PROFESSIONAL PROGRAMME

GROUP 2
ELECTIVE PAPER 7.4

BANKING & INSURANCE – LAWS & PRACTICE

PART I – BANKING LAWS

PART II – INSURANCE LAWS

THE INSTITUTE OF
Company Secretaries of India
भारतीय कम्पनी सचिव संस्थान
IN PURSUIT OF PROFESSIONAL EXCELLENCE
Statutory body under an Act of Parliament
(Under the jurisdiction of Ministry of Corporate Affairs)

STUDY MATERIAL

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PROFESSIONAL PROGRAMME

BANKING & INSURANCE – LAWS & PRACTICE

Banking sector plays a vital role in the development of the economy of a country and day by day the importance of bank is increasing in everybody's daily life. Now a days, Digital Banking shape Indis's banking sector with cheaprer banking alternatives and act as a catalyst for achieving greater financial inclusion in India.

Banks are a subset of the financial services industry. It is a financial institution that provides banking and other financial services to their customers. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans. The banks safeguards the money and valuables and provide loans, credit, and payment services, such as checking accounts, demand drafts, and traveler's cheques and some banks also offer investment and insurance products.

Apart from protecting individuals and businesses from many kinds of potential risks, Insurance contributes a lot to the general economic growth of the society by provides stability to the functioning of process. The insurance industries develop financial institutions and reduce uncertainties by improving financial resources. It also provides stability to the functioning of businesses and generating long-term financial resources for the industrial projects. Among other things, Insurance sector also encourages the virtue of savings among individuals and generates employments for millions, especially in a country like India, where savings and employment are important.

Considering the various recommences the insurance industry provides to the society, economy, businesses and people on one side and considering the capital invested by the people by the people through the instrument of insurance on other side, it is mandated to regulate insurance sector.

In the phase, where plethora of Laws, Regulations and Rules are the guiding the conduct of Banking & Insurance Industries towards good governance, the role of Company Secretaries become much vivacious to meet the challenges of a more dynamic business and regulatory environment on one side and to ensure timely compliance on other side. Considering the role of Company Secretaries in the Banking & Insurance sectors as well as supporting the idea of all-rounded development of our professional brigade, this subject under the title of Banking & Insurance- Laws and Practice serve a one spot resource of understanding basic features of Banking and Insurance Industries along with providing a detailed account of laws and regulation governing the banking and insurance industries in the country.

The legislative changes made upto May 31, 2023 have been incorporated in the study material. In addition to Study Material students are advised to refer to the updations at the Regulator's website, supplements relevant for the subject issued by ICSI and ICSI Journal Chartered Secretary and other publications. Specifically, students are advised to read "Student Company Secretary" e-Journal which covers regulatory and other relevant developments relating to the subject, which is available at academic portal *https://www.icsi.edu/student-n/academic-portal/*. In the event of any doubt, students may contact the Directorate of Academics at academics@icsi.edu.

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PROFESSIONAL PROGRAMME

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BANKING & INSURANCE – LAWS & PRACTICE

SYLLABUS

OBJECTIVES

Part I: To develop a robust knowledge base pertaining to significant facets of Banking Sector among those students who wish to pursue a career in Banking Sector.

Part II: To impart knowledge on insurance related concepts to the students with the aim of broadening professional opportunities in the arena of insurance.

Level of Knowledge: Expert Knowledge

PART I : BANKING LAWS (50 MARKS)

1. **Overview of Indian Banking System:** ● Indian Banking System – Evolution ● Reserve Bank of India and its role ● Structure of Banks in India ● Other Financial Institutions in India

2. **Regulatory Framework of Banks:** ● Legislations applicable to Banking Sector in India ● Salient features of legislations applicable to Banking Sector in India

3. **Control over Organization of Banks:** ● Powers of Reserve Bank of India ● Licensing of Banking Companies ● Shareholding in Banking Companies ● Subsidiaries of Banking Companies ● Board of Directors of Banking Companies - Restrictions on Employment ● Control over Management ● Governance Practices in Banking Companies

4. **Banking Operations**: ● Transactions in Banks ● Know Your Customers (KYC) Documents ● Verification and authentication of documents for KYC ● Operational aspects in regard to opening of all types of accounts ● Scrutiny of loan applications / documents ● Operational Aspects of CBS Environment ● Back office operations in banks ● Handling of unreconciled entries in banks

5. **Digital Banking:** ● Digital Banking ● Components and architecture of CBS ● Core Business Processes Flow and relevant risks ● Controls Reporting System and MIS Data Analytics and Business Intelligence ● Overview of Banking services and IT related risk and controls

6. **Payment and Collection of Cheques and Other Negotiable Instruments (NI)**: ● Salient features of Negotiable Instruments Act ● Role & Duties of Paying & Collecting Banks ● Endorsements ● Forged Instruments ● Bouncing of Cheques ● Return of Cheques ● Cheque Truncation System (CTS)

7. **Various Government Schemes**: ● Pradhan Mantri Jan Dhan Yojana (PMJDY) ● Sukanya Samriddhi Yojana ● MUDRA Bank Yojana ● Pradhan Mantri Jeevan Jyoti Beema Yojana (PMJJBY) ● Pradhan Mantri Suraksha Bima Yojana (PMSBY) ● Atal Pension Scheme ● Other Government Scheme

8. **Consumer Protection:** ● Operational Aspects of Consumer Protection Act ● Banking Ombudsman Schemes

9. **Advances, Securities and Documentation:** ● Types of Borrowers ● Types of Fund Based Credit Facilities ● Types of Non Fund Based Credit Facilities ● Credit Score Authenticity ● Information Utility (IU) ● Types of Securities ● Types of Charges ● Types of Documents ● Stamping ● Limitation ● Securitisation

10. **Calculation of Interest and Annuities:** ● Fixed and Floating Interest Rates ● Calculation of Simple Interest & Compound Interest ● Calculation of Equated Monthly Instalments ● Calculation of Annuities ● Interest Calculation using Products / Balances ● Amortisation of Debt ● Sinking Funds

11. **Performing & Non Performing Assets:** ● Classification of Bank Assets ● Income Recognition Norms ● Provisioning Norms ● Corporate Debt Restructuring (CDR) ● Asset Reconstruction Companies (ARCs)

12. **Analysis of Financial Statements of Banks:** ● Analysis of Financial Statements of Banks ● Disclosure Requirements of Banks ● Additional Disclosures prescribed by Reserve Bank of India (RBI)

13. **Risk Management in Banks and Basel Accords:** ● Introduction to Risk Management ● Types of Risks in Banking Sector ● Reporting of Banking Risks ● Risk Adjusted Performance Evaluation Basel- I, II & III Accords ● Risk Weighted Assets ● Role of RBI in Risk Management in bank ● Risk Based Internal Audit in Banks (RBIA)

PART II : INSURANCE LAWS (50 MARKS)

14. **Concept of Insurance:** ● Introduction ● Evolution of Insurance in India ● Principles of Insurance ● Purpose and Need of Insurance ● Insurance as a social security tool ● Insurance Markets ● Insurance Customers ● Insurance Contracts ● Broad categories of Insurance – Life Insurance, General Insurance, Health Insurance, Specialized Insurance ● Indemnity based Insurance and Benefit based Insurance ● Role of Insurance in Economic Development

15. **Regulatory Framework in Insurance:** ● Insurance Act, 1938 - Registration of Insurance Companies ● FDI and FEMA provisions pertaining to Insurance Sector ● Registration of Re-insurance Companies ● Requirement of Solvency Margin ● Appointment of MD/WTD/CEO ● Rural & Social Obligations of Insurer ● Advance receipt of Premium ● Prohibition on Rebates ● Restriction on the common directorship ● IRDAI Act, 1999 – Constitution ● Role & Powers of IRDAI

16. **Life Insurance:** ● Life Insurance Organization ● Premiums and Bonuses ● Plan of Life Insurance ● Annuities ● Group Insurance ● Linked Life insurance policies ● Policy Documents ● Premium Payment ● Policy Lapse and Revival ● Assignment ● Nomination and Surrender of Policy ● Policy Claims ● Life Insurance Underwriting

17. **General and Health Insurance:** (a) **General Insurance** ● Introduction to General Insurance ● Various sub-classes of General Insurance- Fire & Property, Marine, Miscellaneous – Motor, Health, Personal Accident, Travel, Agriculture & Crop, Aviation, Engineering, Liability ● Workmen Compensation ● Professional Indemnity ● Directors & Officers Liability ● Other miscellaneous lines of business ● Policy Documents and Forms ● Underwriting ● Ratings and Premiums ● Claims under General Insurance (b) **Health Insurance** ● Introduction of Health Insurance and Health system in India ● Health Financing in India ● Health Insurance Products ● Health Insurance Underwriting ● Health Insurance Policy Forms and Clauses Health Insurance Pricing and Reserving Customer Service in Health Insurance

18. **Functions in Insurance & Compliance related thereto: (Part – I):** ● **Appointment & Role of Appointed Actuary** ● Product Pricing ● Reserving ● Product Review ● Actuarial Valuations ● Review of Financial Condition/ Economic condition ● **Product Design & Filings** ● File & Use and Use & File ● Product Filing Guidelines ● **Underwriting** ● Risk selection ● Risk Tolerance ● Rating ● Pricing ● Loading & Discounts

19. **Functions in Insurance & Compliance related thereto: (Part – II):** ● **Marketing & Distribution Channels of Insurance Products:** ● Individual Agency ● Corporate Agency ● Insurance Brokers

● POSP (Point of Sales Person) ● Web Aggregator ● Common Public Service Centres (CPSC) ● Insurance Marketing Firm ● Motor Insurance Service Providers (MISPs) ● E-commerce Platform ● Ceiling of Commission ● Remuneration & Rewards to Insurance Agents & Intermediaries ● **Other Insurance Participants:** ● Network Hospitals ● Third Party Service Providers (TPA) ● Surveyors and Loss Assessors ● Forensic Investigators ● Pre-Inspection Agencies ● Insurance Repositories ● **Claims & Customer Services, Grievance Management** ● Protection of Policyholders' Interest ● Grievance Management ● Claim Settlement Process ● Reporting ● Management of Unclaimed Amount of Policyholders ● Advertisements ● Ombudsman Rules ● Consumer Forums 62 S. No. D

20. **Functions in Insurance & Compliance related thereto: (Part – III):** ● Investments: ● IRDAI Regulations on Investments ● Classification of Investment categories ● Investment of Assets of Insurers carrying life insurance business ● Investment of Assets of Insurers carrying General insurance business ● Decision making for Investment of Funds ● Investments Brokers Role ● Investing in Capital Markets ● Stewardship Codes ● **Accounting:** IRDAI Regulations on preparation of Financial Statements ● Analysing the Financial Statement ● Accounting of Direct, Re-insurance, Co-Insurance and Investment Transactions ● Expense of Management ● Reserving techniques (UPR, PDR, IBNR & IBNER) ● **IT, Cyber security & Data Protection Compliances**

21. **Functions in Insurance & Compliance related thereto: (Part – IV):** ● **Risk Management:** ● Various types of risks in Insurance Companies and managing the same (like market risk, product risk, investment risk, liquidity risk) ● Role of Risk Management Committee ● Business Continuity Procedures ● Risk Governance ● **Re-Insurance:** ● Concepts ● Reinsurance Markets ● Types of Re-insurance Arrangements obligatory ● Quota share ● Treaty and Facultative ● Proportional and non-proportional ● Designing and framing of Reinsurance programme ● Placements of reinsurance covers – treaty and facultative ● **Coinsurance**

22. **Functions in Insurance & Compliance related thereto: (Part – V):** ● **Corporate Governance:** ● IRDAI regulations on Corporate Governance ● Role and responsibilities of the Board of Directors, Independent Directors ● Delegation of functions to various Committees of Board, Audit Committee, Nomination & Remuneration Committee, Investment Committee, Risk Management Committee, Policyholders, Protection Committee, CSR Committee, other Non-Mandatory Committees ● KMPs & their roles & responsibilities ● Audit & Auditors ● Compliance management ● Whistle Blower Policy ● **Compliance Management, Regulatory Filings/ Reporting/ disclosures and other Compliances** ● Compliance Management Framework ● Role of Compliance Officer ● Regulatory Filings/ Reporting & Disclosures - BAP Reporting ● GIC/ LC and IIB Reporting ● **Other Compliances:** ● AML/ PMLA Compliance ● Place of Business ● Outsourcing Regulations

23. **Inspection, Investigation, Penalty & Appellate Procedure:** ● Power of Investigation and Inspection by IRDAI ● Penalty for Default in complying with or act in contravention of the Insurance Act ● Power of Court to Grant Relief ● Cognizance of Offence ● Appellate Provisions-Appeal to Securities Appellate Tribunal

24. **Professional Opportunities:** ● As Company Secretaries and Compliance Officers ● As Independent Directors ● As Governance Risk professionals ● As Corporate Governance professionals and advisors As Secretarial Auditors ● As advisors for various compliances of Companies Act, Insurance laws, IRDAI Regulations, SEBI Regulations, Other legislations ● As arbitrators ● As surveyors ● As agents and marketing professionals ● As valuation experts ● As legal advisors ● CSR Professional ● Policy Development and Drafting ● Trainer to Agents/ Employees ● Principal Officer under AML Laws ● Principal Officer of IMF/ CA/ Brokers/ Web Aggregators

ARRANGEMENT OF STUDY LESSONS

BANKING & INSURANCE – LAWS & PRACTICE

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PART I: BANKING LAWS

PART II: INSURANCE LAWS

LESSON WISE SUMMARY

BANKING & INSURANCE – LAWS & PRACTICE

PART I : BANKING LAWS (50 MARKS)

Lesson 1: Overview of Indian Banking System

Banks are one of the important pillars that support the edifice of economy of every country and so too in India. Banking system in its modernized form in India has evolved over the last two hundred and it continues to do so even to the present day. India has a complex banking structure with Reserve Bank of India ('RBI') playing the pivotal role of Central bank of this country. Apart from its statutory functions (as enshrined in The RBI Act, 1934) the RBI regulates Commercial Banks, Cooperative Banks, Payment Banks and Small Finance Banks, Regional Rural Banks, Local Area Banks, Development Banks/All-India Financial Institutions. In view of emerging global and local regulatory compulsions such as capital adequacy and other related developments, the Government of India has effected a major consolidation of PSU Banks recently. Also, to encourage and expand the reach of financial inclusion among the public at large, setting up of Small Finance Banks and Payment Banks are being actively encouraged. Apart from banks, RBI is also given powers to regulate NBFCs. To have a better regulation based on activity over NBFCs, the RBI has harmonized the classification of NBFCs

Lesson 2: Regulatory Framework of Banks

RBI regulates banks in terms of powers it derives from The RBI Act, 1934 and The Banking Regulation Act, 1949 ('BR Act'). The RBI Act confers power to RBI in the matter of managing itself as well as discharging its supervisory duties vis-à-vis other banks as well as powers to function as Monetary Policy/Control Authority. The BR Act confers vast powers to RBI vis-à-vis banks such as issuing directions to banks in the area of Deposit Accounts, interest rates, advances, foreign exchange, CRR/SLR etc. To increase the effectiveness of regulation over NBFCs, the RBI Act has also confer more powers than ever before, in tune with emerging economic/financial scenario. It also regulates credit in India as per the clauses of the BR Act. RBI has also been empowered to direct banks to initiate insolvency resolution process of borrowers under Insolvency and Bankruptcy Code 2016. Apart from RBI, banks are also regulated by other regulators in a limited way such as Securities and Exchange Board of India, Insurance Regulatory and Development Authority of India, Registrar of Companies, Central / State Registrar of Co-operatives etc. wherever applicable.

Lesson 3: Control over Organization of Banks

RBI exercises control over banks through the power conferred on it by the Banking Regulation Act, 1949. The control measures include Licensing of various categories of banks including branches/banking outlets of banks including RRBs, Small Finance Banks and Payment Banks, prescribing Capital & Reserves, Shareholding, Setting up of banking subsidiaries, composition of Board of Directors, Duties and functions of Chairman, Directors, fit and proper criteria for election of a person as a Director, other officials as well as various Corporate Governance aspects of Banks in India. The extensive regulatory powers conferred on RBI enables it to regulate the following aspects of banking viz. Advances, Guarantees, Rate of Interest, Deposit Portfolio, Affairs of Board of Directors/Directors/ Other officials, Electronic/ Internet Banking, Payment and Settlement systems of banks. In order to make Payment & Settlement system more customer friendly, RBI has announced harmonisation of Turn Around Time (TAT) and customer compensation for failed transactions using authorised Payment Systems. RBI also issues directions in the interest of banking policy to banks and guidelines, on resolving stressed assets. It also maintains Depositor Education and Awareness Fund in respect of specified inoperative deposit accounts and other sundry liability items of banks, provide guidance to banks on Nomination in deposit accounts, safe deposit lockers and safe custody accounts. As a part of its monetary control measures RBI controls issue of various money market instruments. It also guides and monitors the maintenance of reserve fund, Cash Reserve Ratio and Statutory Liquidity Ratios of banks.

Lesson 4: Banking Operations

As Public Financial Entities, banks offer various products and services. Doing so, involves accounting, passing of vouchers, opening accounts for different types of customers across different asset and liability products through cash, clearing and transfer modes. As all routine operations are done practically through computerized packages involving sophisticated software and hardware, it requires proper follow- up, monitoring and reconciliation in the light of directions and guidelines of RBI. In the light of national and global developments in the state of economy, prevention of Money Laundering and other regulatory developments, RBI periodically revises its directions to banks which need careful implementation and follow-up. Also, banks use extensive centralized back-office operations for several services such as opening accounts, KYC verification, cheque book issue, servicing third party products, dematerialized accounts, other investments as well reconciliation of entries.

Lesson 5: Digital Banking

Banking has been transformed in to an Information Technology ('IT') intensive operation which has introduced efficient customer service, better housekeeping and improved internal controls, productivity and decision making. On the flip side, IT based products and services have their inherent risks which need to be managed through preventive, detective and corrective controls. Also, banks implement various other control measures to protect interests of customers and themselves. Majority of commercial banks offer CORE banking based services to customers across various geographical locations with the help of Central Data Centers. CORE banking operations also carry risks which are being managed through various controls. CORE banking has enabled banks to generate various Management Information System reports for decision making, as well as for analysis with a view to improve various products and services offered to customers.

Lesson 6: Payment and Collection of Cheques and Other Negotiable Instruments (NI)

As a part of banking operations banks handle many types of Negotiable Instruments such as Cheques, Bills of Exchange, Demand Drafts etc. on behalf of their customers. Negotiable Instruments Act, 1881 (NI Act) which governs various aspects of Negotiable Instruments, deals with duties and responsibilities of a paying bank as well as a collecting bank of such Negotiable Instruments. To get legal protection under NI Act banks have to adhere to various provisions as enumerated in the said Act. For making payment and collection of NIs such as cheques and DDs, Banks use the process of clearing. Cheque Truncation System (CTS) has been adopted in India in clearing of cheques to speed up customer service, reduce reconciliation problems, eliminate logistic problems and minimize frauds. CTS is subject to detailed rules and procedures prescribed by RBI in this regard.

Lesson 7: Various Government Schemes

To address some of the major issues that affect our economic growth such as unemployment, poor agricultural and industrial growth, non-availability of credit at reasonable interest, social inequities etc., Government of India has been coming up with various bank linked credit delivery schemes from time to time for promoting - agriculture, micro, small and medium industries, employment opportunities (including self-employment) as well making , available credit at affordable rates of interest, nil/marginal security etc. Additionally the Government has introduced socio- welfare schemes for the citizens of the country through banks. Some of the schemes have been state specific and in some cases a collaborative effort between the Centre and the states. The government has started the 'Make In India' initiative to encourage more SMEs to become a part of India's growth journey.

Lesson 8: Consumer Protection

Banking being a service industry dealing with a variety of customers who need to be protected against deficiencies in services extended to them. Bank customers are also covered under the definition of "Consumer" and can take recourse through Consumer Protection Act. A customer can file a case within a period of

2 years from the date cause of action has arisen with Consumer redressal councils according to the monetary jurisdiction applicable. Supreme Court has the ultimate appellate jurisdiction in the matter. Similarly, customers' complaints against banks can also be resolved through Banking Ombudsman Scheme in an inexpensive way. Under this scheme, a bank customer has one year time to complain to Banking Ombudsman after he/she has complained to the bank concerned. Decisions of the Banking Ombudsman can be appealed against with the Appellate authority by either the complainant or the bank, subject to rules in this regard.

Lesson 9: Advances, Securities and Documentation

Lending is one of the generic functions of banks. When banks extend loans and advances, they follow certain basic principles such as safety, liquidity, profitability, security, purpose and spread to minimize risks involved. As banks lend to different types of customers they adopt appropriate legal procedures in consonance with the constitution of such customers. While lending, banks are required to adhere to various directives of RBI issued from time to time. While lending, banks obtain security to safe guard themselves against the risk of default by borrowers. Based on type of advance and the nature of security, banks create appropriate charges against such securities so as to legally enforce their rights in the event of default by borrowers. As a part of lending, banks also provide certain non-fund based facilities such as Letters of Credit and Guarantees. Banks also finance, receivables of a borrower through the facility of 'factoring'. Banks extend sales finance in the form of Purchase/ Discounting of bills to eligible borrowers. Also banks extend finance against Corporate Securities such as Shares/Debentures/ Bonds. Security is something of value given to a lender by a borrower to support his or her intention to repay. Securities given by a borrower comes to the rescue of banks in cases where borrower defaults. To legally enforce their rights, Banks create different types of 'charge' over securities offered by borrowers such as Assignment, Lien, Pledge, Hypothecation, and Mortgage. Documentation is an integral part of bank credit portfolio that enables a bank to identify the borrower, his capacity, security, type of charge created, and also serves as evidence in a court of law in recovery proceedings. Properly executed documents (including registration and stamping wherever necessary) by different types of borrowers are essential to determine limitation period.

Lesson 10: Calculation of Interest and Annuities

For deposits held by customers banks pay interest on simple and compounded basis. They also charge interest on loans and advances, which forms their main source of income, as per their credit policy. Where loans are repayable over a term, banks provide an option of Equated Monthly Instalment (EMI). As a part of financial innovation banks offer fixed or floating interest rates on certain products based on specific terms and conditions. The concept of annuities is used by banks while calculating interest. Banks also collect interest upfront in certain credit facilities like Discounting of bills and also charge interest on daily product basis on facilities like Cash credit etc. Estimation of annuity values are derived by banks based on the Sinking fund concept.

Lesson 11: Performing & Non Performing Assets

As a part of prudential guidelines, Banks follow the RBI norms of Asset Classification, Income Recognition, Provisioning for bad advances and maintain stipulated risk weighted Capital. While making asset classification, banks segregate their assets in to performing and Non-performing, based on the record of repayment of principal and interest by borrowers. Banks also undertake debt restructuring exercise for corporates for the benefit of all stake holders. This study lesson covers, What is restructuring and the prudential norms? When and how the one-time settlement (OTS) is done? What is BIFR and Asset Reconstruction Companies (ARCs)? What are the functioning of Debt Recovery Tribunals (DRTs)? What is SARFEASI Act and its conditions for sale of assets?

Lesson 12: Analysis of Financial Statements of Banks

What are major financial statements and the objective of financial statement analysis? Who are the users of the financial statements and the tools used for the analysis of financial statements? Important ratios for evaluation of performance of the banks. The accounting system followed by banks in India, differs from the general accounting system followed by companies and other business entities. Nevertheless, they are required to prepare and present their Annual Financial Statements as per specified formats in compliance with provisions of B R Act, The Companies Act, RBI directions and ICAI Accounting Standards. While doing so, Banking companies are required provide a summary of Accounting policies followed by them in preparing these financial statements as well as comply with Disclosure/Additional disclosure requirements as advised by RBI, from time to time. Some terms used in Analysis of Bank performance.

Lesson 13: Risk Management in Banks and Basel Accords

Every business organization is exposed to many risks while doing business. Banks too face several financial and non- financial risks such as Credit risk, Market risk, Operational risk, Strategic risk, Funding risk, Political and Legal risks. Based guidelines issued by RBI, banks assess the magnitude of risks faced by them and adopt proper strategies to manage the same. In the light of banks adopting BASEL I, II and III norms, RBI has sensitized them in sound risk management practices, as under the present norms a Bank's capital is linked to various risks faced by it. RBI also monitors compliance of risk management practices of banks through its on- site and off-site surveillance so as to prevent crisis in the banking sector.

PART II : INSURANCE LAWS (50 MARKS)

Lesson 14: Concept of Insurance

Insurance is form of contract or an arrangement where one party agrees in return for a consideration to pay an agreed amount of money to another party to make good the loss, damage or injury to something of value in which the insured has an interest. Being a contract of indemnity, it is based on the principle of utmost good faith. In today's world, insurance companies offer retail insurance policies of varied nature including life, health, fire, marine, etc. Individuals purchase such policies either in their individual capacity or the employee friendly organizations may extend such cover as perks of the employment.

Lesson 15: Regulatory Framework in Insurance

The process of re-opening of the sector had begun in the early 1990s and the last decade and more has seen it been opened up substantially. In 1993, the Government set up a committee under the chairmanship of R N Malhotra, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners. Following the recommendations of the Malhotra Committee report, in 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry.

Lesson 16: Life Insurance

Life insurance is meant to provide financial assistance to the dependents of the life assured in the evet of his death. Earliest form of life assurance was a lump sum payment at the time of death of person whose life was insured. The amount of payment used to be fixed arbitrarily depending on the resources of the organisation. Recreation clubs having large memberships adopted this type of inducement to the existing members to continue their membership of the club or to attract new members by offering some incentive out of the surplus funds they had. The person taking the insurance policy is required to disclose all the facts impacting the assessment of risk truthfully and completely about the subject matter of insurance, to the Insurer in order to enable the insurer to correctly assess the risk on hand. If the principle of utmost good faith is vitiated, insurer has the right to cancel the contract or deny payment of Policy benefits.

Lesson 17: General and Health Insurance

General Insurance: In today's age of consumerism, insurance requirements have expanded to keep pace with the increasing risks. Today we have a wide assortment of risk coverage commencing from health insurance to travel insurance to theft insurance to even a wedding, film or event cancellation insurance. With affluence and spending capacity on the surge there is a growing trend to fulfill needs, deal with responsibilities and secure one's possessions. General insurance companies have willingly catered to these increasing demands and have offered a plethora of insurance covers that almost cover anything under the sun. General insurance products and services are being offered as package policies offering a combination of the covers mentioned above in various permutations and combinations.

Health Insurance: Health insurance is insurance that covers the whole or a part of the risk of a person incurring medical expenses, spreading the risk over a large number of persons. By estimating the overall risk of health care and health system expenses over the risk pool, an insurer can develop a routine finance structure, such as a monthly premium or payroll tax, to provide the money to pay for the health care benefits specified in the insurance agreement. The benefit is administered by a central organization such as a government agency, private business, or not-forprofit entity. Health insurance in India typically pays for only inpatient hospitalization and for treatment at hospitals in India. Outpatient services were not payable under health policies in India

Lesson 18: Functions in Insurance & Compliance related thereto: (Part – I)

In this lesson the students will know who is an Actuary and what his role in Insurance business. How an Actuary is appointed in Insurance company. How the Product Design & Filings is done in Insurance. Several insurance businesses concentrated their risk and compliance strategies on safeguarding themselves against downside risks and adhering to constantly changing regulatory requirements in the past years between the global financial crisis and the COVID-19 pandemic. Business decisions can be influenced by in-depth analyses of business performance, such as unexpected claim patterns or higher-than-expected client retention rates. Several insurance companies are starting to significantly restructure services so they can better carry out their new responsibilities.

Lesson 19: Functions in Insurance & Compliance related thereto: (Part – II)

In a business environment that is changing quickly, exploring insurance distribution channels has become more and more important for insurance firms. While the transition to digital has been a natural process for the majority of global companies in recent years, it has not been simple for the insurance sector. Insurance brokers serve as a bridge between customers and insurance firms, serving as a distribution channel for insurance products. The best insurance policies to meet their demands are sought after by insurance brokers on behalf of their clients. To get the greatest coverage for their clients in terms of distribution, insurance brokers consult with a number of different insurance providers. They ask clients about their insurance requirements and preferences, then investigate the policies provided by various insurance providers to determine which one is the most appropriate. Web Aggregators are online resources that give users a simple method to compare insurance plans offered by different insurance providers. The government established Common Public Service Centers (CPSCs) as physical locations where a variety of services, including insurance products, are provided to the public.

Lesson 20: Functions in Insurance & Compliance related thereto: (Part – III)

Insurance business is globally regulated for reasons of equity and efficiency. Insurance companies receive huge amounts of cash in the form of premiums. These premiums are again invested by Fund Managers in the Insurance Company as per the guidelines of the Insurance Regulatory and Development Authority of India (IRDAI). The investments are regulated as they are made out of the money contributed by the policyholders. In this lesson, the important regulations pertaining to Investments of Life and General insurance companies are discussed in depth.

Lesson 21: Functions in Insurance & Compliance related thereto: (Part – IV)

In this lesson the various risks to which insurance companies are exposed, the risk management process adopted by the insurance companies are discussed. The concept, process and types of reinsurance contracts and co-insurance are also covered. Risk is a condition where there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for. There is no requirement that the possibility should be measurable but only that it must exist. Risk is not necessarily a bad thing. In fact, risk-taking is an essential component of a competitive economy. At the same time, an important characteristic of risk is that some losses will actually occur. There is a financial loss when a wage earner dies, or money is stolen or a building is destroyed by fire. Such losses are examples of primary burden of risk and the main factor prompting individuals and businesses to try to avoid risk or mitigate its impact.

Lesson 22: Functions in Insurance & Compliance related thereto: (Part – V)

This lesson covers crucial aspects of corporate governance, compliance management, regulations with respect to filing and reporting of insurance operations. Besides the rules and regulations relating to AML and PMLA are also covered in detail to give a detail picture of the governance philosophy as propounded by the regulator. Corporate Governance is a system of financial and other controls in a corporate entity and broadly defines the relationship between the shareholders, Board of Directors and Management. In case of the financial sector, where the entities accept public liabilities for fulfillment of certain contracts, the relationship is *fiduciary* with enhanced responsibility to protect the interests of all stakeholders. In addition to compliance, the insurers also have to comply with regulating reporting formalities, including Monthly Returns, Quarterly, Half-Yearly, Yearly Returns and Cyber Security Audit.

Lesson 23: Inspection, Investigation, Penalty & Appellate Procedure

In the insurance industry, various mechanisms and procedures are in place to ensure compliance, transparency, and accountability. These include inspection, investigation, penalties, and appellate procedures. Inspection involves the thorough examination of insurance companies' books, records, and operations by regulatory authorities such as the Insurance Regulatory and Development Authority of India (IRDAI). The purpose of inspection is to assess the financial soundness, compliance with regulations, and overall functioning of insurance entities. Investigation, on the other hand, delves into specific incidents or allegations of misconduct, fraud, or irregularities within the insurance sector. Regulatory bodies, like the IRDAI, possess the authority to conduct investigations to gather evidence, analyze facts, and uncover any wrongdoing. Investigations help maintain integrity within the industry and protect the interests of policyholders.

Lesson 24: Professional Opportunities

A 'Company Secretary' is a senior, strategic-level corporate professional who plays a leading role of a Key Managerial Personnel (KMP) entrusted with the responsibility of the company's Corporate Governance. Corporate Governance is more than just complying with laws, regulations, standards and codes; it is also about creating a culture of good management practices. He provides professional guidance to the board, individual directors, management, shareholders and other stakeholders on the governance aspects of strategic decisions for the growth of the company. As an advisor, he advises the Board on the best management practices and work ethics to be adhered to that will ensure wealth creation for the company. He also plays a critical role in organizing and implementing board's decisions, its committees and general body meetings while ensuring compliance with the existing legal structure to safeguard the interests of all stakeholders. A Company Secretary in employment is a robust professional aiding the efficient management of the corporate sector by playing the role of a Key Managerial Personnel (KMP) or Compliance Officer of a company. Company Secretary in practice is the preferred professional who is finding depth in the areas of Banking & Insurance Intellectual Property, Business advisory, International laws, Commercial laws, Economic growth & Development projects, etc.

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PROFESSIONAL OPPORTUNITIES

PART I

BANKING LAWS

Overview of Indian Banking System

Lesson 1

KEY CONCEPTS

■ Old Generation Private Bank ■ New Generation Private Bank ■ Co-operative Banks ■ Regional Rural Bank (RRBs) ■ Small Finance Banks ■ Payments Bank ■ Development Finance Institutions (DFIs) ■ Non Banking Finance Corporations(NBFCs) ■ National Bank for Agriculture and Rural Development (NABARD) ■ Small Industries Development Bank of India (SIDBI) ■ National Housing Bank (NHB)

Learning Objectives

To understand:

- The Indian Banking system and its evolution
- The role and functions of Reserve Bank of India
- The structure of Banks in India
- Other Financial Institutions

Lesson Outline

- Introduction
- Indian Banking System – Evolution
- Nationalised Banks Private Banks Foreign banks
- Co-operative Banks
- Regional Rural Banks
- Payment Banks
- Small Finance Banks
- Financial Institutions
- Development Banks
- NBFCs
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Reserve Bank of India Act, 1934
- Banking Regulation Act, 1949

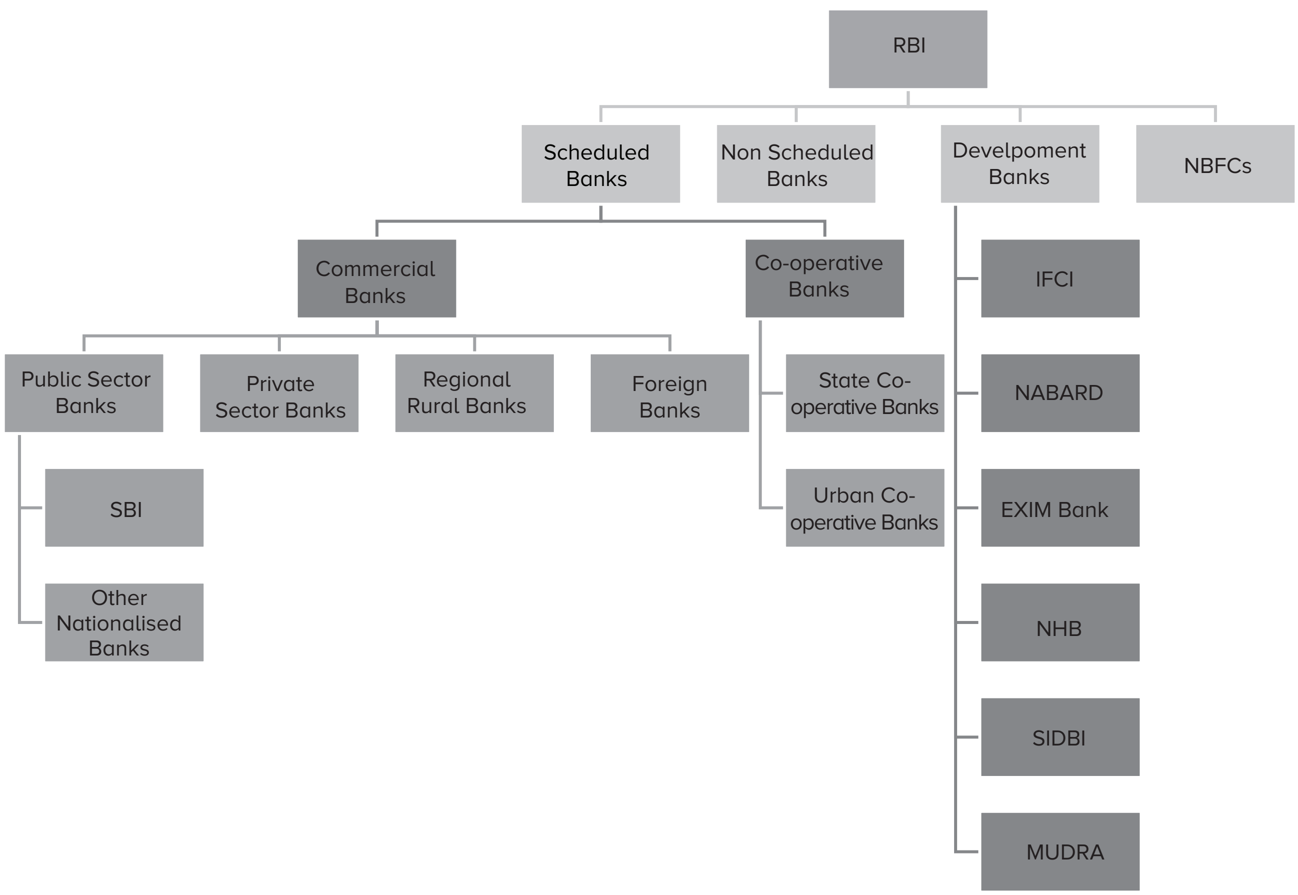
INTRODUCTION

Banks form the backbone of a country's financial system. Modern Banking system in India is more than two centuries old. The Indian banking system consists of various constituent banks which mobilize savings from several sources for lending to productive activities. These banks are regulated by Reserve Bank of India (RBI) which came in to existence in 1935. RBI controls credit, issues currencies and regulates banks and other Non- Banking Financial Companies (NBFCs). Besides these, the services offered by banks also have expanded over the years in the light of various national and international developments. Keeping in mind all these, this Lesson covers evolution of banking system in India, role of RBI and structure of banks which are a must for any student of Banking.

INDIAN BANKING SYSTEM - AN EVOLUTION

The Evolution of Indian Banking System encompasses Agency House Banks, Presidency Banks, Imperial Bank of India, Reserve Bank of India, Private/Joint Stock Banks (Old Generation Private Sector Banks), State Bank of India, Associate Banks, Nationalized Banks, Old and New Generation Private Sector Banks, Foreign Banks, Co-operative Banks, Regional Rural Banks, Small Banks and Payments Banks and Financial Institutions known as Development Banks and Non-Banking Financial Companies.

Indian Banking System



BRIEF OVERVIEW OF THE START OF RESERVE BANK OF INDIA (RBI)

In 1927, the British government appointed a Commission under Hilton- Young (known as the Royal Commission on Indian Currency and Finance) with the main objective to separate the control of currency and credit from the government, as well as spread the banking network across the country. The Commission recommended setting up a central bank in India known as Reserve Bank. However, initially the proposal was not accepted. Later, with a few modifications it was reintroduced and finally it was accepted in 1934. As a consequence, Reserve Bank of India ('RBI') was established on 1935 as a banker to the Central Government. It was initially head quartered in Kolkata and commenced its operations from April 01, 1935. Later in the year 1937 it was shifted to Mumbai.

At the beginning of its operation, RBI was started as a privately owned entity with a share capital of Rs. 5 crores; almost fully subscribed by private shareholders excepting a token shareholding (2.2 per cent) of the Central Government. In 1948, the Central Government took over the institution through an Act named Reserve Bank (Transfer to Public Ownership) Act. All private shareholders were paid compensation. The complete Government take-over took place in 1949 as RBI started it's statutory role from January 01, 1949.

Scheduled Banks

All banks which are included in the Second Schedule to the Reserve Bank of India Act, 1934 are Scheduled Banks. These banks comprise Scheduled Commercial Banks and Scheduled Co-operative Banks.

Commercial Banks

The term Commercial Bank refers to a Financial Institution (FI) that accepts deposits, offers checking account services, makes various loans, and offers basic financial products like Certificates of Deposit (CDs) and Savings Banks Accounts to individuals and small businesses. They make money by providing and earning interest from loans such as mortgages, auto loans, business loans, and personal loans. Customer deposits provide banks with the capital to make these loans.

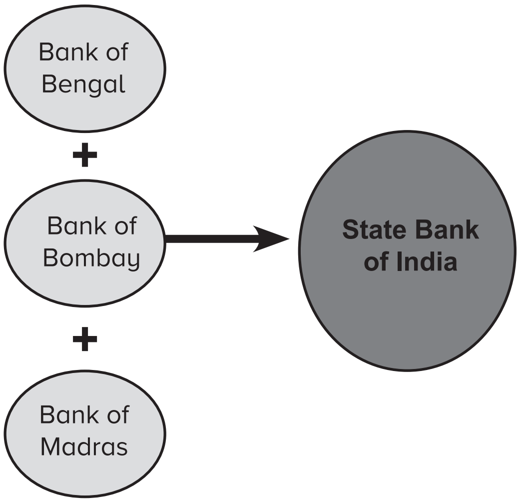
Public Sector Banks

Public Sector Banks are those banks where majority of the stake in the bank is held by Government.

State Bank of India and it's Associate Banks

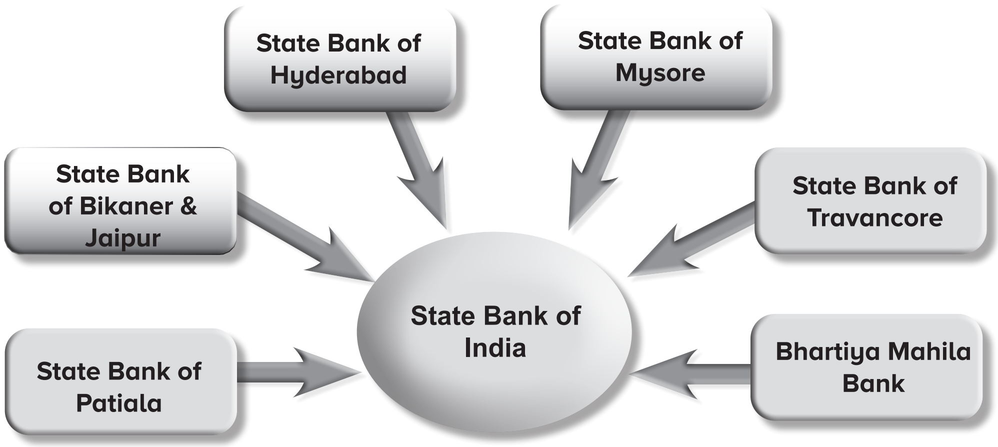
State Bank of India as we know today originated from the three Presidency banks namely Bank of Bengal, Bank of Bombay and Bank of Madras and the successor to these Presidency banks viz. Imperial Bank of India.

These banks were basically created by European masters and served mostly to the common needs of local European commerce in India. Though Imperial Bank of India was recognized for its services and integrity, its contribution was mainly confined to urban populace of India. And it was "not equipped to respond to the emergent needs of economic regeneration of rural areas. As this was an area of concern for the Government of India, the All-India Rural Credit Survey Committee recommended creation of a Government partnered and sponsored bank by taking over the Imperial Bank of India along with those princely states owned banks. Through State Bank of India Act, in 1955 the Government of India constituted State Bank of India that had a 25% share of Indian banking resources at that time.



Subsequently through another enactment viz. State Bank of India (Subsidiary Banks) Act in 1959, all the princely state banks were taken over by State Bank of India. Thus the focus of State Bank of India was concentrated towards social purpose. It had a network of 480 offices, sub-offices,

Local Head Offices to service the planned economic development of the country to start with. Thus State Bank of India was destined to be the prime mover of national development in the banking sphere.



The eight princely State Banks that became associate banks of State Bank of India were State Bank of Patiala, State Bank of Bikaner, State Bank of Jaipur, State Bank of Hyderabad, State Bank of Saurashtra, State Bank of Indore, State Bank of Mysore and State Bank of Travancore. In 1963 State Bank of Bikaner and State Bank of Jaipur were merged to form State Bank of Bikaner and Jaipur. Subsequently on 13th August, 2008 State Bank of Indore and State Bank of Saurashtra were merged with State Bank of India as a part of Government of India's plan for creating a "mega bank" by merging all associate banks with State Bank of India. On 15th February, 2017, the Union Cabinet approved the merger of five associate banks with SBI. Pursuant to this, from 1st April 2017 the remaining associate banks were merged with State Bank of India. Also along with its former Associate Banks, the erstwhile Bharatiya Mahila Bank, an all-women bank established by the Government of India in 2013 for "empowering women and instilling confidence among them to avail bank financing" was also merged. Bharatiya Mahila Bank was set up to provide credit exclusively to women. Apart from India only two countries viz, Pakisthan and Tanzania have a bank especially for women. Immediately before the merger, Bharatiya Mahila Bank had 103 branches and business volume was Rs. 1600 crores. The merger of Bharatiya Mahila Bank was made considering the large outreach of SBI and its record of establishing all women branches and providing loan to women borrowers.

Over the years due to various regulatory developments and relaxations made available in permitted activities by the banking regulator and the Government of India, State Bank of India has created the following non-banking subsidiaries:

- SBI Capital Markets Limited.
- SBI Funds Management Pvt. Limited.
- SBI Factors & Commercial Services Pvt. Limited.
- SBI Cards & Payments Services Pvt. Limited. (SBICPSL)
- SBI DFHI Limited.
- SBI Life Insurance Company Limited.
- SBI General Insurance Company Limited.

Apart from the above, SBI, the largest Indian Bank with 1/4th market share, serves over 45 crore customers through its vast network of over 22,000 branches, 62617 ATMs/ADWMs, 71,968 BC outlets, 229 overseas offices spread over 31 countries having the largest presence in foreign markets among Indian banks.

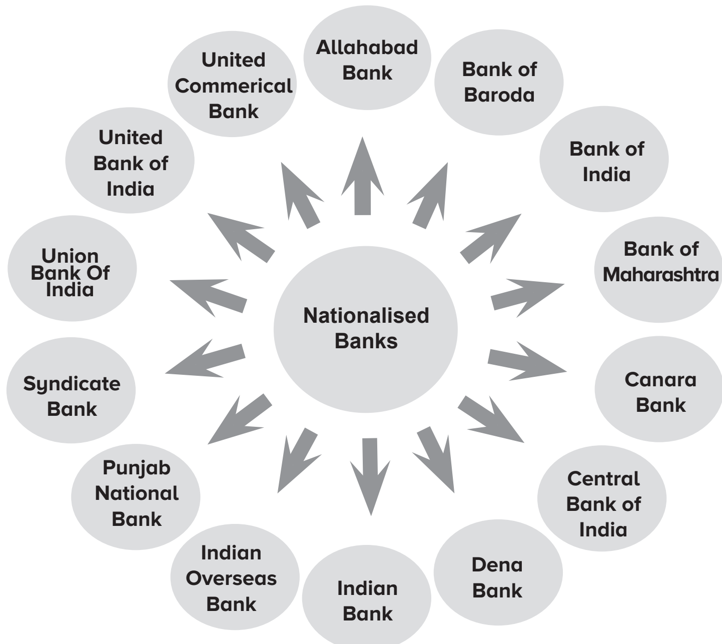
(Source: https://sbi.co.in/web/about-us/about-us)

Other Nationalised Bank

Until 1968 excepting State Bank of India, all other joint stock banks were under private ownership. As these banks were catering to the banking needs of urban India, a large number of them did not involve themselves in the economic upliftment of rural areas, though they mobilized deposits from public at large. Looking at this state of affairs, the Government of India brought in Social Control of Banks in 1967 with a view to make these banks contribute to the economic regeneration of rural and semi-urban areas of the country.

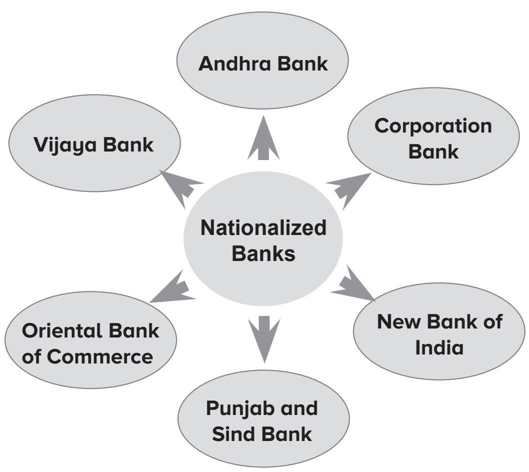
The Banks which were operating under private ownership then were also given targets to be achieved in extending loans to the rural segment. However, dissatisfied with the performance of private banks, the Government nationalized 14 banks in July 1969 through Banking Companies (Acquisition and Transfer of Undertakings) Ordinance which was later made into a law in 1970.

First Phase of Nationalization



A similar exercise was also carried out in 1980 and the Government took over the control of the following six banks which had demand and time liabilities base of Rs. 200 Crores and above.

Second Phase of Nationalization



Till the start of liberalization period Government of India held 100% of the equity capital of banks. Post-liberalization the Government had diluted its stake in several of these PSU Banks in such a way that it has just majority stake in these institutions.

Consolidation of PSU Banks

In view of stringent capital adequacy norms as well as mounting NPAs, especially among the Public Sector Banks and also to arrest sliding performance in their contribution to the economic development of the country, the Government of India took a decision in late 2018 to consolidate the PSU Banks. In pursuance of this objective in April of 2019, Vijaya Bank and Dena Bank were amalgamated with Bank of Baroda. In effect, the operations of Vijaya Bank and Dena Bank have been combined with Bank of Baroda. Ultimately the merged banks are now working under the umbrella of Bank of Baroda brand. Their consolidated operations had commenced from 1st April 2019. As a consequence of these mergers RBI has excluded "Vijaya Bank" and "Dena Bank" from the Second Schedule of the Reserve Bank of India Act, 1934 vide it's circular dated November 28, 2019.

In addition to the above, in August 2019, the Union Finance Minister announced a second dose of consolidation of PSU Banks which came in to effect from 1st April, 2020 to strengthen the banking system for a robust performance.

Details of Merging of PSU Banks

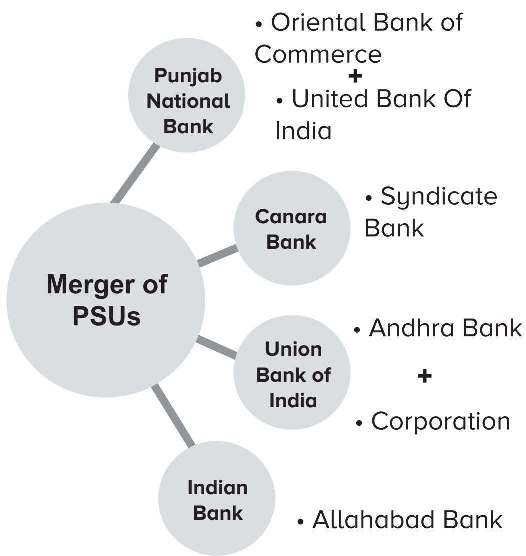
The merged banks have started functioning as a part of Anchor banks with effect from 1st April, 2020.

After merger of PSU banks the names of Syndicate Bank, Oriental Bank of Commerce, United Bank of India, Andhra Bank, Corporation Bank and Allahabad Bank have been excluded from the Second Schedule to the Reserve Bank of India Act, 1934 with effect from April 01, 2020 since these banks have ceased to carry on banking business with effect from April 01, 2020.

With this process of consolidation, the total number of PSU Banks will stand reduced to 12 as indicated below:

They are as follows:

1. Bank of Baroda
2. Bank of India
3. Bank of Maharashtra
4. Central Bank of India
5. Indian Overseas Bank
6. Punjab & Sind Bank
7. State Bank of India
8. United Commercial Bank
9. Canara Bank
10. Indian Bank
11. Punjab National Bank
12. Union Bank of India.



Old Generation Private Sector Banks and New Generation Private Sector Banks

There were many commercial banks that were started as Private/Joint stock banks in India. The Allahabad Bank in 1865 was one of the earliest joint stock banks started in India. Subsequently it was nationalized in 1969 and continues its existence.

On 30 August, 2019, the Ministry of Finance announced that Allahabad Bank would be merged with Indian Bank, another nationalized Bank.

The private sector banks which were operating in India prior to the liberalization year of 1991 are known as Old Generation Private Sector Banks. The banks that came into existence subsequent to Narasimham Committee Report I and revised RBI guidelines in 1993 are known as New Generation Private Sector Banks. The Narasimham Committee-I, recommended to allow private and foreign banks into the industry as a part of economic liberalization policy of Government of India. In deference to the recommendations of the Committee, the RBI formulated guidelines for the establishment of the private sector banks on January 1993. These guidelines prescribed that the private banks should be established as public limited companies under the then Indian Companies Act,1956 (which amended in year 2013 and now it is Companies Act, 2013). The paid-up capital shall not be less than Rs. 100 Crore.

Housing Development Finance Corporation Limited ("HDFC") was the first private bank in India to receive license from RBI, to set up a bank in the private sector in India.

Accordingly, nine banks were set-up in private sector including some by development financial institutions. Prominent among them are ICICI Bank, Global Trust Bank, HDFC and IDBI bank. Bareily Corporation Ltd. merged with Bank of Baroda in 1999, Times Bank merged with HDFC Bank in 1996, Bank of Madura Ltd. merged with ICICI Bank in 2001 and Nedungadi Bank Ltd. merged with Punjab National Bank in 2003.

List of Scheduled Private Sector Banks*	
Sr. No.	**Name of the Bank**
1.	Axis Bank Ltd.
2.	Bandhan Bank Ltd.
3.	CSB Bank Ltd.
4.	City Union Bank Ltd.
5.	DCB Bank Ltd.
6.	Dhanlaxmi Bank Ltd.
7.	Federal Bank Ltd.
8.	HDFC Bank Ltd.
9.	ICICI Bank Ltd.
10.	Induslnd Bank Ltd.
11.	IDFC First Bank Ltd.
12.	Jammu & Kashmir Bank Ltd.
13.	Karnataka Bank Ltd.
14.	Karur Vysya Bank Ltd.
15.	Kotak Mahindra Bank Ltd.
16.	Nainital Bank Ltd.
17.	RBL Bank Ltd.
18.	South Indian Bank Ltd.
19.	Tamilnad Mercantile Bank Ltd.
20.	YES Bank Ltd.
21.	IDBI Bank Ltd.

*(*Source: https://m.rbi.org.in/scripts/bs_viewcontent.aspx?Id=3657)*

Regional Rural Banks

Close on the heels after Nationalization of private banks, Regional Rural Banks (RRBs) were established in 1975 under the provisions of an ordinance promulgated on September 26, 1975 which was followed by Regional Rural Banks Act, 1976. This was done due to a perceived feeling "that even after nationalization, there were cultural issues which made it difficult for commercial banks, even under government ownership, to lend to farmers."

The main objective for establishing these banks were "to develop the rural economy and to create a supplementary channel to the 'Cooperative Credit Structure'" so as to expand the scope of institutional credit for rural and agriculture sector. The share capital of these banks was contributed in the proportion of 50%, 15% and 35% respectively by Government of India, the concerned State Government and the Sponsoring bank, of a RRB. RRBs were permitted to engage in all permitted Banking activities with their area of operation restricted to a few notified districts in a State.

For providing RRBs additional options for augmenting regulatory capital funds, so as to maintain the minimum prescribed Capital to Risk weighted Assets Ratio, besides meeting the increasing business requirements, it RBI has allowed RRBs to issue Perpetual Debt Instruments (PDIs) eligible for inclusion as Tier 1 capital under specified terms and conditions including the following:

They are not permitted to

- issue Perpetual Debt Instruments to retail investors / FPIs / NRIs.
- invest in the Perpetual Debt Instruments of other banks including RRBs. RRBs shall issue the Perpetual Debt Instruments in Indian currency only.

Foreign Banks

Foreign banks too started setting up their branches in India during late 19th century. The Chartered Bank of India which later became Standard Chartered Bank, opened an office in Calcutta in 1858 after getting a Royal Charter from the Queen of England. In Kolkata, Grindlays Bank commenced its operations by opening its first branch in 1864. The arrival of the Hong Kong and Shanghai Banking Corporation (HSBC) was in 1859 after it acquired a bank known as Mercantile Bank in India. The Comptoird' Escompte de Paris, started operations in Kolkata in 1860 which later was one of the constituent of BNP Paris which represented the French. American banking companies entered India in 1902 through Citibank's predecessor, The National City Bank of New York and JP Morgan, a noted name in American banking entered India in 1922 through its affiliation with Andrew Yule and Co. Ltd of Kolkata. The post-liberalization era saw several foreign banks enter India for business opportunities. According to RBI, as of 24 March 2023 there were forty five licensed foreign banks operated in India.

Co-Operative Banks

The beginnings of Indian Co-operative credit institutions can be traced back to the great Bengal famine of 1840s. Problems of rural poverty and indebtedness and matters associated with such conditions of rural farmers forced the then British government to set up a commission to suggest a holistic remedial measures. The Woodhead Commission which enquired in to the famine, suggested many remedial measures to the British Government. One such remedial measure suggested was to make available credit at low rate of interest to the needy people (more so to farmers). The farmers found this proposition very attractive as their experience with private money lenders not to their liking in view of exorbitant interest rates. Subsequently, the Rayat Commission which was set up to look in to the matters including credit availability, suggested creation of Co-operatives as an organizational means to extend credit to farmers in the year 1872. As a sequel to these developments, the first Co-operative Land Mortgage Bank was started.

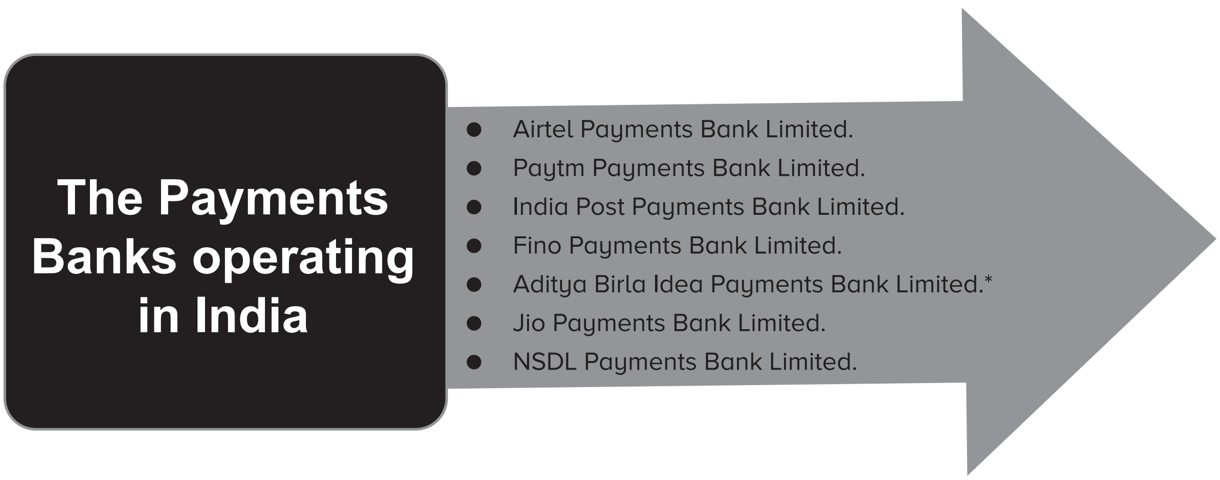
In order to strengthen the credit availability to agriculturists, in the year 1904 the Co-operative credit societies Act was passed enabling establishment of co-operative credit societies for making available agricultural credit through such societies. Further in 1912 a comprehensive Cooperative Societies Act was passed to facilitate starting of non-credit related societies too, since the 1904 Act was oriented only towards "Credit" to the exclusion of other activities.

With the passing of 1904 and 1912 Acts "a large number of Cooperative Credit societies, Central banks. Provincial Cooperative Banks came into existence." The reforms Act of 1919 made 'Co-operation' a provincial (a State) subject. The Bombay Co-operative Societies Act, 1925 brought in the concept of one-man- one-vote. In the year 1929 Land Mortgage Banks were also started for providing long term loans to agriculturists.

Since the subject of 'Co-operation' came under the purview of provinces, several thousand co-operative banks had been set up in various provinces. In 1942, the British Government enacted the Multi-Unit Cooperative Societies Act, 1942 with an object to cover societies whose operations extended to more than one state. After independence in 1966 Co-operative Banks were brought under the supervision of RBI through The Banking Regulation (Co-operative Societies) Rules, 1966. The co-operative banks were also brought under the provision of Banking Regulation Act, 1949. From the year 2012 (through a Banking Law Amendment Act, 2012) a primary Cooperative Society can carry on the business of banking only after obtaining a license from RBI. These banks thus face dual control from State Governments / Central Government (in the case of multi-state co-operative societies) and RBI which exercises control over their banking operations. Co-operative banks are owned by members who subscribe to their shares.

Small Finance Banks and Payments Banks

To deepen and to develop a comprehensive monitoring frame work to track the financial inclusion, a Committee on Comprehensive Financial Services for Small Businesses and Low Income Households (commonly known as the Nachiket Mor Committee) was appointed in September, 2013 by RBI. The Committee submitted its final report on 07 January, 2014. One of the recommendations made by the committee was to establish Small Banks and Payments banks - a new class of banks with an exclusive focus on small businesses and low income households.



Payments Banks

In July 2014, the RBI released the draft guidelines for payments banks, seeking comments from interested entities and public at large. After taking in to account suggestions from respondents in November 2014, RBI released the final guidelines for payments banks and invited applications for opening such banks from interested parties, subject to the guidelines enunciated.

List of Scheduled Payments Banks[1]	
Sr.No.	**Name of the Bank**
1.	India Post Payments Bank Limited
2.	Fino Payments Bank Limited
3.	Paytm Payments Bank Limited
4.	Airtel Payments Bank Limited

([1]Source: https://m.rbi.org.in/scripts/bs_viewcontent.aspx?Id=3657)

* As of November 2019, Aditya Birla Idea Payments Bank Limited is put under Liquidation.

Small Finance Banks

These banks also have been established with an aim of financial inclusion "to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganied sector entities." These banks were expected to provide an institutional mechanism for promoting rural and semi urban savings and extending credit for viable economic activities in the local areas.

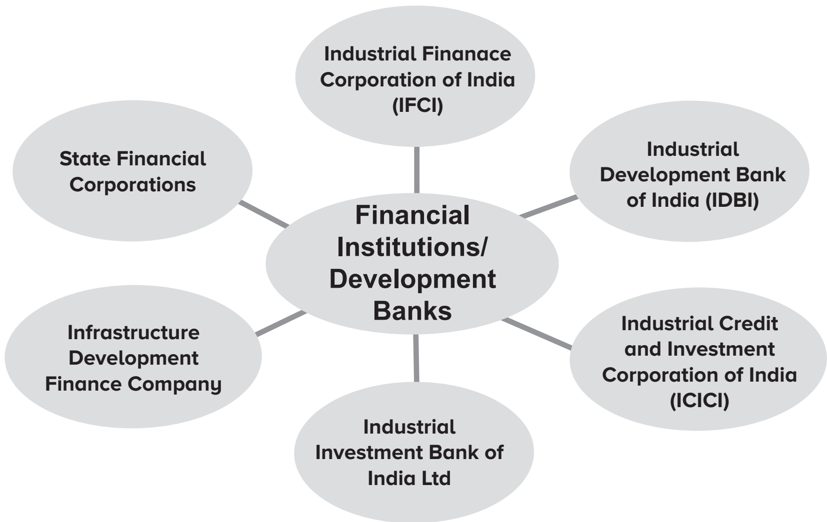
List of Scheduled Small Finance Banks*	
Sr.No.	**Name of the Bank**
1.	Au Small Finance Bank Limited
2.	Capital Small Finance Bank Limited
3.	Equitas Small Finance Bank Limited
4.	Suryoday Small Finance Bank Limited
5.	Ujjivan Small Finance Bank Limited
6.	Utkarsh Small Finance Bank Limited
7.	ESAF Small Finance Bank Limited
8.	Fincare Small Finance Bank Limited
9.	Jana Small Finance Bank Limited
10.	North East Small Finance Bank Limited
11.	Shivalik Small Finance Bank Limited
12.	Unity Small Finance Bank Limited

*(*Source: https://m.rbi.org.in/scripts/bs_viewcontent.aspx?Id=3657)*

Development Banks

The emerging economies of post-colonial era, assumed responsibilities of national economic development activities such as industrial, financial, infrastructure, agricultural, exports etc. themselves. Financial institutions which were created to address these issues of economic importance are called Developmental Financial Institutions ('DFI'). The basic emphasis of a DFI is to offer cheaper long-term financial assistance "for activities or sectors of the economy where the risks may be higher than that the ordinary financial system is willing to bear."

In India soon after independence RBI was entrusted with the responsibility of establishing appropriate institutions in the preferred sectors as per plans of the Government. The need of the hour was to establish institutions to cater to the demand for long-term finance by the industrial sector. This was followed by the formation of Industrial Finance Corporation of India (IFCI) in the year 1948.



The following represents a list in chronological order Development Banks set up in India over the years.

1. **Industrial Finance Corporation of India (IFCI) :** IFCI was established for catering to the long term finance needs of the industrial sector. It was provided access to low-cost funds through the RBI's Statutory Liquidity Ratio (SLR) which in turn enabled it to provide loans and advances to corporate borrowers at concessional rates. This arrangement lasted till 1990s. Later it was decided to access capital markets for its funds needs. For this purpose its constitution was changed to a company under The Companies Act 1956. IFCI's main focus was project finance, financial services and corporate advisory service. It continued to play its pioneering role. IFCI has been revamped over the years.

   IFCI is also a Systemically Important Non-Deposit taking Non-Banking Finance Company (NBFC-ND-SI), registered with the Reserve Bank of India. The primary business of IFCI is to provide medium to long term financial assistance to the manufacturing, services and infrastructure sectors. Through its subsidiaries and associate organizations, IFCI has diversified into a range of other businesses including broking, venture capital, financial advisory, depository services, factoring etc. As part of its development mandate, IFCI was one of the promoters of National Stock Exchange (NSE), Stock Holding Corporation of India Ltd (SHCIL), Technical Consultancy Organizations (TCOs) and social sector institutions like Rashtriya Gramin Vikas Nidhi (RGVN), Management Development Institute (MDI) and Institute of Leadership Development (ILD).

2. **Industrial Credit and Investment Corporation of India (ICICI) :** For providing foreign currency financing over medium term and long term for importing of capital goods for industries, ICICI was formed at the initiative of the World Bank, the Government of India and Indian industry. From 1990s onwards, ICICI focused on Project Finance. However due to liberalization of economic policies of the Government of India, during the period1991- 2000, ICICI transformed itself as a diversified financial services group, including commercial banking services through its subsidiary ICICI Bank. Later in the year 2002 through the merger route, ICICI Ltd. along with two of its subsidiaries merged with ICICI Bank Ltd. to form a single entity. Today, ICICI along with its subsidiaries, has moved close to being an Universal Bank and is functioning under umbrella brand of ICICI Bank.

3. **Industrial Development Bank of India (IDBI) :** Government of India through an Act of parliament established IDBI in the year 1964. IDBI has played a pioneering role in promoting industrial growth through financing of medium and long-term projects from various sectors for the development of Indian economy. IDBI has played a significant role, particularly in the pre-reform era period of 1964-1991. Right from the beginning IDBI focused its objectives on long term financing of industries. Unlike IFCI which focused on a few industries, IDBI had a broad based approach of a gamut of industries including core sector. The basket of services provided included financial assistance in rupee and foreign currencies, for green-field projects as also for expansion, modernization and diversification purposes.

4. **Industrial Investment Bank of India Ltd. (IIBI):** The Industrial Investment Bank of India, earlier known as Industrial Reconstruction Bank of India is one of the oldest banks in India. It was earlier known as The Industrial Reconstruction Corporation of India Ltd., (IRBI) which was set up in 1971 for rehabilitation of sick industrial companies. It was reconstituted in 1985 under the IRBI Act, 1984. With a view to convert the institution into a full-fledged development financial institution, IRBI was incorporated under the Companies Act, 1956, as Industrial Investment Bank of India Ltd. (IIBI) in 1997. IIBI offered a wide range of products and services, including term loan assistance for project finance, short duration non-project asset-backed financing, working capital/ other short-term loans to companies, equity subscription, asset credit, equipment finance as also investments in capital market and money market instruments However, due to plethora of problems faced by this institution on account of impaired assets, IIBI was ordered to be wound up in the year 2012.

5. **Infrastructure Development Finance Company :** IDFC was founded in 1997 in terms of recommendations of an expert group on commercialization of Infrastructure projects under the Chairmanship of Dr. Rakesh Mohan. Later in the year 1998 it applied for a Non-Banking Finance Company registration with RBI. In the year 1999 it was declared as a Public Financial Institution. In

2000 it registers as a Merchant Banker and also as a debenture trustee in 2001. In subsequent years IDFC has forayed in to overseas fund raising for private equity and through infrastructure bonds, investment banking, asset management etc. In 2013 IDFC had applied for a Banking licence to RBI under new licencing policy. In April 2014 RBI had granted an in-principle approval to IDFC for setting up a bank. After 18 months IDFC got a banking licence to commence Banking operations. It started operating Banking services from October 2015. Now, IDFC operates its banking operation through a separate entity called IDFC Bank.

Over the years IDFC had been building up its competence in various areas of financial services like providing assistance by way of debt and equity support, mezzanine financing and advisory services. It encouraged banks to participate in financing of infrastructure projects through 'takeout' financing for a specific term and at a preferred risk profile, with IDFC taking out the obligation after a specific period. Also through its guarantee structure, had helped to promote raising of resources from international markets. IDFC was s actively involved in the process of policy formulation of Government of India, relating to infrastructure sector development. However due to changes in Macro environmental factors globally as well as locally. With a range of expertise under its belt IDFC can be said to be well settled to play a role of an Universal Bank.

6. **State Financial Corporations (SFCs):** The State Financial Corporation Bill passed by both houses of parliament, received the concurrence of the Hon'ble President on 31st October,1951. It came on the statute book as "The State Financial Corporation Act, 1951." This Act empowered each state and union territory to establish a state financial corporation with a view to provide financial assistance to house hold, small and medium scale industries. The area of operation of each State Financial Corporation (SFC) falls within the state, in which it has been established, but in some exceptional cases the activities may be extended to neighboring states or union territory, if there are no state financial corporations in the concerned states. For example, Maharashtra State Financial Corporation's activities extended to Goa, Daman & Diu. Similarly, Delhi Financial Corporation, on reorganization of erstwhile Punjab Financial Corporation (PFC) which was divided into four SFCs in 1967 was established and since then the DFC has been catering the financial needs of the industries in UT of Delhi and Chandigarh. In terms of Section 13(1)(1) of SIDBI Act,1989 SIDBI provides refinance to State Financial Corporations and other banks. Under the scheme, SIDBI sanctions refinance against term loans sanctioned by the SFCs to industrial concerns in Micro, Small and Medium Enterprises (MSMEs) sector for setting up of industrial projects and also for their expansion, modernization and diversification. Based on the annual Business Plan and Resources Forecast (BPRF), refinance limits are sanctioned to SFCs annually.

The services of State Financial Corporations (SFCs), mainly aims at lending money for creation, technology up-gradation, modernization, expansion and overall development of Micro, Small and Medium Enterprises (MSME), including commercial vehicles. SFCs are also providing financial assistance to manufacturing and service industries of their respective states. To diversify its activities, the SFCs are also contemplating to offer their services through Non-Banking Financial Companies (NBFC). By the year 1955-56, only 12 SFCs were set up and 1967-68, all the 18 SFCs came into existence and now are fully in operation. SFCs set up in various states as regional institutions represent an attempt to diversify structure of development banking in India so as to be able to cope up with requirements of wider sections of industrial enterprises.

NON-BANKING FINANCIAL COMPANIES (NBFC)

NBFC is "a company registered under the Companies Act, 1956/2013 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/construction of immovable property. A non-banking institution which is a company and has principal business of receiving deposits under any scheme or arrangement in one lump sum or in installments by way of contributions or in any other manner, is also a non-banking financial company called Residuary non-banking company."

Technically a NBFC has also been defined by RBI as "when a company's financial assets constitute more than 50 per cent of the total assets and income from financial assets constitute more than 50 per cent of the gross income. A company which fulfills both these criteria will be registered as NBFC by RBI".

NBFCs differ from Banks on following grounds:

i. NBFC cannot accept demand deposits; whereas banks can accept the same.

ii. NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself, whereas banks can do so.

iii. Deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs, unlike in case of banks.

iv. An NBFC is not required to maintain Reserve Ratios (CRR, SLR etc.).

v. An NBFC cannot indulge Primarily in Agricultural, Industrial Activity, Sale-Purchase and Construction of Immovable Property.

NBFCs play an important role in the Indian financial system by complementing and competing with banks and by bringing in efficiency and diversity into financial intermediation. The Reserve Bank's regulatory perimeter is applicable to companies conducting non-banking financial activity, such as lending, investment or deposit acceptance as their principal business.

The regulatory and supervisory architecture is, however, focused more on systemically important non-deposit taking NBFCs (with asset size Rs. 5 billion and above) and deposit accepting NBFCs with light touch regulation for other non-deposit taking NBFCs.

Financial Institutions in India

Presently there are four All-India Financial Institutions in India, namely the Export Import Banks of India (Exim Bank), the National Bank for Agriculture and Rural Development (NABARD),Small Industries Development Bank of India (SIDBI) & National Housing Bank (NHB). These Financial Institutions are under the regulation and supervision of Reserve Bank of India and have been classified as Non-Banking Financial Institutions.

Export- Import Bank of India (Exim Bank)

Exim Bank established in 1982 through an Act of Government of India *viz.* Export -Import Bank of India Act, 1981. It was established to make available financial facilities for exporters and importers. Export-Import Bank of India is the premier export finance institution of the country. Also EXIM Bank was intended to serve as principal financial institution coordinating the functioning of those institutions engaged in financing export and import of goods and services with a view to promote International Trade of our country. Commencing its role as a purveyor of export credit, similar to some of its foreign counterparts, EXIM Bank over the period had evolved in to a dependable institution for the global operations of various industries including that of Small and Medium enterprises.

EXIM Bank offers a wide range of products for partner industries such as import of technology and export product development, export production, export marketing, pre-shipment and post-shipment and overseas investments.

National Bank for Agriculture and Rural Development (NABARD)

Till late 1970s there was no institutional credit arrangement for Agriculture and Rural credit in India. The needs were looked after by Reserve Bank of India and Agricultural Refinance and Development Corporation ('ARDC'). However, the importance of institutional credit in boosting rural economy has been clear to the Government of India right from its early stages of planning. Therefore, the Reserve Bank of India (RBI) at the insistence of the Government of India, constituted a Committee to Review the Arrangements For Institutional Credit for Agriculture and Rural Development (CRAFICARD) to look into these very critical aspects. The Committee was formed in 30 March 1979, under the Chairmanship of Shri B. Sivaraman, a former member of Planning Commission, Government of India.

NABARD came into existence in July 1982 by transferring the agricultural credit functions of RBI and refinance functions of the then ARDC. It was dedicated to the service of the nation by the then Prime Minister in November 1982.

Set up with an initial capital of Rs.100 crore. Consequent to the revision in the composition of share capital between Government of India and RBI, NABARD today is fully owned by Government of India. NABARD is involved directly and indirectly in an extensive manner in financing of agriculture, rural development apart from extension activities and supervisory roles.

Small Industries Development Bank of India (SIDBI)

The Small Industries Development Bank of India (SIDBI) came in to existence in 1990 through an Act of Parliament (SIDBI Act, 1989) as a wholly owned subsidiary of IDBI. It was envisaged to be the principal financial institution for promoting, financing the development of industries in the small-scale sector and also carries out coordinating the functions of institutions engaged in similar activities.

SIDBI commenced its operations in April 1990 by taking over the outstanding portfolio and activities of IDBI pertaining to the small-scale sector. By an amendment to the SIDBI Act in 2000, IDBI the majority stake holder, diluted its holdings in SIDBI in favour of a few Public Sector Banks and other Central Government undertakings.

SIDBI's operational domain consist of the entire domain of SSI sector, including the tiny, village and cottage industries as defined under MSME Act, 2008. With appropriate tailor made schemes to meet setting up of new projects, expansion, diversification, modernization and rehabilitation of existing units therein. SIDBI caters the need of SSI sector. SIDBI also offers refinance, bills rediscounting, lines of credit and resource support mechanisms to route assistance to SSI sector through a network of banks and State level financial institutions. SIDBI also offers direct finance for meeting specific requirements of SSI sector. The Government also extends line of credit to SIDBI to enable it to extend loans at more affordable rates to its traditional clientele. Over the years SIDBI has carved for itself a 'niche' in financing of SSI and associated sectors.

National Housing Bank (NHB)

In India there was no institutional arrangement for long term financing of individuals' housing, for a long time. This short coming was identified by the Sub-Group on Housing Finance for the Seventh Five Year Plan (1985-90) as a stumbling block, hindering the progress of the housing sector and recommended setting up of a nodal, national level institution.

The Government of India, accepted the recommendation of the sub-group of the planning commission and a High Level Group under the Chairmanship of Dr. C. Rangarajan, the then Deputy Governor of RBI, was set-up to examine the proposal. The high level group recommended the setting up of National Housing Bank ('NHB') as an autonomous housing finance institution which as accepted by the Government.

While presenting the union budget in 1987-88 the Hon'ble Prime Minister of India, on February 28, 1987 announced the decision to establish the NHB as an apex level institution for housing finance.

Following that, the legislative process for passing an Act was in progress and NHB bill was passed in the winter session of 1987 and in December, 1987, became an Act of Parliament. The National Housing Policy, formulated in 1988 envisaged the setting up of NHB as the Apex level institution for housing. All these steps resulted in setting up of NHB on July 9, 1988 under the NHB Act, 1987. NHB is wholly owned by Reserve Bank of India, which contributed the entire paid-up capital. However the RBI has divested its entire stake in NHB amounting to Rs. 1450 crore on March 19, 2019 in favour of Government of India. With this, the Government of India now holds 100% stake in NHB. This was done on the basis of the recommendation of Narasimham Committee II Report and the Discussion Paper prepared by RBI on Harmonizing the Role and Operations of Development Financials Institutions and Banks. Based on the recommendation, RBI announced the proposal to transfer ownership of its shares in SBI, NHB and NABARD to the Central Government in the Monetary and Credit Policy for the year 2001-02.

The Preamble of the National Housing Bank Act, 1987 describes the basic functions of the NHB as -"... to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other support to such institutions and for matters connected therewith or incidental thereto."

LESSON ROUND-UP

- Reserve Bank of India which was formed in 1935 started playing the roles of central bank and monetary authority which until then were performed by Imperial Bank of India. Post-independence Reserve Bank was nationalized and also is armed with Regulatory powers.
- According to the felt needs of the Government, State Bank of India was established for taking over the functions of Imperial Bank of India. Later banks of all princely States were amalgamated with State Bank of India as its Associates.
- The Associate Banks of SBI were amalgamated in to State Bank of India and presently State Bank of India is a single entity.
- Economic liberalization coupled with banking reforms saw the birth of New Generation Private Sector Banks which have become a force to reckon with in Indian banking.
- Private financing companies which were in existence from 1930s have been brought under a regulatory frame work and today they function as NBFCs.
- To deepen Financial inclusion as well as financing of small businesses and also to track the same, new categories of banks viz. Small Finance Banks and Payments banks were established from 2015/2016 onwards.

GLOSSARY

Indian Banking System : Indian Banking System encompasses Agency House Banks, Presidency Banks, Imperial Bank of India, Reserve Bank of India, Private/Joint Stock Banks (Old generation private sector banks), State Bank of India, Associate Banks, Old Nationalized Banks, New Generation Private Sector Banks, Foreign Banks, Co- operative Banks, Regional Rural Banks, Local Area Banks, Small Finance Banks and Payments Banks and Financial Institutions known as Development Banks and Non-Banking Financial Companies.

Reserve Bank of India : It was established on 1935 as a banker to the central government.

Scheduled Bank : A scheduled bank is one which is included in the Second Schedule of RBI Act and enjoins it to have a minimum capital of Rs. 5 lacs and maintain reserves as per the directions of RBI.

Non-Scheduled Bank : Non-scheduled banks are those which are not listed in the Second schedule of the RBI Act, 1934 having a reserve capital of less than 5 lakh rupees.

Private Sector Banks : As the name implies the ownership of these banks rests with private individuals and corporates including foreign entities.

State Bank of India : State Bank of India originated from the three Presidency banks namely Bank of Bengal, Bank of Bombay and Bank of Madras and the successor to these Presidency banks viz. Imperial Bank of India.

Old Generation Private Bank : The private sector banks which were operating in India prior to the liberalization year of 1991 are known as Old Generation Private Sector Banks.

New Generation Private Bank : The banks that came into existence subsequent to Narasimham Committee Report I and revised RBI guidelines in 1993 are known as New Generation Private Sector Banks.

Co-operative Banks : Cooperative Banks are registered under the Cooperative Societies Act, 1912. And regulated by the Reserve Bank of India under the Banking Regulation Act, 1949 and Banking Laws (Application to Cooperative Societies) Act, 1965.

Regional Rural Bank (RRBs) : RRBs are scheduled banks (Government banks) operating at regional level in different States of India. Regional Rural Banks (RRBs) were established in 1975 under the provisions of the Ordinance promulgated on September 26, 1975 and followed by Regional Rural Banks Act, 1976.

Small Finance Banks : These banks promote financial inclusion to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganised sector entities.

Payments Bank : A payments bank aims to further financial inclusion, especially through savings accounts and payments services. Accordingly, a payments bank is not allowed to give any form of loan or issue a credit card.

Development Finance Institutions (DFIs): Financial institutions which were created to is offer cheaper long-term financial assistance "for activities or sectors of the economy where the risks may be higher than that the ordinary financial system is willing to bear." are called Developmental Financial Institutions ('DFIs').

State Financial Corporations: The services of State Financial Corporations (SFCs), mainly aims at lending money for creation, technology up-gradation, modernization, expansion and overall development of Micro, Small and Medium Enterprises (MSME), including commercial vehicles. SFCs are also providing financial assistance to manufacturing and service industries of their respective states.

Non-Banking Finance Corporations(NBFCs) : NBFC is "a company registered under the Companies Act, 1956 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/ construction of immovable property.

Export Import Bank of India : Export-Import Bank of India is the premier export finance institution of the country. Established in 1982 through an Act of Government of India viz. Export -Import Bank of India Act, 1981

National Bank for Agriculture and Rural Development (NABARD) : NABARD came into existence in July 1982 by transferring the agricultural credit functions of RBI and refinance functions of the then ARDC.

Small Industries Development Bank of India (SIDBI) : Small Industries Development Bank of India (SIDBI) was established in April 1990 and it acts as the Principal Financial Institution for Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector as well as for co-ordination of functions of institutions engaged in similar activities.

National Housing Bank (NHB) : NHB is an apex financial institution for housing. NHB has been established with an objective to operate as a principal agency to promote housing finance institutions both at local and regional levels and to provide financial and other support incidental to such institutions and for matters connected therewith.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Write Short note on -
   i. State Bank of India
   ii. Reserve Bank of India
   iii. All India Financial Institutions (AIFI)
   iv. National Housing Bank (NHB)
2. Explain the reasons for Nationalization of private banks.
3. Merger of Public Sectors Banks (PSUs) gave a new life to Indian banking sector. Explain.

4. Explain the reasons for establishing Small Banks and Payments banks.
5. On what basis Non-Banking Financial Companies (NBFC) are different from banks?

LIST OF FURTHER READINGS

- RBI functions & Other materials - available in www.rbi.org,in
- Banking Law and Practice - P.N. Varshney , 25th Edition, Sultan Chand & Sons
- Law and Practice of Banking - M.L. Tannan
- Commercial Banking - Volume I, II &III - IBA Publication
- Various articles on History of Banking in India from internet
- Evolution of SBI - www.sbi.co.in.

Regulatory Framework of Banks

Lesson 2

KEY CONCEPTS

■ Liquidity Adjustment Facility ■ Marginal Standing Facility ■ Open Market Operations ■ Repo rate ■ Reverse Repo rate ■ Statutory Liquidity Ratio ■ Cash Reserve Ratio (CRR)

Learning Objectives

To understand:

- RBI Act, 1934 and its salient features
- The Banking Regulation Act, 1949 and its salient features
- How Government regulates different banks?
- How other Authorities regulate different banks?

Lesson Outline

- Reserve Bank of India Act, 1934 (An overview)
- Banking Regulation Act, 1949 (An overview)
- Constitution of RBI
- Objectives of RBI
- Functions of RBI
- Tools of Monetary Control
- Regulatory Restrictions on Lending Business of Banking
- Government as a Regulator of Banks
- Control over Co-operative Banks
- Regulation by Other Authorities
- Lesson Round-Up
- Glossary
- Test Yourself

REGULATORY FRAMEWORK

- The Reserve Bank of India Act, 1934
- Banking Regulation Act, 1949
- Payment and Settlement Systems Act, 2007
- Nomination Rules, 1985

INTRODUCTION

Banking companies are regulated in India through various laws. The principal ones among them are Reserve Bank of India Act, 1934 and Banking Regulations Act, 1949. Banks in India are highly regulated and have to ensure compliance and reporting to RBI and other authorities. The principal regulations applicable to banks originate from the Banking Regulation Act, 1949 and The Reserve Bank of India Act, 1934. A detailed knowledge of these are necessary for any student of banking in India. Keeping this in mind, contents this lesson covers constitution and powers of RBI, monetary control measures adopted by banks, constitution & control of banks and other regulatory authorities of banks. These form the broad regulatory frame work of banks in India.

RESERVE BANK OF INDIA ACT, 1934 (AN OVERVIEW)

Reserve Bank of India Act, 1934 (RBI Act, 1934) was enacted with an objective of constituting Reserve Bank of India (as mentioned in Lesson 1) to regulate issue of bank notes, to keep reserves to ensure monetary stability, to operate currency and credit system. The RBI Act, 1934 came into force on 6th March 1934. This Act is the basis for constitution, powers, and functions of RBI. This act does not regulate banking directly though section 18 and 42 of RBI Act, 1934 are used in regulating credit. In broad sense, RBI Act deals with Incorporation, Capital, Management, Business of RBI itself, Central Banking Functions, Collection and furnishing of information, Regulating Non-Banking Institutions receiving deposits and financial institutions, Prohibition of Acceptance of deposits by unincorporated bodies, Regulation of transactions in derivatives, money market instruments, securities etc., Joint mechanism, Monetary Policy, General Provisions, Penalties along with Schedule I and II.

Amendments to RBI Act

While presenting the Finance Bill in August 2019, the Finance Minister proposed the following amendments/ insertions of Sections to RBI Act 1934:-

45 IA – Amendment. Increasing the quantum of Net owned funds of a NBFC, 45-ID – (Insertion) Power of RBI to remove directors of an NBFC from office, 45 IE – (Insertion) Supersession of Board of directors of NBFC (other than Government Company), 45MAA - Power to take action against auditors, 45MBA - Resolution of non-banking financial company, 45NAA – Power in respect of group companies, 58B – (Amendment) Increase in Penalties for Non-compliance and 58G – (Amendment) Increase in Penalties for Non-compliance by NBFCs. Implications of these amendments are as under:-

- RBI has been given more Powers to regulate NBFCs than before including seeking additional financial and
- business information including activities of group/group companies.
- Empowering RBI to remove directors and superseding board of directors of delinquent NBFCs.
- Empowering RBI for a Resolution of problematic NBFCs by way of framing of schemes of amalgamation, reconstruction or splitting in to separate companies, of NBFCs.
- Empowering RBI to forcefully interfere in legitimate business of NBFCs in case of emergencies.

- Arming RBI with power of removal/ debarring of Auditors for a period of three years, at a time from auditing any RBI regulated entities.

THE BANKING REGULATION ACT, 1949 (AN OVERVIEW)

The Banking Regulation Act, 1949 applies to the whole of India including Jammu and Kashmir. The Act was initially brought in to force as the Banking Companies Act, 1949, and later renamed as Banking Regulations Act, 1949 w.e.f. 01.03.1966. The Banking Regulation Act does not apply to primary agricultural credit societies, non-agricultural primary credit societies and cooperative land mortgage banks as per section 3. Till 1965 the coverage of this Act was limited to Banking Companies and later in 1966 Co-operative banks were also brought under its jurisdiction. The Banking Regulation Act, 1949 is applicable along with other statutory laws, unless specifically exempted. Therefore provisions of Companies Act, 2013 are also applicable unless there is an express special provision in the Banking Regulation Act, 1949.

Broadly speaking, the Act regulates the entire activities of banking right from licensing, restrictions on share holding, directors, voting rights etc. In addition to these, by an amendment in August 2017, RBI has also been empowered to issue directions to banks to initiate insolvency resolution to recover bad loan.

The Banking Regulation Act, 1949 further specifies restrictions on loans and advances, interest rates to be charged, maintenance of SLR reserves, Audit, inspection, submission of balance sheet and accounts. There are also provisions regarding control over management, apart from liquidation and winding up as well as penalties.

THE BANKING REGULATION (AMENDMENT) ACT, 2020

The Banking Regulation (Amendment) Act, 2020 has replaced the Banking Regulation (Amendment) Ordinance, 2020.

Features of Banking Regulation (Amendment) Act, 2020

1. substitution of Section 3 to provide that the Act shall not apply to—

   (a) primary agricultural credit society; or

   (b) a co-operative society whose primary object and principal business is providing of long term finance for agricultural development, if such society does not use as part of its name, or in connection with its business, the words “bank”, “banker” or “banking” and does not act as drawee of cheques;

2. amendment of Section 45 to address the potential disruptions in the financial system by providing for the Reserve Bank of India to prepare a scheme for the reconstruction or amalgamation of the banking company without the necessity of first making an order of moratorium;

3. amendment of Section 56 to provide that notwithstanding anything contained in any other law for the time being in force, the provisions of the Act shall apply to co-operative societies, subject to the modifications specified therein.

CONSTITUTION OF RESERVE BANK OF INDIA

The Genesis

Till the establishment of Reserve Bank of India (RBI), there was dual control of currency issuance and credit control by the then Central Government (under British rule) and the Imperial Bank of India respectively. Due to certain developments in the economy, there was a strong view that currency issuance should be delinked from the Government. The Hilton-Young Commission, which was appointed to go in to this issue among others, recommended constituting a central bank to be named as – Reserve Bank of India — which would regulate note issuance and to operate credit system throughout the country. This is evident in the Preamble to the RBI Act, 1934 which reads as “ to constitute a Reserve Bank for India to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency any credit system of the country to its advantage". Hence, the Reserve Bank of India was constituted with these primary objects.

Constitution of RBI & Management

The main purpose for which RBI was constituted has been stated in Chapter II Section 3 (1) and (2) of the RBI Act as under -

"(1) A bank to be called the Reserve Bank of India shall be constituted for the purposes of taking over the management of the currency from the Central Government and of carrying on the business of banking in accordance with the provisions of this Act.

(2) The Bank shall be a body corporate by the name of the Reserve Bank of India, having perpetual succession and a common seal, and shall by the said name sue and be sued."

RBI has been constituted as a body corporate (under the then prevailing Companies Act) in 1935 and continues in the same manner as it was envisaged, with a capital of Rs. 5 crores, which is wholly owned by the Government of India from January 1, 1949. Prior to 1949 RBI was Private entity owned by public shareholders.

In terms of sections 7(2) and section 8 of the RBI Act, the general superintendence and direction of the affairs and business of RBI is vested in Central Board of Directors, consisting of a Governor, 4 Deputy Governors, and 16 Directors (4 from each local boards, 10 nominated directly by Central Government, 2 Government officials) appointed in terms of the Provisions of RBI Act, 1934.

Section 7(1) of RBI Act empowers the Central Government to give directions to the Governor in the public interest after due consultations. The Governor and Deputy Governors hold office for a period of five years, the independent director's tenure is for four years and that of government officials is at the pleasure of the government. All the board officials are eligible for re-appointment. However, independent directors' appointment is restricted to two terms of 4 years each (continuously or intermittently spread over 8 years). A Deputy Governor and Government officials nominated as Director may attend any meeting of the Central Board and take part in its deliberations but shall not be entitled to vote.

However, in the absence of the Governor, and if permitted by Governor in writing, a Deputy Governor may vote in the meetings of Central Board.

In terms of section 9 of the RBI Act, 1934, four local boards have been constituted for each of four areas namely Delhi, Mumbai, Kolkata and Chennai. Local board consists of 5 members each appointed by Central Government to represent, "as far as possible, territorial and economic interests and the interests of co-operative and indigenous banks."

RBI Act, 1934 confers powers to disqualify directors and members of Local Boards, remove and vacate them from their office under section 10 & section 11. The Governor has to convene meeting of Central Board at least six times in a year and at least once in a quarter. If any four directors request the Governor to convene the meeting of Central Board, the Governor has to convene a meeting forthwith.

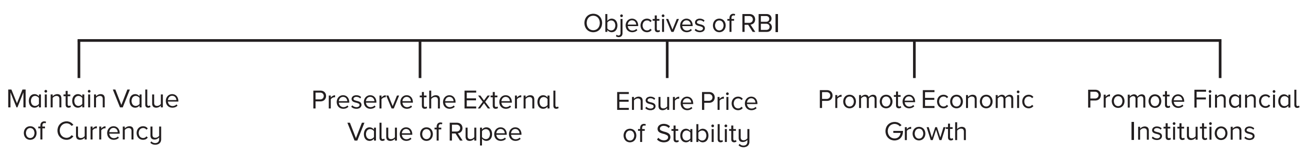
For the day-to-day conduct of the bank's business the Central Board, in terms of the powers vested in it under section 58 of the RBI Act, 1934 can make such regulations as it may consider necessary. The regulations so made will be effective only with the prior sanction of the Central Government. The powers of the Board to make regulations .are fairly wide in that the Board can make regulations to cover all matters for which provision is necessary or convenient for the purpose of giving effect to the provisions of the Act including that of internal functioning of RBI.

In particular, the Board is authorised to make regulations in regard to the following matters:

- Conduct of the business of the Central Board/Local Boards and the procedure that may be followed at meetings;
- Delegation of powers and functions to Central Board to Deputy Governors, Directors, or Officers of the Bank, Local Boards;
- Formation of committees of the Central Board and delegation of functions and powers to such committees;
- Constitution and management of staff and superannuation funds;
- Execution of contracts binding on RBI, Use of the common seal of the Bank;
- Maintenance of accounts and preparation of balance sheets of RBI;
- Remuneration of Directors;
- The relationship of the scheduled banks with the RBI;
- The returns submitted by the scheduled banks to the RBI;
- Conduct and management of clearing houses for scheduled banks;
- Refund of currency notes of the Government of India or bank notes which are lost, stolen, mutilated or imperfect;
- Any other matter for the efficient conduct of the business of the RBI.

OBJECTIVES OF RBI

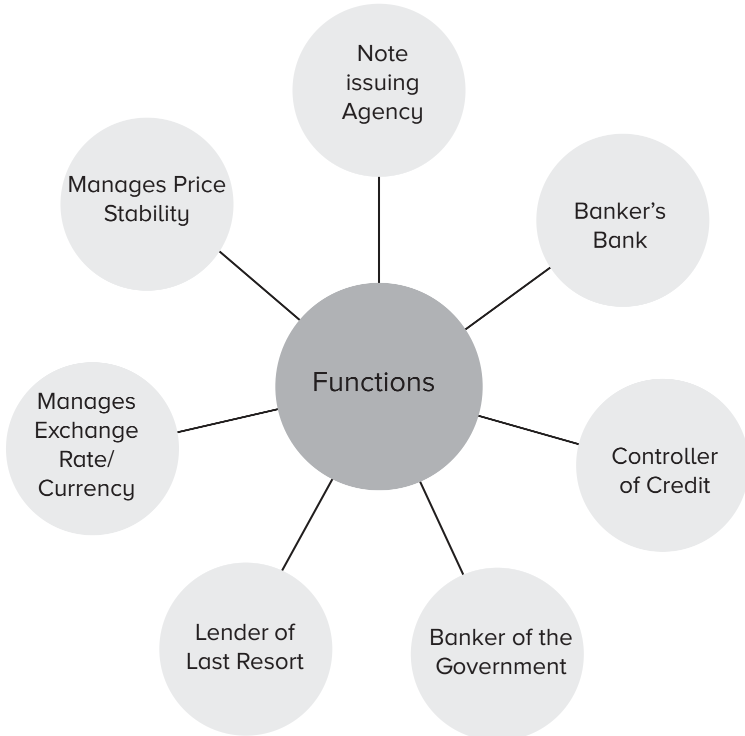
The original objectives for which RBI was established were:



- To regulate the issue of Bank notes.
- To keep reserves with a view to securing monetary stability in India.
- To operate the currency and credit system of the country to its advantage.
- To operate the monetary policy for maintaining price stability while keeping in mind objective of growth.

FUNCTIONS OF RBI

The functions of the RBI have been enumerated in Chapter III of the RBI Act, 1934. The following are the broad functions:



(i) Issue and Management of Currency and distribution of coins

The currency of our country consists of One-rupee notes and coins (including lower denominations thereof) as well as Bank notes issued by RBI. Issuance of bank notes (currency) is one of the original central banking functions for which the RBI was established. In terms of section 22, of the RBI Act, 1934, RBI has the sole right to issue bank notes in India. Such bank notes are issued by a department of RBI known as Issue Department, which is a separate and wholly distinct department from the Banking Department which is responsible for banking business of the RBI.

However the design, form and material of bank notes are to be approved by the Central Government on the basis of recommendations of Central Board of the RBI. Every bank note shall be a legal tender at any place in India. On recommendation of the Central Board, the Central Government may declare any series of bank notes of any denomination to be not a legal tender.

> For example on November 8, 2016, the Government of India announced the demonetization of all Rs.500 and Rs.1,000 banknotes of the Mahatma Gandhi Series. It also announced the issuance of new Rs.500 and Rs.2,000 banknotes in exchange for the demonetised banknotes. Also RBI has introduced new Rs. 200 denomination notes.

Under Section 24 of RBI Act, 1934, the RBI has the power to recommend to Central Government various denominations of bank notes, which shall be two rupees, five rupees, ten rupees, twenty rupees, fifty rupees, one hundred rupees, five hundred rupees, one thousand rupees, five thousand rupees and ten thousand rupees or other denominations not exceeding ten thousand rupees. The issue department keeps its assets, which forms the backing for note issuance, distinctly separate from that of the assets of the banking department.

Within RBI, the Department of Currency Management ('DCM') has the responsibility of administering the functions of currency management. Currency management basically relates to the issue of notes and coins and retrieval of unfit notes from circulation. In order to improve the currency distribution system by leveraging technology, the RBI adopted a hub-and-spoke model for the distribution of banknotes across the country. Fresh note remittances are sent to larger currency chests, which meet the currency needs of a designated area (such as a district). These chests are identified as hub chests and, in turn, supply notes to smaller currency chests in their vicinity which act like spokes in the distribution model. Fresh notes are distributed to every issue office of the RBI as per an allocation plan.

A **currency chest** is a place where the RBI keeps all the excess money in the form of cash under the custody of different banks.

RBI has established a chain of currency chests with several banks in the country. Currency chests are designated branches of commercial banks authorised by the RBI to hold stock of bank notes, rupee notes and coins. These currency chests have the responsibility for distribution of these notes and coins on behalf of RBI. The currency chests get their supply of printed notes from RBI, which are later delivered to the respective banks. Currency chests can be stated to be a depository frame work of the RBI.

The banks which host the currency chests are required to maintain accounts of the chests independently which is subject to monitoring and scrutiny of RBI. Also through a separate set of policy and rules RBI exchanges mutilated or torn notes surrendered by customers through bank branches and currency chests. The bank notes which are issued and circulated by RBI are bearer promissory notes and they are exempt from payment of stamp duty.

Facility for Exchange of Notes and Coins

All branches of banks in all parts of the country are mandated to provide the customer services related to Issuing fresh/good quality notes and coins of all denominations on demand, Exchanging soiled/ mutilated/ defective notes and Accepting coins and notes either for transactions or exchange more actively and vigorously to the members of public so that there is no need for them to approach the RBI Regional Offices for these purposes.

(i) Issuing fresh / good quality notes and coins of all denominations on demand,

(ii) Exchanging soiled / mutilated / defective notes,*

**Small Finance Banks and Payment Banks may exchange mutilated and defective notes at their option. and*

(iii) Accepting coins and notes either for transactions or exchange.

(a) It will be preferable to accept coins, particularly, in the denominations of ₹ 1 and 2, by weighment. However, accepting coins packed in sachets of 100 each would perhaps be more convenient for the cashiers as well as the customers. Such sachets may be kept at the counters and made available to the customers.

(b) All branches should provide the above facilities to members of public without any discrimination on all working days. The scheme of providing exchange facility by a few select currency chest branches on one of the Sundays in a month will remain unchanged. The names and addresses of such bank branches should be available with the respective banks.

(c) The availability of the above-mentioned facilities at the bank branches should be given wide publicity for information of the public at large.

(d) None of the bank branches should refuse to accept small denomination notes and / or coins tendered at their counters. All coins in the denomination of 50 paise, ₹ 1/-, 2/-, 5/-, 10/- and 20/- of various sizes, theme and design issued from time to time by the Government of India continue to be legal tender.

(ii) Banker to the Government

In terms of section 20 of RBI Act, 1934, RBI has an obligation to act as a banker to the Central Government. Under this obligation RBI has to accept monies for account of the Central Government, to make payments up to the amount standing to the credit of Central Government, to carry out its exchange, remittance and other banking operations, including the management of the public debt of the Union of India.

Also under section 21 of RBI Act, RBI has a right to transact Government business in India which include money, remittance, exchange and banking transactions in India; and, the Central Government to deposit free of interest all its cash balances with the RBI under mutually agreed terms. The Reserve Bank is also saddled with the responsibility of receiving and paying money on behalf of the various Government departments. For carrying out its duties as banker to the Government of India, it is not paid any remuneration. RBI is entitled for a commission for managing public debt functions. The Government transaction work also includes maintaining currency chests at places specified by the Central Government. Similarly section 21A of the RBI Act, enables RBI to enter in to agreements with State Governments to transact their businesses.

Under sections 20 and 21(A)(b) of the RBI Act, RBI manages public debt of both Central and State Governments. Float new loans on behalf of Central/State Governments, conduct periodical auctions of Treasury Bills, issue of dated Government securities as well buying and selling the same are some of the additional work done by RBI in its capacity as a Banker to the Government.

Under the mandate signed with Central Government and State Governments RBI extends ways and means advances up to 90 days at an interest rate 2% over the Repo rate. This is basically to manage the temporary mismatches in their short term receipts and payments. RBI also provides investment services by deploying temporary surplus cash balances in Government accounts. RBI also advises the Government on monetary and banking issues when requested to do so. Also manages Consolidated Fund of India, contingency fund and public accounts as these accounts are maintained by RBI.

