining) the risk may have allowed. Not entering a business to avoid the risk of loss also avoids the possibility of earning the profits.

c) Risk Retention: Risk retention implies that the losses arising due to a risk exposure shall be retained or assumed by the party or the organization. Risk retention is generally a deliberate decision for business organizations inherited with the following characteristics. Self-insurance and Captive insurance are the two methods of retention. A 'captive insurer' is generally defined as an insurance company that is wholly owned and controlled by its insured's; its primary purpose is to insure the risks of its owners, and its insured's benefit from the captive insurer's underwriting profits.

d) Risk Control: Risk can be controlled wither by avoidance or by controlling losses. Avoidance implies that either a certain loss exposure is not acquired or an existing one is neglected.

Loss control can be exercised in two ways (i) Create the plan and (ii) Risk Control.

i. Create the Plan: Decide on the combination of methods to be used for each risk. Each risk management decision should be recorded and approved by the appropriate level of management. For example, a risk concerning the image of the organization should have top management decision behind it. Whereas, IT management would have the authority to decide on computer virus risks. The risk management plan should propose applicable and effective security controls for managing the risks. A good risk management plan should contain a schedule for control implementation and responsible persons for those actions. The risk management concept is old but is still not very effectively measured. Example - An observed high risk of computer viruses could be mitigated by acquiring and implementing antivirus software.

ii. Risk Control: Once the risk is evaluated, it has to be controlled. In the case of the worker working under the machine that will fall any moment on top of him, risk control implies primarily moving the worker from under there and then fixing the machine so as it does not fall on anyone. Thus, the steps involved are immediate directions preventing the risk and isolating or better removing the hazard to eliminate the risk. Avoiding the risk is the decision of either proceeding in the planned direction or opts for an alternate route which has less risk and is in line with the final objective. Reducing the risk occurrence probability or impact of its consequences or both can be considered while facing a risk. Transferring the risk is another option, mostly done through buying insurance. Other ways include lease agreements waivers, disclaimers, tickets, and warning signs. Retaining the risk can be another strategy where one knows that it is an inherent part of the event. After the control measures are implemented, it has to be documented. This has multiple benefits such as understanding what was done to tackle a risk thereby allowing similar risks to be tackled in that fashion, to prove that sufficient measures were taken to minimize and eliminate risks and due diligence were exercised etc.

5. Review and evaluation of the plan: Initial risk management plans will never be perfect. Practice, experience and actual loss results, will necessitate changes in the plan and contribute information to allow possible different decisions to be made in dealing with the risk being faced. Risk analysis results and management plans should be updated periodically. There are two primary reasons for this

a) To evaluate whether the previously selected security controls are still applicable and effective and

b) To evaluate the possible risk level changes in the business movement. There are risks that do no change and are static in nature.

However, other dynamic risks of not continually monitored and reviewed may grow like a bubble and their financial, legal and ethical impacts soon get out of control.

4.9. An integrated approach to Corporate Risk Management

Corporate risk management refers to all of the methods that a company uses to minimize financial losses. Risk managers, executives, line mangers and middle managers, as well as all employees, perform practices to prevent loss exposure through internal controls of people and technologies. Risk management also relates to external threats to a corporation, such as the fluctuations in the financial market that affect its financial assets.

a) Protecting shareholders: A corporation has at least one shareholder. A large corporation, such as a publicly traded or employee-owned firm, has thousands, or even millions, of shareholders. Corporate risk management protects the investment of shareholders through specific measures to control risk. For example, a company needs to ensure that its funds for capital projects, such as construction or technology development, are protected until they are ready to use.

b) Types of risk: Consider the types of risk that corporation must address every day. A corporation may become insolvent if it has not bought insurance, implemented loss control measures and used other practices to prevent financial loss. Insurance is no substitute for successfully identifying measures to prevent losses, such as safety training to prevent worker injuries and deaths. Risks can include hazard risks, financial risks, personal injury and death, business interruption / loss of services, damage to a corporation's reputation, errors and omissions and lawsuits.

c) Probability and consequences: To prevent financial losses, a corporation engages in a certain amount of speculation. A risk manager calculates the probability of each type of event that would damage the firm's financial position and the consequences. Calculating the likelihood that something will happen and its associated costs enables a risk manager to recommend ways to address the most probable risks to senior management, the board of directors and owners of the corporation.

d) Solutions: A corporate risk manager is a multi-disciplinary professional with an understanding of internal business processes and many financial instruments. This professional might have a background in business management, finance, insurance or actuarial science. He might suggest solutions to a corporation to protect its assets. For instance, he might recommend buying millions of dollars in commercial liability insurance coverage. Some risks that he calculates, as potentially damaging to the corporation, are ignored while others are covered by this liability policy. He might recommend buying other types of insurance, such as fire or fraud, after first weighting the costs versus the benefits of each type of coverage.

4.10. Risk Management Approaches and Methods

If you are a business leader, then you already know the importance of risk control. It is imperative that your business has a formal policy to limit the loss of assets and income. Here are 6 techniques associated with risk management.

a) Avoidance: Avoidance is the best means of loss control. This is because, as the name implies, you are avoiding the risk completely. If your efforts at avoiding the loss have been successful, then there is a 0% probability that you will suffer a loss. This is why avoidance is generally the first of the risk management techniques that is considered. It is a means of completely eliminating a threat.

b) Loss Prevention: Loss prevention is a technique that limits, rather than eliminates, loss instead of avoiding a risk completely, this technique accepts a risk but attempts to minimize the loss as a result of it. For example, storing inventory in a warehouse means that it is susceptible to theft. However, since there really is no way to avoid it, a loss prevention program is put in place to minimize the loss. This program can include patrolling security guards, video cameras, and secured storage facilities.

c) Loss Reduction: Loss reduction is a technique that not only accepts risks, but accepts the fact that loss might occur as a result of the risk. This technique will seek to minimize the loss in the event of some type of threat. For example, a company might need to store flammable material in a warehouse. Company management realizes that this is a necessary risk and decides to install state-of-the-art water sprinklers in the warehouse. If a fire occurs, the amount of loss will be minimized.

d) Separation: Separation is a risk management technique that involves dispersing key assets. This ensures that if something catastrophic occurs at one location, the impact to the business is limited to the assets only at that location. On the other hand, if all assets were at that location, then the business would face a much more serious challenge. An example of this is when a company utilizes a geographically diversified workforce.

e) Duplication: Duplication is a risk management technique that essentially involves the creation of a backup plan. This is often necessary with technology. A failure with an information systems server should not bring the whole business to a halt. Instead, a backup or failover server should be really available for access in the event that the primary serve fails. Another example of duplication as a risk management technique is when a company makes use of disaster recovery service.

f) Diversification: Diversification is a risk management technique that allocates business resources to create multiple lines of business that offer a variety of products and / or services in different industries. With diversification, a significant revenue loss from one line of business will not cause irreparable harm to the company's bottom line. Risk management is a key component in any sound company strategy. It is necessary to ensure long term organization sustainability and profitability.

4.11. Risk Reporting Process:

Risk reporting is communication of risk and risk management outcomes for the purpose of comparing the results with the policy.