(iii) Banker to the Banks

This is a special relationship that is created due to statutory requirements under the RBI Act. Once the name of a bank is included in the Second Schedule, that Bank is eligible to be called as a Scheduled Bank. Among other conditions, it is bound to maintain the stipulated Cash reserves under section 42 in an account with RBI. The Scheduled Bank status to any bank also confers privileges such as availing financial accommodation from RBI under specified conditions.

Reserve Bank also provides means of transfer and settlement of funds between banks on account of clearing, remittances, lending and borrowing through such accounts. Thus RBI provides a platform for inter-bank financial transactions. Such accounts of banks are maintained by Deposit Accounts Department of RBI. Intra-bank funds transfers also takes place through an RBI portal known as e-Kuber.

(iv) Lender of last resort

When banks exhaust all other means for raising funds for their operations, they fall back on RBI as a source for finance as provided under the RBI Act. Hence RBI is known as Lender of last resort. RBI grants financial accommodation to banks in terms of section 17(2), (3) and 3 (A) "sale, purchase and rediscount of eligible bills" as well as loans and to advances banks under section 17(4) of RBI Act.

Rediscount of bills with RBI by banks are confined to the following categories:

(a) Bonafide Commercial bills forming part of commercial or trade transactions drawn on and payable in India and maturing within 90 days from the date of discount by banks. In case of export bills relating to export from India the maturity may be 180 days. The other pre-requisite is that such bills should have two signatures with one among them that of a scheduled bank.

(b) Bills related to financing agriculture operations or marketing of crops: Such bills which are to mature within 15 months from the date of purchase or discount by banks.

(c) Bills that are associated with Cottage and Small Scale Industries: Such bills that are associated with production or marketing aspects of these industries maturing within 12 months of its discount or purchase by banks, drawn and payable within India and having two signatures one of which that of a State Co-operative Bank or a State Financial Corporation supported by a guarantee from State Government concerned on repayment of Principal and interest on these bills.

(d) Bills representing holding or trading in Government Securities: Such bills drawn and payable within India, bearing the signature of a Scheduled Bank and maturing within 90 days from the date of purchase or re-discount.

(e) A foreign bill: Bills arising out of bonafide export transactions maturing with 180 days drawn in or on any country outside India, such country being a member of International Monetary Fund. For other than export bill, the maturity is not to exceed 90 days.

(v) Loans and Advances

Section 17(4) of the RBI Act empowers Reserve Bank to grant loans among others to, Scheduled Banks, State Co-operative Banks, and State Financial Corporations loans and advances, repayable on demand or on the expiry of fixed periods not exceeding ninety days.

Such loans and advances are granted against the securities of:

- Stocks, funds and other (than immovable property) securities, in which there is an authorization to a trustee to invest monies;
- Gold or silver or documents of title to these;
- Promissory Notes or Bills of Exchange eligible for purchase or rediscount by RBI or guaranteed by State Government regarding repayment of principal and interest due on them;
- Promissory notes of any scheduled bank or State Co-operative Bank which are supported by documents of title to goods (which have been already transferred, assigned or pledged to any other bank as a security for any advance or loan made of bonafide commercial or trade transactions or those in respect of financing agricultural operations or marketing of crops).

Further by means of Section 17(3-A) of the RBI Act, RBI grants financial accommodation at concessional rates on export oriented bills, repayable on demand or a fixed period which mature in not exceeding 180 days based on declarations from banks.

(vi) Emergency Advances

Also RBI, grants emergency advances to specified banks on special occasions as envisaged in Section 18 of the said Act in the interest of regulating credit to trade, commerce, agriculture and industries. This special provision is available despite any restrictions stated under Section 17 and Section 18 to RBI and extend such financial accommodation to banks on such bills which are not financeable by RBI, otherwise. Further under Section 18, RBI can make an advance to a State Cooperative Bank or to a cooperative society based on the recommendations of a State Cooperative Bank. Such advance is repayable on demand, or on the expiry of fixed period generally not exceeding 90 days under the terms and conditions specified by RBI.

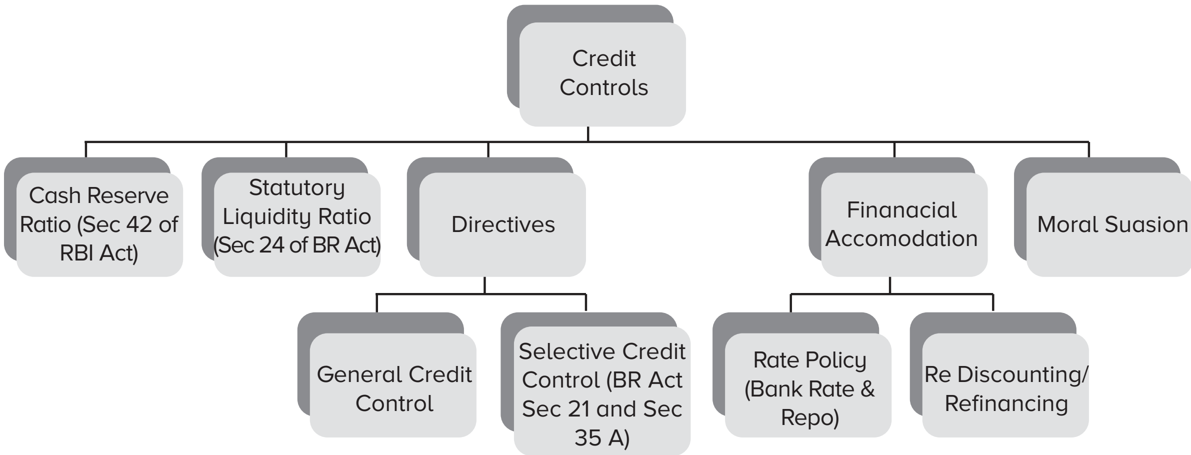
(vii) Controller of Credit

As Bank credit extended by various banks has its own impact on the economy, one of the key functions for which RBI was constituted was to manage the credit for the advantage of the country. RBI exercises control over the credit extended by banks through specific instruments on account of wide powers granted to it by RBI Act as well as Banking Regulation Act, 1949.

The frame work of credit control are implemented through the following instruments at the command of RBI. They are–

a. Cash Reserve Ratio

b. Statutory Liquidity Ratio
c. Directives under BR Act
d. Refinancing of loans
e. Moral Suasion



a. Cash Reserve Ratio (CRR)

In terms of Section 42 of the RBI Act every scheduled bank in India is required to maintain an average daily balance the amount of Cash Reserves with RBI as a percentage of Total Net Demand and Time Liabilities in India. Reserve Bank notifies the percentage of CRR to be maintained by banks at regular intervals through gazette notifications.

> **Cash Reserve Ratio (CRR)** is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank. according to the guidelines of the central bank of a country.

The main purpose of maintaining CRR by the banks is to secure the monetary stability of the country. By increasing the CRR or decreasing the CRR the lendable resources of a bank can be reduced or increased. This would lead to scarcity of availability of funds or increase in availability of funds in the economy resulting in a deflationary or inflationary effect.

When the RBI Act was introduced, the minimum and maximum floor rates of this ratio to be maintained by banks was specified between 3% to 20% .This was amended 2006 and floor rates were abolished, to give RBI the flexibility to decide and announce the percentage of CRR to be maintained by banks from time to time keeping in view the monetary situation prevailing in the country. By varying CRR, RBI can expand or contract the credit extended by a bank, thus affecting the quantum of credit a bank can extend.

All scheduled banks and Non-scheduled banks have to maintain CRR as per section 18 of the RBI Act. Banks have to calculate the CRR on the basis of their respective demand and time liabilities as on the Friday of second preceding fortnight. Reserve Bank of India has prescribed statutory returns i.e. Form A Return (for CRR) under section 42(2) of the RBI Act, and Form VIII Return (for SLR) under section 24 of the Banking Regulation Act, 1949. In addition to the above an incremental CRR in terms of section 42(1A) also need to be maintained as advised by RBI from time to time. At present no incremental CRR need to be maintained. Provisional return of Form A to be submitted by banks within 7 days and final Form A to be submitted within 20 days from expiry of the relevant fortnight.

Maintenance of CRR

(a) Every scheduled bank shall maintain in India with the Reserve Bank, an average daily balance, the amount of which shall not be less than four per cent of the bank's total NDTL in India as on the last

Friday of the second preceding fortnight. The extent of provisions in this regard as applicable to scheduled banks shall, mutatis mutandis, be applicable to Small Finance Banks (SFBs) and Payments Banks (PBs).

(b) Every co-operative bank, (not being a scheduled co-operative bank), shall maintain in India on daily basis by way of cash reserve with itself; or by way of balance in current account with the Reserve Bank or the state co-operative bank of the State concerned; or by way of net balance in current accounts; or in case of a primary (Urban) co-operative bank, balances with District Central Co-operative bank of the district concerned; or in one or more the aforesaid ways, a sum equivalent to four per cent of its NDTL in India, as on the last Friday of the second preceding fortnight.

(c) Local Area Banks shall maintain in India by way of cash reserve with itself or by way of balance in a current account with Reserve Bank, or by way of net balance in current accounts or in one or more of the aforesaid ways, a sum equivalent to four percent of the total of its NDTL in India as on the last Friday of the second preceding fortnight.

b. Statutory Liquidity Ratio (SLR)

In terms of section 24 (2A) of Banking Regulation Act, another tool for controlling credit in the country is available to RBI in the form of Statutory Liquidity Ratio under which, Liquid assets (in the form of prescribed securities by RBI) have to be maintained by all scheduled banks in India.

Statutory Liquidity Ratio (SLR) is the Indian Government term for the reserve requirement that the commercial banks in India are required to maintain in the form of cash, gold reserves, government approved securities before providing credit to the customers.

The value of such assets will be specified by RBI from time to time and “such assets shall be maintained, in such form and manner, as may be specified in such notification.”

SLR has to be maintained by both Scheduled and Non-Scheduled banks in India. Scheduled banks have to maintain SLR in addition to the CRR to be maintained by them under Section 42 of the RBI Act and as far as Non-Scheduled banks are concerned SLR would be in addition to balances to be maintained under section 18 of the Banking Regulation Act, 1949.

Liquid assets are those assets which can be converted into cash within a shortest time. The main aim of this statutory obligation for a bank to maintain SLR is to safeguard the interests of the depositors but it has also been used as an effective credit control instrument in the hands of RBI. The category of assets to be maintained by banks need to be specified by RBI, though it was earlier formed part of Banking Regulation Act itself.

The Securities that banks can invest under SLR are as follows:

(a) Cash.

(b) Gold Valued at the current market price.

(c) Unencumbered securities as under:

   i. Dated Securities of Government of India under market borrowing programme or Market Stabilization Scheme; or

   ii. Treasury Bill of Government of India; or

   iii. State Development Loan securities under their market borrowing programme.

(d) Deposit and unencumbered approved securities under Section 11 of the Banking Regulation Act, 1949 to be made with the Reserve Bank by a banking company incorporated outside India.

(e) Balances maintained by a scheduled bank with the Reserve Bank in excess of the balance required to be maintained under CRR.

(f) Any other securities notified by RBI from time to time.

The procedure for computation of net demand and time liabilities for the purpose of SLR under section 24 of the Banking Regulation Act 1949 is broadly similar to the procedure followed for CRR purpose. On the recommendations of Narasimham Committee, RBI has reduced the SLR from its peak level of 38.5% in 1991 to 27%in 1997 and to 25% in October 1997. By amending Section 24 of the BR Act, RBI has done away with the minimum level of SLR to be maintained by banks that is 25% but has retained the upper cap level of 40%. And in subsequent years the SLR level to be maintained by banks has been gradually scaled down. RBI in its fifth bi-monthly monetary policy review, took a decision that it will reduce the SLR by 25 basis points (0.25 per cent) every calendar quarter until the SLR reaches 18 per cent of the Net Demand and Time Liabilities (NDTL) as part of aligning it with the Liquidity Coverage Ratio (LCR).

If a bank defaults in maintaining SLR, RBI will levy a penalty for that day at the rate of three per cent per annum above the Bank Rate on the shortfall and if the default continues on the next succeeding working day, the penal interest may be increased to a rate of five per cent per annum above the Bank Rate for the concerned days of default on the shortfall.

The effect of increasing SLR would result in leaving lesser amount of lendable funds at the hands of a Bank. Therefore this automatically reduces the supply of funds in the economy resulting in deflationary effect. The same effect can also be created by increasing the interest rates of lendable funds. On the other hand reducing the SLR would have the opposite effect of increasing the availability of lendable funds which may lead to inflationary effect.

As part of post Global Financial Crisis (GFC) reforms, Basel Committee of Reserve Bank of India (RBI) on Banking Supervision (BCBS) had introduced Liquidity Coverage Ratio (LCR), which requires banks to maintain High Quality Liquid Assets (HQLAs) to meet 30 days net outgo under stressed conditions.

Further, as per Banking Regulation Act, 1949, the banks in India are required to hold liquid assets to maintain Statutory Liquidity Ratio (SLR). In view of the fact that liquid assets under SLR and HQLAs under LCR are largely the same, RBI has been allowing banks to use a progressively increasing proportion of the SLR securities for being considered as HQLAs for LCR so that the need to maintain liquid assets for both the requirements is optimised.

c. Directives

Though one of the core businesses of banking is lending, it has to done by the banking system in a judicial manner so that all sectors of the economy are benefitted. One of the key objectives of RBI is to control the credit through which RBI ensures that credit distribution is in line with national priorities. This casts responsibility on it to ensure adequate credit to industry, priority sector (that includes agriculture and others), housing, infrastructure and other consumers. Therefore RBI has put in special mechanisms for credit controls which are carried out through General Credit Control and Selective Credit Control.

Under General Credit Control RBI uses monetary policy instruments such as Repo rate, Bank rate, Open market operations, and moral suasion and under Selective credit control RBI restricts quantum of credit, margins, maximum amount, etc. relating to sensitive commodities and sectors.

d. Rediscounting/Refinance

Reserve Bank as a lender of last resort provides liquidity support though on a temporary basis through rediscounting/refinance of various schemes, the details of which has already been covered under “Lender of last resort”. By increasing or reducing the quantum, rates of interest and period up to which refinance can be availed RBI can curtail or expand the credit availability in the market.

e. Moral Suasion

Moral suasion is a persuasion of banks by Reserve Bank to adhere to the directives and guidelines issued by it. Through advisories the RBI tries influence the banks to follow a desired practice. This is used a soft tool in controlling credit in the economy.

To ensure that the payment systems are safe and secure and the various stakeholders conform to regulatory requirements, on review it has been decided to revise the process of levy of penalty on payment system operators by the Reserve Bank of India.

The revised framework continues to centre around objectivity and transparency in the decision- making process. It may be noted that action taken under this framework would be without prejudice to any other laws of the country.

(viii) Managing the external value of Rupee (i.e. Managing Foreign Exchange)

Under section 40 of the RBI Act, there is an obligation on the part of RBI to buy or sell foreign exchange from or to an Authorised Person based on the exchange rate as well as other conditions as the Central Government may determine. The Authorised Persons are those who are licensed to buy or sell foreign exchange under Foreign Exchange Management Act, 1999 (FEMA).

In addition, RBI is charged with maintaining the foreign exchange reserves of the country and plays a significant role as controller/regulator of foreign exchange transactions in terms of wide powers it derives from FEMA.

Under the Foreign Exchange Regulation Act regime from 1973, RBI had a very highly centralized role in the area of foreign exchange and it had delegated only limited powers to the Authorised Dealers. All foreign currency inflows were to be surrendered by banks to RBI and it was the only agency which can supply foreign currency at the rates it had determined. Therefore it had a pivotal role in determining and administering rupee exchange rate. However gradually over a period from August 1993, due to liberalization and banking reforms RBI started relaxing many controls over foreign exchange transactions. Due to this, surrendering of foreign exchange to RBI is no more obligatory on banks. RBI also had shifted to market determined rates based on demand and supply for exchanging foreign currency.

With the introduction of FEMA in 2000, the RBI's directions are more obligatory on banks. Authorised persons have been delegated considerable powers relating to various foreign exchange transactions including remittances, overseas. Due to India's significant reliance on capital flows, which are often large,

bulk demand for oil imports and bunching up of government payments, along with international political and economic developments, the forex market becomes susceptible to bouts of volatility. Under these circumstances, as a matter of policy RBI intervenes in the market along with monetary and administrative measures to stabilize the exchange rate of Rupee.

The main objective of exchange rate management by RBI is to ensure that exchange rate of Indian rupee reflects the strong economic fundamentals of the country. Additionally, maintenance of external value of Indian Rupee is guided by three major objectives: "first, to reduce excess volatility in exchange rates, while ensuring that the market functions in an orderly fashion; second, to help maintain an adequate level of foreign exchange reserves, and; third, to facilitate the development of a healthy foreign exchange market."

(ix) Collection and furnishing of Credit Information

Section 45(B) of the RBI Act, empowers the RBI to collect credit information regarding borrowers from banks and under Section 45(D) to furnish the same to other banks against request in writing and payment of a nominal fee. The term Credit information includes:

i. the amounts and the nature of loans or advances and other credit facilities granted,

ii. the nature of security taken from any borrower for credit facilities granted,

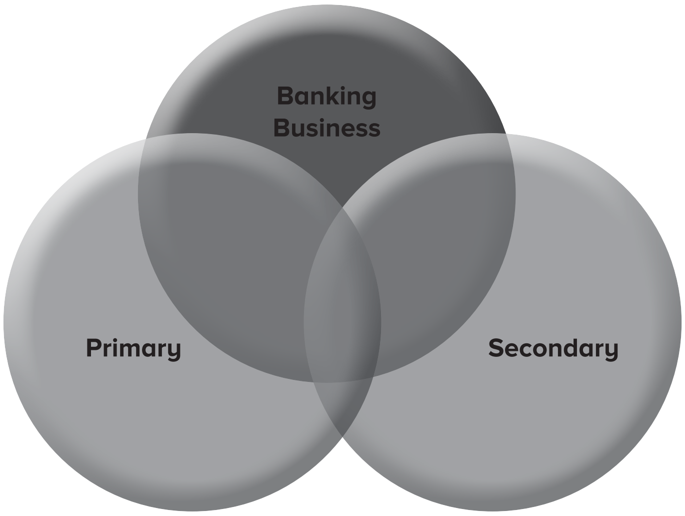
iii. the guarantee furnished by a bank for any of its customers,

iv. the means, antecedents, history of financial transactions and the credit worthiness of any borrower,

v. any other information which the Bank may consider to be relevant for the more orderly regulation of credit or credit policy.

Business of Banking

The business of banking is broadly defined by section 5 & 6 section of Banking Regulation Act. They can be classified as Primary and Secondary functions. These are as follows:



Primary

- Accepting of deposits.
- Lending and investment.

Secondary

The following forms of business in which banking companies may engage are as follows:

i. The borrowing, lending or advancing of money either upon or without security;

ii. The drawing, making, accepting, discounting, buying, selling, collecting and dealing in negotiable instruments and quasi negotiable instruments;

iii. Issuing of letters of credit, traveller's cheques and circular notes;

iv. The buying, selling and dealing in bullion and specie;

v. The buying and selling of foreign exchange including foreign bank notes;

vi. The acquiring, holding, issuing on commission, underwriting and dealingin stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds;

vii. Purchasing and selling of securities and bonds or other forms of securities on behalf of constituents or others, the negotiating of loans and advances;

viii. The receiving of all kinds of bonds, scrips or valuables on deposit or for safe custody or otherwise the providing of safe deposit vaults;

ix. The collecting and transmitting of money and securities.

Agency Business

i. Acting as agents for any Government or local authority or any other person or persons; the carrying on of agency business of any description excluding the business of a Managing Agent or Secretary and Treasurer of a company;

ii. Contracting for public and private loans and negotiating and issuing the same;

iii. Indulging in Merchant banking activities and the lending of money for the purpose of any such issue;

iv. Carrying on and transacting every kind of guarantee and indemnity business;

v. Managing, selling and realising any property which may come into the possession of the banking company in satisfaction or part satisfaction of any of its claims;

vi. Acquiring, holding and generally dealing with any property or any right, title or interest in any such property which may form the security or part of the security for any loans or advances or which may be connected with any such security;

vii. Undertaking and executing trusts;

viii. Undertaking the administration of estates as executor, trustee or otherwise;

ix. Establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company or the dependents or connections of such persons;

x. Granting pensions and allowances and making payments towards insurance; subscribingto or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;

xi. The acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;

xii. Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

xiii. Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this sub- section;

xiv. Doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company;

xv. Any other form of business which the Central Government may, specify for a banking company.

   a. In pursuance of the powers available, the Central Government has permitted banking companies to engage either departmentally or through subsidiaries in Mutual Funds, Locker services,

   b. Housing finance, Life and General Insurance (Bancassurance), Credit Card Services, Wealth management, Factoring, Forfaiting, Demat Services etc.

   c. A banking company cannot engage in any form of business other than those referred to in sub-section of Section 6 of the Banking Regulation Act.

   d. In addition to the above, a Banking company cannot appoint managing agents or employ a person who is an adjudicated insolvent or a person convicted by a court of moral turpitude.

Government as a Regulator of Banks

Directly or indirectly under the RBI Act, 1934 as well as The Banking Regulation Act, 1949, the Government of India, enjoys extensive powers in the banking domain in India. This is primarily due to the following:

i. The Government of India is the owner of RBI as it holds the entire share capital of RBI.

ii. Power to appoint Governor and the Board members of the Central Board, as also removing them is vested in the Government.

iii. Wherever necessary Government has powers to issue special directions to banks in consultation with RBI.

iv. The Government also enjoys the status of appellate jurisdiction vis-à-vis RBI in the matters of removal of managerial persons, cancellation of banking licence, refusal of issuance of certificate regarding floating charge on assets.

v. Besides these, the Government has powers to suspend the operation of the BR Act, 1949 or grant exemption from the applicability of the provisions of the same on the basis of recommendations of RBI.

vi. The Government has power to determine the forms of business a banking company can do under Sec. 6(1) of the BR Act.

vii. Powers to make rules under Section 52 and 45 Y reside with the Government.

viii. The Government also enjoys numerous powers for permitting formation of subsidiary for some business activities, notifying banks for maintenance of assets under Section 24, with reference to accounts and balance sheet, direction for inspection of banks, acquire undertakings, appointment of court liquidator, suspension of business, amalgamation of banks etc.

The Government being the majority share holder in case of SBI, Public Sector Banks etc. also enjoys statutory powers granted under such statues.

Regulation by other Authorities

Apart from RBI, the banking companies come under regulatory jurisdiction of the following Authorities, during the course of business conducted by themselves or through subsidiaries. Major regulators are listed and list is not exhaustive.

S. No.	Function/Reasons	Regulatory Authorities
1	Incorporation as a corporate body/cooperative body/ entity with Registered office	Registrar of Companies/Registrar of Cooperatives (State & Central)
2	Profit earning entities through services provided to customers	Income Tax authorities/ GST Authorities
3	Employing large number of personnel	Labour law authorities/Employment Exchanges.
4	Having a place of business/branch	Local bodies such as Municipal Authorities/ Nagar 'panchayats' etc
5	Offering Equity participation to public/ providing Demat accounts to customers /Merchant banking	Securities Exchange Board of India
6	Offering bancassurance products	Insurance Regulation and Development Authority
7	Housing Finance subsidiaries	NHB
8	Overseas subsidiaries	Host country Regulators/ supervisors
9	ADR/GDR issued by Indian banks	Respective country's capital market authorities like Security Exchange Commission

REGULATION OF PAYMENT SYSTEMS

As on date payment system in India consist of pre-paid payment instruments, card schemes, cross-border in-bound money transfers, Automated Teller Machine (ATM) networks and centralised clearing arrangements. Till the Payment and Settlement Systems Act, 2007 (PSS Act) was legislated, RBI was managing the same with powers available under the Section 58 of RBI Act, 1949 that as well as Section 35A of BR Act, 1949. Section 58 itself was introduced after the Information Technology Act, 2000 was enacted. As per the PSS Act only RBI has the power to commence or operate a payment system in India unless any other entity authorised by RBI.

The Reserve Bank of India had constituted a Committee in June 2019 under the Chairmanship of the Chief Executive, Indian Banks' Association to review the entire gamut of Automated Teller Machine (ATM) charges and fees with particular focus on interchange structure for ATM transactions. The recommendations of the Committee have been comprehensively examined. It is also observed that the last change in interchange fee structure for ATM transactions was in August 2012, while the charges payable by customers were last revised in August 2014. A substantial time has thus elapsed since these fees were last changed. Accordingly, given the increasing cost of ATM deployment and expenses towards ATM maintenance incurred by banks / white label ATM operators, as also considering the need to balance expectations of stakeholder entities and customer convenience, RBI has decided to revise the charges.

INTERNET BANKING GUIDELINES

In the year 2001 the RBI had issued guidelines in respect of internet banking based on recommendations of a Working Group on Internet Banking. The recommendations of the group were accepted by RBI and it had issued guidelines to banks based on the same. The guidelines cover broad areas of the following Information Technology and Security Standards, Legal issues and Regulatory and Supervisory issues. A brief of over view of the same is given under:

Technology & security issues

Banks should :

a. Designate a network and database administrator with clearly defined roles.

b. Have a Board of Directors approved security policy. Segregate duties of Security Officer / Information system security and information Technology division. Information Systems Auditor will audit the information systems.

c. Introduce logical access controls to data, systems, application software, utilities, telecommunication lines, libraries, system software, etc. These may include user-ids, passwords, smart cards or other biometric technologies.

d. Use the proxy server type of firewall so that there is no direct connection between the Internet and the banks system. Install inspection firewall that include security alert.

e. Ensure all the systems supporting dial up services through modem on the same LAN as the application server should be isolated.

f. Use the following alternatives system during the transition, until the Public Key Infrastructure is put in place:

   - Make use of SSL (Secured Socket Layer),
   - Use of at least 128-bit SSL for securing browser to web server communications and, in addition, encryption of sensitive data like passwords in transit within the enterprise.

g. Disable all unnecessary services on the application server such as FTP (File Transfer Protocol), telnet etc. isolate application server from the e-mail server.

h. Maintain proper log of computer accesses, including messages received; reports of security violations (suspected or attempted) and follow up action taken; acquire tools for monitoring systems and the networks against intrusions and attacks; educate their security personnel and also the end-users on an ongoing basis.

i. Undertake periodic penetration tests of the system, which should include:
   - Attempting to guess passwords using password-cracking tools.
   - Search for back door traps in the programs.
   - Attempt to overload the system using DDoS (Distributed Denial of Service) & DoS (Denial of Service) attacks.

j. Check if commonly known holes in the software, the browser and the e-mail software exist.

k. Carry out penetration testing by engaging outside experts.

l. Enforce access controls against internal and external threats. Have proper infrastructure and schedules for backing up data and test the same periodically. Business continuity should be ensured by setting up disaster recovery sites. These facilities should also be tested periodically.

m. Have proper record keeping of all applications for legal purposes. It is necessary to keep all received and sent messages both in encrypted and decrypted form.

n. Test security infrastructure properly before using the systems and applications for normal operations; upgrade the systems by installing patches released by developers to remove bugs and loopholes, and upgrade to newer versions which give better security and control.

REGULATION OF MONEY MARKET INSTRUMENTS

RBI regulates money market in India vide powers vested in it by virtue of Sections 45K, 45L and 45W of the RBI Act 1934. The money market is a part of overall financial markets in India. The other components of financial markets include Capital market, Debt Markets and Foreign exchange markets. The money market is a market where instruments of short term duration (up to one year) are dealt in. The instruments which are traded in the money market consist of the following:

- Call/Notice Money
- Commercial Paper
- Certificates of Deposit and
- Non-Convertible Debentures (original maturity up to one year)

One of the significant features of money market is, these instruments offer better liquidity i.e. they can be converted into cash in a very short time and the cost of transactions is low as compared to capital/foreign exchange/debt markets.

RBI regulates the money market through the following ways:

i. Specifying market players and their eligibility for different products

ii. Setting prudential limits for overall transactions

iii. Setting up of Self-regulatory bodies

iv. Setting up of support systems for dealings and settlements

(i) Call / Notice money market

This is an important market for banks as they are predominant participants. Therefore it is also known as inter-bank call money market as majority of the transactions take place only between banks. Under call money market, funds are lent overnight basis.

In the notice money market, funds are lent for a period between 2 to 14 days. The permitted participants in this market are - Scheduled commercial banks (excluding RRBs), Co-operative banks (other than Land Development Banks) and Primary Dealers (PDs) both as borrowers and lenders. Primary Dealers are legal entities (NBFCs) who are registered and licensed by RBI to deal in government securities. They purchase government securities from RBI whenever there is an issue and resell the same to eligible buyers. Thus they create a market for government securities.

The prudential limits for lending and borrowing in call/notice money markets by various players are as follows:

Sr. No.	Participant Category	Prudential Limit
1	Scheduled Commercial Banks (including Small Finance Banks)	**Call and Notice Money:** (i) 100% of capital funds, on a daily average basis in a reporting fortnight, and (ii) 125% of capital funds on any given day.
		Term Money: (i) Internal board approved limit within the prudential limits for inter- bank liabilities.
2	Payment Banks and Regional Rural Banks	**Call, Notice and Term Money:** (i) 100% of capital funds, on a daily average basis in a reporting fortnight, and (ii) 125% of capital funds on any given day.
3	Co-operative Banks	**Call, Notice and Term Money:** (i) 2.0% of aggregate deposits as at the end of the previous financial year.
4	Primary Dealers	**Call and Notice Money:** (i) 225% of Net Owned Fund (NOF) as at the end of the previous financial year on a daily average basis in a reporting fortnight. **Term Money:** (i) 225% of Net Owned Fund (NOF) as at the end of the previous financial year.

Banks/PDs/ Co-operative banks have to inform their Board approved prudential limits (as above) to Clearing Corporation of India Ltd. (CCIL) for setting of limits in Negotiated Dealing Settlement -CALL System, under advice to Financial Markets Regulation Department (FMRD), Reserve Bank of India. No non-banking institution other than PDs is allowed to participate in call/notice money market.

Interest rates are left to individual participants to decide. However they have to follow procedures prescribed by the Fixed Income Money Market Dealers Association (FIMMDA) in calculation of interest and documentation. RBI's guidelines on timings, settlement method and reporting of transaction are also to be followed.

RBI vide its circular dated October 29, 2018 has permitted Payments Bank and Small Finance Banks– access to Call/Notice/Term Money Market as under – It is clarified that Payments Banks and Small Finance Banks are eligible to participate in the Call/Notice/Term money market (hereafter referred to as Call money market) both as borrowers and lenders. Such eligibility is valid even prior to the completion of the process to get themselves included in the Second Schedule of Reserve Bank of India Act, 1934.

The prudential limits and other guidelines on Call money market for Payments Banks and Small Finance Banks will be the same as those applicable to Scheduled Commercial Banks in terms of the Master Direction referred above.

These Directions have been issued by RBI in exercise of the powers conferred under section 45W of the Reserve Bank of India Act, 1934 and of all the powers enabling it in this behalf.

(ii) Commercial Paper (CP)

It is an unsecured money market instrument issued in the form of a promissory note introduced in the year 1990 to enable highly rated corporates to borrow on short-term basis. It also serves as a additional money market instrument for investment. Later Primary Dealers (PDs) and All-India Financial Institutions (AIFIs) were also permitted to issue CP to borrow funds for meeting their short-term commitments. Companies, PDs, AIFIs are permitted to issue CPs.

A company can issue CP subject to satisfying following conditions:

i. the tangible net worth of the company, as per the latest audited balance sheet, is not less than Rs.4 crore;

ii. the company has been sanctioned working capital limit by bank/s or FIs; and

iii. the borrowal account of the company is classified as a Standard Asset by the financing bank/institution.

(iii) Certificate of Deposits (CDs)

Certificate of Deposit (CD) is one of the money market instruments in the form of a negotiable usance promissory note. It is issued at a discount to face value either in dematerialised form or as a Usance Promissory Note, against funds deposited by an investor with a bank or other eligible financial institution for a specified time period.

CDs are issued by scheduled commercial banks {excluding Regional Rural Banks and Local Area Banks} and select AIFIs as per RBI directions. The quantum of CD issue by a bank will depend on its funds requirements as well as the umbrella limit fixed by RBI's Department of Banking Regulation.

Minimum amount of CD issue will be for a face value of Rs. 1 lac to an investor and it will be issued in multiples of Rs. 1 lac. CDs can be issued to individuals, corporations, companies (including banks and PDs), trusts, funds, associations, etc. Non-Resident Indians (NRIs), can subscribe to CDs on non-repatriable basis only.

Such CDs cannot be transferred to another NRI in the secondary market. CDs can be issued between 7 days and not exceeding one year, from the date of issue. AIFIs can issue CDs for a minimum period of 1 year and a maximum of 3 years, from the date of issue.

Banks / FIs are also allowed to issue CDs on floating rate of interest basis, subject to their disclosing the method of compiling floating rate in a transparent manner. Banks are allowed freedom to determine the rate of interest on CDs issued by them. The floating rate would have to be reset periodically as per changes in pre-decided bench mark rate and the same need be disclosed in a transparent manner.

CRR and SLR are to be maintained on CDs too by banks. CDs are transferable between different holders and there is no lock-in-period applicable in their case. Trading and settlement are to be executed as per RBI's directions in this regard. No loans can be granted against CDs and banks cannot buy back these CDs before maturity.

Normally CDs are to be issued in Demat form. If any investor insists the same in physical form, the same can be issued with permission of RBI. Physical form will attract stamp duty.

If the maturity date of CD happens to be a holiday then it falls due on the immediate preceding working day.

There is no grace period in the repayment CDs. Banks are required to follow the procedure outlined by RBI in respect of redemption of CDs both in physical and demat forms. Issuing banks are required to follow RBI guidelines in respect of issuing of duplicate certificate, accounting, documentation as well as reporting in this regard.

(iv) Non-convertible debentures of original or initial maturity up to one year

These are debt instruments of original maturity period of one year, issued by companies incorporated under Companies Act (including NBFCs) by way of private placement.

The eligibility for issuance of NCDs is the same as applicable in respect of CP issue (except in case of NBFCs including PDs, in respect of net worth). Companies desirous issuing NCDs should get themselves rated by a credit rating agency approved by SEBI. They should have secured a minimum rating of A2 as defined by SEBI in this respect. The credit rating should be current at the time of issuance of NCD and should not have fallen due for review. NCDs should have a minimum maturity period of 90 days from the date of issuance. Its maximum tenor cannot exceed the validity period of its credit rating. If there is a put/call option, it shall not fall due within 90 days from the date of issue of NCDs. NCDs can be issued with a minimum denomination of Rs. 5 lacs (face value) and in multiples of Rs. 1 lac thereof.

The quantum of NCD to be issued will be as decided by the Board of Directors of the company or as indicated by the credit rating agency for the rating given whichever is less. The total issue amount of NCD will have to be raised within a period of two weeks from the date of opening of the NCD issue. All provisions as applicable under the Companies Act, SEBI guidelines on issue and listing should be followed. A certificate from Auditors regarding compliance of eligibility conditions, proper disclosures regarding financial position of the company should be obtained. NCD can be issued at face value carrying an interest rate or at a discount to the face value as decided by the company and it should be issued within the time limit as permitted under the Companies Act. For every issue of NCD, the company should appoint a SEBI registered Debenture Trustee (DT) who will submit periodical information to RBI as per its directions. NCDs may be subscribed by individuals, banks, Primary Dealers (PDs), other corporate bodies including insurance companies and mutual funds registered or incorporated in India and unincorporated bodies, Non-Resident Indians (NRIs) and Foreign Institutional Investors (FIIs). Banks and PDs will invest in NCDs up to the limit as per legal provisions applicable from time to time. Investment by FII will be subject to FEMA rules and regulations including limits up to which they can invest.

Issuer companies, DTs and Credit Rating Agencies should follow applicable guidelines issued by the respective regulatory authorities. Companies should use the disclosure document format issued by FIMMDA for NCD issued. Any non- compliance with RBI directions will be penalized including debarring such companies from NCD market.

CASE LAWS

10.01.2020	*Anuradha Bhasin and Ors. (Petitioner) vs. Union of India (UOI) and Ors. (Respondent)*	Supreme Court of India

Journalists are to be accommodated in reporting and there is no justification for allowing a sword of Damocles to hang over the press indefinitely

Facts of the Case :

The issue starts with the security advisory issued by the Civil Secretariat, Home Department, Government of Jammu and Kashmir stating to cut short their stay and make their safe arrangements to go back. Subsequently, educational institutions and offices were also shut down until further orders. On August 4, 2019 internet services, mobile connectivity and landline were shut down until further orders. On August 5, 2019, the Constitutional Order No. 272 was passed by the President of India applying all provisions of the Constitution of India to Jammu and Kashmir and stripped it from special status enjoyed since 1954. On the same day, due to prevailing circumstances, the District Magistrate passed the order restricting the movement and public gathering, apprehending breach of peace and tranquility under Section 144 of CrPC. Due to this, journalist movements were restricted and this was challenged under Article 19 of the Constitution which guarantees freedom of speech and expression and freedom to carry any trade or occupation. In this context, in the Supreme Court, legality of internet shutdown and movement restrictions are challenged under Article 32 of the Constitution.

Judgement :

In it was observed that widening of the 'Chilling Effect Doctrine' has always been viewed with judicial scepticism. In this context, one possible test of chilling effect is comparative harm. In this framework, the Court is required to see whether the impugned restrictions, due to their broad-based nature, have had a restrictive effect on similarly placed individuals during the period. It is the contention of the Petitioner that she was not able to publish her newspaper from 06-08-2019 to 11-10-2019. However, no evidence was put forth to establish that such other individuals were also restricted in publishing newspapers in the area. Without such evidence having been placed on record, it would be impossible to distinguish a legitimate claim of chilling effect from a mere emotive argument for a self-serving purpose. Journalists are to be accommodated in reporting and there is no justification for allowing a sword of Damocles to hang over the press indefinitely.

LESSON ROUND-UP

- The Reserve Bank of India Act, 1934 was enacted with a view to constitute RBI to regulate issue of bank notes and to control monetary and banking system.
- Banking Regulation Act, 1949 came into the picture which played a very important role in controlling the banking sector & the activities related to it.
- Through the RBI Act, 1934 the role of issuance of notes was allotted to RBI in order to bring in a stability in the economy of India.
- The constitution of RBI started with an initial capital of Rs. 5 crores which is wholly owned by Government of India from 1st Jan 1949, prior to which it was owned by public shareholders.
- Through different quantitative & qualitative measures, the RBI manages monetary stability and plays a critical role to monitor Indian banking system.
- The objectives of RBI are: i) to regulate the issue of Bank notes. ii) To keep reserves with a view to securing monetary stability in India iii) to operate the currency and credit system of the country to its advantage iv) To operate the monetary policy for maintaining price stability while keeping in mind objective of growth.
- Banking Regulation Act, 1949 provides detailed provisions on acceptance of deposits and nomination facilities.
- RBI has come up with different rules regarding issuance of card products.
- In order to settle down customer complaints against different commercial banks, RBI has come up with the Banking Ombudsman Scheme.
- In order to make effective control of the monetary system, RBI uses different tools like Bank rate, SLR, CRR etc.
- RBI uses selective credit controls to channelize the flow of credit to desired sectors and to restrict the flow of credit to sensitive sectors.
- The Government of India through various Acts, Regulations etc. (including Regulations of Self-Regulatory Bodies, e.g. SEBI) regulates different aspects of Banking Business.

GLOSSARY

Monetary Policy Committee ('MPC'): a committee of the Reserve Bank of India that is responsible for fixing the benchmark interest rate in India.

Liquidity Adjustment Facility ('LAF'): is a monetary policy tool which allows banks to borrow money through repurchase agreements.

Marginal Standing Facility ('MSF'): is the rate at which the banks are able to borrow overnight funds from RBI against the approved government securities.

Open Market Operations ('OMO's): refer to the buying and selling of government securities in the open market in order to expand or contract the amount of money in the banking system.

Market Stabilization Scheme (MSS): a monetary policy intervention by RBI to withdraw excess liquidity or money supply by selling government securities in the economy.

Automated Teller Machine (ATM): a machine that dispenses cash or performs other banking services when an account holder inserts a bank card.

Payment and Settlement Systems Act, 2007 ('PSS Act'): provides for the regulation and supervision of payment systems in India and designates the Reserve Bank of India (Reserve Bank) as the authority for that purpose and all related matters.

Foreign Exchange Management Act, 1999 (FEMA): This is an Act of the Parliament of India "to consolidate and amend the law relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange market in India.

Repo: Providing funds by RBI against collateral of government and approved securities for short duration periods to banks against Re-purchase option of such securities by borrowing banks.

Reverse Repo: Borrowing by Reserve Bank of India, on an overnight basis, from banks against the collateral of eligible government securities.

Repo Rate: is the rate at which the central bank of a country (Reserve Bank of India in case of India) lends money to commercial banks in the event of any shortfall of funds.

Reverse Repo Rate: The (fixed) interest rate at which the Reserve Bank absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities.

Statutory Liquidity Ratio: is the Indian government term for the reserve requirement that the commercial banks in India are required to maintain in the form of cash, gold reserves, government approved securities before providing credit to the customers.

Cash Reserve Ratio (CRR): is a specified minimum fraction of the total deposits of customers, which commercial banks have to hold as reserves either in cash or as deposits with the central bank.

Department of Currency Management ('DCM'): has the responsibility of administering the functions of currency management.

Regional Rural Banks ('RRB's): are scheduled banks(Government banks) operating at regional level in different States of India.

TEST YOURSELF

(*These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation*.)

1. Discuss the constitution of RBI.
2. How does RBI manage Issue of currency and distribution of coins.
3. What are the various credit control measures of RBI?
4. Discuss various tools of monetary controls used by RBI.
5. What are the various powers of RBI under Banking Regulation Act?
6. How does RBI control Cooperative banks in India?

Control over Organization of Banks

Lesson 3

KEY CONCEPTS

■ Paid Capital ■ Corporate Governance ■ Point of Sale (PoS) ■ Cash Deposit Machines ■ Foreign Direct Investment

Learning Objectives

To understand:

- Powers of Reserve Bank of India
- Licensing policy of
  – various banks
  – branches of various banks
- Paid Capital and Reserves stipulated for different banks
- Shareholding in Banking Companies and its restrictions
- Setting up of Subsidiaries of Banking Companies
- Board of Directors in Banking Companies
- Control over Management, Directors and other officials of banks
- Corporate Governance aspects of banks in India

Lesson Outline

REGULATORY FRAMEWORK

- Reserve Bank of India, 1934
- Banking Regulation Act, 1949
- Companies Act, 2013
- Deposit Insurance & Credit Guarantee Corporation Act, 1961
- Foreign Exchange Management Act, 1999
- Payment & Settlement System Act, 2007

INTRODUCTION

The Reserve Bank of India (RBI) exercises control over banks through the power conferred on it by the Banking Regulation Act, 1949 (B R Act). There are restrictions at the entry point by way of licensing and then the requirement of permission for opening or shifting of branches.

To commence and operate banking business in India, every banking company needs a licence in terms of Section 22 of the Banking Regulation Act, 1949. Before issuing a licence, the applicant company needs to satisfy RBI about the fulfillment of following conditions:

(i) The company has adequate financial strength or will have strength to pay its present or future depositors in full as and when their claims arise;

(ii) That the company has adequate capital structure and earning prospects;

(iii) The potential scope for expansion of banks is there in the area;

(iv) That the affairs of the company are not and will not be detrimental to the interests of its present or future depositors;

(v) That the character of the management of the applicant bank will not be prejudicial to the public interest or the interest of its depositors;

(vi) that the public interest will be served by the grant of a licence to the company to carry on banking business in India;

At the time of commencement of Banking Regulation Act, 1949 existing banks at that juncture were required to apply for a licence within six months. They were allowed to continue till their application was rejected. One of the objectives behind licensing was to discourage banks which were operating not on sound lines and also indiscriminate formation of banks.

POWERS OF RBI

Reserve Bank derives extensive powers under RBI Act as well as Banking Regulation Act, to regulate and supervise various banks in India.

Under Banking Regulation Act the RBI enjoys the following powers:

Section 10 BB - Power of Reserve Bank to appoint Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of a banking company.

Where the office of the Chairman of the Board of Directors appointed on a whole-time basis or a Managing Director of a banking company is vacant, the Reserve Bank may, if in its opinion that the continuation of such vacancy is likely to adversely affect the interests of the banking company, appoint a person as Chairman of the Board of Directors or a Managing Director of the banking company.

Section 21 - Power of Reserve Bank to control advances by banking companies: Reserve Bank has the powers to determine policies and direct banking companies to follow the same.

Section 22 - Licensing of banking companies: All Banking companies need to get a licence from RBI and it issues licence only after 'tests of entry' are fulfilled.

Section 24A - Power to exempt a Co-operative bank: Without prejudice to the provisions of section 53, the RBI by notification in the Official Gazette, declare that, the whole or any part of the provisions of section 18 or section 24, as may be specified therein, shall not apply to any co-operative bank.

Section 27 - Monthly returns and power to call for other returns and information: At any time, the RBI may direct a banking company to furnish it with such statements and information relating to the business or affairs of the banking company (including any business or affairs with which such banking company is concerned) as RBI may consider necessary or expedient to obtain for the purposes of this Act, apart from calling for information every half-year regarding the investments of a banking company and the classification of its advances in respect of industry, commerce and agriculture.

Section 29A - Power in respect of Associate Enterprises: The RBI may direct a banking company to annex to its financial statements or furnish to it separately, within such time or intervals, necessary statements and information relating to the business or affairs of any associate enterprise of the banking company. It can also conduct an inspection of any associate enterprise of a banking company and its books of account jointly by one or more of its officers or employees or other persons along with the Board or authority regulating such associate enterprise.

Section 30 – Power to order Special Audit: In the public interest or in the interest of the banking company or its depositors, the RBI may at any time by order direct that a special audit of the banking company's accounts.

Section 35 - Inspection of Banking Companies: Reserve Bank on its own or being directed so to do by the Central Government, inspect any banking company and its books and accounts and supply to the banking company a copy of its report on such inspection.

Section 35A - Power of the Reserve Bank to give directions: In the public interest or in the interest of Banking policy RBI has powers to issue, modify or cancel as it deems fit, and the banking companies or the banking company, are bound to comply with such directions.

Section 35AA: Power to Central Government: To, authorise RBI to issue directions to any banking company or banking companies to initiate insolvency resolution process in respect of a default, under the provisions of the Insolvency and Bankruptcy Code, 2016.

Section 35AB. (1) Power to RBI: To issue directions to any banking company or banking companies for resolution of stressed assets. (2) Power to RBI to specify one or more authorities or committees with such members as the Reserve Bank may appoint or approve for appointment to advise any banking company or banking companies on resolution of stressed assets.'

Section 36 - Further powers and functions of Reserve Bank: RBI may caution or prohibit banking companies or any banking company in particular against entering into any particular transaction or class of transactions.

- On a request by the companies concerned and subject to the provision of section 44A, assist, in theamalgamation of such banking companies.
- Give assistance to any banking company by means of a loan or advance in terms of section 18 of the RBI Act.
- Direct the banking company to
  - call for a meeting of Directors
  - discuss such matters with Officers of RBI
  - depute an officer to such meeting, appoint observers to such meetings
  - furnish information of such meetings
  - make changes in management.

In addition to the above the RBI has also been vested with powers to remove managerial and other persons from office (section 36AA), to appoint additional Directors (section 36AB), to issue directions in respect of stressed assets (Section 35AB), Supersede Board of Directors in certain cases (Section 36ACA), Supersede Board of Directors of a multi-State Co-operative bank (Section 36AAA) and also to impose penalty (Section 47).

In addition to the above, RBI also enjoys certain powers vis-a-vis banks under RBI Act as per the following table-

S. No.	Power	Section
1	Power of direct discount.	18
2	Power to require returns from co-operative banks.	44
3	Power to collect credit information.	45B
4	Power to call for returns containing credit information	45C
5	Power to determine policy and issue directions	45JA
6	Power to call for information from financial institutions and to give directions.	45L
7	Power to regulate transactions in derivatives (excluding capital market derivatives), money market instruments	45W
8	Power of Bank to depute its employees to other institutions	54AA
9	Power of the (RBI's) Central Board to make regulations.	58

Note : The following amendments were inserted in the RBI Act in August 2019: 45 IA – Amendment. Increasing the quantum of Net owned funds of a NBFC, 45-ID – (Insertion) Power of RBI to remove directors of an NBFC from office, 45 IE – (Insertion) Supersession of Board of directors of NBFC (other than Government Company), 45MAA - Power to take action against auditors, '45MBA - Resolution of non-banking financial company, 45NAA – Power in respect of group companies, 58B – (Amendment) Increase in Penalties for Noncompliance and 58G – (Amendment) Increase in Penalties for Non-compliance by NBFCs.

ISSUING OF LICENSE

Issuing Licenses to an applicant bank is at the discretion of RBI. Before a licence is issued RBI satisfies itself regarding the 'Tests of entry' namely :

Issuing of License

- Information about back ground, credentials of promoters
- Funding aspects of capital
- Sources of such funds
- Background of key supporting professionals
- Geographical coverage of the proposed bank
- Business and economical activity to be financed
- Profitability aspects
- Public interest

RBI may also scrutinize the books of accounts of the applicant company and also gather market information to satisfy itself about the advisability of granting a licence.

Section 11(2) & Section 11(3) of Banking Regulation Act, 1949 specifies a minimum capital and reserves for a foreign bank, local banks operating in more than one state and in one state. RBI has powers to specify a higher amount of paid up capital for the purpose of licensing.

Refusal of license by RBI

The granting of licence by the Reserve Bank of India may be subject to such conditions as the RBI may think fit in each case. The granting of licence or refusal of RBI, if based on relevant material and germane consideration, cannot be challenged in a court of law. In the matter of Shivabhai Zaverbhai Patel vs. RBI AIR 1986 Guj. 19; (1985) 1 GLR 257, Hon'ble High Court of Gujarat upheld the RBI's decision of rejection of application for a banking licence which was based on diligent study and material facts.

Licensing of Foreign Banks in India

Foreign banks wishing to open a branch in India require a licence under the Banking Regulation Act, 1949. In some countries there is a requirement of multiple licences for dealing in local currency and foreign currencies with different categories of clientele. Like domestic banks foreign banks enjoy similar facilities to the payments and settlement systems and they are admitted as full members of clearing houses and payments system.

Procedurally, foreign banks are required to apply to RBI for opening their branches in India. Foreign banks' application for opening their maiden branch is considered under the provisions of Section 22 of the Banking Regulation Act, 1949. Before granting any licence under this section, RBI may require to be satisfied that the Government or the law of the country in which it is incorporated does not discriminate in any way against banks from India. Other conditions as enumerated in section 2(5) of the Banking Regulation Act, 1949 are also required to be fulfilled.

Unlike the restrictive practices of certain foreign countries, India is liberal in respect of the licensing andoperation of the foreign bank branches as illustrated by the following:

- India issues a single class of banking licence to foreign banks and does not place any limitations on their operations. All banks can carry on both retail and wholesale banking.
- Deposit insurance cover is uniformly available to all foreign banks operating in India at a non- discriminatory rate of premium.
- The norms for capital adequacy, income recognition and asset classification are by and large the same.
- Other prudential norms such as exposure limits are the same as those applicable to Indian banks.

Licencing of Private Sector Banks in India

Prior to 1993 licensing of Private Sector banks were done in a routine way under Section 22 of the Banking Regulation Act, 1949. In the year 1993 the RBI has announced a new set of guidelines as a part of economic liberalization in that year and a few in the subsequent years. In 2001 the RBI had revised the guidelines for licensing Private Sector banks in India and two more banks namely Kotak Bank and Yes Bank were issued licences. The policy was known as 'Stop and Go'. In February 2013, a need was felt for reviewing of the licensing of banks under 'Stop and Go' in view of emerging scenarios in International banking and Indian banking, and also in the light of recommendations of Raghuram G. Rajan Committee and other points of view, RBI decided to have an explicit policy on banking structure. After due deliberations, existing *'Stop and Go'* licensing policy was reviewed and in its place a *'continuous authorization [or on tap]'* policy was announced with effect from August 1, 2016, with a view to increase the level of competition and bring new ideas into the system. There are totally 21 private sector banks in India.

Licensing of Local Area Banks

In the year 1996 the RBI decided to allow Local Area Bank (LABs) to be set up in the private sector for bridging gaps as well enhance credit availability in the rural and semi-urban areas in the country to provide competitive financial intermediation.

Minimum start-up capital of a Local Area Bank was stipulated at Rs.5 crore which should be brought upfront. A family among the promoter group was permitted to hold not more than 40% of the capital. Non-Resident Indians were also allowed to contribute a maximum equity of 40% of the paid-up capital. A lock-in-period of 3 years was fixed for capital contributed by promoters (including their friends and relatives/associates) from the date of licensing of the bank. Promoter's capital is to be locked up for further period of 2 years beyond the initial period of 3 years subject to a review before expiry of five years from the date of licensing of the bank.

A LAB has to be registered as a public limited company under the Companies Act, 2013 to get licensed under the Banking Regulation Act, 1949 and would be eligible for inclusion in the Second Schedule of the RBI Act, 1934. As per the procedure followed, RBI initially grants an in-principle approval along with terms and conditions for setting up an LAB. Once these terms and conditions are fulfilled a licence is granted.

Small Finance Bank (SFB)

SFBs can be promoted by resident individuals/professionals with 10 years of experience in banking and finance as well as companies and societies owned and controlled by residents. Existing Non-Banking Finance Companies (NBFCs), Micro Finance Institutions (MFIs), and Local Area Banks (LABs) that are owned and controlled by residents are also permitted to convert themselves in to SFBs. Promoter/promoter groups should have a five year successful record of professional experience or of running their businesses are eligible to promote small finance banks.

The minimum paid-up equity capital for SFB should be Rs. 100 crore with a leverage ratio not less than 3 per cent, i.e., its outside liabilities should not exceed 33.33 times its net worth (paid-up capital and reserves). The promoter's minimum initial contribution has to be at least 40% of paid-up equity capital for the first five years from the commencement of its business and gradually brought down to 26 per cent within 12 years from the date of commencement of business of the bank. On 5th December 2019 Reserve Bank of India released on its website, "Guidelines for 'on tap' Licensing of Small Finance Banks in the Private Sector".

Major changes from the earlier Guidelines on Small Finance Banks dated November 27, 2014, are

(i) The licensing window will be open on-tap;

(ii) minimum paid-up voting equity capital / net worth requirement shall be Rs. 200 crore;

(iii) for Primary (Urban) Co-operative Banks (UCBs), desirous of voluntarily transiting into Small Finance Banks (SFBs) initial requirement of net worth shall be at Rs. 100 crore, which will have to be increased to Rs. 200 crore within five years from the date of commencement of business. Incidentally, the net-worth of all SFBs currently in operation is in excess of Rs, 200 crore;

(iv) SFBs will be given scheduled bank status immediately upon commencement of operations;

(v) SFBs will have general permission to open banking outlets from the date of commencement of operations;

(vi) Payments Banks can apply for conversion into SFB after five years of operations, if they are otherwise eligible as per these guidelines.

According to the clarification issued by RBI, the term 'paid-up equity capital' means 'paid-up voting equity capital'. Further, it has also been clarified by RBI, regarding cessation or exit of a promoter after completion of a period of five years, would depend on the RBI's regulatory and supervisory comfort / discomfort and SEBI regulations in this regard at that time. The foreign shareholding is allowed and would be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time. SFBs are subject to all prudential norms applicable to existing Commercial banks including CRR, SLR.

The small finance banks will be required to extend 75 per cent of its Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL) by the Reserve Bank. At least 50 per cent of its loan portfolio should constitute loans and advances of upto Rs. 25 lakh. If a SFB wants to convert in to a universal bank, it would be subject to fulfilling minimum paid-up capital / net worth requirement as applicable to universal banks, its track record of performance as a SFB and the RBI's due diligence exercise.

For granting of licenses an External Advisory Committee (EAC) comprising eminent professionals will evaluate the applications. On the basis of evaluation, RBI will issue an in-principle approval for setting up of a SFB or otherwise. RBI decision will be final. The in-principle approval issued by the Reserve Bank will be valid for eighteen months.

Payment Banks (PB)

A promoter/promoter group can have a joint venture with an existing scheduled commercial bank to set up a payments bank. Scheduled commercial banks can take equity stake as permitted under Section 19 (2) of the Banking Regulation Act, 1949. Promoter/promoter groups should be 'fit and proper' with a sound track record of professional experience or running their businesses for at least a period of five years in order to be eligible to promote payments banks.

Payment Banks can be promoted by:

(i) Existing non-bank Pre-paid Payment Instrument (PPI) issuers;

(ii) Individuals/professionals;

(iii) Non-Banking Financial Companies (NBFCs);

(iv) Corporate Business Correspondents(BCs);

(v) Mobile Telephone Companies;

(vi) Super-Market Chain;

(vii) Public Companies;

(viii) Real sector cooperatives; that are owned and controlled by residents; and

(ix) Public Sector Entities.

The capital requirements for obtaining Payment Bank License in India are as follows:

(i) The applicant company must have a minimum paid up equity of Rs. 100 crore to start payment in India;

(ii) In India, a payment bank is required to maintain a minimum CAR (Capital Adequacy Ratio) of 15 percent of its total RWA (Risk Weighted Assets). The same is subject to any such higher amount as specified by the RBI from time to time;

(iii) Tier I Capital needs to be at least 7.5 percent of the total Risk Weighted Assets;

(iv) Tier II Capital needs to be limited to a maximum of 100% of the whole Tier I Capital;

(v) A Payment Bank is not eligible to deal with sophisticated items. That means the Capital Adequacy Ratio (CAR) is identified based on the Basel Committee's Standardised approaches.

Following table depicts salient differences between Payment Banks and Small Finance Banks.

Payment Banks	Small Finance Banks
Payment Banks (PBs) can receive deposits and remittances but can not lend.	Small Finance Banks(SFBs) will lend to unserved and underserved sections including small business unit, micro and small industries and small and marginal farmers.
Deposits from a customer should not exceed Rs. 2 Lakh.	It can provide basic services of excepting deposits and lending.
Cannot give loans and cannot issue credit cards but can issue ATM/Debit Card.	No restriction of area of operation.
Can distribute non-risk financial products such as, Mutual Funds and Insurance Products.	Loan portfolio to the extent of 50% or more should constitute loans and advances of upto Rs. 25 Lakhs.

BRANCH LICENSING

Every company or entity wishing to commence or for carrying on an activity of banking, should obtain a licence under Section 22 of the Banking Regulation Act, 1949. In addition to this, in terms of Section 23 (1) (a), (b) of the Banking Regulation Act, 1949, RBI's permission is also needed for opening a new 'place of business' or changing of location of existing place of business. However if the change of location is within the same city, town or village such prior permission is not needed. Similarly a banking company incorporated in India, needs prior RBI permission to open a new place of business or change a place business (except when the change of place is within the same city, town or village) outside India. Place of business has been defined as "includes any sub-office, pay office, sub pay office and any place of business at which deposits are received, cheques cashed or moneys lent."

Where an existing place of business is there, a Bank may open a temporary place for business up to one month in an exhibition, mela, conference and similar occassion, no prior permission from RBI is required. The temporary facility has to be within limits of the city or town or village of the existing place of business.

Before granting any permission under this section, the RBI needs to be satisfied through inspection under Section 35 of the Banking Regulation Act, 1949 or otherwise, regarding financial condition, history of the company, the general character of its management, the adequacy of its capital structure and earning prospects and that public interest will be served by the opening or, change of location of the place of business.

If a banking company had failed to comply with any of the conditions imposed on it under this Section 23, the Reserve Bank of India Act, 1934 after giving a reasonable opportunity to the bank concerned, may revoke its permission in writing, granted earlier for opening a place of business.

Regional Rural Banks('RRB's) need to route their application for opening a place of business through NABARD, which will put its recommendation on the same and forward to RBI. RRBs also need to send an advance copy to RBI.

Revised Branch Licensing Policy of RBI

In tune with liberalization and banking reforms, RBI has over a period of time relaxed its norms for branch licensing. RBI has issued revised branch licensing policy covering branches and permissible methods of outreach bearing in mind attributes of various banks and the types of services that are dispensed.

General Permission

Domestic scheduled commercial banks (other than RRBs) are permitted to open, by RBI, 'Banking Outlets' in Tier 1 to Tier 6 centres (on the basis of population as per Census 2011), without prior permission in each case otherwise specifically restricted.

‘Banking outlet’ for a Domestic Scheduled Commercial Bank (‘DSCB’), a Small Finance Bank (‘SFB’) and a Payment Bank (‘PB’) is” a fixed point service delivery unit, manned by either bank’s staff or its Business Correspondent where services of acceptance of deposits, encashment of cheques/ cash withdrawal or lending of money are provided for a minimum of 4 hours per day for atleast five days a week.”

Such an outlet should carry the usual attributes of a place of business such as signage with name of the bank and authorisation from Head office, contact details of the controlling authorities and complaint escalation mechanism. It should be regularly monitored to ensure proper supervision, ‘uninterrupted service’ (except temporary interruptions due to telecom connectivity, etc.) and timely addressing of customer grievances. The working hours/days need to be displayed prominently.

Any fixed point service delivery unit of the bank which does not comply with the prescription regarding minimum working hours/days will be considered as a ‘Part-time Banking Outlet’.

Extension Counters, Satellite Offices, Part-shifted Branches, Ultra Small Branches and Specialised Branches, subject to their satisfying the definition mentioned above, are eligible to be treated as independent ‘Banking Outlets’ or ‘Part-time Banking Outlets’, as the case may be.

ATMs, E-lobbies, Bunch Note Acceptor Machines (BNAM), Cash Deposit Machines (CDM), E- Kiosks and Mobile Branches will not be treated as ‘Banking Outlets’.

Point of Sale (PoS) terminals where limited cash withdrawal facility is allowed by banks in terms of existing norms without having an arrangement with the concerned entities as ‘business correspondents’ will not be considered as ‘Banking Outlets’.

An Unbanked Rural Centre (URC) is defined as a rural (Tier 5 and 6) centre that does not have a CBS-enabled ‘Banking Outlet’ of a Scheduled Commercial Bank, a Payment Bank or a SFB or a Regional Rural Bank nor a branch of a Local Area Bank or licensed Co-operative Bank for carrying out customer based banking transactions.

This is however subject to following conditions given below:

At least 25 percent of the total number of ‘Banking Outlets’ opened during a financial year must be opened in an unbanked rural centres (Tier 5 and Tier 6).

Merger/Closure/ Shifting/Conversion of ‘Banking Outlets’

a. Banks having general permission are allowed to shift, merge or close all ‘Banking Outlets’ (except rural outlets and sole semi-urban outlets) at their discretion.

b. Merger, Closure and shifting of any rural ‘Banking Outlet’ as well as a sole semi urban ‘Banking Outlet’ would require approval of the DCC (District Consultative Committee)/DLRC (District Level Review Committee).

c. Conversion of any rural or sole semi-urban banking outlet into a full-fledged brick and mortar branch and vice versa would not require such approval. While merging/closing/shifting/converting a rural or a sole semi urban ‘Banking Outlet’, banks and DCC/DLRC shall ensure that the banking needs of the centre continue to be met.

d. Banks should ensure that customers of the Banking Outlet, which is being merged/closed/shifted are informed well in time and also continue to fulfill the role entrusted to these ‘Banking Outlets’ under the Government sponsored programmes and Direct Benefit Transfer Schemes.

e. It may further be ensured that ‘Banking Outlets’ are shifted within the same or to a lesser population category, i.e., semi urban ‘Banking Outlets’ to semi urban or rural centres and rural ‘Banking Outlets’ to other rural centres.

Guidelines for Banks which do not have General Permission

Domestic Scheduled Commercial Banks from whom general permission has been withdrawn, require prior approval of Department of Banking Regulation (DBR), Central Office, RBI for opening all their branches.

Further, in respect of their fixed point BC outlets, they shall also approach RBI for permission except for outlets opened in Tier 5 and 6 Centres.

Small Finance Banks, Payment Banks as well as Local Area Banks (LABs) need to have prior approval of DBR, Central Office, RBI for all categories of banking outlets.

These banks are to submit their Annual Banking Outlet Expansion Plan (ABOEP) with the consolidated details of proposals for opening, closing, shifting, merger and conversion of these banking outlets.

The guidelines are as applicable to banks having general permission. On approval of the consolidated proposal, individual proposals for opening branches at specific centres, for which prior permission is required from RBI, must be submitted in the prescribed form to RBI.

4 Proposals required to be submitted to RBI in this regard should have the approval of the Board of Directors of the bank or such other authority to which powers have been delegated by the Board of the bank. Banks shall ensure that an authenticated / certified copy of such approval is invariably submitted along with these proposals.

Support to MFI Structure of the Small Finance Banks

In order to provide an enabling environment to preserve the advantages of the Micro Finance Institutions('MFI')/ Non-Banking Financial Company ('NBFC') structure of SFBs they are allowed a time of 3 years from the date of commencement of business, to comply with branch licensing guideline of RBI. Till such time, they are allowed to continue the existing structure and would be treated as 'Banking Outlets' though not immediately reckoning for the 25 per cent norm.

At the end of three years from the date of their commencement of business, all SFBs should have opened in URCs, at least 25 per cent of their total Banking Outlets failing which penal measures including restrictions on further expansion by such banks will be considered and imposed. This is for ensuring a level playing field for all such entities.

Manning of ATMs/E-kiosks/CDMs/BNAMs/Mobile Branches

Banks are allowed to set up onsite/offsite Automated Teller Machines (ATMs) at centres/places identified by them, including SEZs. Banks are permitted to post suitable staff member(s) to provide guidance to the customers using the services of these outlets. Such ATMs shall not be reckoned as 'banking outlets'. Banks are allowed to open/operate mobile branches in all Centres. These mobile branches will not be considered as Banking Outlets.

Setting up of Administrative Offices, Back Offices (Central Processing Centres/Service Branches) and Call Centres etc.

Banks having general permission can set up Administrative Offices (Head/Regional/Zonal Offices etc.), Training Centres, Back Offices (Central Processing Centres (CPCs)/Service Branches), Treasury Branches and Call Centres, etc. without prior permission from Reserve Bank of India.

The banks should ensure that back offices i.e. CPCs/Service Branches which are set up exclusively to attend to back office functions such as data processing, verification and processing of documents, issuance of cheque books, etc. should not have any direct interface with customers for them to be not considered as banking outlets.

Information as per specified formats regarding opening, merger, conversion, closure etc. of Business outlets are to be communicated to Department of Statistics and Information Management (DSIM) of RBI on a quarterly basis (instead of Annual basis) with effect from April 2017.

Opening of branches in India by Foreign banks

The policy for approving foreign banks applications to open maiden branch and further expand their branch presence has been incorporated in the 'Roadmap for presence of Foreign banks in India' indicated in the Press Release dated February 28, 2005 as well as in the liberalized branch authorisation policy issued on September 8, 2005. The branch authorisation policy for Indian banks has been made applicable to foreign banks subject to the following:

- Foreign banks are required to bring an assigned capital of US $25 million up front at the time of opening the first branch in India.
- Existing foreign banks having only one branch would have to comply with the above requirement before their request for opening of second branch is considered.
- Foreign banks may submit their branch expansion plan on an annual basis.
- In addition to the parameters laid down for Indian banks, the following parameters would also be considered for foreign banks :
  - Foreign bank and its group's track record of compliance and functioning in the global markets would be considered. Reports from home country supervisors will be sought, wherever necessary.
  - Weightage would be given to even distribution of home countries of foreign banks having presence in India.
  - The treatment extended to Indian banks in the home country of the applicant foreign bank would be considered.
  - Due consideration would be given to the bilateral and diplomatic relations between India and the home country.
  - The branch expansion of foreign banks would be considered keeping in view India's commitments at World Trade Organisation (WTO). Licences issued for off-site ATMs installed by foreign banks are not included in the ceiling of 12 (explained below).

In terms of India's commitment to WTO, as a part of market access, India is committed to permit opening of 12 branches of foreign banks every year. Reserve Bank of India has permitted more number of branches in the past. The Bank follows a liberal policy where the branches are sought to be opened in unbanked/under-banked areas. Off-site ATMs are not counted for the purpose of calculation of limit.

Financially Sound and Well Managed (FSWM) UCBs are those which satisfy following criteria:

- Capital to Risk Assets Ratio not less than 10 per cent;
- Gross NPA of less than 7% and Net NPAs not more than 3%;
- Net profit for at least three out of the preceding four years subject to it not having incurred a net loss in the immediate preceding year;
- No default in the maintenance of CRR / SLR during the preceding financial year;
- Sound internal control system with at least two professional directors on the Board;
- Core Banking Solution (CBS) fully implemented; and
- Bank should have track record of regulatory compliance and no monetary penalty should have been imposed on violation of any RBI directives / guidelines during the last two financial years.

Branch licensing policy for Regional Rural Banks (RRBs)

- , RRBs are required to obtain prior approval of RBI for opening new branches in Tier 1 centres. The applications will be considered on a very selective basis on merits of each case including the overall financial position of the RRB, quality of its management, efficacy of the internal control system, CBS compliance and other relevant factors.
- RRBs are permitted to open branches in Tier 2 to Tier 6 centers (with population of up to 99,999 as per Census 2001) without having the need to take prior permission from RBI in each case, subject to reporting, provided they fulfill the conditions laid down in this regard. RRBs which do not satisfy the said conditions should obtain prior approval from the Regional Office of RBI.
- RRBs which require prior approval for opening branches should submit applications to the concerned Regional Office of the Reserve Bank, through respective Regional Office of NABARD in the prescribed Forms under Banking Companies Rules, 1949 which will give its comments on the merits of the application.
- The RRBs need to submit an advance copy of the application to the concerned Regional Office of the RBI.
- RRBs should open at least 25 percent of the total number of branches proposed to be opened during a year in unbanked rural (Tier 5 and Tier 6) centres.

Recently RBI has issued a separate Branch licensing policy for RRBs. It is as follows:

Opening of Banking Outlets by Regional Rural Banks

Regional Rural Banks are permitted to open banking outlets in Tier 1 to Tier 6 centres subject to the following: Prior RBI approval is required for opening of banking outlets (excluding BC outlets) in Tier 1 to 4 centres, RRBs have to fulfill the following conditions:

(a) Minimum CRAR of 9% .

(b) Net NPA ratio does not exceed five percent.

(c) No default in maintenance of CRR and SLR during last two years.

(d) Should have registered net profit in the previous financial year.

(e) All branches and Head offices of the RRB should be CBS compliant and have in place system generated NPA recognition.

No specific approval is needed from RBI for opening banking outlets in rural centres (i.e. Tier 5 and 6 centres) in each case, subject to post facto reporting (within seven days of opening a banking outlet) to Regional Office RBI. Only after the RRB has achieved the target of opening 25 percent of the total banking outlets in unbanked rural centres, during the previous financial year, permission for opening new branches in tier 1 to 4 centres will be granted in the current year. If they fail to achieve no permission will be granted for opening branches in tier 1 to 4 in the current year. RRBs opening branches in Tier 5 and 6 centres, may approach the Regional Office concerned of RBI for post-facto automatic issue of the licence/s. Such licences should be displayed in branches for the information of customers. Regional Office concerned of RBI, through the Empowered Committee on Regional Rural Banks, will be monitoring opening/ closing/shifting /merger of banking outlets of the RRBs under their jurisdiction.

Directions for opening of ‘Banking Outlets’ during a financial year will be subject to the following conditions:

- At least 25% of the total number of banking outlets opened during a financial year must be opened in unbanked rural centres. A part-time banking outlet, opened in any Centre, will be counted and added to the denominator as well as numerator on pro rata basis for computing the requirement as well as the compliance with the norm of opening 25% banking outlets in unbanked rural centres.

- A banking outlet/part-time banking outlet opened in any Tier 3 to Tier 6 centre of North-Eastern States as well as in any Tier 3 to 6 centre of Left-Wing Extremism (LWE) affected districts as notified by the Government of India periodically, will be considered as equivalent to opening a banking outlet/ part-time banking outlet, as the case may be, in a URC. As the overall objective is enabling expansion of banking facilities, each banking outlet opened, irrespective of the banked/unbanked status of the centre, will be reckoned as having been opened in an URC.
- The first fixed point BC outlet of a bank as well as the first 'brick and mortar' branch of any bank opened in a URC will be reckoned for computing compliance with the 25% norm.
- The time given to a RRB for opening a banking outlet is one year. If a bank fails to adhere to the requirement of opening 25% banking outlets in URC in a year, appropriate penal measures, including restrictions on opening of banking outlets in Tier 1 to 4 centres (except tier 5 and 6) shall be imposed. To encourage the RRBs to open more number of banking outlets in unbanked rural centres, they will be allowed to carry forward the benefit of the banking outlets, if any, opened in excess of the requirement specified in these rules for a period of next 2 years. No further extension to avail the benefit will be allowed.
- For identifying an unbanked rural centre, State Level Bankers Committees (SLBCs) will compile and provide an updated list of all unbanked rural centres in the state on their website. This list will help RRBs to choose/indicate the place where they wish to open a banking outlet and coordinate with the SLBC to earmark the centre identified by them. If a bank fails to open the banking outlet in the prescribed period of 1 year as provided above, the SLBC convenor bank may indicate the centre as available for other banks to open a banking outlet. Prior approval of Government Authority as well as RBI are needed if a RRB proposes to undertake government business at any of the banking outlets/ part-time banking outlets.

Merger/Closure/ Shifting/Conversion of 'Banking Outlets' by RRBs

RRBs can shift, merge or close all banking outlets (except rural outlets and sole semi-urban outlets) at their discretion. Merger, closure and shifting of any rural banking outlet as well as a sole semi urban banking outlet would require approval of the DCC/DLRC and Regional Office concerned of RBI. However, conversion of any rural or sole semi-urban banking outlet into a full-fledged brick and mortar branch and vice versa would not require such approval. While merging/closing/shifting/converting a rural or a sole semi urban banking outlet, banks and DCC/DLRC shall ensure that the banking service needs at that centre continue to be met, without disruptions.

RRBs are to ensure that customers of the banking outlet, are kept informed of merger/closure /shifting two months in advance so as to avoid inconvenience. However RRBs to ensure that they continue to fulfil their obligations and role entrusted to these banking outlets under the Government sponsored programmes and Direct Benefit Transfer schemes. Also RRBs to ensure that while shifting banking outlets they are shifted within the same or to a lesser population category , i.e., semi urban banking outlets to semi urban or rural centres and rural banking outlets to other rural centres.

Annual Plans

RRBs are required to submit their Annual Banking Outlet Expansion Plan (ABOEP), which is approved by Board of Directors, together with the consolidated details of proposals for opening, closing, shifting, merger and conversion of these banking outlets as per Proforma given in these guidelines to Regional Office concerned of RBI, and to NABARD for monitoring.

Manning of ATMs/E-kiosks/CDMs/BNAMs

RRBs are allowed to set up onsite/offsite Automated Teller Machines (ATMs) at centres/places identified by them. Banks at their discretion may post suitable staff member(s) to provide guidance to the customers using the services of these outlets. Such ATMs shall not be reckoned as banking outlets as defined in the circular.

Mobile Branches–Extension to all Tiers

The scheme of mobile branch envisages extension of banking facilities through a well-protected van with arrangements for two or three officials of the bank sitting in it with books, safe containing cash, etc. The mobile unit would visit the places proposed to be served by it on specific days/hours. The mobile offices would be attached to a branch of an RRB.

Regional Rural Banks are allowed to open/operate mobile branches in all Centres. These mobile branches will not be considered as 'Banking Outlets'.

Setting up of Regional Offices, Administrative Offices, Back Offices (Central Processing Centres/ Service Branches) and Call Centres, etc.

RRBs shall be allowed to open one Regional Office (RO) for every 50 banking outlets for which they are required to obtain licence from the concerned Regional Office of RBI prior to functioning / opening of these offices. RRBs having up to 50 banking outlets will be under the direct control of the Head Office, without any intermediate tier. for any relaxations in these norms due to geographical / other conditions, it has to be referred to the Empowered Committee (EC) and referred to Central Office, Department of Banking Regulation (DBR) for consideration.

The ROs are not permitted to transact any banking business. RRBs can either shift or close / merge these offices at their discretion without prior approval of RBI, and report the same post-facto to the concerned Regional Office of RBI at the earliest, but not later than one month from the date of shifting. As regards closure / merger of such offices, the same to be communicated to the concerned Regional Office of RBI for cancellation immediately after the closure / merger of the office under advice to the DSIM of RBI.

RRBs may set up Training Centres, Back Offices (Central Processing Centres (CPCs)/Service Branches), Treasury Branches and Call Centres, etc. exclusively to attend to back office functions and other functions incidental to their banking business after obtaining necessary permission from the concerned Regional Office of RBI. They should not have any interface with customers and will not be allowed to be converted into general banking branches.

RRBs to ensure that administrative offices, training centres, back offices do not have any direct interface with customers for them to be not considered as banking outlets. Banks currently having specific permission to allow customer interface at these back offices (service branches and/or CPCs), have to align with the above instructions within one year from the date of this circular and report compliance to Regional offices concerned of RBI.

Business Facilitator/ Business Correspondent Model

RRBs to follow instructions on Business Facilitators/Business Correspondents as notified in July 2015. They are also required to follow instructions on Customer Education as advised in Master Circular dated July 1, 2015. The instructions on Business Facilitator/Business Correspondent Model as contained in our Master Circular DBR. CO.RRB.BL.BC.No.17/31.01.002/2015-16 dated July 01, 2015 remain unchanged.

Reporting Requirements

RRBs shall furnish the information on opening of new place of business i.e. branch/office/NAIOs (Non-Administratively Independent Office) as per Proforma I and any change on change in status – merger, conversion, closure, etc. Proforma II given in these instructions to Banking Statistics Division, Reserve Bank of India, Central Office, C-8/9, Bandra-Kurla Complex, Mumbai-400051.

RRBs are also required to report regarding fixed point BC outlets classified as banking outlets, as per Annex VIII on quarterly basis starting from April 01, 2018. In order to furnish the initial statistics, banks have to furnish the first such report to DSIM, Reserve Bank of India (position as on March 31, 2017), not later than one month from the date of issue of this Circular. From the year 2018-19, the reporting on opening of branches to the Department of Banking Regulation, Central Office has been dispensed with.

Scheme for setting up of IFSC Banking Units (IBU) by Indian Banks

The RBI had issued a notification under FEMA vide Notification No. FEMA.339/2015-RB dated March 02, 2015 setting out RBI regulations relating to financial institutions set up in International Financial Services Centres (IFSC). In line with the above Notification, RBI has formulated a detailed scheme applicable for Indian banks and foreign banks already having presence in India for setting up of IFSC Banking Units (IBUs) by banks in IFSCs. The scheme covers Eligibility criteria, Licensing, Capital, Reserve requirements, Resources and deployment, Permissible activities, Prudential regulations, Anti-Money Laundering Measures, Regulation, Supervision, Reporting, Ring fencing of activities, Priority sector Lending, deposit Insurance, Lender of last resort etc.

Licensing of Urban Co-operative Bank (UCB) branches

Introduction

On July 1, 2015 RBI liberalised and rationalised the branch authorisation norms for Financially Sound and Well Managed (FSWM) UCBs in the States that have signed Memorandum of Understanding (MoU) with it, as well as those registered under Multi-State Co-operative Societies Act, 2002. The present policy is given in the following paragraphs.

Eligibility Criteria

- FSWM UCBs will be eligible to open branches/Extension Counters (ECs) in their approved area of operation beyond the current annual ceiling of 10 per cent and upgrade ECs which are in operation for more than three years, provided they have the required headroom capital in terms of assessed net worth (ANW) per branch, including existing branches and subject to fulfillment of the six FSWM criteria.

Classification of UCBs

Tier I Banks

(i) Banks having deposits below Rs.100 crore operating in a single district;

(ii) Banks with deposits below Rs.100 crore operating in more than one district will be treated as Tier I provided the branches are in contiguous districts and deposits and advances of branches in one district separately constitute at least 95 per cent of the total deposits and advances respectively of the bank; and

(iii) Banks with deposits below Rs.100 crore, whose branches were originally in a single district but subsequently, became multi-district due to reorganisation of the district may also be treated as Tier I UCBs.

Tier II Banks: All other Banks

(Deposit and advances are reckoned as on 31st March of the immediate by preceding financial year). FSWM UCBs should maintain a minimum CRAR of 10 per cent on a continuous basis with minimum Assessed Net Worth (ANW) commensurate with the prevalent entry point capital norms for the centre where branch is proposed / where it is registered. Entry point norms for various categories of UCBs are given as below.

In the tables below A, B, C and D denote centres with the following population:

Category of centre	Population
A	Over 10 lakh
B	5 lakh and above but less than 10 lakh
C	1 lakh and above but less than 5 lakh
D	Less than 1 lakh

I. **Entry Point Norms for General Category**

Particulars	**A**	**B**	**C**	**D**
Assessed Net Worth (Rs. lakh)	400	200	100	25
Membership	3000	2000	1500	500

II. **Entry Point Capital Norms for Unit Banks /Banks organised by Mahilas/SCs/STs and those organised in less developed States**

Particulars	**A**	**B**	**C**	**D**
Assessed Net Worth (Rs. lakh)(50% of EPN)	200	100	50	12.50
Membership	3000	2000	1500	500

III. **Entry Point Norms for Banks organised in least developed States/North-Eastern States/ Tribal Regions**

Particulars	**A**	**B**	**C**	**D**
Assessed Net Worth (Rs. lakh)(33.33% of EPN)	133.33	66.67	33.33	8.33
Membership (66.67% of normal membership)	2000	1334	1000	334

- UCB which are categorized as Unit banks and have been extended relaxation in the entry point capital as indicated, would be eligible to open branches only after augmenting their Assessed Net Worth (ANW) to be computed as per RBI's norms, to the level required for opening a new general category bank at the place where the bank was organised or where the branch is desired to be opened, whichever is higher.
- For example, if a unit bank was organised at a category 'D' centre and it intends to open a branch at a 'B' category centre, such bank's ANW should necessarily be raised to entry point capital prescribed for organising a general category bank at a 'B' category centre.
- Similarly if a bank, other than a unit bank, desires to open a branch at a higher category centre, other than the centre at which it was established, within the district of its registration, the ANW of the bank should at least be equivalent to the entry point capital prescribed for that centre.
- A bank which desires to open a branch at a centre, other than its district of registration but within the state of registration, must have ANW not less than the entry point capital required for organisation of a new general category bank at the highest category centre in that state.

Process of application

UCBs, satisfying applicable norms, to prepare an Annual Business Plan (ABP) for opening of branches (including extension counters and up-gradation of extension counters into full-fledged branches, in their existing area of UCB which are categorized as Unit banks and have been extended relaxation in the entry point capital as indicated, would be eligible to open branches only after augmenting their Assessed Net Worth (ANW) to be computed as per RBI's norms, to the level required for opening a new general category bank at the place where the bank was organised or where the branch is desired to be opened, whichever is higher.

- For example, if a unit bank was organised at a category 'D' centre and it intends to open a branch at a 'B' category centre, such bank's ANW should necessarily be raised to entry point capital prescribed for organising a general category bank at a 'B' category centre.
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- A bank which desires to open a branch at a centre, other than its district of registration but within the state of registration, must have ANW not less than the entry point capital required for organisation of a new general category bank at the highest category centre in that state.

Process of application

UCBs, satisfying applicable norms, are to prepare an Annual Business Plan (ABP) for opening of branches (including extension counters and up-gradation of extension counters into full-fledged branches, in their existing area of operation), for the next 12 months, with the approval of their Board of Directors and submit the ABP, in duplicate, along with specified annexures to the respective Regional Offices of Reserve Bank of India. Normally RBI expects submission of ABPs by end of December of the previous financial year.

Approval for Centres

Eligible banks will be allotted centres strictly in the order of preference given by them. Once a centre is allotted, no request for change in the allotted centre would be entertained.

Authorisation and its Validity Period

After making arrangements for opening of branches, the bank should approach the Regional Offices of Urban Banks Department under whose jurisdiction they operate, in the prescribed form, indicating the exact postal address of the place where the branch is to be opened, for issuance of authorisation within a period of six months from the date of allotment of the centre.

Authorisation will be valid for one year from the date of issue, or one and a half year from the date of allotment of the centre, whichever is earlier.

Extension of period

No extension of time will be granted after the expiry of validity period of licence. In exceptional cases, an extension of time not exceeding six months may be granted by the Regional Offices, under advice to Central Office.

Non-compliance and penalties

Opening of branches without a valid authorisation from the Reserve Bank is an act of violation of Section 23 of the BR Act, 1949, and liable to attract penalties. Where the banks have opened extension counters without complying with the prescribed norms and subsequently approach Reserve Bank of India for up-gradation of the same into full-fledged branches, such banks would not be allotted centres unless they close unauthorised extension counters. Further, a centre where a bank has opened an unauthorised extension counter, such a centre would not be considered for opening a branch in future.

In case, the information/particulars furnished by any bank are found to be incorrect, the Reserve Bank of India will take a serious view in the matter and the bank will be liable for penal action, including debarring it from allotment of centres for a period of three years.

RBI has also given its policy guidelines in respect of Opening of Specialised branches – Central Processing Centres (CPCs)/Retail Asset Processing Centres, Opening of Extension Counters, Up-gradation of Extension Counters into Full-Fledged Branches etc. under the said policy.

PAID UP CAPITAL AND RESERVES OF BANKING COMPANIES

Section 11 of the Banking Regulation Act, 1949 specifies the minimum paid up capital and reserves of banking companies. Before commencing the banking business every bank has to fulfill the conditions under this Section or as directed by RBI in this regard. As on date no bank can start its activities without complying with this provision. The minimum capital are linked to place of business or places of business. A place of business has been defined as "any office, sub-office, sub-pay office and any place of business at which deposits are received, cheques cashed, or moneys lent". If there is a dispute arises in computing the aggregate value of the paid-up capital and reserves of any banking company, the decision of RBI would be final in terms of Section11(6) of the Banking Regulation Act, 1949.

Section 11 (2) and 11(3) of the Banking Regulation Act, 1949 deal with the capital and reserves of Foreign banks that operate in India as well as that of banks in India.

The following summarises the requirement of capital and reserves under the Banking Regulation Act, 1949:

Foreign Banks

1. Keep a deposit of Rs. 15 lacs and if it has place of business in Mumbai or Kolkata or both Rs. 20 lacs with RBI.
2. Additionally to keep 20% of the yearly profit in respect of business transacted through branches in India, as per P & L account, with RBI.
3. Central Government can exempt a bank from this requirement on RBI's recommendations for a specified period if the amounts already deposited is adequate.
4. The capital funds will form the assets of the company to which creditors will have first charge on cessation of business.
5. Mode of funds can be Cash, unencumbered securities or partly both. Securities can be replaced by other unencumbered securities or cash or cash equivalents.

Indian Banks

1. If it has a place of business in more than one state Rs. 5 lacs; if such place of business include Mumbai or Kolkata or both, Rs. 10 lacs.
2. If the place of business is only in one state and not including Mumbai or Kolkata, Rs. 1 lac for principal place of business, plus Rs. 10,000 for other places of business in the same district in which principal place of business is situated, plus Rs. 25,000 in respect of each place of business situated elsewhere in the State other than in the same district, total being not in excess of Rs. 5 lacs.
3. If such a bank has only one place of business the amount is restricted to Rs. 50,000.
4. For the banks commencing business after the commencement of the Banking Regulation Act, paid up capital is stipulated at Rs. 5 lacs.
5. If the places of business are in one state only but one or more of them is in Mumbai or Kolkata Rs. 5 lacs plus Rs. 25,000 for each place of business outside these cities and in total not exceeding Rs. 10 lacs.

REGULATION OF PAID-UP CAPITAL, SUBSCRIBED CAPITAL AND AUTHORISED CAPITAL AND VOTING RIGHTS OF SHAREHOLDERS

Section 12(1) of the Banking Regulation Act, 1949 requires that the subscribed capital of the company is not less than half of the authorised capital, and the paid-up capital is not less than half of the subscribed capital. Further, when the capital is increased, the concerned bank will comply with conditions within a period of two years as RBI may allow.

As amended in 2012, under Section 12 (1) (ii) of the Banking Regulation Act, 1949 a banking company's equity capital should consist of only equity shares or equity& preference shares. Such issuance of preference share would be in accordance with RBI's guidelines.

Voting Rights

Under Section 12(2) of the Banking Regulation Act, 1949 a person holding any share/s in a banking company may exercise voting rights on poll, not exceeding10 % of the total voting rights of all the shareholders of the banking company. With effect from 18th January 2013, RBI has powers to increase the same gradually from 10% to 26%. Further under Section 12(1) (ii)(b) preference holders cannot exercise voting rights in respect of shares held by them in a banking company as specified under Companies Act. Under Section 12 (3) no suit can be filed against a registered share holder except by genuine transferee of such shares or on behalf of minors or lunatic for whom such shares held by a registered share holder.

Limits on brokerage/commission /Discount

Section13 of the Banking Regulation Act, 1949 places a ceiling of 2½% of the price (including the premium) at which shares are issued as commission, brokerage, discount or remuneration on the sale of shares of banking companies.

Dividend

In terms of Section 15 of the Banking Regulation Act, 1949 a company can pay dividend only after capitalized expenses, such as preliminary expenses, organizational expenses, commission on shares sold, brokerage, loss incurred etc. are written off.

RBI has in the light of COVID-19 pandemic, has directed banks not to make any further dividend payouts from the profits pertaining to the financial year ended March 31, 2020 which later on partially removed by the RBI.

Returns to be submitted

The Chairman or CEO of the banking company is obligated to furnish to RBI, particulars of extent and value of his holding of shares, either directly or indirectly, in the banking company, as well as any change in the extent of such holding or any variation in the rights thereof or any other information.

Subsidiaries Of Banking Companies

Section 19 of the Banking Regulation Act, 1949 governs the formation of subsidiaries of banking companies. According this section, banks are allowed to form subsidiary companies for the activities which are permitted under Section 6 (1), including formation of Credit Information subsidiaries under Section 6 of Banking Regulation Act either in India or abroad with prior permission of RBI. The main objective is to prevent trading as well as securing control of Non-banking companies.

Activities which subsidiary companies engage in will not be deemed as a direct or indirect activity of the banking company.

Holding of shares in other companies

Under Section 19(2) of the Banking Regulation Act, 1949 banking company shall hold shares in any company, whether as pledgee, mortgagee or absolute owner, not exceeding thirty per cent of the paid-up share capital of that company or thirty per cent of its own paid-up share capital and reserves, whichever is less. Also Section 19 (3), a banking company cannot hold shares, whether as pledgee, mortagagee or absolute owner, in any company in the management of which any Managing Director or Manager of the banking company is in any manner concerned or interested.

BOARD OF DIRECTORS IN BANKING COMPANIES

In terms of Section 10A of the Banking Regulation Act, 1949 not less than 51% of Board of Directors of a banking company, should have special knowledge or practical experience in any one or more of the following fields : -

(i) accountancy (ii) agriculture and rural economy, (iii) banking, (iv) co-operation, (v) economics, (vi) finance, (vii) law, (viii) small-scale industry, (ix) any other matter which according to RBI to be useful to the banking company. Among them at least two persons having special knowledge or practical experience in respect of agriculture and rural economy, co-operation or small scale industry.

Under Section 10(2), a director of banking company cannot:

- have substantial interest in or any way connected with, as employee, manager or Managing agent, any company, other than a Section 8 Company under Companies Act, 2013 (earlier Section 25 company under Companies Act, 1956) or
- be connected with any trading or commercial or industrial concerns (excluding small scale industrial concern)
- be a proprietor of any trading, commercial or industrial concern, (excluding a small scale industrial concern).

The Reserve Bank of India has issued master directions for criteria and procedure to determine the 'fit and proper' status of a person to be eligible to be elected as a director on the Board of Public Sector Banks:

A summary of the same is as under:

1. These Directions applies to Public Sector Banks.
2. All PSU banks are to constitute a Nomination and Remuneration Committee consisting of a minimum of three non-executive directors from amongst the Board of Directors ('Board'). Out of which not less than one-half shall be independent directors and should include at least one member from Risk Management Committee of the Board, for undertaking a process of due diligence to determine the 'fit and proper' status of the persons to be elected as directors as per Section 19 (C) of the SBI Act/clause and as per Section 9 (3) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/ 1980.
3. The nominee director from Government of India and the director appointed under Section 19(f) of SBI Act/ Section 19 (c) (3) of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/ 1980. can't be a part of the committee mentioned in point 2 above.
4. The Non-executive Chairman of the bank can be a member of the committee but can't chair the meetings. Any other directors nominated to the committee can Chair the meetings.
5. The quorum is three, including the Chairman of the Committee. For want of quorum, In case of absence of any nominated directors, the Board may nominate any other non-executive director to attend the committee meeting.
6. The Board can decide the tenure of the committee while constituting the same.
7. A brief procedure has been spelt out by RBI regarding nomination for election, acceptance of application etc. from applicants for Director's post.
8. Brief criteria:
   a. Candidates should be between 35 to 67 years of age as on the cut-off date. Should be at least a graduate.
   b. Candidates should have special knowledge/experience as per Section 19A(a) of the SBI Act / section 9(3A)(A) of the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970/ 1980.
   c. Tenure for such elected director will be for three years and is eligible for re-election: subject to no such director to hold office for a period exceeding six years, whether continuously or intermittently.
   d. Apart from the **disqualifications** stated in SBI Act/Banking Companies Act 1970/1980 the following also apply:
   i. The candidate should not be a member of the Board of any bank or the RBI or a Financial Institution (FI) or an Insurance Company or a NOFHC holding any other bank.

Explanation: The expression "bank" includes a banking company, a corresponding new bank, State Bank of India, a co-operative bank and a regional rural bank.

ii. A person connected with hire purchase, financing, money lending, investment, leasing and other para banking activities shall not be considered for appointment as elected director on the board of a Public Sector Bank. However, investors of such entities will not be disqualified for appointment as directors, if they do not have any managerial control in them.

iii. No person may be elected/ re-elected on the Board if he/she has served as director in the past on the board of any bank/FI/RBI/Insurance Company under any category for six years, whether continuously or intermittently.

iv. The candidate should not be engaged in the business of stock broking.

v. The candidate should not be a Member of Parliament or State Legislature or Municipal Corporation or Municipality or other local bodies.

vi. The candidate should not be acting as a partner of a Chartered Accountant firm which is currently engaged as a Statutory Central Auditor of any nationalised bank or State Bank of India or as Statutory Branch Auditor or Concurrent Auditor of the bank in which nomination for election is filed.

9. Professional Restrictions: The candidate should not have any business connection (including legal services, advisory services etc.) with the concerned bank and also should not be engaged in activities which might result in a conflict of business interests with that bank.

10. The candidate should not be having any professional relationship with a bank or any NOFHC holding any other bank.

11. In the event of elected as a Director, the candidate should severe his relationship with such bank or as the case may be.

12. The candidate should not be under adverse notice of any regulatory or supervisory authority/agency, or law enforcement agency and should not be a defaulter of any lending institution.

13. Once a candidate is elected as a director he has to submit the prescribed declarations as enumerated in the circular. Also to submit yearly declaration as required under the directions. Failure to do so or suppression of any information or any non compliance of any of the requirement, will be liable for legal consequences.

Limitation on period of office

As per Section 10(2A) of the Banking Regulation Act, 1949 other than a Chairman or whole-time Director, no director can hold office continuously for a period beyond eight years. Also a Chairman or other whole- time Director who has been removed from such posts will cease to be a Director and will not be eligible to be appointed as a Director by any process, for a period of four years from the date of his cessation as Chairman or whole-time Director as applicable.

Reconstitution of Board

In the opinion of RBI, if the composition of the Board of Directors requires reconstitution, RBI shall direct the banking company for such reconstitution through a written communication after giving a reasonable opportunity of being heard. Within two months of such communication, direction of the RBI shall be complied with. In order to reconstitute the Board of Directors, if it is necessary to retire any Director or Directors, it has to be done through drawing of lots, to decide which Director or Directors shall cease to hold office. Such decision will be binding on every Director of the Board.

If the banking company fails to comply with directions, that Bank through lots drawn as prescribed remove the person who ought to be removed from the membership of the Board of Directors, remove such person from the office of the Director of banking company for compliance of provisions, appoint a suitable person as a member of the Board of Directors in the place of the person so removed. The person thus appointed will be considered as deemed to have been duly elected as a Director who will continue in office till his predecessor would have continued. Any reconstitution or removal in terms of these provisions cannot be challenged in any court. No proceedings of the Board of Directors will become invalid, merely because of any defect in the composition of the Board.

CHAIRMAN/MANAGING DIRECTOR OF A BANKING COMPANY

Appointment of a Chairman of a banking company is subject to the provisions of Section 10 (A), (B), (C),(D) of the Banking Regulation Act, 1949. Accordingly one of the Directors a banking company has to be appointed as a whole-time or a part-time Chairman. If the Chairman is appointed on a whole-time basis, he will exercise his powers under the superintendence, direction and control of the Board of Directors. If a Chairman is to be appointed on part-time basis, it requires the prior approval of RBI which may specify conditions thereof. The affairs of the banking company have to be managed by a Managing Director who will exercise his powers subject to the superintendence, control and direction of the Board of Directors.

Appointment of MD & CEO / CEO / Part-Time Chairperson (PTC) in Banks – 'Declaration and Undertaking' and allied matters

In the case of Private Sector Banks including Local Area Banks, Small Finance Banks, Payments Banks and Foreign Banks operating in India, RBI has directed that for the re-appointment of an MD & CEO/ CEO in banks, as above the complete applications in the prescribed format' along with 'Declaration and Undertaking' from candidate(s), along with the remarks of Nomination and Remuneration Committee should be submitted to the Department of Regulation, Central Office, RBI, Mumbai, at least six months before the expiry of the term of office of the incumbent.

For appointment of a new MD & CEO/ CEO, the proposal should contain a panel of at least two names in the order of preference. The proposals should be submitted to the Reserve Bank at least four months before the expiry of the term of office of the present incumbent.

Period of appointment

The period of appointment of a Chairman/ Managing Director on a whole-time basis will be for a period not exceeding five years, as the board of Directors may fix, and also be eligible for re-election/reappointment as specified in the Banking Regulation Act. A Chairman is allowed to be a Director of a subsidiary of the banking company or a company registered under Section 8 Company under The Companies Act, 2013 (earlier Section 25 company under Companies Act 1956).

Qualifications: Whole-time Chairman/Managing Director

Every whole- time Chairman and every Managing Director of a banking company should have special knowledge and practical experience of the working of a banking company, or of the State Bank of India or any subsidiary bank or a financial institution, or financial, economic or business administration.

A Chairman, appointed on a whole time basis or a Managing Director of a banking company -

- Will be disqualified if he is a Director of any company [other than a subsidiary company or a Section 8 company as provided under Section 10 (2)],is a partner of any firm which carries on any trade, business or industry, or has substantial interest in any other company or firm, or is a Director, manager, Managing agent, partner or proprietor of any trading, commercial or industrial concern, or is engaged in any other business or vocation.

May resign his office through a letter in writing addressed to the company. Subject to the approval of RBI, a whole-time Chairman or a Managing Director whose term of office has ended or has resigned is allowed to continue till his successor assumes office.

Removal of Chairman/Managing Director

If in the opinion of RBI any person who, is, or has been elected as whole-time Chairman/ Managing Director is not a fit and proper person, RBI may require the banking company to elect or appoint any other person as Chairman or the Managing Director. If within a period of two months from the date of receipt of such order, the banking company fails to elect or appoint a suitable person, the RBI may remove the first-mentioned person and appoint a suitable person in his place who will be deemed to have been duly elected or appointed, as Chairman or the Managing Director and will hold office for the residual period of office of the person in whose place he has been so elected or appointed.

In the public interest, RBI may permit Whole-time Chairman or the Managing Director undertake part-time honorary work which is not likely to interfere with his duties as Chairman or Managing Director.

Such persons who have been removed by RBI, can appeal to Central Government against the removal The Central Government's decision in the matter will be final and cannot be questioned by any court. In all other cases, RBI's decision will be final.

Powers of RBI to appoint Chairman/ Managing Director

If Chairman or the Managing Director dies or resigns or becomes infirm or incapable of carrying out his duties or is absent on leave or any other circumstances which does not involve vacation of his office, the banking company can make alternate arrangement with the approval of the RBI up to a total period of four months.

Under Section 10 BB, if the position of whole-time Chairman or Managing Director of a banking company lies vacant, and in the opinion of RBI that this may prejudicial to the interests of the bank, it may appoint an eligible person as Chairman on a whole-time basis or a Managing Director. Such a person though may not be a director of that bank, will be deemed as a Director, so long as he holds the post of whole-time Chairman or Managing Director, and will hold office for a period not exceeding three years, as RBI specifies. Such person may also be eligible for reappointment as per the Banking Regulation Act provisions.

Salary and Holding of qualification shares

The whole-time Chairman or a Managing Director appointed by the RBI will draw from the banking company pay and allowances as determined by the RBI and can be removed from office only by the Reserve Bank.

The whole-time Chairman or a Managing Director of by whomsoever appointed and a Director who is appointed by the RBI under Section 10A will not be required to hold qualification shares of the banking company.

Overriding Provisions

Appointment or removal of a whole-time Chairman, Managing Director, Director under the provisions of Section 10 (A), (B), (BB) will over ride all other laws or contracts. A person who is affected by any action taken in terms of these provisions including termination, is not entitled to claim any compensation for any loss.

APPOINTMENT OF ADDITIONAL DIRECTORS

The power to appoint additional directors is vested in RBI under Section 36 AB of Banking Regulation Act.

- In the interest of a banking company and its depositors, through a written order the RBI can appoint, one or more persons to hold office as additional Directors.
- Such a person appointed as additional Director/s
  - will hold office during the pleasure of the RBI, subject to a period not exceeding three years or such further periods not exceeding three years at a time;
  - will not incur any obligation or liability by reason only of his being a Director or for anything done or omitted to be done in good faith in the execution of the duties of his office; or
  - is not required to hold qualification-shares in the banking company.

Any additional Director so appointed, will not be taken in to account for the purpose of reckoning any proportion of the total number of Directors of the banking company.

The powers conferred under Section 36AB have overriding effect on any other law contract or instrument which is in force.

Chief Compliance Officer (CCO)

As part of robust compliance system, banks are required, inter-alia, to have an effective compliance culture, independent corporate compliance function and a strong compliance risk management programme at bank and group level. Such an independent compliance function is required to be headed by a designated Chief Compliance Officer (CCO) selected through a suitable process with an appropriate 'fit and proper' evaluation/ selection criteria to manage compliance risk effectively.

The Reserve Bank of India has place following guidelines to bring uniformity in approach followed by banks, as also to align the supervisory expectations on CCOs with best practices.

1. **Policy :** A bank shall lay down a Board-approved compliance policy clearly spelling out its compliance philosophy, expectations on compliance culture covering Tone from the Top, Accountability, Incentive Structure and Effective Communication & Challenges thereof, structure and role of the compliance function, role of CCO, processes for identifying, assessing, monitoring, managing and reporting on compliance risk throughout the bank. This shall, inter-alia, adequately reflect the size, complexity and compliance risk profile of the bank, expectations on ensuring compliance to all applicable statutory provisions, rules and regulations, various codes of conducts (including the voluntary ones) and the bank's own internal rules, policies and procedures, and creating a disincentive structure for compliance breaches. The bank shall also develop and maintain a quality assurance and improvement program covering all aspects of the compliance function. The quality assurance and improvement program shall be subject to independent external review periodically (at least once in three years). The policy should lay special thrust on building up compliance culture; vetting of the quality of supervisory / regulatory compliance reports to RBI by the top executives, non-executive Chairman / Chairman and ACB of the bank, as the case may be. The policy shall be reviewed at least once a year;

2. **Tenor for appointment of CCO -** The CCO shall be appointed for a minimum fixed tenure of not less than 3 years. The Audit Committee of the Board (ACB) / Managing Director (MD) & CEO should factor this requirement while appointing CCO.

3. **Transfer / Removal of CCO -** The CCO may be transferred / removed before completion of the tenure only in exceptional circumstances with the explicit prior approval of the Board after following a well-defined and transparent internal administrative procedure.

Eligibility Criteria for appointment as CCO

Rank - The CCO shall be a senior executive of the bank, preferably in the rank of a General Manager or an equivalent position (not below two levels from the CEO). The CCO could also be recruited from market;

Age - Not more than 55 years;

Experience - The CCO shall have an overall experience of at least 15 years in the banking or financial services, out of which minimum 5 years shall be in the Audit / Finance / Compliance / Legal / Risk Management functions;

Skills - The CCO shall have good understanding of industry and risk management, knowledge of regulations, legal framework and sensitivity to supervisors' expectations;

Stature - The CCO shall have the ability to independently exercise judgement. He should have the freedom and sufficient authority to interact with regulators/supervisors directly and ensure compliance;

Others - No vigilance case or adverse observation from RBI, shall be pending against the candidate identified for appointment as the CCO.

The duties and responsibilities of the compliance function

These shall include at least the following activities:

i. To apprise the Board and senior management on regulations, rules and standards and any further developments.

ii. To provide clarification on any compliance related issues.

iii. To conduct assessment of the compliance risk (at least once a year) and to develop a risk-oriented activity plan for compliance assessment. The activity plan should be submitted to the ACB for approval and be made available to the internal audit.

iv. To report promptly to the Board / ACB / MD & CEO about any major changes / observations relating to the compliance risk.

v. To periodically report on compliance failures/breaches to the Board/ACB and circulating to the concerned functional heads.

vi. To monitor and periodically test compliance by performing sufficient and representative compliance testing. The results of the compliance testing should be placed to Board/ACB/MD & CEO.

vii. To examine sustenance of compliance as an integral part of compliance testing and annual compliance assessment exercise.

viii. To ensure compliance of Supervisory observations made by RBI and/or any other directions in both letter and spirit in a time bound and sustainable manner.

Note: The bank's Board of Directors shall be overall responsible for overseeing the effective management of the bank's compliance function and compliance risk. The MD & CEO shall ensure the presence of independent compliance function and adherence to the compliance policy of the bank.

GUIDELINES ON COMPENSATION OF WHOLETIME DIRECTORS/CHIEF EXECUTIVE OFFICERS/ MATERIAL RISK TAKERS AND CONTROL FUNCTION STAFF

A review of these guidelines issued in 2012-13 was carried out to comply with Guidelines with Financial Stability Board's (FSB) Principles and Implementation Standards for Sound Compensation Practices and the Supplementary Guidance issued by FSB in March 2018. After extensive consideration of views of all stake holders, the RBI has amended and superseded the 2012-13 guidelines vide its Circular dated November 4, 2019. In year 2021, RBI has clarified that the fair value thus arrived at should be recognised as expense beginning with the accounting period for which approval has been granted.

All applications for approval of appointment/re-appointment or approval of remuneration/revision in remuneration of Whole Time Directors (WTDs)/ Chief Executive Officers (CEOs) shall be submitted with full details as prescribed in amended guidelines.

Private sector banks, foreign banks operating under the Wholly Owned Subsidiary mode (WOS), and foreign banks operating in India under the branch mode are required to obtain regulatory approval for grant of remuneration (i.e. compensation) to WTDs/ CEOs in terms of Section 35B of the Banking Regulation Act, 1949 (B.R. Act, 1949).The approval process will involve, an assessment of whether the bank's compensation policies and practices are in accordance with the Guidelines.

Salient features:

a. The Guidelines are applicable to private sector banks, including Local Area Banks, Small Finance Banks and Payments Banks.

b. Foreign banks operating in India under branch mode would be required to continue to submit a declaration to RBI annually from their Head Offices to the effect that their compensation structure in

India, including that of CEO's, is in conformity with the FSB Principles and Standards. RBI would take this into account while approving CEOs' compensation.

c. The compensation proposals for CEOs and other staff of foreign banks operating in India that have not adopted the FSB principles in their home country are required to implement the compensation Guidelines as prescribed for private sector banks in India, to the extent applicable to them.

d. For the foreign banks operating in India by way of Wholly Owned Subsidiary (WOS) structure, the compensation Guidelines as prescribed for private sector banks in India will be applicable.

These guidelines cover in detail :

- Compensation policy including bonuses, ESOPs, pension plan, gratuity etc.
- Constitution of Nomination and Remuneration Committee (NRC).
- Effective alignment of compensation with prudent risk taking for Whole Time Directors / Chief Executive Officers / Material Risk Takers (MRTs) covering a) Fixed Pay and Perquisites b) Variable Pay c) Malus/ Clawback d) Guaranteed Bonus e) Hedging.
- Guidelines for risk control and compliance staff.
- Guideline for other categories of staff.
- Identification of Material Risk Takers of the bank.
- Disclosure.
- Regulatory and Supervisory Approval / Oversight.

RESTRICTIONS ON EMPLOYMENT

There are certain restrictions imposed on a banking company under Section 10 of the Banking Regulation Act, 1949. They are as under:

A banking company cannot

a. employ or allow a Managing agent to manage its affairs.

b. employ any person who is or at any time in the past has been an adjudicated insolvent, or has suspended payment or has compounded with his creditors, or who is, or has been, convicted by a criminal court of an offence involving moral turpitude or whose remuneration or part of whose remuneration takes the form of commission or of a share in the profits of the company.

c. employ a person whose remuneration according to RBI, is excessive.

d. allow a person to manage its affairs, who is a Director of any other company. (excepting a subsidiary of the banking company, or a company registered under section 8 of the Companies Act, 2013. *[The prohibition mentioned in this sub-clause will not apply in respect of any such Director for a temporary period not exceeding three months or such further period not exceeding nine months as the RBI may allow]*.

e. employ a person who is engaged in any other business or vocation; or whose term of office as a person Managing the company is for period exceeding five years at any one time (excepting renewal of term of office as specified under the Banking Regulation Act, 1949].

CONTROL OVER MANAGEMENT/ DIRECTORS/OTHER PERSONS

As a measure of control over management and other persons of a banking company, Section 36AA of the Banking Regulation Act confers powers to RBI, to remove managerial and other persons from office, under certain circumstances.

If the RBI is satisfied that in the public interest or in the overall interest of the banking company as well as to protect the interests of depositors it is necessary to remove a managerial person, it can remove by a written order with effect from any specified date any Chairman, Director, Chief Executive Officer (by whatever name called) or other officer or employee of the banking company. Before removal, such persons who are being removed would be given a reasonable opportunity to make a presentation to RBI, against the said order.

Pending the consideration of the representation from persons facing removal, in the opinion of RBI any delay in the interim would harm the interests of the bank or its depositors, order such persons not to take part either directly or indirectly in the management of, the banking company. Persons who are facing an order of removal from RBI, within thirty days from the date of communication of the order, can appeal to the Central Government against the order. After considering the appeal, the Central government may take a decision and communicate the same to the concerned persons who have made the appeal and it's decision would be final in the matter. The decision of the Central Government cannot be questioned in any court.

Such persons who are facing removal order from RBI, cease to be Whole-time Chairman, Managing Director or Director or any other employees as the case may be of the banking company and cannot directly or indirectly, be concerned with, or take part in the management of, any banking company for period not exceeding five years or as stated in the order. Any one violating or contravenes the terms such order shall face punishment of fine up to two hundred and fifty rupees for each day during which such contravention continues. The person who has been removed is entitled to claim any compensation for the loss or termination of office.

Through a written order, RBI may appoint a suitable person in place of Chairman or Director or chief executive officer or other officer or employee who has been removed from his office with effect from such date as it may specify. The person who is thus appointed in the position of the removed employee will hold office for a period not exceeding three years and such further period not over three years at a time and such person will not incur any obligation or liability by reason only of his being a Chairman, Director or Chief Executive Officer or other officer or employee for anything done or omitted to be done in good faith in the execution of the duties of his office.

Supersession of Board of Directors

Under Section 36 ACA, RBI has the powers to supersede the Board of Directors of a Banking Company in certain cases. If RBI is of the opinion that it is necessary in the interests of a banking company or its depositors and in consultation with Central Government, through a written order, supersede the Board of Directors of such banking company for a period of not exceeding six months (subject to a maximum period of 12 months) or as specified in the order.

Appointment of Administrator

Upon superseding the Board of Directors, the RBI (after due consultation with the Central Government) will appoint, an Administrator (not an officer of the Central Government or a State Government) who has experience in law, finance, banking, economics or accountancy for such period as it determines. The Administrator so appointed, is bound to follow directions issued by the RBI in this regard. Consequent to the supersession of the Board of Directors, the Chairman, Managing Director and other Directors have to vacate their offices.

Powers/Duties/Role of Administrator

The Administrator will exercise all powers, discharge functions and perform duties that are applicable under the provisions of the Companies Act or the Banking Regulation Act or any other applicable law in force, until the Board of Directors is reconstituted.

Committee to assist the Administrator

The RBI in consultation with Central government may also appoint a committee of three or more persons who holding meetings. The RBI will specify salary and allowances payable to the Administrator and the members of the committee constituted and the same to be borne by the concerned banking company.

Time limit for reconstitution of the Board of Directors

Two months before the expiry of the period of supersession as specified in the RBI order issued earlier, the Administrator will call the general meeting of the company to elect new Directors and reconstitute its Board of Directors.

No compensation is payable to any person for the loss or termination of his office in the process. The Administrator will vacate the office immediately after the reconstitution of Board of Directors.

Highlights of guidelines on Appointment of Managing Director (MD) / Whole-Time Director (WTD) in Primary (Urban) Co-operative Banks

- These directions are applicable to all Primary (Urban) Co-operative Banks (UCBs).
- UCBs with a deposit size of less than `100 crore as per preceding year's audited balance sheet and all Salary Earners' Banks, inter-alia, are exempt from the requirement of seeking prior approval of the Reserve Bank of India.
- UCBs which have appointed CEO with the prior approval of the Reserve Bank in terms of the RBI's guidelines related to Constitution of Board of Management in Primary (Urban) Co-operative Banks, may continue with the CEO so appointed till completion of his / her tenure or for a period of three years from the date of initial appointment, whichever is earlier. After the aforesaid period, UCBs shall follow the directions issued herein for appointment / re-appointment of MD.
- UCBs, other than those stated above shall review the 'Fit and Proper' status of the existing MD in terms of these directions and confirm the same, with the approval of BoD, to the concerned Regional Office (Department of Supervision, Central Office, in case of UCBs under jurisdiction of Mumbai office) of Reserve Bank within a period of two months from the date of issue of this circular. In case, the present MD does not satisfy the prescribed 'Fit and Proper' criteria, the UCB shall initiate the process for appointment of new MD immediately. If a UCB had appointed WTD, the bank shall follow the same procedure to comply with these directions.
- All UCBs shall obtain a deed of covenants in the specified format from the present MD/ WTD who is found to be complying with these directions.
- Managing Director, who may also be designated as Chief Executive Officer or by any other name, is a person who is entrusted with the management of the whole, or substantially the whole of the affairs of a UCB, subject to the regulations or directions issued by the Reserve Bank from time to time. MD shall function under the overall general superintendence, direction and control of the Board of Directors (BoD).
- If a UCB decides to appoint Whole-Time Director (WTD), who may also be designated as Executive Director or by any other name, the need for such an appointment may be decided by the bank keeping in view the growth in business, expansion of activities, geographical footprints and organisational vision for growth in the medium and long term. The creation of the post of WTD and the functions that can be performed may be decided by the BoD and approved by the General Body of the bank. The WTD shall report to the Managing Director.
- The UCBs shall ensure that the 'fit and proper' criteria is fulfilled by the person being appointed as MD/ WTD.

CORPORATE GOVERNANCE

Corporate Governance and its importance

Banks are the backbone of an economy and play a crucial role in the distribution of capital. Hence, the proper governance of banks is essential for economic growth and development of the nation as a whole. According to Cadbury Committee report, corporate governance means the system by which companies are directed and controlled. 'Corporate Governance' in the context of banking denotes, managing the affairs of a banking company by adopting the global best practices so as to protect the interests of all stake holders such as depositors, other customers, investors, employees, regulatory authorities and society at large. Therefore the gamut of corporate governance involves several governance aspects namely regulatory, market, stake holder and internal governance aspects. For a balanced performance of an economy the country's economic and financial systems have to be stable. If any of these factors is found wanting there could be destabilization of the economy.

Banks are which are highly regulated in India form the back bone of the economy. Any failure of the governance factors will have its chain reaction on other sectors of the economy as banking industry is linked to nearly 80 industries. Therefore banks must follow and act in many ways so as to inspire confidence among all its stake holders. Hence good governance practices are a pre-requisite for a robust banking system in the interest of all. Poor governance in the banking system can lead to bank failures and consequently erode the confidence of depositors and other customers leading to run on banks and will have significant national and international negative fallouts.

Why Corporate governance is important for banking institutions?

The reasons are as follows:

- Financial institutions play a pivotal role in an economy. Any mishap therein will be detrimental to the economy and to get back to normalcy, it would take a long time which may impede growth plans.
- Financial institutions, especially banks are highly leveraged and this make them vulnerable to any adverse developments in the economy. Therefore in order to ensure economic stability, governance of these institutions is a must.
- Among financial institutions, banks are highly trusted organizations that deal with funds of the public at large. Anything amiss in its functions will result in loss of trust, leading eventually to the collapse of such institutions and also will have its contagion effect on the economy. Therefore good corporate governance is essential for building of trust among all stake holders in these institutions.
- Banks act as agents for transmission of monetary policies to the public. They also play a vital role in payment and settlement system in an economy. Any weaknesses arising out of poor or inadequate monitoring can be set right with robust internal controls which is an essential part of governance.

Therefore Corporate governance plays a beneficial role in an economy.

Evolution of Corporate Governance in Indian Banking

Though banks in India were highly regulated by RBI, guidelines for corporate governance were very limited before the reforms took place in the banking sector in India. Dominance of Public sector banks with a few private sector banks along with cooperative sector banks formed the space of banking in India previously. However the economic reforms of 1991-92 and subsequent banking reforms changed the scenario, More number of private banks and foreign banks entered the Indian banking scenario and began to function in a competitive manner with Public sector banks and old generation private sector banks in India. Banks were given more freedom in their functions as well as autonomy. Over a period, the share holding of Government of India also came down in Public sector banks, giving way to public shareholding. This has compelled banks to improve their governance standards.

International developments in corporate governance also contributed its share in the development of the same in India during late 1990s and early 2000. Guidelines of the Basel Committee, the Organization for Economic Cooperation and Development (OECD) principles on Corporate governance, developments in US during this period etc. had its impact on corporate governance aspects of banks in India. The South East Asian crisis of 1997 also made its impact about the need for proper corporate governance aspects of banks.

The seeds of corporate governance for banks in India began with the announcement of by Dr. Bimal Jalan, the then RBI Governor who in 2001 constituted an advisory group under Dr. R.H. Patil. This group looked in to the state of corporate governance prevailing in banks made a set of recommendations regarding governance standards in Indian banks in line with international best practices. Subsequently, a group under Dr. A.S. Ganguly was appointed, to study the role of Board of Directors of banks and suggest ways to strengthen the same. This report was shared with all banks and submitted to Central Government also for its consideration in mid 2002. Along with these another study group headed by Mr. M.S. Verma (former Chairman of SBI) was set up to make recommendations on Banking Supervision. This study group submitted its recommendations in early 2003. The Reserve Bank then took measures to strengthen the corporate governance in the Indian banking sector and try to bring it at par with international standards. On 21 August 2002, the then Department of Company Affairs instituted a committee to look into various corporate governance issues in the country.

The economic reforms and banking reforms brought in several changes in banking environment in India including Corporate governance. Increased entry of private and foreign banks, enhanced level of competition between various banks, conferring greater independence to Public Sector bank boards, granting morefunctional autonomy, appointment of independent directors on boards etc. called for a more enhanced level of corporate governance in banks in India. Though banks are highly regulated, the primary responsibility to develop governance practices rests on themselves. The Banking scams that took place in 1990s pointed to the gaps in disclosure and governance aspects of banks. All these developments resulted in bringing in a need for adoption and enforcement of best corporate governance standards among banks in India.

The April 2001 regulatory compulsion of SEBI on companies including banking companies in India, to follow strict corporate governance practices and disclosures under Clause 49 of the Listing Agreement ushered in a milestone in corporate governance among banks in India. However, in spite of various initiatives taken to entrench best Corporate governance practices among banks, certain impediments such as vast powers enjoyed by Government in appointment of members of board of banks, directive powers of RBI, disclosure practices etc. still exist.

Effect of lack of Corporate Governance

There are glaring national and international examples of involving banks that showed what an ineffective corporate governance can do to financial institutions and national economies. Enron crisis in early 2000, sub- prime crisis leading to collapse of Lehman Brothers and near collapse of the global financial system in 2008, the recent LIBOR crisis involving several leading American and European banks are all some of the international examples. Harshad Mehta Scam in 1992, Ketan Parekh scandal in 1997, Software giant Satyam Computer's crisis, folding up of Global Trust Bank (which later merged with a PSU Bank) etc. are some of the national examples in this regard. Even the latest Nirav Modi's case, points to the failure of governance aspects on the part of the concerned bank. The Punjab Maharashtra Co-operative Bank crisis which has erupted on September 23, 2019 also reveals the lack of proper corporate governance practices including failure of oversight functions leading to erosion of public confidence in banking institutions.

Good Corporate Governance standards include the following:

1. Establishing code of conduct and ethical behaviour right from the Board of Directors level to all other employees including accountability aspects thereof.
2. Constant review of role, responsibilities as well as accountability aspects of the Board of Directors.
3. Evaluating the effectiveness managing the operations of the bank by senior management.
4. Supervising strategic management and oversee risk management by establishing appropriate procedures for managing risks.

The Basel Committee in 1999, had pronounced some important oversight aspects within the organizational structure to maintain proper checks and balances. They are "(i) oversight by the board of directors or supervisory board; (ii) oversight by individuals not involved in the day-to-day running of the various business areas; (iii) direct line supervision of different business areas; (iv)Independent risk management and audit functions". Additionally there was an emphasis on key personnel being 'fit and proper' for their roles. These recommendations convey an undercurrent of governance standards in banks.

Regulatory Bodies involved in Corporate Governance of Banks

Among the financial regulators, RBI and SEBI play complementary roles in corporate governance of banks in India. Prudential norms and associated principles of Basel norms, form the basis of corporate governance in banks. Within RBI, the Board of Financial Supervision is concerned with corporate governance functions which has supervisory oversight of Department of Banking Supervision and Department of Non-banking Supervision and Financial Institutions Division. On the other hand SEBI which regulates securities markets, oversees the mandatory compliance of corporate governance norms in listed banks.

Qualitative Standards in Corporate Governance of Banks

Qualitative standards of corporate governance of a bank is reflected, in the following areas of working of a bank.

- Standard of Ethics in the organization;
- Standards of internal control;
- Role of Board of Directors;
- Disclosure standards;
- Accounting system;
- Risk management systems.

Governance and day to day management

It is the basic responsibility of operating management consisting of CEO, top management functionaries and line managers. It is the responsibility of operating management to ensure day to day management functions are carried out within the governing standards and plug loopholes by constant review.

Bench marks for evaluating Corporate Governance Standards

The bench marks for evaluation of corporate governance standards of a banking company include the following model codes for best practices, role of the board of directors and various committees, recommended disclosure requirements, level of transparency, reporting system to various levels including to the board of directors, policies framed by the board, monitoring performances at periodical intervals.

Indian scenario – RBI's initiatives

Due to economic liberalization, banking reforms as well as introduction of prudential regulations in 1990s, the emphasis of regulator shifted from control to governance. Banks were given more freedom as well as autonomy in their functional areas. This called for greater governance standards from the Board of Directors of banks. Keeping in mind the changed scenario several guidelines were issued by RBI to strengthen corporate governance in banks. These guidelines were in line with Basel Committee recommendations such as Role of the Board of Directors, fit and proper criteria of Board members, separation of the post of Chairman and Managing Director, remuneration aspects, role of independent directors, ownership and extent of shareholding in private sector banks and governance thereof. Further recently, guidelines on Non-Operative Financial Holding Companies, Fit and proper status of groups, Prompt Corrective Action etc. were also issued to strengthen Corporate governance of banks in India.

Judicial Pronouncement

In the matter of Assistant General Manager and Ors. vs. Radhey Shyam Pandey (02.03 . 2020 - SC) the Honorable Supreme Court was of the opinion that the employees who completed 15 years of service or more as on cutoff date were entitled to proportionate pension under SBI VRS to be computed as per SBI Pension Fund

Rules. Let the benefits be extended to all such similar employees retired under VRS on completion of 15 years of service without requiring them to rush to the court. However, considering the facts and circumstances, it would not be appropriate to burden the bank with interest. Let order be complied with and arrears be paid within three months, failing which amount to carry interest at the rate of 6 per cent per annum from the date of this order. The appeals are accordingly disposed of. No costs were issued.

LESSON ROUND-UP

- The Banking Regulation Act, 1949 was enacted with the view to provide a law for the banking companies.
- Licensing which includes the permission provided to banking companies for operating forms a major part of the BR Act, 1949.
- Certain eligibility criteria like Background of the banking companies, their sources of funds, their geographical locations are required to be fulfilled before to get licence to run banking business.
- In case of any non-fulfilment of the required conditions on continuous basis the license may be cancelled by RBI.
- When foreign banks want to operate in India, they have to seek permission of RBI for license. The prescribed procedures are almost same as applicable to other banks in the country.
- For private sectors banks continuous authorization policy is prescribed in place of Stop and Go policy.
- Other than licensing, RBI has provided separate guidelines for carrying out the activities of insurance, mutual funds etc.
- For Small Finance Banks & Payment Banks, RBI provides separate licensing norms and a handful number of banks are now operating in India. Directions for On-tap licensing has been made available now with for starting Payment Banks by private sector players.
- RBI provides detailed guidelines for branch licensing and no bank can operate unless it is licensed under Section 22 of Banking Regulation Act, 1949.
- Banks having general permission are allowed to shift, merge or close all ‘Banking Outlets’ (except rural outlets and sole semi-urban outlets) at their discretion.
- Merger, Closure and shifting of any rural ‘Banking Outlet’ as well as a sole semi urban ‘Banking Outlet’ would require approval of the DCC/DLRC.
- However where general permission has been withdrawn banks have to take the approval of Department of Banking Regulation in order to open the branches.
- A minimum amount of paid up capital has to be maintained both for domestic & foreign banks to start up their operations.
- Under Banking Regulation Act not less than 51% of the directors of the Board of Directors of the banking companies should have practical & special knowledge in subjects like Accountancy, economics, Taxation etc. Recently RBI has issued directions on– Not only that, the RBI holds special power to appoint and/ or remove Managing Director/Chairman in specified circumstances.
- Recently RBI has issued directions concerning procedure and criteria for determining the ‘fit and proper’ status of a person to be eligible to be elected as a director on the Board of Public Sector Banks.
- RBI has further announced conditions for appointments of MD&CEO/CEO/Part-time Chairman of Private Sector Banks in India.
- RBI has announced detailed guidelines on compensation of whole time directors/ chief executive officers/ material risk takers and control function staff in the light of compliance with Financial Stability Board’s (FSB) Principles and Implementation Standards for Sound Compensation Practices and the, covering the specified Private Sector Banks and foreign banks operating in India.

- RBI has released guidelines for formation of Board of Management (BoM) for Primary (Urban) Co- operative Banks (UCBs) with deposits of Rs. 100 crores and above including criteria for selection and appointment of members of BoM.
- To tighten the control on UCBs, RBI has also announced detailed guidelines on rationalization of Supervisory Action Framework incorporating Financial Action Parameters and Action trigger points.
- In line with Basel Committee recommendations, RBI has issued Guidelines on corporate governance covering areas such as Role of the Board of Directors, fit and proper criteria of Board members, separation of the post of Chairman and Managing Director, remuneration aspects, role of independent directors etc

GLOSSARY

Payment Banks ('PB') : a niche bank that can accept demand deposits (up to Rs 1 lakh), offer remittance services, mobile payments/transfers/purchases and their banking services like ATM/debit cards, net banking and third party fund transfers.

Foreign Direct Investment (FDI) : is an investment in the form of a controlling ownership in a business in one country by an entity based in another country.

Priority sector lending (PSL) : is an important role given by the Reserve Bank of India (RBI) to the banks for providing a specified portion of the bank lending to few specific sectors like agriculture and allied activities, micro and small enterprises, poor people for housing, students for education and other low income groups and weaker sections.

External Advisory Committee (EAC) : a committee appointed by RBI for evaluating Applications of Small Finance Banks and Payments Banks.

Non-Banking Finance Companies (NBFCs) : is a company registered under the Companies Act, 1956/2013 engaged in the business of loans and advances, acquisition of shares/stocks/bonds/ debentures/ securities issued by Government or local authority or other marketable securities of a like nature, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business

is that of agriculture activity, industrial activity, purchase or sale of any goods (other than securities) or providing any services and sale/purchase/ construction of immovable property.

Micro Finance Institutions (MFIs) : is an organization that offers financial services to low income populations.

Non-Operative Financial Holding Company (NOFHC) means a non-deposit taking NBFC referred to in the "Guidelines for Licensing of New Banks in the Private Sector"1 issued by Reserve Bank, which holds shares of a banking company and shares of all other financial services companies in its group, whether regulated by Reserve Bank or by any other financial regulator, to the extent permissible under the applicable regulatory prescriptions.

Local Area Banks (LABs) : small private banks, conceived as low cost structures which would provide efficient and competitive financial intermediation services in a limited area of operation, i.e., primarily in rural and semi-urban areas, comprising three contiguous districts.

Board of Management – (BoM) : A body of persons with special knowledge and practical experience in banking and other specified fields to facilitate professional management and focused attention to the banking related activities and advising Board of Directors of the UCBs.

Supervisory Action Framework (SAF) : A set of corrective action points to be adopted by RBI, for improvement and for expediting resolution of financially stressed UCBs.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What are the powers of RBI with reference to appointment Chairman, Managing Director and other directors of banks?
2. Write a brief note on branch licensing aspects of banks in India.
3. What are the various powers of RBI regarding control over Directors and other employees of banks? Discuss briefly the licensing of Private sector banks and RRBs in India.
4. Write a note on Importance and Evolution of Corporate governance in Banks in India.
5. Summarize the fit and proper criteria for a person to be elected as a Director in a PSU Bank.

Banking Operations

Lesson 4

KEY CONCEPTS

■ Know Your Customers (KYC) ■ CBS ■ Scrutiny ■ Unreconciled Entries

Learning Objectives

To understand:

- Accounting system and vouchers passed by banks under cash, clearing and transfer mode of transactions
- KYC and associated documentation formalities
- Operational formalities of loans including scrutiny of applications and documentation requirements
- An over view of back office operations
- Handling reconciliations

Lesson Outline

- Introduction
- Preparation of Vouchers, cash receipt and payment entries, clearing inward and outward entries, transfer debit and credit entries.
- What is KYC?
- What are the different documents to satisfy KYC?
- How to verify KYC and authenticity of documents?
- Operational aspects regarding opening of all types of accounts.
- Scrutiny of loan applications/documents.
- Accounting entries involved at various stages.
- Operational aspects of CBS environment.
- Back office operations in banks.
- Handling of un-reconciled entries in banks.
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Prevention of Money Laundering Act, 2002 (PMLA).
- The Income-tax Act, 1961.
- Banking Regulation Act, 1949.
- The Limited Liability Partnership Act, 2008.
- The Companies Act, 2013.

INTRODUCTION

The topic presented in this chapter deals with many aspects of operational banking areas such as preparation of vouchers; accounting entries; cash accounting; clearing; KYC; opening of accounts for different types of customers and formalities thereof; loan applications and related formalities, CBS environment, back office and reconciling of accounting entries. The objective of the contents is to give a reader an in-depth understanding of major operational domains in which a banker functions. The coverage of topics is interspersed with practical examples as found in day to day working of a bank for easy understanding. The contents will reinforce the basic knowledge of banking and add value in thorough understanding of certain nitty- gritties involved in operations.

The contents are based on RBI directions and will be useful in practical understanding of certain operational domains of deposits and advances, apart from the technology systems involved. The contents have been elab-orated to offer rationale for various procedures adopted by banks. The contents are of Level 1 and 2 orientation enabling students to reinforce themselves with deeper operational knowledge.

PREPARATION OF VOUCHERS

A voucher is essentially the backup documents / proof for a transaction. The Banks when debit or credit the customer's or other accounts, the customers or their details of the transaction is noted on a piece of paper (approved format by the bank) which is called as voucher. Example - paying-in-slip, cheques, office debit and credit vouchers used for their internal transactions (These do not have counterfoils). They serve as documentary evidence for a transaction. Office debit /credit vouchers are to be authenticated by sanctioning authority before the transaction is entered the system.

Whenever banks do any transaction for a customer, it results in accounting entries which are to be properly done as per the internal accounting procedures of the bank. To facilitate accounting entries vouchers are passed. Banks being commercial organizations follow double entry system of accounting. Double entry system consists of a debit and an equivalent credit to the respective heads of accounts.

For certain transactions customers themselves prepare the vouchers as given in the following example. A & B are having an account in the same branch.

A gave cheque to B for Rs. 10,000

↓

B filled pay-in-slip with all required details

↓

B handed over the slip with cheque to Branch

↓

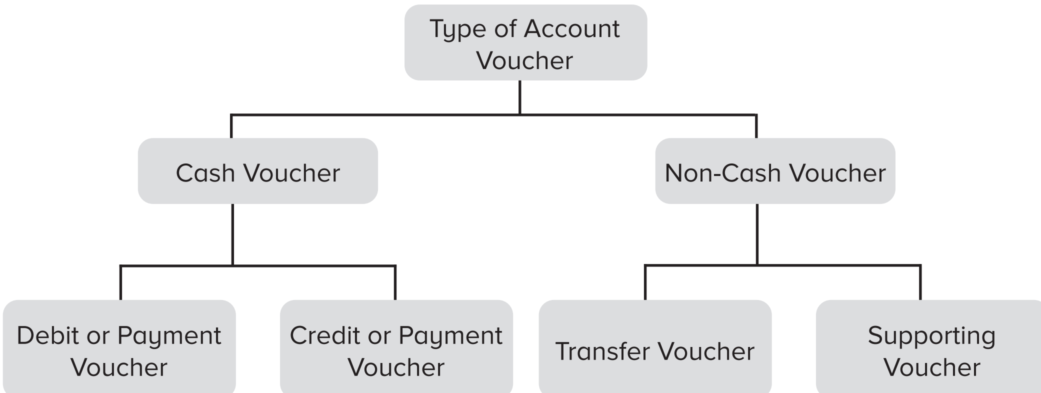
B handed over the slip with cheque to Branch

↓

Bank verify the details, Debit A's account and credit B's account with Rs. 10,000

Vouchers are prepared by banks themselves for transactions like debiting of charges towards interest due on loan accounts, locker rent, service charges, insurance charges, standing instructions etc. For this purpose, they would use a debit voucher of the bank, fill up all the required details, get it authorized and debit to the concerned account head and pass on the credit voucher which would have also been filled up by the same department, duly signed by the department-in-charge where debit entry originates.

ACCOUNTING ENTRIES OF TRANSACTIONS



Depositing a cheque for opening a term deposit of Rs. 1,00,000 from own Savings bank account, the resultantentries under the double entry system of accounting will be -

- **Debit:** Customer's Saving Bank Account Rs. 1,00,000.
- **Credit:** Term Deposit Account of the customer Rs. 1,00,000.

As it is evident from the above example, credit and debit entries are self- balancing in nature. Thus, in a bank branch there would be a series of transactions of debit and credit during a given day, due to large number of transactions of customers. However, due to age old accounting practice in banks, for normal day to day transactions of customers, vouchers are first posted in ledgers (basically these are equivalent 'subsidiaries' in accounting parlance) and later they are entered in journals. This is a diametrically opposite practice of conventional accountancy. Later at the end of the day the credit vouchers and debit vouchers of transactions pertaining to Savings Bank, Current Account, Term deposits, different loans accounts, bills etc. are entered in separate summary voucher sheets/books under cash, clearing, transfer types and thereafter the totals are posted in General ledger. Subsequently trial balance is prepared from the General ledger balances every day.

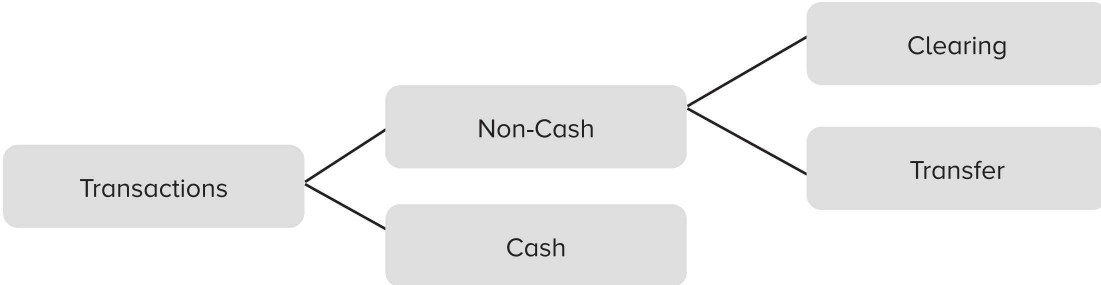
Before the introduction of computers, banks traditionally were doing all accounting entries manually by-passing physical vouchers for every transaction involving double entry system of accounting as described above. With computerized system of accounting, preparation of manual vouchers has reduced to a great extent.

It should be remembered however that computerized accounting is based on Double Entry System of accounting only. Hence staff members of banks should have a clear understanding of the basic concepts of preparation of vouchers using double entry system so that there is clarity about accounting entries made through computers.

> Double Entry System, in accounting, is a system of book keeping where every entry to an account requires a corresponding and opposite entry to a different account. The double-entry system has two equal and corresponding sides known as debit and credit.

Transaction types in a bank

In a bank, transactions can be classified in to cash and non-cash categories. The non-cash mode is made up oftwo components namely clearing and transfer. Thus, it can be represented as below:



The transactions may involve Customer to Customer, Customer to Bank, Bank to Customer and Bank to another Bank. For all practical purposes therefore, transaction vouchers may belong to any one of the three modes viz., cash or clearing or transfer.

Instruments / Vouchers used in Banking transactions

The following types of instruments/vouchers are generally being used as Debit vouchers in banks:

i. Cheques of customers.

ii. Banker's cheques (also known as Pay orders). Banker's cheques / Pay orders are issued by the bank of a branch on itself.

[***Note***: *Banks have stopped issuing Pay order in favor of customers as per RBI directions. They issue these only for settling payments with other banks*].

iii. Withdrawal forms at the counter issued to Savings Bank customers.

iv. Letter of Authority (for debits) issued by customers duly signed by Authorized Signatories for standing instructions/ transfer in respect of specific transactions.

v. Drafts issued by the branches of the same bank on one another / Payable at par drawn on service branches.

vi. Drafts issued by correspondent banks on one another for payment. (Similar to DD issued branches on one another).

vii. Deposit receipts/Recurring deposit pass books, on maturity of the respective deposits.

viii. Interest warrants/Dividend warrants/Refund orders issued by the banks/corporates and payable by the bank/branch as per arrangement with Corporates. [Issuing and paying banks in Merchant Banking].

ix. Bank's Debit vouchers duly authorized by customers/officials of the bank towards transactions where debit to customers' accounts are involved.

x. Travelers cheques/Gift cheques of the bank or other banks as per arrangement.

xi. Debit advices of other branches/banks in respect of certain collection charges etc. (Inter-bank and intra-bank).

It is also a practice in banks to prepare a common/single debit voucher for many payments originating from a single account such as Salary payment, Bonus payment, interest payments on term deposits etc.

The following are being used as Credit Vouchers in banking transactions:

i. Pay-in-slips of banks.

ii. Applications for NEFT / RTGS / Pay orders / Gift cheques / Travelers cheques etc. made by customers / bankers for the respective transactions.

iii. Challans for State/Central Government transactions such as Income Tax, GST, Professional Tax, Estate Duty Tax, Wealth tax, Public Provident Fund, Municipal Taxes, Stamp duty payments etc.

iv. Credit Vouchers prepared by the bank on its stationery for various transactions either on behalf of customer or on its own account.

v. Credit Memo/Advice from other banks in respect of collection items sent to other banks.

It is also a practice in banks to prepare a single/common credit voucher for many debits involving multiple accounts at the same branch and the credit is afforded to a single beneficiary's account e.g., electricity bill, school fees etc.

Cash receipt and payment entries

Following are some examples:

A. Cash Receipt transaction / entry

Mr. R deposits Rs. 10,000 in his Savings Bank account. The accounting Voucher / Debit entries will be

- **Debit-** (Cash) A/c - Rs. 10,000. (For cash transaction no separate voucher is passed as per prevailing practice; but it gets reflected in the total of the cash scroll taken in the cash book).
- **Credit** - Saving Bank account of Mr. R - Rs. 10,000 [through a Pay-in-slip (Credit voucher for Cash entry)].

The transaction set will be reflected as cash transactions in subsidiary books of account as well as in journals.

B. Cash Payment (Withdrawal) transaction / entry

Mr. B & Co., a proprietorship company has issued a bearer cheque to Mr. J for Rs. 3000 and the bearer has come to the branch with the cheque for encashment. The accounting Voucher / Debit entries will be:

- **Debit** - B & Co. account - Rs.3000. The cheque itself will form the debit voucher which will be first entered in the ledger account and after due verification will be delivered to the cash department for payment.
- **Credit** - Cash Account - Rs. 3000 (For cash transaction no separate voucher is passed as per prevailing practice; but it gets reflected in the total of the cash payments scroll taken in the cash book).

Clearing outward and inward entries, transfer debit and credit entries.

Clearing Transactions

C. Clearing Outward: The term represents cheques received by the collecting banker from their customers through the clearing house at the respective centres. (If A deposits a cheque in his account with SBI which is given to him by B who has his account with Bank of Baroda. Then this cheque is clearing outward for SBI which acts as Collecting bank and is clearing inward for bank of Baroda which acts as a Paying Bank.

An example to illustrate the clearing outward transaction is given below:

A Limited has deposited a clearing cheque for amount of Rs. 1,00,000 drawn on SBI, with its bank for the credit of its account.

- **Debit** - Clearing Adjustment Account of Service branch Rs. 1,00,000. (This will ultimately be reflected in the debit raised on the drawee bank, i.e., SBI, through the clearing house. The cheque deposited by A Limited will serve as debit voucher. However, as cheques belonging to different banks would be sent to them, a gross debit voucher for the entire clearing of the branch would be passed, in which the amount of Rs. 1,00,000 would also be included).

- **Credit** - Current Account of 'A' Limited through a Credit Voucher (Pay-in-slip prepared by A Limited at the time of deposit of cheque). However as per clearing house practices the amount so deposited will be available to the customer only after the return time zone as per local clearing house practice.

D. Clearing inward: Clearing inward term represents cheques received by a bank for debiting its customer's accounts with it. In other words, the bank which received the cheques for payment will be the drawer's bank (paying bank) which has to pay the amount of the cheques to the collecting bank) through the clearing house at the respective centres.

An example to illustrate the clearing inward transaction is given below:

Info Limited holder of s a Current Account with Canara Bank has issued a salary cheque to Mrs. P for Rs. 8000. Mrs. P maintains a Savings Bank account with Bank of India.

The entries during inward clearing:

- **Debit -** Info Limited account for Rs. 8000 maintained with Canara Bank and the amount would be passed on as a Credit to Bank of India through the clearing house for crediting to the account of Mrs. P. The cheque would have been presented to Canara Bank in their inward clearing by Bank of India through the local clearing house. The cheque itself would serve as the debit voucher in the transaction. The amount of Rs. 8000 would also have been included as a part of total debit raised by Bank of India through clearing house on Canara Bank.

- **Credit-** Bank of India Savings Bank account of Mrs. P, Pay-in-slip prepared by Mrs. P at the time of deposit of her salary cheque with Bank of India would serve as the credit voucher. However as per clearing house practices the amount so deposited will be available to the customer only after the return time as per local practice. Canara Bank would have included the amount of Rs.8000 as a part of the total credit passed on to Bank of India through the clearing house.

E. Transfer Transaction

Mrs. N has given a cheque for Rs. 2,00,000 from her bank account towards a term deposit to be opened in her name along with a pay-in-slip for crediting her deposit account. Since the transaction is a transaction in the same branch the entries are as follows-

- **Debit -** SB Account of Mrs. N for Rs. 2,00,000 by way of transfer. The cheque itself will serve as the debit transfer voucher.

- **Credit -** New Term deposit account of Mrs. N. The pay-in-slip itself will serve as the credit transfer voucher.

The transaction set will be reflected as transfer transaction in subsidiary books of account as well as in journals.

KYC IN BANKS

What is KYC?

KYC stands for Know Your Customer. KYC forms part of Anti-Money Laundering measures taken by the Government of India and RBI, as a part of international agreements. Money laundering activities are those activities in which money earned by illegal means [as defined in the Prevention of Money Laundering Activities Act, 2002 (PMLA)] are made to appear as proceeds from legal means. In this process unscrupulous persons/ criminals use banks as conduits for depositing and transferring illegal money. To prevent such attempts of

Form KYC Version - II - 071212

Know Your Customer(KYC) Form

(To be filled in black ink with BLOCK LETTERS by consumer while registering for LPG Gas connection
* are mendatory)

Paste your photo here

1. **Customer Details ***

a. Name shall be entered as per Photo ID Proof)

(Mr./Ms./Mrs/Miss/Dr)*

First Name*	
Middle Name	
Last Name*	

b. Gas Consumer Number

(Mandatory for existing customers)

c. Date of Birfth*

D D M M Y Y

2. **Details of Close Relatives**

a. Father's Name*

b. Mother's Name

c. Name of Spouse

3. **Proof of address (POA)** (At least copy of one of the following documents listed below is to be attached/scanned with this form. Consumer is required to produce the original of document for verification by the distributor, when sought for. Kindly tick the POA provided by you below and fill up address details in S.No. 4 below accordingly)

- Aadhaar (UID)
- Lease agreement
- Telephone/Electricity/Water bill
- Self-declaration attested by a Gazetted Officer
- Flat allotment/possession letter
- LIC Policy
- Driving License
- Voter ID
- Passport
- Ration Card
- House registration document
- Bank/Credit Card Statement

4. **Connection Address/Contact Information*** (Address should be written as per Proof of Address)

House #*	
House Name/Flat Floor #	
Housing Complex/Building #	
Street/Road Name	
City/Town/Village*	
District*	
State*	
PIN Code*	
Furnish here any other address related information which is not in the Proof of Address, but will help locate the house (Floor, landmark etc)	

banks being used as conduits in the money laundering process, RBI has issued specific directions/guidelines. In terms of such directions every banking entity must frame policies, procedures and controls duly approved by respective Board of Directors, for managing the risk of money laundering.

From time to time, RBI issues updated KYC directions/ guidelines for all financial institutions covering deposits, loans as well as money remittances. This is required to be complied with banks, failing which stiff penalties are levied.

These guidelines cover the following:

(1) **Customer Acceptance Policy:** This policy must be followed by every bank/financial institution so that accounts are opened for genuine customers based on stipulated documentary proof. This is also to ensure that:

(a) No account is opened in anonymous or fictitious/benami name.

(b) No account is opened where the Reporting Entity (RE) is unable to apply appropriate Customer Due Diligence ('CDD') measures, either due to non- cooperation of the customer or non- reliability of the documents/information furnished by the customer.

(c) No transaction or account-based relationship is undertaken without following the CDD procedure.

(d) The mandatory information to be sought for KYC purpose while opening an account and during the periodic up-dation, is specified.

(e) Optional/additional information is obtained with the explicit consent of the customer after the account is opened.

(f) REs shall apply the CDD procedure at the UCIC level. Thus, if an existing KYC compliant customer of a RE desires to open another account with the same RE, there shall be no need for a fresh CDD exercise.

(g) CDD Procedure is followed for all the joint account holders, while opening a joint account.

(h) Circumstances in which, a customer is permitted to act on behalf of another person/entity, is clearly spelt out.

(i) Suitable system is put in place to ensure that the identity of the customer does not match with any person or entity, whose name appears in the sanctions lists circulated by Reserve Bank of India.

(j) As per RBI circular dated January 9, 2020 where PAN is obtained, the same shall be verified from the verification facility of the issuing authority. And where an equivalent e-document is obtained from the customer, RE shall verify the digital signature as per the provisions of the Information Technology Act, 2000.

Customer Acceptance Policy shall not result in denial of banking/financial facility to members of the general public, especially those, who are financially or socially disadvantaged.

2. Risk Management

For Risk Management, Banks shall have a risk based approach which includes the following:

(a) Customers shall be categorised as low, medium and high risk category, based on the assessment and risk perception of the banks.

(b) Risk categorisation shall be undertaken based on parameters such as customer's identity, social/ financial status, nature of business activity, and information about the clients' business and their location etc. While considering customer's identity, the ability to confirm identity documents through online or other services offered by issuing authorities may also be factored in.

Provided that various other information collected from different categories of customers relating to the perceived risk, is non-intrusive and the same is specified in the KYC policy.

"Officially Valid Document" (OVD) means -

- The passport,
- The driving license,
- Proof of possession of Aadhaar number,
- The Voter's Identity Card issued by the Election Commission of India,
- Job card issued by NREGA duly signed by an officer of the State Government, and Letter issued by the National Population Register containing details of name and address.

For this clause, a document shall be deemed to be an OVD even if there is a change in the name subsequent to its issuance provided it is supported by a marriage certificate issued by the State Government or Gazette notification, indicating such a change of name.

Provided that,

a. where the customer submits his proof of possession of Aadhaar number as an OVD, he may submit it in such form as are issued by the Unique Identification Authority of India.

b. where the OVD furnished by the customer does not have updated address, the following documents shall be deemed to be OVDs for the limited purpose of proof of Address.

   i. utility bill which is not more than two months old of any service provider (electricity, telephone, post-paid mobile phone, piped gas, water bill);

   ii. property or Municipal tax receipt;

   iii,. pension or family pension payment orders (PPOs) issued to retired employees by Government Departments or Public Sector Undertakings, if they contain the address;

   iv. letter of allotment of accommodation from employer issued by State Government or Central Government Departments, statutory or regulatory bodies, public sector undertakings, scheduled commercial banks, financial institutions and listed companies and leave and licence agreements with such employers allotting official accommodation.

c. the customer shall submit OVD with current address within a period of three months of submitting the documents specified at 'b' above.

d. where the OVD presented by a foreign national does not contain the details of address, in such case the documents issued by the Government departments of foreign jurisdictions and letter issued by the Foreign Embassy or Mission in India shall be accepted as proof of address. For undertaking CDD, REs shall obtain the following from an individual while establishing an account-based relationship or while dealing with the individual who is a beneficial owner, authorised signatory or the power of attorney holder related to any legal entity:(a) a certified copy of any OVD containing details of his identity and address (b) one recent photograph (c) the Permanent Account Number or Form No. 60 as defined in Income-tax Rules, 1962, and (d) such other documents pertaining to the nature of business or financial status specified by the REs in their KYC policy.

3. Customer Identification Procedure (CIP)

REs shall undertake identification of customers in the following cases:

a. Commencement of an account-based relationship with the customer.

b. Carrying out any international money transfer operations for a person who is not an account holder of the bank.

c. When there is a doubt about the authenticity or adequacy of the customer identification data it has obtained.

d. Selling third party products as agents, selling their own products, payment of dues of credit cards/sale and reloading of prepaid/travel cards and any other product for more than rupees fifty thousand.

e. Carrying out transactions for a non-account-based customer, that is a walk-in customer, where the amount involved is equal to or exceeds rupees fifty thousand, whether conducted as a single transaction or several transactions that appear to be connected.

f. When a RE has reason to believe that a customer (account- based or walk-in) is intentionally structuring a transaction into a series of transactions below the threshold of rupees fifty thousand.

g. REs shall ensure that introduction is not to be sought while opening accounts.

For the purpose of verifying the identity of customers at the time of commencement of an account- based relationship, REs, shall at their option, rely on customer due diligence done by a third party, subject to the following conditions:

a. Records or the information of the customer due diligence carried out by the third party is obtained within two days from the third party or from the Central KYC Records Registry.

b. Adequate steps are taken by REs to satisfy themselves that copies of identification data and other relevant documentation relating to the customer due diligence requirements shall be made available from the third party upon request without delay.

c. The third party is regulated, supervised or monitored for, and has measures in place for, compliance with customer due diligence and record-keeping requirements in line with the requirements and obligations under the PML Act.

d. The third party shall not be based in a country or jurisdiction assessed as high risk.

e. The ultimate responsibility for customer due diligence and undertaking enhanced due diligence measures, as applicable, will be with the RE.

On May 04, 2023 RBI amended the Master Direction on KYC and it has been decided to amend the MD on KYC to (a) align the instructions with the recent amendments carried out in the Prevention of Money Laundering (Maintenance of Records) Rules, 2005, (b) incorporate instructions in terms of the Government Order dated January 30, 2023, titled "Procedure for Implementation of Section 12A of the Weapons of Mass Destruction (WMD) and their Delivery Systems (Prohibition of Unlawful Activities) Act, 2005 (WMD Act, 2005)"; (c) update certain instructions in accordance with FATF Recommendations; and (d) refine certain extant instructions post review.

What are the different documents to satisfy KYC?

The following table gives different documents required under KYC norms, depending upon the legal status of different customers such as Individuals, Proprietorship, Partnership, Trust, Companies, Trust etc.

Type of Account holder/Legal entity	Documents for Identity Proof & Proof of Address
Accounts of Individual	For undertaking Customer Due Diligence, Banks shall obtain the following from an individual while establishing an account-based relationship or while dealing with the individual who is a beneficial owner, authorised signatory or the power of attorney holder related to any legal entity: (a) a certified copy of any officially valid document (OVD) containing details of his identity and address (b) one recent photograph (c) the Permanent Account Number or Form No. 60 as defined in Incometax Rules, 1962, and (d) such other documents pertaining to the nature of business or financial status specified by the REs in their KYC policy. Provided that, i) Banks shall obtain the Aadhaar number from an individual who is desirous of receiving any benefit or subsidy under any scheme notified under section 7 of the Aadhaar (Targeted Delivery of Financial and Other subsidies, Benefits and Services) Act, 2016 (18 of 2016). or he decides to submit his Aadhaar number voluntarily to a bank or the proof of possession of Aadhaar number where offline verification can be carried out or where offline verification cannot be carried out or any OVD or the equivalent e-document thereof containing the details of his identity and address and the Permanent Account Number or the equivalent edocument thereof or Form No. 60 as defined in Income- tax Rules, 1962; and such other documents including in respect of the nature of business and financial status of the customer, or the equivalent e-documents thereof as may be required by the RE (RBI circular dated January 9, 2020):

	Banks, at receipt of the Aadhaar number from the customer may carry out authentication of the customer's Aadhaar number using e-KYC authentication facility provided by the Unique Identification Authority of India. According to RBI Circular dated January 9, 2020, further, in such a case, if customer wants to provide a current address, different from the address as per the identity information available in the Central Identities Data Repository, he may give a self-declaration to that effect to the RE.
	i) Where proof of possession of Aadhaar under clause mentioned above where offline verification can be carried out, the RE shall carry out offline verification. ii) an equivalent e-document of any OVD, the RE shall verify the digital signature as per the provisions of the Information Technology Act, 2000 (21 of 2000) and any rules/ issues thereunder and take a live photo as specified. iii) any OVD or proof of possession of Aadhaar number under the above clause where offline verification cannot be carried out, the RE shall carry out verification through digital KYC as specified under. Provided that for a period not beyond such date as may be notified by the Government for a class of REs, instead of carrying out digital KYC, the RE pertaining to such class may obtain a certified copy of the proof of possession of Aadhaar number or the OVD and a recent photograph where an equivalent e-document is not submitted. iv) Banks may carry out Aadhaar authentication/ offline-verification of an individual who voluntarily uses his Aadhaar number for identification purpose. (Note: "Offline" verification as defined in Section 2 of The Aadhar Act, 2016) In cases where successful authentication has been carried out, other OVD and photograph need not be submitted by the customer. Provided further that in case biometric e-KYC authentication cannot be performed for an individual desirous of receiving any benefit or subsidy under any scheme notified under section 7 of the Aadhaar (Targeted Delivery of Financial and Other subsidies, Benefits and Services) Act, 2016 owing to injury, illness or infirmity on account of old age or otherwise, and similar causes, Regulated Entities shall, apart from obtaining the Aadhaar number, perform identification preferably by carrying out offline verification or alternatively by obtaining the certified copy of any other OVD from the customer. Customer Due Diligence done in this manner shall invariably be carried out by an official of the, Regulated Entities and such exception handling shall also be a part of the concurrent audit as mandated in Section 8 of the Aadhar Act, 2016. REs shall ensure to duly record the cases of exception handling in a centralised exception database. The database shall contain the details of grounds of granting exception, customer details, name of the designated official authorising the exception and additional details, if any. The database shall be subjected to periodic internal audit/inspection by the, Regulated Entities and shall be available for supervisory review *Explanation 1:* Regulated Entities shall, where its customer submits his Aadhaar number or proof of possession of Aadhar containing Aadhar number, ensure such customer to redact1 or blackout his Aadhaar number through appropriate means where the authentication of Aadhaar number is not required under clauses mentioned above. *Explanation 2:* Biometric based e-KYC authentication can be done by bank official/ business correspondents/business facilitators.

	Explanation 3: The use of Aadhaar, proof of possession of Aadhaar etc., shall be in accordance with the Aadhaar (Targeted Delivery of Financial and Other Subsidies Benefits and Services) Act, the Aadhaar and Other Law (Amendment) Ordinance, 2016 and the regulations made thereunder. Accounts opened using OTP based e-KYC, in non-face-to-face mode are subject to the following conditions: i. There must be a specific consent from the customer for authentication through OTP. ii. the aggregate balance of all the deposit accounts of the customer shall not exceed rupees one lakh. In case, the balance exceeds the threshold, the account shall cease to be operational, till CDD as mentioned at (v) below is complete. iii. the aggregate of all credits in a financial year, in all the deposit accounts taken together, shall not exceed rupees two lakh. iv. As regards borrowal accounts, only term loans shall be sanctioned. The aggregate amount of term loans sanctioned shall not exceed rupees sixty thousand in a year. v. Accounts, both deposit and borrowal, opened using OTP based e-KYC shall not be allowed for more than one year within which identification as per Section 16 is to be carried out. vi. If the CDD procedure as mentioned above is not completed within a year, in respect of deposit accounts, the same shall be closed immediately. In respect of borrowal accounts no further debits shall be allowed. vii. 12A declaration shall be obtained from the customer to the effect that no other account has been opened nor will be opened using OTP based KYC in non-face-to-face mode with any other Regulated Entities. Further, while uploading KYC information to CKYCR, Regulated Entities shall clearly indicate that such accounts are opened using OTP based e-KYC and other, Regulated Entities shall not open accounts based on the KYC information of accounts opened with OTP based e-KYC procedure in non-face-to-face mode. viii. Regulated Entities shall have strict monitoring procedures including systems to generate alerts in case of any non-compliance/violation, to ensure compliance with the above mentioned conditions.
In case an individual customer who does not possess Section 16 of KYC Master Directions	A Bank may open a 'Small Account', subject to: a. the aggregate of all credits in a financial year does not exceed rupees one lakh; b. the aggregate of all withdrawals and transfers in a month does not exceed rupees ten thousand; and the balance at any point of time does not exceed rupees fifty thousand. c. Provided, that this limit on balance shall not be considered while making deposits through Government grants, welfare benefits and payment against procurements. Further, small accounts are subject to the following conditions: a. The bank shall obtain a self-attested photograph from the customer. b. The designated officer of the bank certifies under his signature that the person opening the account has affixed his signature or thumb impression in his presence. Provided that where the individual is a prisoner in a jail, the signature or thumb print shall be affixed in presence of the officer in-charge of the jail and the said officer shall certify the same under his signature and the account shall remain operational on annual submission of certificate of roof of address issued by the officer in-charge of the jail.

[1] censor or obscure (part of a text) for legal or security purposes

	c. Such accounts are opened only at Core Banking Solution (CBS) linked branches or in a branch where it is possible to manually monitor and ensure that foreign remittances are not credited to the account. d. Banks to ensure that the stipulated monthly and annual limits on aggregate of transactions and balance requirements in such accounts are not breached, before a transaction is allowed to take place. e. The account shall remain operational initially for a period of twelve months which can be extended for a further period of twelve months, provided the account holder applies and furnishes evidence of having applied for any of the OVDs during the first twelve months of the opening of the said account. f. The entire relaxation provisions shall be reviewed after twenty four months. g. Notwithstanding anything contained in clauses (e) and (f) above, the small account shall remain operational between April 1, 2020 and June 30, 2020 and such other periods as may be notified by the Central Government. h. The account shall be monitored and when there is suspicion of money laundering or financing of terrorism activities or other high risk scenarios, the identity of the customer shall be established as per Section 16 of the Master Directions on KYC. i. Foreign remittance shall not be allowed to be credited into the account unless the identity of the customer is fully established as per Section 16 of the Master Directions on KYC.
Sole proprietary firm	1. For opening an account in the name of a sole proprietary firm, CDD of the individual (proprietor) shall be carried out. 2. Any two of the following documents or the equivalent e-documents there of as proof of business/ activity in the name of the proprietary firm: a. Registration certificate. b. Certificate / licences issued by the municipal authorities under Shop and Establishment Act. c. Sales Tax and income tax returns. d. CST/VAT/GST certificate(provisional/final). e. Certificate/registration document issued by Sales Tax / Service Tax / Professional Tax authorities f. IEC (Importer Exporter Code) issued to the proprietary concern by the office of DGFT Or Licence / certificate of practice issued in the name of the proprietary concern by any professional body incorporated under a statute g. Complete Income Tax Return (not just the acknowledgement) in the name of the sole proprietor where the firm's income is reflected, duly authenticated/ acknowledged by the Income Tax authorities. i. Utility bills such as electricity, water, and landline telephone bills. ii. If the bank is satisfied that it is not possible to furnish two such documents, at its discretion, accept only one of those documents as proof of business/ activity subject to field verification of the authenticity of address and business activity. Provided REs undertake contact point verification and collect such other information and clarification as would be required to establish the existence of such firm, and shall confirm and satisfy itself that the business activity has been verified from the address of the proprietary concern.

Account of a company	Certified copies or the equivalent e-documents thereof each of the following - a. Certificate of incorporation; b. Memorandum and Articles of Association; c. Permanent Account Number of the company; d. A resolution from the Board of Directors and authority granted to its managers, officers or employees to transact on its behalf; and e. In addition, documents for CDD of individuals in respect of managers, officers or employees holding an attorney to transact on its behalf are to be obtained. f. Documents, as specified in Section 16 of the Master Directions, relating to beneficial owner, the managers, officers or employees, as the case may be, holding an attorney to transact on the company's behalf.
Account of a Partnership firm	Certified copies or the equivalent e-documents thereof of a. Registration certificate: b. Partnership deed; c. Permanent Account Number of the partnership firm; d. Documents, as specified in Section 16 of the Master Directions, relating to beneficial owner, managers, officers or employees, as the case may be, holding an attorney to transact on its behalf.
Account of a Trust	Certified copies or the equivalent e-documents thereof of each of the following documents to be obtained: a. Registration certificate; b. Trust deed; and c. Permanent Account Number or Form No. 60 of the trust. Documents as specified in Section 16 of the Master Directions, relating to beneficial owner, managers, officers or employees, as the case may be, holding an attorney to transact on its behalf.
Account of an unincorporated association or a body of individuals.	Certified copies or the equivalent e-documents thereof of each of the following documents to be obtained; a. Resolution of the managing body of such association or body of individuals; b. Authority granted to transact on its behalf (Resolution); c. Permanent Account Number or Form No. 60 of the unincorporated association or a body of individuals; d. Power of attorney granted to transact on its behalf;
(Note: Unregistered trusts/ partnership firms shall be included under the term 'unincorporated association'. The term 'body of individuals' includes societies.)	e. Documents as specified in Section 16, relating to beneficial owner, managers, officers or employees, as the case may be holding an attorney to transact on its behalf; and Such information as may be required by the RE to collectively establish the legal existence of such an association or body of individuals.

Accounts of juridical persons not specifically covered in the earlier part, societies, universities and local bodies like village panchayats.	Certified copies or the equivalent e-documents thereof the following documents to be obtained: a. Document showing name of the person authorized to act on behalf of the entity; b. Documents, for CDD, of the person holding an attorney to transact on its behalf; and c. Any other document bank may require establishing the legal existence of such an entity / juridical person such as orders of the concerned Government Department.
Self Help Groups (SHGs)	Under the simplified norms: a. CDD of all the members of SHG shall not be required while opening the savings bank account of the SHG. CDD of all the office bearers shall suffice. b. CDD of all the office bearers shall suffice. c. No separate CDD as per the CDD procedure mentioned in Section 16 of the Master Directions of the members or office bearers shall be necessary at the time of credit linking of SHGs. d. On April 01, 2021, the RBI after review of Master Direction on KYC norms of Self Help Groups decided to amend clause (c) of Section 43 to read as under: "Customer Due Diligence (CDD) of all the members of SHG may be undertaken at the time of credit linking of SHGs." and shall come into force with immediate effect.
Foreign Students	Banks can open a Non-Resident Ordinary (NRO) bank account of a foreign student based on the following documents: (a) His/her passport (with visa & immigration endorsement) bearing the proof of identity and address in the home country; with a photograph and a letter offering admission from the educational institution in India. Provided declaration about the local address shall be obtained within a period of 30 days of opening the account and the said local address is verified. Provided further pending the verification of address, the account shall be operated with a condition of allowing foreign remittances not exceeding USD 1,000 or equivalent into the account and a cap of rupees fifty thousand on aggregate in the same, during the 30-day period. (b) The account to be treated as a normal NRO account, and to be operated in terms of RBI's instructions on Non-Resident Ordinary Rupee (NRO) Account, and the provisions of FEMA, 1999. (c) Students with Pakistani nationality require prior approval of the RBI for opening the account.

Periodic Updation

Amended Section 38:

According to RBI guidelines, periodic updation of KYC data shall be carried out at least once in every two years for high risk customers, once in every eight years for medium risk customers and once in every ten years for low risk customers as per the following procedure by RBI.

Individual Customers:

a. **No change in KYC information:** In case of no change in the KYC information, a self-declaration from the customer in this regard shall be obtained through customer's email-id registered with the RE, customer's mobile number registered with the RE, ATMs, digital channels (such as online banking / internet banking, mobile application of RE), letter etc.

b. **Change in address:** In case of a change only in the address details of the customer, a self-declaration of the new address shall be obtained from the customer through customer's email-id registered with the RE, customer's mobile number registered with the RE, ATMs, digital channels (such as online banking / internet banking, mobile application of RE), letter etc., and the declared address shall be verified through positive confirmation within two months, by means such as address verification letter, contact point verification, deliverables etc.

   Further, REs, at their option, may obtain a copy of OVD or deemed OVD or the equivalent e-documents thereof, as defined in Section 3(a)(xiii), for the purpose of proof of address, declared by the customer at the time of periodic updation. Such requirement, however, shall be clearly specified by the REs in their internal KYC policy duly approved by the Board of Directors of REs or any Committee of the Board to which power has been delegated.

c. **Accounts of customers who were minor at the time of opening account on their becoming major:** In case of customers for whom account was opened when they were minor, fresh photographs shall be obtained on their becoming a major and at that time it shall be ensured that CDD documents as per the current CDD standards are available with the REs. Wherever required, REs may carry out fresh KYC of such customers, i.e., customers for whom account was opened when they were minor, on their becoming a major.

Customers other than individuals:

a. **No change in KYC information:** In case of no change in the KYC information of the LE customer, a self- declaration in this regard shall be obtained from the LE customer through its email id registered with the RE, ATMs, digital channels (such as online banking / internet banking, mobile application of RE), letter from an official authorized by the LE in this regard, board resolution etc. Further, REs shall ensure during this process that Beneficial Ownership (BO) information available with them is accurate and shall update the same, if required, to keep it as up-to-date as possible.

b. **Change in KYC information:** In case of change in KYC information, RE shall undertake the KYC process equivalent to that applicable for on-boarding a new LE customer.

Sharing KYC information with Central KYC Records Registry (CKYCR)

Effective from July 2015 Banks are required to share KYC information with the CKYCR in the manner mentioned in the Rules, as required by the revised KYC guidelines in formats prepared for 'individuals' and 'Legal Entities' as the case may be. Government of India has authorized the Central Registry of Securitization Asset Reconstruction and Security Interest of India (CERSAI), to act as, and to perform the functions of the CKYCR vide Gazette Notification No. S.O. 3183(E) dated November 26, 2015.

i. Banks must upload the KYC data pertaining to all new individual accounts opened on or after January 1, 2017 with CERSAI in terms of the provisions of the Prevention of Money Laundering (Maintenance of Records) Rules, 2005.

ii. Banks other than Scheduled Commercial Banks are to upload KYC data pertaining to all new individual accounts opened on or after from April 1, 2017 with CERSAI in terms of PMLA Rules, 2005.

iii. As the CKYCR is now fully operational for individual customers, it has been decided by the RBI to extend the CKYCR to Legal Entities (LEs). Accordingly, REs shall upload the KYC data pertaining to accounts of Legal Entities opened on or after April 1, 2021, on to CKYCR in terms of Rule 9 (1A) of the PML Rules.

iv. In order to ensure that all existing KYC records of individual customers are incrementally uploaded on to CKYCR, REs shall upload the KYC data pertaining to accounts of individuals opened prior to

January 01, 2017, at the time of periodic updation as specified in Section 38 of the Master Direction, or earlier when the updated KYC information is obtained/received from the customer in certain cases. REs shall ensure that during periodic updation, the customers' KYC details are migrated to current CDD standard.

Reporting Requirements to Financial Intelligence Unit - India (FIU-IND)

REs shall furnish to the Director, Financial Intelligence Unit-India (FIU-IND) the following information as per Rule 3 of the PML (Maintenance of Records) Rules, 2005 in terms of Rule 7 thereof. Director, FIU-IND shall have powers to issue guidelines to the REs for detecting transactions referred to in various clauses of sub-rule (1) of rule 3, to direct them about the form of furnishing information and to specify the procedure and the manner of furnishing information.

The reporting formats and comprehensive reporting format guide, prescribed/ released by FIU-IND and Report Generation Utility and Report Validation Utility developed to assist reporting entities in the preparation of prescribed reports shall be taken note of. The editable electronic utilities to file electronic Cash Transaction Reports (CTR) / Suspicious Transaction Reports (STR) which FIU-IND has placed on its website shall be made use of by REs which are yet to install/adopt suitable technological tools for extracting CTR / STR from their live transaction data.

The Principal Officers of those REs, whose all branches are not fully computerized, shall have suitable arrangement to cull out the transaction details from branches which are not yet computerized and to feed the data into an electronic file with the help of the editable electronic utilities of CTR/STR as have been made available by FIU-IND on its website.

While furnishing information to the Director, FIU-IND, delay of each day in not reporting a transaction or delay of each day in rectifying a mis-represented transaction beyond the time limit as specified in the Rule shall be constituted as a separate violation. REs shall not put any restriction on operations in the accounts where an STR has been filed. REs shall keep the fact of furnishing of STR strictly confidential. It shall be ensured that there is no tipping off to the customer at any level.

Reporting requirement under Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS)

Reporting requirement under Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS) Under FATCA and CRS, REs shall adhere to the provisions of Income Tax Rules 114F, 114G and 114H and determine whether they are a Reporting Financial Institution as defined in Income Tax Rule 114F and if so, shall take following steps for complying with the reporting requirements:

(a) Register on the related e-filling portal of Income Tax Department as Reporting Financial Institutions follow below procedure:

Click at http://incometaxindiaefiling.gov.in

Click at login then click on My Account

Register as Reporting Financial Institution

(b) Submit online reports by using the digital signature of the 'Designated Director' by either uploading the Form 61B or 'NIL' report, for which, the schema prepared by Central Board of Direct Taxes (CBDT) shall be referred to.

Explanation: REs shall refer to the spot reference rates published by Foreign Exchange Dealers' Association of India (FEDAI) on their website at http://www.fedai.org.in/RevaluationRates.aspx for carrying out the due diligence procedure for the purposes of identifying reportable accounts in terms of Rule 114H.

(c) Develop Information Technology (IT) framework for carrying out due diligence procedure and for recording and maintaining the same, as provided in Rule 114H.

(d) Develop a system of audit for the IT framework and compliance with Rules 114F, 114G and 114H of Income Tax Rules.

(e) Constitute a "High Level Monitoring Committee" under the Designated Director or any other equivalent functionary to ensure compliance.

(f) Ensure compliance with updated instructions/ rules/ guidance notes/ Press releases/ issued on the subject by Central Board of Direct Taxes (CBDT) from time to time and available on the web site.

How to verify KYC and authenticity of documents?

The verification of authenticity of a document submitted by a prospective customer/existing customer at a branch level, must be based on the original documents submitted by such customers; however, there are few additional verification methods available, such as given here:

i. Income Tax Department has made available PAN verification facility to a few reputed agencies in India. Therefore, if a customer submits a PAN Card it can be verified from the verification facility through the accredited agencies. All banks have a link with such agencies and through such arrangements PAN verification can be done.

ii. Authentication, of Aadhar Number already available with the Bank can also be done with explicit consent of the customer in applicable cases through the Aadhar data base and biometric data available with Central Identification Registry (CIDR).

iii. In the case of Electricity bills/Telephone bills these can also be verified through the service providers by mentioning the consumer number/telephone number as well as through verification software available online.

iv. In case of Companies and Directors, the data submitted by such customers can be verified through the website data of Ministry of Corporate Affairs.

v. In case of certain banks, they employ field personnel who make a visit to the address provided by the prospective customer and physically verify the details provided by such customers.

vi. Also, at the time opening a new account/establishing a new relationship, the customer will be checked against watch lists provided by International/National/Local authorities including Central Banks and Anti-terrorist Organizations. If the names of such customers match with any of such names in the list, a thorough screening will take place to ensure such accounts are not opened. If such names are detected it must be reported to concerned agencies including RBI.

Additional points on verification of KYC documents

Verification of customers' KYC data will also be carried out in case of borrowers too. If third party agencies are involved in verification of KYC data such agencies will also be evaluated keeping in mind the norms prescribed by RBI. In case identification information available with Aadhar does not contain current address an OVD containing current address may be obtained. Certified copy of OVD containing identity and address shall be obtained at the time of periodic up-dation from individuals not eligible to obtain Aadhar, except from individuals who are categorized as 'low risk'. In case of low risk customers when there is no change in status with respect to their identities and addresses, a self-certification to that effect shall be obtained. In case of Legal entities, banks shall review the documents sought at the time of opening of account and obtain fresh certified copies wherever it is required.

Operational aspects regarding opening of all types of accounts

One of the basic functions of a bank is accepting deposits. Deposits constitute the working capital of a bank for doing its business by way of lending and investment. Acceptance of deposits involves paying of interest, which is a cost and therefore from the profitability aspect, most banks try to have an optimum mix of low cost and high cost deposits. Thus, for accepting deposits, banks offer a range of deposit accounts. Basic features of deposits are the same across banks. However due to discretionary powers conferred on banks by RBI, banks incorporate attractive and unique features in such accounts to attract customers. For example, Kotak Mahindra bank offers a higher rate of interest on certain Savings Bank Deposit accounts, using the discretionary option when compared to other banks.

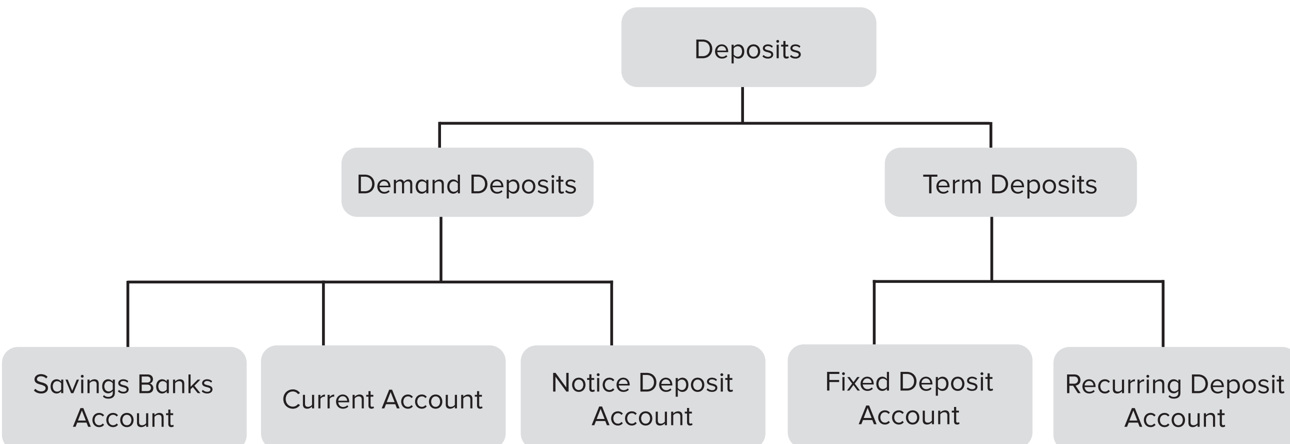
Following are the salient features of different deposit accounts offered by banks in brief.

Deposit accounts offered by banks can be classified under

a. Demand deposit accounts; and

b. Term deposit accounts.

Broad Classification of Types of Deposit Accounts



According to Indian Banks' Association, deposits are classified under different types as below:

1. **Demand deposits:** It means a deposit received by a Bank which is withdrawable on demand.

2. **Savings deposits:** It means a form of demand deposit which is subject to restrictions as to the number of withdrawals as also the amounts of withdrawals permitted by a Bank during any specified period.

3. **Term deposit:** means a deposit received by a Bank for a fixed period withdrawable only after the expiry of the fixed period and include deposits such as Recurring / Double benefit Deposits / Short Deposits / Fixed Deposits where Monthly /Quarterly Interest are paid etc.

4. **Notice Deposit:** It means term deposit for specific period but withdrawable on giving atleast one complete banking days' notice.

5. **Current Account:** It means a form of demand deposit wherefrom withdrawals are allowed any number of times depending upon the balance in the account or up to an agreed amount and will also include other deposit accounts which are neither Savings Deposit nor Term Deposit.

Features of Savings Bank Accounts (SB)

a. Savings Bank accounts are meant for promoting Savings habit among people.

b. These accounts can be opened by Individuals singly, two or more individuals jointly, certain organizations as permitted by RBI (See box item). Minors' accounts can be opened by their guardians.

c. Business organizations engaged in profit generating activities are generally not permitted to open SB accounts.

d. Minors above the age of 10 are also allowed to open Self-operated SB accounts under certain conditions as per RBI directions. This is basically to inculcate Savings habit in them.

Organizations which are permitted to open SB accounts are as under:

- Primary Co-operative Credit Society financed by a bank,
- Self Help Groups (Registered or Unregistered) /Farmers Club,
- Agriculture Produce Marketing Committees,
- Khadi & Village Industries Board,
- Societies registered under Societies Act 1860 or any other corresponding law in States or Union territories,
- Companies registered under Section 8 of Companies Act 2013 (Corresponding to Section 25 erstwhile of the Companies Act of 1956 or corresponding Act of 1913),
- Government Departments/bodies/agencies receiving grants/subsidies for implementation of various Government sponsored Schemes/Programmes by the Central/State Governments on production of authorization of the concerned Government Ministries/Departments.

e. Cheque book facility is offered in these accounts. Due to electronic banking ATM/Debit Card are also offered. Internet banking facility is also offered to customers subject to conditions stipulated by banks in this regard. Upon request, Credit card facility is also offered.

f. Government Departments, Municipal authorities, political parties, trade/professional/business entities, or associations are not allowed to open these accounts.

g. Cheques can be used for withdrawals or for making any payments. Since the advent of electronic banking there are several online payment options available for transfer of money which can be made use of.

h. The number of withdrawals in these accounts is restricted as per RBI directions as these accounts are not meant for business or trading. However there is no restriction on the number of deposit transactions.

Other features of SB Accounts

Before opening an account, every bank would complete the KYC verification process of prospective customers. In case of joint accounts KYC for all joint holders would be done. Every bank will stipulate minimum balance to be maintained in the account. Failure to do so will result in levy of charges as per Banks' schedule of charges. Similarly, there can be charges for issue of cheques books, additional statement of accounts, duplicate pass book, folio charges, SMS charges etc. All such details, regarding terms and conditions for operation of accounts and schedule of charges for various services provided will be communicated to the prospective depositor while opening the account.

Nomination as applicable under Nomination Rules, 1985 may also be obtained wherever applicable in these accounts.

Interest rates on Saving Bank Account

Interest is generally paid at 4% p.a. on the daily closing balances. Such interests will be credited once in a quarter as per latest RBI directions. Banks also have discretion to pay higher rate of interest (called preferential rate of interest) on deposits held by staff members, senior citizens, retired employees, widows/widower of retired employees; also, on deposits of association of employees in which employees are members etc.

Pass Books

Right from the opening of the account, Pass books are to be issued to customers. If a customer who is not issued cheque book will have to present the pass book to get a withdrawal form from the bank. Pass books are needed to be updated whenever they are presented by customers.

Due to spread of electronic banking instead of pass books customers are issued statements either in hard copies or email versions as per agreement with the bank. Also, now-a-days banks are providing separate pass book printing machines to enable customers to update their pass book on their own.

Operations in Joint Accounts

Joint Accounts opened by individuals can be operated either by only one person among the joint holders, or more than one according to the arrangements agreed to by the joint holders. Such mandates for operating the account can be modified with the consent of all account holders at any time by them with due intimation to the bank. The Savings Bank Account opened by minor jointly with natural guardian / guardian can be operated by guardian only.

Mandates in case of joint account

The joint account holders can give any of the following mandates for operation as well as the disposal of balance in the above accounts:

(i) ***Former or Survivor:*** If the account is held by two individuals say D & E, under this mandate D only will have the authority to operate the account. After, the death of D the balance in the account will be paid to E.

(ii) ***Either or Survivor:*** If the account is held by two individuals say, A & B, it can be operated by any one. Also, it implies that the final balance along with interest, if applicable, will be paid to survivor on death of anyone of the account holders.

(iii) ***Anyone or Survivor/s:*** If the account is held by more than two individuals say, A, B and C, the final balance along with interest, if applicable, will be paid to the survivor on death of any two account holders.

This mandate can be modified by the express consent of all the account holders.

Transfer of accounts

On an application by a customer an account can be transferred from one branch to another free of cost. In such cases all unused cheque leaves must be surrendered to the branch where the account is held. The transferor branch will forward the original account opening form and specimen signature cards after due cancellation of the same to the transferee branch after retaining a Xerox copy of the same.

However, with the introduction of CBS and issuance of multi-city cheques transfer of accounts has become a thing of past.

Conversion of accounts

Savings Bank account rules permit the conversion of individual accounts in to joint accounts. In this case a fresh joint account opening form duly signed by all account holders is to be submitted along with a request letter to convert the existing account in to a joint account. KYC formalities need to be completed in respect of all joint account holders. They need to mention the mandate of operation in such cases.

Closure of accounts

Savings Bank accounts can be closed at the request of the account holder. Account holder must submit a letter in writing requesting for closure and along with all unused cheque leaves to the bank.

In case of joint accounts, all joint account holders should sign the request letter for closure and submit the same along with unused cheque leaves to the bank.

The balance in the account to be paid after adding up to date interest in the account and ensuring that all applicable charges are debited to the account as per schedule of charges of the bank.

Inoperative / Dormant Account

A Savings Bank account or a Current account will be treated as an inoperative/dormant account if there are no customer induced transactions for a period of two years and above. Normally in practice if there are no operations in the account for of one year the customer is contacted with a request to operate the account. If the customer does not operate the account even after reminders the account will be classified as inoperative account. Subsequently if there are operations, the same needs to be scrutinized by a higher official and if found genuine, after a proper due diligence, operations may be allowed.

If the customer wants to revive the account a letter needs to be obtained from the account holder regarding the same and the accounts would be transferred from inoperative account to operative accounts.

Inoperative accounts need to be segregated and a strict control should be exercised as it is a fraud prone area. Inoperative SB accounts continue to earn interest on their balances till they are transferred to DEAF of RBI as described below.

If any of such accounts remain inoperative beyond a period of ten years and above the balances are to be transferred to Depositors Education and Awareness Fund (DEAF) of RBI. Subsequently when a claim arises later the same should be claimed from RBI as per directions of RBI in this regard. RBI will pay interest on these accounts from the date of their transfer to RBI. A detailed procedure has been enumerated by RBI in respect of DEAF which needs to be followed by banks.

Information to Depositors on Inoperative accounts / Unclaimed deposits

RBI has directed banks to display on their websites details of inoperative accounts in their branches by adopting the following method:

i. Such lists should contain only the name/s of the account holder/s and address.

ii. If such accounts are not held by individuals, names of authorized signatories who are authorized to operate the accounts should be displayed.

iii. Account number, type/s of accounts and name of the branch are not to be displayed.

iv. Banks should also provide ‘Find’ option to enable the members of the public to search the list by name.

v. Banks should also display the process of claiming the same (including forms/documents) from the concerned bank.

vi. Banks should also put in place proper procedures of due diligence for verification of genuineness of the claim.

Salient Features of Current Accounts

1) These accounts are meant for customers who have large number of transactions of credit and debit on everyday basis.

2) Current accounts can be opened by individuals, proprietary concerns, partnership concerns, public and private limited companies, trusts, associations, societies and other institutions.

3) Unlike Savings bank accounts, no interest is paid on current account balances (Exception: Accounts of Regional Rural Banks maintained by sponsoring banks or as per RBI directions from time to time).

4) While opening a new account it is usually done with a cash deposit of the stipulated minimum amount.

5) Customers are expected to maintain the minimum balances in their accounts as per the rules of business of the bank concerned.

6) There are no restrictions on the number of withdrawals or deposit transactions that can be routed through a current account.

7) Withdrawals from these accounts normally are to be done through cheque leaves issued to the customers.

8) If a cheque book is issued through a bearer, a separate confirmation is to be obtained from the account holder regarding the receipt of the cheque book by him.

9) Whenever requests for cheque books are received from clients, a banker has to satisfy himself about the genuineness of each request by verifying the signature etc.

10) Even the cheque requisition slip should be signed as per mandate given to the bank and if a cheque book is to be delivered to a bearer then the bearer should carry an authorization from the account holder to obtain a cheque book from the bank.

11) As soon as cheque books are issued to the account holder, the serial number particulars should be noted in the account folio.

12) Based on the mandate of a customer, banks can debit the account of the customer through debit vouchers.

13) ATM Cards/Debit cards, internet banking facility are also provided to the account holders.

14) Normally current accounts cannot be allowed to be opened by pardanashin[1] women, illiterates and blind persons. However, guardians can operate current accounts of minors.

15) If any overdraft arrangements are made this will be as per rules stipulated by the bank including period, interest rate, quantum and validity of such facility.

16) Nomination facility is available only in the account of proprietary concerns among current accounts.

Opening of Current Accounts by Banks - Need for Discipline

- No bank shall open current accounts for customers who have availed credit facilities in the form of cash credit (CC) / overdraft (OD) from the banking system and all transactions shall be routed through the CC/ OD account.

- In case of customers who have not availed CC / OD facility from any bank, banks may open current accounts as under:

    - Banks shall monitor all current accounts and CC/ODs regularly, at least on a quarterly basis, specifically with respect to the exposure of the banking system to the borrower, to ensure compliance with these instructions.

    - Banks should not route drawal from term loans through current accounts. Since term loans are meant for specific purposes, the funds should be remitted directly to the supplier of goods and services. Expenses incurred by the borrower for day-to-day operations should be routed through CC/OD account, if the borrower has a CC / OD account, else through a current account.

[1] Pardanashin women are women, who have almost zero contact with the outside world. A pardanashin lady is one who remain in complete seclusion and does not transact with people other than members of her family. Though Pardanashin lady is legally competent to enter into a contract, she may be able to able to avoid it on the pretext of undue influence and the onus of proving of influence is on the bank. Therefore, bank should take extra care in this regards. Signature of pardanashin lady should be attested by her guardian if she is unmarried and by her husband if she is married. The signature may be attested by any other member of the family also. If she is illiterate she will not be issued cheque book and for every payment she will have to give the discharge in the presence of an independent witness. However, in case of literate Woman, cheque book will be issued and payment will be made on the basis of recorded signatures.

- As regards existing current and CC / OD accounts, banks shall ensure compliance with the above instructions within a period of three months from the date of this circular.

Term Deposit Accounts/Fixed Deposit accounts

1) Fixed deposits or Term deposits are those deposits that are parked with a bank for specified period at an interest rate offered by a bank. These are generally availed by risk aversion minded depositors for income. Though these deposits carry a fixed interest, banks also offer floating rate of interest-based term deposits.
2) Floating rate of interest term deposits are those whose deposit rates are linked to a bench mark rate and whenever there is change in the bench mark interest rate there will be a revision in the interest rate. For example, Bench mark rate could be 'Repo' rate or Bank rate of RBI.
3) Banks also offer compound interest-based term deposits apart from Recurring/Cumulative deposits.
4) As per RBI directives interest is paid on Fixed Deposits on a quarterly basis or half yearly basis on yearly basis. However monthly interest can be paid at a discounted rate as per RBI directives.
5) Fixed deposits period can vary from a minimum of 7 days to a maximum of 10 years. Accordingly, banks offer interest rate for different periods. These rates can change periodically in tune with RBI's Monetary Policy.
6) It is important to note that fixed deposits up to Rs.1 lakh per person per capacity per bank are mandatorily insured under the scheme of deposit insurance provided by Deposit Insurance and Credit Guarantee Corporation, a wholly owned subsidiary of RBI.
7) Fixed deposits can be withdrawn pre-maturely subject to some penalty as per RBI directives to banks in this regard.
8) Deposit holders can avail loan against pledge of Fixed Deposits receipts; banks offer up to 90% of the principal as loan amount at 1 or 2% higher interest rate than the rate of interest offered on the deposit.
9) Senior citizens are generally paid higher interest rates compared to interest rate offered to public.
10) TDS is applicable on the interest paid by banks as per prevailing Income Tax rules. Exemption from TDS is also granted to General public/Senior citizens against submission of Form 15G or 15H.

Recurring Deposit

A Recurring Deposit or RD (in some banks it is also known by the name Cumulative Deposit) is also a form of term deposit in which depositors can make deposits at regular intervals for a term and earn interest on a compounded basis at the end of the term.

As FDs are rigid in certain respects, a Recurring Deposit is an ideal investment cum savings option.

All banks in India offer a Recurring Deposit Account, for a minimum period of 6/12 months and a maximum period of 10 years, suiting to the needs of depositors. The interest rate remains fixed throughout the term and upon maturity, the depositors will be paid proceeds of the deposit that includes compounded interest earned on the principal amount deposited every month. Interest calculations will be based on monthly balances held in the account.

Recurring deposits can also be closed before maturity if a customer so desires because of emergency situations. Interest would be paid as per the rules of the bank which is like that of the term deposits. No recurring deposits are accepted under Foreign Currency Non-Resident Deposit scheme.

Certificate of Deposit (CD)

This is a variant of term deposit and issued at a discount to face value. These are short-term negotiable money market instrument which attracts stamp duty. A detailed coverage of CDs has been dealt in the earlier chapter.

Cash certificates

These are term deposits which offer interest payments on a cumulative or compounded basis. They are governed by the same rules as applicable to term deposits.

Some operational features of Fixed deposits are covered in the later part of this chapter.

Different types of Accounts that can be opened for different entities.

Following are the operational aspects of deposit accounts:

Accounts of an individual

(a) Account opening form must be completed, including all mandatory details.

(b) Documents required as per KYC norms are to be obtained.

(c) Should be advised to nominate a nominee to the account. Nomination must be registered and an acknowledgement must be given to the customer.

Account of a Minor

(a) A minor is a person who has not completed 18 years of age, under Indian Majority Act, 1875. A person who is under the custody of a court, remains a minor till he completes 21 years.

(b) As a contract with a minor is void, a minor's account can be opened in the name of a minor, to be operated by his/her guardian. A Guardian could be a Natural guardian or a Legal Guardian or a Testamentary Guardian.

(c) Parents are the Natural Guardians. Legal Guardian is appointed by the Court in the absence of parents. Guardian appointed by Will is known as Testamentary guardian. Whenever a guardian operates the account his fiduciary capacity should be clearly brought out in cheques and other instruments.

(d) A guardian's power to operate the account ceases once the minor attains majority. The moment a minor attains majority, new account opening forms and specimen signature cards etc. should be got signed by him. A letter confirming the balance in the account on the date when the minor became a major should also be obtained.

(e) In the case of Hindus and Christians, Father and Mother constitute Natural guardians in that order. In case of Muslims, Father constitutes the first natural guardian and the person named in his Will becomes a guardian of the minor, after his demise. If the father has not named any one in his Will, the father's father becomes the natural guardian after the demise of father. While opening accounts we also accept a guardian appointed under Mental Disabilities Act, 1999.

Joint Accounts

(a) When two or more persons jointly open an account, it is called a joint account. As far as possible a joint account should be opened only among close relatives. Account opening form should be signed jointly by all.

(b) A clear operational mandate from the account holders should be obtained, as to who would operate the account.

(c) Photographs, id and address proof of all individuals as a part of KYC process are to be obtained.

(d) All joint account holders should jointly nominate a nominee.

Sole Proprietorship Accounts

(a) Business carried out in a firm's name solely by an individual is known as "Sole Proprietorship". Only Current accounts can be opened.

(b) Formalities while opening the account will include compliance with KYC norms.

(c) While opening this account, if it is a new proprietorship account, a declaration in the letter head of the firm should be obtained. If it is an existing proprietorship, any proof regarding its existence such as tax returns, Municipal licence under Shop & Establishment Act should be obtained.

Partnership Accounts

(a) A partnership is a relation between persons who have agreed to share the profits of a business carried on by all or any one of them acting for all. The relationship is spelt out in a document called, “Deed of Partnership”.

(b) The minimum number of partners in a partnership should be 2. The maximum number of partners allowed is 100. These restrictions/revisions are in accordance with The Companies Act, 2013.

(c) A partnership can be either registered or un-registered. Where partnerships require compulsory registration with Registrar of Firms, while opening partnership accounts, the registration certificate should be obtained.

(d) A minor cannot be admitted to a partnership, but he can be admitted to the benefits of a partnership, with consent from other partners. Hence minor is represented by a guardian in partnerships.

(e) When a minor attains majority, he within 6 months of attaining majority, has the option to exit the partnership. If he fails to do so, he is deemed as a partner from the date of his admission to the partnership and will be responsible for any liabilities and loss too.

(f) Every single partner can bind a partnership by his action. Hence, while opening a partnership account, signatures from all the partners in their individual capacity as well as the fiduciary capacity of a partner, should be obtained.

(g) If the partnership has applied for registration at the time of opening the account obtain the provisional receipt from the partners as proof.

(h) Clear instructions regarding as to who will operate the account, should be obtained from the partners at the time of opening the account.

(i) If a new partner is admitted, operations in the account can be allowed subject to making changes in the account opening forms and bank’s data base. If a partner retires from a partnership, all other remaining partners have to authenticate the transactions. Partnership suffers dissolution on account of death/ retirement/insolvency of any one of the partners unless the Deed provides otherwise.

(j) When a partnership is dissolved, the operations in the account are to be stopped if the account is in debit balance.

(k) In a partnership account any one partner can stop the operations. The bank needs to inform all the other partners about the stopping of operations in the account through a specific letter.

(l) The bank will allow any further transactions, only after all partners jointly authorize the bank to do so, through a letter.

(m) A Hindu Undivided Family (HUF) is not allowed as a partner in a partnership. But individual members of HUF can become members of the Partnership subject to the legal limit of partnership.

(n) Cheques drawn in favour of the firm should not be allowed to be collected in the individual account of a partner. Cheques drawn by a partner in his own favour if sought to be credited to his individual account, should be counter signed by any other partner, so that, the bank is not held liable for conversion.

(o) Documentation to be obtained while opening an account will include -

- Bank’s account opening form duly completed and signed by all partners.
- Id and address proof of the firm.

- Photographs and address proof of all the partners; Partnership deed copy.
- Rubber stamp of the firm should be impressed on the application form and partner's signature should be affixed under it.
- Mandate regarding operation of the account.

Limited Liability Partnerships

(a) Limited Liability Partnerships (LLP) were introduced in India in 2009. This legal entity is a combination of traditional partnership and a limited liability aspect of a company. To overcome the limitation placed by Indian Partnership Act regarding total number of partners as well as unlimited liability aspect, The Limited Liability Partnership Act, 2008 (LLP Act) was introduced.

(b) LLP can be incorporated for only business purposes; not for charity or philanthropy purposes.

(c) There is no limit on the number of partners in this entity. It is a separate legal entity from Partners. Partners of an LLP enter in to an agreement on mutually agreed terms. The registering Authority of LLP in some states is Registrar of Companies and in some states, it is Registrar of LLPs.

(d) Liability of a partner is limited to the extent of his contribution in the LLP. Personal assets of a partner are not liable except in case of fraud committed by any individual partner.

(e) Every LLP should have at least 2 designated partners, out of which, one of them should be resident in India. Designated partners will look after the affairs of the LLP.

(f) One partner is not liable for the acts of misconduct of other partners except in certain circumstances. LLP is having perpetual succession.

(g) An individual/ a company or other LLP can be partners. HUF,NBFC cannot be partners in LLP.

(h) LLP can borrow on its own name on the security of assets; it can create charges on its assets in favour of a lender. LLPs must submit their annual financial statements to ROC/RoLLPs.

For opening an account of LLP, the following documents are needed:

(i) Certificate of Registration of LLP. (Registration of LLP is mandatory)

(ii) LLP Agreement (In the absence of LLP agreement, provisions of Schedule I of the Act become applicable).

(iii) Designated Partner identification numbers of all the partners, (minimum no. of designated partners is 2, out of which one must be resident of India, in case where all the partners are Body Corporate, the nominees of such bodies act as Designated Partners).

(iv) Resolution signed by all the partners indicating the authorized signatories.

(v) KYC documents of all the authorized signatories.

Accounts of Companies

(a) Companies are artificial persons which have legal existence. Companies which are incorporated under the Companies Act, 2013 can open accounts with banks. Companies can be broadly divided in to Private Limited and Public Limited companies.

(b) Private Limited companies cannot issue shares to public and the minimum number of shareholders are 2 and the maximum number of shareholders are restricted to 200.

(c) Public Limited company can issue shares to public. The minimum number of shareholders are 7 and there is no ceiling of maximum number of shareholders.

(d) Formalities relating to opening accounts of companies will include obtaining the following documents namely

(i) Memorandum of Association and Articles of Association [Memorandum of association usually contains various details such as name of the company, place of registered office, objects, statement of liability and details of capital (division of the share capital). Articles of Association usually contains operational rules for day to day functioning as well as other internal matters.]

(ii) Certificate of Incorporation issued by the Registrar of Companies in whose jurisdiction the company is registered.

(iii) Certificate of Commencement of Business. As per revised Companies Act, 2013 provisions, a company with a share capital can commence business or exercise borrowing powers after a declaration is filed with Registrar of Companies that the paid-up capital is not less than Rs. 5 lacs (public company) or Rs. 1 lac (private company) or as applicable. Such declarations should be obtained and kept on record.

(iv) Copy of Board resolution certified by the Chairman to open an account with the bank. Operating instructions regarding execution of documents, the name/s of director/s other executives authorized to sign etc.

(v) Copy of latest Audited Balance sheet and Profit and Loss account, List of present directors duly certified by the Chairman, Address of the registered office along with the KYC documents pertaining to the Company should also be obtained along with KYC documents in respect of authorized signatories.

(vi) All account opening forms should be signed by authorized signatories. Photographs of authorized signatories as per KYC norms should be obtained.

(vii) All documents should contain the company's seal (Embossing Stamp).

(viii) In case of change of constitution, the company has to inform to the bank. In case of death of a director, as a company is a legal entity having perpetual existence, its account should not be stopped.

(ix) A fresh resolution by the board of directors, authorizing the new directors and their specimen signatures should be submitted to the bank.

Accounts of Trusts

A trust is a body created by a person/s (called "Author/s") for the benefit of another person/s (called "Beneficiary") or for a cause and managed by a person or a group of persons (known as "Trustee/s").

(a) There is a document through which a trust is created known as "Trust Deed". Trusts can be created for private purposes or for public purposes. A trust can be a registered body or an unregistered body. The property belonging to a trust is normally handled by trustees as per the terms and conditions contained in the trust deed. While opening such accounts the original trust deed should be called for.

(b) This deed should be scrutinized to identify the rights and duties of trustees and to ensure that no undue onus is placed on the bank. A certified true copy along with rules, bye-laws should be studied to know the rights, powers, duties and restrictions of the trustees while operating the account.

(c) If it is a public trust, trust registration certificate should be obtained. If the trust is a private trust concerned registration certificate issued by competent authorities should be obtained.

(d) Specific resolution for operation in the account should be obtained from the trustees as to who among them will operate the account. Account opening form should be signed by all trustees. KYC documents of the Trust should also be obtained.

(e) A trustee can't appoint any other person as a proxy unless the trust deed provides. Balance confirmation letter should be obtained from the trustees on a half yearly basis and the same must be kept on record.

(f) If there are changes in the board of trustees, a resolution in this regard signed by all trustees, should be obtained and kept on record. Any of the trustees can stop payment of a cheque. In case if a trustee dies, the operations in the account should be stopped unless the trust deed states otherwise. In case of lunacy of a trustee, operations in the account should be stopped, unless the trust deed allows the trust to continue.

(g) Bankruptcy/insolvency of a trustee does not affect the trust. Normally no over drawings to be allowed in the trust account. Cheques collected on behalf of trust should not be credited to a trustee's account as otherwise the bank maybe held for "conversion".

Accounts of Clubs and Associations

(a) Clubs, Societies and Associations are bodies of members, who come together for a common cause. Generally, non-trading clubs, societies and associations approach banks to open accounts. Such bodies do not share profits with members.

(b) Clubs can be registered or unregistered. Accounts of unregistered clubs, societies and associations cannot be opened as individual members are not liable for debts of the body, hence suits can't be enforced.

(c) While opening of accounts of Clubs and Associations obtain the account opening form along with photos of the office bearers, address proof of all the office bearers, certified true copy of the original certificate of registration, certified true copy of memorandum of association, certified true copy of the rules, regulations, bye-laws, resolution of managing committee appointing the authorized persons to operate the account. (To be certified true by The Chairman/Secretary). KYC documents of the Club/ Association should also be obtained.

(d) The type of account to be opened should be specified in the resolution. Resolution should be in terms of rules, regulations, bye-laws of the body.

(e) Upon the death of the Chairman/Secretary/ Treasurer, cheques signed by any one of them before their death, can be passed after due enquiry.

(f) Cheques in the name of clubs/associations/societies should not be collected and credited to the accounts of office bearers. Otherwise the bank may be liable for conversion.

Accounts of Co-operative Societies

Co-operative societies are bodies formed by individuals under Central Co-operative Societies Act or State Co-operatives Act. They require registration from designated authorities such as Central Registrar of Co-operatives or State Registrar of Co-operatives. Co-operative societies receive their capital from members and can indulge in legally permitted activities.

(a) For opening an account, first obtain true copy of the letter from Registrar of co-op societies permitting the opening of the account with a bank. Obtain Copy of latest balance sheet, Certified list of office bearers, Certified true copy of resolution of general body or managing committee appointing persons authorized to operate the bank accounts, Specimen signatures and photographs of persons authorized to operate the account. Latest KYC documents of the society should also be obtained apart from the KYC documents for all office bearers authorized to operate the account.

(b) If there is any change in office bearers/ managing committee, a certified true copy of resolution of managing committee incorporating the change to be obtained and kept on record with the existing account opening forms.

Accounts of Special Types

(1) Lunatics

(a) A banker does not knowingly open the account of a lunatic, as he is incompetent to contract. If after opening an account when a banker comes to know the lunacy of the account holder, operations in the account should be stopped until a Court of competent jurisdiction gives an order, or a banker has a solid proof the account holder's sanity. A solid proof includes written report from a competent specialist like a psychiatrist/psychologist.