An organization should ensure that information about risks derived from the risk management process is adequately reported, and used as a basis for decision making at all relevant levels. For this, clear reporting line mechanisms and strong inter-department knowledge sharing should be established in order to encourage accountability of risk, and to ensure reports are delivered in an accurate, consistent and timely manner. Moreover, the risk management policy should clearly state the way risk management performance will be reported. Inadequate risk reporting can lead to a failure to fully integrate identified risks into strategic and operational decisions. The organization should report on progress against the risk management plan by proving how well the risk management policy is being followed, to ensure that risk management is effective and continues to support organizational performance. More specifically:

1. The results from risk monitoring and review should be recorded and reported internally and externally, if appropriate.
2. Development in implementation of risk treatment plans should be incorporated into the organization's overall performance management.
3. Enhanced risk management includes continual communications with

external and internal stakeholders. The quality and success of risk reporting depends on the following factors are: a) Target audience. b) Input and processes. c) Frequency d) Content e) Format f) Dissemination channels.
There are two areas of risk reporting - a) Reporting to internal audiences
b) Reporting to external audiences.
The reporting of risks is essential for internal decision makers to integrate risk evaluation into their operational and investment strategy, to review performance and to review compensation / reward decisions. External risk reporting has rapidly developed in recent years, corporate governance reports also focus attention on internal control, and a review of risks is generally included in the annual reports. Both internal and external audiences can be further divided in subgroups, on the one hand some audiences (i.e. boards of directors and regulators, among external audiences) must be informed about the organizational risks and risk management processes because of regulation or recommendations. Voluntary disclosure to other internal audiences (i.e. employees) and external stakeholders (i.e. media, citizens, associations) is recommended because of anticipated benefits to an improved decision making. 'Inputs' and 'processes' are also critical.
The most important inputs are represented by
a) The various risks an organization is facing.
b) The stakeholder risk reporting requirements and expectations.
c) The organization's existing risk management governance that provides the context for establishing risk reporting processes.
d) The organizational resources (such as individuals with the necessary skills and experience financial resources, and access to required information). Decision must be taken on which risks to report in what detail, and with what reporting frequency.
a) Internal Reporting: The organization should establish internal reporting mechanisms in order to support and encourage accountability and ownership of risk. These mechanisms should ensure that, key components of the risk management framework, its effectiveness and the outcomes and any subsequent modifications, are properly disseminated, relevant information derived from the application of risk management is available at appropriate

levels and times, and there are processes for consultation with internal stakeholders. These mechanisms should, where appropriate, include processes to consolidate risk information from a variety of sources, and may need to consider the sensitivity of the information. Internal risk reports can either be real-time or periodic. The main purpose of periodic internal risk reports is to provide aggregate information about various relevant organizational risks, with trend indicators and periodic comparisons highlighting changes in risks. Periodic internal risk reporting contributes to strategic oversight and decision making, as well as improved operational business decisions. Risk information may be organized around specific key risk categories rather than around phases of the risk management process. Residual risk reporting involves comparing gross risk (the assessment of risk before controls or risk responses are applied) and net risk (the assessment or risk, taking into account any controls or risk responses applied) to enables a review of risk response effectiveness and alternative management options. Risk reporting to the board and committees should be made at least quarterly. Internal audiences will not only interest in disclosure of specific risks, but also in the risk management process. A well established and properly managed process will assure internal audiences about the reliability of risk reports; organizations must therefore include information on the quality of their risk management process, particularly in their period risk reports.

b) External reporting: Organizations are under increasing pressure for greater transparency, mandated or voluntary, and a better alignment of externally reported information with that which is reported internally. Stakeholders expect intensified corporate dissemination regarding risk, and awareness of the critical role of proper risk management. In view of this, an organization should provide accurate, timely and high-quality reports to meet the external stakeholder's needs. Specifically, it should periodically conduct a review of the effectiveness of the risk management system and report to stakeholders on that, and a robust assessment of the principal risks, describing them and explaining how they are being managed or mitigated. Organizations may consider preparing different, customized risk reports for different external stakeholders. Whilst internal risk reports aim exclusively at internal audiences, external risk reporting, including corporate annual reports, may more broadly include both external users and interested internal groups.

4.12. Risk Management Organization Structure

Organizational structure is the framework that holds an organization together and defines the lines of authority within a company, nonprofit organization or governmental agency. A well-defined organizational structure provides a clear path for risk assessment procedures. Before risk assessment teams can begin to work, each member of the team must have a good working understanding of how the company is organized. The organizational structure will show team members who is responsible for each area or operation being evaluated.

a) Traditional Structures: Traditional organizational structures typically show clear lines of authority that emanate from a central manager at the top of the organization. The authority vested in each department is clearly defined by its place within the organizational structure. Risk assessment operations can become bogged down when assessment operations are required to strictly follow established lines of authority in the company. The management of risks that cross these established lines can become a complicated process requiring intervention from the senior leadership.

b) Modern Structures: Modern organizational structures are arranged around teams, organizational processes, organizational functions and virtual operations. These types of organizational structures allow companies greater flexibility to react and adjust to changing market conditions and advancing technology. Risk assessment teams may find modern organizational structures difficult to understand because there may not be clear lines of authority for reporting identified risks. In response to these changing business realities, many organizations are turning to enterprise risk management systems to evaluate and control risks. Effective Risk Management (ERM) helps management define how risk factors are interrelated in an organization.

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UNIT - V

INSURANCE BUSINESS IN INDIA

5.1. Introduction

In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). The writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine. This was probably a pre-cursor to modern day insurance. Ancient Indian history has preserved the earliest traces of insurance in the form of marine trade loans and carriers' contracts. Insurance in India has evolved over time heavily drawing from other countries, England in particular.

1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta. This Company however failed in 1834. In 1829, the Madras Equitable had begun transacting life insurance business in the Madras Presidency. 1870 saw the enactment of the British Insurance Act and in the last three decades of the nineteenth century, the Bombay Mutual (1871), Oriental (1874) and Empire of India (1897) were started in the Bombay Residency. This era, however, was dominated by foreign insurance offices which did good business in India, namely Albert Life Assurance, Royal Insurance, Liverpool and London Globe Insurance and the Indian offices were up for hard competition from the foreign companies.

In 1914, the Government of India started publishing returns of Insurance Companies in India. The Indian Life Assurance Companies Act, 1912 was the first statutory measure to regulate life business. In 1928, the Indian Insurance Companies Act was enacted to enable the Government to collect statistical information about both life and non-life business transacted in India by Indian and foreign insurers including provident insurance societies. In 1938, with a view to protecting the interest of the Insurance public, the earlier legislation was consolidated and amended by the Insurance Act, 1938 with comprehensive provisions for effective control over the activities of insurers.

5.2. Major Insurance Legislation

On 19th January, 1956, the management of life insurance business of 245 Indian and foreign insurers and provident societies then operating in India was taken over by the Central Government. The Life Insurance Corporation (LIC) was formed in September 1956 by the Life Insurance Corporation Act, 1956 (LIC Act), which granted LIC the exclusive privilege to conduct life insurance business in India. However, an exception was made in the case of company, firm or person intending to carry on life insurance business in India in respect of the lives of "persons ordinarily resident outside India" provided the approval of the Central Government was obtained. The exception was however not absolute and a curious prohibition existed. Such company, firm or person would not be permitted to insure the life of any "person ordinarily resident outside India", during any period of their temporary residence in India. However, the LIC Act left outside its purview the Post Office Life Insurance Fund, any Family Pension Scheme framed under the Coal Mines Provident Fund, Family Pension and Bonus Schemes Act, 1948 or the Employees' Provident Funds and the Family Pension Fund Act, 1952. The general insurance business was also nationalised with effect from 1st January, 1973, through the introduction of the General Insurance Business (Nationalization) Act, 1972 (GIC Act). Under the provisions of the GIC Act, the shares of the existing Indian general insurance companies and undertakings of other existing insurers were transferred to the General Insurance Corporation to secure the development of the general insurance business in India and for the regulation and control of such business. The GIC was established by the Central Government in accordance with the provisions of the Companies Act, 1956 (Companies Act) in November 1972 and it commenced business on 1st January, 1973. Prior to 1973, there were 107 companies, including foreign companies, offering general insurance in India. These companies were amalgamated and grouped into four subsidiary companies of GIC, viz. the National Insurance Company Ltd. (National Co.), the New India Assurance Company Ltd. (New India Co.), the Oriental Insurance Company Ltd. (Oriental Co.), and the United India Assurance Company Ltd. (United Co.). GIC undertakes mainly reinsurance business apart from aviation insurance. The bulk of the general insurance business of fire, marine, motor and miscellaneous insurance business is under taken by the four subsidiaries. Nationalization was accomplished in two stages; initially the management of the companies was taken over by means of an Ordinance, and later, the ownership too was taken by means of a comprehensive bill. However, it was only in 1956 LIC was nationalized, with the objective of spreading life insurance much more widely and in particular to the rural areas with a view to reach all insurable persons in the country, providing them adequate financial cover at a reasonable cost. And as of 2007, LIC is India's leading Insurance company, with 2000 branches, which probably is the highest number of branches across India insurance sector.

Liberalisation of Indian Insurance

In 1994, insurance sector invited private participation to induce a spirit of competition amongst the various insurers and to provide a choice to the consumers. In 1997, insurance regulator IRDA was set up as the need was felt:

(a) to set up an independent regulatory body that provides greater autonomy to insurance companies in order to improve their performance;

(b) to enable them to act as independent companies with economic motives;

(c) to protect the interest of holders of insurance policies;

(d) to amend the Insurance Act, 1938, the Life Insurance Corporation Act, 1956 and the General insurance Business (Nationalization) Act, 1972;

(e) to end the monopoly of the Life Insurance Corporation of India and General Insurance Corporation and its subsidiaries.

In the first year of insurance market liberalization (2001) as much as 16 private sector companies including joint ventures with leading foreign insurance companies have entered the Indian insurance sector. Of this, 10 were under the life insurance category and six under general insurance. Thus, in all there are 25 players (12 life insurance and 13 general insurance) in the Indian insurance industry till date.

5.3. Growth of Industry

The beginnings of the insurance industry in India date back to the nineteenth century when the first life insurance company was established at Kolkata in

1818. Subsequently, the first general insurance company commenced operations at Kolkata in 1850. Over the years the industry expanded, with numerous entities operating in both life and general insurance segments. The insurance business is normally classified into two segments viz. life and non-life. General insurance is part of the non-life segment and refers to fire, marine and miscellaneous insurance. The term "miscellaneous insurance" includes engineering, motor vehicle insurance, health insurance, etc.

Insurance in India: Milestones

a. 1938 - Enactment of the Insurance Act, 1938, replaced earlier legislation and consolidated the law relating to both life and general insurance.
b. 1956 - Nationalization of the life insurance business by enactment of the Life Insurance Corporation Act, 1956.
c. 1968 - Amendment of the Insurance Act, 1938 providing for, the establishment of the Tariff Advisory Committee (TAC) to fix, control and regulate premium rates and conditions of policies.
d. 1971 - The Central Government took over the management of general insurance companies under the General Insurance (Emergency provisions) Act, 1971.
e. 1972 - Enactment of the General Insurance Business (Nationalization) Act, 1972, paving the way for the formation of the General Insurance Corporation of India (GIC) along with its four subsidiaries viz. the United India Insurance Company (UIIC), the New India Assurance Company Limited (NIAC), the National Insurance Company Limited (NIC) and the Oriental Insurance Company Limited (OIC). These companies were given the exclusive privilege of carrying on general insurance business in India.
f. 1994 - The Committee, headed by Shri R.N. Malhotra, submitted its report on the structure of the insurance industry making significant recommendations like allowing domestic and foreign operators entry into the sector and setting up an independent insurance regulatory authority.

g. 1999 - The Insurance Regulatory and Development Authority (IRDA) Act, 1999 was enacted with the objectives of protecting the interests of holders of insurance policies and to regulate, promote and ensure the orderly growth of the insurance industry. The IRDA Act also amended the Life Insurance Corporation Act, 1956 and the General Insurance Business (Nationalization) Act, 1972, withdrawing the exclusive privilege of the LIC and GIC and its subsidiaries of carrying on life and general insurance business.
h. 2002 - The General Insurance Business (Nationalization) Act, 1972 was amended. Consequently, the four subsidiary companies of GIC became independent companies wholly owned by the Government of India. The role of GIC was restricted to the business of reinsurance.

5.4. Agricultural Insurance

Agriculture insurance is specifically targeted insurance for agriculture and allied sector. Agriculture insurance covers production related risks of agriculture and allied sector viz. sector crops, livestock, aquaculture, and forestry. Agriculture insurance consists of crop insurance, cattle insurance, farm equipment and production related risks of agriculture allied activities having direct or indirect impact. However, it does not include cover of other normal risks of farming community; for example - health, property (other than crop and agriculture equipment), life and old age risks. Agriculture insurance forms part of miscellaneous insurance business in India. Agriculture in India is characterized by high dependence on monsoon, low productivity, small operational holdings, low investment in technology and high dependence of population. Both cultivation practices and market of output is unorganized. These characteristics put together has resulted in low bargaining power of farmers. The issue becomes complex because of the risks involved in agriculture practices related with backward linkages as well as forward linkages. The high risk in agriculture makes farmers a weak link in the whole agrarian economy. It is important to understand the risk profile of agriculture to get right perspective of agriculture insurance in India. The next section elaborates the risk profile of Indian Agriculture. Risk in agriculture originates from different variables such as- biological, climatic, agricultural practice and price. Biological variables are adversities coming from pests and diseases. Climatic variables account for vagaries of nature in form of drought and flood or change in weather parameters. Variables associated with agricultural practices are types of agricultural inputs used, and method of cultivation. Price variables are associated with volatility of output prices in the agricultural commodity market. A farmer faces risks in both favorable and unfavorable cropping conditions. In favorable condition, it faces risk of price whereas in unfavorable conditions it faces risk of low production.

The risks faced by agriculture are identified as:

(a) Production risks: Production risks impact the net income from farm because of uncertainty associated with amount of crop output. Production risks originate from two principal factors- change in expected weather parameters (rains, wind velocity, temperature etc.) and incidence of pest and diseases; which impact overall productivity of crop.

(b) Price/Market risk: Price or market risks as the name represents originate from price volatility of input and output prices in the primary agriculture market. Information asymmetry related with use of input and price of output adversely impacts farmers.

(c) Financial/Credit risk: Financial and credit risks emanate from high dependence of Indian farmer on informal course of credit, high transaction cost and interlinkage of transactions in terms of purchase of input on credit and sale of output from the same source.

(d) Institutional risk: Institutions play an important role in wellbeing of farmers as regulations and policies by Governments highly impact farmers' decisions. Institutional risks arise from change in input and output support, input subsidy, minimum support price, import and export policy etc.

(e) Technology risk/Information risk: High or low use of technology brings with it associated risks that impact farm income. Use of High Yielding variety seeds, agrochemicals need information of new agricultural practices and development in agricultural technologies related with knowledge of soil type and nutrients, weather forecasts and farm management practices. In absence of complete information, farmers loose on net income as they make heavy investments without having adequate knowhow.

(f) Personal risks: Personal risk are risks of life, health, asset, accident faced by a farming household. Natural calamities impact health and life of the members of household as well as the productive asset like livestock and farm implements. Apart from it, they face risks due to exposure to hazardous chemicals that are used in pesticides and micro-organisms, in handling of agriculture equipment, wild animals and other agents of nature.

5.4.1. Types Of Agriculture Insurance

Agriculture insurance is classified based on type of asset, type of risk, type of risk assessment method and risk management method. It can be classified in three categories based on type of Asset-Crop, Livestock and Farm implements. Crop insurance covers protect farmers against uncertainty of crop yield arising out of natural reasons beyond their control. Crop insurance is further classified on the basis of type of crop in three categories- food crop, commercial crop and plantation/ horticulture. Livestock insurance covers risks of animal husbandry, poultry, fisheries, sericulture, apiculture etc. it can be divided into cattle insurance, small farm animals, poultry, fisheries and others. Cattle insurance includes covers for cattle used in dairy farming, meat production or draft purpose. Insurance cover is also available for small farm animals like sheep, goat, pigs etc. Poultry insurance provides cover for bird species like chicken and ducks. Fisheries insurance covers risks involved in fish and prawn farming. Insurance cover is also available for large animals like elephant, camel, horse etc. insects used in bee and silk farming. Insurance cover for large farm implements like tractor and thresher as well as small farm implements like agriculture pump-set, oil engines is available under agriculture insurance.