(b) Drunkards in their drunken state are of unsound mind and are incompetent to contract. Contracts entered in the drunken state are void. Therefore, a banker stands to lose if he knowingly opens a drunkard's account.

(2) Illiterate persons

(a) They can enter in to contractual relationships. Hence a banker opens accounts of illiterates with some precautions.

(b) Since illiterate persons do not know to read/write, their thump impressions are obtained in lieu of signatures. For males, their left-hand thumb (LHT) impression is obtained and for females, their right- hand thumb (RHT) impression is obtained. These thumb impressions are got witnessed/attested by known witnesses.

(c) Other forms of identification such as Photographs, Address proof etc. are obtained as per KYC norms. Photographs are properly to be affixed along with seals to prevent substitution. Due to the presence of photographs, the need for witness stands reduced at every withdrawal transaction.

(3) Blind person

(a) A blind person, if mentally sound can enter in to contract. If a blind person can sign he should be asked to sign account opening forms. Also, a blind person should be properly informed of the care he should take regarding the pass book, deposit receipts which will be issued to him.

(b) He/she should come in person to open the account.

(c) If the blind person wants to open an individual or joint account, he/she may be allowed to do so.

(d) While opening the account itself, the branch official should read out the rules of business and other terms and conditions in presence of a witness and accordingly obtain the signature of the witness.

(e) If the blind person is literate, in addition to thumb impressions, signature should also be obtained in the account opening forms. This should be countersigned by the Manager.

[**Note:** *While opening an account for illiterate and blind persons, mark the account as "illiterate" or "blind" across the Account Opening Form.*]

(4) Executors and Administrators

- An Executor is one who is appointed in terms of a Will of a person (known as 'Testator'). An Administrator is a person appointed by a Court to manage some one's estate or property, when an owner of a property dies without leaving a Will or leaves a Will without naming an Executor or an Executor dies before the maker of the Will or the appointed Executor refuses to undertake the responsibilities.

  (i) Before opening the account, a banker should obtain certified copies of "Probate" or "Letters of Administration" and keep the same on record. The operations in these accounts will be in terms of these documents. If there are more than one Executor or Administrator, the account will bear all their name under the style.

(ii) Account opening forms should be signed by all Executors/Administrators as mentioned in the document. KYC documents of the individual Executor or Administrators are to be obtained.

(iii) In case of accounts having more than one Executor or Administrator, clear mandate should be obtained regarding the operations in the account. Any one of the Executors/Administrators can stop the payment of a cheque pertaining to the account. In case of revocation all of them should jointly sign a letter and authorize the bank to do so.

(iv) Executors/administrators cannot delegate their authority to any one and a banker should not honour cheques signed by such delegatee. In case an Executor or Administrator becomes lunatic his authority stands terminated.

Under this circumstance, a banker should not honour cheques drawn by such Executor/ Administrator but seek instructions from fellow Executors/Administrators or the Court as the case may be.

(v) Bankruptcy of an Executor/Administrator will not affect the bank account. A banker should always be on guard to prevent any misappropriation of funds held in the account by Executors/ Administrators. Otherwise the bank will be held liable for Conversion.

- **Liquidators:** Are appointed by a Court to dispose off properties and assets of institutions as well as collect the amount from debtors and settle the claims of creditors while winding up of a company. While opening an account of a Liquidator, first the terms of court order appointing the Liquidator should be studied and understood.

(i) In case of voluntary liquidation of a company wherein a Liquidator has been appointed, terms in resolution of the company to open account should be studied. Such a resolution must be certified by Chairman of the meeting (winding up).

(ii) If an account is to be opened it should be titled as Liquidator a/c of (name of the company). We must obtain account opening form duly signed by the Liquidator. Also obtain all other KYC documents pertaining to the individual/s appointed as Liquidator/s.

Certain Operational aspects of Deposit Accounts

(1) Operation in Minor's Account

When a deposit account of a minor is opened, the proof of birth should be verified with reference to the school / birth certificate and a certified copy of it should be kept on record.

The birth date of the minor must be properly noted in the Customer/ Account Master. Constant watch has to be kept on accounts of minors and their attaining majority, particularly where the accounts are operated by the guardians of the minor, because the erstwhile minor may question withdrawals from his account by the guardian after he attains majority. To eliminate this risk and to safeguard the Bank's interest, it is necessary to keep a watch on such accounts. At present in the Core banking system this information is generated and made available to branches at the beginning of every month.

If withdrawal/cheque signed by the guardian, is presented for payment, after the date on which the minor became major, the erstwhile minor must be contacted, and his instructions sought. If he cannot be contacted, the withdrawal form/ cheque should be returned with reason. "Mr./Miss/ Mrs.______________________has since attained majority."

(2) Tax Deducted at Source (TDS)

As per the prevailing regulations, Income Tax must be deducted at source (TDS) if the annual interest paid to the customer/s exceeds Rs. 40,000 (For senior citizens it is Rs. 50,000) during the financial year. The rate at which income tax is to be deducted is as notified from time to time by Income Tax authorities.

Exemption from deduction of tax is applicable for Shareholders (members) and Nominal Members of Co-operative banks as per Income Tax regulations applicable from time to time. Therefore, at the time of accepting or renewing any deposit, this aspect must be confirmed and accordingly dealt with.

If any depositor such as Senior Citizen (one who has completed 60 years of age as defined by Income Tax department) claims exemption from deduction of TDS, they should be asked to submit duly filled in Form No. 15H to the Bank within the time limit specified under the Income Tax Act. Three copies of Form No15H are taken and one form is returned to the customer after acknowledging the same. One such form is forwarded for onward submission to Income Tax Department. If an eligible Depositor fails to submit Form 15G or 15H, then TDS must be deducted at the appropriate rate as advised by Head office of the respective banks.

(3) Premature closure of Term Deposits

If a deposit account is closed before its maturity a letter signed by the depositor/s as per operating instructions on the account opening form should be obtained.

The interest rate payable will be 1% less than the actual rate of interest applicable for the period for which the deposit has remained with the bank, prevailing as on the date when the deposit account was opened, as given in the examples below:-

Example 1: Where the interest is payable on simple interest basis on the deposit at the time of opening and if such a deposit is sought to be prematurely closed, then the interest payable on the deposit will also be the applicable rate for the period for which the deposit remained with us less 1% on simple interest basis. Any excess interest will have to be recovered from the customer as given in the following example.

- Customer X has kept a Fixed Deposit of Rs. 10,000 for 36 months at a simple interest rate of say 10%. After two years he approaches the bank for closing the deposit prematurely. The rate of interest applicable for two-year period at that point of time when the customer opened the FD was, say 6%.
- The customer will be paid simple interest on Rs. 10,000 at the rate of 6-1= 5%.
- The bank will have to recover the excess interest paid, i.e., 10-5=5% on Rs. 10,000 for two years from the customer.

Example 2: Where the interest is payable on a compounded basis on the deposit at the time of opening and if such a deposit is sought to be prematurely closed, then the interest payable on the deposit will be applicable rate for the period for which the deposit remained with us less 1%. Any excess interest will have to be recovered from the customer as given in the following example.

- Customer A has kept a compounding interest deposit of Rs. 20,000 for a period of 36 months at an interest rate of say 9% p.a. (paid on a compounded basis).
- After 18 months the customer approaches us for a premature repayment. If the deposit rate applicable for 18 months at the time of opening the deposit, is say 7.5% p.a.
- Therefore, the customer will be paid compounded interest at the rate of 7.5 - 1 = 6.5% for 18 months.
- Excess interest paid in this case will be recovered from the customer.

***Note*:** Under Core banking environment calculations as mentioned above are done by computers.

(4) Auto renewal of Deposits

Many banks have introduced auto renewal of deposits to overcome the problem of late renewal of deposits and its attendant problems like interest for intervening period etc.

Under the scheme of auto renewal, a depositor will be given two options.

i. At the time of accepting the deposit itself option for automatic renewal of the term deposit receipts at the rate of interest prevailing on the date of maturity or option to await the customer's instruction for disposal of Maturity proceeds. Such instructions to be given one week before the date of maturity.

ii. Separate form is printed for accepting the Auto renewal instructions from the depositor.

iii. The bank branches can get the forms filled up for the existing depositors one week before the date of maturity and enter the details in the core banking system.

iv. In case getting the instructions from the depositor is not possible even then the receipts from the cut-off date would be Auto renewed.

v. While sending the maturity notices to existing depositors, they should be made aware of the process.

vi. Term Deposit products like NRE, NRO, FCNR, Tax Saver Term deposits etc. do not come under the purview of the Auto renewal process.

vii. Generally, all the Term Deposit receipts on which lien are marked would also be excluded from the Auto renewal process.

(5) Addition/Deletion of in the name of the Depositors

Addition/Deletion of a depositor is allowed in the deposit accounts provided all the existing account holder/s express their consent in writing to the Bank.

(6) Mode of Payment of Term deposit of Rs. 20,000 and over

Under the prevailing Income Tax laws, the limit for repaying the maturity proceeds of a term deposit in cash is up to Rs.20,000.

If the maturity proceeds together with interest is Rs. 20,000 and over, it must be paid either by credit to the account the depositor/depositors concerned or by way of crossed pay order.

When the depositor/s has more than one term deposit maturing on the same or on different dates even though the amount of individual deposits is less than Rs. 20,000, whether maturing on the same date or on different dates the aggregate of all such deposits should be taken into consideration for this purpose.

(7) Death of a depositor

In case of a death of a depositor the same must be dealt with as per the survivorship instructions. In case of death of a sole depositor the balance in the account will be paid to the Nominee as per the claim settlement procedure spelt out by the Bank concerned.

(8) Dealing with “Stop payment of cheques”

Whenever Savings Bank, Current Account and Cash Credit account holders give “Stop payment Instructions” of the cheque/s issued by them the following precautions need to be observed by a bank:

- Before accepting the instruction, it is to be verified whether the authorised signatory has signed the instruction. If this is not, then it should be insisted for an authorized signatory’s signed instruction.
- Banker must ensure that before they accept the instruction whether the cheque has already been passed. If the cheque has already been passed bank cannot accept the instruction.
- If the concerned cheque has not been passed already, it is to be verified whether the instruction contains the cheque number, the payee’s name, date of the cheque, and the amount of the cheque. It is also needed to be ascertain the reason for stopping the payment of the cheque.
- If the instruction is otherwise satisfactory, an acknowledgement is given to the customer and then the stop payment instruction is entered in the proper field in the Core banking system pertaining to the account and must be authorized.

- If a cheque for which a "Stop payment" instruction has been received from a customer, is presented in clearing or across the counter, the same should be returned to the presenter.
- Before returning, the concerned cheque should be defaced with the words "Payment Stopped by the drawer" and then it should be returned with cheque returning/objection memo indicating the appropriate reason for return.
- Immediately the cheque returning charges should be debited to the customer's account.
- In case of joint accounts and Partnership firms any one of the joint account holders/partners can give the "Stop payment of Cheque" instruction.
- If the same must be revoked all the account holders/partners should jointly sign the revocation instruction.

(9) Deposits Maturing on a Holiday

As per the Master Circular of RBI RBI/2010-11/92 UBD.PCB. MC. No. 11 /13.01.000/ 2010-11 dated July 01, 2010 on Interest rates on Rupee Deposits, in respect of a term deposit maturing on a Sunday or Holiday the bank shall pay interest at the contracted rate till the next working day at the contracted rate -

- On the maturity value in case of reinvestment deposits and recurring deposits.
- On the original principal amount in case of ordinary term deposit (based on 365 days in a year).

(10) Coverage under Deposit Insurance and Credit Guarantee Corporation (DICGC)

Through a Press Note No: 2019-2020/1878 dated 4th February 2020 Reserve Bank of India, has raised the limit of insurance cover for Deposits held by customers such as savings, fixed, current, recurring, etc. from the present level of Rs.1 lakh to Rs.5 lakh per depositor for deposits held by them in the same capacity and in the same right at all the branches of the Bank taken together with effect from February 4, 2020 with the approval of Government of India. The following deposits are not covered by DICGC:

(i) deposits of foreign governments,

(ii) deposits of Central/ State Governments,

(iii) deposits of State Land Development Banks with the State cooperative banks,

(iv) inter-bank deposits,

(v) deposits received outside India, and

(vi) deposit specifically exempted by the DICGC with the previous approval of the Reserve Bank. The premium for the insurance cover is borne by the Bank.

(11) Interest Rates on Deposits

Interest rates on Term Deposits are subject to periodical changes. The latest rates of interest as well as the maturity values based on the same are to be provided to customers. There should not be any mistake in quoting rates to the customers. Quoting wrong rates sometimes results in monetary loss to the Bank which should be avoided.

Scrutiny of loan applications/documents Types of borrowers & loan applications

Different customers of banks may approach a bank for loans for various needs. The borrowers can be:

(a) Individuals/Self-Help groups/Joint Liability groups

(b) Sole proprietary firms

(c) Partnership firms

(d) Hindu Undivided Families

(e) LLPs

(f) Companies

(g) Statutory Corporations

(h) Trusts

(i) Co-operative Societies

As different laws are applicable to these types of borrowers, procedures evolved by banks in respect of these borrowers are also different.

SCRUTINY OF LOAN APPLICATIONS/DOCUMENTS

This is known as pre-sanction procedure which is followed in all banks. There are various stages in the same and they are as follows:

Receipt of Loan applications & other formalities

In terms of BCSBI guidelines standardized loan applications are collected in respect of different borrowers. Most of the banks also provide check lists to help borrowers regarding documents to be submitted along with application in support of their loan proposals. The staff members of the bank also brief customers regarding requirements. Now-a-days these details are also provided in the website of respective banks alongwith details of various schemes and downloadable application forms.

It has to be ensured that application forms submitted by borrowers are properly filled with the required details such as Name, age, father's/husband's name, present address, telephone/mobile contact numbers, email id, employer's name and id, salary details/business income/ annual profit, details of existing bank borrowings etc., details of security offered, guarantors details, etc. These details are to be obtained at the initial stage itself, so that these will be useful later, at the time of recovery. Signatures of the applicant along with those of guarantors are also to be obtained. These are to be verified with reference to documents submitted by the applicant. As KYC norms are also applicable to loan applications, required checks in that regard are also to be done. In the case industrial/business borrowers their business address, factory address / godown address/Administrative office address/Head office etc. are to be obtained.

Thirdly, it must be ensured that the borrower submits all applicable information such as Salary particulars of borrower and Guarantors, Income Tax returns/Assessment order, quotation for assets to be purchased in case of consumer loans/car/estimates for house/demand letter for fees to be paid in case of education etc. In case of industrial/ business borrowers financial statements/cash flow/projected balance sheet/ quotations for machinery purchase/ stock purchase etc. are required to be submitted. In short it should be ensured that documents as specified by internal guidelines are required to be obtained.

Fourthly, it must be ensured that the particulars entered in the loan application match with the data contained in the enclosures which are submitted along with the application form.

Verification/Scrutiny of application helps a bank to advise a customer to rectify any omission or commission. Also, it can help a bank to reject if it doesn't conform to the norms. Proper scrutiny of a loan application will reveal the eligibility of a borrower to avail the loan in terms of internal guidelines.

Also, a proper scrutiny will lead to proper evaluation of the proposal in terms of various directions of RBI including prudential exposure and risk management aspects. The required degree of scrutiny may vary depending upon the amount of loan applied for.

The following aspects will be considered for evaluating a proposal in terms of technical feasibility, economic viability as well as commercial prudence.

1. Whether the activity proposed included under banned list or negative list as per policies of Government /RBI /banks (e.g. Financing Commercial real estate/oil extraction unit/Steel units etc.)

2. Will the quantum of finance exceed the exposure norms as prescribed by RBI?

3. Whether the borrower has relevant experience in managing similar activity? If not what other arrangements are made by him?
4. Back ground of promoters.
5. Performance of existing units/ Projected performance of the unit in comparison to peer units.
6. Technical feasibility aspects.
7. Inputs availability for sustained viability of the unit.
8. Financial analysis of the unit including promoters' stake in the unit.
9. Capacity of the unit to break even and generate profitability.
10. Guarantees, main and collateral securities offered.
11. Borrowers status in terms of credit report from credit rating agencies/other banks
12. History of conduct of the accounts with other banks.

Thus, a detailed scrutiny of a proposal will help a bank to arrive at a prudent credit decision. It will also enable the processing/sanctioning of proposal less time consuming.

Allowing drawals and accounting entries involved at various stages.

While sanctioning loans/advances for working capital to trading, manufacturing and other activities against stocks, book debts/receivables etc. banks fix the quantum of finance based on drawing powers fixed for the borrowers in cash credit accounts. Banks also fix up drawing powers in respect of certain securities like shares,

selective credit control items. The drawing power fixed for a borrower indicates the maximum quantum of finance a borrower can avail during a stipulated period. In respect of trading concerns and manufacturing concerns the drawing power fixed for a customer may vary on a month to month basis due to the value of stocks held by the borrower. Also, in the case of shares too due to fluctuating market prices, the drawing power will undergo changes.

Let us understand the concept of drawal limit through the following examples:

Drawls in respect of Term Loans

In respect of term loan, the drawal limit is limited to the extent of finance sanctioned and availed indicates the drawing power. Subsequent payments made by the borrower will gradually reduce the finance availed. For example, if a trader is sanctioned Rs. 20 lacs loan on the security of properties worth Rs. 50 lacs and the loan is repayable in 5 years, at the end of the 1st year the outstanding will be Rs.16 lacs, at the end of 2nd year outstanding will be Rs. 12 lacs and so on. The outstanding indicates the drawing power utilized by the borrower.

Drawls in respect of Cash Credit accounts

In practice drawls in respect of Cash Credit accounts are fixed based on the value of Securities, less the margin prescribed in respect of each security. However, the drawl in the cash credit account will be limited to the limit sanctioned or drawl fixed based on securities whichever is lower. The following example will illustrate the concept of drawls or Drawing Power as it is commonly known in banking.

Details	Example 1 (Against stocks only)	Example 2 (Against Stocks with Sundry Credits	Examples 3 (Against Stocks, Book Debts with Sundry Creditors)
Sanctioned Limit (A)	50	50	50
Value of Stocks (B)	80	80	80
Less Sundry creditors (C)	0	30	30

Details	Example 1 (Against stocks only)	Example 2 (Against Stocks with Sundry Credits	Examples 3 (Against Stocks, Book Debts with Sundry Creditors)
Paid Stocks (D) =(B-C)	80	50	50
Less Margin for stocks -			
25% of D (E)	20	12.5	12.5
DP for stocks (F)	60	37.5	37.5
Book Debts (G)	Nil	Nil	25
Margin for book debts -			
40% of G (H)	Nil	Nil	10
D P for book debts (I)	Nil	Nil	15
Total D P (F+I)	50**	37.5	50**
** Though total DP comes to 60, it cannot Exceed 50 which is the sanctioned limit.			** Though total DP comes to 52.5, it cannot Exceed 50 which is the sanctioned limit.

ACCOUNTING ENTRIES INVOLVED IN VARIOUS STAGES OF A LOAN

Term loans are usually disbursed in one or more instalments depending upon the sanction terms or need of a borrower. For example, in case if a term loan for house construction loan may be released in instalments as and when various stages of construction is completed. In respect of education loans loan may be released in one or two or three installments as per demand from an educational institution on the student.

i. At the time of release of loan generally the following entries are passed: (Example of a housing loan where the house is under construction)

   Debit: Loan Account of the borrower

   Credit: DD issued in favour of the builder (for direct payment to the builder)

ii. At the time of debiting interest amount to the loan

   Debit: Loan account of the customer

   Credit: P& L Account -Interest on Loans

iii. At the time of repayment of interest & installment amount by the borrower

   Debit: Borrower's Savings Bank account (Amount of installment+ interest)

   Credit: Loan account of the borrower (Amount of installment+ interest)

iv. At the time of debiting service charges to the customer account

   Debit: Customer's loan account

   Credit: P&L account - Income head: Service charges

   The service charge debited to the borrower's account, should be recovered by the following debit to the borrower's account:

   Debit: Borrower's Savings Bank account

   Credit: Customer's loan account.

v. At the time of paying/renewing insurance policy on the house

Debit: Customer's loan account

Credit: DD Issued account or NEFT account in favour of Insurance Company Simultaneously

Debit: Borrower's Savings Bank account

Credit: Customer's loan account

[*Sometimes in respect of examples iv and v to reduce the accounting entries the accounting is done by Debit: Borrower's SB account and Credit: Income head & Debit: SB account of the borrower and DD issued or NEFT account respectively.*]

Note: Now-a-days under the core banking in the case of Equated Monthly Instalment paid by a customer from every instalment some portion of the repayment will be adjusted towards interest and the balance towards principal amount. In initial stages the proportion of credit towards the interest will be higher and towards the end of repayment period, the credit towards the principal will be higher. Interest calculations are done through the software used by the respective banks. The example given above illustrates the manual system of passing entries, for proper understanding.

OPERATIONAL ASPECTS OF CBS ENVIRONMENT

Introduction

CBS stands for Core Banking Solutions. It signifies, a banking process where a customer's transactions are done in a centralized manner through the data stored in a central computer server in a bank. The centralized data is made use by branches which are net worked together for handling customer's transactions across various geographical locations. CBS is one of the shining examples of Technology and Communication coming together in one platform.

CBS is the advanced stage of computerization of banks, which commenced during late 1980s in India. The Narasimham Committee also recommended computerization of banks in its report for efficient customer service and proper housekeeping of banks. CBS operations are carried out though tailor made software provided by specialized software companies. Depending upon the size and uses by banks, the software varies.

Need for CBS

The need for CBS arose in view of several adverse factors noticed in customer service provided by banks due to manual processing of transactions. Inordinate delays in processing transactions, pass book updation, poor housekeeping, revenue leaks, delays in MIS generation etc. were responsible for introduction of CBS.

Essential Requirements for CBS

The following are the essential frame work needed for CBS namely Central Data Centre, Disaster recovery sites, Business process re-engineering, Software, Networking and trained personnel.

1. **Central Data Centre ('CDC'):** This houses the Central server for the entire bank that facilitates online transactions. All delivery channels are linked to this centre which provides 24x7availability of data for processing. It should be operational throughout the year for a smooth functioning of the bank. Powerful equipment of enough storage capacity forms the main hardware in these sites.

2. **Disaster Recovery Sites:** Every computer site is prone to failure due to technical reasons. To avoid any such disruptions in centralized data centre, as a risk management measure, most of the banks maintain a back-up system of servers which will ensure non-stop availability of data for processing transactions as well as managing various delivery channels.

3. **Business process re-engineering:** This is to realign the existing business process in an organization in the light of introduction of new technologies. In the banking sector most of the banking transactions

were done manually/partly through computers before the introduction of CBS. Therefore, to reap the full benefit of the introduction of CBS, existing business practices were modified through business process re- engineering. Several leading companies specialized in business process re-engineering were involved in bringing about the desired changes in banks in this regard.

4. **Software:** CBS software consists of branch modules in respect of various functions, modules for various associated delivery channels such as ATM, tele-banking, internet banking and other inter-face software for connecting to RTGS, NEFT, CTS and other payment gateways.

5. **Networking:** Networking of branches to the central server as per standard specifications through Wider Area Network is required with backup network such as Integrated Services Digital Network (ISDN). "ISDN is an internationally accepted communications standard for simultaneous digital transmission of voice, video, data, and other network services over the traditional circuits of the public switched telephone network."

6. **Trained personnel:** Skilled and trained manpower is a pre-requisite for implementation and maintenance of uninterrupted CBS.

Reserve Bank of India has been encouraging all banks to switch over to CBS in the interests of Customer service, proper housekeeping, timely reconciliation and balancing and tallying of books of account, preparation of MIS, submission of returns etc. Due to variety of benefits accruing to the banks, large number of banks in India have successfully implemented CBS.

Uses of CBS to Banks

CBS is useful to banks in the following functional activities:

i. Opening of accounts

ii. Recording/handling of routine Transactions even from remote branches

iii. Interest calculations on all products

iv. Pass book updation/Statements of Accounts generation

v. Cash deposits and withdrawals

vi. Clearing and Money transfers

vii. Managing accounts of various types

viii. Generation of Statements for Reporting and Management Information System

ix. Customer Relationship Management

CBS is seamlessly linked to both onsite and offsite ATMs facilitating cash withdrawals, Fund transfers, Cheque book requisitions, mobile banking/internet banking. This feature enables customer convenience of doing transactions at their will. As CBS is also linked to CTS, clearing of cheques is also speeded up. CBS helps better housekeeping and plugs income leaks. Similarly, execution of standing instructions is done promptly. Intra- bank operations on behalf of customers also become easy. Payments like Utility bill payments, tax payments etc. can be conveniently done by customers. Thus, there are several advantages flowing to customers and banks.

Transactions flow in CBS

Transactions flow in CBS begins with login to the system by staff members of banks. For this purpose, each staff member is allotted a user id and the concerned staff member must create his own password. While logging in to the system every staff member must use his/her login id and password. Always staff members must maintain confidentiality of their passwords.

Once a transaction is entered by a staff member it is filtered through maker-checker protocol in the system. When a transaction is initiated at a lower level (clerical/teller) the same needs to be authorized by a senior supervisory level official, if the transaction exceeds the authority level fixed for such lower level staff. Once the transaction passes through the system, the transaction will be validated by the system. The user (i.e., the staff) will receive an indication whether the transaction is complete or not. While validating the transaction the system will analyse the account number, authority level of staff who puts through the transaction, authority level of supervisory official who authorizes the transaction and other points of validation as per set parameters as applicable to the respective transaction.

The process of accounting through the CBS

There are different levels of software in the CBS that are involved while accounting a transaction. One level of software takes care of transactions and another level takes care of posting of entries in the general ledger. There is a connecting inter-face between these two levels.

While accounting a transaction in the CBS entries are passed through an intermediary stage known as balancing account (also known as 'temporary parking account'). The following example illustrates the same:

Let us assume that Mr. K has given a cheque for Rs. 1,00,000 towards a term Deposit account in his name. The entries through the system will be:

Debit: Mr. K's Saving Bank Account Rs. 1,00,000

Credit: Balancing Account Rs. 1,00,000

Simultaneously the following entries will also be done in the system

Debit: Balancing Account: Rs. 1,00,000

Credit: Term deposit Account of Mr. K: Rs.1,00,000.

Similarly, in respect of transactions where a single debit results in, multiple credit and vice versa known as Batch transactions the following accounting entries will be generated.

Let us say a company gives a single cheque of Rs. 2,00,000 with a request to credit a sum of Rs. 20,000 being a lumpsum payment to 10 different staff members' SB accounts maintained with the branch.

Debit: Current Account of the Company: Rs. 2,00,000

Credit: Balancing account: Rs. 2,00,000

Debit: Balancing Account: Rs. 2,00,000

Credit: Individual SB Account of 10 staff members (each Rs. 20,000): Rs. 2,00,000

Other routine operational aspects under CBS

Startup activities: A day start up activity should be done by the Data Base Administrator (DBA). Usually in every branch, a senior officer is designated as a DBA. In small branches the branch head himself may perform this function. Every day after the startup an entry should be made in the log book or register should be signed to indicate as to who has initiated the day start up. Startup activities should be performed at the commencement of business hours. Before doing so, security checks (including check sum verification) as per internal guidelines should be carried out. Along with these verifications of banking date is also to be done.

Begin of Day operations: Every day a branch commences its work with 'Begin of the Day' (BOD) first. Only after this is performed will the staff members be able to login with their individual id and passwords to put through other transactions.

End of the Day operations at branches: Like BOD transaction every branch will have to do the End of Day (EOD) process to complete the day end routines. Back up of the day's transactions is taken during the EOD and statements are also generated. Once EOD is done staff members will not be able to access the transactions modules, but they may be able to access enquiry modules.

Operational aspects of Day end activities at branches

Every branch must carry out the following day end activities through their designated DBA or branch head as the case may be:

i. Checking of supplementary activities and deletion of special users.

ii. Minimum balance calculated.

iii. Products calculated for debit balances in current account.

iv. Generation of mandatory reports as per internal guidelines.

v. Taking up of Day end back-up and recording the same in the register meant for that purpose. These are to be stored securely as per procedure recommended in internal guidelines.

vi. Activation of fall back procedures.

vii. Log book updation. (Recordings).

viii. Filing reports in their respective files.

ix. Shut down of the system and locking of server room.

During the day end the following reports namely Access log, Supplementary, Audit trail, Transaction number report for each transaction entered are also be generated.

EOD at CDC

Also, at the CDC there will also be EOD operation usually late in the night, say around 10 or 11 p.m. By doing EOD at CDC, branches will be cut-off from the main host server at the CDC so that branches do not do any transaction after the EOD commences. Back up is also taken at CDC in which the entire data of the bank is stored at CDC level. During back up process all data gets updated and posted. Reports are also generated during the EOD process. After the EOD process a separate Start of the Day process is also done at CDC so that branches will be able to have access the CDC server. ATM transactions and other such transactions that have taken place during the EOD run get recorded once the Start of the Day process commences. EOD and SOD at CDC covers the entire branch network across the bank.

Operational aspects of Controls in CBS

1. Password controls: As access to computerized banking is only through passwords, staff members should ensure the following:

   (a) Maintain the secrecy of their individual passwords. This applies to all levels of staff members. Several frauds have taken place due to the disclosure of passwords or not changing of passwords.

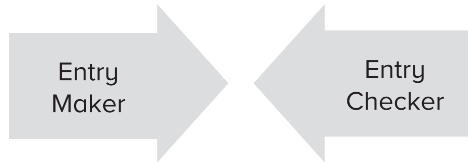
Username	***************
Password	***************

   (b) Passwords for certain critical and sensitive operations such as access to Master Data, access to operating system, taking of back-up, disk space creation etc. should be confined only to the Head of the branch or DBA.

   (c) The operating system passwords should be held under joint control of the Head of the branch and other designated official. It should be held in sealed cover and to be opened only in the presence of two officials. Immediately it should be changed, and the new password should be held in joint custody.

   (d) Password register is to be maintained for recording and updation.

2. **Transaction controls:** Transaction controls are maintained at the data base level and every branch must ensure the following:



   (a) Date must be authorized by the Head of the branch or the DBA.

   (b) Software control accepts only the current date and rejects any back date or future dated transactions.

   (c) In case of unused work stations, they are to be logged off. Work stations which are manned, only to be connected to the network.

   (d) Every software problem is entered in the register meant for that purpose and follow-up action is taken.

   (e) Printing of special batch reports, their checking and filing of the same appropriately.

Biometric Device to login

3. **Personnel control:** Branch must maintain the following controls in respect of staff who are involved in the operations under CBS.

   (a) Clear allotment of work and proper segregation of duties.

   (b) Rotation of duties at regular intervals.

   (c) Ensuring authorization limits are defined for various levels of staff and documented.

   (d) Ensuring deletion of passwords of transferred/retired employees. Also ensure that no access is given to employees who are facing suspension/disciplinary action.

4. **Logical access control:** Logical access control deals with safety of CBS assets, maintaining of data integrity etc. To ensure logical access control the following need to be ensured:

   (a) Staff should be given access levels on need basis only, that too to specific menus/files that relate to their work, and servers.

   (b) File maintenance access should be restricted to limited number of staff with proper approval and periodical review.

   (c) Encryption of Password files in the system for restricting the access.

   (d) Security violation alerts should be given immediate attention.

   (e) Access to work stations are restricted after working hours.

   (f) Access to sever/modem is to be restricted and controlled.

5. **Security control:** The following need to be ensured for a proper security control aspect under CBS environment.

   (a) In case of power failure or mechanical failures the system restarts with proper completion of entries and records.

   (b) Anti-virus of latest version is in place in branches/servers.

   (c) Periodical release of security patches by software vendors are applied to the systems.

   (d0 Back-ups are properly taken and stored including that of off-site stored back-ups.

   (e) Unauthorized amendments are not accepted by the system.

(f) Authenticate changes made in parameters and user levels are authorised.

(g) Ensure all modules are implemented.

(h) Exceptional transaction reports are generated and verified on a day to day basis.

(i) All GL codes authorised by controlling office/HO exist in the system.

(j) Important Passwords are kept in a sealed cover with the Manager /Branch Head so that in case of need/absence of staff it can be used.

Responsibilities of Banks under CBS

In these days of information technology, banks are increasingly becoming vulnerable to cyber-attacks and electronic frauds such as hacking, ransomware attacks and other malicious activities. Therefore, there is an imperative need for banks to have proper counter threat mechanisms to thwart, arrest and minimize such attacks. RBI has issued specific guidelines in this behalf in the year 2011 after the acceptance of the report by G. Goplakrishna Committee. Also, in the year 2013 RBI has additionally issued guidelines on the topic. Subsequently, in the year 2016 through its circular bearing Ref. No: DBS.CO/CSITE/BC.11/33.01.001/2015-16 dated June 2, 2016 the RBI advised banks about Cyber Security framework to be put in place.

A gist of the above is as follows:

1. All banks should have their Board of Directors approved Information Technology Policy including the structure, environment of the concerned bank's IT system. The policy should be updated in the light of developments that take place from time to time.
2. Banks also should have a separate Information Security Policy through which they can identify and implement appropriate information security management measures/practices keeping in view their business needs. The policies need to be supported with relevant standards, guidelines and procedures.
3. Senior management should ensure the implementation of a safe IT Operation environment. Policies and procedures defined as a part of IT Operations should support bank's goals and objectives, as well as statutory requirements.
4. Board and senior management have the responsibility for an effective governance mechanism and risk management process for all outsourced operations.
5. All banks to have an effective Information System Audit that include:
    a. Determining effectiveness of planning and oversight of IT activities.
    b. Evaluating adequacy of operating processes and internal controls.
    c. Determining adequacy of enterprise-wide compliance efforts, related to IT policies and internal control procedures.
    d. Identifying areas with deficient internal controls, recommend corrective action to address deficiencies and follow-up, to ensure that the management effectively implements the required actions.
6. Various IT related frauds need to be included in the fraud reporting system and banks should take adequate steps to mitigate such risks.
7. Banks should also frame policies, standards and procedures to ensure continuity, resumption and recovery of critical business processes, at an agreed level and limit the impact of the disaster on people, processes and infrastructure (includes IT); or to minimise the operational, financial, legal, reputational and other material consequences arising from such a disaster. There should also be clearly spelt out plans of Disaster recovery and business continuity.

8. There needs to be commitment from the Board of Directors/Senior Management towards the process of consumer education initiatives by providing adequate resources, evaluating the effectiveness of the process and fine-tuning and improving customer education measures on an ongoing process.
9. The Risk Management Committee at the Board-level needs to put in place, the processes to ensure that legal risks arising from cyber laws are identified and addressed. It also needs to ensure that the concerned functions are adequately staffed and that the human resources are trained to carry out the relevant tasks in this regard.
10. Banks to have operational Risk Group and this group needs to incorporate legal risks as part of operational risk framework and take steps to mitigate the risks involved in consultation with its legal functions within the bank. Also, the legal department /functionaries within the bank needs to advise the business groups on the legal issues arising out of use of Information Technology with respect to the legal risk identified and referred to it by the Operational Risk Group.
11. To address the need for the entire bank to contribute to a cyber-safe environment, the Cyber Security Policy should be framed by banks. It should be distinct and separate from the broader IT policy / Information Security policy so that it can highlight risks from cyber threats and measures to address / mitigate these risks.
12. While identifying and assessing the inherent risks, banks are required to reckon the technologies adopted, alignment with business and regulatory requirements, connections established, delivery channels, online / mobile products, technology services, organisational culture, internal & external threats.
13. Depending on the level of inherent risks, banks are required to identify their riskiness as low, moderate, high and very high or adopt any other similar categorisation.
14. Riskiness of the business component also may be factored into while assessing inherent risks.
15. While evaluating the controls, Board oversight, policies, processes, cyber risk management architecture including experienced and qualified resources, training and culture, threat intelligence gathering arrangements, monitoring and analysing the threat intelligence received vis-à-vis the situation in banks, information sharing arrangements (among peer banks, with IDRBT/RBI/CERT-In), preventive, detective and corrective cyber security controls, vendor management and incident management & response are to be outlined.
16. Testing for vulnerabilities at reasonable intervals of time is very important. The nature of cyber-attacks is such that they can occur at any time and in a manner that may not have been anticipated.
17. Hence, it is mandated that every bank to set up a Security Operations Centre to ensure continuous surveillance and keep itself regularly updated on the latest nature of emerging cyber threats.
18. Banks depend on technology in providing cutting-edge digital products to their customers and in the process collect various personal and sensitive information. They as owners of such data, should take appropriate steps in preserving the confidentiality, integrity and availability of the same, irrespective of whether the data is stored/in transit within themselves or with customers or with third party vendors; the confidentiality of such custodial information should not be compromised in any situation and therefore suitable systems and processes across the data/information lifecycle need to be put in place by banks.
19. Every bank should have a Cyber Crisis Management Plan (CCMP) and it should be a part of the overall Board approved strategy.
20. As cyber-risk is different from many other risks, the traditional Business Continuity Plan /Disaster Recovery arrangements may not be adequate and hence needs special attention keeping in view the nuances of the cyber-risk.

21. In India, CERT-IN (Computer Emergency Response Team - India, a Government entity) provides proactive and reactive services as well as guidelines, threat intelligence and assessment of preparedness of various agencies across the sectors, including the financial sector.

22. CERT-IN also has come out with National Cyber Crisis Management Plan and Cyber Security Assessment Framework. CERT-In/NCIIPC/RBI/IDRBT guidance may be referred to by banks while formulating the CCMP which should address the following four aspects:

    i. Detection
    ii. Response
    iii. Recovery and
    iv. Containment.

23. Banks are expected to be well prepared to face emerging cyber-threats such as 'zero-day' attacks, remote access threats, and targeted attacks. Also, banks should take necessary preventive and corrective measures in addressing various types of cyber threats including, but not limited to, denial of service, distributed denial of services (DDoS), ransom-ware / crypto ware, destructive malware, business email frauds including spam, email phishing, spear phishing, whaling, vishing frauds, drive-by downloads, browser gateway fraud, ghost administrator exploits, identity frauds, memory update frauds, password related frauds, etc.

Scheme of Penalties for bank branches based on performance in rendering customer service to the members of public

Scheme of Penalties for bank branches based on performance in rendering customer service to the members of public In the year 2020, the RBI issued master circular on Scheme of Penalties for bank branches including currency chests order to ensure that all bank branches provide better customer service to members of public with regard to exchange of notes and coins, in keeping with the objectives of Clean Note Policy.

The Competent Authority to decide the nature of irregularity will be the Officer-in-Charge of the Issue Department of the Regional Office under whose jurisdiction the defaulting currency chest/bank branch is located. Appeal against the decision of the Competent Authority may be made by the Controlling Office of the currency chest/ branch to the Regional Director/Chief General Manager/Officer-in-Charge of the Regional Office concerned, within one month from the date of debit, who may decide whether the same can be accepted / rejected.

Sharing of information on cyber-security incidents with RBI

(i) RBI has observed that banks are hesitant to share cyber-incidents faced by them. However, the experience indicates that collaboration among entities in sharing the cyber-incidents and the best practices would facilitate timely measures in containing cyber-risks.

(ii) Banks need to report all unusual cyber-security incidents (whether they were successful or were attempts which did not fructify) to the RBI. Banks are also encouraged to actively participate in the activities of their Chief Information Security Officers' Forum coordinated by Institute for Development and Research in Banking Technology (IDRBT) and promptly report incidents to Indian Banks - Center for Analysis of Risks and Threats (IB-CART) set up by IDRBT.

Mandatory Leave for Employees Posted in Sensitive Positions or Areas of Operation

As per notification issued by RBI in July, 2021 as a prudent operational risk management measure, the banks shall put in place a 'mandatory leave' policy wherein the employees posted in sensitive positions or areas of operation shall be compulsorily sent on leave for a few days (not less than 10 working days) in a single spell every year, without giving any prior intimation to these employees, thereby maintaining an element of surprise.

BACK OFFICE OPERATIONS IN BANKS

In financial services institutions such as Banks, depending on functionalities, an office can be divided in to Front office, mid office and back office. Front offices are those offices consist of client-facing staff members on a day-to-day basis. In this case, typically, an operating branch. Mid offices consist of staff who look after risk management, research, compliance and follow-up departments, as well as technology centres. Back offices consist of Centralised Processing Centres such as Clearing, KYC Verification and account opening, Cheque book issue, Demat transaction processing, Processing of Retail and other Loans such as MSME, Data processing, Reconciliation, Treasury and forex operations, etc.

The following broadly cover specific functions of some of the back offices in a bank:

i. Deposit related: Reminder generation in respect of maturing deposits, posting of service charges, interest calculation, obtaining confirmations etc. KYC scrutiny and centralised opening of accounts, handling of customer complaints etc.

ii. Loans related: Loan origination management, servicing of loans, follow-up, recoveries (collections), Calculation of interest and EMIs, posting various entries relating to various charges, interest, penal interest etc.

iii. Compliance: Various reports generation for internal and external users, Implementation of customer grievance decisions.

iv. Accounting: Maintenance of GL and other books of accounts, preparation of financial statements, reconciliation of various accounts and follow-up of pending items.

v. Demat: Settling transactions.

vi. Digital banking: Handling/Trouble shooting/Resolving issues relating to internet banking, mobile banking, ATMs, Other smart card related operations including PINs, Passwords etc.

HANDLING OF UN-RECONCILED ENTRIES IN BANKS

Banks while doing their business have to carry out reconciliation of the following:

i. *Reconciliation of inter branch entries in respect of various transactions.*

In every bank, daily, a lot of inter-branch transactions are done in which one leg of a transaction is done in one branch and other leg of the transaction is done in another branch which is involved in the transaction. Usually such transactions are done through a routing account known as Inter-branch account (Also known as HO account in some banks.)

Let us see an example in this regard. A Demand Draft is issued by a branch in Mumbai on behalf its customer 'A' in favour of another customer 'B' at Delhi. The Mumbai branch will issue the DD on its own service branch at Delhi. For this transaction, Mumbai branch will debit its customer's account for DD and crediting the amount of DD to Inter-branch Account. At the time of payment at Delhi Service branch, (after due verification of DD) it will debit Inter-branch account with the amount of DD and crediting the amount of DD to 'B's account. From the point of reconciliation, after the payment of the said DD, there won't be any pending item relating to this transaction in the inter-branch account. This is how reconciliation is done in respect of such transactions. Since there could be many transactions, reconciliation would be done at a centralized back office.

However as per RBI's study the major problem before computerization was noticed in reconciliation of pending entries in intra-branch entries pertaining to Other assets/Sundry Assets and Suspense accounts.

Suspense account is a parking account for a temporary period in respect of those transactions where particulars of transaction are incomplete or absent. After the full information is available the relevant credit entry to this account is reversed and credited to the proper account. Similarly, when interest/ dividend etc. are paid by debit to suspense account on behalf of a company pending adjustments with the branch where the main account of the company is held. Upon payment by the company of the total of such amounts, the amount is credited to suspense account. The suspense account would be nullified by proper credit from the company concerned towards such interest/dividend payments. If reconciliation is done it will be known as to how many such items in suspense are outstanding and remedial action could be taken to resolve them. Otherwise large number of pending entries (especially credit entries) in Suspense account may give rise to frauds through siphoning of funds. Similarly pending debit entries also need to be reconciled to avoid any fraudulent debits with intent to siphon-off funds. Hence reconciliation must be done in these accounts. Similar is the case of Sundry Deposits account.

ii. *Reconciliation of accounts maintained with other banks including RBI:*

Every bank maintains a Current Account with RBI through which reserve maintenance, clearing adjustments, payment adjustments such as RTGS/NEFT/ECS etc. repo/reverse repo transactions and other adjustments are done. Banks must always keep this account properly funded to meet any contingencies. For this purpose, banks reconcile the balances in this account against payables with the help of statement of account obtained from RBI daily and accordingly fund this account. Due to computerization of banks and RBI, the account statement is downloaded electronically and reconciled. Similar type of reconciliation is done when securities are sold or bought with Subsidiary General Ledger account maintained by RBI. Also, banks are mandated to reconcile their investment account balances with Public Debt Office of RBI every quarter/month depending upon the volume of transactions.

In addition to the above banks in different locations (other than metros/State Capitals) maintain their bank account with other banks for the purposes of receivable/payable in respect of clearing adjustments/ collections/cash management etc. These accounts are operated by the respective branch officials at these locations. As a standard procedure these accounts are to be reconciled keeping in mind no items of P& L nature, collections, clearing remain pending. Due to computerization of banks status of accounts can be ascertained online and reconciliation is done so that proper balance is maintained in these accounts to meet any commitment or deploy any excess funds in these accounts for revenue generation.

iii. *Reconciliation of accounts with Correspondent banks in India/abroad:*

When a bank conducts a foreign exchange transaction, Nostro accounts are involved. Nostro accounts are those accounts maintained by banks from India in an overseas country in the local currency. When transactions pertaining to credit/ receivable to India result in the credit to this account and similarly when payments are to be made to overseas entities debits are made to this account. When banks receive intimation of credit in their Nostro account they trace out the relevant transaction and pass on the credit to the concerned beneficiary in India. Similarly, when payments are to be made they will pass on instructions to the correspondent bank which maintains the account to effect payments by debiting this account. Hence these accounts are reconciled on a day to day basis for credits and pending items and accordingly action is taken.

iv. *Reconciliation of transactions with third party service providers and sub-contractors. (For example, ATM management services):*

With proliferation of ATMs across India (It is more than 2,00,000 ATMs across India as on date) banks employ third parties/vendors for loading cash as well as collecting cash deposited by account holders in ATMs. To avoid any fraud in this respect banks monitor activities centrally in respect of ATMs. Monitoring also involves reconciling of cash loading and collection transactions and balances held at ATMs.

v. *Reconciliation of transactions with other intermediaries:*

The rapid spread of electronic payment mechanisms through Point of Sale, Internet, e-Commerce portals, mobile commerce portals etc. involve Merchants. Such payments made by users are done through certain intermediary agencies such as Payment gateways, Aggregators etc. In the case of e-Commerce and Mobile commerce transactions, these are supported by platforms provided by third party intermediaries. For example - Paytm.

In the cycle of transactions when payments are made by users of these services, first it is credited to the account of the intermediary. Thereafter it is forwarded to the credit of concerned merchants. Any delay in the transmission of payments made by users to the merchants will make the users lose the confidence in the payment system as well as bring in suspicion on traders and intermediaries. Hence banks have to ensure that payments made by users are properly reconciled by intermediaries receiving these payments and also ensure such payments are also passed on to Merchants.

NOMINATION FACILITY

The nomination facility is intended to facilitate expeditious settlement of claims in the accounts of deceased depositors and to minimise hardship caused to the family members on the death of the depositors.

Provisions in the Banking Regulation Act, 1949

The Banking Regulation Act, 1949 was amended by Banking Laws (Amendment) Act, 1983 by introducing new Sections 45ZA to 45ZF, to enable a banking company to:

a. make payment to the nominee of a deceased depositor, the amount standing to the credit of the depositor.

b. return articles left by a deceased person in its safe custody to his nominee, after making an inventory of the articles in the manner directed by RBI.

c. release contents of a safety locker to the nominee of the hirer of such locker, in the event of the death of the hirer, after making an inventory of the contents of the safety locker in the manner directed by RBI.

THE BANKING COMPANIES (NOMINATION) RULES, 1985

For making nomination in a prescribed manner the Government of India in consultation with the RBI framed, The Banking Companies (Nomination) Rules, 1985. These Rules, along with new Sections 45ZA to 45ZF of the Banking Regulation Act, 1949 regarding nomination facilities were brought into force with effect from 1985.

Nomination Rules, 1985 were framed for providing:

i. Nomination Forms for deposit accounts, articles kept in safe custody and contents of safety lockers.

ii. Forms for cancellation and variation of the nominations.

iii. Registration of Nominations and cancellation and variation of nominations, and

iv. matters related to the above.

Forms to be used under Nomination Rules

The nomination can be made, cancelled or varied in the prescribed form as follows:

Facility	Deposit Account	Safe Custody	Safety Locker (Sole Hirer)
Nomination	DA1	SC 1	SL 1
Cancellation	DA2	SC 2	SL 2
Variation	DA3	SC 3	SL 3

Nomination facilities in respect of safe deposit locker / safe custody articles

Sections 45ZC to 45ZF of the Banking Regulation Act, 1949 provide for nomination and release of contents of safety lockers / safe custody article to the nominee and protection against notice of claims of other persons. Banks are guided by the provisions of Sections 45 ZC to 45 ZF of the Banking Regulation Act, 1949 and the Banking Companies (Nomination) Rules, 1985 and the relevant provisions of Indian Contract Act and Indian Succession Act.

In the matter of returning articles left in safe custody by the deceased depositor to the nominee or allowing the nominee/s to have access to the locker and permitting him/them to remove the contents of the locker, the Reserve Bank of India, in pursuance of Sections 45ZC (3) and 45ZE (4) of the Banking Regulation Act, 1949 has specified the formats for the purpose.

In order to ensure that the amount of deposits, articles left in safe custody and contents of lockers are returned to the genuine nominee, as also to verify the proof of death, banks have devised their own claim formats and follow the procedure, as suggested by the Indian Banks' Association for the purpose.

Nomination Facility - Sole Proprietary Concern

Banks extend the nomination facility also in respect of deposits held in the name of a sole proprietary concern.

Nomination Facility in Single Deposit Accounts

As per Allahabad High Court direction "the Reserve Bank of India has issued guidelines to the effect that no Savings Account or Fixed Deposit in single name be accepted unless name of the nominee is given by the depositors. It will go a long way to serve the purpose of the innocent widows and children, who are dragged on long drawn proceedings in the Court for claiming the amount, which lawfully belongs to them".

Therefore, banks generally insist that the person opening a deposit account make a nomination. In case the person opening an account declines to fill in nomination, the bank explains advantages of nomination and asks him to give a specific letter to the effect that he does not want to make a nomination. In case the person opening the account declines to give such a letter, the bank records the fact on the account opening form and proceed with opening of the account if otherwise found eligible. Banks cannot refuse to open an account merely because the person opening the account refused to nominate.

Acknowledgement of Nomination & Registering the nomination

In terms of Nomination Rules 2 (9), 3 (8) and 4 (9) applicable to Banking Companies they acknowledge in writing to the depositor(s) / locker hirers (s) the filing of the relevant duly completed Form of nomination, cancellation and / or variation of the nomination. Such acknowledgement is given to all the customers irrespective of whether the same is demanded by the customers or not.

In terms of Nomination Rules 2 (10), 3 (9) and 4 (10) banks are required to register in their books the nomination, cancellation and / or variation of the nomination. The banks should accordingly act to register nominations or changes therein, if any, made by their depositor(s) / hirers.

Incorporation of the legend "Nomination Registered" in pass book, deposit receipt etc. and indicating the Name of the Nominee in Pass Books / Fixed Deposit Receipts

When an account holder has opted for the nomination facility, it has to be indicated on the passbook so that, in case of death of the account holder, his relatives can take suitable action with the bank. This practice holds good for term deposit receipts too. Also, if a customer agrees, banks can indicate the name of the Nominee in the Pass Books / Statement of Accounts / FDRs.

Separate nomination for savings bank account and pension account

As Banking Companies (Nomination) Rules, 1985 are distinct from the Arrears of Pension (Nomination) Rules, 1983 a separate nomination is necessary in terms of the Banking Companies (Nomination) Rules, 1985 in case a pensioner desires to avail of nomination facility.

Nomination facility in respect of deposits

i. Nomination facility can be availed by individuals including a sole proprietary concern.

ii. Nomination can be made only in favour of individuals. As such, a nominee cannot be an association, trust, society or any other organisation or any office-bearer thereof in his official capacity. Due to this any nomination other than in favour of an individual will not be valid.

iii. There cannot be more than one nominee in respect of a joint deposit account at any time.

iv. Banks allow variation/cancellation of an existing nomination by all the surviving depositor(s) acting together. This is also applicable to deposits having operating instructions "either or survivor".

v. In the case of a joint deposit account the nominee's right arises only after the death of all the depositors.

vi. Witness in Nomination Forms: Under Nomination Rules, in various Forms prescribed, only the thumb-impression(s) of illiterate customers are to be attested by two witnesses. Signatures of the account holders need not be attested by witnesses.

vii. Nomination in case of Joint Deposit Accounts: Nomination facility is available for joint deposit accounts also. Banks are, to ensure that their branches offer nomination facility to all deposit accounts including joint accounts opened by the customers.

Nomination in Safe Deposit Lockers/Safe Custody Articles

(i) Nomination facilities are available only in the case of individual depositors and not in respect of persons jointly depositing articles for safe custody.

(ii) In terms of Section 45ZE of the Banking Regulation Act, 1949 a minor can be a nominee for obtaining delivery of the contents of a locker. However, banks must ensure that when the contents of a locker were sought to be removed on behalf of the minor nominee, articles are handed over to a person who, in law (i.e., a guardian), is competent to receive the articles on behalf of the minor.

(iii) In respect of lockers hired jointly, on the death of any one of the joint hirers, the contents of the locker are only allowed to be removed jointly by the nominees and the survivor(s) after an inventory was taken in the prescribed manner. In such a case, after such removal preceded by an inventory, the nominee and surviving hirer(s) may keep the entire contents with the same bank, if they so desire, by entering into a fresh contract of hiring a locker.

Settlement of claims in respect of deceased depositors - Simplification of Accounts with survivor/nominee clause

If a depositor/s had made a valid nomination or where the account was opened with the survivorship clause ("either or survivor", or "anyone or survivor", or "former or survivor" or "latter or survivor"), the payment of the balance in the deposit account to the survivor(s)/nominee of a deceased deposit account holder represents a valid discharge of the bank's liability provided:

a. the bank has established with proper care and diligence, the identity of the survivor(s) / nominee and the fact of death of the account holder, through applicable documentary evidence;

b. there is no injunction or restraining order from any competent court on the bank from making the payment from the account of the deceased;

c. it has been made clear to the survivor(s) / nominee that he would be receiving the payment from the bank as a trustee of the legal heirs of the deceased depositor, i.e., such payment to him shall not affect the right or claim which any person may have against the survivor(s) / nominee to whom the payment is made;

d. If payment is made to the survivor(s) / nominee, based on the foregoing conditions, it would be deemed as a full discharge of the bank's liability; and

e. Any further demand on production of legal representation is superfluous and will be viewed as inconvenience to the survivor(s) / nominee. This would be viewed seriously by RBI. Therefore, banks should not demand production of succession certificate, letter of administration or probate, etc., or obtain any bond of indemnity or surety from the survivor(s)/nominee, irrespective of the amount standing to the credit of the deceased account holder.

Accounts without the survivor / nominee clause

If a deceased depositor had not made any nomination or for the accounts other than those styled as “either or survivor” (such as single or jointly operated accounts), banks are required to adopt a simplified procedure for repayment to legal heir(s) of the depositor and within their risk management framework fix a minimum threshold limit, for the balance in the account of the deceased depositors, up to which claims in respect of the deceased depositors could be settled without insisting on production of any other documentation except a letter of indemnity.

Premature Termination of term deposit accounts

In the case of term deposits, banks are required to include a clause in the account opening form itself to the effect that in the event of the death of the depositor, premature termination of term deposits would be allowed. Terms and conditions in such cases should also be specified in the account opening form. No penalty will be applicable on such premature withdrawals.

Treatment of flows in the name of the deceased depositor

If banks receive credits in the name of the deceased depositors after their death, banks should adopt any one of the following methods to avoid hardship to the survivor(s) / nominee of a deposit account:

i. The bank can obtain an authorization from the survivor(s) / nominee of a deceased account holder to open an account styled as ‘Estate of Shri/Smt. ,the Deceased’ where all the pipeline flows in the name of the deceased account holder could be allowed to be credited. However, no withdrawals will be permitted till final settlement.

   OR

ii. The bank can obtain an authorization to return the pipeline flows to the remitter with the remark “Account holder deceased”. The survivor(s) / nominee / legal heir(s) could then approach the remitter to settle such payments in the name of the appropriate beneficiary.

Interest payable on the deposit account of deceased depositor

In the case of a term deposit standing in the name/s of

i. a deceased individual depositor, or

ii. two or more joint depositors, where one of the depositors has died, for payment of interest on matured deposits in such cases should be based on the Board of Directors approved policy of the respective banks which should be disclosed to depositors.

In case of a deceased individual depositor/sole proprietorship concern, interest should be paid only from 1st May 1983, or from the date of death of the depositor, whichever is later, till the date of repayment to the claimant/s at the rate of interest applicable to savings deposit as on the date of payment.

Time limit for settlement of claims

Banks should settle the claims in favour of survivors/nominees in respect of deceased depositors and release payments within a period not exceeding 15 days from the date of receipt of the claim. This is however subject to the production of proof of death of the depositor and suitable identification of the claimants to the bank’s satisfaction.

At periodical intervals banks should report to the Customer Service.

Committee of the Board of Directors, the details of the number of claims received pertaining to deceased depositors / locker-hirers / depositors of safe custody article accounts and those pending beyond the stipulated period, giving reasons thereof.

Claim Forms to be made available

For facilitating timely settlement of claims on the death of a depositor/s, banks are to provide claim forms for settlement of claims. Formats of claim forms are to be put on the bank’s website.

Access to the safe deposit lockers / Return of safe custody articles to Survivor(s) / Nominee(s)/ Legal heir(s)

The generality of nomination rules which are applicable to deposit accounts also apply to safe deposit lockers/ safe custody articles.

However, the following specific guidelines in this regard are applicable.

Access to the safe deposit lockers / return of safe custody articles (with survivor/nominee clause)

On the death of a sole locker hirer, the nominee should be given access of the locker and liberty to remove the contents.

If a locker was hired jointly with the instructions to operate it under joint signatures, and the locker hirer(s) have nominated a nominee, upon the death of any of the locker hirers, the bank should give access of the locker and the liberty to remove the contents jointly to the survivor(s) and the nominee(s).

If a locker was hired jointly with survivorship clause and the hirers instructed that the access of the locker should be given over to "either or survivor", "anyone or survivor" or "former or survivor" or according to any other survivorship clause, banks should follow the mandate in the event of the death of one or more of the locker- hirers.

Precautions to be taken before handing over the contents of locker:

(a) Banks to take proper care and caution in identifying the survivor(s) / nominee(s) and should have proper documentary evidence in respect of the death of the locker hirer;

(b) Banks should ensure that there are no order/s from a competent court restraining the bank from giving access to the locker of the deceased; and

(c) Banks should make the survivor(s) / nominee(s) understand that access to locker / safe custody articles is given to them only as a trustee of the legal heirs of the deceased locker hirer, i.e., such access given to him shall not affect the right or claim which any person may have against the survivor(s) / nominee(s) to whom the access is given.

Banks are required to follow a similar procedure in respect of return of articles placed in the safe custody of the bank. Banks should be aware that the facility of nomination is not available in case of deposit of safe custody articles by two or more persons.

Access to the safe deposit lockers / return of safe custody articles (without survivor/nominee clause)

In case where the deceased locker hirer had not made any nomination or where the joint hirers had not given any mandate regarding the access to one or more of the survivors by a clear survivorship clause, banks are required to adopt procedure drawn up in consultation with their legal department/advisers for giving access to legal heir(s) / legal representative of the deceased locker hirer. Similar procedure should be followed for the articles under safe custody of the bank.

Preparing Inventory

Banks should prepare an inventory before returning articles left in safe custody / before permitting removal of the contents of a safe deposit locker as per RBI's Notification DBOD.NO.Leg.BC.38/ C.233A-85 dated March 29, 1985. Banks are not required to open sealed/closed packets left with them for safe custody or found in locker while releasing them to the nominee(s) and surviving locker hirers / depositor of safe custody article.

Further, if the nominee(s) / survivor(s) / legal heir(s) wish to continue with the locker, banks may enter into a fresh contract with nominee(s) / survivor(s) / legal heir(s) and adhere to KYC norms in respect of the nominee(s)/ legal heir(s).

LESSON ROUND-UP

- Banks open different types of deposit accounts such as demand deposits which include savings bank deposits, current accounts, notice deposits and term deposits that include fixed deposits, recurring deposits etc. for their customers under the broad guidelines provided by RBI. Customers for whom banks open accounts include individual, joint individuals, minors, sole proprietary concerns, partnership firms, LLPs, Companies, trusts, clubs and associations, cooperative societies, special customers like illiterate persons, blind, executors and administrators, liquidators etc.

- Banks also are statutorily required to comply with TDS norms of Income-Tax Department while paying interest, except in cases where customers submit specific exemption forms. They also follow operational rules regarding paying interest on premature closure of term deposit accounts; pay interest on deposits if they mature on a holiday; auto renew deposits in the absence of disposal instructions, provide insurance cover for deposits under DICGC.
- Banks deal with different types of borrowers. They follow relevant documentation procedures at pre-sanction and post-sanction stages. They scrutinize, process and sanction loans/advances as per set procedures.
- Banks have adopted core banking solution (CBS) environment in operational banking to improve customer service as a part of computerization of banking operations. CBS has been adopted by banks to bring in efficiency and improve productivity and profitability in banking operations. Essential requirement for CBS include central data centre, disaster recovery sites, business process reengineering, software, networking and trained personnel. In view of the risks involved in CBS, banks have various controls such as password controls, transaction controls, personnel control, logical access control, security control. Banks shoulder specific responsibilities in terms of RBI's directives on CBS. They are also responsible for reporting any cyber frauds that are attempted or took place in their banks. Banks also have established back offices for deposit related, loan related, compliance, accounting, Demat and digital banking functions for increasing efficiency and better customer service. Banks carry out voluminous transactions across inter-branch, inter-bank, correspondent banks, third party service providers and intermediaries which necessitates reconciling their transactions to eliminate/ minimize risk of frauds, settle and square-up transactions, and improve confidence among parties involved in the transactions.

GLOSSARY

OVD-Officially Valid Documents: OVDs that can be accepted for establishing the legal name and current address of Individuals. E.g. Copy of Aadhaar/Voter ID Card, Passport, the validity of Card etc.

Central KYC Records Registry (CKYCR): The Central Know Your Customer Registry (CKYC) is a centralised depository of KYC documents of customers availing various services of the financial sector.

Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI): CERSAI has been established as a company under section 8 of the Companies Act, 2013 by the Government of India. CERSAI was formed to identify and check fraudulent activity in lending transactions against equitable mortgages.

Financial Intelligence Unit (FIU): Financial Intelligence Unit - India (FIU-IND) was set by the Government of India in 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions.

Foreign Account Tax Compliance Act (USA) (FATCA): The Foreign Account Tax Compliance Act (FATCA) is a tax law that compels U.S. citizens at home and abroad to file annual reports on any foreign account holdings.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Discuss briefly the salient features of Savings bank accounts.
2. Discuss operational aspects of Partnership accounts.
3. Write a note on Scrutiny of loan applications.

4. How the drawls in a Cash credit account are fixed? Illustrate with an example.
5. What are the essential requirements of CBS?
6. What are the operational controls under CBS? Discuss each of these controls.
7. Write a note on reconciliation functions in a bank.
8. What are the precautions that a bank needs to exercise in case the holder of a Savings Bank Account is a - (i) Pardanashin; (ii) Minor; (iii) Blind man; (iv) Illiterate.

LIST OF FURTHER READINGS

- Banking Law and Practice - P.N. Varshney
- Practice and Law of Banking - M.L. Tannan
- Master Circulars/Directions of RBI
- Recommendations of various committees of RBI on Information Technology/ Cyber Security
- Circulars of Indian Banks Association
- Credit Appraisal - Dr. T.C.G, Namboodiri

Digital Banking

Lesson 5

KEY CONCEPTS

■ Digital Banking ■ CBS ■ MIS ■ UCB ■ NEF ■ RTGS ■ECS ■ IMPS ■ AI ■ CRM

Learning Objectives

To understand:

- The concept, trends, and significance of Digital Banking
- The latest and emerging trends in Digital Banking
- The faces and architecture of digital banking, namely digitization, and digitalization
- The opportunities and challenges for public and private sector banks in digital banking
- The growing significance of Core Banking and related frauds in Indian Banking

Lesson Outline

- Introduction
- Digital Banking
- Components and architecture of CBS
- Core Banking Process Flow and Relevant Risks
- Challenges in Core Banking Solution (CBS)
- Core Business Process Flow and Relevant Risk Controls
- Reporting System and MIS Data Analytics and Business Intelligence
- Overview of Banking Services and IT related Risk & Control
- Digital Currency
- Lesson Round-Up
- Test Yourself
- List of Further Readings

INTRODUCTION

With the continuous advancement in information and communication technology (ICT), the monetary and financial sector is also changing their faces. One of the recent developments in the monetary and financial sector out of technological development is the introduction of digital banking. The use of physical cash is on the decline as people have adopted plastic money and other electronic means of transferring money. New and new ways of payment and transfer methods of money are developing. Payments through electronic wallets, mobile wallets, and plastic cards are picking up. This is not just a European trend, but in India too, the trend of digital banking or net banking is proliferating. Further, the demonetization drive has also fuelled the growth of digital banking in the country and taken the country towards a cashless economy.

In developed countries like US and UK, only a small fraction of the currency is in physical circulation. Most people in the west prefer e-money as an alternative to physical currency. Though physical currency has numerous advantages in certain situations, its circulation has decreased. Therefore, for a banking student, there is an imperative now about information technology-based services offered by banks as this is full of risks. A banking graduate must be aware of such risks and techniques to be followed to mitigate these risks to offer safe and seamless banking services. Considering the chapter attempts to cover all relevant topics of level one orientation to familiarise students with emerging IT-based banking trends in digital banking and fintech.

Technology plays a vital role by ushering in a fundamental shift in banks' functioning compared to the manual system of operations earlier. It helps banks bring improvements not only in their internal functioning but also enables them to provide better customer service. Technology has broken all boundaries in bringing seamless banking and encouraged speedier cross-border banking business. RBI attributes this growth in digital banking to 'higher levels of sustainable development and financial inclusion.' Deep telecom penetration, the availability of the internet, and the ready adaptation of technology have accelerated credit access, and efficient payment systems for now and the future of digital banking are all responsible for this flourishing growth.

With the Indian Government's vision of a cashless economy and rapid development in improving internet penetration throughout the nation, the country recorded over 25.5 billion real-time payment transactions in 2020 (the highest in the world), exceeding china by 60 percent. Consequently, most Indian banks in the country offer Digital Banking services today, which have become an integral part of banking. True Digital Banking meaning is a transformation!

DIGITAL BANKING

In simplified form, banking done through the digital platform, doing away with all the paperwork like cheques, pay-in slips, demand drafts, and so on, is coined as digital banking. Digital means the availability of all banking activities online.

> **Digital Banking Defined**
>
> Digital banking involves the digitization of all traditional banking products, processes and activities to serve customers through online channels.

Digital banking gives you the luxury of freely accessing and performing all traditional banking activities 24x7 without having to personally go to a bank branch to get your work done. Digital Banking can be done through a laptop, tablet, or mobile phone. Following are some of the key benefits of digital banking that separate it from traditional banking: -

(i) **Cash Withdrawal**: With ATMs in most localities, customers need not visit a bank branch. Digital Banking allows you to withdraw cash from the ATM at any time of the day or night.

(ii) **Fund Transfers:** The ease of transferring funds is one of the most significant benefits offered by Digital Banking. There is no need to go through the hassle of issuing cheques or Demand Drafts by bank officials. All you need to do is use Digital Banking to transfer funds to anyone, anytime. Several options are available, like IMPS, RTGS, NEFT, etc. It's even easier to do it on the Mobile Banking App.

(iii) **Getting Statements: Today, bank customers can use** Digital Banking to download bank statements for any period at any time. It does not require visiting a bank branch and getting a printout. It is there on your device to access whenever you want.

(iv) **Investments: Digital banking has made investing hassle-free and just with the click of a mouse or mobile touch.** It just takes a few seconds to open a Fixed Deposit with the bank or renew the recurring deposit (RD). Besides this, modern consumers can use Digital Banking to make investments in other instruments as well, such as investing in mutual funds through SIP, buying insurance plans or Mediclaim policies, transferring school fees of kids, and applying for bank loans; all is possible through your mobile phone or personal computers.

(v) **Keeping Track of Transactions:** Digital Banking has made it much easier for customers to track transactions. Want to know if your salary has been credited to your account? Just whip out your smartphone and check -- you'll know in a matter of seconds. Plus, banks send SMSs if money has been debited from your account. So, in the unlikely event of a fraudulent transaction, you'll come to know of it immediately.

(vi) **Mobile Banking:** The first phase of the Digital Banking revolution was through the internet. The second phase of Digital Banking involves mobile phone platforms. After smartphones came into the market, Digital Banking took off significantly. Smartphones now allow customers to carry out bank transactions on the go. They can transfer funds, invest in Fixed Deposits, and pay the bills even while commuting on the go. Most banks like HDFC Bank have apps for customers, such as Mobile Banking App and PayZapp, among many others. HDFC Bank also has a mobile phone application called HDFC Bank Mobile Banking LITE that can be used without an Internet connection. This app allows users to check balances, get statements, place requests for checkbooks, view fixed deposit summaries, etc.

(vii) **Paying the Bills:** Digital Banking has made it much easier to pay your bills. All you need to pay is via logging in, whether it's electricity, gas, phone, or other bills. And there's the auto-debit facility that allows your bills to be paid automatically as and when they arrive. HDFC Bank allows you even to recharge your pre-paid mobile phone number. Digital Banking has indeed transformed the everyday life of an individual!

(viii) **Stop Cheques:** Sometimes, you may need to stop cheques for some reason – like you may have got the amount wrong, or the beneficiary was not the one you wanted. In that case, Digital Banking makes it very easy to stop cheques. All you need to do is log in, and with a simple click, you can update the cheque processing.

Categories of Digital Banks

Different types of digital banking systems in India have not only touched the urban elite but are also permeating the rural sector. Different types of digital payments categorize digital banking. These modes of digital payment use electronic means to replace cash and cheque. The main types of digital banks operational in India are as follows:

(i) **Neo bank:** Neo bank is a digital bank operating online, without any physical presence, which provides its customers remote access to its services via a mobile app. Many Neo banks don't hold a bank license and partner with an existing bank for bank-licensed operations (which means their customers need to create an account at the partner bank). Often, the range of services a neo-bank offers is narrower compared to licensed banks.

(ii) **Challenger bank:** This term originated in the UK and refers to a recently launched bank that "challenges" traditional banking institutions. Being more user-friendly and cost-effective for an end-user, challenger banks focus on the audience segments that are underserved by the big financial institutions.

(iii) **New bank:** These are fully licensed neo-banks that provide a full range of banking services, and their only difference from the brick-and-mortar banks is the mode of operation – which is completely online. Revolut, Monzo, N26, and Starling Bank are examples of new banks.

(iv) Nonbank: As the name implies, these are nonbanking institutions that provide financial services – for example, streamlined loans or mortgages, but they don't simultaneously accept deposits or offer checking and savings accounts. Some of the nonbanks, like Monese, operate on EMI licenses.

Types of Digital Banking Payments

(i) Aadhaar Enabled Payment System (AEPS): AEPS lets the client initiate banking instructions after verifying the Aadhaar number successfully.

(ii) Banking Cards: Cards are used to withdraw cash and enable other forms of digital payment. Cards can be used for online transactions and on the point of Sale (PoS) machines. Banks can also issue prepaid cards; they are not linked to the bank account but function through the money loaded onto them.

(iii) Internet and Mobile Banking: Commonly known as e-banking, internet banking refers to obtaining certain banking services over the internet, such as fund transfers and opening and closing accounts. Internet banking is a subset of digital banking because internet banking is only limited to core functions. Similarly, mobile banking is availing banking services through mobile-based applications.

(iv) Mobile Wallets: Mobile wallets have eliminated the need to remember four-digit card pins, enter CVV details, or carry loose cash. Mobile wallets store bank account and card credentials to easily add funds to the wallet and make payments to other merchants with similar applications. Popular mobile wallets are Paytm, Freecharge, MobiKwik, etc. Mobile wallets, however, generally limit how much can be deposited in the wallet. A small fee may also be charged on depositing the funds from the mobile wallet back into the bank account.

(v) PoS Terminals: PoS machines are portable devices that read a card to authorize and complete the payment. Supermarkets and gas stations opt for this method of payment. However, with digital banking thriving, PoS terminals have evolved into more than physical PoS devices. Virtual and Mobile PoS terminals have surfaced, using the mobile phone's NFC feature and web-based applications to initiate payment.

(vi) Unified Payments Interface (UPI): UPI is the most trending form of digital banking. UPI uses a virtual payment address (VPA), so the user can transfer funds without entering bank account details or an IFSC code. Another striking feature of UPI is that the applications let you consolidate all your bank accounts in one place. Funds can be transferred and received around the clock with no time restrictions. UPI-based apps in India are BHIM, PhonePe, and Google Pay. BHIM application, in addition to transferring funds to other virtual addresses and bank accounts, also lets the user transfer funds to another Aadhaar number. More importantly, UPI-based payments are free of cost.

(vii) Unstructured Supplementary Service Data (USSD): By dialling the number *99#, mobile transactions can be carried out without an application and internet connection. The number holds nationwide applicability and promotes greater financial inclusion on the ground level. The service lets the caller surf through an interactive voice menu and chooses the desired option on the mobile screen. The only catch is that the caller's mobile number should be linked to the particular bank account.

(viii) National Electronic Fund Transfer (NEFT): This system has enabled individuals, firms, and corporates to transfer funds from one bank to another in the country participating in the system. The salient features of NEFT are:

- NEFT is a convenient mode of money transfer between banks in India.
- Internet is used to transfer funds.
- It is an electronic transfer of money from one bank or bank branch to another.

- NEFT functions on a 'batch settlement' basis.
- The batches are settled in hourly time slots.

ONLINE PROCEDURE FOR NEFT

The procedure for doing online transaction may vary from bank to bank but almost all the banks follow these four step criteria to do any online transactions. The online procedure for doing NEFT transactions is as follows:

Step 1: First login to your net banking account.

If you do not have a net banking accounts then register for it on the website of your bank.

Step 2: Add the beneficiary as a payee. To do so, you have to enter the following details about the beneficiary in the 'Add New Payee' section:

- Account Number.
- Name.
- IFSC Code.
- Account Type.

Step 3: Once the payee is added, choose NEFT as mode of Fund Transfer.

Step 4: Select the account you wish to transfer money from, select the payee, enter the amount that you wish to transfer and add remarks (optional).

Step 5: Click on submit button.

(ix) Real Time Gross Settlement (RTGS): RTGS, real-time gross settlement, is an electronic fund transfer system that enables money to move from one bank to another on a real-time and gross basis. 'Real-time means that the beneficiary bank receives the instructions for fund transfer immediately, and 'gross' means that it is not bunched with any other transaction and settlements of funds transfer instructions happen individually. Since the funds' settlement takes place in the Reserve Bank of India (RBI) books, it makes transaction payments final and irreversible. The salient features of RTGS are:

- It is a fast and convenient mode of money transfer between banks in India.
- Internet is used to transfer funds.
- As soon as the transaction is processed, the funds are transferred to the beneficiary.
- RTGS is generally meant for large-sized transactions. The minimum amount that can be remitted through RTGS is ₹ 2 lakh.
- RTGS does not have an upper ceiling for transactions.

IMPORTANT INFORMATION NEEDED FOR RTGS & NEFT PAYMENT

The Remitter has to provide the following details:

(i) Amount to be remitted
(ii) Account number to be credited
(iii) Name of the beneficiary bank
(iv) Name of the beneficiary customer
(v) Sender to receiver information, if any

(vi) IFSC code of the receiving branch

(vii) Mobile number of the remitter.

The amount will be credited to the account basing on the account number only. As such remitter has should be cautious on the account number while transferring the amounts in electronic mode.

DIFFERENCES BETWEEN NEFT AND RTGS

Sl. No	Point of Difference	NEFT	RTGS
1.	Full Form	National Electronic Funds Transfer	Real Time Gross Settlement
2.	Suitable for	Small Transfers	Large Transfers
3.	Settled In	batches	Batches
4.	Minimum Transfer	No Minimum	₹ 2 Lakhs
5.	Maximum Transfer	Depends on Nature of Account	No Limit
6.	Service Charges	₹ 5-25	₹ 30-55
7.	Funds Transfer	30 minutes to 72 hours	30 minutes
8.	Timings on Mon – Fri	8:00 am – 6:30 pm	9:00 am – 4:30 pm
9.	Timings on Saturday	8:00 am – 12:30 pm	9:00 am – 1:30 pm

(x) Electronic Clearing System (ECS): ECS electronic clearing system is an electric mode of transferring funds from one account to many bank accounts. The ECS facility is used by organizations that make repetitive payments to many persons. Paying monthly salary, dividend, and pension is done through ECS. The ECS facility can also pay utility bills and other charges such as electricity, water, mobile, or EMIs of banks and other financial institutions. RBI introduced the ECS facility. ECS facility can be used for both credit and debit purposes. There are two forms of ECS transfers - ECS Credit and ECS Debit. ECS Credit is used by an organization interested in transferring funds to distribute salary, interest, pension, annuity, or dividend. While the ECS debit facility is used by an organization subject to receiving periodic payments from many people. This facility is very useful for payment of utility bills such as mobile/electricity/water bills or collections of funds such as cess, loans, and mutual investments.

(xi) Immediate payment Services (IMPS): Immediate Payment Service is an interbank electronic instant mobile money transfer service through mobile phones. The beneficiary account is credited immediately when a Fund Transfer request is made. This service is available 24x7 throughout the year, including Sundays and any bank holiday. IMPS was introduced by NPCI ((National Payments Corporation of India) in 2010. The Salient features of IMPS are:

- Mobile-based payment service
- Instant Funds Transfer
- 24 x 7 x 365 availability
- Credit and debit confirmations to sender and receiver immediately
- Simple & Easy to use
- Fast, inexpensive, safe & secure, accessible

Disadvantages of Digital Banking

Undoubtedly, digital banking is full of advantages and the need of the day. But still, the question, “Is digital banking actually safe?” needs a crystal-clear answer. Contrary to the popular opinion that digital banking poses security concerns, most readers will be surprised to know that digital banking is safer than traditional branch banking. While digital banking forums are prone to susceptibilities and hacks such as phishing, pharming, identity theft, and keylogging, banking institutions invest a lot in their security systems. Security is at the forefront when considering a service such as digital banking. If security were to be compromised, banks would lose a crucial selling factor, and more so than risking user data and resources, banking institutions cannot afford negative publicity. This is why banks have been spending heavily on making their system fully proof and hack-free. But banking customers also have to take certain precautions. Some of these are as follows: -

- Use Anti-virus software to protect your systems from virus attacks, as these software offer an extra layer of security to your systems.
- Never use any public networks and devices to access digital banking. Remember to clear the cache and browsing data if you use a public device. It is good practice not to allow the browser to save your username and password for bank details.
- Remember that banks never ask for your confidential information, such as your date of birth, PAN card, or Aadhar card details, so refrain from sharing it with anyone who asks.
- Make a habit of following prompts to change your passwords regularly and keep your passwords confidential.
- The URL address MUST begin with 'https,' or a padlock must appear next to the website address. The padlock is a security certificate. The address bar turns green when the site is secured with an SSL certification, which is an additional validation for the website's security. Therefore, use the bank's URL and refrain from clicking on other links. Banks generally use minimum SSL/128-bit encryption.
- Last but not least, disconnect from the internet when the system is left.

CORE BANKING SOLUTION

Core Banking Solution (CBS) is a back-end system that connects multiple branches of the same bank together to deliver operations like loan management, withdrawals, deposits, and payments in real-time. The term **CORE** stands for Centralized Online Real-time Environment, which implies that the customer can experience the bank as a single entity, regardless of their location – with the aim to provide more independence for the customers in terms of using their accounts and conducting transactions from any location in the world.

Core Banking Systems aim to empower existing and probable customers to have greater freedom in their account transactions. Technological evolutions make transactions safer, faster, and less cumbersome. The fact that these transactions can be executed remotely from any part of the world has made core banking systems a significant aspect of banking these days.

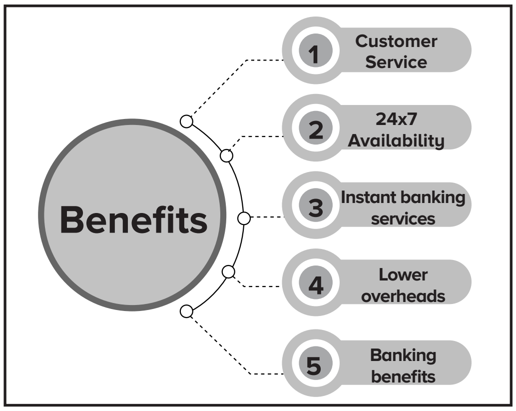
Core banking always considerably reduces operational costs, ensuring lesser manpower requirements for execution. It also enables greater accountability of the customers. Software application-based platforms make core banking systems user-friendly and more efficient. The benefits of core banking systems are multi-faceted – keeping pace with the fast-evolving market, simplifying banking processes and making it more convenient for the customers, and expanding the outreach of the banks to remote places.

Thus, core banking, in simple terms, is a highly efficient "customer accounting" and transaction processing engine for high volumes of back-office transactions. The main purpose of a core banking system is thus to give banks the ability to process large transaction volumes quickly and efficiently. Core banking also handles transactions such as interest and fee calculation, pre-processing for statement printing, end-of-day processing, and consolidation of daily individual transactions as "accounting entries," which are posted into the bank's general ledger system according to its chart of accounts structure for the daily trial balance sheet preparation. The CBS process is convenient for both - customers and banks.

Need for CORE Banking

Nowadays, the use of Information Technology (IT) is a must for the survival & growth of any organization, and the banking industry is no exception. By using ICT in any industry, banks can minimize the operation cost; also, banks can offer products & services to customers at competitive rates. Following are some of the prominent reasons that necessitate Core Banking in the country: -

- Ensure anytime, anywhere banking through ATMs.
- To expand presence in rural & remote areas.
- To have fast payment processing through Internet banking and mobile banking.
- To improve & simplify banking processes so that bank staff can focus on sales & marketing stuff.
- To increase the efficiency of banking transactions.
- To meet the dynamically changing market & customer needs.
- To offer convenience to customers as well as banks.
- To offer the provision of banking services round the clock
- To provide anywhere banking by eliminating branch banking.



Technological Requirement for Core Banking Solution (CBS)

In the core banking solution, all servers are centrally located at a place called "The Central Data Centre." All branches are connected to this data center through a leased line or network connectivity with security and redundancy. Most servers, like the Application server and Database server, are placed behind the firewall and protected from unauthorized access. Multiple servers performing the same function are clustered to manage load and build redundancy. All servers are not in the same local area network (LAN). They are segregated using the concept of a virtual local area network (VLAN), which has its own built-in security. A perfect CBS system has to meet the following technological requirements: -

- CORE banking environment consists of –
  - Central Database Server that stores the data of the bank.
  - Application architecture /Central Application Server that runs the CORE banking solution (CBS) centrally accessed by branches.
  - Necessary infrastructure to provide for internet banking and Automated Teller Machine (ATMs).
  - Authentication techniques.
  - Information Security system.

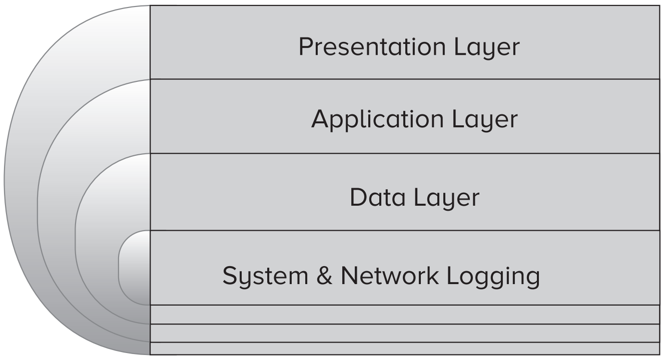
Application Architecture Requirements for Core Banking Solution (CBS)

A computer-based application may be built as a huge software, may be structured to run on a client–server environment, or even have three or multi-tiered architecture. A computer application typically separates its three main tasks-

(i) interactions with the user;

(ii) processing of transactions as per the business rules; and

(iii) the storage of business data.



These three tasks can be viewed as three layers, which may run on the same system (possibly a large, proprietary computer system), or may be separated into multiple computers (across the Internet), leading to three-tier or multi-tier architecture.

These layers can be briefly described as follows: -

- **Presentation Layer:** This layer is responsible for managing front-end devices, which include browsers on personal computers, Personal Digital Assistants (PDAs), Mobile phones, Internet kiosks, Web TV etc. The presentation layer takes care of user interface-related issues like display details, color, layout, image etc. It also has important responsibilities in user authentication and session management activity.
- **Application layer:** It contains the business logic (for processing of a and transactions) and necessary interfaces to the data layer. It processes requests from the presentation layer, connects to the data layer, receives and processes the information and passes results back to the presentation layer. It ensures that all business rules are incorporated into the software. The issues of scalability, reliability, and performance of the services greatly depend upon the application layer architecture.
- **Data Layer:** The data layer uses a database package to store, retrieve and update application data. The database may be maintained on one or multiple servers. A database package also supports back- up and recovery of data, as well as logging of all transactions.
- **System & Network logging:** "Logging" basically means recording activities. All computers are automatically programmed to create a record of activities. Operating systems, database packages, and even business applications produce a 'log' of various tasks performed by them. Most operating systems keep a log of all user actions. Log files are the primary record of suspicious behavior. Log files alert the administrator of database system to carry out further investigation in case of suspicious activity and help in determining the extent of the intrusion. Log files can also provide evidence in case of legal proceedings.

The administrator has to select the types of information to be logged, the mechanisms for logging, locations for logging, and locations where the log files are stored. The information required to be logged should include login/logout information, location and time of failed attempts, changes in status, status of any resource, changes in system status such as shutdowns, initializations and restart, file accesses, change to file access control lists, mail logs, modem logs, network access logs, web server logs, etc. The log files must be protected and archived regularly and securely.

Challenges in Core Banking Solution

Undoubtedly, Core banking systems have been a blessing and a breath of fresh air for customers who were tired of transactions taking days to complete between branches of the same bank. With core banking systems, technology has moved from a support system and business enabler to a driving force in the banking industry. Core banking systems have given banks a convenient, centralized processing capability, which translates to banking services anytime and anywhere for customers. But like all good things, core banking systems also come with their share of challenges and opportunities. Following is the list of some of the key challenges faced by Indian banks that require immediate attention and shape the market for a new future: -

(i) A new core banking system implementation requires its seamless integration with the other components of banking architecture and channels like CRM and other middleware.

(ii) Because of the lengthy pay-off period and enormous investments, banks might feel a pressing need to evaluate Return on investment (ROI) with the help of turnover ratios, process improvement approach, and effective strategic management.

(iii) Core banking software implementation projects have longer time spans and hence are usually prone to project extensions.

(iv) To create an IT architecture that is robust, reliable, and scalable.

(v) To meet the regulatory standards, cybersecurity protocols, and privacy laws are necessary for a core banking solution to succeed.

(vi) With everyone on the core banking movement, the range of offerings banks can provide on their CBS platforms is a deciding factor.

(vii) Successful Core banking software implementation calls for efficient business process re-engineering and abundant resources.

(viii) Nobody likes change. Like any other organizational change, core banking software implementation faces a difficult change management process.

Therefore, modern banks need a flexible, customer-centric core banking environment equipped with multi-currency and multi-lingual features since the industry is getting increasingly globalized. For instance, Canara Bank recently enabled CBS at as many as 1150 branches, which is one of the banking industry's largest implementations in the banking industry and includes agricultural loans, loan processing, foreign exchange, and service branch functionality. This has helped the bank move in line with the changing market scenario.

CYBERCRIME

Concept and Meaning of Cyber Crime

Cybercrime is defined as any criminal activity which takes place on or over the medium of computers, or internet or, other technology recognized by the Information Technology Act. Cybercrime is the most prevalent crime playing a devastating role in the banking domain. It is a problem banks have been facing since the advent of e-commerce in the 1990s, and its threat only increases with each passing year. All of these threats have potentially serious financial, legal and reputational implications. Many banks are finding that their systems are being probed for weaknesses hundreds of times a day but damage/losses arising from security breaches have so far tended to be minor.

However, some banks could develop more sensitive burglar alarms, so that they are better aware of the nature and frequency of unsuccessful attempts to break into their system. The most sensitive computer systems, such as those used for high value payments or those storing highly confidential information, be likely to be the most carefully secured. Complex encryption software is used to protect account information. However, there are no perfect systems. Accounts are prone to hacking attacks, phishing, malware and illegal activities.

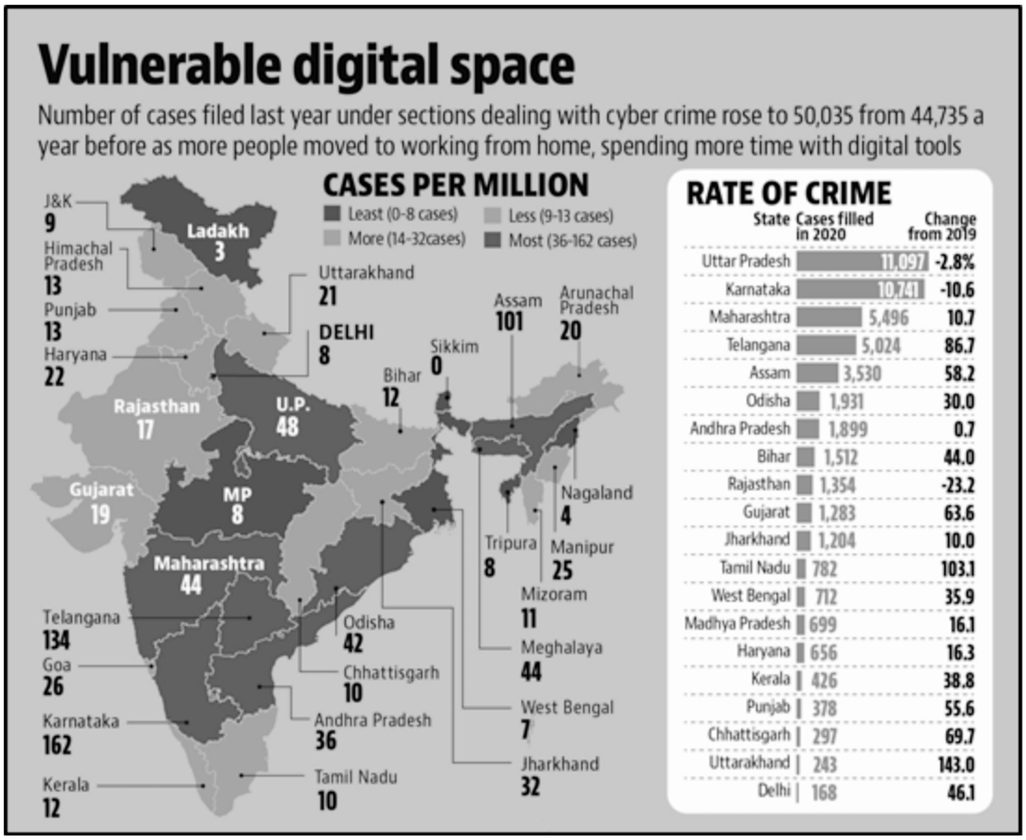
A primary effect of cybercrime is financial. Cybercrime can include many types of profit-driven criminal activity, including ransomware attacks, email and internet fraud, identity fraud, and attempts to steal financial account, credit card or other payment card information. Cybercriminals may target an individual's private information or corporate data for theft and resale. As many workers settle into remote work routines due to the pandemic, cybercrimes are expected to grow in frequency in 2023, making it especially important to protect backup data.

Types of Cyber Banking Frauds in Indian Banking

Every day, fraudsters are trying to think of new and innovative ways of tricking innocent customers. Therefore, there is dire need to be aware and never give out any personal or banking account details. In order to keep you up to date with the various kinds of cyber frauds, we present a comprehensive list of such frauds reported to Indian Banks so far. These ae as follows: -

(i) **Networks:** The word botnet is made from two words - robot and network. A cyber-crime is called 'Bot Networks', when hackers remotely take control upon computers by using malware software. Computers can be co-opted into a botnet when they execute malicious software. A botnet's originator can control a group of computers too remotely.

(ii) **Carding:** It means false ATM cards i.e. Debit and Credit cards used by criminals for their monetary benefits through withdrawing money from the victim's bank account.



(iii) Cracking: It is a dreadful feeling to know that a stranger has broken into user computer systems without user's knowledge and consent and has tampered with precious confidential data and information. A Cracker differs from the hacker because hacker is hired by companies to audit network security or test software but cracker do the same work for their own profit or to harm others.

(iv) Cross-site Scripting: Cross-Site Scripting (XSS) is a type of computer security vulnerability. By cross-site scripting attacker can bypass the predefined access permissions of website. Reflected XSS is the most frequent type of XSS attack. Reflected XSS attack is also known as non-persistent XSS. Scripting languages like java script, VB script etc. are used for Reflected XSS attack.

(v) Cyber Crime & Social Networking: Cyber criminals use social media for not only to commit crime online, but also for carrying out real world crime owing to "over-sharing" across these social platforms. This risk is associated with our identities. Identity theft can happen to anyone who exposes too much personal information online on various social networking sites. To protect one self, get to know the security and privacy settings, and configure them to protect from identity theft. One in five online adults (21 percent) have reported of becoming a victim of either social or mobile cybercrime and 39 percent of social network users have been victims of profile hacking, scam or fake link.

(vi) Cyber Squatting: Squatting is the act of occupying an abandoned or unoccupied space. Cyber-squatting is the act of registering a famous domain name and then selling it to needy for a high cost. It means where two persons claim for the same Domain Name either by claiming that they had registered the name first or by right of using it before the other or using something similar to that previously.

(vii) Cyber stalking: Online harassment and online abuse all comes under stalking. The term "stalking" generally involves harassing or threatening behaviour that an individual engages in repeatedly, such as following a person, appearing at a person's home or place of business, making harassing phone calls, leaving written messages or objects, or vandalizing a person's property. Cyber stalking shares important characteristics with offline stalking. Many stalkers (online or off line) are motivated by a desire to control their victims. A major damaging effect of online abuse is a victim avoiding his/her friends, family and social activities.

(viii) Cyber Trafficking: It may be trafficking in drugs, human beings, arms weapons etc. which affects large number of persons through internet. Trafficking in the cyberspace is also a gravest crime.

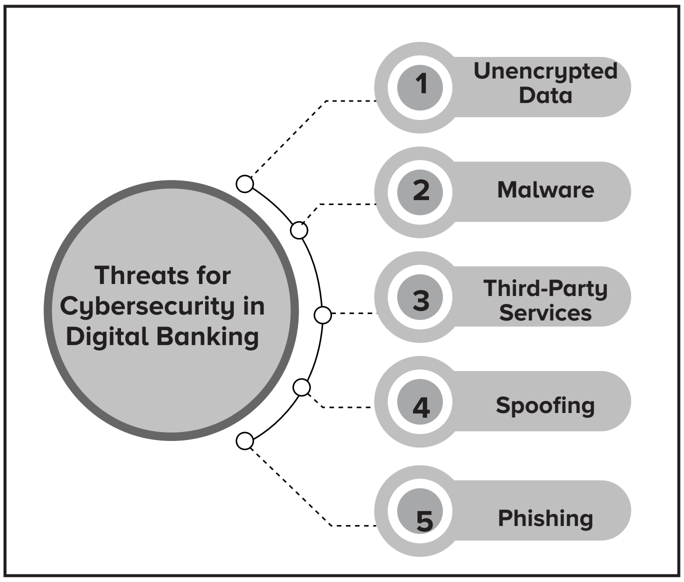
(ix) Cyber Trespass: It means to access someone's computer without the proper authorization of the owner without disturbing, altering, misusing, or damaging data or system by using wireless internet connection.

(x) Cyber Vandalism: Vandalism means destroying or damaging property of another. Thus cyber vandalism means destroying or damaging the data when a network service is stopped or disrupted. It may include within its purview any kind of physical harm done to the computer of any person.

(xi) E-Mail/SMS Spoofing: A spoofed E-mail/ SMS may be said to be one, which misrepresents its origin. It shows its origin to be different from which actually it originates. Here an offender steals identity of another in the form of email address, mobile phone number etc. and send the message via internet.

(xii) Hacking: In general, the word 'hacking' means seeking and exploiting weakness and security of a computer system or a computer network for unauthorized access. The person who does hacking is known as hacker. A Hacker uses his/her computer expertise and some tool or scripts to hack any computer system.

(xiii) Intellectual Property Crimes: Intellectual property consists of a person's creations such as articles, books, paintings, photos or any such intellectual content. Any unlawful act by which an owner of such intellectual property is deprived completely or partially of his rights is an offence and this is known as intellectual property crime. The common form of IPR violation/crime may be said to be software piracy, infringement of copyright, trademark, patents, designs and service mark violation, theft of computer source code, etc.



(xiv) Internet Time Thefts: Basically, Internet time theft comes under hacking. It is the use by an unauthorized person, of the Internet hours paid for by another person. The person who gets access to someone else's Internet Service Provider given user ID and password, either by hacking or by gaining access to it by illegal means, uses it to access the Internet without the person's knowledge.

(xv) Phishing: It is an attempt to 'fish' for your banking details. Phishing could be an e-mail that appears to be from a known institution like banks / a popular website. Please note that banks will never ask for confidential data like login and transaction password, One Time Password (OTP) etc.

(xvi) Voice Phishing: The term is a combination of "voice" and "phishing". Voice phishing is used to gain access of private, personal and financial information from the public. Voice phishing uses a landline telephone call to get information.

CORE BUSINESS PROCESS FLOW AND RELEVANT RISK CONTROLS

The transaction flow in CBS is described as under:

First the user logs in after the day begin is activated at the branch. Once log in is successful the user is allowed to access different product modules. Let us take an example to understand the process flow in the CBS system. Assume that Mr. X has come to the branch to withdraw Rs. 1,00,000/- from his SB account through a cheque.

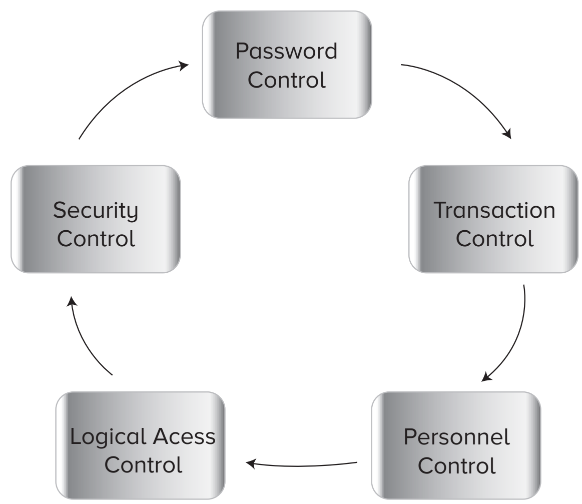
The cheque is given to the user who after verifying the cheque for its validity, enters all particulars of the cheque in the system. According to the branch procedures the user has only powers up to pass cheques only up to Rs. 5,000/- Therefore his transaction has to be verified and authorized by a senior official of the branch who has been given powers to pass cheques up to Rs. 5,00,000/.

Since the powers of the user is restricted up to Rs. 5,000/- as soon as the user enters the cheque data it is transmitted to what is known as maker checker functionality in the system through which the senior official (who has more power to pass the cheque) will authorize the transaction after due verification. Once this transaction is registered by the host server flashes back a message to the user whether the transaction is successful and complete. During the entire process the CBS system validates account number, cheque number, date, balance in the account, authority level of teller and senior official etc. as per the parameters for validation already set and stored in the system.

This is how the flow of the transactions normally takes place in the core banking for all transactions.

Controls in the flow of transactions under CBS: -

The following controls forms part of transactions flow in CBS:



- **(i) Password control:** Every authorized user/ operator is given a User id and Password for login in to the system. **These are required to be kept confidential by the respective user.** The preventive aspect in this is to change passwords at suitable intervals. In the case visiting officials who come to the branch for inspection, investigation or temporary postings etc. they are given guest login arrangement with a user Id and password. This should be deleted as soon as their work is over. Also, if an existing authorized user is no more associated with the branch/bank due to long leave, outside deputations, transfers, retirement, sickness, suspensions or death etc. they should be deactivated.

- **(ii) Transaction control:** Inactive work stations or desktops or terminals are to be logged off. Only those who are present their workstation or terminals should be enabled for transactions. Authorization of date in the system should be done by designated officials only. Reports such as special batch reports should be checked and authenticated by designated officials. Software problems encountered in operations should be recorded and rectification work should be carried out with the help of authorized officials/ vendors.

- **(iii) Personnel control:** Job rotation at periodical intervals as per bank's policy should be done and a written record is maintained in this regard. it should be ensured proper clear distribution duties is affected. Similarly, authorization limits for various levels of staff is fixed and documented.

- **(iv) Logical Access control:** To ensure logical access control give access to menus to Staff on "need" only basis. Restrict file maintenance access to a few staff documented approval. This needs review at regular intervals. Encrypt Pass word files for restricted access. Give top priority to Security violations and ensure that they are investigated and remedial action is taken. Restrict access to work stations during and after, office hours. Completely restrict access to sever room and modem installations.

(v) **Security control:** To maintain security control under CBS, Ensure proper remedial action, in case of power failure or mechanical failures. Also ensure system restarts with proper completion of entries and records which were in midway when the power was disrupted. Install latest Anti-virus version in servers.

Updating patches whenever or wherever made available by software vendors should also applied on an ongoing basis. Take proper back-ups at appropriate times and ensure its proper storage either on-site or off-site. Ensure only authorized amendments are accepted by the system. Authenticate/ authorize parametric changes and user levels. Unauthorized amendments are not accepted by the system. Ensure all authorized modules are installed and activated. Generate exception transaction reports on a daily basis and they are scrutinized. Ensure all authorized GL codes from Head office / controlling departments are in existence. Keep important Passwords in a sealed cover with Branch Head /Manager for easy access in case of need /absence of staff.

REPORTING SYSTEM AND MIS, DATA ANALYTICS AND BUSINESS INTELLIGENCE

Banking business environment is characterized by battle for the customer, as need to grow in volume has given way to selective growth strategies (rather than messages about a slowing of new business). An undeniable competitive advantage is provided by robust, reliable and useful systems for measuring customer profitability or value, both current and potential, in connection with budgeting and pricing methodologies. This is due both to their capacity to identify where to generate value and to the capacity to direct the actions of branches and sales staff, identifying the real profitability of each customer in order to focus on those making the greatest contribution to the margin while at the same time that working on the profitability of those who at present contribute less. This is achieved by a proper Management Information System.