The following section describes important aspects of each type of agriculture insurance covers available in India.

Crop Insurance

Crop insurance is a product aimed at protecting cultivators from farm production related risks, which are measured in terms of yield or weather parameters. Mahul and Stutely (2010) define crop insurance as 'Insurance that provides financial compensation for production or revenue losses resulting from specified or multiple perils, such as hail, windstorm, fire, or flood. Most crop insurance pays for the loss of physical production or yield. Coverage is also often available for loss of the productive asset, such as trees in the case of fruit crops. Crop insurance accounts for more than 90 percent of global agricultural insurance.

History And Growth of Crop Insurance in India

Crop insurance took formal shape in independent India in 1970. Major conceptual contribution to this step came from Prof. V. M. Dandekar, a prominent economist, who strongly advocated for introduction of crop insurance based on an area approach. The first crop insurance scheme was introduced by the Government in 1972. Country has come long way since then covering about 30% of the total number of land holdings in the country. The next big leap in this direction came after launch of ambitious crop insurance scheme 'Pradhan Mantri Fasal Bima Yojana' (PMFBY) launched by central Govt. in 2016. A brief description of crop insurance schemes implemented by Government of India and subsequently through Agriculture Insurance Company of India since inception is chronologically presented in next section.

First Crop Insurance Program

A number of models of crop insurance were considered for feasibility by the Government and the 'first crop insurance program'(FCIS) based on 'Individual Approach 'was introduced in 1972-73 for cotton, Groundnut, Wheat and Potato and implemented in the states of Gujarat, Maharashtra, Tamil Nadu, Andhra Pradesh, Karnataka and West Bengal. This experimental scheme continued up to 1978-79 and covered only 3110 farmers for a premium of Rs 4.54 lakhs against claims of Rs 37.88 lakhs. It was realized that crop insurance programs based on the individual farm approach would not be viable and sustainable.

Pilot Crop Insurance Scheme

Based on the learning's of FCIS a second scheme named Pilot Crop Insurance Scheme (PCIS) was introduced in1979. The scheme was linked to institutional credit, i.e., crop loan and was based on 'area approach'. Participation by the State Governments was voluntary in this scheme. The scheme covered cereals, millets, oilseeds, cotton, potato, gram and barley. The risk was shared by General Insurance Corporation (GIC) and the respective State Govt. in the ratio of 2:1. The insurance premium ranged from 5 to 10 per cent of the sum insured. The scheme ran till 1984-85 and 13 States participated in the scheme. The scheme covered 6.27 lakh farmers. The premium income from the scheme was Rs 1.97 crore against claims of Rs1.57 crore.

Comprehensive Crop Insurance Scheme

Based on the learning's of PCIS, a scheme called Comprehensive Crop Insurance Scheme (CCIS), was implemented from Kharif 1985 at the all-India level. This Scheme was also optional for the State Governments. It took 'Homogeneous Area approach' and was compulsory for short-term crop credit. The CCIS was implemented for 15 years, from Kharif 1985 to Kharif 1999. Fifteen States and two UTs participated during its tenure. In this entire period, the scheme covered Rs. 7.63 crore farmers under an area of 12.76 crore hectares, for a sum insured of Rs. 24,949 crores at a premium of Rs. 403.56 crore. Correspondingly, the total claims outgo was Rs. 2303.45 crore, thus having a claim ratio of 1: 5.71. About 59.78 lakh farmers were benefitted, and the majority of the claims were paid in the States of Gujarat with Rs 1086 crore (47%); Andhra Pradesh with Rs. 482 Crores (21%); Maharashtra with Rs. 213 crores (9%) & Orissa with Rs. 181 Crores (8%).

National Agricultural Insurance Scheme

This scheme was replaced by a new and improved scheme in 1999 named National Agricultural Insurance Scheme (NAIS). NAIS was launched with the aim to make crop insurance schemes sustainable by shifting to an actuarial regime. The scheme was based on an indexed approach, where the index used was 'crop yield' of the given area. Three coverage levels were made available under NAIS and the threshold yield was set at 60, 80 and 90 percent. The NAIS offered insurance for Food Crops (Cereals, Millets & Pulses), Oilseeds, Commercial/ Horticultural crops through state owned insurer GIC and subsequently by Agriculture Insurance Company of India (AIC). NAIS was available to borrowers and non-borrowers of crop loan. Premiums for crop insurance depend on the crop grown and was subsidized by 50% for small and marginal farmers. Farmers have the option of buying additional coverage to a maximum of 150 percent of the threshold yield multiplied by a defined price. The defined price could be the market price or floor price established by government.

Pradhan Manrti Fasal Bima Yojana (PMFBY)

Pradhan Mantri Fasal Bima Yojana (PMFBY) is an area-based yield-based crop insurance scheme introduced by Government of India in January 2016. The Defined Area (i.e., unit area of insurance) for this scheme is Village/Village Panchayat level. The unit of insurance for loss assessment is the affected insured field of the individual farmer for Risks of localised calamities and post-harvest losses on account of defined peril. There is provision of Individual farm level loss assessment for localised peril and Unit level loss assessment for Yield losses. All the Crops for which past yield data is available and grown during the notified season are covered under the scheme.

Livestock Insurance

Livestock is important for balanced growth of agrarian economy as it is important alternative source of income and food. Livestock substantiate the farm income by using by-products of farming. At the same time, by products of livestock add to the fertility of the land. Thus, cultivation and livestock form a symbiotic relationship in agrarian economy. However, livestock insurance has not developed because of inherent issues like adverse selection, morale hazard and fraud. Due to these reasons, cost of insurance is high, so it becomes deterrent for farmers. At the same time, loss ratio is high, so it becomes deterrent for insurers. The protection offered under livestock products includes against losses arising from death, injury and loss of function as a result of accidents, natural causes, fire, lightning, acts of God and acts of individuals other than the owner. Additional coverage can generally be purchased for veterinary expenses, transport and non-epidemic diseases. The sum insured is based on the market value of the animal and can be reduced based on the animal's age. Premium rates range from 1.5 percent to 10 percent of the sum insured based on the type of animal, its age, location and the functions it performs. Deductibles range from no deductible to ten percent. Insured animals are differentiated from each other from ear tagging, which is numbered and facilitated identification of animal. Traditionally, epizootic (general or widespread) diseases have been a standard exclusion under livestock policies although some companies have begun to offer cover on a very selective basis. Apart from this, theft, accident, injury during transportation is excluded. The new technological advancements like Radio Frequency Identification Device (RFID), tagging and muzzle printing can revolutionize cattle insurance. Livestock mortality index insurance is a relatively new form of livestock insurance that was introduced into Mongolia.

5.5. Health Insurance

Health Insurance Policy is a contract between the Insurance Company and the Insured where the Insurance Company receives premium from the Insured and agrees to indemnifies the Insured in case of financial loss suffered by him due to medical care or hospitalization or sickness or surgery during the policy period.

➢The cost of the Health Insurance policy i.e. premium depends on coverage amount, age, past medical history, occupation, lifestyle and current health of the insured.

Benefits Of Health Insurance

1. Health Insurance helps the families to avail medical facilities when required, without disturbing their budget and avoid financial crisis.
2. It provides security against unexpected and huge medical expenses.
3. It also helps the Insured to go for preventive health care and getting regular medical checkups.
4. Also, it provides tax benefit under Section 80D of the Indian Income Tax Act to people who have bought the health insurance policy.

Scope of Health Insurance

It covers various expenses which are as follow:

- ➢ Hospital or Nursing home room and boarding expenses.
- ➢ Nursing expenses/ consultancy/ operation fees of surgeons/ anesthetize/ physicians and specialists Anaesthesia, blood, oxygen, operation theatre charges, surgical appliances, medicines, drugs, diagnostic materials, X-ray, Dialysis, chemotherapy, Radio therapy, cost of pacemaker, Artificial limbs, cost or organs and similar expenses.

- Compensation is only paid when patient is hospitalized for a minimum time period which is usually of 24 hours in the hospitals empanelled by the Insurance Company. This condition is not applicable in case of treatment of dialysis, eye surgery, chemotherapy, dental surgery, radiotherapy and accidental injuries.
- It also covers pre and post hospitalization medical expenses. Pre hospitalization is 30 days prior to the hospitalization and post hospitalization is 30 or 60 days from the discharge date. These expenses are also reimbursed by the Insurance Company if they are related to sickness for which the patient was hospitalized.
- Health policy may also contain provisions for reimbursement for health check-ups which can be done once in four years.
- The Insurance Company provides add on facilities or benefits such as hospital cash, surgical expense benefits which can be purchased separately or along with the hospitalization policy.
- They are certain things which are excluded from the health Insurance policy which are as follow:
- All pre-existing diseases which are homogeneously defined by all the Insurance companies. Any claim made by the Insured for sickness or disease within 30 days from the date of purchasing the policy for the first time. This will not include for accidental insurance claims.
- During first year of cover – cataract, Benign prostatic hypertrophy, Hysterectomy for Menorrhagia or Fibromyoma, Hernia, Hydrocele, Congenital Internal diseases, Fistula in anus, piles, sinusitis and related disorders.
- Spectacles, contact lens and hearing aids
- Dental treatment or surgery unless it requires hospitalization.
- Naturopathy Treatment.
- Convalescence, general debility, congenital external defects, V.D., intentional self-injury, use of intoxicating drugs / alcohol, AIDS, Expenses for Diagnosis, Xray or lab tests not consistent with the disease requiring hospitalization.

- Treatment relating to pregnancy or birth of the child including C section Expenses on vitamins and tonics unless mentioned in the treatment.

Types Of Health Insurance Policy

1. Hospitalization policy: It reimburses for the hospitalization treatment expenses incurred by the insured during the policy period. It also includes pre and post hospitalization expenses but doesn't cover outpatient treatment. It can be of following types:

a. Individual medical insurance: It is the simplest policy where policy covers hospitalization and medical expenses of an individual limited to sum insured. For example, Rajesh takes four Individual med claim policies for himself, his wife and two children each of coverage of 5,00,000. In case his son and his wife fall ill, expenses come out to 5,00,000 and 5,00,000 respectively. Then they can claim for the mentioned amount under the two policies.

b. Family floater policy: In this policy a single sum insured covers all the family members. For example, a medical family floater policy of 5,00,000 will cover Rajesh, his wife and his two children. The total claim by all the four members cannot exceed 5, 00,000. In the case mentioned above, Rajesh can claim either for his wife or his son's expenses as total amount will exceed the sum insured limit. The premium is less in this case.

c. Group health insurance policy: This policy is taken by an organization or Institution or Corporate body having designated no. of people. Since it is taken for a group, it leads to providing discount in premium by the Insurance Company. Unlike, the individual medical insurance it doesn't contain reimbursement for health check-up. For example, Atul Ltd. has taken a group Insurance policy of 5, 00,000 for each of his employees and their family.

2. Critical illness policy: This policy covers specific illness which occurs rarely and requires heavy medical expenses due to its critical nature. As soon as the policy holder is diagnosed with a critical illness as mentioned in the policy, lump sum amount is paid to the insured and the policy ceases to remain in operation. These plans cover diseases such as kidney failure, cancer, stroke, paralysis, organ transplant and etc.

3. Overseas medical policy: This policy is for those people who are working or travelling or studying abroad and compensates them in case they suffer any

financial loss due to hospitalization or sickness. It was introduced in 1984 in India and has been modified over the years.

4. Daily cash benefit plans: In this policy, for each day of hospitalization, a fixed sum is paid on a daily basis by the Insurance Company to the insured.

5. Unit linked health plan: This type of policy is a combination of Insurance and Investment where after the policy period expires, Insured receives a certain amount, depending on the market performance. It is a new plan and still in its development stage.

Health Plans Offered by Government

Employee state insurance scheme: It applies to factory work and provides medical benefits such as hospitalization, outpatient treatment, and special care through ESIS facilities, public care centers and NGOs.

- Central government health insurance scheme: It provides medical benefits to employees and retired people of Government and semi government organizations. It includes medical care, free medicines and diagnostic services provided through public care centres and certain private hospitals.
- Universal health insurance scheme: It is health insurance provided by the Government for the poor people at a very low premium of around 300 for coverage of 30,000.

5.6. Reinsurance

Insurance companies take on significant financial risks. It can lead to huge and frequent pay-outs. The company must understand their finances. It will help them know how much they can afford. For example, a massive accident or fire may lead to multiple claims. All these claims will be together. The company will have to pay all the holders their dues at once. It puts a strain on its finances. These companies thus also have a lower revenue or profit. That's why reinsurance means is a prevailing concept. It helps these companies lower their risk and protect their financial stability.

5.6.1. Define Reinsurance

- Reinsurance means getting insurance from an insurance company. Insurance companies have exposure to financial risks. It can be frequent claims and huge pay-outs. The company can thus get insurance for such big claims to lower their liability.

- Reinsurance means a contract between two insurance parties. One company gets insurance from another company. It is often when the company issues a policy which may lead to a huge pay-out.
- Reinsurance means lowering one's risks. The company that buys insurance is the ceding party. The company that provides it is the reinsurance company.
- Reinsurance means that the company takes over a part of the policy claim. It may also take all of the policy liability. The ceding party gets this insurance to prevent a financial risk leading to bankruptcy.
- The reinsurance contract has these two parties. The ceding company transfers the pay-out liability to the reinsurance company. It may be a percentage or all of its issued policies.
- Small insurance companies may use this method. It helps them fulfil the contract terms in a huge policy claim. They can take reinsurance from a big business.
- Reinsurance means that the reinsurance company will receive premiums. The contract may be different as per the company relationship.
- They may take a part of the premium paid by the insured individual or business. Both companies may share the premium as well.
- These terms depend on the percentage of the claim amount taken by the reinsurance party.
- Thus, reinsurance means when an insurance company take insurance from another company. It is for the policies they've issued to the insured people or companies.

5.6.2. How Reinsurance Works?

Reinsurance means useful for insurance companies. They can help avoid bankruptcy or total asset sale for the business. The insurance company has to pay claims when all conditions are suitable. The business becomes liable even if there are frequent or simultaneous claims. However, it may not have enough liquid assets for the same. Thus, reinsurance means avoiding this case. The reinsurance company can help the business and fulfill part of those claims. Understand the below example.

- Suppose a company provides health insurance to another business's employees. The terms cover all the medical bills for the employees.
- The business is multinational with a huge office. There are thousands of people in every branch.
- Unfortunately, most of the employees got harmed due to a fire incident in the office. The claim was a huge amount by all the office employees.
- The insurance company suddenly faced this payout but didn't have enough liquid resources. The business, however, had a reinsurance contract.
- The reinsurance company steps in and pays part of the payouts as per the terms. It helps fulfil claims on time. Also, the ceding party doesn't have to face financial risk.
- Reinsurance means this contract protects the company. It is common when small businesses to insure large companies with a potentially massive claim.

5.6.3. Benefits of Reinsurance

Reinsurance means sharing the risk among companies. It is common in the insurance business. Read below the benefits of this concept.

- **Taking More Clients**

Reinsurance means to lower one's financial liability. The lower liability helps insurance companies take more clients. They will still be able to fulfil the claims. It thus helps a business grow and take more risks. They can build a solid customer base with the same.