Management Information System (MIS)

MIS is the use of information technology, people, and business processes to record, store and process data to produce information that decision makers can use to make day to day decisions. The full form of MIS is Management Information Systems. The purpose of MIS is to extract data from varied sources and derive insights that drive business growth. The three components of MIS provide a more complete and focused definition, where System suggests integration and holistic view, Information stands for processed data, and Management is the ultimate user, the decision makers.

Management information system can thus be analyzed as follows –

(i) **Management:** Management covers the planning, control, and administration of the operations of a concern. The top management handles planning; the middle management concentrates on controlling; and the lower management is concerned with actual administration.

MIS Defined

Management Information System or 'MIS' is a planned system of collecting, storing, and disseminating data in the form of information needed to carry out the functions of management.

(ii) **Information:** Information, in MIS, means the processed data that helps the management in planning, controlling and operations. Data means all the facts arising out of the operations of the concern. Data is processed i.e. recorded, summarized, compared and finally presented to the management in the form of MIS report.

(iii) **System:** Data is processed into information with the help of a system. A system is made up of inputs, processing, output and feedback or control.

Thus, MIS means a system for processing data in order to give proper information to the management for performing its functions.

Objectives of MIS

The goals of an MIS are to implement the organizational structure and dynamics of the enterprise for the purpose of managing the organization in a better way and capturing the potential of the information system for competitive advantage.

Following are the basic objectives of an MIS –

(i) **Capturing Data** – Capturing contextual data, or operational information that will contribute in decision making from various internal and external sources of organization.

(ii) **Processing Data** – The captured data is processed into information needed for planning, organizing, coordinating, directing and controlling functionalities at strategic, tactical and operational level. Processing data means –

(a) making calculations with the data

(b) sorting data

(c) classifying data and

(d) summarizing data.

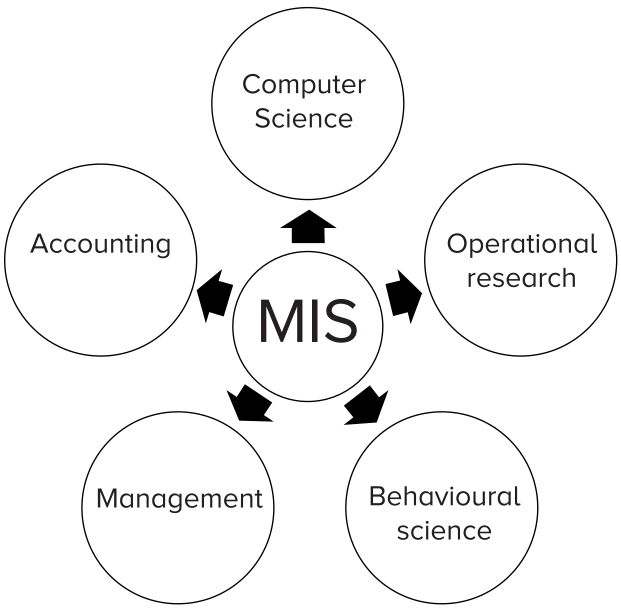
(iii) **Information Storage** – Information or processed data need to be stored for future use.

(iv) **Information Retrieval** – The system should be able to retrieve this information from the storage as and when required by various users.

(v) **Information Propagation** – Information or the finished product of the MIS should be circulated to its users periodically using the organizational network.

Nature and Scope of MIS

The following diagram shows the nature and scope of MIS –



Components of MIS

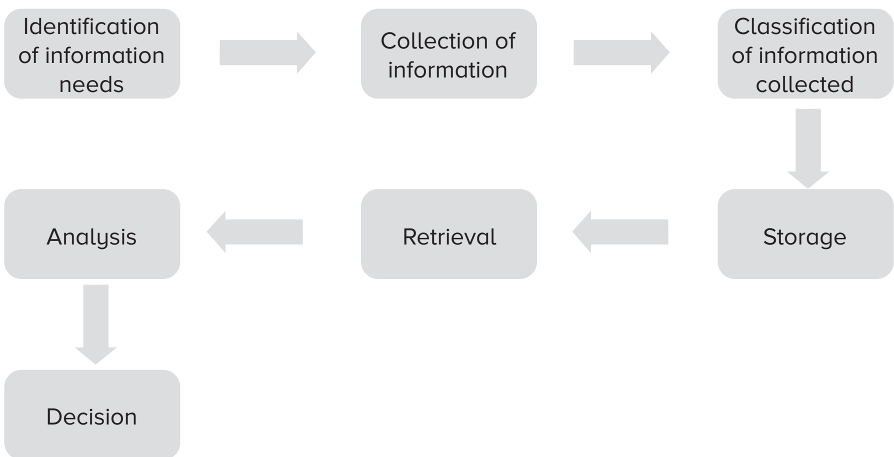
The major components of a typical MIS long-form (Management Information System) are:

- **People** – people who use the information system
- **Data** – the data that the information system records
- **Business Procedures** – procedures put in place on how to record, store and analyze data
- **Hardware** – these include servers, workstations, networking equipment, printers, etc.
- **Software** – these are programs used to handle the data. These include programs such as spreadsheet programs, database software, etc.

Types of Information Systems

The type of information system that a user uses depends on their level in an organization. The following diagram shows the three major levels of users in an organization and the type of information system that they use.

In the design of the MIS, the following six basic stages of a MIS, in their sequential order, are followed:



Characteristics and Application of MIS

- The MIS of a Bank whose branches are so well-spread becomes a pivotal point of study as it caters to many segments of the society (urban and rural) and offering a diversified portfolio of services like credit cards, loans, bank accounts, etc. Thus, it becomes absolutely essential for a bank to maintain an accurate mass record of all transactions of every individual or corporate. One cannot ignore the fact that every record / data should have a reliable back-up in case of any uncertainty like System Crashing', 'Virus Attack', etc.
- MIS helps to validate our theoretical understanding.
- Leads a better understanding of an organization by top management, without which the efficient management of that organization would become difficult.
- While computers cannot create business strategies by themselves they can assist management in understanding the effects of their strategies, and help enable effective decision-making. MIS systems can be used to transform data into information for useful for decision making. Computers can provide financial statements and performance reports to assist in the planning, monitoring and implementation of strategy.
- MIS provides a valuable function in that they can collate into coherent reports of unmanageable volumes of data that would otherwise be broadly useless to decision makers.

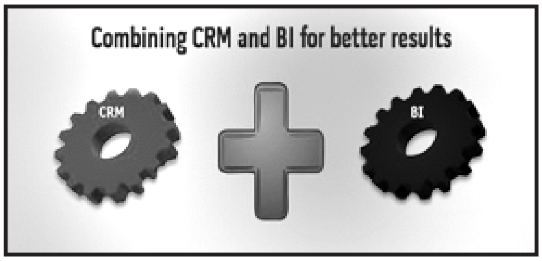
- Not only do MIS allow for the collation of vast amounts of business data, but they also provide a valuable time saving benefit to the workforce. Where in the past business information had to be manually processed/compiled for filing and analysis, data can now be entered quickly and easily onto a computer by a data processor, allowing for faster decision making and quicker reflexes for the enterprise as a whole.

Business Intelligence and Data Analytics

The term intelligence has been used by researchers in artificial intelligence since the 1950s. Business intelligence ('BI') became a popular term in the business and IT communities only in the 1990s. In the late 2000s, business analytics was introduced to represent the key analytical component in BI. More recently big data and big data analytics have been used to describe the data sets and analytical techniques in applications that are so large (from terabytes to Hexabytes) and complex (from sensor to social media data) that they require advanced and unique data storage, management, analysis, and visualization technologies. Business Intelligence and Data Analytics (BI&DA) is a unified term and deals with big data analytics. BI&DA is a collection of decision support technologies for gathering, providing access to, and analyzing data for the purpose of helping enterprise users (executives, managers and analysts) make better and faster business decisions. The term implies having a comprehensive knowledge of all of the factors that affect the business. It is imperative that companies have an in-depth knowledge about factors such as the customers, competitors, business partners, economic environment, and internal operations to make effective and good quality business decisions. Business intelligence enables firms to make these kinds of decisions. Enterprises aim at enabling knowledge to executives, managers and analysts to make better and faster decisions.

Business Intelligence (BI) and Customer Relationship Management (CRM)

CRM and BI form an integral part of a bank's strategy. BI allows banks to pull together usable information from disparate systems. CRM and BI tools provide a bank with the ability to look at customer data and use it to drive business. Integrating BI capabilities into applications is important. Banks are choosing to implement data warehousing solutions to consolidate data from diverse sources into one easy-to-use database to facilitate time critical decision support. Banks can track and respond to business trends and analyze data in the light of business perspectives. Banks can utilize BI to focus on: -



- Customer acquisitions/profitable accounts
- Track customer needs
- Identify cross-selling opportunities
- Provide customer satisfaction at levels hitherto not even dreamt of.

CRM can be an effective method by which banks can attract new customers and retain existing customers. It involves reorienting bank operations around the needs of the most profitable customers. CRM enables banks to segment customer bases. Tailor make appropriate products for different segments and add personalized services.

CRM is a key component of the bank‘s growth strategy. Many banks are now participating in strategic partnerships with IT companies. These are not just limited to outsourcing initiatives. Banks are looking at partnerships to obtain timely and predictable returns on their IT investments. The benefits accruing to banks from strategic alliances include one-stop-shopping experience and procurement of best product/s, carefully integrated and fine-tuned.

Data Analytics

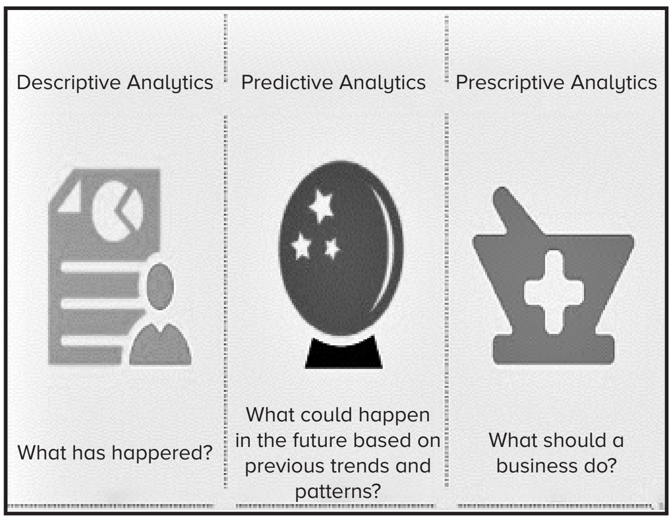
Data Analytics plays a significant role in virtually every field, where data could be collected and stored. Data Analytics is vastly different from data analysis. While data analysis, by convention, connotes statistics, data analytics goes beyond statistics, into the fields of computer science (via machine learning subsuming new wave of artificial intelligence) and operations research. In fact, Dr. Jim Gray of Microsoft, refers to it as the fourth paradigm of science with theoretical, experimental and computational paradigms being the others that preceded it in the evolution of science. Interestingly, all the four complement one another and all are required in sufficient proportion to conduct meaningful research/practice in numerous fields nowadays.

Service industries including banking derive immense advantage from data analytics. Analytics is of three types:

(i) Descriptive;

(ii) Predictive; and

(iii) Prescriptive.



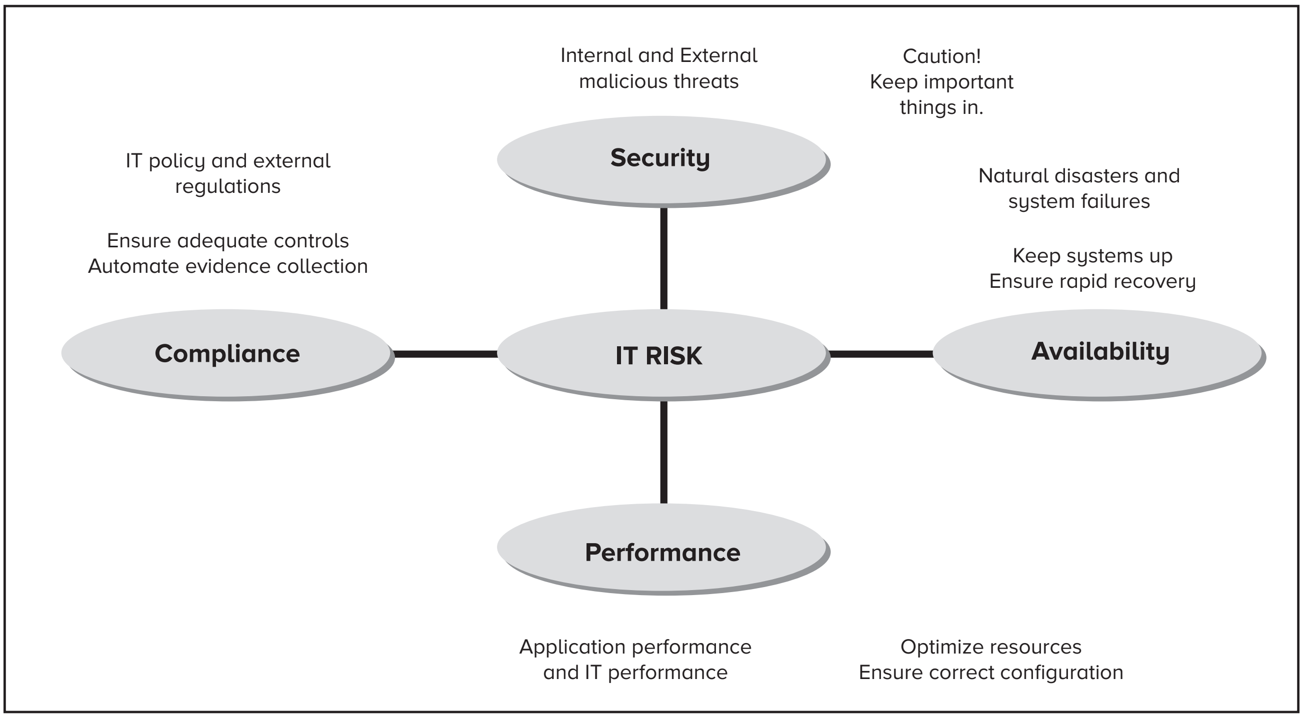
Descriptive analytics concerns various ways of depicting the past and present data using Statistics and Online Analytical Processing, whereas predictive analytics answers questions like what is going to happen based on the past data using data mining, text mining and web mining. However, prescriptive analytics provides insights from the data that is not necessarily predictive in nature using operations research and optimization techniques.

IT RELATED RISKS AND CONTROLS

Classifying IT risk

Identification, analysis, measurement and management of IT risk, requires specialized knowledge and skill. IT risk management has to be done in every organization, and each has its own unique IT risk profile. Technology risks have a deep impact on financial, operations, regulatory and reputation of the banks. IT risks can be classified according to their impact on the organization, as listed below:

1. Security risk
2. Availability risk
3. Performance risk
4. Compliance risk



Security risk – The risk that information will be altered, accessed, or used by unauthorized parties. Sources of security risk could be external attacks, malicious code, physical destruction, inappropriate access, unsatisfied employees, variety of platform and messaging types.

Potential impacts associated with them are corruption of information, external fraud, identity theft, theft of financial assets, damage to reputation and damage to assets.

Availability risk – The risk that information or applications will be inaccessible due to system failure or natural disaster, including recovery period. Sources of availability risk are hardware failures, network outages, data centre failures, force majeure etc. Potential impacts associated with them are abandoned transactions and lost sales, reduced level of customer, partner, or employee confidence, interruption or delay of business critical processes, reduced IT staff productivity.

Performance risk – The risk that under performance of systems, applications, or personnel, or IT as a whole can diminish business productivity or value. Sources of performance risk are poor system architectures, network congestion, inefficient code, inadequate capacity etc. Potential impacts associated with them are reduced customer satisfaction and loyalty, interruption or delay of business critical process, lost IT productivity.

Compliance risk – It is a risk of information handling or processing which fail to meet regulatory, IT or business policy requirements. Usually, it involves penalties, fines, or loss of reputation from failure to comply with laws or regulations, or consequences of non-compliance with IT policies. Sources of compliance risk are regulations unique to each jurisdiction, legal actions, internal IT safeguards supporting compliance, inadequate third-party compliance standards etc. Potential impacts associated with them are damage to reputation, breach of client confidentiality, litigation.

These four areas of IT risk are shown in below mentioned figure, each with its own set of drivers and potential impacts.

Controls required for managing IT risks

An effective control mechanism is required managing risks in IT areas. These controls are:

(i) **Preventive controls:** This is a control mechanism that stops and reduce errors and mistakes from occurring. Good layout of forms or screen to a large extent reduces the likelihood of mistakes happening while inputting the data.

(ii) **Detective controls:** They identify the errors after they are committed. This is done through what is known as validation protocols or programmes.

(iii) **Corrective controls:** These controls eliminate or reduce errors after identification of such data with errors or irregularities.

The basic purpose of these controls is to prevent the occurrence of errors or irregularities in the system. Secondly in spite of such prevention if such errors or irregularities occur they need to be detected and eliminated or corrected.

In addition to generic controls mentioned above, depending upon the nature of controls that can be exercised in managing risks are as follows:

Physical controls: These are the controls that restricts physical access to IT assets such as computers, servers, computer room, media, documentation, data storage places, other hardwares / components etc.

- The first restriction to be put, is to ensure that only authorized persons are allowed access for repairs, maintenance servicing etc. through a prior log in entry in a register, validated by a proper authentication.
- Care should also be taken to see such persons are not allowed access to data stored.
- Access to system and software is to be restricted through PINs, Passwords or biometric verification.
- Similarly, access register/log should be maintained to record access to the system by various users.
- Clear segregation of machines should be done such that machines which are meant for operations are not used for developing or testing software and vice-versa. Similarly hard copies of various transactional reports should be kept under proper security and access should be given to these to only authorized persons/staff.
- Preventive checks of disaster prevention equipments such as Fire alarm, fire extinguishers, smoke detectors, CCTV cameras, physical locking arrangements etc. should be done on outline basis. Similarly hardware servicing at periodical intervals should also be done to prevent failures through AMCs.

Internal controls: These controls are in-built computers, for checking accuracy and reliability of data. Indirectly they ensure operational efficiency and safeguard assets too. there are two types of Internal controls: They are

(i) Accounting controls

(ii) Administrative controls.

These controls also ensure that adherence to procedures and policies formulated by a bank. Accounting controls form part of the Software and can be seen in the form of –

Administrative control flows through spelt out policies of responsibility and procedures. One may also see existence of controls in the following activities such as:

- Validation / authorization of:
  - (i) transactions relating to limits, authorizations on bank`s software, passing of cheques and vouchers,
  - (ii) drawing powers, defective / incorrect drawn cheques, stop payment orders, reactivation of dormant and inoperative accounts, standing instructions, money transfer transactions etc.
- pre-transaction verification of due dates, rates of interest etc.

Operational controls: These are embedded in software itself to ensure data integrity, consistency apart from processing. Check sum verification is another example of operational control exercised during day begin operations. Double checking concept of inputter and authorizer of every system transaction should be introduced by banks to control operations risk.

Additionally the following controls are also available for banks to monitor system and its operations by authorized personnel.

Audit trail: Recording of all events that occur in a system on a chronological order. There are two types of Audit trails - Accounting Audit trail and Operations Audit trail.

- Accounting Audit trail maintains chronological order based record of processes that had taken place within the system involving data and information.
- Operations Audit trail gives a chronological record of access to a terminal, user id, data, time of access, authorization record etc. which are generated by the system itself. This will provide evidence in case of any violations or unauthorized use.

Data encryption: This is control measure involved while transmitting data from one place to another using encoding process. It is a fixed algorithm based and uses a key word. At the receiving end the encryption is decoded. At both ends if the codes match, it indicates that message has not been altered and thus integrity of the transmitted message is confirmed. If there is no matching, then it triggers an investigation. This process is also used for electronic funds transfers.

Chief Information Security Officer (CISO)

CISO stands for Chief Information Security Officer. CISO is responsible for planning, implementing, and overseeing an organization’s security posture, including physical and cybersecurity. CISOs ensure that an organization’s data and infrastructure are protected from threats and are responsible for developing and implementing security policies and procedures, as well as overseeing the work of security staff. They also work closely with other executives to ensure security is integrated into all aspects of the business.

RBI has issued guidelines for CISO in banks. CISO is a senior level official responsible for articulating and enforcing the policies that the banks uses to protect its information assets apart from coordinating the cyber security related issues / implementation within the organisation as well as relevant external agencies. The CISO shall be primarily responsible for ensuring compliance to various instructions issued on information/cyber security by RBI. CISO report directly to the top executive overseeing the risk management function or in his absence to the CEO directly. He has to place a separate review of cyber security arrangements/ preparedness of the banks before the Board on a periodic basis.

CENTRAL BANK DIGITAL CURRENCY (CBDC)

Management of currency is one of the core central banking functions of the Reserve Bank for which it derives the necessary statutory powers from Section 22 of the RBI Act, 1934. Along with the Government of India, the Reserve Bank is responsible for the design, production and overall management of the nation’s currency, with the goal of ensuring an adequate supply of clean and genuine notes in the economy.

Irrespective of the form of money, in any economy, money performs three primary functions - medium of exchange, a unit of account and a store of value. Money as a medium of exchange may be used for any transactions wherein goods or services are purchased or sold. Money as a unit of account can be used to value goods or services and express it in monetary terms. Money can also be stored or conserved for future purposes. India has made impressive progress towards innovation in digital payments. India has enacted a separate law for Payment and Settlement Systems which has enabled an orderly development of the payment eco-system in the country. The present state-of-the-art payment systems that are affordable, accessible, convenient, efficient, safe, secure and available 24x7x365 days a year are a matter of pride for the nation.

With the developments in the economy and the evolution of the payments system, the form and functions of money has changed over time, and it will continue to influence the future course of currency. The concept of money has experienced evolution from Commodity to Metallic Currency to Paper Currency to Digital Currency. Advancement in technology has made it possible for the development of new form of money viz. Central Bank Digital Currencies (CBDCs).

(e₹-W) & (e₹-R) Launched by RBI

Government of India announced the launch of the Digital Rupee — a Central Bank Digital Currency (CBDC) from FY 2022-23 onwards in the Union Budget 2022. In the budget announcement it was stated that the introduction of CBDC will give a big boost to the digital economy. The broad objective to be achieved by the introduction of CBDC using blockchain and other technologies as a 'more efficient and cheaper currency management system' were also laid down in the budget.

Retail CBDC (e₹-R)

Retail CBDC (e₹-R) would be potentially available for use by all, viz., private sector, non-financial consumers and businesses, while Wholesale CBDC (e₹-W) is designed for restricted access to select financial institutions. Retail CBDC would be potentially available for use by all viz. private sector, non-financial consumers and business. Retail CBDC is an electronic version of cash primarily meant for retail transactions. Retail CBDC can provide access to safe money for payment and settlement as it is a direct liability of the Central Bank.

Wholesale CBDC (e₹-W)

While Wholesale CBDC is intended for the settlement of interbank transfers and related wholesale transactions, Retail CBDC is an electronic version of cash primarily meant for retail transactions. Wholesale CBDC is designed for restricted access to select financial institutions and intended for the settlement of interbank transfers and related wholesale transactions. Wholesale CBDC has the potential to transform the settlement systems for financial transactions and make them more efficient and secure.

The pilot in wholesale segment, known as the Digital Rupee -Wholesale (e₹-W), was launched on November 01, 2022, with use case being limited to the settlement of secondary market transactions in government securities. Use of (e₹-W), is expected to make the inter-bank market more efficient. Settlement in central bank money would reduce transaction costs by pre-empting the need for settlement guarantee infrastructure or for collateral to mitigate settlement risk. The pilot in retail segment, known as digital Rupee-Retail (e₹-R), was launched on December 01, 2022, within a closed user group (CUG) comprising participating customers and merchants.

RBI has identified eight banks for phase-wise participation in the retail pilot project. The first phase includes four banks, namely the State Bank of India, the ICICI Bank, the Yes Bank and the IDFC First Bank. Subsequently, another four banks, viz., the Bank of Baroda, the Union Bank of India, the HDFC Bank and the Kotak Mahindra Bank will participate in the retail pilot.

RBI has already rolled out a pilot in the retail version of the CBDC (e₹-R), on December 01, 2022. The e₹-R is in the form of a digital token that represents legal tender. It is being issued in the same denominations as the paper currency and coins. It is being distributed through financial intermediaries, i.e., the banks. Users will be able to transact with e₹- R through a digital wallet offered by the participating banks. Transactions can be both Person to Person (P2P) and Person to Merchant (P2M). The e₹-R offers features of physical cash like trust, safety and settlement finality. Like cash, the CBDC will not earn any interest and can be converted to other forms of money, like deposits with banks.

LESSON ROUND-UP

- Digital banking is part of the broader context for the move to online banking, where banking services are delivered over the internet. Information Technology based banking was introduced in India since late 1980s for bringing in efficient customer service, better housekeeping and internal controls, improving productivity as well as faster decision making.
- CBS stands for Core Banking Solution, which is the networking of various bank branches through a robust IT infrastructure.
- As products and services offered are IT based, they are also subject to risks such as Security, Availability Performance and Compliance risks. However, these risks can be managed with the help of controls such as Preventive, Detective and Corrective controls.
- Additionally, Physical control, internal control and operational controls can also be exercised to safe guard the interest of banks and customers. RBI has issued specific directions for banks including UCBs in the area of comprehensive cyber security controls as well pertaining to Third party ATM Switch Application Service Providers.
- Large number of banks today are on the platform of CORE banking for facilitation bank wide transactions simultaneously across several geographical locations with the help of Central Data Centres. Core banking also has certain inherent risks which can be managed through appropriate controls such as Password control, Logical access controls, Personnel controls and Security controls.
- With the introduction of IT based system banks are able to generate MIS for faster decision making. Also banks nowadays use analytical methodologies such as Business intelligence and data analytics to study customer requirements for offering tailor made products and services.
- Reserve Bank broadly defines CBDC as the legal tender issued by a central bank in a digital form. It is akin to sovereign paper currency but takes a different form, exchangeable at par with the existing currency and shall be accepted as a medium of payment, legal tender and a safe store of value.

TEST YOURSELF

(These are meant for recapitulation only. Answers to this questions are not to be submitted for evaluation.)

1. What is the need for digital banking?
2. Why CRM and BI are considered an integral part of a bank's strategy?
3. What are the reasons for increasing cyber frauds in banking?
4. Why mobile wallets are becoming popular?
5. Why India is moving towards Core Banking?
6. What is the concept of Digital Banking? What are various types of digital payments and instruments used? Illustrate with industry examples.
7. Elucidate the concept of Core Banking? Also explain the technology requirements and challenges faced in its implementation.
8. What do you understand by MIS? What components are required in its implementation and also describe various types of MIS systems, as applicable in industry?
9. Why Business Intelligence and Data Analytics are getting attention in Indian Banking? What are its Pros and Cons?
10. Central Bank Digital Currency is akin to sovereign paper currency but it is different. Explain.

LIST OF FURTHER READINGS

- https://sdk.finance/what-is-digital-banking/
- https://sdk.finance/what-is-core-banking/
- https://www.javatpoint.com/mis-management-information-systems
- https://www.inspirisys.com/blog-details/Evolution-and-Application-of-Business-Intelligence-in-the-Banking-Sector/90
- https://www.legalserviceindia.com/legal/article-7694-an-overview-of-cyber-crimes-in-banking-sector.html
- https://rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1218

Payment and Collection of Cheques and Other Negotiable Instruments (NI)

Lesson 6

KEY CONCEPTS

■ Negotiable Instruments ■ Bills of Exchange ■ Cheques Money Order ■ Promissory Notes ■ Noting ■ Protest ■ Compensation ■ Crossing of a Cheque

Learning Objectives

To understand:

- The concept and nature of negotiable instruments
- The significance of the negotiable instruments Act, 1881
- The collection and payment of Negotiable Instruments
- The role and duties of a paying bank
- The role and duties of a collecting bank

Lesson Outline

- Introduction
- Concept of Negotiable Instrument
- Endorsements
- Role and Duties of a Paying Bank
- Forged Instruments
- Bouncing/Return of Cheques and its Implications
- Role and Duties of a Collecting Bank
- Cheque Truncation System (CTS)
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Banking Regulation Act, 1949
- Banking Negotiable Instruments Act, 1881

INTRODUCTION

Negotiable Instruments have been used in the commercial world for a long as one of the convenient modes for transferring money. The law relating to negotiable instruments is the law of the commercial world which was enacted to facilitate the activities in trade and commerce, providing sanctity to the instruments of credit which could be deemed to be convertible into money and easily passable from one person to another. In the absence of such instruments, trade and commerce activities were likely to be adversely affected as it was not practicable for the trading community to carry on with it the bulk of the currency in force.

The Law in India relating to negotiable instruments is contained in the Negotiable Instruments Act of 1881. It deals with Promissory Notes, Bills of Exchange, and Cheques. These are the three most common types of negotiable instruments. The Act applies to all of India and to all person resident in India, whether foreigners or Indians. The provisions of this Act are also applicable to *Hundis*, unless there is a local usage to the contrary. Other native instruments, like Treasury Bills, Bearer debentures, etc., are also considered negotiable instruments either by mercantile custom or under other enactments.

The chapter is designed in such a way that it would help to equip you with basic knowledge and operational practicalities as well as for an advisory role in the future should he chooses to take it.

CONCEPT OF NEGOTIABLE INSTRUMENT

A negotiable instrument is a signed document that promises payment to a specified person or the assignee. Negotiable instruments are transferable, allowing the holder to take the funds as cash or use them appropriately for the transaction or according to their preference. Examples of negotiable instruments include checks, money orders, and promissory notes.

Negotiable instruments are distinct from non-negotiable ones in that they can be transferred to different people, and, in that case, the new holder obtains full legal title. Negotiable instruments contain key information such as principal amount, interest rate, date, and, most importantly, the payor's signature.

Features of Negotiable Instruments

According to section 13 of the Negotiable Instruments Act, 1881, a negotiable instrument means "Promissory note, bill of exchange, or cheque, payable either to order or to bearer". Some of the standard features of these negotiable instruments are as follows: -

- For debt, it is considered one of the simplest mode.
- It is always a written document.
- It is payable to the bearer than it is transferred just by delivery. And it is payable to the ordered than it is transferred by delivery and endorsement.
- It works just like money and can be transferred from one person or the other.
- The person who holds the negotiable document can sue based on this document.

- There is no consideration mentioned in the instrument. It is presumed already that it has been drawn for a valuable consideration.
- It always has a signature of its maker.
- It must be delivered to other party.

NEGOTIABLE INSTRUMENTS ACT, 1881

The Negotiable Instrument Act was promulgated in the year 1881 which was introduced to ease the growth of banking and commercial transactions. The basic purpose was to legalize the system of negotiable instruments. The Act was enforced during British rule and to date, most of the provisions still remain unchanged. The Ministry of Finance is the nodal organization that regulates the system related to negotiable instruments. The process of transfers from one person to another in dealings of monetary value in terms of legal documents is the negotiable instrument. The legal definition of negotiable is that something can be transferable from one party to another party by delivery so that the title shall pass with or without the endorsement to the transferee. Let us have a look at the purpose of the Negotiable Instrument Act.

- The Act aims to create the legal provisions for the negotiable instruments system that is currently in operation throughout the country. The regulatory laws would systematically organize the system and the Act would define a decisive authority to decide any issues relating to negotiable instruments.
- The Act defines every subject related to the negotiable instruments for better clarity and understanding. For example, who is the drawer, drawee, acceptor, etc. are mentioned in the various sections.
- The Act provides the penal provisions for effective implementation of the negotiable instruments process among the parties. If any party breaches its obligation or there is nonfulfillment of the said duty then they may be charged with offenses leading to imprisonment.
- The Act protects the right of the parties when they discharge their obligations diligently.
- The Act mentions different conditions about the transaction systems and laid down its specific provisions.
- The Act eliminates all kinds of discrepancies or hurdles that may arise between the parties. In case of any dispute, the parties would have to undergo the established provisions, and such would legally resolve the matter.
- The Act regulates the different negotiable instruments like promissory notes, Bills of Exchanges, and cheques.

The various sections under the act are defined as follows: -

Section	Deals with
Section 4	Promissory Note
Section 5	Bill of Exchange
Section 6	Cheque
Section 7, 8 & 9	Parties to a Negotiable Instrument
Section 10	Payment in Due Course
Section 11 & 12	Inland and Foreign Instrument
Section 14	Negotiation - Better Title to Transferee
Section 15 and 16	Endorsements
Section 18 to 38, 43,46, 79, 80, 85 to 89	Characteristics of Negotiable Instruments under various sections
Section 99	Noting

Section 100 & 101	Protest
Section 117	Compensation
Section 118	Presumptions
Section 123 to 131A	Crossing of a cheque
Section 138	Dishonour of Cheque for Insufficiency, etc., of Funds in the Account
Section 139	Presumption in Favour of Holder
Section 140	Defence which may not be allowed in any Prosecution under Section 138
Section 141(1)	Offences by Companies
Section 142A	Validation for Transfer of Pending Cases
Section 143	Power of Court to try Cases Summarily
Section 144	Mode of Service of Summons
Section 145	Evidence on Affidavits
Section 146	Bank's Slip Prima Facie Evidence of Certain Facts
Section 147	Offences to be Compoundable
Section 148	Power of Appellate Court to Order Payment Pending Appeal against Conviction

Types of Negotiable Instruments

A negotiable instrument is a document that guarantees payment of a specific amount of money to a specified person (the payee). It requires payment either upon demand or at a set time and is structured like a contract. Negotiable instruments are distinct from non-negotiable instruments in that they can be transferred to different people, and, in that case, the new holder obtains full legal title to them. Negotiable instruments contain key information such as principal amount, interest rate, date, and, most importantly, the signature of the payor. The most commonly used negotiable instruments are as follows: -

1. **Bills of Exchange**: Used in transactions related to both goods and services, bills of exchange are legally binding documents. They instruct one party to pay a predetermined sum to a secondary party. The payer signs the bill of exchange, creating a written contract of payment. When issued by a financial institution, a bill of exchange is often called a bank draft. When issued by an individual, it's called a trade draft.

Bill of Exchange

A "Bill of exchange" is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.

2. **Cheques:** Cheques are perhaps the most common negotiable instrument example. This is an instrument in writing with a specific payment amount. Upon receipt, the payer's financial institution pays out these funds to the bearer, either in cash or to a chosen bank account. Cheques are used to pay many different types of bills, from loans to university fees and rent. They're being phased out in favour of online banking transactions, but cheques still provide a helpful paper trail for businesses.

Cheque

A "cheque" is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

3. **Traveller's Cheque:** Another less common form of negotiable instrument is a traveller's cheque. These require two signatures for the transaction to be approved. The payer signs the document at the time of issue, with a countersignature added when payment is issued. These documents are financial institutions in prepaid amounts. However, traveller's cheques are becoming increasingly rare and aren't accepted by all foreign retailers.

(Source:https://en.numista.com/catalogue/exonumia301185.html)

4. **Money Order:** Money orders offer a quick and efficient payment method. They can be issued by a financial institution or other entity. You can pay for a money order in cash to specify its value before sending it to the payee. It's then exchanged for cash at the other end. The main difference between money orders and cheques is that they usually come with a limit on issued value. They also contain less personal information than a cheque, as no personal bank account details are necessary.

(Source: https://corporatefinanceinstitute.com/resources/valuation/money-order/)

5. **Promissory notes:** When a promissory note is issued, it shows the amount owed together with the date of payment and interest rate. Like other negotiable instruments, they are written documents showing the promise of payment between a payer and payee. The document contains all relevant information, including interest rate, principal amount, date of issue, and payer signature. The benefit of a promissory note is that it enables businesses to obtain financing from sources outside of official financial institutions.

> **Promissory Note**
>
> A **"Promissory note"** is an instrument in writing containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

Parties of a Negotiable Instrument

(i) **Maker/drawer:** the person who makes or executes the note promising to pay the amount stated therein.

(ii) **Drawee:** The person directed to pay the money by the drawer. The drawee is the paying bank in case of cheque.

(iii) **Payee:** Payee is the person whose name is written on the promissory note or bill of exchange or cheque. The payee is entitled to receive amount mentioned in the note or bill or cheque.

(iv) **Holder:** Holder is either the payee or some other person to whom he may have endorsed the promissory note or bill of exchange or cheque. A person cannot be a holder unless he is the payee or indorsee (endorsee) thereof.

(v) **Holder in due course:** Holder in due course means any person who for consideration became the possessor of a promissory note, bill of exchange or cheque, if payable to bearer, or the payee or indorsee thereof, if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title."

(vi) **Endorser:** A signature of the owner (the holder of the instrument) would serve the legal rights to transfer an instrument to another party. The holder of the instrument who transfers his right to another party by endorsement is called endorser.

(vii) **Endorsee:** If the endorser adds a direction to pay the amount mentioned in the instrument to, or to the order of, a specified person, the person so specified is called the "endorsee" of the instrument.

(viii) **Endorsement:** If the endorser signs his name only, it is called endorsement in blank. If the endorsement contains the instructions of endorser to pay the amount mentioned in the instrument to, or to the order of, a specified person, the endorsement is called endorsement in full.

(ix) **Drawee in the case of need:** In addition to drawee's name, the name of a person is given in the bill or endorsement, to have resorted in case of need. Such person is called drawee in case of need.

(x) **Acceptor for honour:** In the event of refusal of acceptance of bill by the original drawer or in cases of providing better security when demanded by notary public, with the consent of the holder some other person who is originally not liable for payment of bill, may accept it for honor of any party liable on the bill. Such acceptor is called 'Acceptor for honour".

Characteristics of Negotiable Instrument Under Various Sections

Section 18 of Negotiable Instruments Act: Where the amount undertaken or ordered to be paid is stated differently in figures and in words, the amount stated in words shall be the amount undertaken or ordered to be paid. For example, The amount in words in cheque is mentioned as Rs. Six thousand only and in the figures it is mentioned as Rs.60,000/-, cheque should be paid with Rs. 60,000/-.

Section 19 of Negotiable Instruments Act: A promissory note and a bill of exchange, in which no time is for payment is specified, and a cheque are payable on demand.

Section 21 of Negotiable Instruments Act: In a promissory note or bill of exchange the expressions "at sight" and "on presentation" mean "on demand". The expression "after sight" means, in a promissory note, after presentation and in bill of exchange, after acceptance, or noting for non-acceptance or protest for non- acceptance.

Section 22 of Negotiable Instruments Act: "Maturity" of a promissory note or bill of exchange is the date at which it falls due. Every promissory note or bill of exchange which is not expressed to be payable on demand, at sight or on presentation is at maturity on the third day after the day on which it is expressed to be payable. ("Days of Grace")

Section 23, 24 & 25 of Negotiable Instruments Act: In calculating the maturity date of promissory note or bill of exchange, made payable at stated number of months after date or after sight, the period stated shall be held to terminate on the day of the month which corresponds with the day on which the instrument is dated, or presented for acceptance or sight. If the month in which the period would terminate has no corresponding day, the period shall terminate on the last day of such month.

In calculating the date at which promissory note or bill of exchange made payable a certain number of days after date or sight, the day of the date, or presentation, sight shall be excluded. When the day on which a promissory note or bill of exchange is at maturity is a public holiday (or Sunday or any other day declared as public holiday by notification), the instrument will be due on next preceding business day.

Examples:

1. A bill dated 31st August, 2022 payable 3 months after date will be due on 3rd November, 2022. (since November has 30 days, the 3 months period will complete on November 30. Adding 3 days of grace, the 3rd day of grace will be the due date which is 3rd November).

2. A bill dated 1st January 2022, payable 30 days after date will be due on 3rd February, 2022. (31 days of January, day of the bill to be exclude so 30 days completed on 31st January. Adding 3 days of grace, the 3rd day of grace being the due date, it will be 3rd February 2022).
3. If the above bill in example 2, is payable 30 days after sight and is accepted on 5th of January 2022, the due date of the bill would be 7th February 2022. (excluding date of acceptance 26 days of January plus 4 day of February will make 30 days. Thereafter adding 3 days of grace, the third day of grace will be 7th February 2022, which will be the due date).
4. If the same bill in example 2, is payable one month after date, the due date would 4th February 2022. (excluding date of bill that is 1st January, from 2nd of January one month will be completed on 1st of February. Adding 3 days of grace the third day of grace would be 4th February 2022).
5. if the same bill in example 2, is payable one month after sight and is accepted on 5th January, the due date would be 8th February 2022. (excluding date of acceptance that is 5th January, from 6th of January one month will be completed on 5th February. Adding 3 days of grace, the third day of grace that is 8th February 2022 will be the due date).

Section 26 of Negotiable Instruments Act: Every person capable of contracting, according to the law to which he is a subject, may bind himself and be bound by the making, drawing, acceptance, endorsement, delivery and negotiation of a NI. Minor may draw, endorse, deliver and negotiate such instrument so as to bind all parties except himself.

Section 27 & 28 of Negotiable Instruments Act: Every person capable of binding himself or of being bound, may so bind himself or be bound by a duly authorized agent acting in his name. An agent who signs his name to a NI without indicating thereon that he signs as agent, or that he does not intend thereby to incur personal responsibility, is liable personally on the instrument.

Section 30 of Negotiable Instruments Act: The drawer of a bill or cheque is bound, in case of dishonour by the drawee or accepter thereof, to compensate the holder, provided due notice of dishonour has been given to or received by the drawer.

Section 31 of Negotiable Instruments Act: The drawee of a cheque having sufficient funds of the drawer in his hands properly applicable to the payment of such cheque must pay the cheque when duly required so to do, and, in default of such payment, must compensate the drawer for any loss or damage caused by such default.

Section 36 of Negotiable Instruments Act: Every prior party to a negotiable instrument is liable thereon to a holder in due course until the instrument is duly satisfied.

Section 38 of Negotiable Instruments Act: Example: A (drawer) draws a bill to his own order on B (drawee) who accepts it (acceptor). A afterwards endorses the bill to C, C to D, and D to E. As between E and B, B is principal debtor and A, C and D are sureties. As between E and A, A is the principal debtor and C and D are sureties. As between E and C, C is the principal debtor and D is surety.

Section 43 of Negotiable Instruments Act: A negotiable instrument made, drawn, accepted, endorsed or transferred without consideration, or for a consideration which fails, creates no obligation of payment between the parties to the transaction. But if any such party has transferred the instrument with or without endorsement to a holder for consideration, such holder, and every subsequent holder deriving title from him, may recover the amount due on such instrument from the transferor for consideration or any prior party thereto.

Section 46 of Negotiable Instruments Act: The making, acceptance or endorsement of a promissory note, bill of exchange or cheque is completed by delivery, actual or constructive. NI payable to bearer is negotiable by the delivery thereof. NI payable to order is negotiable by the holder by endorsement and delivery thereof.

Section 79 & 80 of Negotiable Instruments Act: When interest at a specified rate is expressly made payable on a promissory note or bill of exchange, interest shall be calculated at the rate specified, on the amount of the principal money due thereon, from the date of the instrument, until tender or realization of such amount, or until such date after the institution of a suit to recover such amount as the court directs.When no rate is specified in the instrument, interest will be calculated at the rate of 18% p.a.

Section 85 & 85A of Negotiable Instruments Act: Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the dr awee is discharged by payment in due course. Order cheques can be transferred by endorsement and delivery from one person to another.

When a cheque is originally expressed to be payable to bearer, the drawee is discharged by payment in due course to the bearer thereof, notwithstanding any endorsement whether in full or in blank appearing, thereon, and notwithstanding that any such endorsement purports to restrict or excludes further negotiation. Bearer cheques can be transferred by mere delivery from one person to another.

Where any draft (DD - Demand Draft) payable to order on demand, purports to be endorsed by or on behalf of the payee, the bank is discharged by payment in due course.

Section 87 & 88 of Negotiable Instruments Act: Any material alteration of a NI renders the same void against anyone who is a party thereto at the time of making such alteration and does not consent thereto, unless it was made in order to carry out the common intention of the original parties. Any alteration in the cheques need to be authenticate by the drawer with full signature. Signature of the drawer on the negotiable instrument is a mandate of the drawer therefore any material alteration in the cheques change the customer's mandate. Example alteration in payee's name, date, amount in words or figures. Opening of crossing etc. requires drawer's full signature. Any such alteration, if made by endorsee, discharges its endorser from all liability to him in respect of the consideration thereof.

Section 89 of Negotiable Instruments Act: Where a NI has been materially altered but does not appear to have been so altered, or where a cheque is presented for payment which does not at the time of presentation appear to be crossed or to have had crossing which has been obliterated, - Payment thereof in due course, shall discharge such a person or bank from all liability thereon.

Where the cheque is an electronic image of a truncated cheque, any difference in apparent tenor of such electronic image and the truncated cheque shall be a material alteration and it shall be the duty of the bank or the clearing house, as the case may be, to ensure the exactness of the apparent tenor of electronic image of the truncated cheque while truncating and transmitting the image. Any bank or a clearing house which receives a transmitted image of a truncated cheque, shall verify from the party who transmitted the image to it, that the image so transmitted to it and received by it, is exactly the same.

Noting

Section 99 of Negotiable Instruments Act: When a promissory note or bill of exchange has been dishonoured by non-acceptance, or non-payment, the holder may cause such dishonour to be noted by a notary public upon the instrument, or upon a paper attached thereto. Such note must be made within a reasonable time after dishonour, and must specify the date of dishonour, the reason if any for dishonour, or if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured, and the notary charges.

Protest

Section 100 & 101 of Negotiable Instruments Act: When a promissory note or bill of exchange has been dishonoured by non-acceptance or non-payment, the holder may, within a reasonable time, cause such dishonour to be noted and certified by a notary public. Such certificate is called a protest. The protest must contain -

(a) Either the instrument itself or a literal transcript of the instrument.

(b) The name of the person for whom and against whom the instrument protested.

(c) A statement (payment, acceptance, better security) that has been demanded of such person by the notary public.

(d) Date, place and time of dishonour.

(e) The subscription of notary public making the protest.

(f) The name of the person by whom, of the person for whom, and the manner in which, such acceptance or payment was offered and effected.

Compensation

Section 117 of Negotiable Instruments Act: The compensation payable in case of dishonour of a promissory note, bill of exchange or cheque, by any party liable to the holder or any endorser shall be determined by the following rules -

(a) The holder is entitled to the amount together with the expenses incurred in presenting, noting and protesting.

(b) When the person charged resides at a place different from that at which the instrument was payable, the holder is entitled to receive such sum at the current rate of exchange between two places.

(c) The endorser is entitled to the amount paid with interest from the date of payment until tender or realization thereof, together with all expenses caused by the dishonour and payment.

(d) When the person charged and such endorser reside at different places, the endorser is entitled to receive such sum at the current rate of exchange between two places.

(e) The party entitled to compensation may draw a bill upon the party liable to compensate him, payable at sight or on demand, for the amount due to him. Such bill must be accompanied by the instrument dishonoured and the protest, if any. If such bill is dishonoured, the party dishonouring is liable to make compensation thereof in the same manner as in the case of original bill.

Presumptions

Section 118 of Negotiable Instruments Act: Until the contrary is proved, the following presumptions shall be made to negotiable instrument.

(a) Consideration - that every negotiable instrument was made or drawn for consideration, and that such instrument, when it was accepted, endorsed, negotiated or transferred, was accepted, endorsed, negotiated or transferred for consideration.

(b) Date - that every negotiable instrument bearing a date was made or drawn on such date.

(c) Time of acceptance - that every accepted bill of exchange was accepted within the reasonable time after its date and before its maturity.

(d) Time of transfer - that every transfer of negotiable instrument was made before its maturity.

(e) Order of endorsements - that the endorsements appearing upon a negotiable instrument were made in the order in which they appear thereon.

(f) Stamp - that a lost instrument was duly stamped.

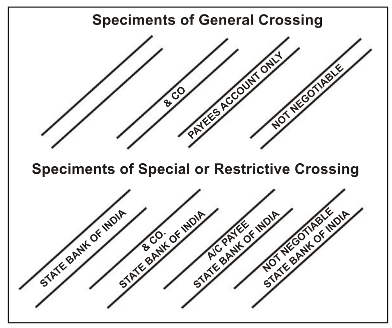
(g Holder is a holder in due course.

Crossing of a cheque

Section 123 of Negotiable Instruments Act: Where a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words “not negotiable”, that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally. Crossed cheque cannot be paid on the bank branch counter for cash payment and has to be paid through clearing process.

Section 124 of Negotiable Instruments Act: Where a cheque bears across its face an addition of the name of a banker, either with or without the words “Not Negotiable”, that addition shall be deemed a crossing and the cheque shall be deemed to be crossed specially, and to be crossed to that banker. (in special crossing, two parallel transverse line are not necessary) . (e.g. a cheque is drawn as “Pay State Bank of India Account No.111 Mr. XYZ., is also a cheque specially crossed to SBI even if it does not bear two parallel transverse lines on the face of it. Special crossed cheques need to be mandatory collected by the bank whose name is mentioned between the two parallel lines and where the payee’s account is maintained. Special crossing make the cheque more safe and reduces the risk of wrong credit.

Section 125 of Negotiable Instruments Act: Where a cheque is uncrossed, the holder may cross it generally or specially.



– Where a cheque is crossed generally, the holder may cross it specially.

– Where a cheque is crossed generally or specially, the holder may add the words “Not Negotiable”

– Where a cheque is crossed specially, the banker to whom it is crossed may again cross it specially to another banker, his agent for collection.

Section 126 of Negotiable Instruments, Act: Where a cheque is crossed generally, the banker on whom it is drawn shall not pay it otherwise than to a banker.

– Where a cheque is crossed specially, the banker on whom it is drawn shall not pay it otherwise than to the banker to whom it is crossed, or his agent for collection.

– Section 127 of Negotiable Instruments Act: Where a cheque is crossed specially to more than one banker, except when crossed to an agent for the purpose of collection, the banker on whom it is drawn shall refuse payment thereof.

Section 128 of Negotiable Instruments Act: Where the banker on whom a crossed cheque is drawn has paid the same in due course, the banker paying the cheque, and (in case such cheque has come to the hands of the payee) the drawer thereof, shall respectively be entitled to the same right, and be placed in the same position in all respects, as they would respectively be entitled to and placed in if the amount of the cheque had been paid to and received by the true owner thereof.

Section 129 of Negotiable Instruments Act: Any banker paying a cheque crossed generally otherwise than to a banker, or a cheque crossed specially otherwise than to a banker to whom it is crossed, or his agent for collection, being a banker, shall be liable to the true owner of the cheque for any loss he may sustain owing to the cheque having been so paid.

Section 130 of Negotiable Instruments Act: A person taking a cheque crossed generally or specially, bearing in either case the words “not negotiable”, shall not have, and shall not be capable of giving, a better title to the cheque than that which the person from whom he took it had.

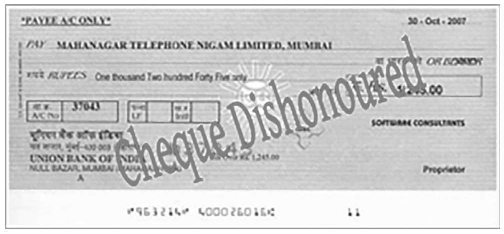
Section 131 of Negotiable Instruments Act: A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title of the cheque proves defective, incur any liability to the true owner of the cheque by reason only of having received such payment.

– A banker receives payment of a crossedcheque for a customer within the meaning of this section notwithstanding that he credits his customers’ account with the amount of the cheque before receiving payment thereof.

– It shall be the duty of the banker who receives payment based on an electronic image of a truncated cheque held with him, to verify the prima facie genuineness of the cheque to be truncated and any fraud, forgery or tampering apparent on the face of the instrument that can be verified with due diligence and ordinary care.

Section 131A of Negotiable Instruments Act: These provisions shall apply to any draft, as defined in section 85A, as if the draft were a cheque.

Penalties for dishonour of a cheque



Chapter XVII of the Negotiable Instruments Act, 1881 provides for penalties in case of dishonour of certain cheques for insufficiencies of funds in the accounts. Sections 138 to 147 deal with these aspects.

Chapter XVII has been amended by the Negotiable Instruments (Amendment and Miscellaneous Provisions) Act, 2002. The amendments have provided the drawer with more time to send notice, made the punishment for the offence more stringent, given power to court for condonation of delay in filing of complaint, excluded liability of government nominated directors, made provision for summary trial of cases under the Chapter and time bound disposal of cases, have relaxed the rules of evidence, and made the offences under the Act compoundable.

The working of the provisions of Chapter XVII for a period of more than a decade had brought to the fore front various lacunae and shortcomings from which it suffered. It was seen that there were enormous delays in the disposal of the cases filed under Section 138 and the drawer of the cheques, by taking shield of various technicalities and procedures were frustrating the very object of the Chapter.

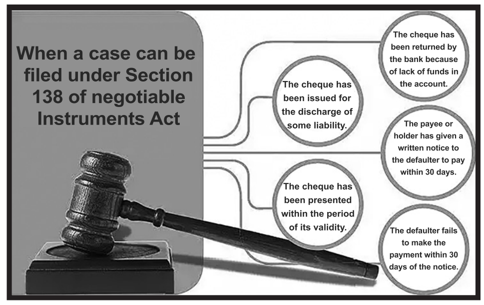
Further Chapter XVII amended by the Negotiable Instruments (Amendment) Act, 2015. The amendment focused on clarifying the jurisdiction related issues for filing cases for offence committed under section 138 of the Negotiable Instruments Act, 1881. The Negotiable Instruments (Amendment) Act, 2015, facilitates filing of cases only in a court within whose local jurisdiction the bank branch of the payee, where the payee delivers the cheque for payment through his account, is situated, except in case of bearer cheques, which are presented to the branch of the drawee bank and in that case the local court of that branch would get jurisdiction. The Negotiable Instruments (Amendment) Act, 2015 provides for retrospective validation for the new scheme of determining the jurisdiction of a court to try a case under Section 138 of the Negotiable Instruments Act, 1881. The Negotiable Instruments (Amendment) Act, 2015 also mandates centralisation of cases against the same drawer.

With a view to address the issue of undue delay in final resolution of cheque dishonour cases so as to provide relief to payees of dishonoured cheques and to discourage frivolous and unnecessary litigation, Parliament enacted the Negotiable Instruments (Amendment) Act, 2018 and notified by the Central Government on 1st September, 2018.The Amendments Act strengthen the credibility of cheques and help trade and commerce in general by allowing lending institutions, including banks, to continue to extend financing to the productive sectors of the economy. The Negotiable Instruments (Amendment) Act, 2018 inserted two new sections i.e. Section 143A dealing with Power to direct interim compensation and Section 148 dealing with Power of Appellate Court to order payment pending appeal against conviction.

Dishonour of Cheque for Insufficiency, etc., of Funds in the Account

Section 138 of the Act provides that where any cheque drawn by a person on an account maintained by him with a banker for payment of any amount of money to another person from out of that account for the discharge, in whole or in part, of any debt or other liability, is returned by the bank unpaid, either because of the amount of money standing to the credit of that account is insufficient to honour the cheque or that it exceeds the amount arranged to be paid from that account by an agreement made with that bank, such person shall be deemed to have committed an offence and shall, without prejudice to any other provision of this Act, be punished with imprisonment for a term which may be extended to two years', or with fine which may extend to twice the amount of the cheque, or with both.

Provided that nothing contained in this section shall apply unless -



(a) the cheque has been presented to the bank within a period of six months from the date on which it is drawn or within the period of its validity, whichever is earlier;

(b) the payee or the holder in due course of the cheque, as the case may be, makes a demand for the payment of the said amount of money by giving a notice; in writing, to the drawer of the cheque, within thirty days] of the receipt of information by him from the bank regarding the return of the cheque as unpaid; and

(c) the drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.

Presumption in Favour of Holder

As per Section 139 of the Act, it shall be presumed, unless the contrary is proved, that the holder of a cheque received the cheque of the nature referred to in section 138 for the discharge, in whole or in part, of any debt or other liability.

Defence which may not be allowed in any Prosecution under Section 138

Section 140 states that it shall not be a defence in a prosecution for an offence under section 138 that the drawer had no reason to believe when he issued the cheque that the cheque may be dishonoured on presentment for the reasons stated in section 138.

Offences by Companies

According to Section 141(1) of the Act, if the person committing an offence under section 138 is a company, every person who, at the time the offence was committed, was in charge of, and was responsible to, the company for the conduct of the business of the company, as well as the company, shall be deemed to be guilty of the offence and shall be liable to be proceeded against and punished accordingly.

Provided that nothing contained in this sub-section shall render any person liable to punishment if he proves that the offence was committed without his knowledge, or that he had exercised all due diligence to prevent the commission of such offence.

Provided further that where a person is nominated as a Director of a company by virtue of his holding any office or employment in the Central Government or State Government or a financial corporation owned or controlled by the Central Government or the State Government, as the case may be, he shall not be liable for prosecution under Chapter XVII.

Further Section 141 (2) states that notwithstanding anything contained in sub-section (1), where any offence under this Act has been committed by a company and it is proved that the offence has been committed with the consent or connivance of, or is attributable to, any neglect on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of that offence and shall be liable to be proceeded against and punished accordingly.

Explanation: For the purposes of section 141 (a) "company" means anybody corporate and includes a firm or other association of individuals; and (b) "director", in relation to a firm, means a partner in the firm.

Cognizance of Offences

As per Section 142(1) of the Act, notwithstanding anything contained in the Code of Criminal Procedure, 1973 -

(a) no court shall take cognizance of any offence punishable under Section 138 except upon a complaint, in writing, made by the payee or, as the case may be, the holder in due course of the cheque;

(b) such complaint is made within one month of the date on which the cause of action arises under clause (c) of the proviso to Section 138.

Clause (c) of the proviso to Section 138 provides that the drawer of such cheque fails to make the payment of the said amount of money to the payee or, as the case may be, to the holder in due course of the cheque, within fifteen days of the receipt of the said notice.

Provided that the cognizance of a complaint may be taken by the Court after the prescribed period, if the complainant satisfies the Court that he had sufficient cause for not making a complaint within such period;

(c) no court inferior to that of a Metropolitan Magistrate or a Judicial Magistrate of the first class shall try any offence punishable under Section 138.

Further, Section 142(2) provides that the offence under Section 138 shall be inquired into and tried only by a court within whose local local jurisdiction -

(a) if the cheque is delivered for collection through an account, the branch of the bank where the payee or holder in due course, as the case may be, maintains the account, is situated; or

(b) if the cheque is presented for payment by the payee or holder in due course, otherwise through an account, the branch of the drawee bank where the drawer maintains the account, is situated.

Explanation: For the purposes of clause (a), where a cheque is delivered for collection at any branch of the bank of the payee or holder in due course, then, the cheque shall be deemed to have been delivered to the branch of the bank in which the payee or holder in due course, as the case may be, maintains the account.

Validation for Transfer of Pending Cases

Section 142A (1) of the Negotiable Instrument Act states that notwithstanding anything contained in the Code of Criminal Procedure, 1973 or any judgment, decree, order or direction of any court, all cases transferred to the court having jurisdiction under section 142(2), as amended by the Negotiable Instruments (Amendment) Ordinance, 2015, shall be deemed to have been transferred under this Act, as if that sub-section had been in force at all material times.

As per Section 142A(2), notwithstanding anything contained in Section 142(2) or Section 142(1), where the payee or the holder in due course, as the case may be, has filed a complaint against the drawer of a cheque in the court having jurisdiction under section 142(2) or the case has been transferred to that court under Section 142(1) and such complaint is pending in that court, all subsequent complaints arising out of section 138 against the same drawer shall be filed before the same court irrespective of whether those cheques were delivered for collection or presented for payment within the territorial jurisdiction of that court.

Section 142A(3) states that if, on the date of the commencement of the Negotiable Instruments (Amendment) Act, 2015, more than one prosecution filed by the same payee or holder in due course, as the case may be, against the same drawer of cheques is pending before different courts, upon the said fact having been brought to the notice of the court, such court shall transfer the case to the court having jurisdiction under Section 142(2), as amended by the Negotiable Instruments (Amendment) Ordinance, 2015, before which the first case was filed and is pending, as if that sub-section had been in force at all material times.

Power of Court to try Cases Summarily

Section143 (1) of the Act provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973 all offences under Chapter XVII of the Act shall be tried by a Judicial Magistrate of the first class or by a Metropolitan Magistrate and the provisions of sections 262 to 265 (both inclusive) of the Code of Criminal Procedure, 1973 shall, as far as may be, apply to such trials.

Provided that in the case of any conviction in a summary trial under this section, it shall be lawful for the Magistrate to pass a sentence of imprisonment for a term not exceeding one year and an amount of fine exceeding five thousand rupees.

Provided further that when at the commencement of, or in the course of, a summary trial under this section, it appears to the Magistrate that the nature of the case is such that a sentence of imprisonment for a term exceeding one year may have to be passed or that it is, for any other reason, undesirable to try the case summarily, the Magistrate shall after hearing the parties, record an order to that effect and thereafter recall any witness who may have been examined and proceed to hear or rehear the case in the manner provided by the Code of Criminal Procedure, 1973.

As per Section143(2), the trial of a case under this section shall, so far as practicable, consistently with the interests of justice, be continued from day to day until its conclusion, unless the Court finds the adjournment of the trial beyond the following day to be necessary for reasons to be recorded in writing.

Section143(3) states that every trial under this section shall be conducted as expeditiously as possible and an endeavour shall be made to conclude the trial within six months from the date of filing of the complaint.

Power to Direct Interim Compensation

- Section 143A(1)Negotiable Instruments Act provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the Court trying an offence under section 138 of the Negotiable Instrument Act,1881 (Dishonour of cheque for insufficiency, etc., of funds in the account) may order the drawer of the cheque to pay interim compensation to the complainant-
  - in a summary trial or a summons case, where he pleads not guilty to the accusation made in the complaint; and
  - in any other case, upon framing of charge.
- Section 143A (2) states that the interim compensation under sub-section (1) shall not exceed twenty per cent of the amount of the cheque.
- Section 143A (3), the interim compensation shall be paid within sixty days from the date of the order under sub- section (1), or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the drawer of the cheque.
- As per Section 143A (4), if the drawer of the cheque is acquitted, the Court shall direct the complainant to repay to the drawer the amount of interim compensation, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the complainant.
- Section 143A (5) provides that the interim compensation payable section 143A may be recovered as if it were a fine under section 421 of the Code of Criminal Procedure, 1973.
- As per Section 143A (6), the amount of fine imposed under section 138 or the amount of compensation awarded under section 357 of the Code of Criminal Procedure, 1973, shall be reduced by the amount paid or recovered as interim compensation under this section.

Mode of Service of Summons

According to Section 144 of the Act, a Magistrate issuing a summons to an accused or a witness may direct a copy of summons to be served at the place where such accused or witness ordinarily resides or carries on business or personally works for gain, by speed post or by such courier services as are approved by a Court of Session.

Where an acknowledgment purporting to be signed by the accused or the witness or an endorsement purported to be made by any person authorised by the postal department or the courier services that the accused or the witness refused to take delivery of summons has been received, the Court issuing the summons may declare that the summons has been duly served.

Evidence on Affidavit

Section 145 of the Act provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, the evidence of the complainant may be given by him on affidavit and may, subject to all just exceptions be read in evidence in any enquiry, trial or other proceeding under the Code of Criminal Procedure, 1973.

The Court may, if it thinks fit, and shall, on the application of the prosecution or the accused, summon and examine any person giving evidence on affidavit as to the facts contained therein.

Bank's Slip Prima Facie Evidence of Certain Facts

According to Section 146, the Court shall, in respect of every proceeding under this Chapter, on production of Bank's slip or memo having thereon the official mark denoting that the cheque has been dishonoured, presume the fact of dishonour of such cheque, unless and until such fact is disproved.

Offences to be Compoundable

Section 147 of the Act provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, every offence punishable under the Negotiable Instrument Act Act shall be compoundable.

Power of Appellate Court to Order Payment Pending Appeal against Conviction

Section 148(1) provides that notwithstanding anything contained in the Code of Criminal Procedure, 1973, in an appeal by the drawer against conviction under section 138 of the Negotiable Instrument Act, 1881(Dishonour of cheque for insufficiency, etc., of funds in the account), the Appellate Court may order the appellant to deposit such sum which shall be a minimum of twenty per cent. of the fine or compensation awarded by the trial Court.

The amount payable shall be in addition to any interim compensation paid by the appellant under section 143A. Section 148(2) states that the amount referred to in sub-section (1) shall be deposited within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the appellant.

As per Section 148(3) the Appellate Court may direct the release of the amount deposited by the appellant to the complainant at any time during the pendency of the appeal:

It may be noted that if the appellant is acquitted, the Court shall direct the complainant to repay to the appellant the amount so released, with interest at the bank rate as published by the Reserve Bank of India, prevalent at the beginning of the relevant financial year, within sixty days from the date of the order, or within such further period not exceeding thirty days as may be directed by the Court on sufficient cause being shown by the complainant.

ROLE AND DUTIES OF PAYING BANK

Under section 31 of NI Act, it is the duty of a bank to honour the cheque of a customer subject to fulfillment of certain conditions (Customer as a creditor has right to ask his money back from his banker who is debtor). Otherwise the bank has to compensate the drawer (customer) for any loss or damage caused due to non-payment. The conditions to be fulfilled include -

1. The drawer should have sufficient and properly applicable funds in the account from which the cheque is issued.

Drawer may have more than one account in the same branch of the bank or different branches of the same bank; he cannot expect bank to combine the balances in his different accounts to honour the cheque. Similarly the drawer's balance includes the funds, which are not yet realized, the balance may be sufficient but not applicable. If a competent court has issued order to the bank, restraining from making payment, the balance in the drawer's account may be sufficient but not applicable.

If more than one cheque are received for payment simultaneously, and the balance in the account is not sufficient to honour all the cheques; it is the decision of the bank to decide which cheque(s) is(are) to be honoured. This is because it is the duty of a customer to ensure, at the time of issuing cheque, that adequate balance is available in the account. However, bank's decision under such situation depends on -

(a) who is the payee? A government department, statutory payments will have priority over individuals.

(b) May be maximum number of cheques and maximum amount of liability is paid. (c) The dates of the cheques issued earlier are paid first. (d) Amount of the cheques (if cheque(s) of very small amount is/ (are) dishonoured, the reputation in the market is damaged to a large extent).

2. Demand made must be in order. This means-

(a) cheque used is from the cheque book issued by the bank.

(b) cheque is signed by authorized person whose signature is on bank's record.

(c) cheque is presented within business hours on a working day. (due to technology available, any branch banking and payment through ATMs are also possible)

(d) cheque is not outdated / postdated.

Under following circumstances, even if sufficient balance is available in the drawer's account and the presentation is also proper, the paying bank should not honour the cheque -

(a) Death of a drawer, in case of accounts in the name of individuals (single or joint), proprietor, HUF and partnership. Even if the cheque bears the date before the death of a drawer, such cheque should be returned. The status at the time of payment (when the drawer is deceased), matters. In case of joint savings account with either or survivor operative instructions, a fresh cheque with the signature of the survivor should be issued. In case of HUF account, the next senior most male coparcener will become Karta, after the death of Karta. In case of partnership accounts, the cheque can be honoured with the consent of other partners. In case of death of a director of company the cheque can be passed, since the company is a separate legal entity, different from the director and has perpetual existence.

(b) Insanity and Insolvency of the drawer - insanity and insolvency bring an end to the operative instructions. Insanity should be certified by a competent medical practitioner (not MBBS doctor). Competent court serves notice of insolvency and the balance in the account is vested thereafter with official receiver.

(c) Liquidation of company - here the liquidator is appointed by the court to look after the operations in the account.

(d) Payment countermanded by the drawer - the drawer who has right to issue cheque, has equal right to stop (countermand) the payment of cheque. Only drawer can effectively stop the payment of the cheque. The stop payment instructions must be given in writing and the bank, after noting the date and time of receipt of the instructions, and making entry in the system, must issue proper acknowledgement for the same.

(e) Cheques issued or endorsed in favour of company, government department, corporate bodies etc., even if they are open (uncrossed) and bearer should not be paid in cash. These entities must clear the cheques by depositing them in their account with their bankers.

CASES LAW ON RESPONSIBILITY OF PAYING BANKER

The cases law on the responsibility of paying banker is as following: -

Case of forged of a Drawer's Signature

Where the signature on a cheque is forged or placed without authority of a person whose signature is forged or unauthorized signature then banker has no right to mandate to pay. The payment cannot be regarded as Customer's order.

Example: -

A manager in a company who, in his usual authority, is not entitles sign or authority the payment of cheque.In an emergency, while Director or the appropriate officer is not immediately available. This is a case of unauthorized signature not amounting to forgery. On the other hand, where a cheque issued by authorized officer of the company is proved to have been issued in order to defraud the company or employer such a cheque will be considered as forged. In case of forgery, the banker may be able to recover the money from the person to whom it made the payment. On the ground that one had been paid under a mistake of fact. But it seems that the claim may fail if it is proved that Defendant has acted honestly and has altered his position to by paying away the money in or having received the payment lawfully.

Paying bank gets protection in following circumstances.

(a) If payment is made in due course. (section 10)

(b) In case the cheque bears endorsements, the endorsements are in order (chain is not broken, even if they may not be genuine). (section 85)

(c) Material alteration on the cheque which is not apparent at the time of payment. (section 89)

Dishonour/Return of Cheques and Its Implications

When a banker dishonours a cheque of a customer, appropriate reason in writing, duly signed by its official must be given. Such cheque may either be returned across the counter or through the clearing. Following are common reasons for which the cheques are returned.

(a) Refer to drawer - In the past, banks used to return cheques with this reason when there was no sufficient balance in the drawer's account to honour the cheque. However, after addition of section 138 in NI Act, it is now expected that no such reason for insufficiency of funds be given. Some authors are of the opinion that when the drawer of the cheque becomes insane, the cheque signed by him should be returned with the reason "refer to drawer". Except this situation, the reason should not be used.

(b) Not arranged for - basically it means, the drawer has not arranged funds in the account to honour the cheque.

(c) Effects not clear, present again - where drawer has deposited cheque/(s) which is(are) sent for the clearing but not yet realized.

(d) Funds expected, present again - where the drawer has submitted some bills for collection, the payment of which is expected to be received.

(e) Exceeds arrangements - when the overdraft / cash credit facility sanctioned to the drawer will exceed the limit, if the cheque is honoured.

(f) Payment countermanded (stopped) by the drawer.

(g) Drawer's signature differs / required.

(h) Cheque is outdated (stale) / postdated.

(i) Amount in words and figures differs. - although in such cases NI Act says that amount stated in words should be honoured, the general practice followed amongst bankers is to return such cheques.

(j) Cheque crossed to two banks (unless the presenting bank is acting as an agent for another bank, whose crossing appears on the cheque)

FORGED INSTRUMENTS

An instrument (negotiable instrument like cheque/bill of exchange/promissory note) is called forged instrument when forgery takes place in signature of the drawer, signature of the endorser, and alteration in name of the payee, alteration in amount, alteration in date etc. validated by forged signature.

A forged instrument is meaningless as far as drawer/endorser whose signature is forged is concerned because holder of such instruments is not protected under law. Forgery is void ab-initio and confers no title to the holders. Therefore, transferee will not be able to enforce payment from parties to the bill, cheque and promissory note. In case such transferee gets payment by mistake such payment can be claimed back from him/her. For example, when the forged cheque is paid by the drawee bank, it is deemed payment without actual mandate of the customer. The paying bank is required to make good of loss to the customer. Similarly, a bank which collected the cheque on the basis of forged endorsement, will be held responsible and may have to return the proceeds collected by it.

ROLE AND DUTIES OF A COLLECTING BANK

When a person receives cheque in his favour, if it is open (uncrossed) and bearer, he can go the bank on which it is drawn and en-cash the same (receive cash across the counter). However, if it is a crossed and order cheque, he has to deposit it in the bank where he has account. Thereby he appoints his bank as his agent, who collects the payment for its customer from the bank on which the cheque is drawn. The bank thus acts as a Collecting Bank and performs the function of agency for its customer. While doing so, the collecting bank acts either as an agent of customer where the customer is allowed to withdraw money, after the bank receives it from the drawee bank or as holder for value where the customer is allowed to withdraw money before the cheque is realized (this is called as cheque purchased).

The most important aspect of collection of cheque for a collecting bank is to avoid conversion. Conversion means wrongful or unlawful interference (using, selling, occupying or holding) with another person's property. Negotiable instruments are included in the term "property" and hence banker may be charged for conversion if it collects cheques for a customer who has no title or defective title to the instrument. The basic principle is that rightful owner of the goods can recover the same from anyone who takes it without his authority and in whose hands, it can be traced. When the banker acts as an agent of its customer for the collection of his cheques, he cannot escape this liability.

Section 131 and 131 A provides statutory protection to the collecting banker, when it collects cheques and demand drafts for its customer. However, to avail the protection, collecting banker must fulfill the following conditions.

1. **Cheque must be a crossed cheque -** since the protection is not available to un-crossed (open) cheques, but only for crossed cheques, the collecting bank should ensure that before the cheques are sent to paying bank, each cheque is affixed with a special crossing stamp, bearing the name of collecting bank. Customers should also be advised to cross the cheques before they are deposited.

2. **The payment must be received for the customer -** bankers should ensure that person depositing cheque for collection has an account with the bank (savings, current or other). The general practice followed by the bankers is, they first open the account of customer and then extend this cheque collection facility to them.

3. **Collecting bank should have acted in good faith and without negligence -** 'good faith' means the bank should have acted bonafide and honestly (whether negligently or not). 'Without negligence' means with reasonable care and without doubt about the genuineness of the validity of title of the customer. Some examples of negligence are as under:

   (a) The account of customer is not properly KYC complied.

   (b) The endorsement(s) is(are) not genuine. To ascertain genuineness of endorsement is the duty of collecting banker.

   (c) No enquires are made in case of doubtful cases e.g. - a customer of ordinary means deposits a cheque of large amount, cheques payable to corporate bodies are endorsed by the authorized signatories for the credit of their personal accounts or for the credit of accounts of their relatives.

   (d) Cheque bearing "Not Negotiable" crossing is negotiated further.

   (e) Cheque bearing "Account Payee only" crossing is collected for the account, other than the payee. The words "Account Payee", though not mentioned in NI Act, they are still considered to be a part of the law due to highly extensive practice and usage of this custom. The RBI vide its circular issued to banks, have advised that an account payee cheque is required to be collected for the payee constituent only.

Duties of Collecting Bank

- To present the cheque for collection in reasonable time, else will be liable for damages if customer incurs, due to delayed presentation.
- RBI vide its circular has advised banks as under:

  (a) Banks are required to give immediate credit up to Rs. 15,000.00 of outstation / local cheques deposited by all savings, current and cash credit customers - after satisfying about proper conduct of the account by the customer. In the event of the cheque being returned unpaid, the bank can recover interest in conformity with applicable interest rate directive of RBI. No interest to be charge for the period from the date of credit of outstation cheque to date of its return. Where cheque is credited to a savings account no interest will be charged if the cheque is returned. A notice regarding the availability of facility should be displayed prominently at each branch.
- If the delay in collection of outstation cheques / instruments is beyond 10days in the case of cheques lodged at and drawn on state headquarters and beyond 14 days in all other cases, banks should pay interest at the rate as applicable for appropriate tenure of fixed deposit for the period of delay. Further, banks should also pay penal interest at the rate of 2 percent above fixed deposit rate for abnormal delay caused by the branch in collection of outstation instruments.
- While the cheque drop facility may be made available to the customers, the facility of acknowledgement of cheques at the regular collection counter should not be denied to them. No branch should refuse to give an acknowledgement on cheques being tendered by the customers at their counters. Customers should be made aware of both options available to them.

CASES OF FRAUDULENT, ALTERATION OF AMOUNT ON A CHEQUE

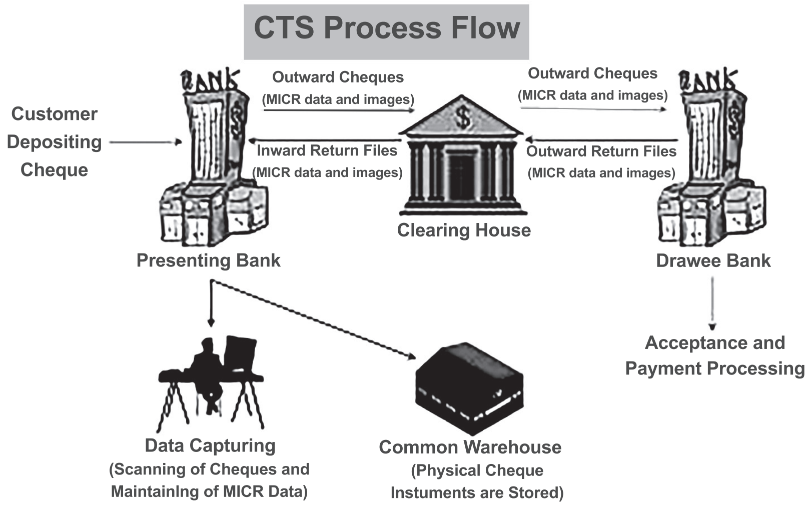
If a cheque presented to a banker for payment had been fraudulently altered and alteration is apparent. The banker will be fault if cheque is paid by him. Where the banker cannot debit the customer's account with anything more than the original amount on the cheque. Since the customer is not negligent.

Nigerian Advertising Service Ltd v/s United Bank of Africa Ltd.

In this case, the court clearly states the legal position that where there were forgeries which were not due to a customer's negligence. It is the duty of the banker to credit the amount of such a customer whose cheque has been forged.But the banker may be able to recover from the forger the amount paid to him in an action for money had received. Later on it may be liable for criminal prosecution by the state.

CHEQUE TRUNCATION SYSTEM

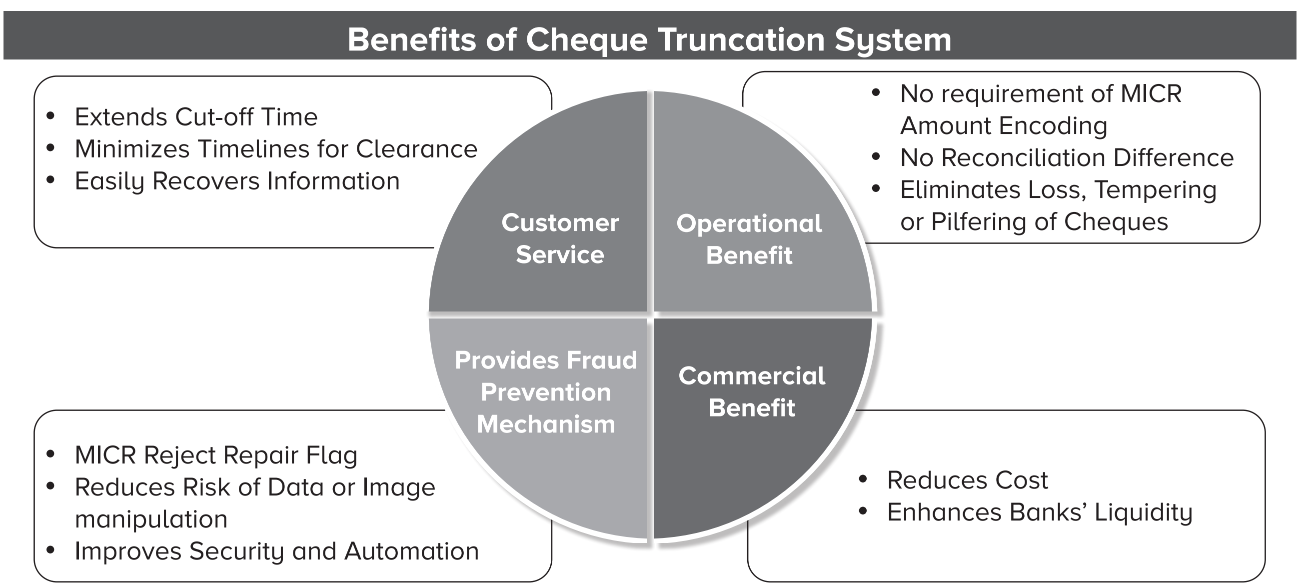
Cheque Truncation System (CTS) is a cheque clearing system undertaken by the Reserve Bank of India (RBI) for quicker cheque clearance. As the term proposes, truncation is the course of discontinuing the flow of the physical cheque in its way of clearing. Instead of this an electronic image of the cheque is transferred with vital essential data. Cheque Truncation System brings elegance to the whole activity of cheque processing & clearing and offers numerous benefits to banks like time and cost savings, cost effectiveness, including human resource rationalization, business process re-engineering and enhanced customer service.



Reserve Bank of India (RBI) introduced pan-India CTS in September 2020 to make cheque clearing safer and faster. Recently, it was made mandatory for all banks to implement Cheque Truncation System (CTS) in all their branches across the country by September 30, 2021.

CTS will be a great move towards Digital India. IMPS, RTGS and NEFT were the game changers for the banking sector. Cheques are still one of the prominent modes of payments in India, and the speedy cheque clearance cycle via CTS will definitely result in better customer experience. It will also make the process more efficient, cost-effective and safer for the banks.

Benefits of Cheque Truncation System



- Time, money and manpower expended on physical transfer of cheques from banks to clearing house are eliminated.
- Clearing related frauds become less plausible.
- Probability of cheques misplaced in transit is eliminated.
- CTS is more advanced and more secure.
- It provides quicker clearance of cheques.
- Reduces operational risk and risks related to paper clearing.
- There are no extra charges levied for the collection of cheques drawn on a bank located within the grid, further providing no geographical restrictions

Highlights of Cheque Truncation System Cheques

- All CTS cheques hold a watermark, with 'CTS-INDIA', which is visible when held against any light source.
- Pantograph (wavelike design) with hidden / embedded word 'VOID' become clearly visible in photocopies of a cheque.

Process of Cheque Truncation System (CTS)

(i) Collection of Cheques

(ii) Capturing of Data

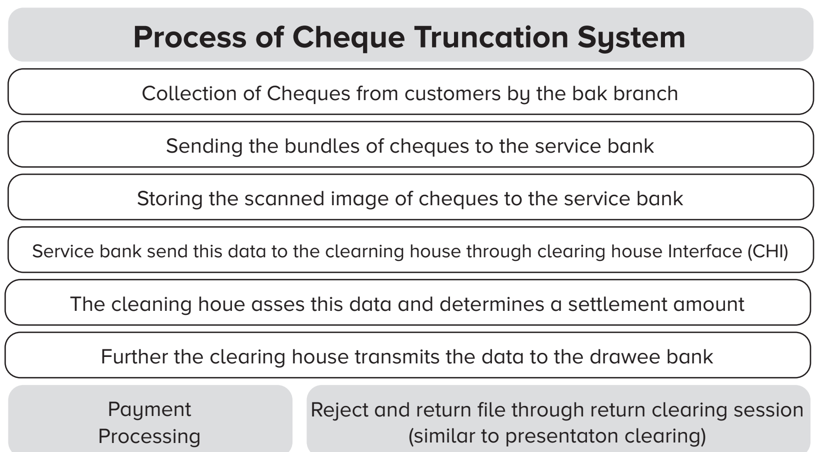
(iii) Security of Data

(iv) Clearing House Interface

(v) Presentation Clearing

(vi) Processing of Payment

(vii) Completion of Cycle



Extension of Cheque Truncation System (CTS) across all bank branches in the country

RBI on December 04, 2020 has announced the extension of Cheque Truncation System (CTS) across all bankbranches in the country:

1. The CTS is in use since 2010 and presently covers around 1,50,000 branches. All the erstwhile 1219 non- CTS clearing houses (ECCS centres) have been migrated to CTS effective September 2020. It is, however, seen that there are branches of banks that are outside any formal clearing arrangement and their customers face hardships due to longer time taken and cost involved in collection of cheques presented by them.
2. To leverage the availability of CTS and provide uniform customer experience irrespective of location of her/his bank branch, it has been decided to extend CTS across all bank branches in the country. To facilitate this, banks shall have to ensure that all their branches participate in image-based CTS under respective grids by September 30, 2021.

Introduction of Legal Entity Identifier for Large Value Transactions in Centralised Payment Systems

The Legal Entity Identifier (LEI) is a 20-digit number used to uniquely identify parties to financial transactions worldwide. It was conceived as a key measure to improve the quality and accuracy of financial data systems for better risk management post the Global Financial Crisis.

1. It has now been decided to introduce the LEI system for all payment transactions of value Rs. 50 crore and above undertaken by entities (non-individuals) using Reserve Bank-run Centralised Payment Systems viz. Real Time Gross Settlement (RTGS) and National Electronic Funds Transfer (NEFT).

   In preparation for the wider introduction of LEI across all payment transactions, member banks should:

   i. advise entities who undertake large value transactions (Rs.50 crore and above) to obtain LEI in time, if they do not already have one;

   ii. include remitter and beneficiary LEI information in RTGS and NEFT payment messages (details of the identified fields in the messaging structures of RTGS and NEFT for inclusion of LEI information are at Annex);

   iii. maintain records of all transactions of Rs.50 crore and above through RTGS and / or NEFT.

2. Entities can obtain LEI from any of the Local Operating Units (LOUs) accredited by the Global Legal Entity Identifier Foundation (GLEIF), the body tasked to support the implementation and use of LEI. In India, LEI can be obtained from Legal Entity Identifier India Ltd. which is also recognised as an issuer of LEI by the Reserve Bank under the Payment and Settlement Systems Act, 2007.

CASE LAWS

1. ***Rajeshbhai Muljibhai Patel and Ors vs. State of Gujarat and Ors (dated 10.02.2020)***

   Court had the power to quash the criminal complaint filed under Section 138 of the N.I. Act on the legal issues like limitation, etc.

   The Validity of - Sections 114, 406, 420, 465, 467, 468 and 471 of Indian Penal Code, 1860 and Sections 138 and 139 of Negotiable Instruments Act, 1881 was in question.

   Hence, present appeal - Whether High Court erred in quash criminal case against Accused under Section 138 of Act and declining to quash FIR against Appellants under Sections 114, 406, 420, 465, 467, 468 and 471 of Code.

   Supreme Court held, while allowing the appeals that though, the Court had the power to quash the criminal complaint filed under Section 138 of the N.I. Act, 1881 on the legal issues like limitation, etc. Criminal complaint filed under Section 138 of the N.I. Act, 1881 against accused ought not to have been quashed merely on the ground that there are inter se dispute between Appellant No. 3 and Respondent No. 2. Without keeping in view the statutory presumption raised under Section 139 of the N.I. Act,1881 the High Court, committed a serious error in quashing the criminal complaint filed under Section 138 of N.I. Act, 1881.

2. ***Pareshbhai Amrutlal Patel and Ors. vs. The State of Gujarat and Ors.(dated 28.02.2020)***

   Since the issue in both the cases revolves around the same cheque, therefore, instead of quashing the FIR, the ends of justice would meet if proceedings arising out of FIR were transferred to the Court of Judicial Magistrate

   Quashing of proceedings - Denial of - Sections 114, 120-B, 379, 406, 419, 420, 465, 467, 468 and 475 of Indian Penal Code, 1860 and Section 138 of the Negotiable Instrument Act, 1881 was in question.

   Hence, in present appeal - Whether impugned proceedings initiated against Appellants liable to be quashed. It is held, while disposing off the appeal:

   (i) The issue in both the complaints pertains to cheque which was said to be from the cheque book of the Company of which Respondent No. 2 was the officer.

(ii) Since the issue in both the cases revolves around the same cheque, therefore, instead of quashing the FIR, the ends of justice would meet if proceedings arising out of FIR were transferred to the Court of Judicial Magistrate, where the proceedings of other complaint under Section 138 of the NI Act were pending so that the complaint filed by the Appellants and the proceedings arising out of FIR alleged by Respondent No. 2 were decided together to avoid contradictory judgments and to facilitate the issues which were common in both.

3. ***HDFC Bank Ltd vs. Deepa Revankar (dated 28.09.2020)***

Dishonor of cheque due to insufficiency of funds

Facts of the Case:

This complaint is filed by the Complainant bank against the Accused for the offence punishable u/s 138 of Negotiable Instruments Act (N.I. Act). The brief facts of Complainant case is that, complainant is a banking company incorporated and registered under the Companies Act. The complainant bank represented by its authorized representative. It is stated that the accused had borrowed personal loan bearing loan No.37021112 and she had executed all necessary documents. The accused had agreed to abide by the terms and conditions. After availing the personal loan the accused has not paid the installments regularly and towards due installments of loan amount, the accused had issued the cheque and assured the complainant that she will maintain sufficient balance in her account and cheque will be duly honoured on the due date. But on the contrary when the cheque bearing No.000057 dated 07.11.2017 drawn on HDFC Bank, East Wing, KHB Building, K. G. Road, branch, Bangalore for Rs. 40,725/-was presented, the same was dishonoured for "funds Insufficient " with bankers memo dated 09.11.2017. After receiving the endorsement, the Complainant issued legal notice on 13.11.2017 through RPAD the same has been returned as 'addressee left' at address No.1 and another notice issued to 2nd address has been returned as 'refused' on 17.11.2017.

Judgement:

On total reading of entire evidence and documents, it appears that the accused failed to rebut the presumption which was available in favor of Complainant. Therefore the Complainant bank has clearly established that the alleged cheque was given by accused to discharge her liability. Therefore the Honorable court is of the opinion that the Complainant has proved its case that the accused has committed an offence punishable under section 138 of N.I. Act.

LESSON ROUND-UP

- A negotiable instrument is a signed document that promises a sum of payment to a specified person or the assignee.
- Negotiable instruments are transferable in nature, allowing the holder to take the funds as cash or use them in a manner appropriate for the transaction or according to their preference. Common examples of negotiable instruments include checks, money orders, and promissory notes.
- Paying banker refers to the banker who holds the cheques of the drawer and is obliged to make payment if the funds of the customer are sufficient to cover the amount of his cheque drawn.
- A negotiable instrument like cheque or bill of exchange or promissory note is called forged instrument when forgery takes place in signature of the drawer, signature of the endorser, and alteration in name of the payee, alteration in amount, alteration in date etc.
- A dishonoured cheque is a cheque presented to a drawee bank which remains unpaid. The drawee bank may refuse to pay the cheque amount to the payee due to insufficient funds, incorrect information, overwriting, mismatched signatures, etc. Such a cheque is also known as a bounced cheque or returned cheque.
- Cheque Truncation System (CTS) is a process of clearing cheques electronically rather than processing the physical cheque by the presenting bank en-route to the paying bank branch. It is a step undertaken by the Reserve Bank of India (RBI) for quicker cheque clearance.

- Collecting bank is a bank that collects money from the account of the writer of a cheque on behalf of the person who has deposited the cheque into the bank.

GLOSSARY

Promissory Note : A "Promissory note" is an instrument in writing containing an unconditional undertaking, signed by the maker, to pay a certain sum of money only to, or to the order of, a certain person or to the bearer of the instrument.

Bill of Exchange : A "bill of exchange" is an instrument in writing containing an unconditional order, signed by the maker, directing a certain person to pay a certain sum of money only to, or to the order of a certain person or to the bearer of the instrument.

Cheque : A "cheque" is a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand and it includes the electronic image of a truncated cheque and a cheque in the electronic form.

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

Endorsement : Indorsement (endorsement) - when the maker or holder of a NI signs the same, otherwise than as maker, for the purpose of negotiation, on the back or face thereof or on a slip of paper annexed thereto for purpose of receiving an additional endorsements as sufficient space may not be there on the back of the page (Allonge), he is said to indorse (endorse) the same and is called as indorser (endorser).

Crossings of Cheque : Where a cheque bears across its face an addition of the words "and company" or any abbreviation thereof, between two parallel transverse lines, or of two parallel transverse lines simply, either with or without the words "not negotiable", that addition shall be deemed a crossing, and the cheque shall be deemed to be crossed generally.

TEST YOURSELF

(These are meant for recapitulation only. Answers to this questions are not to be submitted for evaluation).

1. Explain the features of a negotiable instrument?
2. What is the role and duties of a paying bank?
3. Describe about negotiable instrument act 1881.
4. How an instrument becomes a forged instrument?
5. What are the implications of dishonor of a cheque?
6. Explain the role and duties of a collecting bank?
7. What do you mean by Dishonor of a cheque? What penalties are prescribed for dishonor of a cheque? Also explain the key reasons for dishonoring of a cheque?
8. What is the concept of Cheque Truncation System? What are its benefits and main highlights of a CTS system? Also explain the process of CTS with suitable examples, wherever necessary.

LIST OF FURTHER READINGS

1. Negotiable Instrument Act : https://indiankanoon.org/search/?formInput=negotiable+instrument+act
2. Forged Instrument : https://bankingschool.co.in/negotiable-instrument-act/what-is-a-forged-instrument chequebillpromissory-note/
3. Negotiable Instruments : https://cleartax.in/s/negotiable-instruments
4. Dishonor of Cheque : https://www.elearnmarkets.com/blog/12-reasons-for-dishonour-of-cheque/
5. CTS : https://www.rbi.org.in/Scripts/FAQView.aspx?Id=63

Various Government Schemes

Lesson 7

KEY CONCEPTS

■ PMJDY ■ PMMY ■ PMJJBY ■ APY ■ SSAY ■ MUDRA ■ PMSBY ■ PMFBY ■ PMEGP ■ NRLM ■ NULM

Learning Objectives

To understand:

- Background
- Objectives of the schemes
- Formalities relating to account opening formalities (where applicable)
- The salient features of the scheme
- Documents required
- Eligibility
- Benefits
- Details of the scheme
- Conditions to be fulfilled.

Lesson Outline

- Introduction
- Pradhan Mantri Jan Dhan Yojana (PMJDY)
- MUDRA Bank Yojana Sukhanya Samriddhi Account Yojana
- Pradhan Mantri Jeevan Jyoti Beema Yojana (PMJJBY)
- Pradhan Mantri Suraksha Bima Yojana (PMSBY)
- Atal Pension Yojana (APY)
- Pradhan Mantri Fasal Bima Yojana (PMFBY)
- Pradhan Mantri Employment Generation Programme (PMEGP)
- Deendayal Antodya Yojana – NRLM
- Deendayal Antodya Yojana –NULM
- Differential Rate of Interest Scheme
- Prime Minister's Awas Yojana –Urban
- Prime Minister's Awas Yojana – Gramin (Standup)
- Stand-Up India Scheme (For Financing SC / ST and / Or Women Entrepreneurs)
- Lesson Round-Up
- Test Yourself

REGULATORY FRAMEWORK

- Banking Regulation Act, 1934
- Insurance Act, 1938

INTRODUCTION FOR STARTING GOVERNMENT SCHEMES

Indian Government, at all levels, announces Welfare Schemes for a cross-section of the from time to time. These schemes could be either Central, State specific or a collaboration between the Centre and the States. In this section, we have attempted to provide easy and single-point access to information about several welfare schemes of the Government and their various aspects including eligible beneficiaries, types of benefits, scheme details etc.

PRADHAN MANTRI JAN-DHAN YOJNA (PMJDY)

Hon'ble Prime Minister, Sh. Narendra Modi on 15th August 2014 announced "Pradhan Mantri Jan-Dhan Yojana (PMJDY)" which is a National Mission for Financial Inclusion. Financial Inclusion is the provision of banking services at an affordable cost, to the disadvantaged sections of society, who are hitherto excluded and deprived of Financial Services, to enable them to improve their standard of living. The task is gigantic and is a National Priority.

The Pradhan Mantri Jan-Dhan Yojana launched on 28 August, 2014, across the nation simultaneously. It was launched formally in Delhi with parallel functions at the State levels and also at district and sub-district levels. The Pradhan Mantri Jan-Dhan Yojana lies at the core of development philosophy of **"Sab Ka Sath Sab Ka Vikas".**

Purpose of the Scheme: With the slogan **"Mera Khata - Bhagya Vidhaata"**, Pradhan Mantri Jan-Dhan Yojana (PMJDY) aims to ensure access to financial services, namely, Banking/ Savings & Deposit Accounts, Remittance, Credit, Insurance, Pension in an affordable manner.

An account can be opened in any bank branch or Business Correspondent (Bank Mitr) outlet. Accounts opened under PMJDY are being opened with Zero balance. However, if the account holder wishes to get a cheque book, he/she will have to fulfil the minimum balance criteria.

Pradhan Mantri Jan - Dhan Yojana

(All figures in Crore)

Beneficiaries as on 01/03/2023

Bank Name / Type	Number of Beneficiaries at rural/semi-urban centre bank branches	Number of Beneficiaries at urban metro centre bank branches	No Of Rural-Urban Female Beneficiaries	Number of Total Beneficiaries	Deposits in Accounts (In Crore)	Number of Rupay Debit Cards issued to beneficiaries
Public Sector Banks	23.78	14.16	20.91	37.94	150947.10	28.18
Regional Rural Banks	7.71	1.25	5.17	8.96	37746.80	3.44
Private Sector Banks	0.70	0.67	0.73	1.37	5500.39	1.12
Grand Total	**32.19**	**16.08**	**26.82**	**48.27**	**194194.29**	**32.74**

(Source: Website of PMJDY- https://pmjdy.gov.in/account)

Documents required for opening account : An account can be opened by presenting any one of the following officially valid documents:

- If the applicant has an Aadhaar card, then no need to require other documents. In case the address has been changed, then self-certification would be needed for the current address.
- If the applicant does not have an Aadhar card, then they need to provide one of the following documents:
  - Passport,
  - Driving license,
  - Permanent Account Number (PAN) Card,
  - Voter's Identity Card issued by the Election Commission of India,
  - job card issued by NREGA duly signed by an officer of the State Government, or

  Any other documents as notified by the Central Government in consultation with the Regulator.

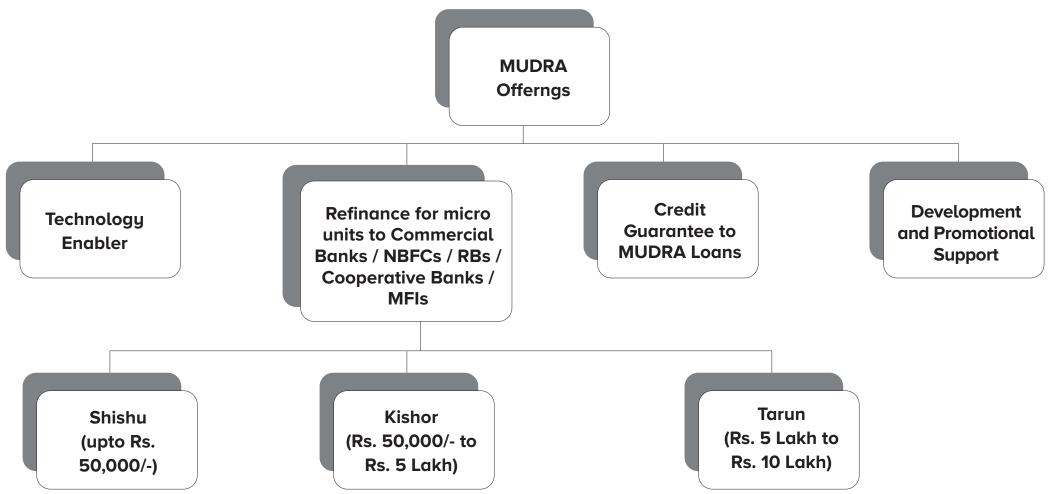
Provided that where simplified measures are applied for verifying the identity of the clients the following documents shall be deemed to be officially valid documents: -

a. identity card with applicant's Photograph issued by Central/State Government Departments, Statutory/ Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks, and Public Financial Institutions;

b. letter issued by a Gazetted officer, with a duly attested photograph of the person.

Reserve Bank of India (RBI), vide its Press Release dated 26.08.2014, has further clarified that those persons who do not have any of the 'officially valid documents' can open "Small Accounts" with banks. A "Small Account" can be opened based on a self-attested photograph and putting his/her signature or thumbprint in the presence of officials of the bank. Such accounts have limitations regarding the aggregate credits (not more than Rupees one lakh in a year), aggregate withdrawals (not more than Rupees ten thousand in a month) and balance in the accounts (not more than Rupees fifty thousand at any point of time). These accounts would be valid normally for a period of twelve months. Thereafter, such accounts would be allowed to continue for a further period of twelve more months, if the account holder provides a document showing that he/she has applied for any of the Officially Valid Documents, within 12 months of opening the small account.

PRADHAN MANTRI MUDRA YOJANA (PMMY)



Micro Units Development and Refinance Agency Ltd. [MUDRA] is an NBFC supporting development of micro enterprise sector in the country. MUDRA is a public sector institution for providing loans to small entrepreneurs launched on 08.04.2015. MUDRA provides refinance support to Banks / Micro Finance Institutions (MFIs) for lending to micro units having loan requirements up to Rs. 10 lakhs. MUDRA provides refinance to micro businesses under the Scheme of Pradhan Mantri MUDRA Yojana. The other products are for development support to the sector. It targets mainstream young, educated or skilled workers and entrepreneurs who cannot have access to credit from regular banking system.

The bouquet of offerings of MUDRA is depicted below. The offerings are being targeted across the spectrum of beneficiary segments.

MUDRA has launched the following three loan instruments, as given below:

1. Shishu (the starters) up to Rs. 50,000.
2. Kishor (the mid stage finance seekers) above Rs. 50,000 and up to Rs. 5 lakhs.
3. Tarun (growth seekers) Above Rs. 5 lakh and up to Rs. 10 lakhs.

Under Credit Guarantee Fund for Micro Units (CGFMU) for loans under the MUDRA scheme, guarantee is offered by National Credit Guarantee Trust Company for which the following loans are eligible:

- All loans sanctioned under PM MUDRA Yojana by Commercial banks,
- MFIs and Non-Banking Finance Companies [these are called Member Lending Institutions (MLI)] - in the categories of Shishu, Kishor and Tarun and overdraft up to Rs. 5,000.00 under PM Jan Dhan Yojana.

In these loans, the Member Lending Institutions should not obtain any collateral security or 3rd party guarantee from the borrower.

Average loan size

The average size of loans extended under PMMY in different categories of loan is analysed and given below:

Amount sanctioned (Rs. in crore)		**No. of loan accounts**		**Average loan size (Rs. in crore)**	
2020-21	**2021-22**	**2020-21**	**2021-22**	**2020-21**	**2021-22**
3,21,759.25	**3,39,110.35**	**5,07,35,046**	**5,37,95,526**	**63,419.52**	**63,036.91**

(Source Annual Report 2021-22 MUDRA)

MUDRA Card : MUDRA Card is an innovative product which provides working capital facility as a cash credit arrangement. MUDRA Card is a debit card issued against the MUDRA loan account, for working capital portion of the loan.

The borrower can make use of MUDRA Card in multiple withdrawal and credit, to manage the working capital limit in a most efficient manner and keep the interest burden minimum. MUDRA Card will also help in digitalization of MUDRA transactions and creating credit history for the borrower. National Payment Corporation of India (NPCI) has given RuPay branding to MUDRA Card and separate BIN / IIN for the same, by which credit history can be tracked. MUDRA Card can be operated across the country for withdrawal of cash from any ATM / micro-ATM and make payment through any 'Point of Sale' machines.

The design of the MUDRA card as approved by Department of Financial Services (DFS), GoI and NPCI is given below. Banks can customize the same by incorporating their logo and name.

SUKANYA SAMRIDDHI ACCOUNT YOJANA (SSAY)

Objective : Sukanya Samriddhi Account is Government of India backed savings scheme targeted at the parents of girl child. The Sukanya Samriddhi Yojana was launched as a part of the **Beti Bachao, Beti Padhao** campaign by the Modi Government on 22 January 2015 after seeking the subjugating conditions of the girl children in the country.

The scheme encourages parents to build a fund for the future education and marriage of a girl child.

Features of the scheme:

1. **Who will open this account:** A Sukanya Samriddhi Account can only be opened by the parent/legal guardian for a maximum of two female children. An exemption is provided by presenting a medical certificate from an authorized medical institution for twins and triplets.

2. **Age Criteria:** A Sukanya Samriddhi account can only be opened for a girl child anywhere between her birth and 10 years of age.

3. **Residential status:** This account can only be opened for a girl child who is a resident of India. This scheme is unavailable for a girl child having non-resident status. Even if the parents or the legal guardians are non- residents, then also this scheme will not be available to them. If the girl child becomes a non-resident after opening this account, then this change should be intimated to the concerned post office/ bank within 1 month of such change after which the account gets closed.

4. **Account in the name of the girl child:** Sukanya Samriddhi account must always be opened in the name of a girl child and not in the name of her parents or legal guardians. They will only deposit an amount in the account on behalf of the minor girl child.

5. **Number of accounts:** A single parent/legal guardian can open only one account for every girl child in the family. A maximum of two accounts for two girl children can be opened in one family.

6. **Where to open this account:** This account is opened in the authorized branches of Post Offices or commercial banks like State Bank of India, Bank of Baroda, Punjab National Bank, Bank of India, Canara Bank, and UCO Bank, to name a few.

7. **Documents required:** There are certain documents required to open this account-

   – Birth certificate of the girl child.

   – Address and identity proof of the depositor (parents or the legal guardians)- Aadhaar card, PAN card, passport, ration card, driving license.

   – In case of twins or triplets, a medical certificate proving the order of birth of children.

   – Certificate stating the nature of a relationship with the girl child. In cases where this account is opened by the biological parents of the girl child, the birth certificate will serve the requirement of this certificate. But in the case of the adopted girl child, this certificate becomes necessary.

8. **Threshold of deposits:** Sukanya Samriddhi account can be opened with a minimum deposit of Rs.250 per account. A maximum limit on the amount of deposit to this account has been set at Rs.1.50 lakhs per account per financial year. There is no limit in the number of deposits in a month or a fiscal year.

9. **Mode of payment of deposits:** The cheque or the demand draft should be in the name of the-

   – For Banks/Financial institutions- Concerned Bank Manager

   – For Post Office- Concerned Postmaster

The parent or the guardian is required to write the girl child's name and the account number on the back of the cheque or draft while making the payment of deposit.

10. **Account Transferability:** The option to transfer the Sukanya Samriddhi Account from the post office to post office, bank to bank, post office to the bank, and bank to post office on furnishing certain documents is available.

11. **Penalty:** A penalty of Rs. 50 will be imposed if there is a failure in meeting the minimum deposit requirements.

12. **Rate of Interest:** The rate of for the 4^{th} quarter of Financial year 2022-23, i.e. 1^{st} January 2023 to 31^{st} March 2023, has been kept remain unchanged at 7.6% since last two years.

    Interest is compounded on yearly basis.

13. **Maximum duration of deposit:** The maximum duration for which a parent/guardian is required to deposit an amount in this account is 14 years. After the end of this duration, no more money is required to be deposited to this account and it will continue to accumulate interest until it matures/closed.

14. **Closure of Account:** This account gets closed after it attains maturity after completing the tenure of 21 years. The money lying in this account including the interest is paid to girl child after attaining 18 years of age and on submission of an account closure application along with address and identity proof, proof of residence and citizenship.

15. **Taxation aspects:** Tax exemption under Section 80C of Income-tax Act, 1961.

16. **Tenure of account:** This savings account remains active for a maximum period of 21 years from the date of opening of this account, after which the account stops to accrue any interest.

17. **Premature closure of account -**

    (1) In the event of death of the account holder, the account shall be closed immediately on production of death certificate issued by the competent authority, and the balance at the credit of the account shall be paid along with interest till the month preceding the month of premature closure of the account to the guardian of the account holder.

    (2) Where the Central Government is satisfied that operation or continuation of the account is causing undue hardship to the account holder, it may, by order, for reasons to be recorded in writing, allow pre-mature closure of the account only in cases of extreme compassionate grounds such as medical support in life threatening diseases, death, etc.

PRADHAN MANTRI JEEVAN JYOTI BIMA YOJANA (PMJJBY)

Government of India backed Life Insurance Scheme for the benefit of weaker sections of the society. PMJJBY is an Insurance Scheme offering life insurance cover for death due to any reason. It would be a one year cover, renewable from year to year. Hon'ble Prime Minister launched PMJJBY schemes nationally in Kolkata on 9th May, 2015.

Scope: All individual account holders of participating banks in the age group of 18 to 50 years are entitled to join. In case of multiple bank accounts held by an individual in one or different banks, the person is eligible to join the scheme through one bank account only. Aadhar is the primary KYC for the bank account.

Enrolment period: The cover period is from 1st June to 31st May, subscribers are required to enroll and give their auto-debit consent by 31st May every year. Those joining subsequently would be able to do so with payment of full annual premium for prospective coverage.

For subscribers enrolling for the first time on or after 1st June 2016, insurance cover shall not be available for death (other than due to accident) occurring during the first 45 days from the date of enrolment into the scheme (lien period) and in case of death (other than due to accident) during lien period, no claim would be admissible.

Individuals is free to exit the scheme at any point and may re-join the scheme in future. The exclusion of insurance benefits during the lien period shall also apply to subscribers who exit the scheme during or after the first year and rejoin on any date on or after 1st June 2016.

In future years, new entrants into the eligible category or currently eligible individuals who did not join earlier or discontinued their subscription shall be able to join while the scheme is continuing subject to the 45 days lien period described above.

Benefits: Rs.2 lakh is payable on member's death due to any cause.

Premium: Rs.330/- per annum per member. The premium is deducted from the account holder's bank account through 'auto debit' facility in one instalment, as per the option given, on or before 31st May of each annual coverage period under the scheme. Delayed enrolment for prospective cover after 31st May is possible with full payment of annual premium.

Eligibility Conditions:

Individual bank account holders of the participating banks aged between 18 years (completed) and 50 years (age nearer birthday) who give their consent to join / enable auto-debit, as per the above modality, will be enrolled into the scheme.

Termination of assurance: The assurance on the life of the member shall terminate on any of the following events and no benefit will become payable there under:

1) On attaining age 55 years subject to annual renewal up to that date (entry, however, will not be possible beyond the age of 50 years).

2) Closure of account with the Bank or insufficiency of balance to keep the insurance in force.

3) In case a member is covered under PMJJBY with LIC of India / other company through more than one account and premium is received by LIC / other company inadvertently, insurance cover will be restricted to Rs. 2 Lakh and the premium paid for duplicate insurance(s) shall be liable to be forfeited.

4) If the insurance cover is ceased due to any technical reasons such as insufficient balance on due date or due to any administrative issues, the same can be reinstated on receipt of full annual premium, subject however to the cover being treated as fresh and the 45 days lien clause being applicable.

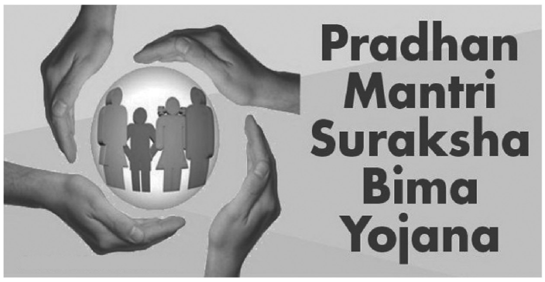
5) Participating Banks shall remit the premium to insurance companies in case of regular enrolment on or before 30th of June every year and in other cases in the same month when received.

Administration: The scheme, subject to the above, is administered by the LIC P&GS Units / other insurance company setups.

It is responsibility of the participating bank to recover the appropriate annual premium in one instalment, as per the option, from the account holders on or before the due date through 'auto-debit' process. Members may also give one-time mandate for auto-debit every year till the scheme is in force.

The acknowledgement slip may be made into an acknowledgement slip-cum-certificate of insurance.

PRADHAN MANTRI SURAKSHA BIMA YOJANA (PMSBY)



PMSBY provides personal accident cover as a part of providing Social Security cover to the weaker section population through Public Sector General Insurance Companies (PSGICs) and other General Insurance companies willing to offer the product on similar terms with necessary approvals and tie up with Banks for this purpose.

The scheme is for one-year cover, renewable from year to year, Accident Insurance Scheme offering accidental death and disability cover for death or disability on account of an accident.

Scope: All savings bank account holders in the age 18 to 70 years in participating banks are entitled to join.

In case of multiple saving bank accounts held by an individual in one or different banks, the person is eligible to join the scheme through one savings bank account only. Aadhar is the primary KYC for the bank account.

Enrollment Period: The cover shall be for the one-year period stretching from 1st June to 31st May for which option to join / pay by auto-debit from the designated savings bank account on the prescribed forms are required to be given by 31st May of every year.

Individuals is free to exit the scheme at any point and may re-join the scheme in future years through the above modality.

Benefits:

Sr. No.	Particulars	Sum Insured
A	Death	Rs. 2 Lakh
B	Total and irrecoverable loss of both eyes or loss of use of both hands or feet or loss of sight of one eye and loss of use of hand or foot	Rs. 2 Lakh
C	Total and irrecoverable loss of sight of one eye or loss of use of one hand or foot	Rs. 1 Lakh

Premium: The premium of Rs. 20 per annum deducted from the account holder's savings bank account through 'auto debit' facility in one installment on or before 1st June of each annual coverage period under the scheme.

Eligibility Conditions: The savings bank account holders of the participating banks aged between 18 years (completed) and 70 years (age nearer birthday) who give their consent to join / enable auto-debit, as per the above modality, can enrolled into the scheme.

Termination of cover: The accident cover for the member shall terminate on any of the following events and no benefit will be payable there under:

1) On attaining age 70 years (age nearest birth day).

2) Closure of account with the Bank or insufficiency of balance to keep the insurance in force.

3) In case a member is covered through more than one account and premium is received by the Insurance Company inadvertently, insurance cover will be restricted to one only and the premium shall be liable to be forfeited.

4) If the insurance cover is ceased due to any technical reasons such as insufficient balance on due date or due to any administrative issues, the same can be reinstated on receipt of full annual premium, subject to conditions that may be laid down. During this period, the risk cover will be suspended, and reinstatement of risk cover will be at the sole discretion of Insurance Company.

5) Participating banks will deduct the premium amount in the same month when the auto debit option is given, preferably in May of every year, and remit the amount due to the Insurance Company in that month itself.

Administration: The scheme, subject to the above, is administered as per the standard procedure stipulated by the Insurance Company. The data flow process and data proforma will be provided separately. It is the responsibility of the participating bank to recover the appropriate annual premium from the account holders within the prescribed period through 'auto-debit' process. Enrollment form / Auto-debit authorization in the prescribed proforma shall be obtained and retained by the participating bank. In case of claim, the insurance company may seek submission of the same. Insurance Company reserves the right to call for these documents at any point of time.

The acknowledgement slip may be made into an acknowledgement slip-cum-certificate of insurance.

ATAL PENSION YOJANA (APY)

The scheme is for Indian citizen workers in unorganized sector. It was launched in 2015. The scheme is administered by the Pension Fund Regulatory and Development Authority (PFRDA) under the National Pension Scheme (NPS). Subscribers would receive a fixed minimum of Rs. 1000 or Rs. 2,000 or Rs. 3,000 or Rs. 5000 per month at the age of 60 years depending on their contribution.

Benefit: Fixed pension for the subscribers between Rs. 1000 to Rs. 5000 per month, if he joins and contributes between the age of 18 years and 40 years.

Eligibility: Atal Pension Yojana (APY) is open to all bank account holders or Post Office account holder. The Central Government would also co- contribute 50% of the total contribution or Rs. 1000 per annum, whichever is lower, to each eligible subscriber account, for a period of 5 years.

The Government co-contribution is payable to eligible PRANs by PFRDA after receiving the confirmation from Central Record Keeping Agency at such periodicity as may be decided by PFRDA.

Age of joining and contribution period : The minimum age of joining APY is 18 years and maximum age is 40 years. The age of exit and start of pension would be 60 years. Therefore, minimum period of contribution by the subscriber under APY would be 20 years or more.

Focus of APY: Mainly targeted at unorganized sector workers.

Enrolment and Subscriber Payment : All bank account holders under the eligible category may join APY with auto debit facility to accounts, leading to reduction in contribution collection charges. The subscribers should keep the required balance in their savings bank accounts on the stipulated due dates to avoid any late payment penalty.

Enrolment agencies : All Points of Presence(POP) (Service Providers) and Aggregators under Swavalamban Scheme can enrolls through architecture of National Pension System. The banks, as POP or aggregators, may employ BCs/Existing non - banking aggregators, micro insurance agents, and mutual fund agents as enablers for operational activities. The banks may share the incentives received by them from PFRDA/Government, as deemed appropriate.

Administration : It is Government of India Scheme, which is administered by the Pension Fund Regulatory and Development Authority. The Institutional Architecture of NPS would be utilised to enroll subscribers under APY. The offer document of APY including the account opening form would be formulated by PFRDA.

Government would provide

(i) fixed pension guarantee for the subscribers;

(ii) would co-contribute 50% of the total contribution or Rs. 1000 per annum, whichever is lower, to eligible subscribers; and

(iii) would also reimburse the promotional and development activities including incentive to the contribution collection agencies to encourage people to join the APY.

Funding of APY : Under APY, the individual subscribers shall have an option to make the contribution monthly. Banks are required to collect additional amount for delayed payments, such amount will vary from minimum Rs. 1 per month to Rs. 10/- per month as shown below:

- Rs. 1 per month for contribution up to Rs. 100 per month.
- Rs. 2 per month for contribution up to Rs. 101 to Rs. 500 per month.
- Rs. 5 per month for contribution between Rs. 501 to Rs.1000 per month.
- Rs. 10 per month for contribution beyond Rs. 1001 per month.

The fixed amount of interest/penalty remains as part of the pension corpus of the subscriber.

Discontinuation of payments of contribution amount shall lead to following:

- After 6 months account will be frozen.
- After 12 months account will be deactivated.
- After 24 months account will be closed.

Exit and pension payment : Upon completion of 60 years, the subscribers have to submit the request to the associated bank for drawing the guaranteed monthly pension.

Exit before 60 years of age is not permitted, however, it is permitted only in exceptional circumstances, i.e., in the event of the death of beneficiary or terminal disease.

PRADHAN MANTRI FASAL BIMA YOJANA (PMFBY)

Introduction : The Government of India, in April 2016 had launched PMFBY after rolling back the earlier insurance schemes - National Agriculture Insurance Scheme (NAIS), Weather based Crop Insurance scheme and Modified National Agricultural Insurance Scheme (MNAIS). The scheme is implemented by Agriculture Insurance Company of India (AIC) and other empaneled private general insurance companies which are selected by the State Governments through bidding.

PRADHAN MANTRI FASAL BIMA YOJNA
PMFBY
Fasal Ka Rakhwala

Objectives:

i. Providing financial support to farmers suffering crop loss / damage arising out of unforeseen events.

ii. Stabilizing the income of farmers to ensure their continuance in farming.

iii. Encouraging farmers to adopt innovative and modern agricultural practices.

iv. Ensuring flow of credit to the agriculture sector which contributes to food security, crop diversification and enhancing growth and competitiveness of agriculture sector besides protecting farmers from production risks.

Coverage of Farmers:

1. All farmers including sharecroppers and tenant farmers growing the notified crops in the notified areas are eligible for coverage.

2. **Compulsory Component**

   All farmers availing Seasonal Agricultural Operations (SAO) loans from Financial Institutions (i.e., loanee farmers) for the notified crop(s) would be covered compulsorily.

3. **Voluntary Component**

   The Scheme would be optional for the non-loanee farmers.

4. Special efforts shall be made to ensure maximum coverage of SC / ST/ Women farmers under the scheme.

Crops covered by PMFBY:

a) Food crops (Cereals, Millets and Pulses);

b) Oil seeds;

c) Annual Commercial / Annual Horticultural crops;

d) In addition, pilots for coverage can be taken for those perennial horticultural/commercial crops for which standard methodology for yield estimation is available.

Main conditions of sum insured / coverage limit in PMFBY:

i. Sum insured per hectare for both loanee and non-loanee farmers is same and equal to the Scale of Finance as decided by the District Level Technical Committee

ii. Sum insured for individual farmer is equal to the Scale of Finance per hectare multiplied by area of the notified crop proposed by the farmer for insurance. Area under cultivation shall always be expressed in hectare.

iii. Sum insured for irrigated and un-irrigated areas may be separate.

Risk covered :

1) Yield Losses (standing crops, on notified area basis). Comprehensive risk insurance is provided to cover yield losses due to non-preventable risks, such as Natural Fire and Lightning, Storm, Hailstorm, Cyclone, Typhoon, Tempest, Hurricane, Tornado. Risks due to Flood, Inundation and Landslide, Drought, Dry spells, Pests/ Diseases also will be covered.

2) In cases where majority of the insured farmers of a notified area, having intent to sow/plant and incurred expenditure for the purpose, are prevented from sowing/planting the insured crop due to adverse weather conditions, shall be eligible for indemnity claims up to a maximum of 25 per cent of the sum insured

3) In post-harvest losses, coverage will be available up to a maximum period of 14 days from harvesting for those crops which are kept in "cut & spread" condition to dry in the field.

4) For certain localized problems, Loss / damage resulting from occurrence of identified localized risks like hailstorm, landslide, and Inundation affecting isolated farms in the notified area would also be covered.

Premium rates and premium subsidy on PMFBY

1) For Kharif crops, the farmer's part of premium is 2% of sum assured.

2) For Rabi crops, the farmer's part of premium is 1.5% of the sum assured.

3) For annual commercial and horticultural crops, the farmer's part of premium is 5%.

The remaining part of premium is paid equally by the central and respective state governments. All funds for this scheme come from Krishi Kalyan Kosh.

The Government under this system has migrated from claim-based insurance scheme to an upfront subsidy for premium based system. It is a demand driven scheme; therefore, no targets are fixed.

Farmers' details are required to be entered by banks in the unified portal for crop insurance which is available at www. agri-insurance.gov.in in order to facilitate assessment of coverage of crops insured, premiums deducted, etc.

While restructuring the loans in areas affected by a natural calamity, banks shall also take into account the insurance proceeds, if any, receivable from the Insurance Company. The insurance proceeds shall be adjusted to the 'restructured accounts' in cases where fresh loan have been granted to the borrower. However, banks shall act with empathy and consider restructuring and granting fresh loans without waiting for the receipt of insurance claim in cases where there is reasonable certainty of receiving the claim.

PRIME MINISTER'S EMPLOYMENT GENERATION PROGRAMME (PMEGP)

This scheme was launched by Government of India to promote employment opportunities through launching of new Micro enterprises in India. PMEGP is an outcome of merger of two earlier schemes of Government of India namely Prime Minister's Rojgar Yojana (PMRY) and Rural Employment Generation Programme (REGP) with an objective of generating employment opportunities through establishment of new micro enterprises in rural as well as urban areas. This is a credit linked subsidy programme.

PMEGP is a central sector scheme administered by the Ministry of Micro, Small and Medium Enterprises. (MoMSME) and implemented by Khadi and Village Industries Commission (KVIC). Ministry of MSME is in Administrative control of the programme as a single nodal agency.

Other objectives of the PMEGP include

- bringing together widely dispersed traditional artisans/ rural and urban unemployed youth and give them self-employment opportunities to the extent possible, at their place.
- to help arrest migration of rural youth to urban areas by providing employment locally.
- to increase the wage earning capacity of artisans and contribute to increase in the growth rate of rural and urban employment.

At the State level, the Scheme will be implemented through State KVIC Directorates, State Khadi and Village Industries Boards (KVIBs) and District Industries Centres (DICs) and banks. The Government subsidy under the Scheme will be routed by KVIC through the identified Banks (PSU Banks/RRBs/ SIDBI/Approved Private Sector Bank/Co-operative Banks) for eventual distribution to the beneficiaries / entrepreneurs in their Bank accounts.

Identification of beneficiaries, of area specific viable projects, and providing training in entrepreneurship development will be taken care by KVIC, KVIBs and DICs in conjunction with reputed NGOs, Self Help Groups (SHGs)/ National Small Industries Corporation (NSIC) / Udyami Mitras empanelled, Panchayati Raj institutions and other relevant bodies including banks. Banks cannot directly sanction loan to an applicant as it has to be identified by a Task force at District level consisting of District Magistrate/ District Collector/KVIC/DIC/Banks. Defaulters of bank loans are not eligible to avail the loan.

- The Bank will sanction 90% of the project cost in case of General Category of beneficiary/ institution and 95% in case of special category of the beneficiary/institution disburse suitably for setting up of the project.
- Bank will finance Capital Expenditure in the form of Term Loan and Working Capital in the form of cash credit. Bank can also finance in the form of Composite Loan consisting of Capital Expenditure

and Working Capital. Max The maximum cost of the project/unit admissible in manufacturing sector is Rs.25 lakhs and in the business/service sector, it is Rs.10 lakhs.

- Bank Credit will be ranging between 60-75% of the total project cost after deducting 15-35% of margin money (subsidy) and owner's contribution of 10% from beneficiaries belonging to general category and 5% from beneficiaries belonging to special categories.
- Banks will claim Margin Money (subsidy) on the basis of projections of Capital Expenditure in the project report and sanction thereof, Margin Money (subsidy) on the actual availment of Capital Expenditure and excess, if any, will be refunded to KVIC, immediately after the project is ready for commencement of production.

Rate of interest and repayment schedule Normal rate of interest shall be charged. Repayment schedule may range between 3 to 7 years after an initial moratorium as may be prescribed by the concerned bank/ financial institution.

Eligibility for Borrowers and other conditions: Individuals, should be above 18 years of age and have passed VIII Standard. In case of project above Rs.10.00 lakhs in manufacturing and above Rs. 5.00 lakhs for Service Sector. Apart from individuals, Charitable Trusts, Institutions Registered under Societies Registration Act-1860, SHGs (including those belonging to BPL provided that they have not availed benefits under any other Scheme) and Production based Co-operative Societies are also eligible for applying under this scheme.

There is no income ceiling specified under the scheme. Only new projects including Village Industries projects except activities indicated in the negative list of Village Industries, will receive assistance under the PMEGP. Existing Units and the units that have already availed Government Subsidy under any other scheme of Government of India or State Government are not eligible.

Other Conditions : Only one person from one family is eligible for obtaining financial assistance for setting up of projects under PMEGP. The definition of 'family' includes self and spouse.

Applicants, who have already undergone training of at least 2 weeks under Entrepreneurship Development Programme (EDP) / Skill Development Programme (SDP) / Entrepreneurship cum Skill Development Programme (ESDP) or Vocational Training (VT) will be allowed to submit applications directly to Banks.

Quantum of Bank Finance, Subsidy conditions

- The Maximum project cost for a manufacturing sector unit is pegged at Rs. 25 lacs and for service and business-oriented unit is pegged at Rs.10 lac. The Bank will sanction 90% of the project cost in case of General Category of beneficiary/ institution and 95% in case of special category of the beneficiary/ institution and disburse suitably for setting up of the project.
- Bank will finance Capital Expenditure in the form of Term Loan and Working Capital in the form of cash credit. Bank can also finance in the form of Composite Loan consisting of Capital Expenditure and Working Capital Max.
- Bank Credit will be ranging between 60-75% of the total project cost after deducting 15-35% of margin money (subsidy) and owner's contribution of 10% from beneficiaries belonging to general category and 5% from beneficiaries belonging to special categories.

Negative List of Activities

The following list of activities will not be permitted under PMEGP for setting up of micro enterprises/ projects /units. Any industry/business connected with Meat (slaughtered), i.e., processing, canning and/or serving items made of it as food, production/manufacturing or sale of intoxicant items like Beedi / Pan/ Cigar/ Cigarette etc., any Hotel or Dhaba or sales outlet serving liquor, preparation/producing tobacco as raw materials, tapping of toddy for sale.

Any industry/business connected with cultivation of crops/ plantation like Tea, Coffee, Rubber etc. sericulture (Cocoon rearing), Horticulture, Floriculture, Animal Husbandry like Pisciculture, Piggery, Poultry, Harvester machines etc.

- Banks will claim Margin Money (subsidy) on the basis of projections of Capital Expenditure in the project report and sanction thereof, Margin Money (subsidy) on the actual availment of Capital Expenditure and excess, if any, will be refunded to KVIC, immediately after the project is ready for commencement of production.
- Rate of interest and repayment schedule Normal rate of interest shall be charged. Repayment schedule may range between 3 to 7 years after an initial moratorium as may be prescribed by the concerned bank/financial institution.

Eligibility for subsidy: The Institutions/Production Co-operative Societies/Trusts specifically registered as such and SC/ ST/ OBC/ Women/ Physically Handicapped / Ex-Servicemen and Minority Institutions with necessary provisions in the bye-laws to that effect are eligible for Margin Money (subsidy) for the special categories. Institutions / Production Cooperative Societies/ Trusts not registered as special categories, will be eligible for Margin Money (Subsidy) for general category.

Institutions through which beneficiaries can avail the scheme:

All Public Sector Banks. All Regional Rural Banks. Co- operative Banks, Private Sector Scheduled Commercial Banks approved by State Level Task Force Committee, Small Industries Development Bank of India (SIDBI).

Claim of subsidy by banks:

After the release of Bank finance either partly or fully, Bank submit Margin Money (subsidy) claim in the prescribed format to the designated Nodal Branch of the State/Region where KVIC has placed lump sum deposit of Margin Money (subsidy) in advance in the Savings Bank Account in the name of KVIC, for release of Margin Money (subsidy). RRBs and SIDBI follow respective guide lines issued to them in this regard. If a subsidy claim is rejected. Detailed grounds for rejections are maintained by KVIC/KVIBs/DICs.

Administration:

Ministry of MSME is the monitoring authority of this scheme. The Ministry allocates target, sanction and release required funds to KVIC. Quarterly review meeting also held in the Ministry on the performance of PMEGP.

DEENDAYAL ANTYODAYA YOJANA (DAY)

A. National Rural Livelihood Mission (NRLM)

Background

The Ministry of Rural Development, Government of India launched a new programme known as National Rural Livelihoods Mission (NRLM) by restructuring and replacing the Swarnjayanti Gram Swarozgar Yojana (SGSY) scheme with effect from April 01, 2013. NRLM was renamed as DAY-NRLM (Deendayal Antyodaya Yojana - National Rural Livelihoods Mission) w.e.f. March 29, 2016.

Objectives behind NRLM :

The principal objective behind NRLM is poverty reduction through building strong institutions of the poor, particularly women thereby enabling access to a range of financial services and livelihoods services. The Scheme provides a continuous hand-holding support to the institutions of poor such as Self-Help Groups (SHGs) for a period of 5-7 years till they come out of poverty. The support from DAY-NRLM includes all round capacity building of the SHGs ensuring that the group functions effectively on all issues concerning their members, financial management, providing them with initial fund support to address vulnerabilities and high cost indebtedness, formation and nurturing of SHG federations, making the federations evolve as strong support organizations, making livelihoods of the poor sustainable, formation and nurturing of livelihoods organizations, skill development of the rural youth to start their own enterprises or take up jobs in organized sector, enabling these institutions to access their entitlements from the key line departments, etc.

Role of State Governments

The DAY-NRLM, enable States to formulate their own State specific poverty reduction action plans at State, district and block level. The States will implement these programmes through identified blocks and districts as intensive blocks and districts, whereas remaining will be non-intensive blocks and districts. The selections of intensive districts are done by the states based on the demographic vulnerabilities and will be rolled out in a phased manner over the next 7-8 years. Initially 250 such intensive blocks have been identified. Rest of all blocks in the country will become intensive blocks over time. SHG is an informal group and registration under any Societies Act, State cooperative Act or a partnership firm is not mandatory.

Beneficiaries

Women SHGs under DAY-NRLM consist of 10-20 persons (70% or more should be belonging to Below Poverty Line or urban poor segment). In case of special SHGs i.e., groups in the difficult areas, groups with disabled persons, and groups formed in remote tribal areas, this number may be a minimum of 5 persons. Only for groups to be formed with Persons with disabilities, and other special categories like elders, transgenders, DAY-NRLM will have both men and women in the self-help groups.

Financial Assistance to the SHGs & Conditions

DAY-NRLM provides Revolving Fund (RF) support to SHGs in existence for a minimum period of 3 to 6 months and follow the norms of good SHGs, i.e., they follow 'Panchasutra' - regular meetings, regular savings, regular internal lending, regular recoveries and maintenance of proper books of accounts.

Only such SHGs that have not received any RF earlier will be provided with RF, as corpus, with a minimum of Rs.10,000 and up to a maximum of Rs.15,000 per SHG. The purpose of RF is to strengthen their institutional and financial management capacity and build a good credit history within the group. No Capital Subsidy will be sanctioned to any SHG from the date of implementation of DAY-NRLM.

Cluster Investment Fund (CIF) will be provided to the SHGs in the intensive blocks, routed through the Village level/ Cluster level Federations, to be maintained in perpetuity by the Federations. The CIF will be used, by the Federations, to advance loans to the SHGs and/or to undertake the common/collective socio-economic activities.

Interest Subvention Scheme

Interest subvention scheme on Credit to Women SHG during the year 2022-23 for all Public Sector Banks, Private Sector Banks and Small Finance Banks in all districts

(i) The scheme is limited to Women Self Help Groups under DAY-NRLM in rural areas only.

(ii) For loans up to Rs. 3 lakh under the scheme, banks will extend credit at a concessional interest rate of 7% per annum. For outstanding credit balance up to Rs. 3 lakh, banks will be subvented at a uniform rate of 4.5% per annum during FY 2022-23.

(iii) For loans above Rs. 3 lakh and up to Rs. 5 lakh under the scheme, banks will extend credit at interest rate equivalent to their 1 year-MCLR or any other external benchmark-based lending rate or 10% per annum, whichever is lower. For outstanding credit balance above Rs. 3 lakh and up to Rs. 5 lakh, banks will be subvented at a uniform rate of 5% per annum during FY 2022-23.

(iv) Interest Subvention will be payable only for the period during which an account remains in standard category

(v) Women SHGs promoted by other agencies and following the DAY-NRLM protocols will also be eligible for benefit of subvented loans subject to prior submission of the details of such SHGs on the DAY-NRLM SHG database.

(vi) The interest subvention scheme shall be implemented for banks through a Nodal Bank selected by the Ministry of Rural Development (MoRD). The Nodal Bank will operationalize the scheme through a web-based platform, as advised by MoRD. For the year 2022-23, Indian Bank has been nominated as the Nodal bank by MoRD.

(vii) In order to avail the interest subvention on credit extended to the women SHGs, banks may ensure that the accounts of SHGs (both savings and loans) under DAY-NRLM are appropriately identified in their CBS with unique codes assigned by DAY-NRLM/SLRMs.

(viii) All banks participating in the interest subvention scheme are required to upload information on the SHG savings and loan account, etc. on the respective Nodal Bank/ Nodal Agency portal as per the required technical specifications provided.

Eligibility criteria for the SHGs to avail loans

SHG should be

- In active existence at least since the last 6 months as per the books of account of SHGs and not from the date of opening of S/B account;
- Practicing 'Panchasutras' i.e., Regular meetings; Regular savings; Regular inter-loaning; Timely repayment; and Up-to-date books of accounts;
- Qualified as per grading norms fixed by NABARD. Grading can also be done by Federations of SHGs come to existence;
- Even defunct SHGs are also eligible for credit if they are revived and continue to be active for a minimum period of 3 months.

Loan amount

SHGs are eligible for multiple doses of assistance under DAY-NRLM over a period of time. They may avail either Term Loan (TL) or a Cash Credit Limit (CCL) loan or both based on the need. In case of need, additional loan can be sanctioned even though the previous loan is outstanding.

Cash Credit Limit (CCL): The quantum of CCL and Term Loan (TL) limits that can be sanctioned to a SHG are as per table below. Under CCL, yearly drawing power can be enhanced annually based on the repayment performance of the SHG. The drawing power (DP) in case of CC account as well as TL quantum, calculations are as below:

DP for CCL	Quantum	TL Dose
1st year	6 times of the existing corpus or minimum of Rs.1.5 lakh whichever is higher.	I Dose
2nd year	8 times of the corpus at the time review/ enhancement or minimum of Rs. 3 lakhs, whichever is higher.	II Dose
3rd year	Minimum of Rs. 6 lakhs, based on the Micro credit plan prepared by the SHGs and appraised by the Federations /Support agency and the previous credit History.	III Dose
4th year onwards	Above Rs. 6 lakhs based on the Micro credit plan prepared by SHG and appraised by the Federations /Support agency and the previous credit History.	IV Dose

Banks should take necessary measures to ensure that eligible SHG are provided with repeat loans. Banks are advised to work with DAY-NRLM to institutionalize a mechanism for online submission of loan application of SHGs for tracking and timely disposal of application.

Corpus = Revolving funds (if any, received by that SHG) + Own savings+ Interest earned by SHG from on- lending to its members + Income from other sources+ Funds from other sources in case of promotion by other institutions/NGOs.

Purpose of loan and repayment

The loan amount would be distributed among members based on the Micro Credit Plan (MCP) prepared by the SHGs. The loans may be used by members for meeting social needs, high cost debt swapping, construction or repair of house, construction of toilets and taking up sustainable livelihoods or to finance any viable common activity started by the SHGs.

In order to facilitate use of loans for augmenting livelihoods of SHG members, at least 50% of loans above ₹1 lakh, 75% of loans above ₹4 lakh and at least 85% of loans above ₹6 lakh should be used primarily for income generating productive purposes. MCPs prepared by SHGs would form the basis for determining the purpose and usage of loans.

Repayment schedule for Term Loans may be as follows:

a) The first dose of loan may be repaid in 24-36 months in monthly/quarterly instalments.

b) The second dose of loan may be repaid in 36-48 months in monthly/quarterly instalments.

c) The third dose of loan may be repaid in 48-60 months based on the cash flow in monthly/quarterly instalments.

d) From the fourth dose onwards, loans may be repaid between 60-84 months based on the cash flow in monthly/quarterly instalments.

Security and Margin

(a) No collateral and no margin will be charged up to Rs. 10.00 lakhs limit to the SHGs. No lien should be marked against savings bank account of SHGs and no deposits should be insisted upon while sanctioning loans.

(b) For loans to SHGs above ₹10 lakh and up to ₹20 lakh, no collateral should be obtained, and no lien should be marked against savings bank account of SHGs. However, the entire loan (irrespective of the loan outstanding, even if it subsequently goes below ₹10 lakh) would be eligible for coverage under Credit Guarantee Fund for Micro Units (CGFMU).

(c) For loan to SHGs above ₹10 lakh and up to ₹20 lakh, a margin not exceeding 10% of the loan amount exceeding ₹10 lakh may be obtained as per the bank's approved loan policy.

DEENDAYAL ANTYODAYA YOJANA (DAY)

B. National Urban Livelihood Mission (NULM)

Background

DAY- NULM

DEENDAYAL ANTYODAYA YOJANA NATIONAL - URBAN LIVELIHOOD MISSION (NULM)

The Government of India, Ministry of Housing and Urban Poverty Alleviation (MoHUPA), restructured the existing Swarna Jayanti Shahari Rozgar Yojana (SJSRY) and launched the National Urban Livelihoods Mission (NULM) in 2013. NULM has been under implementation w.e.f. September 24, 2013 in all district headquarters (irrespective of population) and all the cities with population of 1 lakh or more. With a view to improving the livelihood opportunities for the poor in urban areas including hawkers/street vendors, Ministry of Housing and Urban Poverty Alleviation

(UPA Division), Government of India decided to enhance the scope of NULM in 2016. The Mission with enhanced scope was renamed as "Deendayal Antyodaya Yojana - National Urban Livelihoods Mission (DAY-NULM)".

The Self Employment Programme (SEP) provides financial assistance to individuals / groups including street venders / hawkers of urban poor for setting up gainful self-employment ventures / micro-enterprises, suited to their skills, training, aptitude and local conditions. The programme also supports Self Help Groups (SHGs) of urban poor to access easy credit from bank and avail interest subsidy on SHG loans. The programme will also focus on technology, marketing and other support services to the above beneficiaries engaged in micro enterprises for their livelihoods and will also facilitate issuance of credit cards for working capital requirement of the entrepreneurs.

The underemployed and unemployed urban poor will be encouraged to set up small enterprises relating to manufacturing, service and small business for which there is considerable local demand. Local skills and local crafts should be particularly encouraged. Each ULB should develop a compendium of such activities/projects keeping in view skills available, marketability of products, costs, economic viability etc.

Special focus groups

The percentage of women beneficiaries under SEP shall not be less than 30%. SCs and STs must be benefited at least to the extent of the proportion of their strength in the city / town population of poor. A special provision of 5% reservation should be made for the differently-abled under this program. In view of the Prime Minister's 15-Point Program for the Welfare of Minorities, at least 15% of the physical and financial targets be earmarked for the minority communities.

Eligibility

Individuals of above 18 years, Groups of urban poor including Self-Help Groups. No minimum educational qualification is required for prospective beneficiaries. However, where the identified activity for micro- enterprise development requires some special skills, appropriate training must be provided to the beneficiaries before extending financial support.

Identification of beneficiaries

The Community Organizers (COs) and Professionals from Urban Local Body (ULB) identify the prospective beneficiaries from among the urban poor. Also, they may identify eligible borrowers from references made by SHGs, Area Level Federations, Banks (including cases identified by their Business Correspondents/ Business Facilitators). The community structures formed under Social Mobilization & Institutional Development (SM&ID) component of DAY- NULM viz. Self-Help Groups (SHGs) and Area Level Federations (ALFs) may also refer prospective individual and group entrepreneurs for purpose of financial assistance under SEP to ULB. The beneficiaries may directly approach ULB or its representatives for assistance. Banks may also identify prospective beneficiaries at their end and forward such cases directly to ULB. The Banks may also use their empaneled Business Correspondents (BCs) and Business Facilitators (BFs) to increase the outreach. Due diligence IS undertaken as per the Bank's policy in this regard.

Application procedures

The application for individual and group enterprise loans is sponsored by the Urban Local Body (ULB) which is the sponsoring agency for the individual and group enterprise. The applicants seeking loan can submit an application to the concerned ULB officials on a plain paper with basic details viz: Name, Age, Contact details, Address, Aadhaar details (if any), amount of loan required, bank account number (if available), type of enterprise/ activity, category etc. The application can also be sent by mail /post to the ULB office. The ULB shall accept such intents throughout the year.

On receipt of applications from beneficiaries respective ULBs will enter the details in a register/or MIS if available and hence will generate a waiting list of beneficiaries. The ULB will issue an acknowledgement to the beneficiary with a unique registration number, which may be used as a reference number for tracking the status of application.

ULB will call the beneficiaries in order of the waiting list to complete requisite documentation including filling of Loan Application Form (LAF), activity details, identity proof, address proof, bank account details etc. The LAF will contain basic data in respect of economic status of the beneficiary and her / his family. The State Urban Livelihoods Mission (SULM) may develop a Loan Application Form (LAF) in suitable format in consultation with State Level Bankers Committee (SLBC) convenor bank. To verify the identity of the beneficiary, her/his Aadhar number will also be brought on record. If beneficiary does not have Aadhar card, his/ her any other unique identification document like voters' card, driving license etc. will be taken and she/ he will be helped to obtain Aadhar card as soon as possible. This data will be such that it can be used to analyse impact of the benefits on her/his economic status at a later stage.

Task Force constituted at ULB level will scrutinize the applications based on experience, skills, viability of Scheduled commercial banks (SCBs) which are on the Core Banking Solution (CBS) platform would be eligible activity, scope of the activity etc. Thereafter, the Task Force will shortlist the applications and call for interview of the applicants before recommending or rejecting the application or call for additional information from the applicant, if required.

Procedure for Sanction of Loans by banks

The cases recommended by the task force will be forwarded by the ULB to the concerned banks for further processing. Such cases have to be processed by concerned banks within a time frame of 15 days. Any rejection of such cases by banks has to be only in exceptional circumstances. Banks will send a periodic report to the ULB on the status of the applications received.

Banks can also directly accept the loan applications of urban poor beneficiaries on the basis of relevant documents as per the guidelines of Prime Minister MUDRA Yojana (PMMY) or any other such scheme without the need of having prior sponsoring from ULB.

The banks can send details of such loans sanctioned by them to ULBs for confirmation of their eligibility for interest subsidy under DAY-NULM. The subsidy will be transferred directly to the loan account of DAY-NULM beneficiaries. This procedure will also be direct benefit transfer compliant.

Financial Assistance

- The financial assistance will be in the form of Interest subsidy on the bank loans.
- Interest subsidy, over and above 7% rate of interest will be available on a bank loan for setting up of individual or group enterprises. The difference between 7% p.a. and the rate of interest charged by the bank will be provided to banks under DAY-NULM.
- Interest subsidy will be given only in case of timely repayment of loan. Suitable certification from banks will be obtained in this regard.
- An additional 3% interest subvention will be provided to all Women Self Help Groups (WSHGs) who repay their loan in time.
- The Interest subsidy will be subject to timely repayment of the loan (as per the loan repayment schedule) and suitable certification obtained from banks by the ULB.
- The additional 3% interest subvention amount will be reimbursed to the eligible WSHGs. The banks should credit the amount of 3% interest subvention to the eligible WHSGs accounts and thereafter seek the reimbursement.

PRADHAN MANTRI AWAS YOJANA

A. Pradhan Mantri Awas Yojana - Urban

Introduction

"Housing for All" Mission for urban area is being implemented during 2015-2022 and this Mission will provide central assistance to implementing agencies through States and UTs for providing houses to all eligible families/ beneficiaries by 2022. Pradhan Mantri Awas Yojana (Urban) [PMAY(U)] is being implemented as Centrally Sponsored Scheme (CSS) except for the component of credit linked subsidy which will be implemented as a Central Sector Scheme. Mission with all its components has become effective from the date 17.06.2015 and will be implemented up to 31.03.2022.

Eligibility condition for Beneficiaries

A beneficiary family will comprise husband, wife, unmarried sons and/or unmarried daughters. The beneficiary family should not own a 'pucca' house either in his/her name or in the name of any member of his/her family in any part of India to be eligible to receive central assistance under the Mission.

A beneficiary family will be eligible for availing only a single benefit under any of the existing options i.e., slum redevelopment with private partner, credit linked subsidy, direct subsidy to individual beneficiary and affordable housing in partnership, as detailed in PMAY (U) guidelines.

Coverage and Duration

All Statutory Towns as per Census 2011 and towns notified subsequently are eligible for coverage under the Mission.

Role of Urban Local bodies

Urban Local Bodies should ensure that individual houses under credit linked interest subsidy should have provision for basic civic services like water, sanitation, sewerage, road, electricity etc.

The minimum size of houses constructed under the Mission under each component should conform to the standards provided in National Building Code (NBC). All houses built or expanded under the Mission should essentially have toilet facility.

The houses under the Mission should be designed and constructed to meet the requirements of structural safety against earthquake, flood, cyclone, landslides etc. conforming to the National Building Code and other relevant Bureau of Indian Standards (BIS) codes.

The houses constructed/acquired with central assistance under the Mission should be in the name of the female head of the household or in the joint name of the male head of the household and his wife, and only in cases when there is no adult female member in the family, the house can be in the name of male member of the household.

Role of SLNA

State Level Nodal Agency (SLNA) identified by State/UT for implementing the Mission will facilitate the identified eligible beneficiaries in getting approvals and documents, etc. to avail of credit linked subsidy. For identification as an EWS or LIG beneficiary under the scheme, an individual loan applicant will submit self- certificate/affidavit as proof of income.

In case a borrower who has taken a housing loan and availed of interest subvention under the scheme but later on switches to another PLI for balance transfer, such beneficiary will not be eligible to claim the benefit of interest subvention again.

Beneficiaries can take advantage under one component only.

In order that beneficiaries do not take advantage of more than one component, PLIs should take NOCs quarterly from State/UT Governments or designated agency of State/UT Governments for the list of EWS beneficiaries being given benefits under credit linked subsidy.

For enabling this process, the beneficiaries should be linked to his/her Aadhaar/ Voter ID Card/Any other unique identification Number or a certificate of house ownership from Revenue Authority of Beneficiary's native district and State/UT Government or its designated agency should furnish the NOC within 15 days of receipt of such request.

Administration and Implementation

The Programme will have a three-tier implementation structure. An inter-ministerial committee viz. Central Sanctioning and Monitoring Committee (CSMC) is constituted under the Chairpersonship of Secretary (HUPA) for implementation of the Mission, approvals there under and monitoring. A Committee of Secretary (HUPA) and Secretary (DFS) in Government of India is also constituted for monitoring the credit linked subsidy component of the Mission, giving targets to lenders etc. States/UTs are required to constitute an inter-departmental State Level Sanctioning & Monitoring Committee (SLSMC), headed by Chief Secretary, for approval of Action Plans and projects under various components of the Mission.

Each State/UT will identify a State Level Nodal Agency (SLNA) under the Mission wherein a State Level Mission Directorate will be set up for coordination of the scheme and reform-related activities. State may nominate a separate State Level Nodal Agency (SLNA) under the credit linked subsidy component of the Mission to identify, motivate and organize beneficiaries to seek housing loans.

A city level Mission for selected cities should be set up under the chairpersonship of the Mayor or Chairman of the ULB as the case may be.

Suitable grievance redressal system exits at State and City level to address the grievances in implementing the PMAY (U) Mission including CLSS for EWS/LIG from various stakeholders.

PRADHAN MANTRI AWAS YOJANA

B. Prime Minister Awas Yojana - Gramin

Background

Public housing programme in the country started with the rehabilitation of refugees immediately after independence and since then, it has been a major focus area of the Government as an instrument of poverty alleviation. Rural housing programme, as an independent programme , started with Indira Awaas Yojana (IAY) in January 1996. Although IAY addressed the housing needs in the rural areas, certain gaps were identified during the concurrent evaluations and the performance Audit by Comptroller and Auditor General (CAG) of India in 2014. These gaps, i.e., non-assessment of housing shortage, lack of transparency in selection of beneficiaries, low quality of the house and lack of technical supervision, lack of convergence, loans not availed by beneficiaries and weak the mechanism for monitoring was limiting the impact and outcomes of the programme. To address these gaps in the rural housing program and in view of Government's commitment to providing "Housing for All'' by 2022, the scheme of IAY has been re-structured into Pradhan Mantri Awaas Yojana - Gramin (PMAY-G) w.e.f. 1st April 2016.

Aims and Objectives PMAY - G

PMAY-G aims at providing a 'pucca' house, with basic amenities, to all houseless householder and those households living in kutcha and dilapidated house, by 2022. The immediate the objective is to cover 1.00 crore household living in kutcha house/dilapidated house in three years from 2016-17 to 2018- 19. The minimum size of the house has been increased to 25 sq.mt (from20sq.mt) with a hygienic cooking space. The unit assistance has been increased from Rs. 70,000 to Rs. 1.20 lakh in plains and from Rs75,000 to Rs. 1.30 lakh in hilly states, difficult areas and IAP district. The assistance for construction of toilet shall be leveraged through convergence with SBM-G, MGNREGS or any other dedicated source of funding.

Cost of assistance

The cost of unit assistance is to be shared between Central and State Government in the ratio 60:40 in plain areas and 90:10 for North Eastern State, 2 Himalayan States and 1 U.T. of Jammu & Kashmir (subject to change) 100% financing will be offered by the Central government for the construction of houses in Union Territories including the newly-formed union territory of Ladakh.

Process of identification of beneficiaries

The selection of beneficiary under PMAY - G is done by using housing deprivation parameters in the Socio Economic and Caste Census (SECC), 2011 which is to be verified by the Gram Sabhas. Using the data households that are houseless and living in 0, 1 and 2 rooms, kutcha wall and kutcha roof houses can be segregated and targeted. The Permanent Wait List so generated also ensures that the states have the ready list of the household to be covered under the scheme in the coming years (through Annual Select Lists) leading to better planning of implementation. To address grievances in beneficiary selection, an appellate process has also been put in place.

Eligible Borrowers under PMAY - G Scheduled Tribes / Scheduled Castes

- Freed bonded labourers
- Minorities and non - SC/ST rural households in the BPL category
- Widows and next-of-kin to defence personnel/paramilitary forces killed in action (irrespective of their income criteria), ex-servicemen and retirement Scheme.

Conditions for Loan

- The family applying for a loan under this scheme must include a husband, wife and child/children that are unmarried. The family must not own a pucca house
- The applicant and his family must fulfil the income criteria mandated by this scheme and has to belong to either the EWS (Economically Weaker Section), LIG (Lower Income Group), or BPL (Below Poverty Line) category
- The income of the applicant's family should be - EWS Rs. 0 to 3 lakhs and LIG 3 to Rs. 6 lakhs
- Any loan amount above Rs.6 lakh, the interest rate on the additional amount will be as per market rate.

Excluded category of persons

The following candidates who apply for a loan are excluded:

Candidates that

- have a motorised two-wheeler / three wheeler/four wheeler/refrigerator
- have fishing boat
- have a mechanised three-wheeler / four wheeler agricultural equipment
- have Kisan Credit Card (KCC) with a limit greater or equal to Rs.50,000 Any household that has at least
- one member that is employed with the government
- one member earning more than Rs.10,000 a month
- pays income tax/professional tax
- a landline phone connection.

Benefit under PMAY – G

Home loans obtained under PMAY - G are eligible for a 3% concession on interest rates on housing loans of up to Rs.2 lakh.

STAND-UP INDIA SCHEME (FOR FINANCING SC / ST AND / OR WOMEN ENTREPRENEURS)

Background

Women in India had always faced problems in many social, professional and entrepreneurial fronts. It is more so in the case of women of SC/ST category. In order to assist such women who, have entrepreneurship qualities in them, Government of India, introduced "Stand Up India'. This scheme helps to promote entrepreneurship spirit among women, especially SC & ST category i.e., those sections of the population facing significant hurdles due to lack of advice/mentorship as well as inadequate and delayed credit.

STAND UP India
Endeavour and Prosper

The intention of the scheme to leverage the institutional credit structure to reach out to these SC/ST women in starting greenfield enterprises to empower them economically. It caters to both experienced and new (trainee) borrowers. The Stand-Up India scheme is based on recognition of the challenges faced by SC, ST and women entrepreneurs in setting up enterprises, obtaining loans and other support needed from time to time for succeeding in business. The scheme therefore hopes to create a climate of enabling system which facilitates and continue to extend support measures for doing business activities by such SC/ST women.

Stand-up India scheme in addition to providing financial support also incorporates hand-holding support to the potential borrowers. Thus, it provides for convergence with Central/State Government schemes. The Stand-Up India scheme has been extended up to Financial year 2025.

Objective

To facilitate bank loans between 10 lakh and 1 Crore to at least one Scheduled Caste (SC) or Scheduled Tribe (ST) borrower and at least one-woman borrower per bank branch for setting up a greenfield enterprise. This enterprise may belong to manufacturing, services or the trading sector. In case of other than individuals, i.e., enterprises, at least 51% of the shareholding and controlling stake of such enterprises should be held by either an SC/ST or Woman entrepreneur.

Eligibility

1. SC/ST and/or woman entrepreneurs, above 18 years of age.
2. The loan is available for only green field project, that is, to say a first-time venture of the beneficiary in the manufacturing or services or trading sector.
3. In case of non-individuals such as other legal entities, 51% of the shareholding and controlling stake should be held by either SC/ST and/or Women Entrepreneur.
4. Borrower should not be a defaulter with any bank/financial institution.

Coverage and access to loans

The scheme is available to all branches of Scheduled Commercial Banks. The scheme, will be accessed in any of the three potential ways:

- Directly at the branch or
- Through SIDBI's Stand-Up India portal
- The Lead District Manager (LDM) - under the Lead Bank Scheme.

A potential borrower can register on the portal directly which can be accessed at home, at Common Service Centers (CSCs), through a bank branch (through the nodal officer for MUDRA at the branch) or through the LDM. or through an internet access point facility.

Approach and assistance to women borrowers

The borrowers are assessed based on the response to following parameters, for guidance handholding right from the initial stage.

1. Location of the borrower.
2. Category - SC/ ST/ Woman.
3. Nature of business planned.
4. Availability of place to operate the business.
5. Assistance needed for preparing a project plan.
6. Requirement of skills/training (technical and financial).
7. Details of present bank account.
8. Amount of own investment into the project.
9. Whether help is needed to raise margin money.
10. Any previous experience in business.

Based on the response, the portal provides relevant feedback and helps in categorizing the visitor to the portal as a ready borrower or a trainee borrower.

Ready Borrower

1. In case the borrower who requires no guidance, then registration on the portal as itself starts the process of application for the loan at the selected bank. While registering an application number will be generated and information about the borrower shared with the bank concerned, the LDM (posted in each district) and the relevant linked office of NABARD/ SIDBI. The offices of SIDBI and NABARD shall be designated Stand-Up Connect Centers (SUCC). The loan application will now be generated and tracked through the portal.
2. Trainee Borrower (*New borrower*)

   Where the borrower requires need for handholding, then the borrower will be registered as a Trainee Borrower on the portal which will link the borrower to the LDM of the concerned district and the relevant office of SIDBI/ NABARD. This process can be done through internet at borrower's home, or at a CSC or through a bank branch by the officer dealing with MUDRA cases.

Support will be arranged by SIDBI (79 offices) and NABARD (503 offices) through Stand-Up India Connect Centers. The trainee will be given support as per request in one or more of the following ways:

a. Financial training - at the Financial Literacy Centers (FLCs).

b. Skilling - at skilling centers (Vocational Training Centers - VTPs/ Other Centers -OCs).

c. EDPs - at MSME DIs/ District Industries Centers (DICs)/ Rural Self Employment Training Institutes (RSETIs).

d. Factory/ work shed - DICs.

e. Margin money - e.g., State SC Finance Corporation, Women's Development Corporation, State Khadi & Village Industries Board (KVIB), MSME-DIs etc.

f. For mentoring support - DICCI, Women Entrepreneur Associations, Trade bodies, well established NGOs.

g. For utility connections - Offices of utility providers.

h. Detailed Project Reports - Project profiles available with SIDBI/ NABARD/ DICs.

If an applicant requires any assistance even after the loan has been sanctioned, they may access the services of the Stand-Up Connect Centers.

Nature of Loan

Composite loans (which includes term loan and working capital) between Rs.10 lakh and up to Rs.100 lakh as per requirement.

Purpose of Loan

For setting up a new ventures/ enterprise in manufacturing, trading or services sector by SC/ST/Women entrepreneur.

Size of Loan

Loan size will be85% of the project cost including term loan and working capital. If the borrower's margins exceed 15% then loan size will be accordingly be lessened.

Interest Rate

The minimum applicable rate of the bank for that rated category of borrower. Interest not to exceed (MCLR + 3%+ tenor premium according to individual bank's rate structure.

Security and Risk coverage

Besides primary security plus collateral security or guarantee of Credit Guarantee Fund Scheme for Stand-Up India Loans (CGFSIL) as decided by the banks from time to time.

Repayment

The loan is repayable in 7 years with a maximum moratorium period of 18 months.

Working Capital

Working capital up to Rs.10 lakh will be by way of way of overdraft. Any working capital loan exceeding Rs. 10 lakhs will be through Cash Credit limit. Banks can also issue RuPay debit card for the convenience of the borrower.

Margin Money

As per scheme 15% margin money to be brought in by the borrower. This can be provided in convergence with eligible Central / State schemes. While such schemes can be drawn upon for availing admissible subsidies or for meeting margin money requirements, in all cases, the borrower shall be required to bring in minimum of 10% of the project cost as own contribution.

A list of Central / State wise subsidy/incentive schemes is provided on the SIDBI Portal. This can be used by borrowers to secure subsidies. New schemes will be added as they become available to this portal.

LESSON ROUND-UP

- For the economic upliftment, poverty alleviation, creation of employment opportunities, elimination of social inequities of people of India, Government of India has launched several credit linked and social security based schemes such as Prime Ministers Employment Generation Programme (PMEGP), Deendayal Antyodaya Yojana (DAY) - National Rural Livelihood Mission (NRLM) & National Urban Livelihood Mission (MULM), Differential Rate of Interest Scheme, Scheme for Rehabilitation of Manual Scavengers (SRMS) 2013, Pradhan Mantri Jana DhanYojna (PMJDY), Micro Units Development and Refinance Agency (MUDRA) Bank Yojana, Pradhan Mantri Awas Yojana (Urban), Pradhan Mantri Awas

Yojana - Gramin, Start-up India Scheme, Sukanya Samriddhi Account, Pradhan Mantri Jeevan Jyoti Bima Yojana. (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), Atal Pension Yojana (APY), Pradhan Mantri Fasal Bima Yojana. (PMFBY).

- PMJDY was launched on 28.08.2014, is a National Mission for Financial Inclusion to ensure access to banking / savings and deposit accounts, Remittance, Credit, Pension, Insurance in an affordable manner to those who were excluded from main stream banking. The scheme started off "Basic Banking Accounts" with overdraft facility of Rs. 5000 after 6 months and RuPay Debit card with inbuilt accident insurance cover of Rs. 1lakh and RuPay Kisan card.
- Under Prime Minister's Mudra Yojana (PMMY) has been formulated in the year 2015 to provide financial assistance to eligible entrepreneurs in the SME sector to obtain collateral free financial assistance from banks from Rs. 50,000 to Rs. 10 lakhs by MUDRA loans are provided for income generating small business activity in manufacturing, processing, and service sector or trading. The Project cost is decided based on business plan and the investment proposed. MUDRA loan is not for consumption/ personal needs.
- Sukanya Samriddhi Account Yojana is Government of India backed savings scheme targeted at the parents of girl children. It is a Girl Child Prosperity Account. The scheme encourages parents to build a fund for the future education and marriage expenses for their female child. The scheme was launched in 2015.
- Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) is a Government of India backed Life Insurance Scheme for the benefit of weaker sections of the society. Life cover of Rs. 2.00 lac is available at a yearly premium of Rs. 330 and is renewable every year. The scheme is available to people in the age group of 18 to 50 years, life cover up to age of 55.
- Pradhan Mantri Suraksha Bima Yojana (PMSBY) is another Government of India backed personal accident insurance cover at a nominal premium of Rs. 12 per year providing an insurance cover of Rs.2 lac in the event of death. Bank account holders between age of 18 and 70 in participating banks are eligible.
- Atal Pension Yojana covers people employed in the unorganized sectors in India who are denied of social security benefits. To offer a social security and safety net Atal Pension Yojna was launched in the year 2015 covering Indian citizen workers in unorganized sector. The scheme is administered by the Pension Fund Regulatory and Development Authority (PFRDA) under the National Pension Scheme (NPS). Subscribers would receive a fixed minimum of Rs. 1000 to Rs. 5000 per month at the age of 60 years depending on their contribution
- The Government of India, in April 2016 had launched Prime Minister's Fasal Bima Yojana after rolling back the earlier insurance schemes - National Agriculture Insurance Scheme (NAIS), weather based crop insurance scheme and Modified National Agricultural Insurance Scheme (MNAIS). The main objectives of the scheme are providing financial support to farmers suffering crop loss / damage arising out of unforeseen events there by stabilizing the income of farmers to ensure their continuance in farming and protecting farmers from production risks.
- PMEGP is a central sector scheme administered by the Ministry of Micro, Small and Medium Enterprises the Scheme is being implemented by Khadi and Village Industries Commission (KVIC). At the State level, the Scheme will be implemented through State KVIC Directorates, State Khadi and Village Industries Boards (KVIBs) and District Industries Centres (DICs) and banks. The main objective is to generate employment opportunities in rural as well as urban areas of the country through setting up of new self- employment ventures/projects/micro enterprises by providing assistance in the form of subsidies to individuals, Charitable Trusts, Institutions Registered under Societies Registration Act- 1860, Self Help Groups (including those belonging to BPL provided that they have not availed benefits under any other Scheme) and Production based Co-operative Societies.

- Under DAY NRLM the principal objective is poverty reduction through building strong institutions of the poor, particularly women thereby enabling access to a range of financial services and livelihoods services. The programme is a means to strengthen women's self-help groups, the primary building block of the DAY-NRLM community institutional design. The mission provides a continuous handholding support to the institutions of poor for a period of 5-7 years till they come out of poverty. DAYNRLM has a provision for interest subvention, to cover the difference between the Lending Rate of the banks and 7%, on all credit from the banks/ financial institutions availed by women SHGs, for a maximum of Rs. 3,00,000 per SHG.
- Under DAY NULM, Ministry of Housing and Urban Poverty Alleviation (MoHUPA) Government of India, restructured the existing Swarna Jayanti Shahari Rozgar Yojana (SJSRY) and launched the National Urban Livelihoods Mission (NULM) in 2013. It was renamed as DAY MULM in 2016. The Self Employment Program (SEP) of NULM focuses on providing financial assistance through provision of interest subsidy on loans to support establishment of Individual & Group Enterprises and Self- Help Groups (SHGs) of urban poor.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Explain the documents required in PMJDY scheme?
2. Explain MUDRA Yojana in detail.
3. What do you understand by MUDRA Card?
4. What do you understand by Sukanya Samriddhi Account Yojana?
5. Explain Pradhan Mantri Jeevan Jyoti Bima Yojana in detail.
6. Explain benefits and eligibility of Atal Pension Yojana.
7. Which farmers are covered under PMFBY?
8. Explain the features of stand-up India scheme for financing SC/SC and/or women enterprises.
9. What are the criteria of margin money under stand-up India scheme for financing SC/SC and/or women enterprises?
10. Describe scheme details of Pradhan Mantri Awaas Yojana (Urban).

Consumer Protection

Lesson 8

KEY CONCEPTS

■ Consumer Protection Act ■ Consumer Protection Rules ■ National Council ■ State Council ■ District Council ■ Central Protection Authority ■ Banking Ombudsman

Learning Objectives

To understand:

- Consumer Protection
- Bodies established for Consumer Protection
- Procedures relating to filing Complaints
- Provisions of the COPRA Act, 2019
- Banking Ombudsman
- Operations of the Scheme
- Grounds for Complaint

Lesson Outline

REGULATORY FRAMEWORK

- The Consumer Protection Act, 2019
- The Consumer Protection (Consumer Disputes Redressal Commissions) Rules, 2020
- The Consumer Protection (E - Commerce) Rules, 2020
- The Ombudsman Scheme, 2006
- Ombudsman Scheme for Digital Transactions, 2019
- The Reserve Bank - Integrated Ombudsman Scheme, 2021

INTRODUCTION

The Consumer Protection Act (COPRA) was enacted in India for the first time in the year 1986 to protect the interests of consumers of goods and services. As it evolved over a period of time different sections of consumers as well as the providers of goods services were brought under it's scope. Post liberalization of economic reforms in the year 1991 and its fall out over trade and commerce in India, necessitated amendments to COPRA 1986 which was done in the year 2002. However, past two decades has seen tremendous developments in e-Commerce and online based dispensation of goods and services for which the COPRA was found to be inadequate. To address the shortcomings noticed in this back ground, the COPRA 1986 Act was repealed and replaced by The Consumer Protection Act 2019. The 2019 Act aims at safeguarding and reinforcing the rights of the consumers by establishing regulatory authorities, spelling out strict liabilities and penalties on manufacturers, various service providers including electronic service providers, misleading advertisers, and by providing additional settlement consumer disputes through mechanisms such as mediation. The new Consumer Protection Act, 2019 (COPRA 2019) had received the assent of the President of India on 9.8.2019. However, while exercising the powers conferred by sub-section (3) of section 1 of the COPRA 2019, the Central Government had fixed 20th day of July, 2020 as the 'appointed date', i.e., the date on which the provisions of the said Act came into force.

Consumer rights

The right to

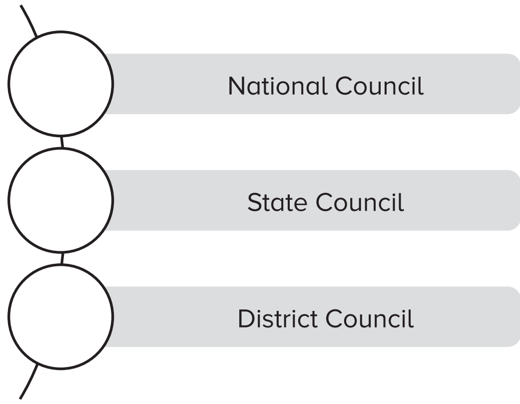
- **be protected against the marketing of hazardous goods, products or services;**
- **be informed about the quality, quantity, potency, purity, standard and price of goods, products or services, as a protection against unfair trade practices;**
- **be assured, wherever possible, access to a variety of goods, products or services at competitive prices;**
- **be heard and to be assured that consumer's interests will receive due consideration at appropriate fora;**
- **seek redressal against unfair trade practice or restrictive trade practices or unscrupulous exploitation of consumers;**
- **consumer awareness.**

The Act is applicable to the whole of India.

Various Authorities created under COPRA 19: The following is a list of various authorities created under COPRA 19:

Advisory Bodies

1. National Consumer Protection Council (National Council).
2. State Consumer Protection Council (State Council).
3. District Consumer Protection Council (District Council).



Consumer Rights Protection Authorities

1. The Central Consumer Protection Authority (Central Authority).
2. The Director-General of Investigation Wing appointed under sub-section (2) of section 15 under Central Authority known as "Director-General". (Note: District Collectors are also empowered under the Act to play the role of consumer protection authority as and when necessary).

Consumer Disputes Resolution Forum

1. The National Consumer Disputes Redressal Commission established under sub-section (1) of section 53 known as "National Commission".
2. State Consumer Disputes Redressal Commission under sub-section (1) of section 42 to be known as "State Commission".
3. District Consumer Disputes Redressal Commission under sub-section (1) of section 28 to be known as "District Commission".
4. Consumer Mediation Cell (at National/State/District Commissions).

CONSTITUTION OF CONSUMER PROTECTION COUNCILS / AUTHORITY/ REDRESSAL FORUM

Central Consumer Protection Council

(1) The Central Government shall, by notification, establish with effect from such date as it may specify in that notification, the Central Consumer Protection Council to be known as the Central Council.

(2) The Central Council shall be an advisory council and consist of the following members, namely:-

(a) the Minister-in-charge of the Department of Consumer Affairs in the Central Government, who shall be the Chairperson; and

(b) such number of other official or non-official members representing such interests as may be prescribed.

(3) The Central Council shall meet as and when necessary, but at least one meeting of the Council shall be held every year.

State Consumer Protection Council

(1) Every State Government shall, by notification, establish with effect from such date as it may specify in such notification, a State Consumer Protection Council for such State to be known as the State Council.

(2) The State Council shall be an advisory council and consist of the following members, namely:-

(a) the Minister-in-charge of Consumer Affairs in the State Government who shall be the Chairperson;

(b) such number of other official or non-official members representing such interests as may be prescribed;

(c) such number of other official or non-official members, not exceeding ten, as may be nominated by the Central Government.

(3) The State Council shall meet as and when necessary but not less than two meetings shall be held every year.

(4) The State Council shall meet at such time and place as the Chairperson may think fit and shall observe such procedure in regard to the transaction of its business, as may be prescribed.

(5) The objects of every State Council shall be to render advice on promotion and protection of consumer rights under this Act within the State.

District Consumer Protection Council

(1) The State Government shall, by notification, establish for every District with effect from such date as it may specify in such notification, a District Consumer Protection Council to be known as the District Council.

(2) The District Council shall be an advisory council and consist of the following members, namely:

(a) The Collector of the district (by whatever name called), who shall be the Chairperson; and

(b) Such number of other official and non-official members representing such interests as may be prescribed.

(3) The District Council shall meet as and when necessary but not less than two meetings shall be held every year.

(4) The District Council shall meet at such time and place within the district as the Chairperson may think fit and shall observe such procedure in regard to the transaction of its business as may be prescribed.

(5) The objects of every District Council shall be to render advice on promotion and protection of consumer rights under this Act within the district.

Adjudicating Authorities under Act

- ***Central Consumer Protection Authority***
- ***District Commission***
- ***State Commission***
- ***National Commission***

Pecuniary Jurisdiction of Commissions under Act?

- District Commission: ***does not exceed one crore rupees.***
- State Commission: ***exceeds rupees one crore, but does not exceed rupees ten crore***.
- National Commission: ***exceed rupees ten crore.***

CENTRAL CONSUMER PROTECTION AUTHORITY

(1) The Central Government shall, by notification, establish with effect from such date as it may specify in that notification, a Central Consumer Protection Authority to be known as the Central Authority to regulate matters relating to violation of rights of consumers, unfair trade practices and false or misleading advertisements which are prejudicial to the interests of public and consumers and to promote, protect and enforce the rights of consumers as a class.

(2) The Central Authority shall consist of a Chief Commissioner and such number of other Commissioners as may be prescribed, to be appointed by the Central Government to exercise the powers and discharge the functions under this Act.

(3) The headquarters of the Central Authority shall be at such place in the National Capital Region of Delhi, and it shall have regional and other offices in any other place in India as the Central Government may decide.

(4) The Central Government may, by notification, make rules to provide for the qualifications for appointment, method of recruitment, procedure for appointment, term of office, salaries and allowances, resignation, removal and other terms and conditions of the service of the Chief Commissioner and Commissioners of the Central Authority.

(5) No act or proceeding of the Central Authority shall be invalid merely by reason of-

(a) any vacancy in, or any defect in the constitution of, the Central Authority; or

(b) any defect in the appointment of a person acting as the Chief Commissioner or as a Commissioner; or

(c) any irregularity in the procedure of the Central Authority not affecting the merits of the case.

(6) The Central Government shall provide the Central Authority such number of officers and other employees as it considers necessary for the efficient performance of its functions under this Act.

(7) The salaries and allowances payable to, and the other terms and conditions of service of, the officers and other employees of the Central Authority appointed under this Act shall be such as may be prescribed.

(8) The Central Authority may engage, in accordance with the procedure specified by regulations, such number of experts and professionals of integrity and ability, who have special knowledge and experience in the areas of consumer rights and welfare, consumer policy, law, medicine, food safety, health, engineering, product safety, commerce, economics, public affairs or administration, as it deems necessary to assist it in the discharge of its functions under this Act.

(9) The Central Authority shall regulate the procedure for transaction of its business and allocation of its business amongst the Chief Commissioner and Commissioners as may be specified by r egulations.

(10) The Chief Commissioner shall have the powers of general superintendence, direction and control in respect of all administrative matters of the Central Authority:

(11) The Central Authority shall have an Investigation Wing headed by a Director- General for the purpose of conducting inquiry or investigation under this Act as may be directed by the Central Authority.

(12) The Central Government may appoint a Director-General and such number of Additional Director-General, Director, Joint Director, Deputy Director and Assistant Director, from amongst persons who have experience in investigation and possess such qualifications, in such manner, as may be prescribed.

(13) Every Additional Director-General, Director, Joint Director, Deputy Director and Assistant Director shall exercise his powers, and discharge his functions, subject to the general control, supervision and direction of the Director-General.

(14) The Director-General may delegate all or any of his powers to the Additional Director-General or Director, Joint Director or Deputy Director or Assistant Director, as the case may be, while conducting inquiries or investigations under this Act.

(15) The inquiries or the investigations made by the Director- General shall be submitted to the Central Authority in such form, in such manner and within such time, as may be specified by regulations.

(16) The District Collector (by whatever name called) may, on a complaint or on a reference made to him by the Central Authority or the Commissioner of a regional office, inquire into or investigate complaints regarding violation of rights of consumers as a class, on matters relating to violations of consumer rights, unfair trade practices and false or misleading advertisements, within his jurisdiction and submit his report to the Central Authority or to the Commissioner of a regional office, as the case may be.

(17) A complaint relating to violation of consumer rights or unfair trade practices or false or misleading advertisements which are prejudicial to the interests of consumers as a class, may be forwarded either in writing or in electronic mode, to any one of the authorities, namely, the District Collector or the Commissioner of regional office or the Central Authority.

(18) The Central Authority shall-

(a) protect, promote and enforce the rights of consumers as a class, and prevent violation of consumers rights under this Act;

(b) prevent unfair trade practices and ensure that no person engages himself in unfair trade practices;

(c) ensure that no false or misleading advertisement is made of any goods or services which contravenes the provisions of this Act or the rules or regulations made there under;

(d) ensure that no person takes part in the publication of any advertisement which is false or misleading;

(e) inquire or cause an inquiry or investigation to be made into violations of consumer rights or unfair trade practices, either suo motu or on a complaint received or on the directions from the Central Government;

(f) file complaints before the District Commission, the State Commission or the National Commission, as the case may be, under this Act;

(g) intervene in any proceedings before the District Commission or the State Commission or the National Commission, as the case may be, in respect of any allegation of violation of consumer rights or unfair trade practices;

(h) review the matters relating to, and the factors inhibiting enjoyment of, consumer rights, including safeguards provided for the protection of consumers under any other law for the time being in force and recommend appropriate remedial measures for their effective implementation;

(i) recommend adoption of international covenants and best international practices on consumer rights to ensure effective enforcement of consumer rights;

(j) undertake and promote research in the field of consumer rights;

(k) spread and promote awareness on consumer rights;

(l) encourage non-Governmental organisations and other institutions working in the field of consumer rights to co-operate and work with consumer protection agencies;

(m) mandate the use of unique and universal goods identifiers in such goods, as may be necessary, to prevent unfair trade practices and to protect consumers' interest;

(n) issue safety notices to alert consumers against dangerous or hazardous or unsafe goods or services;

(o) advise the Ministries and Departments of the Central and State Governments on consumer welfare measures;

(p) issue necessary guidelines to prevent unfair trade practices and protect consumers' interest.

The Central Authority may, after receiving any information or complaint or directions from the Central Government or of its own motion, conduct or cause to be conducted a preliminary inquiry as to whether there exists a prima facie case of violation of consumer rights or any unfair trade practice or any false or misleading advertisement, by any person, which is prejudicial to the public interest or to the interests of consumers and if it is satisfied that there exists a prima facie case, it shall cause investigation to be made by the Director-General or by the District Collector.

Where, after preliminary inquiry, the Central Authority is of the opinion that the matter is to be dealt with by a Regulator established under any other law for the time being in force, it may refer such matter to the concerned Regulator along with its report. For the purposes of investigation, the Central Authority, the Director General or District Collector may call to produce any document or record in his possession.

Where the Central Authority is satisfied on the basis of investigation that there is sufficient evidence to show violation of consumer rights or unfair trade practice by a person, it may pass such order as may be necessary, including -

(a) recalling of goods or withdrawal of services which are dangerous, hazardous or unsafe;

(b) reimbursement of the prices of goods or services so recalled to purchasers of such goods or services; and

(c) discontinuation of practices which are unfair and prejudicial to consumers' interest.

Provided that the Central Authority shall give the person an opportunity of being heard before passing an order under this section.

Where the Central Authority is satisfied after investigation that any advertisement is false or misleading and is prejudicial to the interest of any consumer or is in contravention of consumer rights, it may, by order, issue directions to the concerned trader or manufacturer or endorser or advertiser or publisher, as the case may be, to discontinue such advertisement or to modify the same in such manner and within such time as may be specified in that order.

While determining the penalty under this section, regard shall be had to the following, namely:-

(a) the population and the area impacted or affected by such offence;

(b) the frequency and duration of such offence;

(c) the vulnerability of the class of persons likely to be adversely affected by such offence; and

(d) the gross revenue from the sales effected by virtue of such offence.

The Central Authority shall give the person an opportunity of being heard before an order under this section is passed.

For the purpose of conducting an investigation under the Act, the Director-General or any other officer authorised by him in this behalf, or the District Collector, as the case may be, may, if he has any reason to believe that any person has violated any consumer rights or committed unfair trade practice or causes any false or misleading advertisement to be made, shall;

(a) enter at any reasonable time into any such premises and search for any document or record or article or any other form of evidence and seize such document, record, article or such evidence;

(b) make a note or an inventory of such record or article; or

(c) require any person to produce any record, register or other document or article.

The provisions of the Code of Criminal Procedure, 1973, relating to search and seizure shall apply, as far as may be, for search and seizure under this Act.

Every document, record or article seized shall be returned to the person, from whom they were seized or who produced the same, within a period of twenty days of the date of such seizure or production, as the case may be, after copies thereof or extracts there from certified by that person, in such manner as may be prescribed, have been taken.

Where any article seized are subject to speedy or natural decay, the Director-General or such other officer may dispose of the article in such manner as may be prescribed.

Any person aggrieved by any order passed by the Central Authority under this Act may file an appeal to the National Commission within a period of thirty days from the date of receipt of such order.

The Central Government may, after due appropriation made by Parliament by law in this behalf, make to the Central Authority grants of such sums of money as that Government may think fit for being utilised for the purposes of this Act.

The Central Authority shall maintain proper accounts and other relevant records and prepare an annual statement of accounts in such form and manner as may be prescribed in consultation with the Comptroller and Auditor-General of India.

The accounts of the Central 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 Central Authority to the Comptroller and Auditor-General of India. The Comptroller and Auditor- General of India or any other person appointed by him in connection with the audit of the accounts of the Central Authority shall have the same rights, privileges and authority in connection with such audit as the Comptroller and Auditor-General of India generally has, in connection with the audit of the Government accounts and, in particular, shall have the right to demand the production of books, accounts, connected vouchers and other documents and papers and to inspect any of the offices of the Central Authority.

The accounts of the Central 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 which shall cause the same to be laid before each House of Parliament.

The Central Authority shall prepare once in every year, in such form, manner and at such time as may be prescribed, an annual report giving full account of its activities during the previous year and such other reports and returns, as may be directed, and copies of such report and returns shall be forwarded to the Central Government. A copy of such annual report shall be laid, as soon as may be after it is received, before each House of Parliament.

Consumer Protection (Jurisdiction of the District Commission, the State Commission and the National Commission) Rules, 2021 *VND* 30th December, 2021

- District Commission: ***does not exceed fifty lakh rupees.***
- State Commission: ***exceeds fifty lakh but does not exceed two crore rupees.***
- National Commission: ***exceed two crore rupees.***

Procedure for filing the complaint before Consumer Commission?

A complaint:

- Should be in writing
- Can be filed in a regular way (offline)
- Can be filed online – *http://edaakhil.nic.in/*

A complaint can be presented by the complainant in person or by his agent. It can even be sent by registered post along with the court fee.

Normally three copies of the complaint are required to be submitted out of which one retained for the official purpose, one is forwarded to the opposite party and one is the for the complainant. In case the number of opposite parties is more correspondingly more copies of the complaint are required.

District Consumer Disputes Redressal Commission

The State Government shall, by notification, establish a District Consumer Disputes Redressal Commission, to be known as the District Commission, in each district of the State.

Provided that the State Government may, if it deems fit, establish more than one District Commission in a district.

Each District Commission shall consist of-

(a) a President; and

(b) not less than two and not more than such number of members as may be prescribed, in consultation with the Central Government.

The Central Government may, by notification, make rules to provide for the qualifications, method of recruitment, procedure for appointment, term of office, resignation and removal of the President and members of the District Commission.

The State Government may, by notification, make rules to provide for salaries and allowances and other terms and conditions of service of the President, and members of the District Commission.

If, at any time, there is a vacancy in the office of the President or member of a District Commission, the State Government may, by notification, direct-

(a) any other District Commission specified in that notification to exercise the jurisdiction in respect of that district also; or

(b) the President or a member of any other District Commission specified in that notification to exercise the powers and discharge the functions of the President or member of that District Commission also.

The State Government shall provide the District Commission with such officers and other employees as may be required to assist the District Commission in the discharge of its functions. The officers and other employees of the District Commission shall discharge their functions under the general superintendence of the President of the District Commission. The salaries and allowances payable to, and the other terms and conditions of service of, the officers and other employees of the District Commission shall be such as may be prescribed.

The District Commission shall have jurisdiction to entertain complaints where the value of the goods or services paid as consideration does not exceed one crore rupees.

Provided that where the Central Government deems it necessary so to do, it may prescribe such other value, as it deems fit.

A complaint shall be instituted in a District Commission within the local limits of whose jurisdiction,

(a) the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, ordinarily resides or carries on business or has a branch office or personally works for gain; or any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office, or personally works for gain, provided that in such case the permission of the District Commission is given; or

(b) the cause of action, wholly or in part, arises; or

(c) the complainant resides or personally works for gain.

The District Commission shall ordinarily function in the district headquarters and may perform its functions at such other place in the district, as the State government may, in consultation with the State Commission, notify in the Official Gazette from time to time. A complaint, in relation to any goods sold or delivered or agreed to be sold or delivered or any service provided or agreed to be provided, may be filed with a District Commission by-

(a) the consumer,

    (i) to whom such goods are sold or delivered or agreed to be sold or delivered or such service is provided or agreed to be provided; or

    (ii) who alleges unfair trade practice in respect of such goods or service;

(b) any recognised consumer association, whether the consumer to whom such goods are sold or delivered or agreed to be sold or delivered or such service is provided or agreed to be provided, or who alleges unfair trade practice in respect of such goods or service, is a member of such association or not;

(c) one or more consumers, where there are numerous consumers having the same interest, with the permission of the District Commission, on behalf of, or for the benefit of, all consumers so interested; or

(d) the Central Government, the Central Authority or the State Government, as the case may be.

Provided that the complaint under this sub-section may be filed electronically in such manner as may be prescribed.

Explanation- For the purposes of this sub-section, “recognised consumer association” means any voluntary consumer association registered under any law for the time being in force.

Every complaint filed shall be accompanied with such fee and payable in such manner, including electronic form, as may be prescribed.

Every proceeding before the District Commission shall be conducted by the President of that Commission and at least one member thereof, sitting together:

Provided that where a member, for any reason, is unable to conduct a proceeding till it is completed, the President and the other member shall continue the proceeding from the stage at which it was last heard by the previous member.

On receipt of a complaint the District Commission may, by order, admit the complaint for being proceeded with or reject the same.

Provided that a complaint shall not be rejected unless an opportunity of being heard has been given to the complainant.

Provided further that the admissibility of the complaint shall ordinarily be decided within twenty-one days from the date on which the complaint was filed.

Where the District Commission does not decide the issue of admissibility of the complaint within the period so specified, it shall be deemed to have been admitted.

Where the parties agree for settlement by mediation and give their consent in writing, the District Commission shall, within five days of receipt of such consent, refer the matter for mediation. The District Commission shall, on admission of a complaint, or in respect of cases referred for mediation on failure of settlement by mediation, proceed with such complaint.

Where the complaint relates to any goods, the District Commission shall -

(a) refer a copy of the admitted complaint, within twenty-one days from the date of its admission to the opposite party mentioned in the complaint directing him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days as may be granted by it;

(b) if the opposite party on receipt of a complaint referred to him under clause (a) denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Commission, proceed to settle the consumer dispute;

(c) if the complaint alleges a defect in the goods which cannot be determined without proper analysis or test of the goods, obtain a sample of the goods from the complainant, seal it and authenticate it in the manner as may be prescribed and refer the sample so sealed to the appropriate laboratory along with a direction that such laboratory to make an analysis or test, whichever may be necessary, with a view to finding out whether such goods suffer from any defect alleged in the complaint or from any other defect and to report its findings thereon to the District Commission within a period of forty-five days of the receipt of the reference or within such extended period as may be granted by it;

(d) before any sample of the goods is referred to any appropriate laboratory under clause (c), require the complainant to deposit to the credit of the Commission such fees as may be specified, for payment to the appropriate laboratory for carrying out the necessary analysis or test in relation to the goods in question;

(e) remit the amount deposited to its credit under clause (d) to the appropriate laboratory to enable it to carry out the analysis or test mentioned in clause (c) and on receipt of the report from the appropriate laboratory, it shall forward a copy of the report along with such remarks as it may feel appropriate to the opposite party;

(f) if any of the parties disputes the correctness of the findings of the appropriate laboratory, or disputes the correctness of the methods of analysis or test adopted by the appropriate laboratory, require the opposite party or the complainant to submit in writing his objections with regard to the report made by the appropriate laboratory;

(g) give a reasonable opportunity to the complainant as well as the opposite party of being heard as to the correctness or otherwise of the report made by the appropriate laboratory and also as to the objection made in relation thereto.

If the foregoing procedures cannot the adopted by the District Commission in case of the complaint admitted by it in relation to goods or if the complaint relates to any services, it shall -

(a) refer a copy of such complaint to the opposite party directing him to give his version of the case within a period of thirty days or such extended period not exceeding fifteen days as may be granted by the District Commission; and

(b) if the opposite party, on receipt of a copy of the complaint, referred to him under clause (a) denies or disputes the allegations contained in the complaint, or omits or fails to take any action to represent his case within the time given by the District Commission, it shall proceed to settle the consumer dispute

(i) on the basis of evidence brought to its notice by the complainant and the opposite party, if the opposite party denies or disputes the allegations contained in the complaint; or

(ii) ex parte on the basis of evidence brought to its notice by the complainant, where the opposite party omits or fails to take any action to represent his case within the time given by the Commission.

(c) decide the complaint on merits if the complainant fails to appear on the date of hearing.

The District Commission may, by order, require an electronic service provider to provide such information, documents or records, as may be specified in that order.

Every complaint shall be heard by the District Commission on the basis of affidavit and documentary evidence placed on record:

Provided that where an application is made for hearing or for examination of parties in person or through video conferencing, the District Commission may, on sufficient cause being shown, and after recording its reasons in writing, allow the same.

Every complaint shall be disposed of as expeditiously as possible and endeavor shall be made to decide the complaint within a period of three months from the date of receipt of notice by opposite party where the complaint does not require analysis or testing of commodities and within five months if it requires analysis or testing of commodities.

No adjournment shall ordinarily be granted by the District Commission unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by the Commission. The District Commission shall make such orders as to the costs occasioned by the adjournment as may be specified by regulations. In the event of a complaint being disposed of after the period so specified, the District Commission shall record in writing, the reasons for the same at the time of disposing of the said complaint.

Where during the pendency of any proceeding before the District Commission, if it appears necessary, it may pass such interim order as is just and proper in the facts and circumstances of the case and the District Commission shall have the same powers as are vested in a civil court under the Code of Civil Procedure, 1908 while trying a suit in respect of the following matters, namely:

(a) the summoning and enforcing the attendance of any defendant or witness and examining the witness on oath;

(b) requiring the discovery and production of any document or other material object as evidence;

(c) receiving of evidence on affidavits;

(d) the requisitioning of the report of the concerned analysis or test from the appropriate laboratory or from any other relevant source;

(e) issuing of commissions for the examination of any witness, or document; and

(f) any other matter which may be prescribed by the Central Government.

In the event of death of a complainant who is a consumer or of the opposite party against whom the complaint has been filed, the provisions of Order XXII of the First Schedule to the Code of Civil Procedure, 1908 shall apply subject to the modification that every reference therein to the plaintiff and the defendant shall be construed as reference to a complainant or the opposite party, as the case may be.

Where the District Commission is satisfied that the goods complained against suffer from any of the defects specified in the complaint or that any of the allegations contained in the complaint about the services or any unfair trade practices, or claims for compensation under product liability are proved, it shall issue an order to the opposite party directing him to do one or more of the following, namely:

(a) to remove the defect pointed out by the appropriate laboratory from the goods in question;

(b) to replace the goods with new goods of similar description which shall be free from any defect;

(c) to return to the complainant the price, or, as the case may be, the charges paid by the complainant along with such interest on such price or charges as may be decided;

(d) to pay such amount as may be awarded by it as compensation to the consumer for any loss or injury suffered by the consumer due to the negligence of the opposite party:

Provided that the District Commission shall have the power to grant punitive damages in such circumstances as it deems fit;

(e) to pay such amount as may be awarded by it as compensation in a product liability action;

(f) to remove the defects in goods or deficiencies in the services in question;

(g) to discontinue the unfair trade practice or restrictive trade practice and not to repeat them;

(h) not to offer the hazardous or unsafe goods for sale;

(i) to withdraw the hazardous goods from being offered for sale;

(j) to cease manufacture of hazardous goods and to desist from offering services which are hazardous in nature;

(k) to pay such sum as may be determined by it, if it is of the opinion that loss or injury has been suffered by a large number of consumers who are not identifiable conveniently:

Provided that the minimum amount of sum so payable shall not be less than twenty-five per cent. of the value of such defective goods sold or service provided, as the case may be, to such consumers;

(l) to issue corrective advertisement to neutralise the effect of misleading advertisement at the cost of the opposite party responsible for issuing such misleading advertisement;

(m) to provide for adequate costs to parties; and

(n) to cease and desist from issuing any misleading advertisement.

In any proceeding conducted by the President and a member and if they differ on any point or points, they shall state the point or points on which they differ and refer the same to another member for hearing on such point or points and the opinion of the majority shall be the order of the District Commission:

Provided that the other member shall give his opinion on such point or points referred to him within a period of one month from the date of such reference. Every order made by the District Commission shall be signed by the President and the member who conducted the proceeding:

Provided that where the order is made as per majority opinion, such order shall also be signed by the other member.

The District Commission shall have the power to review any of the order passed by it if there is an error apparent on the face of the record, either of its own motion or on an application made by any of the parties within thirty days of such order.

Any person aggrieved by an order made by the District Commission may prefer an appeal against such order to the State Commission on the grounds of facts or law within a period of forty-five days from the date of the order, in such form and manner, as may be prescribed:

Provided that the State Commission may entertain an appeal after the expiry of the said period of forty-five days, if it is satisfied that there was sufficient cause for not filing it within that period:

Provided further that no appeal by a person, who is required to pay any amount in terms of an order of the District Commission, shall be entertained by the State Commission unless the appellant has deposited fifty per cent. of that amount in the manner as may be prescribed:

State Consumer Disputes Redressal Commission

The State Government shall, by notification, establish a State Consumer Disputes Redressal Commission, to be known as the State Commission, in the State.

The State Commission shall ordinarily function at the State capital and perform its functions at such other places as the State Government may in consultation with the State Commission notify in the Official Gazette.

Provided that the State Government may, by notification, establish regional benches of the State Commission, at such places, as it deems fit.

Each State Commission shall consist of:

(a) a President; and

(b) not less than four or not more than such number of members as may be prescribed in consultation with the Central Government.

The Central Government may, by notification, make rules to provide for the qualification for appointment, method of recruitment, procedure of appointment, term of office, resignation and removal of the President and members of the State Commission. The State Government may, by notification, make rules to provide for salaries and allowances and other terms and conditions of service of the President and members of the State Commission. The State Government shall determine the nature and categories of the officers and other employees required to assist the State Commission in the discharge of its functions and provide the Commission with such officers and other employees as it may think fit.

The officers and other employees of the State Commission shall discharge their functions under the general superintendence of the President. The salaries and allowances payable to and the other terms and conditions of service of, the officers and other employees of the State Commission shall be such as may be prescribed.

The State Commission shall have jurisdiction-

(a) to entertain-

(i) complaints where the value of the goods or services paid as consideration, exceeds rupees one crore, but does not exceed rupees ten crore:

Provided that where the Central Government deems it necessary so to do, it may prescribe such other value, as it deems fit;

(ii) complaints against unfair contracts, where the value of goods or services paid as consideration does not exceed ten crore rupees;

(iii) appeals against the orders of any District Commission within the State; and

(b) to call for the records and pass appropriate orders in any consumer dispute which is pending before or has been decided by any District Commission within the State, where it appears to the State Commission that such District Commission has exercised a jurisdiction not vested in it by law, or has failed to exercise a jurisdiction so vested or has acted in exercise of its jurisdiction illegally or with material irregularity.

The jurisdiction, powers and authority of the State Commission may be exercised by Benches thereof, and a Bench may be constituted by the President with one or more members as the President may deem fit:

Provided that the senior-most member shall preside over the Bench.

Where the members of a Bench differ in opinion on any point, the points shall be decided according to the opinion of the majority, if there is a majority, but if the members are equally divided, they shall state the point or points on which they differ, and make a reference to the President who shall either hear the point or points himself or refer the case for hearing on such point or points by one or more of the other members and such point or points shall be decided according to the opinion of the majority of the members who have heard the case, including those who first heard it:

Provided that the President or the other members, as the case may be, shall give opinion on the point or points so referred within a period of one month from the date of such reference.

A complaint shall be instituted in a State Commission within the limits of whose jurisdiction:

(a) the opposite party or each of the opposite parties, where there are more than one, at the time of the institution of the complaint, ordinarily resides or carries on business or has a branch office or personally works for gain; or

(b) any of the opposite parties, where there are more than one, at the time of the institution of the complaint, actually and voluntarily resides, or carries on business or has a branch office or personally works for gain, provided in such case, the permission of the State Commission is given; or

(c) the cause of action, wholly or in part, arises; or

(d) the complainant resides or personally works for gain.

On the application of the complainant or of its own motion, the State Commission may, at any stage of the proceeding, transfer any complaint pending before a District Commission to another District Commission within the State if the interest of justice so requires.

The State Commission shall have the power to review any of the order passed by it if there is an error apparent on the face of the record, either of its own motion or on an application made by any of the parties within thirty days of such order.

Any person aggrieved by an order made by the State Commission may prefer an appeal against such order to the National Commission within a period of thirty days from the date of the order in such form and manner as may be prescribed.

Provided that the National Commission shall not entertain the appeal after the expiry of the said period of thirty days unless it is satisfied that there was sufficient cause for not filing it within that period.

Provided further that no appeal by a person, who is required to pay any amount in terms of an order of the State Commission, shall be entertained by the National Commission unless the appellant has deposited fifty per cent. of that amount in the manner as may be prescribed. An appeal shall lie to the National Commission from any order passed in appeal by any State Commission, if the National Commission is satisfied that the case involves a substantial question of law.

In an appeal involving a question of law, the memorandum of appeal shall precisely state the substantial question of law involved in the appeal. Where the National Commission is satisfied that a substantial question of law is involved in any case, it shall formulate that question and hear the appeal on that question:

Provided that nothing shall be deemed to take away or abridge the power of the National Commission to hear, for reasons to be recorded in writing, the appeal on any other substantial question of law, if it is satisfied that the case involves such question of law. An appeal may lie to the National Commission from an order passed ex parte by the State Commission.

An appeal filed before the State Commission or the National Commission, as the case may be, shall be heard as expeditiously as possible and every endeavor shall be made to dispose of the appeal within a period of ninety days from the date of its admission:

Provided that no adjournment shall ordinarily be granted by the State Commission or the National Commission, as the case may be, unless sufficient cause is shown and the reasons for grant of adjournment have been recorded in writing by such Commission. The State Commission or the National Commission, as the case may be, shall make such orders as to the costs occasioned by the adjournment, as may be specified by regulations. In the event of an appeal being disposed of after the period so specified, the State Commission or the National Commission, as the case may be, shall record in writing the reasons for the same at the time of disposing of the said appeal.

National Consumer Disputes Redressal Commission

The Central Government shall, by notification, establish a National Consumer Disputes Redressal Commission, to be known as the National Commission.

The National Commission shall ordinarily function at the National Capital Region and perform its functions at such other places as the Central Government may in consultation with the National Commission notify in the Official Gazette.

Provided that the Central Government may, by notification, establish regional Benches of the National Commission, at such places, as it deems fit.

The National Commission shall consist of-

(a) a President; and

(b) not less than four and not more than such number of members as may be prescribed.

The Central Government may, by notification, make rules to provide for qualifications, appointment, term of office, salaries and allowances, resignation, removal and other terms and conditions of service of the President and members of the National Commission:

Provided that the President and members of the National Commission shall hold office for such term as specified in the rules made by the Central government but not exceeding five years from the date on which he enters upon his office and shall be eligible for re-appointment. No President or members shall hold office as such after he has attained such age as specified in the rules made by the Central Government which shall not exceed:

(a) in the case of the President, the age of seventy years;

(b) in the case of any other member, the age of sixty-seven years.

Mediation

The State Government shall establish, by notification, a consumer mediation cell to be attached to each of the District Commissions and the State Commissions of that State. The Central Government shall establish, by notification, a consumer mediation cell to be attached to the National Commission and each of the regional Benches. A consumer mediation cell shall consist of such persons as may be prescribed.

Every consumer mediation cell shall maintain-

(a) a list of empanelled mediators;

(b) a list of cases handled by the cell;

(c) record of proceeding; and

(d) any other information as may be spec ified by regulations. Every consumer mediation cell shall submit a quarterly report to the District Commission, State Commission or the National

Commission to which it is attached, in the manner specified by regulations. For the purpose of mediation, the National Commission or the State Commission or the District Commission, as the case may be, shall prepare a panel of mediators to be maintained by the consumer mediation cell attached to it, on the recommendation of a selection committee consisting of the President and a member of that Commission. The qualifications and experience required for empanelment as mediator, the procedure for empanelment, the manner of training empanelled mediators, the fee payable to empanelled mediator, the terms and conditions for empanelment, the code of conduct for empanelled mediators, the grounds on which, and the manner in which, empanelled mediators shall be removed or empanelment shall be cancelled and other matters relating thereto, shall be such as may be specified by regulations. The panel of mediators prepared shall be valid for a period of five years, and the empanelled mediators shall be eligible to be considered for re-empanelment for another term, subject to such conditions as may be specified by regulations. The District Commission, the State Commission or the National Commission shall, while nominating any person from the panel of mediators, consider his suitability for resolving the consumer dispute involved.

It shall be the duty of the mediator to disclose-

(a) any personal, professional or financial interest in the outcome of the consumer dispute;

(b) the circumstances which may give rise to a justifiable doubt as to his independence or impartiality; and

(c) such other facts as may be specified by regulations.

Where the District Commission or the State Commission or the National Commission, as the case may be, is satisfied, on the information furnished by the mediator or on the information received from any other person including parties to the complaint and after hearing the mediator, it shall replace such mediator by another mediator. The mediation shall be held in the consumer mediation cell attached to the District Commission, the State Commission or the National Commission, as the case may be. Where a consumer dispute is referred for mediation by the District Commission or the State Commission or the National Commission, as the case may be, the mediator nominated by such Commission shall have regard to the rights and obligations of the parties, the usages of trade, if any, the circumstances giving rise to the consumer dispute and such other relevant factors, as he may deem necessary and shall be guided by the principles of natural justice while carrying out mediation. The mediator so nominated shall conduct mediation within such time and in such manner as may be specified by regulations.

Pursuant to mediation, if an agreement is reached between the parties with respect to all of the issues involved in the consumer dispute or with respect to only some of the issues, the terms of such agreement shall be reduced to writing accordingly, and signed by the parties to such dispute or their authorised representatives.

The mediator shall prepare a settlement report of the settlement and forward the signed agreement along with such report to the concerned Commission. Where no agreement is reached between the parties within the specified time or the mediator is of the opinion that settlement is not possible, he shall prepare his report accordingly, and submit the same to the concerned Commission.

The District Commission or the State Commission or the National Commission, as the case may be, shall, within seven days (7 days) of the receipt of the settlement report, pass suitable order recording such settlement of consumer dispute and dispose of the matter accordingly. Where the consumer dispute is settled only in part, the District Commission or the State Commission or the National Commission, as the case may be, shall record settlement of the issues which have been so settled and continue to hear other issues involved in such consumer dispute. Where the consumer dispute could not be settled by mediation, the District Commission or the State Commission or the National Commission, as the case may be, shall continue to hear all the issues involved in such consumer dispute.

Product Liability

Product liability shall apply to every claim for compensation under a product liability action by a complainant for any harm caused by a defective product manufactured by a product manufacturer or serviced by a product service provider or sold by a product seller. A product liability action may be brought by a complainant against a product manufacturer or a product service provider or a product seller, as the case may be, for any harm caused to him on account of a defective product.

A product manufacturer shall be liable in a product liability action, if-

(a) the product contains a manufacturing defect; or

(b) the product is defective in design; or

(c) there is a deviation from manufacturing specifications; or

(d) the product does not conform to the express warranty; or

(e) the product fails to contain adequate instructions of correct usage to prevent any harm or any warning regarding improper or incorrect usage.

The major definitions are as under:

- A Consumer is a person who buys goods or hires services, for a price (consideration) for use and not for resale. Any user of such goods and services, with the permission of the buyer is also a consumer.
- But does not include a person who avails of such services for any commercial purposes. (for the purpose of this clause, 'commercial purpose' does not include use by a person of goods bought and used by him and services availed by him exclusively for the purpose of earning his livelihood by means of self- employment).
- All goods and services including banking, insurance, transport, processing etc. in private, public and cooperative sector are covered.
- A consumer individually or jointly, any voluntary consumer organization, central or state government can file a complaint. A complainant also means one or more consumers, where there are numerous consumers having the same interest. In case of death of a consumer, his legal heir or representative can file a complaint.
- "Complaint" means any allegation in writing made by a complainant that:

  i) An unfair trade practice or a restrictive trade practices has been adopted by any trader or a service provider.

  ii) the goods bought by him or agreed to be bought by him suffer from one or more defects.

  iii) services hired / availed / agreed to be hired / availed; suffer from deficiency in any respect.

  iv) a trader or service provider, as the case may be, has charged for the goods / services mentioned in the complaint a price in excess of the price - fixed by or under any law for the time being in force, displayed on the goods or any package containing such goods, displayed on the price list exhibited by him or under any law, agreed between the parties.

  v) goods / services which are hazardous to life and safety when used or being offered for sale to the public.
- Limitation period is 2 years from the date of cause of action. A complaint may be entertained after the period the period specified if the complainant satisfies the District Forum, The State Commission or the National Commission, as the case may be, that he had sufficient cause for not filing the complaint with in such period.