- **Lower Risk Burden**

Reinsurance means to shift some risk burden to another company. It is an effective strategy to help the business grow. The reinsurance company can participate in the contract and fulfil the claim amounts.

- **Advice for Insurance Companies**

New insurance companies can use such contracts to enter into a partnership. They can take advice from a big brand. It helps evaluate risks. Also, the business can grow under the brand and have a bigger client base.

- **Natural Calamities**

Natural disasters lead to simultaneous insurance claims. It can be risky for the company if it can't manage all the claims simultaneously. It may have to sell assets or declare inability to pay. Such events are avoidable. Reinsurance means dividing these pay outs. The reinsurance business will thus share these claims. It helps during natural disasters.

- **Financial Stability**

The ceding company can avoid using all liquid assets with frequent claims. Reinsurance means to provide stability. The business can survive financial difficulty and cater to all pay outs.

- **Reduce Competition**

Reinsurance means relying on another insurance business. The ceding company enters into the contract for this reason. It can depend on the other business in times of need. It promotes cooperation in the insurance market. The firms work together. Also, it reduces the competition with co dependence.

- **Profit Stabilization**

Reinsurance means the sharing of risks. It also leads to expenses for the ceding party. The company pays premiums or agreed-upon terms for the reinsurance. However, it prevents vast pay outs. The business can stabilize profits. These profits will change if the company still has huge claims under its liabilities.

- **Reduces Policy Numbers**

A client may have to take multiple policies for the same event or property. It happens with expensive properties where one company cannot cover the entire claim. It results in various contracts and loss of time. But reinsurance means avoiding this and offering better services. The ceding party can insure the property and take reinsurance. The client, thus, won't have to worry about entering multiple contracts.

- **Safeguard Insurance Funds**

The ceding company can protect its insurance funds. These funds won't have to be used all at once. It helps provide security to the company.

5.6.4. Types of Reinsurance

Reinsurance means entering into a contract with another insurance business. But there are different types. The ceding company can decide as per the needs. It helps understand which reinsurance contract is better for the business.

Facultative reinsurance: This reinsurance covers only a specific contract or risk for the ceding company. The reinsurance company reviews individual agreements. It can also be a block of contracts of the same risk. The reinsurance company is only liable for a specific set of contracts. The company has to renegotiate to increase the covered policies. However, the reinsurance party decides what they want to cover. Businesses use this to cover insurance policies with higher claim amounts.

Treaty reinsurance: This reinsurance is for a specific time. Reinsurance means to cover the losses. The treaty agreement includes all policies the company takes in a set time. The business may pay a higher fee for each increasing policy. It can also be part of the premium money. This type helps transfer the liability of several policies to the reinsurance company.

These two are the primary types of reinsurance contracts. They have two more types based on the claim amount.

Proportional reinsurance: Proportional reinsurance means to cover part of the claim liability. The reinsurance company receives a pre decided premium proportion. The party also covers the same proportional claim for the policies. The reinsurance company is thus liable for only a part of the policy amount.

Non-proportional reinsurance: This reinsurance means that the party only pays if the losses exceed a limit. This limit is in the reinsurance contract. The reinsurance company becomes liable when the business incurs significant losses above a set amount. The reinsurance business doesn't receive a premium part. It may be a fixed fee or other terms.

Reinsurance means these types of contracts. The business can assess its finances to select the best reinsurance type.

5.6.5. Insurance Act

There are around 15 different Insurance Acts passed in India. All the acts were passed over a period of time and have some significance when it comes to the Insurance Act. The Insurance acts date from back in 1938 to the latest one in 2021. There were 3 amendments in the year 2021. The first Insurance Act dates from 1938 followed by the Life Insurance Act, 1956 then the Life Insurance Corporation Act 1957. The Insurance Amendment Act 2002. These were a few examples of Insurance Acts passed in India and their terms.

Insurance Acts in India

There are a total of 15 Insurance Acts which have been passed till now in India, and every act is important in its own way. They altogether build up the Insurance ecosystem present in India. All the acts make it easy and more reliable for the citizens to invest and buy insurance. It also decreases the chances of fraud and improves security by having a close look at all the companies which provide insurance to the people of the country. There is also a regulatory body set up which can be termed as IRDAI (Insurance Regulatory and Development Authority of India) which looks after all the issues or matters related to insurance.

Let us look at all the Insurance Acts in India till now:

- Insurance Act 1938.
- Life Insurance Act 1956.
- LIC (Life Insurance Corporation) (Amendment) Act 1957.
- Marine Insurance Act, 1963.
- Emergency Risks Undertaking Insurance Act 1971.
- Emergency Risks Goods Insurance Act, 1971.
- General Insurance Business Act 1972.
- IRDAI (Insurance Regulatory and Development Authority of India) Act, 1999.
- General Insurance Business (Nationalisation) Amendment Act, 2002.
- Actuaries Act, 2006.
- The Securities and Insurance Laws (Amendment and Validation) Act, 2012.
- The Insurance Laws (Amendment) Act, 2015.
- The Insurance Amendment Act, 2021.
- General Insurance Business Amendment Act, 2021.

- Notification reg. effective date of General Insurance Business (Nationalisation) Amendment Act, 2021.
- This is the full list of all types of Insurance Acts in India.

5.7. LIC Act

The LIC (Life Insurance Corporation of India) is a leading life insurance and investment company owned by the government of India. The LIC arises out of the Life Insurance Act of India that put the insurance industry under the government's control through nationalization. The Life Insurance Corporation of India came into existence on 01st September, 1956, after the government of India passed the Life Insurance of India Act and nationalized the private insurance sector in the country.

The Life Insurance Corporation of India aims to provide its customers a higher return on economic security through its various products and services than other investment companies, thereby aiding in providing better quality of life and economic development as well. The corporation is headquartered in Bombay, Maharashtra, with an approximate asset value of over INR 2,529,390 crores. The Life Insurance Corporation of India was established by merging over 245 insurance companies and provident societies.

LIC – Overview

Let's start with knowing the mission and vision of the Life Insurance Corporation of India:

Mission**:** Ensure and enhance the quality of life of people through financial security by providing products and services of aspired attributes with competitive returns, and by rendering resources for economic development.

Vision: A trans-nationally competitive financial conglomerate of significance to societies and Pride of India.

The LIC (Life Insurance Corporation) of India is a leading life insurance providing company headquartered in Bombay. It is the largest life insurance company in India with an approximate asset value of over 2,529,390 crores. The company is well established in the urban as well as rural areas of the country.

The LIC of India was established on 01st September 1956 when the government of India passed the Life Insurance of India Act, nationalizing the private insurance sector in the country.

The LIC offers a wide variety of life insurance plans such as Unit Linked Insurance Plans (ULIPs), term insurance, child plans, pension plans, and so on

Due to technological advancements, the LIC of India has also established itself online by selling myriad savings and investments products over the World Wide Web.

LIC – Objectives

Now that we know about the mission, vision, and awards and recognition of the LIC, let us take a look at the company's objectives. These are:

i. The primary objective of the LIC of India is to spread the importance of life insurance among the rural areas and to the people belonging to the socially and economically backward classes. The company functions with a view to provide such individuals with financial assistance against death at a reasonable cost.

ii. The company aims to cater to the diverse life insurance needs of the community depending on the changing social and economic environment.

iii. The main objective of the LIC of India is to safeguard the interests of the life insurers as well as act as a trustee in their individual and collective capacities.

iv. To maximize the ability of savings by providing a wide variety of life insurance products to choose from.

v. The Life Insurance Corporation of India fully encourages the participation and involvement of its employees and LIC agents so that they work towards attaining the objectives of the company.

5.8. GIC Act.

The General Insurance Corporation of India Ltd., or the GIC, is a government-owned insurance company under the ownership of the Ministry of Finance. The GIC was incorporated on 22nd November 1972 under the Companies Act, 1956. The General Insurance Business (Nationalization) Act of 1972 (GIBNA) nationalized the entire general insurance business in India. Hence, the General Insurance Corporation of India (GIC) was formed in pursuance of

Section 9 (1) of GIBNA. Through nationalization, the Indian government took over the shares of 55 Indian insurance companies and the undertakings of 52 insurers carrying on the general insurance business. The GIC was incorporated on 22nd November 1972 under the Companies Act of 1956 as a private company limited by shares. The GIC was formed to superintend, control, and carry on the business of general insurance across the country.

5.8.1. Meaning of GIC

The General Insurance Corporation of India (GIC) was formed under Section 9 (1) of the General Insurance Business (Nationalization) Act (GIBNA). As soon as the GIC was formed, the government of India transferred all the shares of the 55 general insurance companies to GIC.

Simultaneously, the nationalized undertakings were transferred to the Indian insurance companies. After a process of mergers among the Indian insurance companies, four of them were left as fully owned subsidiaries of the GIC.

As of August 2020, the Chairman cum Managing Director of GIC is Mr. Devesh Srivastava. The next milestone occurred on 19th April 2000, when the Insurance Regulatory and Development Authority Act (IRDAA) came into existence.

5.8.2. Objectives of the GIC

Following are the objectives of the General Insurance Corporation of India (GIC):

- ❖ To carry on the general insurance business, other than life, such as fire, accident, theft, etc.
- ❖ To help and promote the subsidiaries to conduct the business of insurance, and
- ❖ To help them conduct of investment strategies of the GIC subsidiaries in a productive and efficient manner.

5.8.3. Role and Functions of the GIC

Now, let us understand the roles and functions of the General Insurance Corporation of India in this section. They are as below:

1. To carry on of any part of the general insurance, if it thinks it is worthwhile to do so

2. To assist, advise, and aid the acquiring companies in the matter of setting up the standards of conduct and fair practice in the business of general insurance.
3. To render efficient services to the general insurance policyholders.
4. To issue directives to the acquiring companies in relation to the conduct of the business of general insurance.
5. To advise the acquiring companies in the matters concerning investing their funds.
6. To issue directions to the acquiring companies and encourage competition among them in order to render efficient services.

5.8.4. Classification of the Indian General Insurance Industry

General Insurance is also called non-life insurance in India. In total, there are 16 general insurance companies in the country. These have been broadly categorized into the following:

- ☐ PSUs (Public Sector Undertakings)
- ☐ Private Insurance Companies

PSUs (Public Sector Undertakings)

These insurance companies are the subsidiaries of the GIC and wholly owned by the government of India. Further, the PSUs are subdivided into:

- ➢ The New India Assurance Company Ltd. (Bombay)
- ➢ Oriental Insurance Company Ltd. (New Delhi)
- ➢ United India Insurance Company Ltd. (Chennai)
- ➢ National Insurance Company Ltd. (Kolkata)

Private Insurance Companies

Mainly there are 11 private General Insurance companies in India as below:

1. Apollo DKV Health Insurance Ltd
2. Bajaj Allianz General Insurance Co. Ltd.
3. Cholamandalam MS General Insurance Co. Ltd
4. Future General Insurance Company Ltd
5. HDFC Ergo General Insurance Co Ltd
6. ICICI Lombard General Insurance Ltd
7. Iffco Tokio General Insurance Pvt Ltd

8. Reliance General Insurance Ltd
9. Royal Sundaram General Insurance Co Ltd
10. Star Health and Allied Insurance
11. Tata AIG General Insurance Co Ltd

5.9. IRDA Act. (Insurance Regulatory & Development Authority Act)

IRDA Acts which are directly related to insurance business and some acts which indirectly deal with the insurance business. In the following para we have referred about two Acts LIC Act 1956 and GIBN Act 1972 but we will not explain these acts as they have lost their importance due to changed scenario in respect of the Insurance sector in the country. We will be covering the following Acts in this module:

- Insurance Regulatory & Development Authority Act 1999.
- Insurance Act 1938.
- Consumer Protection Act 1986.
- Insurance Ombudsman.
- Marine Insurance Act 1963.
- Carriage of Goods by sea Act 1925.
- Bill of Lading Act 1855.
- Motor Vehicle Act 1988.
- Inland Steam Vessels Act 1977.
- Public Liability Act 1991.
- Workman's Compensation Act 1923.

For the benefit of those of you who are studying various Acts for the first time, we would like to mention that Acts lay down the rules and regulations framed by the Government in respect of specific activities. These rules & regulations are explained in sections which have been serially numbered and are called "Section 1 or 2 or 30 and so on".

At the end of this lesson, you will be able to:

- Know about the Controlling and regulating Authority for Insurance sector in India.
- Define how many members constitute the Authority.
- Enumerate procedure of their appointment.

- Enlist the Duties, Power and functions of Authority.

5.9.1. History of IRDA Act.

In India also, Government started exercising control on Insurance business by passing two acts in the year 1912 namely.

- Provident Insurance Societies Act V of 1912 and
- Indian Life Insurance Companies Act VI of 1912. These acts were later comprehensively amended and a new Act namely Insurance Act 1938 came into existence for controlling.
- Investment of funds
- Expenditure and
- Management of the insurance companies

The Office of Controller was established to implement this act. Again, this Act was amended in 1950 as per the need of the hour. But in view of growing malpractices in Life Insurance business and also due to the illiteracy level being high and lack of will for spread of Life Insurance business, it was nationalized by Government of India. LIC Act was passed in June; 1956, and this Act came into force from 1st Sept.1956. Similarly general insurance business was nationalized Act came into force w.e.f 1st April 1973 through General Insurance Business Nationalization Act 1972 (GIBN Act 1972). To implement these acts the Government made some minor changes in the Insurance Act 1938. In early 90's, with the world market forces playing with full strength; growing literacy level; better regulatory systems and need for fast growth in this sector, the need of the hour was to go with the world and throw open Life & General Insurance Sector to private entrepreneurs once again so that there is no monopoly and the customer/ consumer/ buyer gets more choices than one type of Insurance product. To study the liberalization process in Insurance sector in India, Malhotra Committee was formed under the Chairmanship of Late Shri R.N. Malhotra. The Malhotra committee submitted its report in 1994 which recommended that private companies be allowed to operate in India. The Government accepted the Committee's recommendation and Insurance Regulatory Authority (IRA) was set up in 1996 to show the path for privatization of insurance Industry. The main aim was the development of Insurance covering all strata of society (to not only rich but poor, folks from rural, tribal, unorganized sector, social sector, disabled community, daily wagers, women at large, etc.) gained importance through concerns put forth by political leaders, trade unionists, social organizations, cooperatives and policy makers; which amended the name IRA to IRDA (Insurance Regulatory & Development Authority). Again, some amendments were made in the Insurance Act 1938 for smooth functioning of IRDA.

5.9.2. Insurance Regulatory Development Authority Act (IRDA) 1999

This Act was passed by Parliament in Dec.1999 & it received presidential assent in Jan.2000. The aim of the Authority is "to protect the interest of holders of Insurance policies to regulate, promote and ensure orderly growth of Insurance industry & for matters connected therewith or incidental thereto." Under this Act, an authority called IRDA is established which replaces Controller of Insurance under Insurance Act 1938.

Definitions

Like any other Act, various terms have been defined as follows under section 2: -

a. "Appointed Day" means the date on which the Authority is established.
b. "Authority" means the Insurance Regulatory and Development Authority.
c. "Chairperson" means the chairperson of the Authority.
d. "Fund" means the Insurance Regulatory and Development Authority Fund.
e. "Interim Insurance Regulatory Authority" means the Insurance Regulatory Authority set up by the Central Government.
f. "Intermediary or Insurance intermediary" includes insurance brokers, reinsurance brokers, insurance consultants, surveyors and loss assessors.
g. "Member" means a whole time or a part time member of the Authority and includes the Chairperson.
h. "Notification" means a notification published in the Official Gazette.
i. "Prescribed" means prescribed by rules made under this Act.
j. "Regulations" means the regulations made by the Authority.