- Provided that no such complaint shall be entertained unless the National Commission, the State Commission or the District Forum, as the case may be, records its reasons for condoning such delay.
- A simple written complaint in duplicate with name and address of complainant and opposite party, facts of the case, copies of supporting documents and relief sought should be covered. A consumer should obtain proper receipt / cash memo for purchase made and guarantee / warranty card duly stamped and signed by the seller where ever applicable.
- Relief includes removal of defect from goods, removal of deficiencies from services, replacement of new goods free from defect, refund of fee / charges / price, award of compensation for loss or injury suffered, discontinuation or non-repetition of unfair and restrictive trade practices, prohibition of sale of goods of hazardous nature, providing for adequate cost to party.
- Penalty for non-compliance of orders include imprisonment for minimum one month and maximum three years or fine of minimum Rs. 2,000 and maximum Rs. 10,000 or both imprisonment and fine.
- Cost awarded against complaint is maximum of Rs. 10,000.00.
- Period for appeal is 30 days from the date of order.

Some complaints and decisions:

1. **The complaint:** Not provided with the withdrawal slip for the reason that the customer did not bring the pass-book.

   Decision: It was held that it is not deficiency of service on the part of the bank when the rules required that a pass-book is must for issue of withdrawal slip.

2. **The complaint:** Amount of Rs.1,85,000/- lying deposited in 3 FDs were claimed by the complainant in the capacity of beneficiary under registered will executed by the depositor. The bank directed the beneficiary to establish the authenticity of will before a competent court of law and to secure a succession certificate in order to make payment.

   Decision: No deficiency in service in asking the complainant to produce succession certificate for disbursement of amount of depositor who died leaving a will.

3. **The complaint:** A complaint was filed for increase in service charges levied by banks for collection of cheques, issue of demand drafts, processing of loans etc.

   Decision: Complaint dismissed as it does not fall within the provisions of COPRA, 1986.

4. **The complaint:** The salary cheques were not cleared by the service branch of the bank due to riots / disturbances in the city.

   Decision: It was held not amounting to deficiency of service on the part of the bank.

5. **The complaint:** The cheque book facility was refused to the appellant – customer on the ground that minimum balance in the account was not maintained at Rs. 250/- as required by the rules of the bank.

   Decision: There was no deficiency in service on the part of the bank in such refusal.

6. **The complaint:** A customer en-cashing cheque insisted on the payment of the amount of cheque only in the denomination of Rs. 100/- as a right and initially refused to accept payment in Rs. 50/- currency notes as offered by the cashier. Filed case against the Bank.

   Decision: No deficiency of service on the ground that the complainant had neither any legal right nor justification to refuse the payment in Rs. 50/- denominations the same being legal tender. The complaint was dismissed.

7. **The complaint:** The bank was alleged to have failed to issue bank guarantee despite sufficient security and the complainant suffered financial loss.

Decision: Non-issuance of bank guarantee despite security deposit with the bank would amount to deficiency in service.

The complainant would be entitled to interest on the security amount.

8. **The complaint**: A cheque drawn in favour of the bank itself without striking off the word bearer. Bank paid the cheque to unknown outsider considering it as bearer.

   Decision: Bank has clearly shown utter negligence in paying a huge amount Rs. 20,000/- to an unknown outsider and thus caused loss to the account holder. The customer is entitled to the loss and costs of the complaint.

9. It was held that dishonor of cheque of a customer on the ground of insufficiency of funds when the customer had sufficient balance will obviously amount to "faulty" and "imperfect" **manner of** performance of service.

   Decision: On the quantum of damages, it was found that there was a clear nexus between the default of the respondent bank and the denial of allotment of debentures to complainant and the bank is liable to compensate the loss.

10. **The complaint:** A complaint was filed by one of the account holders of the bank alleging that an amount of Rs. 95,000/- has been withdrawn from his account on the basis of a forged cheque. The said cheque was not from the cheque book issued to the account holder.

    Decision: The bank was guilty of deficiency of service in allowing withdrawal of amount on a forged cheque, which was not issued by the bank to the complainant.

11. **The complaint:** Dividend warrants were issued by respondent No.1 and were sought to be encashed by respondent No. 2, a Banker at Panjim. The appellant filed a complaint before the District Forum as the warrants were returned unpaid with the remarks, "no advice" despite a letter dispatched to them by Industrial Finance Branch of SBI, Chandigarh. Respondent no. 2 took the defense that they cannot honour dividend warrants unless they received intimation from local Head Office at Mumbai.

    Decision: The State Commission however held that refusal to clear the dividend warrants was deficiency in service as question arise in view of the letter from Industrial Finance Branch of SBI, Chandigarh. Respondent No. 2 and Respondent No. 1 were held to be jointly liable.

12. **The complaint:** In a case concerning the security at the banking premises, cash was snatched from the hands of the complainant at the gate of the respondent bank. The appellant alleges that the absence of security on the gate and the non-provision of steps like siren / alarm system etc. amounts to deficiency in service on the part of the respondent bank.

    Decision: The State Commission held that the non-provision of security on the gate of the bank on the date of occurrence, i.e., snatching of cash in bank premises cannot be held to be amounting to deficiency in service by the complainant.

13. **The complaint:** The bank charged, unilaterally without prior information or consent of the bank customer, for providing their services by supply of MICR cheque.

    Decision: Consumer Forum and State Commission held it as deficiency of service but National Commission held that it was related to pricing and therefore, not in jurisdiction of the Consumer Fora to decide. The Supreme Court held that the charges by the bank for issuance of MICR cheques, is not against the directives of RBI. The question of it, being unilateral or with the consent of each customer does not arise.

14. **The Complaint:** Consumers were claiming the market value of the goods as compensation and not the price paid by them.

    Decision: A question arose before National Commission in an appeal as to what is the ground on which the pecuniary jurisdiction of the Commission is to be decided. The Commission stated that in deciding the pecuniary jurisdiction the aggregated price of the goods and the compensation claimed must be taken into consideration and if its a class action suit then the aggregate prices of all the goods involved and the total compensation claimed must be taken into consideration in deciding the pecuniary jurisdiction of the Commission. Further clarifying, the Commission also cleared the question regarding whether the market value of the goods is to be considered or the price at which the goods were purchased by the consumer. The Commission stated that the price by the consumer must be the price that is considered. (The COPRA, 19 also prescribes the same.) The rationale of this Commission was affirmed by the Supreme Court bench in 2019. [In the case of *Rameshwar Prasad Shrivastava v. Dwarkadhin Project (P) Ltd. [(2019) 2 SCC 417]*.

THE CONSUMER PROTECTION (E-COMMERCE) RULES, 2019

In the exercise of powers conferred by sub-section (zg)(1) of section 101 of the Consumer Protection Act, 2019 (35 of 2019) the Central Government hereby makes the following rules, namely:-

1. **Short Title & Commencement -**

   (1) These rules may be called the Consumer Protection (e-Commerce) Rules, 2019.

   (2) They shall come into force on the date of their publication in the official Gazette.

2. **Definitions. -** (1) In these rules unless the context otherwise requires, -

   a) **"Act"** means the Consumer Protection Act, 2019 (35 of 2019).

   b) **"Consumer"** shall have the same meaning as provided under the Consumer Protection Act, 2019.

   c) **"E-Commerce entity"** means a company incorporated under the Companies Act, 1956 or the Companies Act, 2013 or a foreign company covered under section 2 (42) of the Companies Act, 2013 or an office, branch or agency in India as provided in Section 2 (v) (iii) of FEMA 1999, owned or controlled by a person resident outside India and includes an electronic service provider or a partnership or proprietary firm, whether inventory or market place model or both and conducting the e-Commerce business.

   Provided that "e-Commerce Entity" does not include any entity or business notified otherwise by the Government for the said purpose from time to time.

   d) **"Electronic Record"** means data, record or data generated, image or sound stored, received or sent in an electronic form or micro film or computer generated micro fiche; (as per Information Technology Act).

   e) **"Electronic Service Provider"** means a person who provides technologies or processes to enable a product seller to engage in advertising or selling of goods or services to a consumer and includes any online market place or online auction sites.

   f) **"Goods"** means goods as defined in the Sale of Goods Act, 1930.

   g) **"Inventory based model of e-Commerce"** means an e-Commerce activity where inventory of goods and services is owned by e-Commerce entity and is sold to the consumers directly.

   h) **"Information"** includes data, message, text, images, sound, voice, codes, computer programmes, software and databases or micro film or computer generated micro fiche; (as per Information Technology Act).

   i) **"Market place model of e-Commerce"** means providing of an information technology platform by an e-Commerce entity on a digital & electronic network to act as a facilitator between buyer and seller.

   j) **"Seller"** means product seller as defined in the Sale of Goods Act, 1930 and includes a Service Provider.

k) **“Service”** means Service as defined in the Consumer Protection Act, 1986.

Note: Words and expressions used in these guidelines and not defined but defined in the Consumer Protection Act, 2019 shall have the meanings respectively assigned to them in the Act.

3. General Conditions for carrying out e-Commerce business.-

CONSUMER PROTECTION (E-COMMERCE) RULES, 2020

PROVISIONS FOR E-COMMERCE FIRMS

1. Mandatory display of ‘country of origin’ on products

2. Display total price of goods &services offered for sale (+break-up of other charges)

3. Mention the ‘expiry date ‘of goods offered for sale

4. Specify details about return, refund exchange warranty and guarantee delivery and shipment

5. No manipulation of prices for unreasonable profit

6. No cancellation charges

7. Provide information on available payment methods

8. Information about the ‘sellers’ offering goods and services

9. Violation to attract penal action under con-sumer protect Act 2019

Every e-Commerce entity carrying out or intending to carry out e-Commerce business in India subsequent to the publication of this notification in the Gazette, shall, within 90 days, comply with the following set of conditions for the conduct of e-Commerce business:

i It shall be a registered legal entity under the laws of India;

ii It shall submit a self-declaration to this Department stating that it is in compliance with these Guidelines;

iii The promoter or key management personnel should not have been convicted of any criminal offence punishable with imprisonment in last 5 years by any Court of competent jurisdiction;

iv It shall comply with the provisions of Information Technology (Intermediaries Guidelines) Rules, 2011;

v Payments for sale may be facilitated by the e-Commerce entity in conformity with the guidelines of the Reserve Bank of India;

vi Details about the sellers supplying the goods and services, including identity of their business, legal name, principal geographic address, name of website, e-mail address, contact details, including clarification of their business identity, the products they sell, and how they can be contacted by customers shall be displayed in the web site.

4. Liabilities of E Commerce entity -

(1) An E-commerce Entity shall not -

i directly or indirectly influence the price of the goods or services and shall maintain a level playing field;

ii adopt any trade practice which for the purpose of promoting the sale, use or supply of any goods or for the provision of any service, or composite supply, adopts any unfair methods or unfair or deceptive practice that may influence transactional decisions of consumers in relation to products and services;

iii falsely represent themselves as consumers or post reviews about goods and services in their name; or misrepresent or exaggerate the quality or the features of goods and services.

(2) An e-Commerce Entity shall :

i) display terms of contract between e-Commerce entity and the seller relating to return, refund, exchange, warranty / guarantee, delivery / shipment, mode of payments, grievance redressal mechanism etc. to enable consumers to make informed decisions;

ii) ensure that the advertisements for marketing of goods or services are consistent with the actual characteristics, access and usage conditions of such of goods or services;

iii) mention safety and health care information of the goods and service advertised for sale;

iv) provide information on available payment methods; the security of those payment methods, how to use those methods; how to cancel regular payments under those methods; charge back options and any costs applicable to those payment methods;

v) ensure that personally identifiable information of customers are protected, and that such data collection and storage and use comply with provisions of the Information Technology (Amendment) Act, 2008;

vi) accept return of goods if delivered late from the stated delivery schedule or delivery of defective, wrong or spurious products, and/or not of the characteristics/features as advertised;

vii) effect all payments towards accepted refund requests of the customers within a period of maximum of 14 days;

viii) if the e-commerce entity is informed by the consumer or comes to know by itself or through another source about any counterfeit product being sold on its platform, and is satisfied after due diligence, it shall notify the seller and if the seller is unable to provide any evidence that the product is genuine, it shall take down the said listing and notify the consumers of the same;

ix) be held guilty of contributory or secondary liability if it makes an assurance vouching for the authenticity of the goods sold on its market place - or if it guarantees that goods are authentic.

5. **Liabilities of Sellers -** Any seller selling or advertising his products or services through an e-Commerce platform shall, **-**

   a) have prior written contract with the respective e-Commerce entity in order to undertake or solicit such sale or offer;

   b) provide all information required to be provided either by law or by any other mandatory regime for disclosing contractual information and compliance with that regime will be treated as sufficient;

   c) display single-figure total and break up price for the goods or service, that includes all compulsory charges such as delivery, postage, taxes and handling and conveyance charges;

   d) comply with mandatory display requirements as per Legal Metrology (Amendment) Rules, 2017 for pre- packaged commodities;

   e) provide mandatory safety and health care warnings and shelf life that a consumer would get at any physical point of sale;

   f) provide fair and reasonable, delivery terms, or to directly reference the shipping policy;

   g) be responsible for any warranty/guarantee obligation of goods and services sold;

   h) be upfront about how exchange, returns and refund process work, and who bears the costs of return shipping.

6. **Consumer grievance redress procedure.** - Every e-Commerce entity:

   i) Shall Publish on its website the name of the Grievance Officer and his contact details as well as mechanism by which users can notify their complaints about products and services availed through their web site;

   ii) The Grievance Officer shall redress the complaints within one month from the date of receipt of Complaint;

   iii) Provide facility to consumers to register their complaints over phone, email or website and shall provide complaint number for tracking the complaint;

   iv) Provide consumers with transparent and effective consumer protection that is not less than the level of protection offered in other forms of commerce;

   v) Provide mechanism/system to converge with NCH in grievance redressal process.

BANKING OMBUDSMAN SCHEME, 2006

Introduction and Background

The Banking Ombudsman, as a quasi-judicial authority, was introduced under section 35A of the Banking Regulation Act, 1949 by RBI with effect from 1995. The Banking Ombudsman is an official authority to investigate the complaint from the customers and address the complaint and thereby bring the solution among the aggrieved parties. So, the Banking Ombudsman plays the role of a mediator and serves the purpose of reconciliation. The Scheme is introduced with the object of enabling resolution of complaints relating to certain services rendered by banks and to facilitate the satisfaction or settlement of such complaints.

Award by the Banking Ombudsman under the Scheme:

(1) If a complaint is not settled by agreement within a period of one month from the date of receipt of the complaint or such further period as the Banking Ombudsman may allow the parties, he may, after affording the parties a reasonable opportunity to present their case, pass an Award or reject the complaint.

(2) The Banking Ombudsman shall take into account the evidence placed before him by the parties, the principles of banking law and practice, directions, instructions and guidelines issued by the Reserve Bank from time to time and such other factors which in his opinion are relevant to the complaint.

(3) The award shall state in brief the reasons for passing the award.

(4) The Award passed under Sub-Clause (1) shall contain the direction/s, if any, to the bank for specific performance of its obligations and in addition to or otherwise, the amount, if any, to be paid by the bank to the complainant by way of compensation for any loss suffered by the complainant, arising directly out of the act or omission of the bank.

(5) Notwithstanding anything contained in Sub-Clause (4), the Banking Ombudsman shall not have the power to pass an Award directing payment of an amount towards compensation which is more than the actual loss suffered by the complainant as a direct consequence of the act of omission or commission of the bank, or two million rupees whichever is lower. The compensation that can be awarded by the Banking Ombudsman shall be exclusive of the amount involved in the dispute.

(6) The Banking Ombudsman may also award compensation in addition to the above but not exceeding rupees 0.1 million to the complainant, taking into account the loss of the complainant's time, expenses incurred by the complainant, harassment and mental agony suffered by the complainant.

(7) A copy of the Award shall be sent to the complainant and the bank.

(8) An award shall lapse and be of no effect unless the complainant furnishes to the bank concerned within a period of 30 days from the date of receipt of copy of the Award, a letter of acceptance of the Award in full and final settlement of his claim. Provided that no such acceptance may be furnished by the complainant if he has filed an Appeal under Sub-Clause (1) of clause 14.

(9) The bank shall, unless it has preferred an appeal under Sub-Clause (1) of Clause 14, within one month from the date of receipt by it of the acceptance in writing of the Award by the complainant under Sub-Clause (8), comply with the Award and intimate compliance to the Banking Ombudsman.

INTERNAL OMBUDSMAN SCHEME, 2018 FOR SCHEDULED COMMERCIAL BANKS

Reserve Bank of India (RBI) had, in May 2015, advised all public-sector and select private and foreign banks to appoint Internal Ombudsman (IO) as an independent authority to review complaints that were partially or wholly rejected by the respective banks. The IO mechanism was set up with a view to strengthen the internal grievance redressal system of banks and to ensure that the complaints of the customers are redressed at the level of the bank itself by an authority placed at the highest level of bank's grievance redressal mechanism so as to minimize the need for the customers to approach other fora for redressal.

As a part of this customer-centric approach, to enhance the independence of the IO while simultaneously strengthening the monitoring system over functioning of the IO mechanism, RBI has reviewed the arrangement and issued revised directions under Section 35 A of the Banking Regulation Act, 1949 in the form of 'Internal Ombudsman Scheme, 2018'. The Scheme covers, inter-alia, appointment / tenure, roles and responsibilities, procedural guidelines and oversight mechanism for the IO.

All Scheduled Commercial Banks in India having more than ten banking outlets (excluding Regional Rural Banks), are required to appoint IO in their banks. The IO shall, inter alia, examine customer complaints which are in the nature of deficiency in service on the part of the bank, (including those on the grounds of complaints listed in Clause 8 of the Banking Ombudsman Scheme, 2006) that are partly or wholly rejected by the bank. As the banks shall internally escalate all complaints, which are not fully redressed to their respective IOs before conveying the final decision to the complainant, the customers of banks need not approach the IO directly. The implementation of IO Scheme, 2018 will be monitored by the bank's internal audit mechanism apart from regulatory oversight by RBI.

OMBUDSMAN SCHEME FOR DIGITAL TRANSACTIONS, 2019

Digital transaction in the banking industry is increasing day by day. In order to deal specifically with complaints relating to digital transaction, the RBI has introduced a separate Ombudsman Scheme for digital transactions in January 2019. The salient features of the schemes are as under:

- The scheme may be called the Ombudsman Scheme for Digital Transaction, 2019.

Grounds of Complaint

(1) Prepaid Payment Instruments: Non-adherence to the instructions of RBI by system participants about Prepaid Payment Instruments on any of the following:

a) Failure in crediting merchant's account within reasonable time;

b) Failure to load funds within reasonable time in wallets / cards;

c) Unauthorised electronic fund transfer;

d) Non-transfer / refusal to transfer / failure to transfer within reasonable time, the balance in the Prepaid Payment Instruments to the holder's 'own' bank account or back to source at the time of closure, expiry of validity period etc. of the Prepaid Payment Instrument;

e) Failure to refund within reasonable time / refusal to refund in case of unsuccessful / returned / rejected / cancelled / transactions;

f) Non-credit / delay in crediting the account of the Prepaid Payment Instrument holder as per the terms and conditions of the promotion offer(s) from time to time, if any;

g) Non-adherence to any other instruction of the RBI on Prepaid Payment Instruments.

(2) Mobile / Electronic Fund Transfers: Non-adherence to the instructions of the RBI on Mobile / Electronic fund transfers by System Participants on any of the following:

a) Failure to effect online payment /Fund transfer within reasonable time;

b) Unauthorized electronic fund transfer;

c) Failure to act upon stop payment instructions within the time frame and under the circumstances notified to the customers within prescribed timeline;

d) Failure to reverse the amount debited from customer account in cases of failed payment transactions within prescribed timeline;

e) Non-adherence to any other instruction of the RBI on mobile / Electronic fund transfers.

(3) Non-adherence to instructions of RBI / respective System Provider to System Participants, on payment instructions through Unified Payments Interface (UPI) / Bharat Bill Payment System (BBPS) / Bharat QR code / UPI QR Code on the following grounds:

a) Failure in crediting funds to the beneficiaries' account;

b) Failure to return within reasonable time the payment to the originating member in case of failure to credit the funds to the beneficiary's account;

c) Failure to / delay in refund of money back to account in case of transaction failure or decline transactions (failed transactions);

d) Non-adherence to any other instruction of the RBI on Payment transactions / through UPI / BBPS/ Bharat QR code / UPI QR Code.

(4) Non-reversal / failure to reverse within reasonable time, funds wrongly transferred to the beneficiary account due to lapse at the end of System Participant.

(5) Any other matter relating to the violation of the directives including fees / charges, if any, issued by RBI in relation to digital transactions.

The other formalities/procedures are similar to the Banking Ombudsman Scheme which is on operation and hence a separate mention has not been made about the same.

The Reserve Bank of India (RBI) has observed that many digital platforms have emerged in the financial sector claiming to offer hassle free loans to retail individuals, small traders, and other borrowers. The banks and NBFCs lending their money either directly through their own digital platforms or through a digital lending platform under an outsourcing arrangement. The Central bank said that digital delivery in credit intermediation is a welcome development, but RBI has instructed all the banks and NBFCs and said that irrespective of whether they lend through their own digital lending platform or through an outsourced lending platform, must adhere to the Fair Practices Code guidelines in letter and spirit.

Some of the cases:

Case 1

A house in the name of B. Narayanama was given on lease to a bank in1982. Subsequently, the lady died. The Bank did not pay rent from June 1992 to February 1997. Bella Ramarao, the appellant approached the bank and the Bank immediately paid amount around Rs. 3 lac. Bella contended that the interest also should be paid for the period. The bank refused to pay the interest. The appellant approached the Banking Ombudsman.

But the complaint was rejected, holding no merit in the case as it was outside the scope of scheme. Bella approached the Andhra Pradesh High Court. The High Court rejected the appeal, finding that it was outside the jurisdiction of the banking ombudsman.

Case 2

The appellant had the cash credit facility from 1994 with respondent bank and he had also issued two cheques of which one was en-cashed and the other was dishonoured. Respondent bank averred that the appellant had overdrawn account. It was held that when there was credit in favour of the complainant, dishonour of the cheque issued by the complainant could not be said to be bona fide. Respondent bank was guilty of deficiency of service and appellant was held entitled for compensation.

Case 3

The respondent was an exporter. Under discounting agreement, he entrusted documents relating to export and bills of exchange with appellant bank to negotiate the same through a foreign bank. Respondent alleged that the bank had failed to collect money in foreign currency indicated in documents but instead collected in local currency, hence there was deficiency in service on the part of the appellant bank and hence a claim for damages was made.

In appeal to the Ombudsman it was held that there was no deficiency of service on the part of the bank as appellant bank, acting for and behalf of the respondent, had negotiated the documents as provided under agreement. However the conversion of local currency in U.S. dollars became difficult on account of policy of Sudan Government. It was observed that all that was required to be done under terms of the agreement and under contract had been done by the two banks.

Case 4

The complainants had purchased a tractor after taking loan from the respondent bank. The respondent bank did not remit the premium amount to the insurance company with which complainants have insured their tractor as a result of which a loss suffered when the tractor met with an accident could not be recovered from the insurance company.

The issue for consideration is whether non-payment of premium amount by the bank amounted to deficiency in service. It was held that when hire purchase agreement between the bank and buyer of vehicle with the help of bank loan did not contain a condition creating obligation on the part of the bank to remit premium for insurance policy, complainant buyer of vehicle could not hold bank guilty of deficiency in service.

Case 5

The complainant withdrew overdraft facility sanctioned to him by the bank only after availing facility to the extent of Rs. 1,20,000/- the facility was availed by the complainant for business purpose. It was held that where complaint alleging banking service deficiency was found connected with commercial purpose, the consumer complaint would not be maintainable.

Case 6

The complainant had deposited amount for issue of pay order in favour of a particular firm. However, the said pay order was cancelled by the bank and was issued in favour of another party.

It was held that when the bank has acted in good faith in cancellation of bank pay order and issuance of fresh pay order in favour of another party on the request made by manager of the complainant firm, there would be no deficiency in service.

The Reserve Bank of India has introduced an Ombudsman Scheme for Digital Transactions, 2019 (the Scheme). It is an expeditious and cost-free apex level mechanism for resolution of complaints regarding digital transactions undertaken by customers of the System Participants as defined in the Scheme. The Scheme is being introduced under Section 18 Payment and Settlement Systems Act, 2007, with effect from January 31, 2019.

OMBUDSMAN FOR DIGITAL TRANSACTIONS

The Ombudsman for Digital Transactions is a senior official appointed by the Reserve Bank of India to redress customer complaints against System Participants as defined in the Scheme for deficiency in certain services covered under the grounds of complaint specified under Clause 8 of the Scheme.

As on date, 21 Ombudsman for Digital Transactions have been appointed with their offices located mostly in state capitals.

The Scheme has been made applicable to System Participants as defined in Clause 3 (11) of the Scheme.

Grounds of complaints

As per Clause 8 of the Scheme, the Ombudsman for Digital Transactions shall receive and consider complaints on deficiency in services against System Participants defined in the Scheme on any of the following grounds:

(1) **Prepaid Payment Instruments:** Non-adherence to the instructions of Reserve Bank by System Participants about Prepaid Payment Instruments1 on any of the following:

a. Failure in crediting merchant's account within reasonable time;

b. Failure to load funds within reasonable time in wallets / cards;

c. Unauthorized electronic fund transfer;

d. Non-Transfer / Refusal to transfer/ failure to transfer within reasonable time, the balance in the Prepaid Payment Instruments to the holder's 'own' bank account or back to source at the time of closure, expiry of validity period etc., of the Prepaid Payment Instrument;

e. Failure to refund within reasonable time / refusal to refund in case of unsuccessful / returned / rejected/ cancelled / transactions;

f. Non-credit / delay in crediting the account of the Prepaid Payment Instrument holder as per the terms and conditions of the promotions offer(s) from time to time, if any;

g. Non-adherence to any other instruction of the Reserve Bank on Prepaid Payment Instruments.

(2) **Mobile / Electronic Fund Transfers:** Non-adherence to the instructions of the Reserve Bank on Mobile / Electronic fund transfers by System Participants on any of the following:

a. Failure to effect online payment / fund transfer within reasonable time;

b. Unauthorized electronic fund transfer;

c. Failure to act upon stop-payment instructions within the time frame and under the circumstances notified to the customers within prescribed timeline;

d. Failure to reverse the amount debited from customer account in cases of failed payment transactions within prescribed timeline;

e. Non-adherence to any other instruction of the Reserve Bank on Mobile/Electronic fund transfers.

(3) Non-adherence to instructions of Reserve Bank / respective System Provider to System Participants, on payment transactions through Unified Payments Interface (UPI) / Bharat Bill Payment System (BBPS) / Bharat QR Code / UPI QR Code on the following grounds:

a. Failure in crediting funds to the beneficiaries' account;

b. Failure to return within reasonable time the payment to the originating member in case of failure to credit the funds to the beneficiary's account;

c. Failure to / delay in refund of money back to account in case of transaction failure or declined transactions (i.e., failed transactions);

d. Non-adherence to any other instruction of the Reserve Bank on payment transactions / through Unified Payments Interface (UPI) / Bharat Bill Payment System (BBPS)/ Bharat QR Code / UPI QR Code.

4. Non-reversal / failure to reverse within reasonable time, funds wrongly transferred to the beneficiary account due to lapse at the end of System Participant.

5. Any other matter relating to the violation of the directives including on fees / charges, if any, issued by the Reserve Bank in relation to digital transactions.

NOTE: In respect of digital transactions done on third party platforms, it will be the responsibility of the Payment Service Provider to resolve customer disputes arising out of such transactions.

When can one file a complaint?

For redressal of grievance, the complainant must first approach the System Participant (as defined in the Scheme) concerned. If the System Participant does not reply within a period of one month after receipt of the complaint, or rejects the complaint, or if the complainant is not satisfied with the reply given, the complainant can file the complaint with the Ombudsman for Digital Transactions within whose jurisdiction the branch or office of the System Participant complained against, is located. For complaints arising out of services with centralized operations, the same shall be filed before the Ombudsman for Digital Transactions within whose territorial jurisdiction the billing / declared address of the customer is located.

When will one's complaint not be considered by the Ombudsman?

One's complaint will not be considered under the following circumstances:

(i) If the System Participant against whom the complaint is registered, is not covered under the Scheme.

(ii) If one has not approached the System Participant concerned in the first instance for redressal of the grievance.

(iii) If the subject matter of the complaint is not pertaining to the grounds of complaint specified under Clause 8 of the Scheme.

(iv) If one has not made the complaint within one year from the date of receipt of reply from the System Participant; or if no reply is received, and the complaint to the Ombudsman is made after the lapse of more than one year and one month from the date of complaint to the System Participant. In exceptional circumstances as decided by the Ombudsman, a complaint made after the period mentioned above may be accepted by the Ombudsman, provided the complaint is made before the expiry of the period of limitation prescribed under the Indian Limitation Act, 1963 for such claims.

(v) If the subject matter of the complaint is pending for disposal / has already been dealt with at any other forum like court of law, consumer court etc.

(vi) If the complaint is for the same subject matter that was settled through the office of the Ombudsman in any previous proceedings.

(vii) If the complaint is frivolous or vexatious.

(viii) The complaint falls under the disputes covered under Section 24 of the Payment and Settlement Systems Act, 2007.

(ix) The complaint pertains to dispute arising from a transaction between customers.

Procedure for filing the complaint before the Ombudsman

One can file a complaint with the Ombudsman by writing on a plain paper and sending it to the concerned office of the Ombudsman by post/fax/hand delivery. One can also file it by email to the Ombudsman for Digital Transactions. A complaint form along with the scheme is also available on RBI's website, though, it is not mandatory to use this format.

Where can one lodge his/her complaint?

One may lodge complaint with the Office of the Ombudsman for Digital Transactions within whose jurisdiction the branch or office of the System Participant complained against, is located. For complaint arising out of services with centralized operations, complaints can be filed with the office of the Ombudsman for Digital Transactions within whose territorial jurisdiction the billing / declared address of the customer is located.

Filing of complaint through an authorized representative

The complaint can be filed through an authorized representative of the complainant (other than an advocate).

Cost involved in filing a complaint with the Office of the Ombudsman for Digital Transactions

There is no charge or any fee for filing / resolving customers' complaints.

Limit on the amount of compensation that the Ombudsman can sanction

The compensation amount, if any, which can be awarded by the Ombudsman, for any loss suffered by the complainant, is limited to the amount arising directly out of the act or omission or commission of the System Participant, or two million rupees whichever is lower. The compensation shall be over and above the disputed amount.

Compensation for mental agony and harassment

The Ombudsman may award compensation not exceeding rupees 0.1 million to the complainant for mental agony and harassment. The Ombudsman, while giving the compensation, shall take into account the loss of time, expenses incurred by the complainant, harassment and mental anguish suffered by the complainant.

Details required in a complaint to the Ombudsman

The complainant is required to give details such as,

a. The name and the address of the complainant;

b. The name and address of the branch or office of the System Participant against whom the complaint is made;

c. The facts giving rise to the complaint, supported by documents, if any;

d. The nature and extent of the loss caused to the complainant;

e. The relief sought for; and

f. Declaration that the complaint is maintainable under Clause 9(3) of the Scheme.

What happens after a complaint is received by the Ombudsman?

The Ombudsman endeavours to promote settlement of the complaint through conciliation/ mediation by agreement between the complainant and the System Participant. If the terms of settlement (offered by the System Participant) are acceptable in full and final settlement of one's complaint, the Ombudsman will pass an order as per the terms of settlement which becomes binding on the System Participant and the complainant. If the System Participant is found to have adhered to the extant norms and practices in vogue and the complainant has been informed to this effect through appropriate means and complainant's objections, if any, are not received by the Ombudsman within the time frame provided, the Ombudsman may pass an order to close the complaint.

Can the Ombudsman reject a complaint at any stage?

As per Clause 13 of the Scheme, the Ombudsman may reject a complaint at any stage on the following grounds:

a. Complaint not on the grounds of complaint referred to in Clause 8; or

b. Not in accordance with Sub Clause (3) of Clause 9; or

c. The compensation claimed beyond the limit prescribed under Clause 12 (5) and 12 (6); or

d. Requiring consideration of elaborate documentary and oral evidence and the proceedings before the Ombudsman are not appropriate for adjudication of such complaint; or

e. Without any sufficient cause; or

f. Complaint not pursued by the complainant with reasonable diligence; or

g. In the opinion of the Ombudsman there is no loss or damage or inconvenience caused to the complainant.

What happens if the complaint is not settled by agreement?

If the Ombudsman is satisfied that there is indeed a deficiency of service on the part of the System Participant and the complaint is not settled by agreement within a specified period as allowed by the Ombudsman, he/she proceeds to pass an Award. Before passing an Award, the Ombudsman will provide reasonable opportunity to the complainant and the System Participant to present their case. It is upto the complainant to accept the Award in full and final settlement or reject it.

Further recourse if one rejects the Ombudsman's decision

The Scheme provides the appellate mechanism for the complainant as well as the System Participant. Any person aggrieved by an Award issued under Clause 12 or by the decision of the Ombudsman rejecting the complaint for the reasons specified in sub-clause (d) to (g) of Clause 13 of the Scheme, can approach the Appellate Authority.

The Appellate Authority is vested with a Deputy Governor-in-Charge of the department of the RBI implementing the Scheme. The address of the Appellate Authority is:

The Appellate Authority

Ombudsman Scheme for Digital Transactions

Consumer Education and Protection Department

Reserve Bank of India

First Floor, Amar Building, Fort, Mumbai 400 001.

The complainant also has the option to explore other recourse and/or remedies available as per the law.

Time limit for filing an appeal

One can file appeal against the Award or the decision of the Ombudsman rejecting the complaint, within 30 days of the date of receipt of communication of Award or rejection of the complaint. The Appellate Authority may, if satisfied that the applicant had sufficient cause for not making an appeal within prescribed time, may allow a further period not exceeding 30 days.

How does the Appellate Authority deal with the appeal?

The appellate authority may:

a. Dismiss the appeal; or,

b. Allow the appeal and set aside the Award; or,

c. Remand the matter to the Ombudsman for fresh disposal in accordance with such directions as the Appellate Authority may consider necessary or proper; or,

d. Modify the Award and pass such directions as may be necessary to give effect to the Award so modified; or,

e. Pass any other order as it may deem fit.

   Semi-closed System PPIs: These PPIs are issued by banks (approved by RBI) and non-banks (authorized by RBI) for purchase of goods and services, including financial services, remittance facilities, etc., at a group of clearly identified merchant locations / establishments which have a specific contract with the issuer (or contract through a payment aggregator / payment gateway) to accept the PPIs as payment instruments. These instruments do not permit cash withdrawal, irrespective of whether they are issued by banks or non-banks.

RESERVE BANK - INTEGRATED OMBUDSMAN SCHEME, 2021 (RB-IOS, 2021)

Reserve Bank of India (RBI) integrated its three erstwhile Ombudsman Schemes viz. (i) the Banking Ombudsman Scheme, 2006, (ii) the Ombudsman Scheme for Non-Banking Financial Companies, 2018, and (iii) the Ombudsman Scheme for Digital Transactions, 2019, into one Scheme - 'The Reserve Bank - Integrated Ombudsman Scheme, 2021 (the Scheme / RB-IOS, 2021)' with effect from November 12, 2021. The Scheme simplifies the grievance redress process at RBI by enabling the customers of Regulated Entities (REs) like banks, Non-Banking Financial Companies (NBFCs), Payment System Participants (PSPs) and Credit Information Companies to register their complaints at one centralised reference point.

The objective of the Scheme is to resolve the customer grievances involving 'deficiency in service' on part of REs in a speedy, cost-effective and satisfactory manner. RB-IOS, 2021 provides for cost-free redress of customer complaints involving deficiency in services rendered by entities regulated by RBI, if not resolved to the satisfaction of the customers or not replied to within a period of 30 days by the RE.

The following REs of RBI are covered under the RB-IOS, 2021:

(i) **Banks:** All commercial banks, including Public Sector Banks, Private Sector Banks, Foreign Banks, Local Area Banks, Small Finance Banks, Payment Banks, Regional Rural Banks, Scheduled Primary (Urban) Co-operative Banks and Non-scheduled Primary (Urban) Co-operative Banks with deposit size of ₹50 Crore and above, as on the date of the audited balance sheet of the previous financial year;

(ii) **NBFCs registered with RBI:** All Non-Banking Financial Companies (excluding Housing Finance Companies) which (a) are authorized to accept deposits; or (b) have customer interface, with an assets size of ₹100 crore and above as on the date of the audited balance sheet of the previous financial year;

Note: Core Investment Companies, Infrastructure Debt Fund-Non-banking Financial Companies, Non-Banking Financial Companies-Infrastructure Finance Companies, companies in resolution or winding up / liquidation, or any other NBFC specified by RBI are excluded from the ambit of the RB-IOS, 2021.

(iii) System Participants: All Payment System Participants - banks as well as non-banks regulated by RBI are covered under the RB-IOS, 2021. These entities issue Prepaid Payment Instruments (PPIs) and facilitate transactions over National Electronic Funds Transfer (NEFT) / Real Time Gross Settlement (RTGS) / Immediate Payment Service (IMPS) / Unified Payments Interface (UPI) / Bharat Bill Payment System (BBPS) / Bharat QR Code / *99# mobile transaction service using Unstructured Supplementary Service Data (USSD) / Aadhaar Enabled Payment System (AePS), etc.

(iv) Credit Information Companies: All Credit Information Companies as defined in the Companies Act, 2013 (18 of 2013) and granted a Certificate of Registration under sub-section (2) of section 5 of the Credit Information Companies (Regulation) Act, 2005.

A complaint can be filed through any of the following methods**:**

i. Online - on CMS portal of RBI at https://cms.rbi.org.in.

ii. Physical complaint (letter/post) in the form as specified in Annexure 'A' in the Scheme to "Centralised Receipt and Processing Centre, 4th Floor, Reserve Bank of India, Sector-17, Central Vista, Chandigarh - 160017".

iii. Complaints with full details and can be sent by email (crpc@rbi.org.in).

CASE LAWS

1. *Punjab and Sind Bank and Ors. vs. Durgesh Kuwar (25.02.2020 -Supreme Court)*

Considering the period which has elapsed, it would be necessary for the Court to issue a direction, which, while sub-serving the interest of the bank, is also consistent with the need to preserve the dignity of a woman employee who, we hold, has been unfairly treated.

The Honorable Court is of the view that the High Court cannot be faulted in coming to the conclusion that the transfer of the respondent, who was holding the office of Chief Manager in the Scale IV in Indore branch to the branch at Sarsawa in the district of Jabalpur was required to be interfered with. At the same time, a period of nearly four years has since elapsed.

Despite the order of stay, the respondent was not assigned an office at Indore and had to suffer the indignity of being asked to sit away from the place assigned to a Branch Manager. Considering the period which has elapsed, it would be necessary for the Court to issue a direction, which, while sub-serving the interest of the bank, is also consistent with the need to preserve the dignity of a woman employee who, we hold, has been unfairly treated. We accordingly direct that Ms. Durgesh Kuwar, the respondent officer, shall be reposted at the Indore branch as a Scale IV officer for a period of one year from today.

While affirming the decision of the High Court, the appeal is disposed of in terms of the above directions. The respondent would be entitled to costs quantified at Rs 50,000 which shall be paid over within one month.

2. *Canara Bank vs. United India Insurance Co. Ltd. (06.02.2020 Supreme Court)*

Beneficiaries of the policies taken out by the insured are also 'consumers' under the Consumer Protection Act.

In the above case, some farmers had stored their agricultural produce in the cold storage run by a partnership firm and took loan from the Canara Bank against the agricultural produce stored in the cold storage. The cold store was insured with United India Insurance Co. Ltd. A fire took place in cold store, the entire building with agricultural produce was destroyed. The cold store owners had taken out a comprehensive insurance policy and raised claim with the insurance company but the claim was repudiated on the ground that the fire was not an accidental fire. The farmers also issued notice to insurance company in respect of the plant, machinery and building but this claim was also repudiated by the insurance company on additional ground that the farmers had no locus standi to make the claim and there was no privity between the farmers and insurance company. The farmers filed a claim against cold store, Canara Bank and the Insurance Company.

It was found that in the tripartite agreement among the farmers, Canara Bank and Cold store, it was mandatory to insure the agricultural produce hypothecated with the Canara Bank.

The Honorable Supreme Court held that the beneficiaries of the policies taken out by the insured are also 'consumers' under the Consumer Protection Act, even though they are not parties to the contract of insurance.

LESSON ROUND-UP

- The Consumer Protection Act, 2019 seeks to take care to protect the interests of consumers, in the light of certain new developments which have taken place on account of emergence of e-Commerce trade during the last two decades, which was not fully addressed in the earlier Act of 1986. Apart from making provisions for establishing Consumer Councils as well as Consumer Disputes Redressal Commissions, the newly created Act has established A Central Consumer Protection Authority to protect, promote and enforce the rights of consumers as a class, and prevent violation of consumers rights including preventing unfair trade practices, ensuring that no false or misleading advertisement is made of any goods or services which contravenes the provisions of this Act. The 2019 Act also establishes a Director General of Investigation Wing to conduct inquiry or investigation to assist Central Consumer Protection Authority.
- The Consumer Protection (e-Commerce) Rules, 2020 aim to protect the interests of consumers vis-à-vis various entities involved in that line of selling/marketing various products and services. This was a newly emerged domain where the regulation for protecting consumers' interests were lacking and hence these rules have been incorporated. These Rules define duties/liabilities of e-Commerce entities, market place e-Commerce entities, sellers on market place and liabilities of inventory e-commerce entities. Contravention of any of these rules will invite penalties and punishments as applicable under COPRA 2019 Act.
- Digital transaction in the banking industry is increasing day by day. In order to deal specifically with complaints relating to digital transaction, the RBI has introduced a separate Ombudsman Scheme for digital transactions in January 2019.
- Reserve Bank of India (RBI) integrated its three erstwhile Ombudsman Schemes viz. (i) the Banking Ombudsman Scheme, 2006, (ii) the Ombudsman Scheme for Non-Banking Financial Companies, 2018, and (iii) the Ombudsman Scheme for Digital Transactions, 2019, into one Scheme - 'The Reserve Bank - Integrated Ombudsman Scheme, 2021

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Describe the rationale for the introduction of COPRA.
2. Describe the procedure of filing complaints with various redressal for a under COPRA.

3. Who is a Banking Ombudsman? Mention the circumstances under which complaints can be made.
4. Write brief about Appellate Authority in the Scheme of Banking Ombudsman.
5. Discuss general conditions for carrying out e-Commerce business in India.
6. Explain the Reserve Bank - Integrated Ombudsman Scheme, 2021 in detail.

LIST OF FURTHER READINGS

- The Consumer Protection Act, 2019.
- The Reserve Bank - Integrated Ombudsman Scheme, 2021.
- The Banking Ombudsman Scheme - RBI Circular & Annual Reports.

Advances, Securities and Documentation

Lesson 9

KEY CONCEPTS

■ Loans and Advances ■ Retail borrowers ■ Corporate borrowers ■ Fund based facilities ■ Non-fund based facilities ■ Cash credit ■ Overdraft ■ Term Loans ■ Bank Guarantees ■ Letter of Credit ■ Bill Purchase and Discount ■ Factoring ■ Commercial Paper ■ Stamping ■ Limitation ■ Securitisation ■ Execution ■ CERSAI ■ Limitation ■ Stamping ■ Charge Creation ■ ROC ■ Hypothecation ■ Pledge ■ Lien

Learning Objectives

To understand:

- Basic Principles of lending
- Classification of borrowers
  - Retail borrowers
  - Corporate borrowers
- Different types of borrowers
  - Individuals
  - Firms
  - Joint stock companies
  - HUF
  - Societies/Associations/Clubs
  - Trusts
- Types of credit facilities
- Credit Score Authenticity
- Information Utility (IU)
- Types of Securities
- Types of Charges
- Types of Documents
- Stamping
- Limitation
- Securitisation

Lesson Outline

- Introduction
- Difference between Loans and Advances
- Different Types of Borrowers Fund Based Credit Facilities
  - Cash Credit
  - Overdraft Demand Loans Term Loans
  - Bill Finance etc.
- Non Fund Based Credit Facilities
  - Bank Guarantees
  - Letter of Credit (LC)
  - Factoring
  - Commercial Papers (CP)
  - Bills Purchase and Discount
- Types of Securities
- Types of Charges
- Types of Documents
- Stamping
- Limitation
- Securitisation
- Lesson Round-Up
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Banking Regulation Act, 1949
- Reserve Bank of India Act, 1934
- Indian Partnership Act, 1932
- Companies Act, 2013
- Foreign Exchange Management Act, 1999
- Indian Contract Act, 1872
- The Transfer of Property Act, 1882
- The Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002 (SARFESI Act)
- The Insurance Act, 1938
- Sale of Goods Act, 1930

INTRODUCTION

The business of banking involves accepting money from public and lending the same to various borrowers. Banks lend in the form of 'Loans' and 'Advances' which are collectively called 'Credit Portfolio' of a Bank. Though these two terms appear to denote lending and are interchangeably used there are some differences between them as detailed below:

Loan	←Parameter→	Advances
Lending interest bearing funds, which is repayable after a specified period/interval, usually more than a year.	**Meaning**	Lending interest bearing funds for meeting day to day expenses, which is repayable within a short duration, say a year.
Considered as a debt.	**Nature**	Considered as a credit facility.
Repayable over a long term.	**Securities**	Supported by primary security or a guarantee, including collateral securities where necessary.
There could be complex legal formalities	**Legal formalities**	In some cases legal formalities are less complex.
Auto Loan, Educational Loan, Home loan etc.	**Examples**	Cash Credit, Overdraft, Bills purchased, Ad-hoc facilities etc.

The business of lending carries some inherent risks such as default in repayment, delay in repayment etc. Since the money lent to borrowers come from depositors, banks follow certain basic principles to safe guard their interests

BASIC PRINCIPLES OF LENDING

Following are some of the basic principles that banks follow while lending:

1) **Safety of funds:** It is the most important principle of lending because the money that banks lend comes from public, so the safety is the first concern. Bank must ensure that money is in

safe hands and will come back as agreed with interest and without any default. Safety mainly comes from the character of the borrower, capacity of borrower to do the business and his stake involved in the business. Besides this, the nature of security offered by borrower to the bank is also of utmost importance.

2) **Liquidity:** Liquidity means ready availability of funds to meet financial commitments. It is also as important as safety. This is because major portion of bank deposits is repayable on demand or at a short notice. Therefore banks need to ensure availability of funds, so that when depositors demand repayment of their deposits at their maturity, bank has sufficient funds to repay. Bank grants loans on the security of assets which are easily marketable without much loss of time and value, if the borrower defaults repayment of loans/advances granted.

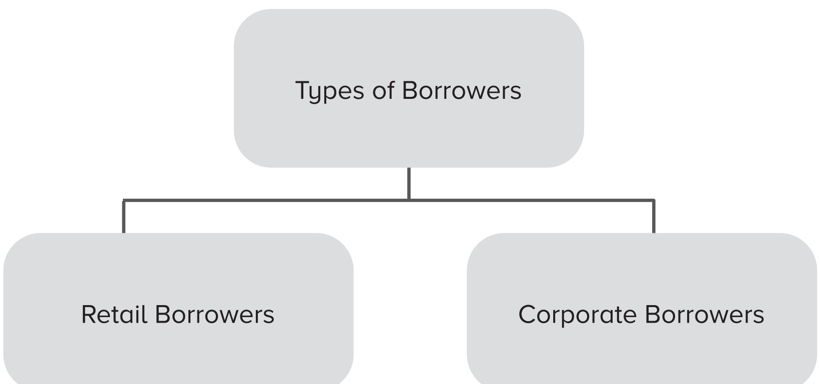
3) **Profitability:** It is important because banking is a business and any business survives and grows only on profits. Bank incurs expenses to maintain deposits such as interest, rent, stationary, infra structure staff salaries etc. Such expenditure also must be recovered. The sound principle of lending is not to sacrifice safety or liquidity for the sake of higher profitability.

4)) **Purpose:** Purpose of the loan should be productive. Loans/Advances granted to a borrower should be properly used by a borrower to expand business activity. This ensures increase in sales and realization of sales proceeds generate additional income from which repayment of loan instalment with interest is made. Banks also lend money for consumption purpose e.g. for purchasing consumer durables, where repayment comes from fixed income of the borrower. Loans are not advanced for speculative and unproductive purpose. RBI has in it's Master Directions indicates the sectors/activities for which loans need to be curtailed by banks from time to time.

5) **Spread or Diversification:** Diversification of lending avoids the risk of concentration. Banks lend money under different facilities like: term loan, cash credit, overdraft, bills, etc., for different purposes like business, housing, education, etc., to different industries like cement, pharmaceutical, agriculture, steel, IT, trade etc., in different geographical areas and so on to spread the risk. In short, banks should follow the principle of "Not putting all the eggs in one basket."

6) **Security:** Securities against which banks lend must be marketable, ascertainable, stable and transferable. Borrower should have clear and transferable title over the security given to the bank, so that if required can be effectively sold in the market by the bank.

DIFFERENT TYPES OF BORROWERS



There are different types of bank borrowers. They may be classified as individuals, partnership firms, companies–public as well as private, public sector undertakings, multinational companies etc. The financial and non- financial credit facilities required to the above customers are many. We can divide them into retail borrowers and corporate borrowers.

Retail Borrowers

The type of borrowers in retail segment may include individuals, retail traders, Micro, Small and Medium enterprises (MSMEs), self-help groups, farmers, agricultural borrowers etc. Individuals borrow from banks for financial assistance in buying homes, vehicles, consumer items etc. Besides banks extend credit facilities to individuals under educational loans, consumer loans and personal loan schemes. Banks are issuing credit cards to their customers as well as general public. The credit cards are issued in the form of revolving line of credit. The retail traders and self-help groups enjoy working capital facilities from banks. MSMEs get financial assistance from banks both for working capital and for purchase of machinery and equipment required for their business usages. Farmers avail crop loans, tractor loans and loans for allied activities.

Credit flow to Micro, Small and Medium Enterprises Sector

After change in criteria of classification of MSME by the Government of India, vide Gazette Notification S.O. 2119 (E) dated June 26, 2020, the Reserve Bank of India has also issued a notification to initiate necessary action for reclassification of enterprises as per the new definition w.e.f. July 1, 2020 and issue necessary instructions to all Commercial Banks/FIs/NBFCs/UCBs/SCBs for their branches /controlling offices in this regard, at the earliest.

Revised Classification of MSME

An enterprise shall be classified as a Micro, Small or Medium enterprise on the basis of the following criteria, namely:

i. a micro enterprise, where the investment in plant and machinery or equipment does not exceed one crore rupees and turnover does not exceed five crore rupees;

ii. a small enterprise, where the investment in plant and machinery or equipment does not exceed ten crore rupees and turnover does not exceed fifty crore rupees; and

iii. a medium enterprise, where the investment in plant and machinery or equipment does not exceedfifty crore rupees and turnover does not exceed two hundred and fifty crore rupees.

Corporate Borrowers

Banks offer credit facility to corporate customers such as trading houses, multinational companies, exceptionally large domestic, industrial and business houses, public sector companies etc. Fund based and non- fund-based facilities extended to corporates are term lending, short term finance, working capital finance, bill discounting, export credit, bank guarantee, letter of credit, collection of bills and documents etc. Besides, banks extend financial assistance like channel financing (extending working capital finance to dealers having business relationships with large companies), Vendor Finance (money lent to be used by the borrower to buy the vendor's products or property), Syndication (allows banks to pool their resources and share risks with other banks while handling large transactions like Project finance, Corporate term loans, working capital loans, acquisition finance etc.). Analysis of financial soundness of any business is generally based on the financial ratios and other accounting variables. The unhealthy position of financial statements directly leads to bankruptcy.

When a bank lends money, it enters into a contract with the borrower. To make that contract enforceable in the court of law, when the need arises, the contract must be a valid contract. In terms of Indian Contract Act, 1872 essential features of a contract are enumerated below:

The essentials of valid contract are:

1. **Offer and acceptance:** It is an offer by one party and acceptance by other. Agreement by both parties is a primary criterion for making a contract.

2. **Mutual Consent:** Parties must agree upon the same thing, in the same sense and at the same time.

3. **Intention to create legal obligation:** Both the parties must have intention to go to court of law, if the other party fails to meet the promise/obligations.

4. **Free Consent:** Consent of parties must be free. It means there should not be force, undue influence, fraud or misrepresentation while obtaining consent.

5. **Parties must be Competent:** Every party to the contract must be major (completed 18 years of age), of sound mind (at the time of making a contract he can understand it and forming a rational judgment so as to its effect on his interest), and not disqualified by law to enter into a contract.

6. **Lawful object:** The object of the contract must be lawful. (not fraudulent, illegal, immoral or opposed to public policy)

7. **Lawful consideration:** Both the parties must get something lawful and real, in return for the promise made.

8. Not expressly declared as void.

Different Types of Borrowers for Lending in Banks

Banks lend money to following types of borrowers:

1. **Individuals:** Individuals can apply for loan in single name or two or more individuals jointly can apply for bank loan. All applicants should individually be capable of entering into contract. In case of joint borrowers, the documents are to be executed jointly. On the death, insanity or insolvency of one of the joint borrowers, the survivor must pay the outstanding dues.

   Position of Individuals in Different Capacities:

   a) **Minors:** Minors, insane individuals and insolvents are legally incompetent and hence cannot apply for loan. Loan given to a minor cannot be secured and recovered from a competent major person by obtaining his guarantee as here the original contract will be invalid so the subsequent contract (guarantee) cannot be enforceable.

   b) **Illiterate Person:** An illiterate person is one who cannot read or write. Especially he is an uneducated who cannot read. However, if he is otherwise competent, he can enter into a valid contract. Since he cannot read and write he must be explained the contents of all the documents in language known to him and a separate declaration to that effect is to be kept on record. Instead of signature, an illiterate person will put his thump impression on all the documents in presence of bank officials.

   c) **Blind Person:** Blind person can be competent to contract. He can be different from an illiterate if he is educated, but banks will treat him like an illiterate when it comes to executing documents.

   d) **Married Woman:** A married woman has a legal entity separate from her husband. She can be adjudicated insolvent in respect of her own debts. Husband shall be liable for a loan raised by a married woman only if loan is granted with the consent of her husband who stands as a guarantor and when loan is availed for necessities of her life.

   e) **Pardanashin Woman:** A pardanashin lady is a woman who remains in complete seclusion and does not transact any business with people other than her family members. In a contract with her, a presumption of undue influence always exists, and she can avoid the contract where she complains of undue influence. The onus of proving absence of undue influence lies on other party.

2. **Firms:** In case of a proprietary firm, the proprietor is treated just like as individual except that he carries out business in the name of the firm instead of his individual name. In a partnership firm, liability of partners is unlimited, and the partners are jointly and severally liable for the debt of the firm. The firm

is not a separate legal entity. Partners are principal, and they act as agent for each other. As per the provisions of Section 464 of Companies Act 2013 the maximum number of partners in a firm can be 100. A joint stock company can be a partner in a partnership firm. It will be treated as one partner.

Firm's bank account: On receipt of an application from one or more of the partners, a bank account in the name of the firm can be opened. A firm's bank account should be opened in the name of a firm and not in the name or names of the individual partner/partners.

Liability of partners in respect of firm's debt: The liability of the partners is unlimited, and every partner is liable to pay the debts of the firm to an unlimited extent. The liability of partners in different positions is as follows:

(i) **If debts are due from the firm as well as from partners:** If the partners are personally indebted, the personal assets of the partners shall be applied first to meet the claims of their individual creditors. Out of the remainder, if any, claims of the firm's creditors will be met.

(ii) **If the partners sign the loan documents in both of their capacity i.e., individual as well as jointly:** In this case the creditor can recover their debt simultaneously from the assets of the firm and the partners. The personal property of a partner may be attached even before judgement is delivered in a suit against the firm and its partners.

(iii) In case of death of a partner:

(a) **If the firm stands dissolved:** On receipt of intimation about the partner's death, the banker will close the firm's account immediately. This is necessary to decide the liability of deceased partner. If this is not done than rule in Clayton's case will apply.

Clayton's Rule

In the absence of any specific directions by a customer, a banker enjoys the right to appropriate the money paid by the customer in to his account to any of the loans including a time- barred debt. But, however, if there is specific direction from the customer regarding appropriation, the banker has to follow the same and does not have power to alter them. In the absence of any directions from the customer banker can appropriate the money paid by the customer as per his own discretion but should keep the customer informed of his action.

In case both the banker and the customer fail to act as per their powers, the rule given in Clayton's case of 1816 would be applied. Under this rule if there is no specific appropriation is made, either by the' debtor or the creditor, the law allows to appropriate the money paid by the customer in to his account by reducing the first item on the debit side of the current account by the first item on its credit side in chronological order. In short, this rule the sets off sum first paid in with the sum that is first paid out. This rule is popularly known as the Rule in Clayton's case and affects current an account, especially when overdrawn. In order to nullify the applicability of this rule, the operations in the account are stopped especially when the current account shows a debit balance especially when there is a death of partner in a partnership firm and other specific circumstances.

(b) **If the firm does not stand dissolved:** If it is reconstituted by the remaining partners, the banker should open a new account in the name of the reconstituted firm.

In any case, the cheques issued by the deceased partner should not be honoured by the banker without confirmation from the surviving partners.

(iv) **Retirement of a partner:** On the retirement of a partner if bank account shows a debit balance, the banker must close the account immediately, to retain its right to claim money from the retiring partner. In absence of this, Rule in Clayton's case will apply. The liability for debts arising out of financial facility would continue in respect of retired partners till the date of notice. Their liability for future loans ceases immediately on serving such notice.

(v) **Insolvency of a partner:** The insolvent partner ceases to be a partner from the date of declaration of his/her insolvency and he shall not be liable for any act of the firm thereafter. The insolvent partner does not remain competent to operate the firm's account. Banker should honour the cheques drawn by the insolvent partner before his adjudication only after getting confirmation from the solvent partners. Normally bankers must close the account and open a new account in the name of reconstituted firm to determine the liability of the insolvent partner. Otherwise, the rule in Clayton's case will apply.

3. **Limited Liability Partnership (LLP)** is a legal entity separate from its partners. The liability of a partner is limited to his contribution. They are not liable for one another. Public disclosure is the critical feature of an LLP. An LLP must have at least two members. In a LLP that has only two members , if one member chooses to leave the partnership, the LLP may have to be dissolved.

4. **Joint Stock Companies:** In case of Private Limited Company minimum members should be 2 and maximum can be 200. Minimum directors should be 2 and no ceiling as to maximum no of directors. In case of Public Limited Company minimum members should be 7 and no ceiling for maximum numbers. Minimum numbers of directors should be 3 and numbers ceiling for maximum numbers.

   - Borrowing Powers of a Company: Borrowing powers of the Board of Directors of a company are stated in Articles of Association (which deals with the internal management), for loans other than short term loans. If powers are not stated, these are deemed to be equal to paid up capital plus free reserves of the company. This restriction does not apply to short-term loans and seasonal loans. Where the Board does not have adequate powers, shareholders can enhance these powers by passing a resolution.

   - The Board of Directors shall exercise the power to borrow money otherwise than on debentures only by means of resolutions passed at the meeting of the Board. The Board may, by a resolution delegate the power to borrow to any committee of directors, the managing director, secretaries and treasurer etc., and shall specify the total amount outstanding at any one time up to which money may be borrowed by the delegates.

   - Borrowing by Board of Directors without Authorization: If loan has been taken by Board without authority and used the sum for the benefits of the company, company cannot repudiate its liability to repay. In this regard it should be noted that any borrowings by the company may be ultra vires the directors but not ultra vires the company.

5. **Hindu Undivided Family (HUF):** HUF is not governed by Indian Partnership Act. Senior most coparcener is a Karta. When the Karta expires or is declared as insolvent or becomes insane, the next senior coparcener becomes the Karta. He has powers to raise loan for family business and legal necessities of the family. His liability is unlimited. He can, without the consent of coparceners, create charge on the assets of family and execute documents. Banks obtain signatures of all major coparceners in their personal capacity, on all loan documents, to make them personally liable.

   Points to be considered by the banker:

   i. Though Karta has implied authority to take a loan, to execute necessary documents and to pledge the securities yet to be on safe side, the loan document should be executed by all the adult members of the family or with their consent by the head of the family.

   ii. Banker must check the purpose of the loan taken. Karta can take the loan and pledge the property of the family only for using the same in family business and not for speculation purposes.

   iii. The coparceners' liability in case of loans granted to HUF is limited to the extent of their interest in joint property. If the adult coparceners themselves contract along with Karta or ratify the contract entered by the Karta, then they become personally liable for the amount borrowed.

iv. In case of minor as coparcener in HUF, then his guardians must sign the loan documents on his behalf. After attaining majority, he should also sign the documents to give his consent to the undertaking given by major coparceners.

Societies, Clubs, Associations etc: These are non-profit making entities and represent group of people. These get legal status only after incorporation. Banks must ensure that the loan applied is consistent with objectives of the institution, loan amount is within the borrowing capacity and the managing committee has passed necessary resolution to that effect.

Points to be consider by the bankers:

(a) Ensure that the applicant society is an incorporated body under The Society Registration Act, 1860 as unregistered society cannot be sued.

(b) Obtain a copy of rules and by-laws of the society to know the powers and functions of the persons managing the affairs of the society.

(c) Obtain a copy of the resolution of the managing committee regarding appointing the bank concerned as the banker of the society, mentioning the name of the persons who are authorized to operate the bank account and giving other directions for the operations of the said account.

(d) Ascertain the borrowing powers of the society from its Charter of Memorandum, Note the purpose for which borrowings is permissible. Check the powers of members of the society to create charge over the assets of the society.

(e) If a person who is authorized to take loan on behalf of the society dies or resigns, the banker should stop the operations of the society's account till society nominates another person.

(f) If the person authorized to operate society's account also have his personal account in the same branch, banker must ensure that funds of the society are not credited to the personal account of the said office bearer.

6. **Trusts:** Trust can be private or public. Trustees do not have implied authority to borrow. Loans can be granted if it is for the trust. Trustee is authorized to borrow as per the trust deed.

FUND BASED CREDIT FACILITIES

Bank finance is tailor made to suit different needs of customers. The loans and advances wherein immediate flow of funds is made available to borrowers, are called funds-based facility. Banks earn interest income from this. In non- funds-based facilities like issuance of letter of guarantee, letter of credit etc., banks get fee income/ commission and there is no immediate outflow of funds from the bank.

1. **Demand Loan:** It is generally granted for short period from few days to several months. It has open ended repayment schedule or must be paid on demand by the lender. Normally there is no penalty for pre- payment. The purpose for which demand loan is sanctioned is generally purchase of raw material, paying of short term liabilities etc. The security can be stock, shares or other tangible assets, land building etc.

2. **Term Loans:** These are granted for specific period with fixed repayment schedule. The interest rates are fixed or floating. The tenure may range from one year to five years or even more. Generally, penalty is charged for pre- payment. These loans are sanctioned for procuring land and building, plant and machinery and other fixed assets to start or expand business. The security is charge on the asset for which or against which loan is sanctioned.

2.1 While funding a project, through a term loan, a banker generally takes into consideration the following aspects/factors:

1. **Land:**
   - i. Land Sales Deeds (Land purchased agreement)
   - ii. Legal Search Report
   - iii. Location and accessibility
   - iv. No Objection certificate from statutory bodies including local bodies for use of land.
2. **Building:**
   - i. Approved Building Plan
   - ii. Building permission from the town planning commission
   - iii. Architects detailed cost estimates
   - iv. Type and nature of structure.
3. **Plant and machinery:**
   - i. Full detail and description of the plant & machinery, whether imported or indigenously available
   - ii. Details of the technology and its suitability, the rate of obsolescence
   - iii. The profile of the supplier
   - iv. Post sales service support extended by the supplier
   - v. Manufacturers catalogue
   - vi. The profile and standing of the project management consultant
   - vii. Any unique feature of the machinery, from the project angle to be clearly specified
   - viii. Copy of the Performa invoices/quotations etc. for the plant and machinery are to be submitted in full.
4. **Miscellaneous Fixed Assets:**

   Details and description of miscellaneous fixed assets, copy of invoices.
5. **Preliminary and Preoperative Expenses:**

   Complete break up and details.
6. **Working Capital Margin:**

   Source of working capital and its Working and calculation.
7. **Project implementation and draw down schedule:**

   The project implementation schedule with details and item wise break up and likely date of completion of the project. The draw down schedule of the project and timings of drawdown linked to the progress of the project.

8. **Assumptions underlying the projections and their basis:**

   The detailed assumptions underlying the projections and the basis of the same supported with conclusive evidence in respect of various cost factors and revenue projections assumed.

9. **Details of securities:**

   The prime, collateral securities, personnel guarantee offered etc.

10. **Technical/project Details:**

    a) Manpower details – requirement of Technically qualified persons, key managerial personnel, process of recruitment, availability and quality of the manpower/labour force, salary structure etc.

    b) The infrastructure availability and its details

    c) Raw material– Consumption, Prices, duty element, price volatility, source and availability of supply etc.

    d) Utilities Details

    - Power –requirement, connected load (For calculation of power consumption), power sanction letter, standby arrangement etc.
    - Water – requirement, source of supply, suitability of water, chemical test report, storage arrangement etc.
    - Fuel and Oil and lubricants etc.

11. **Company Specific Information:**

    a) Copy of Memorandum of Association and Articles of Association, Certificate of Incorporation by Company Registrar.

    b) Copy of the project report.

    c) Extent of expenditure already incurred on the project with item wise breakup; the balance expenditure to be incurred.

    d) The source of funds for the promoters' contribution and extent of funds already brought in with break up and details, and bank statements, suppliers receipts etc.

    e) Last three years income tax returns and income tax returns of the company/group concerns and income tax assessment orders.

    f) Opinion letter (OPL) on the company/group accounts from the existing bankers.

    g) Shareholders agreement.

    h) Technical support agreement.

    i) SWOT (Strength, Weakness, Opportunities, Threats) analysis as perceived by the management Banks have their own project parameters which are considered by them for long term funding. Few project parameters considered by banks for evaluation are given below:

Project Parameters

Parameter	Benchmark
Promoters' Contribution	Not less than 11% of the project cost
Debt Equity Ratio (DER)	2:1 up to 3:1
Fixed Asset Coverage Ratio (FACR)	Not less than 1.25
Repayment Period	Not exceeding 12 years excluding moratorium period
Debt Service Coverage Ratio (DSCR)	Not less than 1.50
Internal Rate Return (IRR)	4% and above from the estimated weightedaverage cost of funds

Resolution Framework for COVID-19-related Stress – Financial Parameters

The Reserve Bank had set up an Expert Committee with Shri K. V. Kamath as the Chairperson, as announced in the press release dated August 7, 2020. The Expert Committee has since submitted its recommendations to the Reserve Bank on September 4, 2020, which have been broadly accepted by the Reserve Bank.

Accordingly, all lending institutions shall mandatorily consider the key ratios (i.e., Total Outside Liabilities / Adjusted Tangible Net Worth (TOL/ATNW), Total Debt / EBITDA, Current Ratio, Debt Service Coverage Ratio (DSCR) and Average Debt Service Coverage Ratio (ADSCR) while finalizing the resolution plans in respect of eligible borrowers.

3. **Overdraft (O/D Account):** It means allowing the customer to draw cheques over and above credit balance in his account. Overdraft is normally allowed to Current Account customers and in exceptional cases Savings Bank account customers are also allowed to overdraw their account. High rate of interest is charged on daily debit balance of overdraft account. Generally, an overdraft facility is given by a bank on the basis of a written application and a promissory note signed by the customer.

   Types of *overdraft* accounts:

   (a) *Temporary or Clean overdraft:* Temporary overdrafts are allowed purely on personal credit of the customer and it is for customer to meet some urgent commitments on rare occasions. Allowing a customer to draw against his cheque sent in clearing also falls under this category.

   (b) *Secured overdraft:* Secured overdraft is allowed up to a certain limit against some tangible security like bank deposits, LIC policy, National Savings Certificates, Shares and other similar assets. Secured overdraft is most popular with traders as it involves lesser operating cost, simple procedure of application and document formalities.

4. **Cash Credit (CC account):** It is short term finance to a borrower having a tenure up to one year which can be renewed for further period by the bank based on projected sales and satisfactory operation in the account during the period of finance. Cash Credit facility is extended in two forms – Open cash credit and Key cash credit (KCC). Open cash credit account is a running account just like a current account where the borrower can maintain debit balance in the account up to a sanctioned limit or drawing power whichever is lower. The cash credit facility is offered to a borrower normally either against pledge (Key Cash Credit) or hypothecation of stocks of raw materials, semi-finished goods and finished goods and book debts (Receivables).

   In KCC, the borrower lodges the stock in his warehouse and the key of the warehouse will be handed over to the bank. The goods lodged in the warehouse is pledged to the bank and they are allowed to be removed by the borrower on remitting into his CC account the amount equivalent to value of the goods. The bank would release further funds to the borrower within the Drawing Power (DP) / sanctioned limit on borrower depositing (pledge) more stock in the warehouse. Therefore, such facility is called Key Cash Credit.

Cash credit limits are also sanctioned to a borrower against security of term deposits, LIC policies, NSCs or Gold jewels. This type of limit is offered mainly to traders who find it difficult to maintain stock register and submission of periodic stock statements. In case of manufacturing units this facility is required for purchase of raw materials, processing and converting them into finished goods. In case of traders, the limit is allowed for purchase of goods which they deal.

Electronic Cards for Overdraft Accounts:

RBI has decided to permit banks to issue electronic cards to natural persons having overdraft accounts that are only in the nature of personal loan without any specific end-use restrictions. The card shall be issued for a period not exceeding the validity of the facility and shall also be subject to the usual rights of the banks as lenders.

The card shall be allowed to be used for domestic transactions only. Adequate check and balances shall be put in place to ensure that the usage of such cards is restricted to facilitate online / non-cash transactions. The restriction on cash transaction will not apply to overdraft facility provided.

Prior to launching the product, the banks shall frame a Board approval policy on issuance of electronic cards to above mentioned overdraft accounts, encompassing appropriate risk management, periodic review procedures, grievance redressal mechanism, etc., which will be subject to supervisory review.

The card shall be issued subject to instructions on terms and conditions, security, grievance redressal, confidentiality of customer information as applicable for debit cards and all other relevant instructions on card operations issued by RBI.

Maximum Permissible Bank Finance (MPBF) - Tandon Committee

As credit availability is scarce in India, RBI set up a study group in 1974 under the chairmanship of Mr. P.L. Tandon, popularly referred to as The Tandon Committee to rationalize computation and assessment of working capital by banks as well as ushering in credit discipline among borrowers.

The committee has recommended the following:

1. Borrowers must observe a proper fund discipline. They should provide to the banker all the information regarding his operational plans well in advance. Accordingly, the banker must carry out a realistic credit appraisal of such plans.

2. The main function of the banker as a lender is to supplement the borrower's resources to carry on acceptable level of current assets. This has two implications:

   (i) Current assets must be reasonable and based on norms, and

   (ii) A part of funds requirement for carrying out current assets must be financed from long term funds.

3. The bank should know the end use of bank credit so that it is used only for purposes for which it was made available.

4. The bank should follow inventory and receivable norms and lending norms. It has suggested inventory and receivable norms for fifteen major industries. It has also suggested three lending norms / methods which are as follows:

   (i) I Method: The borrower must contribute a minimum of 25% of working capital gap from long term funds.

MPBF = 75% of [Current Assets Less Current Liabilities] i.e., 75% of Net Working Capital

(ii) II Method: The borrower must contribute a minimum of 25% of the total current assets from long term funds.

MPBF = [75% of Current Assets] Less Current Liabilities

(iii) III Method: The borrower has to contribute the entire hard-core current assets and a minimum of 25% of the balance of the current assets from long term funds.

MPBF = [75% of Soft-Core Current Assets] Less Current Liabilities

Core current assets is permanent component of current assets which are required throughout the year for a company to run continuously and to stay viable. The III method could not be implemented due to practical difficulties.

RBI has withdrawn the prescription, with regard to assessment of working capital needs, based on the concept of Maximum Permissible Bank Finance (MPBF), in April 1997. Banks are now free to evolve, with the approval of their Boards, methods for assessing the working capital requirements of borrowers, within the prudential guidelines and exposure norms prescribed.

Micro and Small Enterprise (MSE) units having working capital limits of up to Rupees five crore from the banking system should be provided working capital finance computed on the basis of 20 percent of their projected annual turnover. The banks should adopt the simplified procedure in respect of all MSE units.

Example: From the following data, calculate the maximum permissible bank finance under the three methods suggested by the Tandon Committee:

Liabilities	**Rs. in lacs**	**Current Assets**	**Rs. in lacs**
Bank Borrowings	400	Raw Material	150
Creditors	150	Work in Progress	90
Other Current Liabilities	50	Finished Goods	190
		Receivables	160
		Other Current assets	110
Total	**600**	**Total**	**700**

The total Core Current Assets (CCA) are Rs. 280 lacs.

Solution: The maximum permissible bank finance (MPBF) for the firm, under three methods may be ascertained as follows: (CL – Current liabilities less bank borrowings)

Method I = 0.75 (CA- CL)

= 0.75 (700-200)

= Rs. 375 lacs

Method II = 0.75 (CA) – CL

= 0.75(700) - 200

= Rs. 325 lacs

Method III = 0.75 (CA-CCA) - CL

= 0.75 (700-280) - 200

= Rs. 115 lacs

It is noted that the MPBF decreases gradually from the first method to second method and then to third method. As the firm has already availed the bank loan of Rs. 400 lacs, it is eligible to get finance of Rs. 375 lacs only under Method 1.

5. **Bills Finance** is a short-term funding and is self-liquidating in nature. The bills can be classified as Demand Bills and Usance Bills. Demand Bills are payable on Demand. In Usance Bills, the seller gives certain period (Usance) to buyer to pay the bill. The bills are expressed to be payable after some time (30 days / 45 days / 90 days / one month / two months etc.) from either the date of bill or from the sight of bill. Demand Bills are purchased, and Usance Bills are discounted by the banks. Banks negotiate these bills and seller gets credit against these bills immediately for the goods sold. The bank adjusts the money lent from the realization proceeds of the bill (called as self-liquidating advance).

   Bills (Demand / Usance) can be clean or documentary (without or with document of title to the goods accompanying it respectively). The 'Document of Title to Goods' include Railway Receipt (RR), Motor Transport Receipt (MTR), Lorry Receipt (LR), Airway Bill or Bill of Lading. It depends on the mode of transportation used by the seller to send the goods to buyer. The documentary bills are drawn on DP term (documents to be delivered to the buyer against payment of the bill) or DA term (documents to be delivered to the buyer on accepting the bill). The terms DA or DP depend on factors such as seller / buyer relationship, market conditions, nature of goods (perishable or not) etc. Advance against Usance documentary bill with DA term becomes 'Clean' after the document of title is delivered to the buyer. Therefore, while lending money to seller against Usance documentary Bill with DA term, banks take into consideration the credit worthiness of both the seller (drawer) and the buyer (drawee) of the bills and genuineness of underlying transactions / documents.

6. **Packing Credit** facility is sanctioned to an exporter to procure raw material and manufacture goods as required by the buyer, at pre-shipment stage. Bank secures this advance by creating hypothecation charge on the stock of goods and other current assets and debtors. The period for which a packing credit advance is given by a bank will depend upon the circumstances of the individual case, such as the time required for procuring, manufacturing or processing (where necessary) and shipping the relative goods / rendering of services. If pre-shipment advances are not adjusted by submission of export documents within 360 days from the date of advance, the advances will cease to qualify for prescribed (concessional) rate of interest for export credit to the exporter ab initio.

7. **Buyer's Credit** is the credit a buyer (importer) avails from a bank in exporter's country under export credit scheme. The loan is drawn, and exporter is paid fully. Another way is, bank in exporter's country establishes a line of credit in favour of a bank in the importer's country. This bank in turn makes the credit available to the importer. This is mainly for import of capital goods. Banks are permitted to issue Bank Guarantee/Letter of Guarantee in favour of overseas lenders/ Bankers up to USD 50 million per transaction (USD 150 million for oil/gas refining & marketing, airline and shipping companies) for a period up to one year for import of all non-capital goods permissible under Foreign Trade Policy and up to 3 years for import of capital goods subject to prudential guidelines issued by RBI from time to time.

8. **Supplier's Credit** is where the exporter supplier extends a credit to the buyer importer of capital goods. Some amount is paid initially and the balance payment in instalments. The interest on the balance payment is as per the contract of agreement. The deferred payments are supported by the promissory notes or bill of exchange by the importer guaranteed by his banker. The exporter in turn raises loan from his banker under export credit scheme.

9. **Leasing Finance:** Lease is a contract between the owner of an asset (Lessor) and a user of the asset (Lessee). As per terms of lease agreement, the lessor pays money to the supplier who delivers asset to the lessee. The owner of the asset (lessor) transfers the right to another person to use the asset against, payment of fixed lease rents. Owner (lessor) and User (lessee) are the two parties of lease agreement. The lessor remains the owner of the asset and the possession of asset remains with lessee. Banks finance activities of leasing companies. Advance is sanctioned against fully paid new machinery / equipment by creating hypothecation change on the same. The repayment is received from rentals of the machinery / equipment leased out. Lease rentals are decided in advance for the entire leased period. The accelerated lease rental means low rental in the beginning and gradually increasing later. In general, five years or the economic life of the asset, whichever is less is the maximum repayment period allowed.

10. **Hire-Purchase** finance takes place mostly in automobile sector. Here the ownership of the asset continues to remain with the Company till the agreement period ends. At the time of the termination of the agreement the hirer has options either to return the asset to company or purchase the asset upon the terms set out in the hire-purchase agreement. The assets in hire-purchase appears in the balance sheet of hirer, who also claims depreciation. The instalment is partly treated as capital repayment and balance as interest expenditure. Only amount of interest is considered for tax purpose. Since hire-purchase finance takes place mostly in automobile sector, banks have started direct finance to transport operators as the advance under certain conditions is classified as priority sector advance.

    RBI has permitted banks to undertake business of leasing and hire-purchase within a limit of 10% of their total advance.

11. **Loan System for Delivery of Bank Credit:** RBI has issued guidelines in Dec 2018 on enhancing credit discipline among the larger borrowers enjoying working capital facility from the banking system. In respect of borrowers having aggregate fund based working capital limit of Rs. 1500 million and above from the banking system, a minimum level of 'loan component' of 40 percent (to be increased to 60 % later on) shall be effective from April 1, 2019. Accordingly, for such borrowers, the outstanding 'loan component' (Working Capital Loan) must be equal to at least 40 percent of the sanctioned fund based working capital limit, including ad hoc limits and TODs. Hence, for such borrowers, drawings up to 40 percent of the total fund based working capital limits shall only be allowed from the 'loan component'. Drawings in excess of the minimum 'loan component' threshold may be allowed in the form of cash credit facility. The bifurcation of the working capital limit into loan and cash credit components shall be affected after excluding the export credit limits (pre-shipment and post-shipment) and bills limit for inland sales from the working capital limit. Investment by the bank in the commercial papers issued by the borrower shall form part of the loan component, provided the investment is sanctioned as part of the working capital limit. The amount and tenor of the loan component is fixed by banks in consultation with the borrowers, subject to the tenor being not less than seven days. Banks may decide to split the loan component into WCLs with different maturity periods as per the needs of the borrowers.

NON FUND BASED LIMITS

Non-fund Based facilities are those, which do not involve outflow of bank's funds at the time of sanction. Non-fund-based limits may turn into fund-based facility on due date /occurrence of the specified event like devolvement of bills under LC, invocation of Bank Guarantee, etc.

BANK GUARANTEES

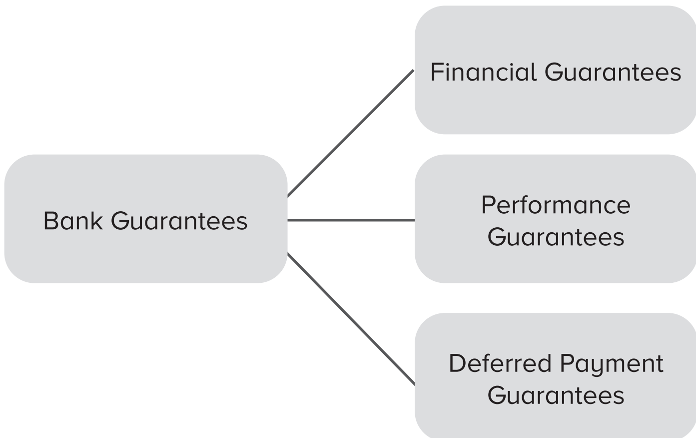
It is a non-fund-based facility required by the borrowers. Banks are often required to issue guarantees on behalf of their customers. A bank guarantee ensures that the liabilities of the debtor will be met in the event he fails to fulfil his contractual obligations. It is an agreement between three parties – the bank, the beneficiary and the applicant who seeks the guarantee from the bank. This agreement acts as an undertaking assuring the beneficiary that the bank would pay the specified amount, in the case of applicant's default in delivering the "financial" or "performance" obligation as mentioned in the guarantee.

While issuing guarantee bank should carefully note the following:

- The guarantee period is specific and clearly mentioned.
- The amount stated is specific.
- The purpose is clearly mentioned and is consistent with applicant's business.
- The grace period allowed to enforce guarantee rights is mentioned.
- The 'default' should by clearly mentioned.
- In a bank guarantee, the extent of monetary liability and the period of validity should be specific. For this reason the limitation clause is included.

Types of Bank Guarantees:

1. **Financial Guarantee –** Under this, bank guarantees that the applicant will meet the financial obligation and in case he fails, the bank as a guarantor is bound to pay (e.g. guarantees towards revenue dues, taxes, duties and for disputed liabilities for litigations pending at courts; credit enhancement; repayment of financial securities etc.).



2. **Performance Guarantee –** Under this, guarantee issued is for honouring a particular task and completion of the same in the prescribed / agreed upon manner as stated in the guarantee document. (e.g. bid bonds, retention money guarantee etc.).
3. **Deferred payment guarantee –** Here, the bank guarantees the payment of instalments payable by the buyer of capital goods such as machinery, on term credit by the supplier.

Under Deferred Payment Guarantee normally 15 to 20% of the invoice price of the capital goods is paid by the borrower and the remaining amount along with the interest at the agreed rate is payable in instalments spread over agreed period – 3 to 5 years or more. The seller draws usance bills which are accepted by the buyer and are either co-accepted by the banker or a guarantee is issued. Seller in turn can get these bills discounted from his banker. On due dates of the instalments buyer's bank arranges the remittance of instalments. Guarantee issuing bank creates charge on assets so purchased and also obtains counter-guarantee from the said applicant buyer.

Invocation of bank guarantee – Amount claimed should be paid to the beneficiary immediately if invocation is in accordance with the terms and conditions of the guarantee contract.

Expiry of guarantee – On the expiry of guarantee period the beneficiary should be intimated by letter with registered acknowledgement, indicating that the liability of the bank under the said guarantee stands discharge and the original guarantee be returned for cancellation. If no reply is received from the beneficiary in a reasonable time, the guarantee is treated as expired and cancelled.

Limitation period – Although the limitation clause is specified in the guarantee contract, the beneficiary can enforce his rights till the limitation period is alive. It is 30 years in case of Government and 3 years in other cases from the stipulated expiry date / invocation whichever is earlier.

RBI guidelines to banks for issuing guarantees on behalf of their customers:

- As a general rule, banks may provide only financial guarantees. However, scheduled banks may issue performance guarantees subject to exercising due caution in the matter.
- Guarantees should not be issued for periods exceeding ten years. Guarantees beyond ten years are allowed under a policy approved by the Boards of respective banks.
- Total volume of guarantee obligations outstanding at any time may not exceed 10% of the total owned resources of the bank comprising paid-up capital, reserves and deposits. Within the overall ceiling, proportion of unsecured guarantees outstanding at any time may be limited to an amount equivalent to 25% of the owned funds (paid up capital and reserves) of the bank or 25% of the total amount of guarantees, whichever is less.
- Banks should preferably issue secured guarantees. A secured guarantee means a guarantee made on security of assets (including cash margin), the market value of which will not at any time be less than the amount of the contingent liability on guarantee, or a guarantee fully covered by counter guarantee(s) of the Central or state governments, public sector financial institutions and / or insurance companies. Banks should generally provide deferred payment guarantees backed by adequate tangible securities or by counter guarantees of the Central or state governments, public sector financial institutions and / or insurance companies and other banks.
- Banks should avoid undue concentration of unsecured guarantee commitments to particular group of customers and / or traders.
- In case of deferred payment guarantees bank should ensure that the total credit facilities including the proposed deferred payment guarantees does not exceed the prescribed exposure ceilings.

The proposals for deferred payment guarantees should be examined having regard to profitability / cash flows of the project to ensure that sufficient surpluses are generated by the borrowing unit to meet the commitments, as a bank has to meet the liability at regular intervals, in respect of due instalments.

- The bank guarantee is a commitment made by the issuing bank to make payment to beneficiary. Failure on the part of the bank to honour the invocation claim legitimately made on it projects a distorted picture of its functioning.
- While co-accepting bills of customers, banks should ensure that they are out of genuine trade transactions and not accommodation bills. Before co-accepting bills, financial position and capacity of the parties to honour the bills, in the event of need should be assessed.
- Banks should adopt the Model Form of Bank Guarantee Bond and ensure that alterations/additions to the clauses whenever considered necessary are not one-sided and are made in agreement with the guaranteeing bank.

LETTER OF CREDIT (LC)

Letter of Credit (LC), also known as a documentary credit Is a payment mechanism used specially in international trade. In an LC, buyer's bank undertakes to make payment to seller on production of documents stipulated in the document of LC. LC play an important role in the trade of a country, especially in its international trade. In most of the cases, the exporters (sellers) are personally not acquainted with the importers (buyers) in foreign countries. In such cases the exporters bear great risk, if they draw bills on importers, after having dispatched the goods as per their orders, because if the latter default in accepting the bills or making the payment, the exporter will suffer heavy losses. To avoid such risks, the exporters ask the importers to arrange a letter of credit from their banker in favour of themselves, on the basis of which goods may be exported to the foreign importers.

Uniform Customs and Practices for Documentary Credits - 600 (UCPDC-600) apply to any LC when its text expressly indicates that it is subject to these rules. The rules are binding to all parties unless expressly modified or excluded. The Uniform Customs & Practice for Documentary Credits (UCP 600) is a set of rules agreed by the International Chamber of Commerce, which apply to finance institutions which issue Letters of Credit – financial instruments helping companies finance trade. Many banks and lenders are subject to this regulation, which aims to standardise international trade, reduce the risks of trading goods and services, and govern trade.

Parties to Letter of Credit (LC)

There are following four main parties to LC transaction:

1. Applicant or he is also called as Opener of LC. The bank opens LC on behalf of the applicant customer who is buyer / importer of goods.
2. Issuing bank is a bank which opens LC and undertakes to make payment to the beneficiary (seller/ exporter) on submission of document as per the terms of LC.
3. Beneficiary is the seller / exporter of goods in whose favour LC is opened.
4. Advising Bank is the bank through whom LC is advised to the beneficiary. Normally it is located in seller's location / country.

In addition to above four parties, following parties may also be involved in LC transaction.

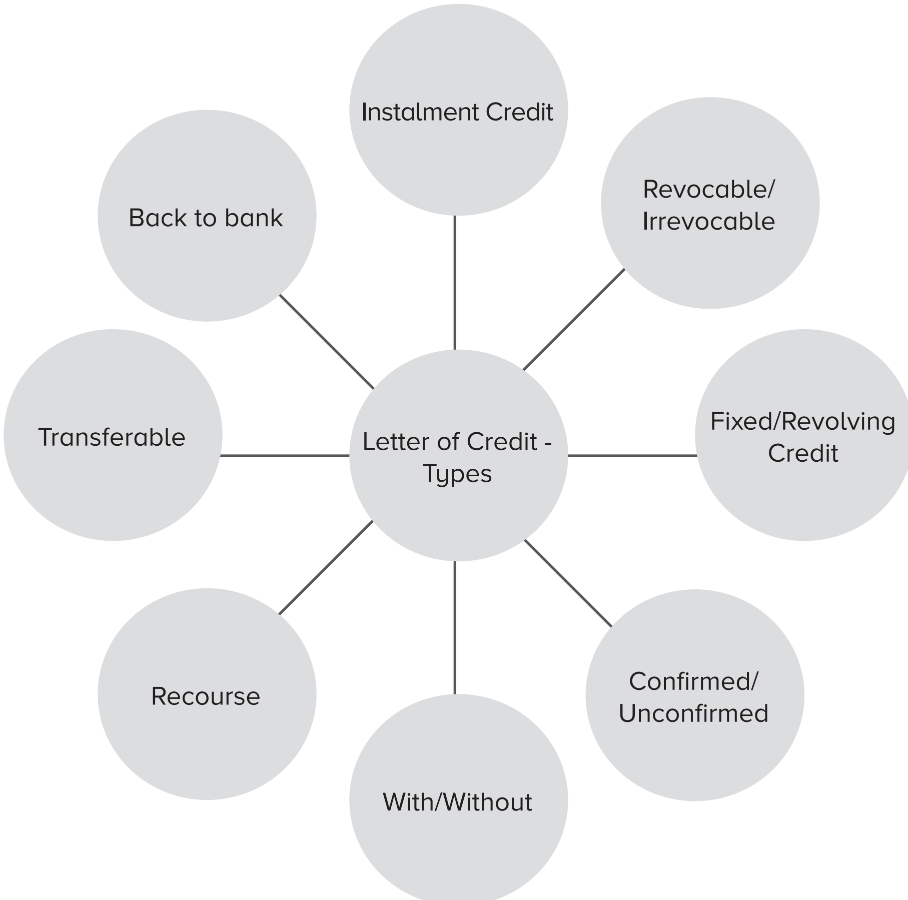
- Confirming Bank is the bank which in addition to LC issuing bank, undertakes the responsibility of payment under LC. This is required since the LC issuing bank may not be known to the exporter and he therefore needs reputed bank from his country to add confirmation to the LC.
- Negotiating Bank negotiates the documents under LC.
- Paying Bank or Nominated Bank is the bank nominated or authorized by the LC issuing bank to make payment under LC. In practice, the paying bank presents the documents received by it either to issuing bank or Reimbursing Bank for payment and transfers the proceeds to the beneficiary's account.
- Reimbursing Bank is a bank with whom the LC issuing bank maintains foreign currency account (NOSTRO account). LC issuing bank authorizes the reimbursing bank to honor the LC reimbursement claim of negotiating bank.

Documents under LC

To receive payment, an exporter must present the documents required by LC. Typical types of documents in such contract include –

- Financial documents: Bill of Exchange, co –accepted draft.
- It is the basic document drawn by the beneficiary (exporter / seller) and has to be drawn as per the terms of the LC.
- Commercial documents – Invoice, packing list.
- It is addressed to the buyer (importer), signed by the seller (exporter) and contains details of sales like quantity, rate , specification and total amount.
- Shipping documents – bill of lading, airway bill, lorry/truck receipt, railway receipt etc. It is a document of title to the goods, proof that the exporter has dispatched the goods.
- Official documents – license, certificate of origin, inspection certificate, health certificate. These are the documents as specified in the LC document.
- Insurance documents – insurance policy or certificate but not a cover note.
- The dispatched goods must be insured for the amount and the kind of risks as specified in LC document. The policy / certificate should be signed by the insurance company.

Types of LCs



1. **Documentary LC and Clean LC:** When the LC contains a clause that the payment is conditional on submission of document of title to goods such as bill of lading (evidence of dispatch of good), it is called Documentary LC. If no such clause is in the LC, it is called a clean LC.

2. **Fixed Credit and Revolving Credit:** Fixed credit is where LC specifies the amount up to which one or more bills can be drawn by the beneficiary within the specified time. The LC remains effective till the specified amount is exhausted within specified time.

   In Revolving Credit, the LC opening bank does not specify the total amount up to which bills may be drawn, but mentions total amount up to which the bills may remain outstanding at a time. Thus after reaching that amount, as soon as the importer pays the bill, to that extent the limit gets reinstated. It is thus automatic and does not need renewal within the specified period of time.

3. **Revocable and Irrevocable LC:** In case of revocable LC, the opening bank reserves the right to cancel or modify the credit at any moment without prior notice to beneficiary. It therefore does not constitute a legally binding undertaking between the opening bank and the beneficiary. If, however, the negotiating bank makes payment to the beneficiary before receiving notice of cancellation or amendment, the opening bank has to honour the liability. Such a credit provides no real security to exporter but a mere intimation to draw bills under credit. As such exporter accepts such LC only from buyers of known integrity.

   Irrevocable credit constitutes a definite undertaking of the issuing bank. Such a LC once established and advised cannot be cancelled or amended except with the consent of interested parties – beneficiary and negotiating bank.

If nothing is mentioned in LC, it is treated as irrevocable under UCPDC regulations.

4. **Confirmed and Unconfirmed LCs:** When the opening bank requests the advising bank in the exporter's country to add its confirmation to an irrevocable LC and the advising bank does so, the LC is "irrevocable and confirmed". The advising bank is then called as 'confirming bank' and its liability then becomes similar to the issuing bank. The confirmation cannot be cancelled or amended unless agreed by all the parties. A confirmed irrevocable LC provides absolute security to the beneficiary.

   If the advising bank does not add its confirmation, the LC remains as unconfirmed. In such case there will be no such obligation on the advising bank.

5. **'With' and 'Without Recourse' Credit:** In case of "with Recourse" bills, the banker as a holder of the bill, can recover the amount of the bill from the drawer, in case the drawee of the bill fails to pay it. In order to avoid such liability, the seller / exporter / drawer asks the importer / buyer to arrange credit "Without Recourse" to the drawer. In such a credit the issuing bank will have no recourse to the drawer (exporter) if the drawee (importer) fails to honour the bill. The liability of such a bill ends as soon as the bill is negotiated.

6. **Transferable LCs:** Ordinarily the beneficiary is authorized to draw bills of exchange under LC. But if the beneficiary is an intermediary in the transaction and the goods are actually to be supplied by someone else, the beneficiary may request the opener to arrange a transferable credit. Under transferable credit, the beneficiary can transfer the credit to one or more persons. But it can be done only if the credit is expressly designated "transferable" by the issuing bank. The credit can be transferred only on the terms and conditions specified in the original credit. The second beneficiary, however, cannot transfer it further, but can transfer the unused portion back to the beneficiary.

7. **Back to Back LC:** When a beneficiary receives a non-transferable LC, he may request a bank to open a new LC in favour of some other person (may be local supplier), on the security of LC issued in his favour. Such LC is called Back to Back LC. The terms of such LC are identical except that the amount (price) may be lower and the validity earlier.

8. **LC with Red Clause / Green Clause:** LC with a clause printed in red ink, contains authority from the issuing bank to the advising / negotiating bank to grant advances (packing credit) to the beneficiary up to a specified amount at the responsibility of former. It is a short term advance recovered from the amount, payable by the negotiating bank to the beneficiary when it negotiates the documents under LC submitted by the beneficiary.

   Green Clause is an extension of red clause LC allowing advances for storage of goods in warehouse in addition to packing credit.

9. **Instalment Credit:** LC is issued for full value of goods but part-shipments of specific quantities of goods within nominated period are required. Credit is not available for missed shipment and shipments thereafter unless permitted in LC document.

Advantages of LCs to the Exporter (seller) and the Importer (buyer)

- Facilitates trade transactions between two parties who are not known to each other and located in two different countries.
- Beneficiary is assured of payment as long as it complies with the terms and conditions of LC.
- The credit risk is borne by the issuing bank and not the applicant (buyer).
- LC accelerates payment of receivables and helps beneficiary (seller) in minimizing collection time.
- The beneficiary's foreign exchange risk is eliminated with LC issued in the currency of seller's country.
- On the basis of LC the exporter may obtain advance from the bank for procuring and processing or manufacturing goods to be exported.

- Buyer is enabled to import goods.
- LC assures importer that bills drawn under LC will be honoured only when they are strictly in accordance with the conditions stipulated in LC document and the documents are duly submitted.

RBI guidelines for grant of LCs Facility

For Commodities covered under Selective Credit Controls, there is no restriction for banks in opening LCs for import of essential items. However, banks are not permitted to open inland LCs, providing a clause therein which would enable other banks to discount Usance Bills under LCs.

- Before issuing LCs, banks should ensure that –
  - i) LCs are issued in security forms only.
  - ii) Large LCs are issued under two signatures, one of the signatory being from HO / Controlling office.
  - iii LCs are not issued for amounts out of proportion to the borrower's genuine requirements, and are issued only after ensuring that the borrowers have made adequate arrangements for retiring the bills.
  - iv) Where LCs are for purchase of raw materials, borrowers do not maintain unduly high inventory of raw materials in relation to the norms/past trends.
  - v) In case of borrowers having banking arrangements on a consortium basis, the LCs are opened within the sanctioned limit on the basis of agreed share of each bank.
  - vi) If there is no formal consortium arrangements for financing the borrower, LCs should not be opened by the existing bank or new bank, without the knowledge of other banks.
  - vii) LCs for acquisition of capital goods should be opened only after banks have satisfied themselves about tying up of funds for meeting the relative liability by way of providing for long term funds or term loans.
  - viii) In no case working capital limits should be allowed to be utilized for retiring bills pertaining to acquisition of capital assets.
- The exposure ceilings and other restrictions prescribed for total credit exposure including non-fund based facility, advances to bank's directors, loans and advances to relatives of directors, unsecured guarantees etc., must be strictly observed.
- Unauthorized LCs are not to be issued.

FACTORING

Factoring is a financial transaction and a type of debtor finance in which a business (client) sells its accounts receivables (invoices) to a third party (called a factor) at a discount. It is the oldest form of business financing. For many companies it is the cash management tool of choice.

Factoring process

- The seller sells the goods to the buyer and raises the invoice on him.
- Invoices are then submitted to the factor for funding.
- Factor pays the seller, after deducting some discount on the invoice value. It pays around 75 to 80 percent of invoice value after deducting the discount.
- Factor then waits till the buyer to make the payment to him.

- On receiving the payment from buyer on due date, the factor pays remaining 20 to 25 percent of the amount to the client after deducting his fee.
- It can be with recourse factoring in which the loss due to non-payment by the buyer is borne by the client or in a without recourse factoring the non-payment risk is borne by the factor.
- Generally in India with recourse factoring is widely done.

Advantages of Factoring

- Since the factor performs the duty of collection of debtors, the client can focus on other areas of business.
- Credit risk of client is reduced, especially in without recourse factoring.
- Working capital is not locked-up, as factor immediately gives funds to the client.
- Reduces cost as the sales ledger and the recovery function is performed by the factor.
- Cash flow and the liquidity position in the business is improved.
- Business creditors can be paid timely or before time thus help in negotiating better discount terms from the suppliers.
- Reduces need for raising new capital in the business.

Disadvantages of Factoring

- Bad behaviour of factor with the debtors may affect the business relationship and the goodwill of the company.
- Factors often avoid risky debtors, so the responsibility of such debtors remains with the company.

RBI guidelines on provision of Factoring services by Banks

- Banks should adhere to the provisions of Factoring Regulation Act, 2011.
- Banks may formulate policy approved by their Boards. The policy may specifically address issues pertaining to the various risks associated with this activity and put in place suitable risk mitigation measures.
- Factoring services may be provided either with recourse or without recourse or on limited recourse basis.
- Proper and adequate control and reporting mechanisms should be put in place before such business is undertaken.
- Receivables acquired under factoring should not exceed 80% of the invoice value.
- Thorough credit appraisal of debtors should be done before entering into factoring arrangement.
- Invoices should represent genuine trade transactions.
- Under without recourse factoring, where the factor is underwriting the credit risk on the debtor, there should be clearly laid down board – approved limit.
- Factoring should be treated at par with loans and advances and accordingly extant prudential norms on loans and advances would be applicable to this activity.
- The facilities extended would be covered within the overall exposure ceiling.
- Interest charged will be subject to the guidelines on interest rates on advances and fees charged will be subject to the guidelines on reasonableness of bank charges.

- Credit information regarding overdue receivables should be furnished to the Credit Information Companies.
- The instructions / guidelines issued in respect of KYC / AML / CFT should be strictly adhered to.
- International factoring arrangements should be in compliance with FEMA guidelines.
- Engagement of Recovery Agents should be strictly as per the guidelines issued from time to time.
- Outsourcing of activities should adhere to the guidelines on “Managing Risks and Code of Conduct in Outsourcing of Financial Services by Banks.
- To increase liquidity support for the MSME sector, RBI has told Bankers that factoring transactions on ‘with recourse’ basis shall be eligible for priority sector classification by banks, which are carrying out the business of factoring departmentally.

COMMERCIAL PAPERS (CP)

Further to details indicated under Lesson 4, a summary regarding CP is as below:

Commercial Paper (CP) is an unsecured money market instrument issued in form of a promissory note (negotiable instrument). It was introduced in 1990 with a view to enable highly rated corporate borrowers to meet their short-term funding requirements for their operations and to provide an additional instrument to investors.

Corporates, Primary Dealers (PDs) and All-India Financial Institutions (‘FIs’) are eligible to issue CP subject to –

- The tangible net worth of the company, as per the latest audited balance sheet is not less than Rs. 4 crore.
- Company has been sanctioned working capital limit by bank/s or FIs.
- The borrowal account of the company is classified as a Standard Asset by the financing bank/s, FIs. All eligible participants shall obtain the credit rating for issuance of CP from credit rating agencies specified by RBI from time to time for the purpose. Minimum credit rating shall be A-2 (as prescribed by Securities Exchange Board of India) and issuer shall ensure at the time of issuance of CP that the rating so obtained is current and has not fallen due for review.