Features of Authority

1. Corporate body by the aforesaid name which means it will act as group of persons, called members, who will work jointly not as an individual person like Controller of Insurance.
2. Having perpetual succession which means any member may resign or die but the Authority will work.
3. A common seal with power to enter into a contract by affixing a stamp on the documents.
4. Sue or be sued means the Authority can file a case against any person or organization and vice versa.

Composition of Authority

The Authority shall consist of nine persons as per details given below:

1. Chairperson.
2. Not more than 5 whole time members.
3. Not more than 4 part time members.

These persons shall be appointed by the Central Govt. from amongst persons of ability, integrity & standing who have knowledge or experience in life Insurance, general Insurance, actuarial science, finance, economics, law accountancy, administration or other discipline which would in the opinion of the Central Govt. be useful to the Authority. (Section 4)

Tenure (Section 5)

1. The Chairman tenure will be for 5 years and eligible for reappointment till he attains the age of 65 years.
2. The appointment of members will be for 5 years and eligible for reappointment but not exceeding the age 62 years.

Removal of Members (Section 6)

The Central Government can remove any member of the Authority if he:-

a. Is declared bankrupt
b. Has become physically or mentally incapable of acting as a member
c. Has been awarded punishment by any Court.
d. Has acquired such financial or other interest which affect his function as a member.

e. Has so abused his position as to render his continuation in office detrimental to the public interest. But no member can be removed from the office unless & until the reasonable opportunity of being heard is given to such member in the matter.

Salary & Allowances (Section 7)

The Chairperson and full-time members shall receive the salary & allowance as prescribed by the Government.

Bar on future employment (Section 8)

The Chairperson and the whole-time members cannot accept any appointment without Govt. approval within 2 years from the date on which he ceases or retires from the office.

Superintendence & Direction (Section 9)

The Chairperson shall have overall control & provide direction in respect of all administrative matters of the Authority. He will chair the meeting as and when he is present in the meeting.

Meeting of Authority (Section 10)

The meeting of the Authority will be held at the time and place as decided by the Chairperson as per regulation made under this act. If the Chairperson is unable to attend the meeting, then the members will choose the Chairperson from amongst the present members. All the issues to be discussed in the meeting shall be decided by a majority of votes by the present and voting. In case of equal voting the decision of Chairperson of that meeting will be final.

Invalidation of proceedings of Authority (Section 11)

The proceedings of Authority will not become invalidate (not valid in the eyes of law) due to following reasons: -

- Defects in the formation of the Authority.
- Defect in appointment of any Member.

Officers& Employees of Authority (Section 12)

The Authority may appoint officers and employees as it considers necessary for the efficient discharge of its functions. The terms & conditions of such officers shall be governed as per the regulations made under this Act.

Transfer of Assets, Liabilities etc. (Section 13)

As stated above that initially the Authority was formed under the name

“Insurance Regulatory Authority (IRA)” and later on the name was changed to “Insurance Regulatory & Development Authority.” (IRDA) Therefore the assets and liabilities of IRA will be transferred to IRDA on the date of establishment of the Authority.

Duties, Powers & Functions of Authority (Section 14)

Duties: The Authority shall have the duty to regulate, promote and ensure orderly growth of the Insurance business and reinsurance business subject to the provisions of any other provisions of the act.

Powers & Functions to: -

a. Issue to the applicant (Insurance company or Insurance Agent or Surveyors or Insurance Brokers or Third-Party Administrators) a certificate of registration, renew, modify, withdraw, suspend or cancel such registration; (b) Protection of the interests of the policyholders in matters concerning assigning of policy, nomination by policyholders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;
b. Specifying requisite qualifications, code of conduct and practical training for insurance brokers, agents, surveyors, Third Party Administrator;
c. Specifying the code of conduct for surveyors and loss assessors (Who assess the loss of policyholder in case of General Insurance);
d. Promoting efficiency in the conduct of insurance business;
e. Promoting and regulating professional organisations connected with the insurance and re-insurance business;
f. Levying fees and other charges on insurance companies, agents, insurance brokers, surveyors and Third-party Administrator;
g. Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organisations connected with the Insurance business;
h. Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance

business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (w.e.f., 1/1/2007 TAC has ceased to function).

i. Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;
j. Regulating investment of funds by insurance companies;
k. Regulating maintenance of margin of solvency i.e., having sufficient funds to pay insurance claim amount;
l. To settle the disputes between insurers and intermediaries or insurance intermediaries;
m. Supervising the functioning of the Tariff Advisory Committee;
n. Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organisations referred to in clause (f);
o. Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and
p. Exercising such other powers as may be prescribed.

Grants from the Central Government (Section 15)

The Government after approval from the Parliament may grant funds to discharge their duties as per this Act.

Constitution of Funds (Section 16) (1)

There shall be a fund to be called "The Insurance Regulatory and Development Authority Fund" and there shall be credited there to:

a. all Government grants, fees and charges received by the Authority;
b. all sums received by the Authority from such other source as may be decided upon by the Central Government;
c. The percentage of prescribed premium income received from the insurer/insurance intermediaries.
d. the salaries, allowances and other remuneration of the members, officers and other employees of the Authority.

e. The other expenses of the Authority in connection with the discharge of its functions and for the purposes of this Act.

Accounts and Audit (Section 17) (1)

1. The Authority shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form as may be prescribed by the Central Government in consultation with the Comptroller and Auditor-General of India.
2. The accounts of the Authority shall be audited by the Comptroller and Auditor-General of India at such intervals as may be specified by him and any expenditure incurred in connection with such audit shall be payable by the Authority to the Comptroller and Auditor-General.
3. The Comptroller and Auditor-General of India and any other person appointed by him in connection with the audit of the of the accounts of the Authority shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General generally has in connection with the audit of the Government accounts and, in the particular shall have the right to demand the production of books of account, connected vouchers and other documents and papers and to inspect any of the offices of the Authority.
4. The accounts of the Authority as certified by the Comptroller and Auditor General of India or any other person appointed by him in this behalf together with the audit-report thereon shall be forwarded annually to the Central Government and that Government shall cause the same to be laid before each House of Parliament.

Establishment of Insurance Advisory Committee (Section 25) (1)

a. The Authority may, by notification, establish with effect from such date as it may specify in such notification, a committee to be known as the Insurance Advisory Committee.

b. The Insurance Advisory Committee shall consist of not more than twenty-five members excluding ex-officio members to represent the interests of commerce, industry, transport, agriculture, consumer fora, surveyors, agents, intermediaries, organisations engaged in safety and loss prevention, research bodies and employees' association in the insurance sector.

c. The Chairperson and the members of the Authority shall be the ex-officio Chairperson and ex officio members of the Insurance Advisory Committee.
d. The objects of the Insurance Advisory Committee shall be to advise the Authority on matters related to insurance.
e. The Insurance Advisory Committee may advise the Authority on such other matters as may be prescribed.

Miscellaneous Provisions

1. The Central Government can issue the direction to the Authority on policy matters not on administrative and technical matters and the Authority is bound to follow such direction.
2. The Central Government can supersede any act of the Authority.
3. The Chairperson, Members and employees of Authority shall be deemed to be public servant while performing the duties as per the provision of this Act.
4. The Authority can delegate its powers to Chairperson or members or officers and employees of the Authority as per regulation made under this act.
5. The Authority has the power to make rules related to salary & allowances and other terms & conditions to be applicable to its chairperson, members, employees or officers.
6. The Authority has power to make regulations to be followed at its meetings.
7. The rule & regulation made by the Authority shall be placed before the Parliament.
8. Any rule or regulations made under this act will bar the applicability of other laws of the land.
9. The Authority has the powers to make amendment in Insurance Act 1938, LIC Act 1956.

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