CP can be issued for maturities between a minimum of 7 days and a maximum of up to one year from the date of issue (the maturity date of the CP should not go beyond the date up to which the rating of the issuer is valid). CP can be issued in denominations of Rs. 5 lakh or multiples thereof. The aggregate amount of CP from an issuer shall be within the limit as approved by its Board or the quantum indicated by the credit rating agency for the specified rating. CP will be issued at a discount to face value as may be determined by the issuer.

Only a schedule bank can act as an Issuing and Paying Agent (‘IPA’) and investors can be individuals, banking companies, other corporate bodies, Non-Resident Indians (‘NRI’s) and Foreign Institutional Investors (within the limits set for them by SEBI from time to time). No issuer shall have the issue of CP underwritten or co-accepted.

CPs can be issued either in form of a promissory note or in a dematerialized form. Banks, FIs and PDs can hold CP only in dematerialized form. Initially the investor in CP is required to pay only the discounted value of CP by means of a crossed account payee cheque to the account of the issuer through IPA. On maturity of CP, the holder of CP shall present the instrument for payment to the issuer through IPA if CP is held in physical form. If held in demat form, the holder will have to get it redeemed through the depository and receive payment through IPA.

Standardised procedures and documentation for CPs are prescribed in consultation with Fixed Income Money Market and Derivatives Association of India (FIMMDA) in consonance with international best practices. CP being a ‘stand alone’ product, it would not be obligatory in any manner on the part of banks and Financial Institutes to provide stand-by facility to the issuer. However they can provide credit enhancement by way of stand-by assistance/credit backstop facility etc. Non-banking entities including corporates can provide unconditional and irrevocable guarantee for credit enhancement for CP issue.

BILLS PURCHASE AND DISCOUNT

The bills of exchange are classified into Demand Bills and Usance Bills. A demand bill is one which is payable 'at sight' or 'on demand' or 'on presentation'. Usance bill is one where drawer (seller) allows certain period of time (Usance) say 30, 60 or 90 days to drawee (buyer) to make the payment. The bills can further be classified as Clean Bill or Documentary Bill. If drawer of a bill encloses document of title to the goods (Railway Receipt, Lorry Receipt, Motor Transport Receipt, Bill of Lading) it is documentary bill, and if no such document is enclosed, it is a clean bill.

In case of Purchase and Discount of bills, the banker credits the customer's account with the amount of the bill after deducting his charges (called discount). This facility extended against Demand bills is called Bills Purchased facility and facility extended against Usance bills is called Bills Discounting facility.

Advantages of Discounting of Bills

- Safety of Bank's funds : Though bank does not get charge over any tangible asset here, the security that the bill is negotiable legal instrument and if it is not paid by the drawee (buyer), bank can always recover by debiting drawer's (seller) account.
- Certainty of payment : As bill finance is of short term nature, bill maturing for payment on demand or after the usance is completed (which is maximum of 90 to 180 days), the advance is self-liquidating. Monitoring also becomes easy as when the bill of a particular party remains unpaid, further discounting bills of such party can be stopped.
- Facility of refinance : In case of need of funds, banks can rediscount the eligible bills with the Reserve Bank of India/SIDBI.
- Stability in the value : The value of the bill as security does not fluctuate. Amount advanced and amount payable are fixed.
- Profitability : Bank credits the amount of bill by recovering its interest (discount) from the amount of bill, hence the yield is more.

Banks have to take into consideration following points while sanctioning Bills facility

- Clean bills are treated by banks as unsecured advance and hence sanctioned only to borrowers of high repute. Documentary bills are safer and advance against it is secured.
- Usance Documentary bills with DP term (documents against payment) are considered safer than DA term (documents against acceptance) as in latter case the goods are parted first and the payment is made by the buyer later.
- The purpose of the facility should be carefully verified.
- Adequate information about the parties on whom the bills are drawn by the borrower should be gathered from the market and their creditworthiness should be assessed, before discounting.
- If borrower draws bills on number of parties, party wise limits within the overall limit should be sanctioned, depending on percentage of sales of each party in total sales.
- Ensure that bills are drawn outof genuine trade and commercial transactions and are not of accommodation nature.

Grant of Non Fund Based Limits (standalone basis)

Scheduled Commercial Banks are permitted by RBI to grant non-fund based facilities including Partial Credit Enhancement (PCE) to those customers, who do not avail any fund based facility from any bank in India, subject to the following conditions:

a) Banks shall formulate a comprehensive Board approved loan policy for grant of non-fund based facility to such borrowers.

b) Verification of Customer credentials: The banks shall ensure that the borrower has not availed any fund based facility from any bank operating in India. However, at the time of granting non-fund based facilities, banks shall obtain declaration from the customer about the non- fund based credit facilities already enjoyed by them from other banks.

c) Credit Appraisal and due-diligence: Banks shall undertake the same level of credit appraisal as has been laid down for fund based facilities.

d) The instructions/ guidelines on Know Your Customer (KYC)/Anti- Money Laundering (AML)/ Combating of Financing of Terrorism (CFT) applicable to banks, issued by RBI from time to time, shall be adhered to in respect of all such credit facility.

e) Submission of Credit Information to CICs: Credit information relating to grant of such facility shall mandatorily be furnished to the Credit Information Companies (specifically authorized by RBI). Such reporting shall be subject to the guidelines under Credit Information Companies (Regulation) Act, 2005.

f) Exposure Norms: Banks shall adhere to the exposure norms as prescribed by RBI from time to time.

Traders who import goods and services from abroad, can now apply for credit facilities in the form of Letter of Credits, Bank Guarantees, all important financial instruments, required to transact overseas mostly, without availing vanilla bank loans.

RESTRICTION ON LENDING

As already indicated under Lesson 4, under Banking Regulation Act, 1949, there are statutory restrictions on banks for lending. Brief of such restrictions is given below:

i) Advances against bank's own shares: In terms of Section 20(1) of the Banking Regulation Act, 1949, a bank cannot grant any loans and advances on the security of its own shares.

ii) Advances to bank's Directors: Section 20(1) of the Banking Regulation Act, 1949 lays down the restrictions on loans and advances to the directors and the firms in which they hold substantial interest.

iii) Advances to Companies for Buy-back of their Securities: As per provisions of the Companies Act, 2013, companies are permitted to purchase their own shares or other specified securities out of their free reserves/securities premium account or from the proceeds of any shares or other specified securities subject to compliance of statutory conditions. In view of the above, banks should not provide loans to companies for buy-back of shares/securities.

iv) Granting loans and advances to relatives of Directors: Without prior approval of the Board or without the knowledge of the Board, no loans and advances should be granted to relatives of the bank's Chairman/ Managing Director or other Directors, Directors (including Chairman/Managing Director) of other banks and their relatives, Directors of Scheduled Co-operative Banks and their relatives, Directors of Subsidiaries/ Trustees of Mutual Funds/Venture Capital Funds set up by the financing banks or other banks.

v) Restrictions on Grant of Financial Assistance to Industries Producing / Consuming Ozone Depleting Substances (ODS): Banks should not extend finance for setting up of new units consuming/ producing the Ozone Depleting Substances (ODS). No financial assistance should be extended to small/medium scale units engaged in the manufacture of the aerosol units using chlorofluorocarbons (CFC) and no refinance would be extended to any project assisted in this sector.

vi) Restrictions on Advances against Sensitive Commodities under Selective Credit Control (SCC): With a view to prevent speculative holding of essential commodities with the help of bank credit and the resultant rise in their prices, Reserve Bank of India issues directives from time to time to all commercial banks, stipulating specific restrictions on bank advances against specified sensitive commodities.

vii) Banks and their subsidiaries should not undertake financing of 'Badla' transactions.

viii) Banks should not extend bridge loans against amounts receivable from Central/State Governments by way of subsidies, refunds, reimbursements, capital contributions, etc. subject to certain exemptions like financing against receivables from Government by exporters (viz. Duty Draw Back and IPRS).

ix) Banks should not extend bridge loans against amounts receivable from Central/State Governments by way of subsidies, refunds, reimbursements, capital contributions, etc. subject to certain exemptions like financing against receivables from Government by exporters (viz. Duty Draw Back and IPRS).

CASE LAWS

1. In the matter of *Bank of India vs. M/s. Brindavan Agro Industries Pvt. Ltd. [Civil Appeal No. 1720 of 2020 arising out of SLP. (Civil) No. 2007 of 2019]*, Honorable Supreme Court set aside the orders passed by the NCDRC and SCDRC. It was found that though, the Bank agreed to refund Rs.9.16 lakhs from the processing charges through email dated 29th June 2012 but the Consumer had not accepted such proposal in its e-mail dated 24th July, 2012. Therefore, the Court held that the Consumer is entitled to refund of Rs.9.16 lakhs only in terms of the decision of the Bank communicated to the Consumer rather than waiver of TEV charges in its entirety. The request was to give concession of 50% of all charges, therefore, it is the cumulative amount of charges which is to be taken into consideration and not the charges under a particular head.

2. ***Vicky vs. State (Govt . of NCT of Delhi) (13.01.2020 Supreme Court)***

   The substantive sentences in first two groups and that in respect of the case in the third group would run consecutively.

   The Honorable court has referred the case of V.K. Bansal, wherein the appellant-accused was facing fifteen cases and the Supreme Court has grouped fifteen cases into three different groups:-

   (i) the first having twelve cases relating to advancement of 8 loan / banking facility to M/s Arawali Tubes Ltd. acting through the appellant thereon as Director;

   (ii) the second having two cases relating to advancement of loan to the appellant M/s Arawali Alloys Ltd. acting through the appellant as its Director; and

   (iii) the third having a single case qua the criminal complaint by the State Bank of Patiala.

The Court directed that the substantive sentences within first two groups would run inter-se concurrently. The Supreme Court directed that the substantive sentences in first two groups and that in respect of the case in the third group would run consecutively.

3. ***Canara Bank vs. United India Insurance Co. Ltd. (06.02.2020 Supreme Court)***

   Beneficiaries of the policies taken out by the insured are also 'consumers' under the Consumer Protection Act

   In the above case, some farmers had stored their agricultural produce in the cold storage run by a partnership firm and took loan from the Canara Bank against the agricultural produce stored in the cold storage. The cold store was insured with United India Insurance Co. Ltd. A fire took place in cold store, the entire building with agricultural produce was destroyed. The cold store owners had taken out a comprehensive insurance policy and raised claim with the insurance company but the claim was repudiated on the ground that the fire was not an accidental fire. The farmers also issued notice to insurance company in respect of the plant, machinery and building but this claim was also repudiated by the insurance company on additional ground that the farmers had no locus standi to make the claim and there was no privity between the farmers and insurance company. The farmers filed a claim against cold store, Canara Bank and the Insurance Company.

It was found that in the tripartite agreement among the farmers, Canara Bank and Cold store, it was mandatory to insure the agricultural produce hypothecated with the Canara Bank.

The Honorable Supreme Court held that the beneficiaries of the policies taken out by the insured are also 'consumers' under the Consumer Protection Act, even though they are not parties to the contract of insurance.

4. ***Bank of Baroda vs. Kotak Mahindra Bank Ltd. (17.03.2020 Supreme Court)***

The period of limitation shall be governed by the Act and not by Section 44A of the CPC, since the latter provides only for the procedure to be followed for executing a foreign decree

Kotak Mahindra Bank Ltd., issued a Letter of Credit for US $1,794,258 on behalf of its customer M/s. Aditya Steel Industries Limited in favour of M/s. Granada Worldwide Investment Company, London. The appellant Bank of Baroda was the confirming bank to the said letter of credit. The Vysya Bank issued instructions to the London branch of the appellant on 12.10.1992 to honour the Letter of Credit. Acting on this instruction the London branch of the appellant discounted the Letter of Credit for a sum of US $ 1,742,376.41 and payment of this amount was made to M/s Granada Worldwide Investment Company on 13.10.1992.

Later in 2009, Bank of Baroda filed an Execution Petition against Kotak Mahindra Bank under Section 44A read with Order 21 Rule 3 of the CPC for recovery of Rs.16,43,88,187.86. The Execution Petition was filed in view of the decree passed by the High Court of Justice, Queens Bench, Divisional Commercial Court of London (UK Court) on 20 February 1995 for US$ 1,267,909.26 in favour of Bank of Baroda. The maintainability of the Execution Petition was challenged primarily on the ground of limitation.

One major Issue in the case for the court to decide 'What is the limitation for filing an application for execution of a foreign decree of a reciprocating country in India?'

For this major issue of the case that related to the limitation period, the Supreme Court had rejected the argument that there is no limitation period for execution of foreign decree in India while observing that the term "application" in Section 3 of the Act shall be deemed to include execution petitions. The period of limitation shall be governed by the Act and not by Section 44A of the CPC, since the latter provides only for the procedure to be followed for executing a foreign decree

Securities for Banker's Loan

Whenever banks advance loan generally securities are obtained. This is to safeguard advances extended by them in the event of a default by a borrower. Banks obtain movable and immovable properties as securities and create a charge on these securities so as to enforce their security interests later when a need arises. Creating a charge over a property depends upon the nature of property as well the nature of charge sought to be created. Keeping these aspects in mind, the chapter covers various aspects of securities accepted by banks as securities towards loans as well as different types of charges that are created thereon. This is an important aspect for any student of banking as one of the principal business of banking is lending. Several examples are also given for an easy understanding of concepts.

Banks sanction loans to borrowers against some security. These securities help bankers in case the borrower fails to repay the loan for one reason or other. Bankers in such cases sale / liquidate the securities and adjust the proceeds to outstanding loan balance including interest and other charges. As such selection of security, stipulating margin of safety, creating appropriate charge on the security etc. assume lot of importance in the process of lending.

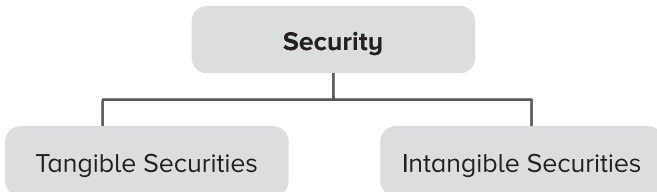
Security can be Main (Principal / Primary) or Collateral (Secondary)

Main security is an asset against which or for the acquisition of which loan is sanctioned by the bank. For instance, if bank sanctions loan to a borrower for purchase of machinery or sanctions loan to a borrower to meet his medical expenses and borrower offers his gold ornaments to the bank as security, then in both these cases the machinery and the gold ornaments are Main securities. However, in case the borrower in addition also offers his Fixed Deposit Receipt to bank as a security, then the FDR becomes collateral security. Thus, the collateral is an additional security that borrower offers to the bank with the main security.

Thus, any security like house property, stock of raw materials, plant and equipment etc. can be main security or collateral security depending on whether bank gives loan for it / against it or it is additional security obtained by the bank, respectively.

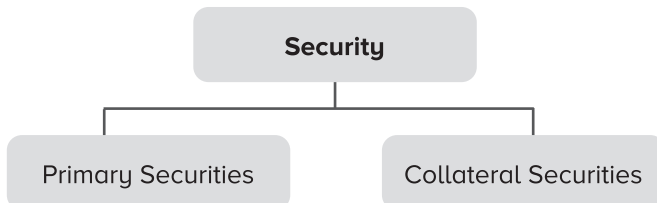
Security can be Personal (Intangible) or Tangible

Personal security is the surety given by the borrower himself or other individual, firm, company by way of guarantee. This gives a bank a right to sue them in their personal capacity in case of need. Tangible security is in the form of plant, machinery, stock, land and building, etc., which is impersonal in nature.



Attributes of Good Security (MAST Principle)

- Marketability (Freely traded in the market and easily convertible in cash).
- Ascertainability (Value and location of security should be easily ascertainable).
- Stability (Value of security should not fluctuate widely).
- Transferability (Ownership of security should be legally transferable).



What is MARGIN and Why MARGIN is required?

When bank lends money to borrowers against securities, it stipulates certain percentage of the value of security (Market price or book value, whichever is less) as a contribution from the borrower, which is called a Margin. If borrower offers his machinery of Rs. 1,00,000.00 as security, bank generally lends Rs. 70,000.00 (70% of value of security) and asks borrower to bring Rs. 30,000.00 (30%) of his own contribution (margin). The percentage of margin varies depending on the nature of the security and risk profile of the borrower.

Margin is necessary for following reasons:

1. Compulsion by regulatory authority. RBI makes it obligatory upon bankers to insist some minimum margin while lending.
2. Margin ensures involvement of borrower in the activity as his stake (own money) is in the asset purchased.
3. Margin acts as a buffer in deterioration in the quality and depreciation in the value of asset.
4. It also acts as a cushion against price fluctuations, non- payment of interest, charges debited to borrower's account and to some extent non-payment of loan installments.

Charge on Assets	
Floating Charge	Fixed Charge

The right of a lender (bank) to be paid from a debtor's (borrower) asset if the debt is not paid is called **Charge on asset**. Borrower creates charge on the securities offered to the bank for availing loan. This gives the bank, right to get payment out of the charged security, however the ownership of asset is not transferred to the creditor (bank).

When charge is created on Fixed Assets like plant and machinery, land and building etc. whose identity do not change during the period of loan is called Fixed Charge.

Charge created on Current Assets like stocks, debtors which undergo changes (from raw material to work in process to finished goods to debtors) is called **Floating Charge**. It is an equitable charge on the assets of a going concern. The charge becomes fixed when the going concern ceases to be a going concern (winding up, appointment of receiver). This is called Crystallization of the charge.

Pari Passu (is a Latin word which means "with an equal step" or "on equal footing").

Charge is created in favour of several creditors each having proportionate right on the asset on the basis of the ratio of their loans. This generally happens when several banks jointly finance a single borrower (consortium advance).

In case of **Exclusive Charge** only one creditor has charge in his favour without intervention of any other creditor. The creditor who is given credit facility security over the property on which the charge is created has a right over the security above all other people. When a charge is created on the assets already charged to another creditor, the second creditor has a charge which is called as **Second Charge.** The right of second charge holder is subject to first charge holder.

ASSIGNMENT

It is transfer of ownership of a property, or of benefits, interests, liabilities, rights under a contract (such as an insurance policy), by one party (the assignor) to another (assignee) by signing a document called deed of assignment. It is transfer of an actionable claim, which may be existing or in future, as a security for loan.

Legal assignment is an absolute transfer of actionable claim. It must be in writing. Signed by the assignor (in case of LIC policy, by the policy holder), and should be informed to the debtor (LIC).

In **Equitable assignment** the possession of document representing actionable claim is handed over but no other formalities are observed. However, debtor (LIC) has to be informed.

Assignment must be in writing and signed by the assignor or his legal representative and must be witnessed. To make the assignment valid, consideration is not must, however notice to the debtor and his acknowledgement is necessary to make debtor liable to assignee. A borrower can assign the book debts, money due from Government Departments, LIC policies to bank as security for an advance.

Assignment only takes place after the original contract has been made. As a general rule, assignment of rights and benefits under a contract may be done freely, but the assignment of liabilities and obligations may not be done without the consent of the original contracting party.

The difference between assignment and transfer is that assignment means it's legal to transfer property or a legal right from one person to another, while transfer means it's legal to arrange for something to be controlled by or officially belong to another person.

LIEN

Lien is defined in Indian Contract Act, 1872. It is a right of a creditor to retain the possession of goods and securities owned by the debtor, till the debts are fully paid off. However, creditor does not get right to sell the securities.

The lien can be **Particular lien** or **General lien**. In case of particular lien only those goods and securities in respect of which debts are incurred, can be retained by the creditor (if a wrist-watch is given to watch repairer for repairing, till the repairing charges are paid, the watch repairer has right to retain the wrist watch in his possession). He cannot sell the watch for the recovery of service charges or also cannot retain any other security of the debtor for these repairing charges. In case of general lien, for the general balance due, the creditor can retain the goods and securities of the debtor. Banks in India enjoy not only right of general lien, they can even sell the goods and securities of the debtor in case of need to recover debts. Banker's lien is therefore called as an **Implied Pledge.** Since Limitation Act is not applicable to right of lien, banks can recover time barred debts also.

Differences between Particular Lien and General Lien

Lien is a right to keep possession of property belonging to another person until a debt owed by that person is discharged. A particular lien is one in which the person has a right to retain the possession of goods for which the charges are due. A bailee is entitled to a particular lien only. When the bailee is entitled to retain any goods bailed to him for any amount due to him in respect of those goods or any other goods, it is called General Lien. A general lien is available to bankers, factors, and attorneys of High Court and policy brokers.

Conditions necessary for exercising right of lien:

1. Goods and securities (cheques, bills, shares, debentures etc.) must be owned by the debtor in his own name. Banks may sanction advance to a borrower against third party securities. Such securities cannot be subject matter of lien (except in the name of guarantor).

2. Securities must be received in the capacity of Banker. It means for securing loan and not for other purpose like safe custody, safe deposit vaults, specifically for selling, inadvertently left in the bank, bank handling the securities as trustee or agent etc.

3. Reasonable notice must be given before the sale of securities.

4. There should not be any contract inconsistent to the right of lien.

Sometimes borrower gives an undertaking to the banker as regards his assets that, the assets are free from any charge and without the permission of the bank no charge will be created on it. This undertaking is called **Negative Lien.** This undertaking, however, has no legal standing and has moral value only.

SET-OFF

Set-off is total or partial merging of a claim of one person against another, in the counter claim of latter against former.

For example, if A, in one transaction, owes Rs. 10,000/- to B and in another transaction, B owes Rs. 15,000/- to A. Then it is not necessary that these two transactions should be settled separately. A and B can combine these two transactions, and B can pay Rs. 5,000/- to A. Thus, they can set-off the mutual debts. In banker - customer relationship, bank through this process recovers borrower's dues from his deposit account. Since this right is statutorily available to bank, the time-barred debts can also be recovered through this right of set-off.

Conditions necessary for exercising right of set-off:

1. Mutual debts must be in same name and capacity. This means if Deposit Account is in the name of A jointly with B and loan is in the name of A, then set-off cannot be exercised. Similarly, loan given to Mr. X cannot be recovered from the savings account of his minor son where Mr. X is guardian. Loan given to an individual Mr. Y cannot be recovered from the account of a partnership firm where Mr. Y is one of the partners. However, loan given to a partnership firm can be recovered from the deposit accounts of individual partners, since partners are jointly and severally (individually) liable for firms act.

2. Debts must be due and payable. This means, in case of term loan the installment which is due on 10th day of a month cannot be recovered before 10th.

3. In case the deposit account is in the nature of "Term Deposit", the right can still be exercised, for a lawful debt; however only on maturity of the deposit account.

4. Set-off can be exercised in case of guarantor's account after money is demanded from him.

APPROPRIATION

Appropriation is a right of a debtor. When borrower having more than one debt to the bank, makes payment with an instruction to apply the same to a particular debt, then if the bank accepts this payment, must apply it as per the instructions of the borrower. Instructions can be expressed or implied. Banks need not accept the payment made by the borrower with a condition but if accepts then it cannot ignore the condition (instruction).

When borrower fails to give instruction where the amount is to be applied and even the circumstances also do not indicate to which debt the payment is to be applied then the creditor can apply the payment to any lawful debt which is due and payable.

If neither the debtor nor the creditor exercise right of appropriation then the payment will be applied to discharge the debt in order of time, that is in chronological order (first debit entry will be cleared by first credit entry).

The Rule in case of Clayton's Case is applicable to running accounts like cash credit and overdrafts where the borrower deposits as well as withdraws money from the account continuously. Here the rule states that the debit entry will be set-off by the credit entry by chronological order (first debit by subsequent first credit). In order to crystallize the liability of a deceased, insane, insolvent or retired partner in cash credit / overdraft accounts of partnership firms, banks stop operations in such accounts and allow further operations in fresh

account. Similar steps are taken when loan accounts are secured by the guarantee and the guarantor is deceased, becomes insane or insolvent or guarantee is revoked by the guarantor. If the operations in the same account are continued, the subsequent credits will reduce the liability of such partner / guarantor.

PLEDGE

Pledge is defined in Indian Contract Act, 1872. It is bailment of goods as security for payment of a debt or performance of promise. The person who delivers goods (borrower) is Pledger or Pawnor and the person to whom the goods are delivered (bank) is Pledgee or Pawnee. The owner of the goods, the joint owner with the consent of other owner(s), the agent of the owner can pledge the goods. Here the possession of goods is with the creditor (bank) and ownership remains with the debtor (borrower). The possession can be actual or constructive (by handing over the key of godown where the goods are stored, acknowledgement from the warehouseman, handing over document of title to the goods like railway receipt, bill of lading). The possession is till the repayment of loan. The creditor (bank) has to take proper care of the goods pledged. It is a legal charge and fixed one. The charge is not affected by law of limitation and does not require any registration. The creditor (bank) has right to sale the goods after giving notice.

HYPOTHECATION

It is defined under SARFAESI Act as "Charge on movable property (stock, machinery, vehicle etc.) in favour of secured creditor without delivery of possession of the assets. It is an equitable charge where the possession and the ownership of the assets remain with the borrower. The borrower is called Hypothecator and the bank (creditor) is called Hypothecatee. The right of sale is available to creditor only through a court. Under SARFAESI Act, sale is possible after possession. Creditor cannot take possession without the consent of borrower, however on getting possession, a creditor can sell the security as in case of pledge. Hypothecation is thus a charge against property for an amount of debt, where neither the ownership nor the possession, is passed to the creditor. The document (letter of hypothecation) signed by the borrower provides for an agreement, whereby the borrower agrees to give possession of goods when called upon to do so by the creditor. The charge is required to be registered with the Registrar of Companies (ROC) under section 77 of Companies Act, 2013 (earlier Under Section125 of Companies Act, 1956). Limitation period of 3 years is applicable under Limitation Act. It is different from Mortgage as mortgage relates to immovable properties.

MORTGAGE

It is defined in Transfer of Property Act, 1882 as, transfer of interest in specific immovable property (land, benefits arising out of land, things attached and permanently fastened to earth) to secure an advanced loan, or an existing debt or a future debt or performance of an obligation. Once the amount due is paid to the lender, the interest in the property is restored back to the borrower. Lender gets right to recover the dues in case of default but does not become owner of the property. Mortgagor is the transferor of interest in the property and Mortgagee is the transferee. The principal money and the interest of which payment is secured is called the mortgage money and the instrument by which the transfer is affected is called the mortgage deed.

The mortgagor has right to redeem the document relating to mortgage property, where possession has been given, to get back the possession and where title has been transferred, to get retransferred, on liquidation of money borrowed. This right of redemption can be exercised before the decree for sale or foreclosure is passed by a court.

On default by the mortgagor, the mortgagee has right to obtain a decree from a court to the effect that the mortgagor be debarred for ever to redeem the mortgage. This is called right of foreclosure. The right of foreclosure describes a lender's ability to take possession of a property through a legal process called foreclosure.

Lenders must abide by specific procedures in order for a foreclosure to be legal. The transfer of Property Act contemplates following six types of mortgages:

Simple Mortgage	Mortgage by conditional sale	Usufructuary Mortgage	English Mortgage	Equitable Mortgage	Reverse Mortgage	Anomalous Mortgage

Mortgage

1. **Simple Mortgage**
    - Court intervention required for mortgagee to sell the property.
    - Rent and produce on the property, is not the right of mortgagee.
    - Registration is compulsory.
    - Mortgagor retains the possession of the property.
    - Mortgagor is personally liable too.
2. **Mortgage by conditional sale**
    - Mortgagor is not personally liable for repayment of money borrowed.
    - Mortgagee by applying to court can get decree in his favor and can sue for foreclosure.
    - Right of foreclosure is available for Mortgage by Conditional Sale only.
3. **Usufructuary mortgage**
    - Mortgagee has legal possession of the property till the borrower repays the money borrowed, however sale is not allowed.
    - Mortgagee has right to receive rent and benefits accruing from the property.
    - Mortgagor is not liable personally.
    - Law of limitation is not applicable.

4 **English Mortgage**

- Mortgagee gets absolute transfer of property on condition that the same will be retransferred if the debt is fully paid.
- Mortgagor personally liable to pay debt on a specified date.

5. **Mortgage by deposit of title deeds (Equitable Mortgage/ EMT)**

- Property can be located anywhere but the deposit of title deeds has to be made at towns notified by State Government.
- The title deed deposited should be original. In case original title deed is lost or not in existence, a certified true copy by the sub-registrar can be deposited.
- The intention should be to secure debt.
- Registration with Registrar of Assurances is not required. In case of Company, registration of mortgage is required within 30 days.

6. **Reverse Mortgage**

It is a type of home loan for older homeowners that require no monthly mortgage payments. The amount of loan is determined on the basis of borrower's age, value of property, rate of interest and norms of lending institution. The purpose is to help Senior Citizens to convert their dwelling house property into liquid cash flows to meet their living expenses. Borrowers are still the owners of property and responsible for property taxes and home owner's insurance. Reverse mortgage allows elders to access the home equity they have built up in their homes now, and defer payment of loan until they die, sell or move out of the home. Because there are no required mortgage payments on a reverse mortgage, the interest is added to the loan balance each month. Over the loan's life, the homeowner's debt increases and home equity decreases. When the homeowner dies or moves, the proceeds from the home's sale go to the lender to repay the reverse mortgage's principal, interest, mortgage insurance and fees and balance amount to legal heirs.

Generally, no loan is given against ancestral property since it involves legal issues. Loan in joint names of owner and spouse can be given irrespective of title of property, however one person should be above 60 years and the other above 55 years. Generally, loan is given with a repayment period of 15 years.

When borrower take out a reverse mortgage, he/she can choose to receive the proceeds in one of six ways:

1. **Lump sum:** Get all the proceeds at once when your loan closes. This is the only option that comes with a fixed interest rate. The other five have adjustable interest rates.
2. **Equal monthly payments (annuity):** For as long as at least one borrower lives in the home as a principal residence, the lender will make steady payments to the borrower. This is also known as a tenure plan.
3. **Term payments:** The lender gives the borrower equal monthly payments for a set period of the borrower's choosing, such as 10 years.
4. **Line of credit:** Money is available for the homeowner to borrow as needed. The homeowner only pays interest on the amounts actually borrowed from the credit line.
5. **Equal monthly payments plus a line of credit:** The lender provides steady monthly payments for as long as at least one borrower occupies the home as a principal residence. If the borrower needs more money at any point, they can access the line of credit.

Term payments plus a line of credit: The lender gives the borrower equal monthly payments for a set period of the borrower's choosing, such as 10 years. If the borrower needs more money during or after that term, they can access the line of credit.

7. **Anomalous Mortgage**

- Any mortgage other than one described above, falls in this category.

  The mortgagor can create subsequent mortgage(s) on the same property. The rule of priority is in the order of time they are created. Limitation period for filing suit for sale of mortgaged property is twelve years from the date mortgage debt becomes due. For filing a suit for foreclosure, limitation is thirty years from the date mortgage debt becomes due. Enforcement of mortgage is governed by the Code of Civil Procedure. Suit for sale of mortgage properties should be filed in the court, within whose jurisdiction the mortgaged property is situated.

Key Differences Between Pledge and Hypothecation

The significant differences between pledge and hypothecation are specified below:

1. The pledge is defined as the form of bailment in which goods are held as security for the payment of the debt or the performance of an obligation. Hypothecation is slightly different from the pledge, in which the collateral asset is not delivered to the lender.
2. Thepledgeisdefinedinsection 172 ofthe Indian Contract Act, 1872. Ontheotherhand, Hypothecation is defined in Section 2 of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.
3. In the pledge, the possession of the asset is transferred, but in the case of hypothecation, possession lies with the debtor only.
4. Parties to the contract of the pledge are pawnor (borrower) and Pawnee (lender) whereas in hypothecation the parties are hypothecator (borrower) and hypothecatee (lender).
5. In the pledge, when the borrower default in payment, the lender can exercise his right to sell the asset to recover the debt amount. Conversely, in hypothecation, the lender does not have the possession of goods so he can file a suit to realize his dues to take the possession first and then disposing off them.

INDEMNITIES AND GUARANTEES

Guarantees and Indemnities are a common way in which creditors protect themselves from the risk of debt default. Lenders will often seek a guarantee or indemnity if they have doubts about borrower's ability to fulfill his obligations under a loan agreement.

Contract of Guarantee and contract of Indemnity are defined in Indian Contract Act.

> "A contract of Guarantee is a contract to perform the promise or discharge the liability of a third person in case of his default."

> "A contract of Indemnity is a contract by which one party promises to save other from loss caused to him by the conduct of promissor himself or by the conduct of any other person."

In a simple way it can be explained as under:

If A says to B, you lend money to C. If he doesn't pay, I will pay; is a guarantee. If A says to B, you lend money to C and I will see to it that you get your money back; is an Indemnity.

Contract of Guarantee has following three parties:

1. Guarantor, also called as Surety, who gives guarantee.
2. Creditor, the person to whom guarantee is given.
3. Principal Debtor, the person in respect of who's default the guarantee is given.

Thus there are three contracts involved. One between the debtor and the creditor, where the debtor agrees to pay the debts. Second between the creditor and guarantor, who agrees to pay in case the debtor makes default and third between the debtor and the guarantor, who accepts the request of debtor and gives guarantee to the creditor. Guarantee is thus a secondary contract, the primary being between the debtor and the creditor. As such if the primary contract is invalid the secondary contract is not enforceable in the court of law. Example - If loan is sanctioned to a minor, it becomes invalid contract as contract with a minor is void ab initio. Such loan cannot be recovered even if a third party guarantee is obtained at the time of lending. Guarantor's liability arises only after the default committed by the principal debtor.

Contract of Indemnity has following two parties:

1. Indemnifier, the person who makes promise of indemnity
2. Indemnified, the person with whom the promise is made.

The indemnified in a contract of indemnity is entitled to recover from his indemnifier, the damages, cost and sums when sued.

Salient features of contract of guarantee:

- The contract of guarantee can be either oral or written. Bankers however take a written guarantee to bind the surety by his words.
- Consideration: Anything done or any promise made by the Principal Debtor is sufficient consideration to surety for giving guarantee.
- Types of guarantees: A guarantee given for a particular transaction, undertaking or debt is a specific guarantee. This guarantee once given cannot be revoked. A guarantee which extends to a series of transactions is called continuing guarantee. This guarantee can be revoked (called back) by the surety by giving notice to the creditor, but only for future transactions.
- Invalid guarantee: Guarantee obtained by misrepresentation or concealment of the facts makes the guarantee invalid.
- Nature and extent of guarantor's liability: The liability of the surety is secondary and arises only after the principal debtor making default. If at the time of making a contract, surety sets a limit of his liability then he is liable only to that extent. In the absence of such contract, the liability of guarantor is co-extensive with the principal debtor.

Rights of guarantor:

- Right of subrogation: The surety is entitled to the benefit of every security of the debtor which was in the possession of the creditor at the time a contract of guarantee was signed. This right is not affected even if the surety was not aware about the securities of the debtor with the creditor. If the creditor loses or parts with such security, without the consent of the surety, the surety is discharged from his liability to the extent of value of the security so lost or parted with.
- Right to be indemnified by the principal debtor: There is implied promise by the principal debtor to indemnify the surety. The surety has the right to recover from the principal debtor the amounts which he has rightfully paid under the contract.
- Right to revoke continuing guarantee: The surety has the right to revoke at any time a continuing guarantee by giving a notice of such revocation to the creditor. The surety however remains liable in respect of the transactions which have already taken place.

Liability of the guarantor:

- The extent of liability: The liability of the surety is to the same extent to which the principal debtor is liable to the creditor, provided the surety does not restrict his liability in the contact of guarantee. If the liability of principal debtor increases the liability of surety also increases to the same extent but cannot exceed that of principal debtor. The surety however can undertake fixed liability (lesser than the principal debtor) by specifying in the contract of guarantee. The extent of guarantee may be limited in either of the following ways-
    1. Surety may guarantee only part of the entire debt.
    2. Surety may guarantee full debt but specify the amount up to which he makes himself liable to the creditor.

- The time liability arises: The liability of surety arises on the principal debtor making default. The liability of the surety does not arise unless the liability of the principal debtor is determined. It is not necessary that the creditor should exhaust all his remedies against the principal debtor before proceeding against the surety for recovery.
- Liability of co-sureties: The co-sureties are liable to contribute equal amounts towards the liability of the debtor, provided - there is no agreement to the contrary and they are co-sureties for the same amount of debt. It is immaterial whether the contract of guarantee was the same or separate between each one of them and the creditor and whether they knew about the guarantee given by the other person or not. The contribution of each co-surety shall be equal and not proportionate. The actual amount of such contribution shall, however, not exceed the amount for which the guarantee is given by any one of them. If the creditor releases one of the co-sureties, other sureties are not discharged and the surety so released is also not discharged from his responsibilities to other sureties.

Obligations of Creditor towards surety

- The creditor must not change the original terms of the contract between himself and the principal debtor without taking consent of the surety(ies). Any variance, made without the surety's consent, in the terms of the contract between the principal debtor and the creditor, discharges the surety as to transactions subsequent to the variance.
- The creditor should not release or discharge the principal debtor. The surety is discharged from his obligation if there is a contract between the creditor and the principal debtor, by which the principal debtor is released or if there is any act or omission on the part of the creditor, the legal consequence of which is the discharge of the principal debtor.
- The creditor should not give any indulgence to the debtor. If the creditor enters into a contract whereby, he makes a composition with or he agrees not to sue principal debtor or to extend the time of repayment of debt, the surety will be discharged from his liability unless the surety gives consent to such contract.
- The credit or should not do any act which is inconsistent with the right of the surety and should not omit to do any act which is required of him.
- As soon as the liability of the surety arises, the creditor is entitled to demand payment from him. The banker is also entitled to exercise his right of lien on the securities of the surety in his possession on arising liability of the surety.
- If the surety becomes insolvent, the creditor is entitled to recover the dues from the estate of the insolvent party after determining the surety's liability by recalling the debt from the principal debtor and in case of his default.

Guarantee is not a contract of 'uberrimae fidie' (utmost good faith): A contract of guarantee does not require full disclosure of all material facts by the principal debtor or the creditor to the surety before the contract is entered into. Fraud on the part of principal debtor is not enough to set aside the contract, unless the surety can show that the creditor knew of the fraud and was a party to it. When a guarantee is given to a banker, there is no obligation on the banker to inform the intending surety of matters affecting the credit of the debtor or any circumstances connected with the transaction.

BOOK DEBTS

Book debts mean the amount that the customers of business owe to the business. Thus the trade receivables (debtors and bills receivable) are the book debts of the business. Debtors are the customers (persons or companies) who purchase goods or services from the business and pay money for the same later. Sometimes businesses after selling goods or services to customers, draw bill, which are accepted by them and amount is paid by them on due dates. These are called Bills receivables. Both are current assets of the business and are financed by the banks. It is a short-term finance and is called working capital finance. Banks finance debtors which are not exceeding 90 days of age.

CORPORATE SECURITIES (SHARES / DEBENTURES / BONDS)

Securities issued by joint stock companies broadly fall into two categories:

1. Ownership securities - equity shares and preference shares and
2. Creditor ship securities - debentures.

Preference shares of a company are those shares which carry certain preference rights for their holders over those of equity shareholders. Preference shares carry prescribed rate of dividend, which company will have to pay before any dividend can be distributed to the equity shareholders. Preference shares can be cumulative or non-cumulative. In case of cumulative preference shares, if company is unable to pay the prescribed dividend during any year (s), the same will be payable out of profits of the company in future years. This right is not available to non-cumulative preference shareholders. Preference shares may be redeemable or non-redeemable. Redeemable shares are paid after specified period.

Debentures are generally secured by mortgage of immovable property of the company. The owners of such debentures are the secured creditors of the company. Unsecured debenture holders do not posses any such charge over the assets of company. Debentures are generally redeemable after specified time. Interest payable on debentures is at half yearly rest with an option of either cumulative or non-cumulative basis. Debentures can be fully or partly convertible. 'Debentures with Right Attached' gives holder, a right to subscribe to the shares of the company against cash payment (at a low premium) at a future date.

Bonds are issued by corporations, municipalities or governments to raise money for funding their projects. The bond issuer pays interest to the bond holder at regular intervals at specified rate called coupon rate. The bond amount is paid on maturity. The zero coupon bonds are issued at discount and on maturity paid at face value. Convertible bonds give option to investors to convert bond into equity at fixed conversion price.

RBI guidelines on Loans and Advances against Shares, debentures and Bonds

- Advances may be granted to individuals against these securities held by them.
- The purpose of advance may be to meet contingencies and personal needs or for subscribing to new or right issues of shares/debentures/bonds or for purchase in the secondary market.
- Limit of advance should not exceed Rs. 10.00 lakhs per individual where securities are held in physical form and Rs. 20.00 lakhs per individual if securities are held in dematerialized form.
- Margin should be minimum 50% of the market value of equity shares / convertible debentures held on physical form, and minimum 25% if in dematerialized form. The margins for advances against preference shares, non-convertible debentures and bonds can be decided by individual banks.
- Each bank to formulate its loan policy with the approval of their Board of Directors.
- Share and stock brokers may be provided need-based overdraft facility / line of credit after careful assessment of need. The ceiling of Rs. 10.00 and 20.00 lakhs will not be applicable in their cases.
- Share and stock brokers registered with SEBI and who comply with prescribed capital adequacy norms are only eligible for loans.
- While granting advances against shares held in joint names to joint holders or third-party beneficiaries, banks should be circumspect and ensure that the objective of the regulation is not defeated by granting loans to other joint holders or third-party beneficiaries to circumvent the above limits placed on loans against shares and other securities.
- Banks may grant advances to individuals for subscribing to IPOs. Loans/advances to any individual from banking system against security of shares, convertible debentures, convertible bonds, units of equity oriented mutual funds and PSU bonds should not exceed the limit Rs.10.00laks for subscribing to IPO. The corporate should not be extended credit by banks for investment in other companies' IPOs. Similarly, banks should not provide finance to NBFCs for further lending to individuals for IPOs.

- Banks may extend finance to employees for purchasing shares of their own companies under Employee Stock Option Plan (ESOP) / reserved by way of employees' quota under IPO to the extent of 90% of the purchase price of the share or Rs. 20.00 lakhs whichever is less. Bank employees can not avail loan to purchase shares of their own bank under ESOP/IPOs or from secondary market.
- While advancing against Units of Mutual Funds, bank should ensure that - units are listed on Stock Exchange, units have completed minimum lock-in-period, amount of advance is linked to NAV/ repurchase price or market value, whichever is less and the advance is purpose oriented. The units issued by Mutual Funds relating to tax saving equity plans are not to be treated as approved securities for the purpose of considering loans / advances since they are not traded / listed in the stock exchanges.
- Banks should not undertake arbitrage operations themselves or extend credit facilities directly or indirectly to stockbrokers for arbitrage operations in Stock Exchange. While banks are permitted to acquire shares from the secondary market, they should ensure that no sale transaction is undertaken without actually holding the shares in their investment accounts.
- Advances against primary security of shares/ debentures / bonds should be kept separate and not combined with other advances.
- No advances against partly paid shares to be granted.

CERSAI

A Central Registry has come into effect from 31 st March 2011. Government of India has made it compulsory that Equitable Mortgages created by way of deposit of title deeds are registered with the Central Registry. As per provision of SARFAESI Act, a company has been formed named 'Central Registry of Securitisation Asset Reconstruction and Security Interest of India'(CERSAI) with 51% paid up capital held by Central Government and the remaining 49% of the paid-up capital shared amongst the top 10 PSBs and National Housing Bank. CERSAI has been established as a company under section 8 of the Companies Act, 2013 by the Government of India. The object of the company is to maintain and operate a Registration System for the purpose of registration of transactions of securitisation, asset reconstruction of financial assets and creation of security interest over property, as contemplated under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act). CERSAI is providing the platform for filing registrations of transactions of securitisation, asset reconstruction and security interest by the banks and financial institutions.

CERSAI is a risk mitigation tool for the Banks / Housing Finance companies, FIs and public at large to prevent multiple financing against the same property. Any bank, financial institution or an individual can access the registration platform of CERSAI for a certain fee. By registering themselves with CERSAI, the lenders can pull up the information on an asset or property to validate that whether any previous security interest has been created by a different lender ((banks, financial institutions etc.) in the past. Usually, this is done before the sanction of a loan to a borrower.

Agricultural property is excluded from the purview of SARFAESI Act. Hence bank need not register with Central Registry mortgage/security interest created on agricultural land.

The Government of India has subsequently issued a Gazette Notification dated January 22, 2016 for filing of the following types of security interest on the CERSAI portal:

a. Particulars of creation, modification or satisfaction of security interest in immovable property by mortgage other than mortgage by deposit of title deeds.

b. Particulars of creation, modification or satisfaction of security interest in hypothecation of plant and machinery, stocks, debts including book debts or receivables, whether existing or future.

c. Particulars of creation, modification or satisfaction of security interest in intangible assets, being know how, patent, copyright, trademark, licence, franchise or any other business or commercial right of similar nature.

d. Particulars of creation, modification or satisfaction of security interest in any 'under construction' residential or commercial or a part thereof by an agreement or instrument other than mortgage.

In order to proceed under SARFAESI Act, it is now mandatory to register charge under CERSAI. After registration of security interest with Central Registry, Banks will have priority over all other debts, revenues, taxes, cesses and other rates payable to the central government or state government or local authority. Satisfaction of SI (Security Interest) has to be done on the CERSAI portal when all the loans on the asset have been repaid.

CHARGE CREATION

Charge Creation is required to be registered when charge created on by way of Hypothecation of stocks, book debts, mortgage of immovable properties, ship, goodwill, uncalled share capital of the company. Charge registration is not required in case of Pledge of goods or securities or against Fixed Deposits. Section 77 to 87 of the Companies Act 2013 provides the procedure for registration of Charges. Charges created on a company's assets (except pledge) have to be registered with Registrar of Companies within 30 days of creation of the charge. When charge in favour of two banks is registered, priority of charge is in favour of bank, in whose favour it is created first i.e. date of documents.

CASE LAWS

1. In the matter of ***Aarifaben Yunusbhai Patel and Ors. vs. Mukul Thakorebhai Amin and Ors (2020),*** the the honorable Supreme Court has come to the conclusion that the auction of both the properties were vitiated on account of lack of notice to the judgment-debtor, and that being an error fatal to the validity of auction sale, in light of the decision of the Supreme Court the auction sale cannot be permitted to remain and they have to be quashed. Other submissions of the counsel for the auction purchasers therefore need not be elaborately dealt with, but suffice it to say that the Court is quashing the auction sale on ground of non-compliance with the mandatory provision of notice to the judgment- debtor." The court was constrained to observe that the High Court totally ignored the order of this Court quoted hereinabove. This Court had specifically directed the executing court to decide both, the issue of limitation and objections on merits. This was obviously done with the purpose that in case later if the issue of limitation is decided in favour of the objectors, R-1 and R-3, then the matter again should not be remanded for decision on merits of the case. The issue of limitation could not have been ignored and should have been decided by the High Court.

2. In the matter of Appeal in ***Connectwell Industries Pvt . Ltd . vs . Union of India (UOI) and Ors. (06.03.2020 - SC) (17.03.2020 - Supreme Court)***, the Honorable Supreme Court held that there is no dispute regarding the facts of this case. The property in dispute was mortgaged by BPIL to the Union Bank of India in 2000 and the DRT passed an order of recovery against the BPIL in 2002. The recovery certificate was issued immediately, pursuant to which an attachment order was passed prior to the date on which notice was issued by the Tax Recovery Officer- Respondent No.4 under Rule 2 of Schedule II to the Act. It is true that the sale was conducted after the issuance of the notice as well as the attachment order passed by Respondent No.4 in 2003, but the fact remains that a charge over the property was created much prior to the notice issued by Respondent No.4 on 16.11.2003. The High Court held that Rule 16(2) is applicable to this case on the ground that the actual sale took place after the order of attachment was passed by Respondent No.4. The High Court failed to take into account the fact that the sale of the property was pursuant to the order passed by the DRT with regard to the property over which a charge was already created prior to the issuance of notice on 11.02.2003. As the charge over the property was created much prior to the issuance of notice under Rule 2 of Schedule II to the Act by Respondent No.4, we find force in the submissions made on behalf of the Appellant.

   The judgment of the High Court is set aside and the Appeal is allowed. The MIDC is directed to issue a 'No Objection" certificate to the Appellant.

3. In ***Anuj Jain vs. Axis Bank Limited and Ors. (26.02.2020 - Supreme Court)***, the honorable Supreme Court on the issue as to whether lenders of JAL could be treated as financial creditors, hold that such lenders of JAL, on the strength of the mortgages in question, may fall in the category of secured creditors, but such mortgages being neither towards any loan, facility or advance to the corporate debtor nor towards

protecting any facility or security of the corporate debtor, it cannot be said that the corporate debtor owes them any 'financial debt' within the meaning of Section 5(8) of the Code; and hence, such lenders of JAL do not fall in the category of the 'financial creditors' of the corporate debtor JIL.

4. In ***K. Virupaksha and Ors. vs . The State of Karnataka and Ors. (03.03.2020 -Supreme Court)***

   Criminal proceeding would not be sustainable in a matter of the present nature, exposing the appellants even on that count to the proceedings before the Investigating Officer or the criminal court would not be justified.

   The appellants herein had also referred to the provision as contained in Section 32 of the SARFAESI Act which provides for the immunity from prosecution since protection is provided thereunder for the action taken in good faith.

   The learned senior counsel for the Complainant has in that regard referred to the decision of this Court in the case of General Officer Commanding, Rashtriya Rifles vs. Central Bureau of Investigation & Anr. (2012) 6 SCC 228 to contend that the defence relating to good faith and public good are questions of fact and they are required to be proved by adducing evidence.

   Though on the proposition of law as enunciated therein there could be no cavil, which aspect of the matter is also an aspect which can be examined in the proceedings provided under the SARFAESI Act, 2002. In a circumstance where we have already indicated that a criminal proceeding would not be sustainable in a matter of the present nature, exposing the appellants even on that count to the proceedings before the Investigating Officer or the criminal court would not be justified.

5. ***Pandurang Ganpati Chaugule vs. Vishwasrao Patil Murgud Sahakari Bank Limited (05.05.2020 Supreme Court)***

   Recovery is an essential part of banking; as such, the recovery procedure prescribed under section 13 of the SARFAESI Act, is applicable to Co-operative banks

   The question in this matter for the determination was 'Whether the 'SARFAESI Act' is applicable to Cooperative Banks?

   The Honorable Supreme held that the cooperative banks established under the State Legislation and Multi State Cooperative Banks are 'banks' under section 2(1)(c) of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act).

   It was held that the recovery is an essential part of banking; as such, the recovery procedure prescribed under section 13 of the SARFAESI Act, legislation relatable to Entry 45 List I of the Seventh Schedule to the Constitution of India, is applicable.

   It was further held that the Parliament has legislative competence under Entry 45 of List I of the Seventh Schedule of the Constitution of India to provide additional procedures for recovery under section 13 of the SARFAESI Act with respect to cooperative banks.

   It was concluded that the provisions of Section 2(1)(c)(iva), of SARFESIAct, adding"exabundanticautela", 'a multi State cooperative bank' is not ultra vires as well as the notification dated 28.1.2003 issued with respect to the cooperative banks registered under the State legislation.

DOCUMENT AND PURPOSES OF DOCUMENTS

One of the important areas in Bank credit, is documentation. The purpose of a bank taking documents is multi fold. Documents help banks to identify:

- The borrower and the capacity in which money is borrowed (Individual, partnership firm, company, trustee etc.);
- Type of security (land, building, plant, machinery, stock, debtors, Life Insurance Policy etc.);
- The charge created on it (Pledge, hypothecation, mortgage, assignment etc.);
- To count the limitation period, as the documents have expiry date;
- Present in a court of law the evidence for the recovery of money from the defaulting borrower.

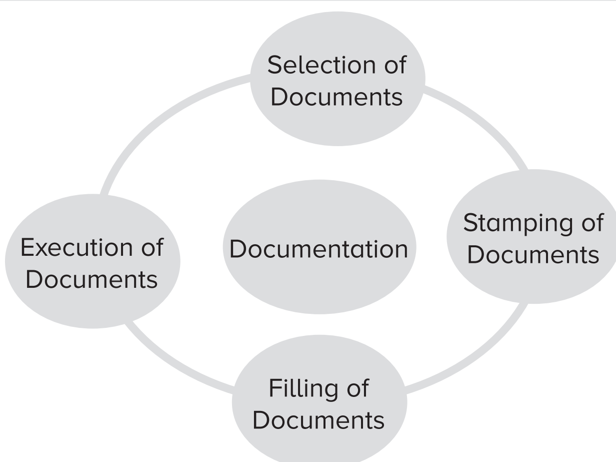
Document means "any matter written, expressed upon **any** substance by means of letters, figures or marks of by more than one of these means, which is intended to be used for the purpose of recorded that matter" and as per Indian stamp Act. Documents include everything by which any right or liability is or proposed to be recorded.

Document includes execution **of** documents properly selected, apropriately stamped by concerned person (s). Execution means signing a document after havind read and understood it.

The execution of documents depend on capacity in which money is borrowed.

Borrower	Signatories
Individual	Himself / Herself or his / her Agent
Joint Borrower	All of them jointly or their respective Agents
Proprietorship firm	Proprietor or Agent
Partnership Firm	All the partners
HUF	The Karta. All the major coparceners if they are to be made personally liable.
Joint stock company	Persons authorized as per the resolution passed by the Board
Trust / Society / Club	Persons authorized as per the resolution

Procedure of Documentation



Selection of Documents

Requirement of documents depends on what is the type of facility (e.g. security may be debtors but facility can be cash credit, bill discounting / purchases), who is the borrower (individual - whether singly or jointly, partnership firm, HUF, joint stock company etc.), what is the charge to be created (security may be stock but charge to be created can be hypothecation or pledge). Documents also depend on additional terms and conditions, if any, stipulated in the letter of sanction. Generally, banks have printed forms of documents approved by their legal department. It should therefore be ensured that appropriate sets of documents are selected for the facility sanctioned to the borrower.

Stamping of Documents

Documents attracting stamp duty and should be stamped before or at the time of execution (not later), by paying appropriate amount of stamp duty. There are documents like Demand Promissory Note, Share Transfer Form, Insurance Policy etc. where the stamp duty is decided by the Central Government, hence it is same throughout the country. Documents like Letter of Hypothecation, Pledge, Guarantee etc., the stamp duty is decided by the State Government, hence it may differ from state to state. There are certain transactions where the stamp duty is not fixed but is ad-valorem that means depends on the value of the transaction represented in the document.

Bank documents are affixed with Non-judicial stamps. The stamp paper should bear the date prior to its execution and also should be less than six months old. Other stamps in use are:

- Judicial - used for filing of suits and postal stamps.
- Non-judicial stamps are of three types:
  - Adhesive stamps such as revenue stamp, share transfer stamp, notary stamp etc.,
  - Special Adhesive stamps which are affixed on letter of guarantee, agreements of pledge, hypothecation etc., and
  - Embossed stamps which are impressed on non-judicial papers used in place of special adhesive stamps.

Documents if unstamped or under stamped at the time of execution are not documents and are not accepted in the court. However, before submitting in the court they can be brought in to order by paying penalty, which is ten times the deficit and then putting the deficit amount of stamps on the document.

For example: a document where stamp duty payable is Rs. 100.00 but is affixed with stamps of Rs. 60.00 (deficit of Rs. 40.00), then after paying penalty of Rs.400.00 (ten times deficit), the deficit amount of Rs. 40.00 will be affixed on document (Total amount Rs.440.00) to bring it in order.

Filling of Documents

Although banks have printed documents, it is necessary to fill the blanks and also to be completed with alterations, overwriting, cutting etc., if any, with proper authentication. It is to be ensured that the documents are completed in all respects and no blank places are left. One person in one sitting should complete the documents in the same ink and same handwriting. Otherwise, it may give impression that the documents were blank at the time of execution. Subsequent filling of documents without the consent of executants makes the document invalid.

Execution of Documents

Documents must be executed in the presence of bank officials. Each and every page of the document should be signed by each and every executant. The signatures on the documents must agree with the signatures on the loan application form. All alterations, insertions, deletions, additions must be authenticated under full signature of the executant. If a single document is signed by more than one executant on different dates and at different places, each executant on the last page of each document must put the date and place below the signature.

If the executant does not understand the language of the document: A separate declaration from him, in the language known to him must be taken stating that the contents of documents are explained to him and he has signed the document after having understood the same. The declaration letter should be witnessed by another person and the same should be attached to the document.

If the person who executes the documents is illiterate: In this case he / she will affix the thumb impression instead of signature. The bank official in whose presence such documents are executed should give separate declaration that the contents of the documents are explained to the executant in a language known to him and thumb impression is affixed after having understood the same. The declaration has to be witnessed by third person and the same should be attached to the document.

If the person who executes the documents is blind: Then the declaration should be obtained by the lawyer or the notary and the same should be attached to the document.

If documents are executed by a partnership firm and the minor is admitted for the benefits of partnership firm: In this case the minor should not sign the documents. When such minor becomes major and if opts to be a partner, a separate declaration from him to be obtained to make him liable for the firm's dues. He then becomes liable for the firm's acts right from the date of his admission to the benefits of the firm. Minor is not liable for the losses of the firm. When minor becomes major or becomes aware of the fact that he has been admitted to the benefits of the firm - whichever date is later - from that day within 6 months he can repudiate the liability as a partner by giving public notice. In case of partnership firm, the documents should be signed by all the partners (irrespective of operating instructions in current account), in their representative (under the rubber stamp) as well as personal capacity.

In case of **HUF** only the Karta should sign the documents and not the coparceners. However, if the bank wants to make the coparceners personally liable then all the major coparceners of HUF should also sign the documents.

In case of a company, only those officials who are authorized to sign documents as per the resolution of the Board, should sign the documents. Bank should obtain a copy of resolution and place on record.

Every company creating a charge on its assets, within or outside India, must register it within 30 days of its creation, with **Registrar of Companies (ROC).** If a charge is registered, a person acquiring such assets shall be deemed to have notice of charge from date of registration. If charge is not registered and a certificate of registration is not issued by ROC, charge created by a company shall not be taken into account by the liquidator or any other creditor.

It is the duty of a company to file the details with the Registrar. In case a company fails, the creditor may apply to the Registrar within prescribed period. ROC, within 14 days, after giving notice to company, allow such registration.

A company shall give intimation to ROC of the **satisfaction** in full, of any charge registered, within a period of 30 days from the date of such satisfaction.

When a charge is registered, the priority of charge will be determined by the date of execution of documents (creation) and not the date of registration.

For example, documents are dated June 5, 2018 with Bank-A (creation of charge) and the charge is registered on June 25, 2018 (within the stipulated time of 30 days). Whereas on the same assets Bank-B has documents dated June 7, 2018 and the charge registered on June 22, 2018. Here although Bank-B has registration done on 22nd June 2018, earlier than Bank-A, who has done registration on 25th June, still Bank-A will have priority as the creation of charge is earlier (and of course registration is done in stipulated time period).

The prescribed details for creation and modification to be filed in form CHG -1 (other than debentures) & CHG-9 (for debentures) and satisfaction of the charge should be filed using CHG-4. A duly certified copy of each document evidencing any creation, modification, satisfaction should be filed with the forms.

In case of **Co-operative Societies,** documents should be executed by the office bearers as per the resolution passed in the general body meeting. Bank should have certified up-to-date true copy of Bye-laws on record and adhere strictly to the procedure / provisions in it as regards credit limit.

Clubs / Institutions / Schools must be incorporated otherwise they are not legal entities and do not have contracting powers. If they are incorporated, their borrowing powers and procedure is mentioned in their Bye-laws. Execution of documents should be as per the resolution passed.

When documents are signed in different states by different parties, then the procedure is, the document will be stamped as per the stamp duty applicable in the state where it is first signed. Then if the document travels to a state where stamp duty payable is more, then the difference will be paid first and then the second person will sign. If the document travels to a state where stamp duty payable is less then there is no need to pay any stamp duty. Any document other than bill of exchange and promissory note, executed out of India, and subsequently brought to India, will have to be stamped again by the first holder within 3 months from the arrival in India.

When documents are executed by Power of Attorney (PA) holders instead of principals, a notice should be sent to principal, intimating him about the same and the acknowledgement should be obtained. Such acknowledgement and the certified copy of PA should be kept on record.

Registration of Loan Documents

The purpose of registration of a document is to give notice to public that such a document is executed and also to ensure that anyone who would like to deal with the property should have complete knowledge of all the transactions affecting the title to the asset / property. It can also help in preventing frauds and forgeries.

The documents are to be registered at the office of Registrar of Assurances under whose jurisdiction the property falls (and not where the documents are executed). The time limit for registration is four months from the execution of document.

Documents required to be registered after their exeution

- A mortgage deed
- Memorandum of deposit of the title of the title deeds for creating equitable mortgage
- Lease deed of immovable property
- Sale Deed of property
- Assignment of right in the property made through a deed

Witnessing of documents

It is the attestation of documents by two or more persons who must see the executants signing or putting the thumb impression, as the case may be, on the documents. Witnessing persons should be third party / should not be the party to the transaction. Documents which require witnessing, if not witnessed, will not be considered as duly executed documents.

The documents which need witnessing are:

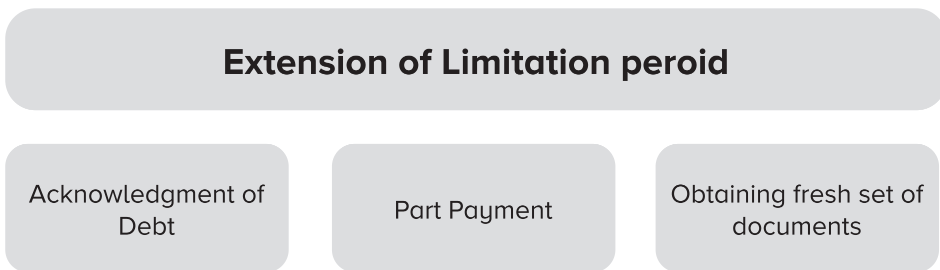
- All types of deeds - mortgage, sale, guarantee.
- Power of attorney.
- Assignment of LIC on the policy itself.

Documents in the form of agreements (hypothecation, pledge, guarantee), lien, set-off, etc. need not be witnessed.

LIMITATION ACT, 1963

The documents taken by banks for a credit facility, do not have perpetual life. The provisions of Limitation Act, 1963 apply to them. The Act prescribes the period of limitation for different types of documents. Limitation period is the time limit within which the parties to a legal agreement, can take action in a court of law to enforce their legal rights. A suit cannot be filed for recovery on the strength of a time barred document. Hence, if the documents are time barred, the bank's right of legal remedy is lost. There are certain rights like lien, set-off, selling the securities which are pledged where remedy through court is not required. As such there is no limitation period for these rights.

Extension of Limitation period



A limitation period can be extended in following ways-

- **Acknowledgement of Debt**

  It is an acceptance of liability by the party liable by Letter of Acknowledgement of Debt (LAD), balance confirmation letter or even ordinary letter. If can be in the form of signing of a balance sheet by authorized person. It has to be before expiry of limitation period.

- **Part payment**

  If a debtor makes a part payment before expiry of limitation period, himself or if it is made by his authorized agent, a fresh limitation period starts from the date of such payment. The pay-in-slip has to be filled in by the debtor himself or signed by him or his agent. It cannot be signed by any other person including employee of the debtor.

- **Obtaining fresh set of documents**

  When the bank obtains the fresh set of documents before expiry of the original documents, fresh period of limitation starts from the date of execution of the fresh documents. A time barred debt can be revived under section 25(3) of Contract Act only by fresh promise in writing and signed by the borrower or his authorized agent. A promissory note / fresh documents executed for the old or a barred debt will give rise to a fresh cause of action and a fresh limitation period will start from the date of such documents.

Some important points to be noted as regards the Limitation Act, 1963

- The limitation period cannot be altered (shortened / extended) by mutual consent.
- While computing the limitation period, the document execution date is considered. It means a Demand Promissory Note (which has a limitation period 3 years from the date of execution) executed on 1st June , 2018 will have a limitation period up to 1st July, 2021.

- If the court is closed on the day when limitation period expires, suit can be filed on the next working day of the court.
- The period of person's absence in India and also where a person is restrained by way of injunction from a court to enforce a legal remedy are excluded for computing the period.
- Most of the documents have limitation period of three years, and the banks therefore should maintain proper register to exercise control.
- When different people sign documents on different dates, the limitation period will start from the date, the last executant has signed.
- It was held by the Supreme Court in one of the cases that the limitation period against the guarantor will start from the day on which demand is made on the guarantor to pay the money.

Some limitation periods

Demand Loans	3 years from the date of loan.
Demand promissory note	3 years from the date of execution / date of the document.
Term Loan	3 years from the due date of each instalment.
Cash Credit	3 years from the date of documents' execution.
Facility under charge of pledge	Limitation period not applicable.
Bill Discounted	3 years from the due date of the bill.
Bill Purchased	3 years from the date of bill.
Loan under mortgage	12 years from the date of documents' execution.
Recover of money lost in fraud	3 years from the date on which fraud is detected.
Deposit Accounts	3 years from the date of demand.
Execution of decree	12 years from the date of decree.

SECURITIZATION

Prior to June 21st, 2002 when the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act was enacted, banks and financial institutions had to enforce their security through courts for the recovery of their advances. The process was slow and time consuming. Moreover, hypothecation, the charge against which majority of advances is granted by banks, had no provision in any law. The SARFAESI Act takes care of these issues.

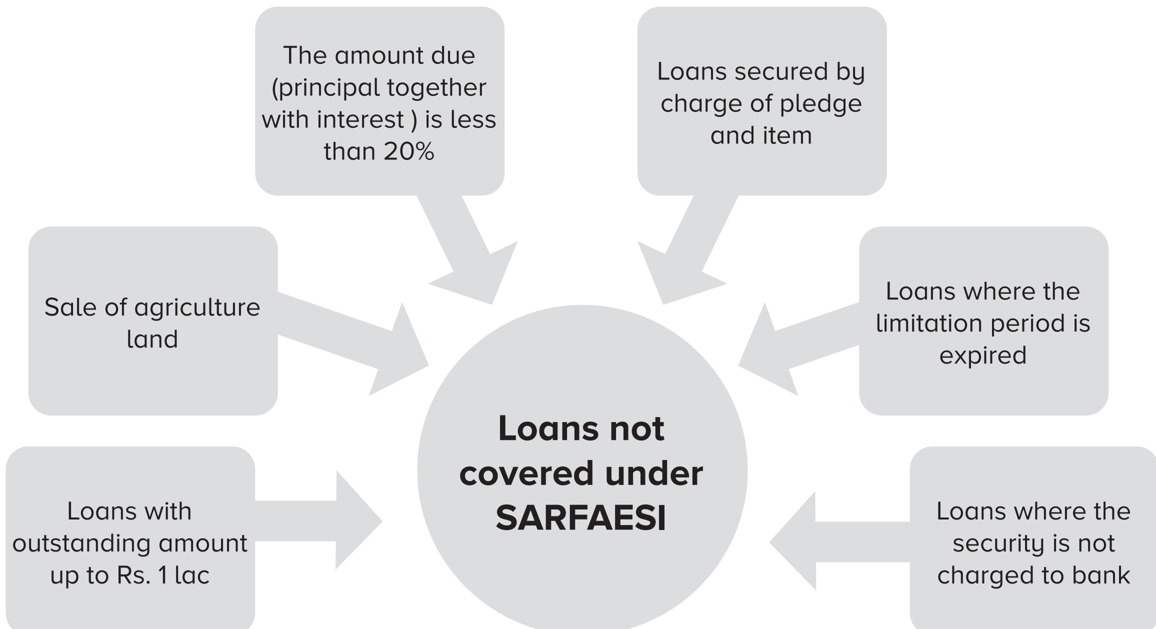
Securitization is the process of acquisition of Non-Performing Assets (NPA) portfolio of a bank or a financial institution by Securitization or Reconstruction Company on mutually agreed terms and conditions as regards sale or transfer price, with or without recourses, transfer or sale etc. Bank gets price in the form of cash or debentures / bonds as mutually agreed upon. This process provides the banks and FIs a summary procedure for recovery of their secured dues which have been classified as NPA in their books, by setting up of Securitization and Reconstruction Company for taking over the defaulted loans.

Securitization or Reconstruction Company may be raising funds for acquisition from their own resources or from the Qualified Institutional Buyers by issuing security receipts representing undivided interest in the financial assets or otherwise. The security receipt is transferable in the market. SARFAESI Act, thus makes the secured NPA portfolio of a bank transferable.

The SARFAESI Act empowers the secured creditor (Bank / FI) as under, if the borrower and or guarantor defaults:

- To take possession, sell or lease the secured assets (prior to this, a notice has to be served to the borrower / guarantor, to clear dues within a time period of 60 days).
- Take over the management of the business or appoint a manager.
- Instruct any person at any time, who holds secured assets of the borrower and from whom any money is due or becoming due to the borrower; to pay such money to the bank (secured creditor).
- To initiate action in Debt Recovery Tribunal.

In case of consortium or multiple lending arrangement, if 60% of the secured creditors in value, agree to initiate recovery action, it will be binding on all secured creditors.



Important Provisions and terms in SARFAESI Act

- **"Asset reconstruction"** means acquisition by any securitization company or reconstruction company, of any right or interest of any Bank / Financial Institution ('FI') in any financial assistance for the purpose of realization of such financial assistance.
- **"Bank" includes all banks -** Nationalized, RRBs, Co-operative etc. and any such banks which the Central Government may by notification, specify for the purpose of this Act, and also FIs.
- **"Borrower"** is any person who has been granted financial assistance by bank / FI, who has given guarantee or created any mortgage or pledge as security for the financial assistance granted by any bank / FI. It also includes a person who becomes borrower of a securitization company or reconstruction company consequent upon acquisition.
- **"Central Registry"** means the registration office set up by the Central Government for the purpose of registration of all the transactions of asset securitization, reconstruction and transactions of creation

of security interests. The registration system operates on the priority of registration basis - person who registers first gets priority over the one who registers later.

- **"Default"** means non-payment of any principal debt or interest thereon or any other amount payable by a borrower to any secured creditor consequent upon which the account of the borrower is classified as non-performing asset in the books of secured creditor.
- **"Financial Assistance"** means any credit facility extended by bank or FI such as loan or advance granted, debentures or bonds subscribed, guarantee given, letter of credit established etc.
- **"Financial Asset"** means any debt or receivables including -
  a. Secured or unsecured claim to any debt or receivables.
  b. Any debt or receivables secured by mortgage or charge on immovable property.
  c. A mortgage, charge hypothecation, or pledge of movable property.
  d. Any right or interest in the security, whether full or part underlying such debt or receivables.
  e. Any beneficial interest (existing, future, accruing, conditional or contingent) in the property, whether movable or immovable, or in such debt, receivables.
  f. Any financial assistance.
- **"Hypothecation"** means a charge in or upon any movable property, existing or future, created by the borrower in favour of a secured creditor without delivery of possession of the moveable property to such creditor, as a security for financial assistance and includes floating charge and crystallization of such charge into fixed charge on movable property.
- **"Non-performing Asset"** means an asset or account of a borrower, which has been classified by a bank or FI as sub-standard, doubtful or loss asset in accordance with the directives or guidelines relating to assets classifications issued by RBI.
- **"Property" means -**
  a. Immovable property.
  b. Movable property.
  c. Debt or right to receive payment of money, whether secured or unsecured.
  d. Existing and future receivables.
  e. Intangible assets - know-how, patent, copyright, trade mark, license, franchise or any other business or commercial right of similar nature.
- **"Qualified Institutional Buyer"** (QIB) means a FI, insurance company, bank, state financial corporation, state industrial development corporation or a foreign industrial investor registered under SEBI Act.
- **"Reconstruction Company"** means a company formed and registered under Companies Act for the purpose of asset reconstruction.
- **"Securitization"** means acquisition of financial assets by any securitization / reconstruction company from any originator, whether by raising of funds by such company on its own or from QIB by issue of security receipts representing undivided interest in such financial assets or otherwise.
- **"Securitization Company"** means any company formed and registered under Companies Act for the purpose of securitization.
- **"Secured Asset"** means the property on which security interest is created.

- **“Secured Creditor”** means any bank or FI or any consortium or group of banks or FIs, including - debenture trustee appointed by any bank or FI or securitization company or reconstruction company.
- **“Secured Debt”** means a debt which is secured by any security interest.
- **“Security Interest”** means right, title and interest of any kind whatsoever upon property, created in favour of any secured creditor and includes any mortgage, charge, hypothecation, assignment.
- “Security Receipt” means a receipt or other security, issued by a securitization company or reconstruction company to any QIB pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitization.

  Central Registry of Securitization Assets Reconstruction and Security Interest of India (CERSAI) has been established as a company under Section 8 of the Companies Act, 2013.

  Transactions to be registered are - securitization and asset reconstruction, all mortgages, securities hypothecated, security interest in intangible assets, security interest in under-construction buildings.

  The registration should be done within 30 days of transaction. Permission of Central registrar is required if 30 days delay thereafter. For further delay the permission of Central Government is required.

  Banks can take possession of only those securities in respect of which the charge is registered with CERSAI. Banks will have priority of recovery over Government dues where charge is registered with CERSAI.

RBI guidelines on sale of NPAs

- At least once in a year - preferably in the beginning - banks shall identify and list internally specific financial assets identified for sale.
- Board should review, at a minimum, all assets classified as ‘doubtful’, above a threshold amount.
- The invitation for bids should preferably be publicly solicited using e-auction platform.
- Prospective buyers must be provided at least 2 week’s time for due diligence.
- Banks should have policy for valuation of assets. In case of exposure beyond Rs. 50.00 crore, banks shall obtain two external valuation reports.
- The discount rate used in the valuation exercise may be either cost of equity or average cost of funds or opportunity cost subject to a floor of the contracted interest rate plus penalty, if any.

Obligations of selling bank

- Any NPA asset in the books, is eligible for sale.
- Banks shall sell NPAs on ‘without recourse’ basis.
- Only on receiving the entire sale consideration, the asset can be taken out of books.
- The selling bank can re-purchase the NPAs sold by it, only after specified period and only where SC/RC have successfully implemented the restructuring plan for the NPAs acquired.

Obligations of the purchasing bank

- Estimated cash flows should normally be realized in 3 years period.
- Can not sell purchased NPAs for a minimum period of one year.
- For the first 90 days from the date of purchase the assets will be classified as standard assets. Thereafter it will be based on the recovery.
- The risk weight for the purpose of capital adequacy will be considered 100%.

LESSON ROUND-UP

- There is a sense of debt in loan, where as an advance is a facility being availed of by the borrower. However, like loans, advances are also repaid. Thus a credit facility repayable in instalments over a period is termed as loan while a credit facility repayable within one year may be known as advances.
- Basic principles that banks must follow while lending are: safety of funds, liquidity, profitability, purpose, spread or diversification & security. There are two types of borrowers viz: Retail Borrowers & Corporate Borrowers. When bank lend money, it enters into a contract and all essentials of a valid contract must be present in the contract. Different types of credit facilities include demand loans, term loans, over draft and cash credit. While extending loans, banks have to follow directives of RBI regarding exposure norms and other such applicable norms in terms of credit policy guidelines. While extending working capital, banks follow the Tandon committee norms of MPBF. Banks also extend bills financing, packing credit; they also arrange Buyers credit, Suppliers credit, leasing and hire purchase. While lending money banks obtain security from the customer/borrower to safe guard itself as well as to fall back upon in case borrower defaults. The security is therefore examined properly using the MAST (Marketability, Ascertainability, Stability and Transferability) principle. Depending upon type of advance and the nature of security, appropriate charge like Lien, Hypothecation, Pledge, Assignment, Mortgage is created on the security.
- Securities help a banker to recover the amount of advances, in case of borrowers' default. Securities can be principal or collateral one.
- Main security is the asset against which advances were given. Collateral security is an additional security that borrower offers to the bank with the main security. A good security has the attributes of MAST.
- Margin is a contribution from borrower which is insisted by a bank when advances are given. Margins enable involvement from borrower, acts as fall back if loans turn bad, acts as a cushion against fluctuations in the value of security.
- Banks create types of different types of 'charge' over securities given by a borrower to enforce their rights. Some of the charges which banks create are Assignment, Lien, Pledge, Hypothecation, Mortgage. Banks also obtain Guarantees and Indemnities from borrowers to safe guard themselves against defaults in certain cases.
- Lien a right of a creditor to retain the possession of goods and securities owned by the debtor, till the debts are fully paid off. However, creditor does not get right to sell the securities. The lien can be Particular lien or General lien. Banks in India enjoy not only right of general lien, they can even sell the goods and securities of the debtor in case of need to recover debts.
- Set-off is total or partial merging of a claim of one person against another, in the counter claim of latter against former. This right is statutorily available to banks.
- Appropriation is a right of a debtor/ borrower. A borrower having more than one debt to the bank, makes payment with an instructions to apply the same to a particular debt his instruction has to be followed. When borrower fails to give instruction, right is of creditor the apply the payment to any lawful debt which is due and payable. If neither the debtor nor the creditor exercise right of appropriation then the payment will be applied to discharge the debt in chronological order.
- Hypothecation is a charge on movable property (stock, machinery, vehicle etc.) in favour of secured creditor without delivery of possession of the assets. It is an equitable charge where the possession and the ownership of the assets remain with the borrower. Guarantees and Indemnities are a common way in which creditors protect themselves from the risk of debt default. One of the important requirements of the lending banker is to hold valid legal documents. The process of execution of required documents in the proper form and according to law is known as documentation. Proper documentation helps in recovery of loans and advances. Banks have their own standard forms for promissory notes and other documents and no deviations are normally permitted. The borrowers are expected to execute these documents as required by the bank. Banks also do not generally give copies of these documents to the borrower which sometimes creates difficulty when these documents become subject matter of a legal dispute.

- Collateral security if properly obtained with all collateral documents as appropriate would assist the banks to protect the interests of the banks in case the borrower defaults. These securities supported by correct and valid documents would assist the banks in recovery process as well.
- Banks should be careful while accepting various securities and ensure such securities are properly charged (like lien, hypothecation, pledge, assignment, set off and mortgages) in favour of the banks.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What are the principles of lending?
2. What are the essentials of valid contract?
3. Distinguish between Lease finance and hire purchase.
4. What is packing credit?
5. Compare buyer's credit and supplier's credit.
6. Name the various types of institutional customers.
7. What are the precautions taken by the banker while giving loan to a society?
8. What do you understand by MPBF? Explain recommendations of Tandon Committee Report.
9. How many types of credit facilities are there? Explain all.
10. Distinguish between Bank Guarantee and Letter of Credit.
11. What are the precautions to be taken by the banker while granting loans to HUF?
12. Explain issuance of electronic cards to overdraft account holders.
13. Write a note on Exposure norms of RBI.
14. Briefly describe the statutory restrictions on banks for lending?
15. List out the documents which require witnessing and documents which do not require witnessing.
16. List out the documents which require registration and documents which don't.
17. Which charges on the company's assets are required to be registered with ROC?
18. What are the different ways in which limitation period can be extended?
19. What is securitization?

LIST OF FURTHER READINGS

- Banking Law & Practiceby – P. N. Varshney
- Principles of Practices of Banking–Indian Institute of Banking & Finance.
- The Indian Partnership Act, 1932.
- The Companies Act, 2013
- Articles on Banking –Shodganga

Calculation of Interest and Annuities

Lesson 10

KEY CONCEPTS

■ Interest ■ Fixed Interest Rate ■ Floating Interest Rate ■ Annuity ■ Amortisation ■ Equated Monthly Installment (EMI) ■ Sinking Fund

Learning Objectives

To understand:

- The concepts of simple, compound interest
- The concepts of annuities and sinking funds
- The calculations of equated monthly installments
- The concept of annuities
- The concept and application of interest calculations based on products
- The concept of amortization
- The concept of sinking funds

Lesson Outline

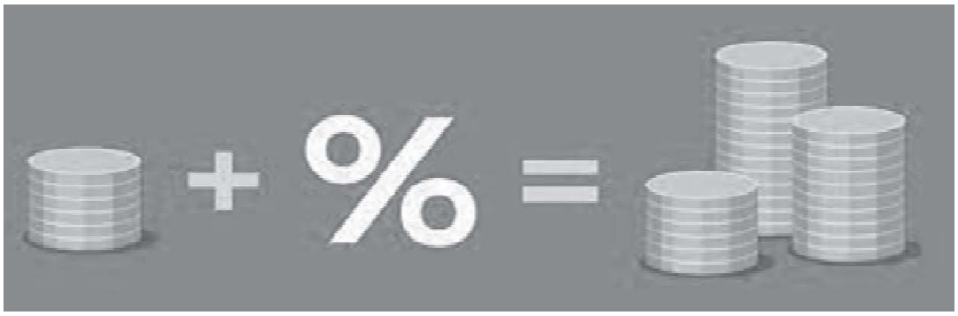
- Introduction
- Calculation of Simple Interest
- Calculation of Compound Interest
- Equated Monthly Instalments
- Fixed Interest Rate
- Floating Interest Rate
- Calculation of Annuities
- Interest Calculation using Products/Balances
- Amortisation of a Debt
- Concept of Sinking Funds
- Lesson Round-Up
- Test Yourself

REGULATORY FRAMEWORK

- Banking Regulation Act, 1949

INTRODUCTION

Interest is payment from a borrower or deposit-taking financial institution to a lender or depositor of an amount above repayment of the principal sum (i.e., the amount borrowed), at a particular rate. It is distinct from a fee that the borrower may pay the lender or some third party. It is also distinct from dividend which is paid by a company to its shareholders (owners) from its profit or reserve, but not at a particular rate decided beforehand, rather on a pro-rata basis as a share in the reward gained by risk-taking entrepreneurs when the revenue earned exceeds the total costs.



In economics, the rate of interest is the price of credit, and it plays the role of the cost of capital. In a free market economy, interest rates are subject to the law of supply and demand of the money supply, and one explanation of the tendency of interest rates to be generally greater than zero is the scarcity of loanable funds.

Interest income is always considered as the main pillar of any banking institution. As we all know, the definition of Banking is accepting deposits for the purpose of lending. Whenever a customer takes a loan from a bank, it charges him/ her certain interest at a predefined and specific rate. The actual meaning of interest is the rate at which a return is paid by the borrower to compensate the bank for a loss in the value of money over a period of time. The payment of the same is either at some time intervals or at the end of the loan period. The said interest is calculated based on the terms of the agreement between the borrower and the Bank. Many times, based on the borrower's needs and the type of loan, the type of interest is ascertained. The contents are of practical utility for a student and aimed to make him thorough with all concepts relating to interest rates.

Interest Rate

An interest rate is the amount of interest due per period, as a proportion of the amount lent, deposited or borrowed (called the principal sum). The total interest on an amount lent or borrowed depends on the principal sum, the interest rate, the compounding frequency, and the length of time over which it is lent deposited or borrowed.

It is defined as the proportion of an amount loaned which a lender charges as interest to the borrower, normally expressed as an annual percentage. It is the rate a bank or other lender charges to borrow its money or the rate a bank pays its savers for keeping money in an account.

The annual interest rate is the rate over a period of one year. Other interest rates apply over different periods, such as a month or a day, but they are usually annualised. Interest rates vary according to:

- the Government's directives to the central bank to accomplish the government's goals;
- the currency of the principal sum lent or borrowed;

- the term to maturity of the investment;
- the perceived default probability of the borrower;
- supply and demand in the market.

CALCULATION OF SIMPLE INTEREST

Simple interest is a type of interest that is applied to the amount borrowed for the entire duration of the loan, without considering any other factors, such as past interest (paid or charged) or any other financial aspects. Simple interest is generally applied to short-term loans, usually one year or less. It is also called a 'Flat rate' as its the amount charged for each year at a fixed percentage for the amount borrowed.

Following is the formula for the calculation of simple interest:

$$\boxed{\text{Interest} = \frac{P \times R \times T}{100}}$$

In above formula

Interest = Total interest charged for the given period

P = Principal amount that was borrowed

R = Rate of interest specified

T = Time or duration of the loan in years

For example, if Mr. A has borrowed Rs. 10,00,000/- from ABC bank @ 9.5% per annum, the interest the Bank would charge is $\text{Interest} = \frac{P \times R \times T}{100}$

$$\text{Interest} = \frac{10{,}00{,}000 \times 9.5 \times 1 \text{ year}}{100}$$

Interest = Rs. 95,000 per annum.

Similarly using the above equation, we can get the value of other variations also.

Illustration: A sum of Rs. 30,000 becomes Rs. 33,000 at the end of 2 years when calculated at simple interest. The rate of interest would be-.

Solution:

Simple interest = 33,000 – 30,000 = 3,000

Time = 2 years.

Interest =R = 3000 * 100 / 30000 * 2

R = 5%.

Illustration: At what rate percent per annum simple interest will a sum of money double itself in 6 years?

Solution:

Let P = x, then A = 2x Also, S.I. = A – P

= 2x – x

= x T = 6 years

We know that S.I. = (P × R × T)/100

(x × R × 6)/100 = x

R = 100x/6x = 16.6 %

Illustration: A sum amounted to Rs. 2,520 at 10% p.a. for the period of 4 years. Find them sum.

Solution:

Let A = Rs. 2,520 R = 10% p.a.

T = 4 years P = ?

Let the principal be x

S.I = (x × 10 × 4)/100 = 2x/5 A = P + I

A = x + 2x/5

A = (5x + 2x)/5 = 7x/5 [But given that A = Rs. 2,520] 7x/5 = 2,520 7x = 2,520 × 5

x = (2,520 × 5)/7 = Rs. 1,800

CALCULATION OF COMPOUND INTEREST

In simple interest calculation, the assumption is that the interest would be charged only once during the given period. Contrary to this, if the interest is charged more than once in the prescribed duration, the interest has to be re-invested. It is called compound interest. It is the addition of interest to the principal amount, or in other words, it is interest on interest. It is the result of reinvesting interest, rather than paying it out, so that interest in the next period is then earned on the principal sum plus previously accumulated interest.

Simple Interest	Compound Interest
It is calculated on the total principal amount for the total tenure.	It is calculated on the principal amount periodically (monthly, quarterly, half-yearly or annually).
The accumulated interest on the principal is not added to the calculation of interest for the next period.	The interest that you accumulate periodically is added to the calculation of interest for the next period.
The interest earned/paid will not increase even if the calculation is done periodically.	The interest earned or paid will increase if the frequency of interest generation or payment is more.
The accumulation of interest is slow.	The accumulation of interest is fast since you get interest on the growing interest amount as well.
Simple interest will not earn you enough for savings and investments but will benefit you if you take a loan.	Compound interest will earn you more in savings and investments but will be costlier on a loan.
It is not good for wealth creation.	It is good for wealth creation.

It is beneficial to the borrower but not to the lender. You will be paying less on a loan that is taken on simple interest.	It is beneficial to the lender but not to the borrower. You will be paying more on a loan that is taken on compound interest.
Simple interest is easy to calculate.	Compound interest is complicated to calculate.

Comparative analysis of Simple Interest and Compound Interest.

The formula for compound interest is: $\mathbf{A = P\,(1 + R)^n}$

Where

P = Principal Amount

R = Rate of interest (Annual) n = Number of years

A = Amount of money accumulated after n years including interest

Financial institutions vary in terms of their compounding rates - daily, monthly, yearly, etc.

For example, a savings account with Rs. 1,000 principal and 10% interest per year (compounded yearly) would have a balance of Rs. 1,100 at the end of the first year. By the end of the second year, the Rs. 1,100 amount would have received 10% more, making Rs. 1,210. And this will continue for the end of the tenure of the principal borrowed.

The formula for annual compound interest, including principal sum, is:

$\mathbf{A = P\,(1 + r/n)^{(nt)}}$

Where:

A = the future value of the investment/loan, including interest

P = the principal investment amount (the initial deposit or loan amount)

r = the annual interest rate (decimal)

n = the number of times that interest is compounded per year t = the number of years the money is invested or borrowed for

Note that this formula gives you the future value of an investment or loan, which is compound interest plus the principal. If we want to derive at the compound interest only, the following formula is useful:

Total compounded interest $\mathbf{= P\,(1 + r/n)^{(nt)} - P}$

Illustration: Mr. Darshan has invested Rs. 20,000/- into a Fixed Deposit, where rate of interest is 10% per annum and the accumulation of the interest is quarterly, how much money will he get after 10 years?

Solution:

Given information P = 20,000, r = 0.1, n = 4, t = 10

$$A = 20{,}000\left[1 + \frac{0.1}{4}\right]^{(4\times 10)}$$

A = 20,000 X 2.685063838

A= 53701.27

So, Mr. Darshan will get Rs. 53701.27 after 10 years.

Illustration: Mr. Sudhakar wants to have Rs. 25,000 after 4 years, how much money he would need to deposit today at 8% annual interest compounded monthly?

Solution:

Given information-

P =?, r = 0.8, n = 12, t = 4, A = 25,000

$$25{,}000 = P\left(1 + \frac{0.08}{12}\right)^{12\times 4}$$

25,000 = P (1.375666)

P = 18173.01

So, Mr. Sudhakar should invest Rs. 18,173.01.

Illustration: If Rs. 60,000 amounts to Rs. 68,694 in 2 years then find the rate of interest.

Solution:

Given information-

A = Rs. 68,694

P = Rs. 60,000

n = 2 years

r=?

A = P(1 + r /100)n

68,694 = 60,000 (1 + r/ 100)2

68,694/60,000 = (1 + r100)2

11,44910,000 = (1 + r100)2

1+ r/100 = √11,449/10,000 = √1.1449

1+ r/100 = 1.07

r/ 100 = 1.07 – 1 = 0.07

r = 0.07× 100 = 7%

Equated Monthly Instalments (EMI)

An Equated Monthly Instalment (EMI) is a fixed payment amount made by a borrower to the lender on a specified date each calendar month. Equated monthly instalments are used to pay off interest and principal each month so that over a specified number of years, the loan is paid off in full. It consists of both, payment towards interest and payment towards principal. EMI is derived based on the amount borrowed, interest rate and the time for which the loan is taken.

E	M	I
Equated	Monthly	Instalments

The formula to calculate the EMI is

$$\textbf{EMI} = [P \times r \times (1 + r)^n] / [(1 + r)^{n-1}]$$

where P = loan amount or principal,

r = interest rate per month [if the interest rate per annum is 9%, then the rate of interest will be 9/ (12 x 100)], and

n = the number of monthly instalments.

Illustration: Calculate EMI if the Loan amount = Rs. 10,00,000, the interest rate is 11% per annum and loan period is 15 years.

Solution:

P = Rs.10,00,000

Interest rate (r) = (11% rate) / 12 months = 11% / 12 months = 0.0091

Loan period (N)= 15 years = 180 months

$\textbf{EMI} = [P \times r \times (1 + r)^n] / [(1 + r)]$

EMI = Rs. 11,365.96

As the interest calculation is on the reducing amount of the principal, the amount of EMI remains constant throughout the period.

Following table can illustrate the calculation and the appropriation of the interest and the principal amount. A loan of Rs. 2,00,000 is taken at 10% interest rate for 18 months.

Date on which the EMI is paid	EMI	Interest Calculated @ 10%	Net amount after Interest adjusted towards principal	Principal outstanding
1/1/2018	12011.42	1666.67	10344.75	189655.25
1/2/2018	12011.42	1580.46	10430.96	179224.30
1/3/2018	12011.42	1493.54	10517.88	168706.41
1/4/2018	12011.42	1405.89	10605.53	158100.89
1/5/2018	12011.42	1317.51	10693.91	147406.98
1/6/2018	12011.42	1228.39	10783.02	136623.95
1/7/2018	12011.42	1138.53	10872.88	125751.07
1/8/2018	12011.42	1047.93	10963.49	114787.58
1/9/2018	12011.42	956.56	11054.85	103732.73
1/10/2018	12011.42	864.44	11146.98	92585.75
1/9/2018	12011.42	956.56	11054.85	103732.73
1/11/2018	12011.42	771.55	11239.87	81345.88
1/12/2018	12011.42	677.88	11333.53	70012.35
1/1/2019	12011.42	583.44	11427.98	58584.37
1/2/2019	12011.42	488.20	11523.21	47061.16

Date on which the EMI is paid	EMI	Interest Calculated @ 10%	Net amount after Interest adjusted towards principal	Principal outstanding
1/3/2019	12011.42	392.18	11619.24	35441.92
1/4/2019	12011.42	295.35	11716.07	23725.85
1/5/2019	12011.42	197.72	11813.70	11912.15
1/6/2019	12011.42	99.27	11912.15	0.00

FIXED INTEREST RATE

A Fixed Interest rate is an unchanging rate charged on a liability, such as a loan or mortgage. It might apply during the entire term of the loan or for just part of the term, but it remains the same throughout a set period. Mortgages can have multiple interest-rate options, including one that combines a fixed rate for some portion of the term and an adjustable rate for the balance. These are referred to as "hybrids."

Salient points as regards fixed interest rate are as under:

- A fixed interest rate avoids the risk that a mortgage or loan payment can significantly increase over time.
- Fixed interest rates can be higher than variable rates.
- Borrowers are more likely to opt for fixed-rate loans during periods of low interest rates.
- Advantages and Disadvantages of Fixed Interest Rates.
- Fixed rates are typically higher than adjustable rates. Loans with adjustable or variable rates usually offer lower introductory rates than fixed-rate loans, making these loans more appealing than fixed-rate loans when interest rates are high.
- Borrowers are more likely to opt for fixed interest rates during periods of low interest rates when locking in the rate is particularly beneficial. The opportunity cost is still much less than during periods of high interest rates if interest rates go lower.

FLOATING INTEREST RATE

As mentioned in the name, this rate is not fixed, it may change subject to the market conditions. That is to say the rate of interest which is tied to a bench mark rate. As and when the bench mark rate undergoes a change the rate of interest under floating rate will change. It is also called as variable rate. The bench mark rate should be made known by the bank to the depositor or borrower at the time of making the deposit or taking advances. Example of bench mark rates could be Repo rate or Bank rate or Marginal Cost of Lending Rate (MCLR). Let us see an example of floating rate linked to repo rate. If the floating rate quoted by the bank is = Repo rate + 100 basis point (i.e., 1%)

Let's us assume the repo rate for four quarters as:

1st Quarter = 5.50 %; 2nd Quarter = 5.75%;

3rd Quarter = 5.40%; 4th Quarter = 5.90%.

Then the corresponding interest rates will be :

1st Quarter = 6.50%; 2nd Quarter = 6.75%; 3rd Quarter = 6.40%; 4th Quarter = 6.90%.

It can be seen from the above that floating rates can increase or decrease depending upon the movement of bench mark rate. It can be advantageous to the customer or it can be disadvantageous depending upon the bench mark rate movement. These days banks offer floating rate-based deposits as well as loans such as housing loans / personal loans. This is subject to the conditions that there has to be complete transparency regarding the rate calculation from the bank side. Under the floating rate loan if the loan is being repaid by an EMI, the repayment tenure will be changed without disturbing the amount of EMI.

Reasons for Interest Rate Changes

- **Political short-term gain:** Lowering interest rates can give the economy a short-run boost. Under normal conditions, most economists think a cut in interest rates will only give a short-term gain in economic activity that will soon be offset by inflation. The quick boost can influence elections. Most economists advocate independent central banks to limit the influence of politics on interest rates.
- **Deferred consumption:** When money is loaned the lender delays spending the money on consumption goods. Since according to time preference theory people prefer goods now to goods later, in a free market there will be a positive interest rate.
- **Inflationary expectations:** Most economies generally exhibit inflation, meaning a given amount of money buys fewer goods in the future than it will now. The borrower needs to compensate the lender for this.
- **Alternative investments:** The lender has a choice between using his money in different investments. If he chooses one, he forgoes the returns from all the others. Different investments effectively compete for funds.
- **Risks of investment:** There is always a risk that the borrower will go bankrupt, abscond, die, or otherwise default on the loan. This means that a lender generally charges a risk premium to ensure that, across his investments, he is compensated for those that fail.
- **Liquidity preference:** People prefer to have their resources available in a form that can immediately be exchanged, rather than a form that takes time to realize.
- **Taxes:** Because some of the gains from interest may be subject to taxes, the lender may insist on a higher rate to make up for this loss.
- **Banks:** Banks can tend to change the interest rate to either slow down or speed up economic growth. This involves either raising interest rates to slow the economy down, or lowering interest rates to promote economic growth.
- **Economy:** Interest rates can fluctuate according to the status of the economy. It will generally be found that if the economy is strong then the interest rates will be high, if the economy is weak the interest rates will be low.

ANNUITIES

An annuity is a financial product that provides certain cash flows at equal time intervals. Annuities are created by financial institutions, primarily life insurance companies, to provide regular income to a client.

An annuity is a reasonable alternative to some other investments as a source of income since it provides guaranteed income to an individual. However, annuities are less liquid than investments in securities because the initially deposited lump sum cannot be withdrawn without penalties.

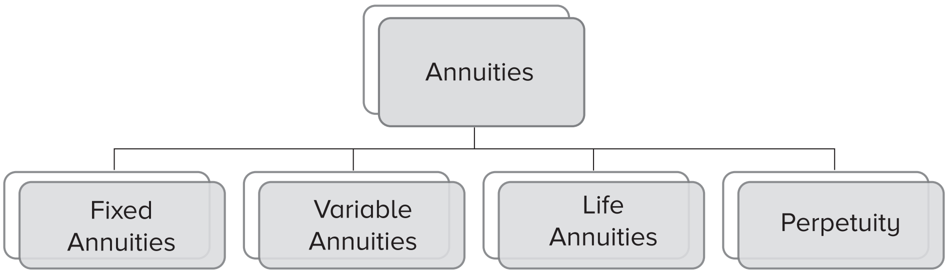
Upon the issuance of an annuity, an individual pays a lump sum to the issuer of the annuity (financial institution). Then, the issuer holds the amount for a certain period (called an accumulation period). After the accumulation period, the issuer must make fixed payments to the individual according to predetermined time intervals.

Annuities are primarily bought by individuals who want to receive stable retirement income.

Types of Annuities

There are several types of annuities that are classified according to frequency and types of payments. For example, the cash flows of annuities can be paid at different time intervals. The payments can be made weekly, biweekly, or monthly.

The primary types of annuities are:



1. **Fixed annuities**

   Annuities that provide fixed payments. The payments are guaranteed, but the rate of return is usually minimal.

2. **Variable annuities**

   Annuities that allow an individual to choose a selection of investments that will pay an income based on the performance of the selected investments. Variable annuities do not guarantee the amount of income, but the rate of return is generally higher relative to fixed annuities.

3. **Life annuities**

   Life annuities provide fixed payments to their holders until his/her death.

4. **Perpetuity**

   An annuity that provides perpetual cash flows with no end date. Examples of financial instruments that grant the perpetual cash flows to its holders are extremely rare.

   Timing of payments

   Payments of an annuity-immediate are made at the end of payment periods, so that interest accrues between the issue of the annuity and the first payment. Payments of an annuity-due are made at the beginning of payment periods, so a payment is made immediately on issue.

Contingency of payments

Annuities that provide payments that will be paid over a period known in advance are annuities certain or guaranteed annuities. Annuities paid only under certain circumstances are contingent annuities. A common example is a life annuity, which is paid over the remaining lifetime of the annuitant. Certain and life annuities are guaranteed to be paid for a number of years and then become contingent on the annuitant being alive.

Variability of payments

- **Fixed annuities** – These are annuities with fixed payments. If provided by an insurance company, the company guarantees a fixed return on the initial investment.
- **Variable annuities** –A variable annuity is a type of annuity contract that allows for the accumulation of capital on a tax-deferred basis. As opposed to a fixed annuity that offers a guaranteed interest rate and a minimum payment at annuitization, variable annuities offer investors the opportunity to generate higher rates of returns by investing in equity and bond subaccounts. If a variable annuity is annuitized for income, the income payments can vary based on the performance of the subaccounts.

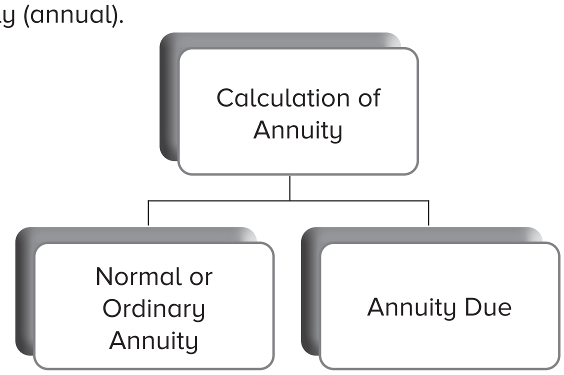
- **Equity-indexed annuitie**s – Annuities with payments linked to an index. Typically, the minimum payment will be 0% and the maximum will be predetermined. The performance of an index determines whether the minimum, the maximum or something in between is credited to the customer.

Deferral of payments

An annuity which begins payments only after a period is a deferred annuity. An annuity which begins payments without a deferral period is an immediate annuity.

Calculation of Annuities

A series of fixed payments over a period of time or receipt of payments is known as an Annuity. The fixed period can be monthly, quarterly, half-yearly (semi-annual), and yearly (annual).



Under Ordinary Annuities payments are received at the end of the period. The best example is fixed deposit interests received at the end of every quarter or interest payments received on bonds at the end of year.

Under Annuities Due, payments are received at the commencement of the period. Rental payments which are paid in advance to a land lord by a tenant.

Annuity calculations involve the concept of Present value and future value of money. Present value of future receivables:

If we have to determine the present value of future cash flows or payments, we have to use the present value table for ordinary annuity. We can also use the mathematical formula. In other words, we will arrive at the discounted value or the present value of every future cash flow.

This can be mathematically done by using the following formula:

$$\textbf{PV of ordinary annuity} = \frac{C\,[\,(1+r)\ \hat{}\ n - 1\,]}{r\,(\,1 + r\,)\ \hat{}\ n}\ \textbf{Equation 1}$$

Where, C = Cash flow per period

r = rate of interest

n = number of payments

Illustration: Mr. Shyam has invested some amount on which he receiving Rs. 10,000 every year as interest for the next 5 years and he is investing the amount of interest @ 5%.

Then the PV of ordinary annuity = 10,000 [(1 + 0.05) 5 - 1) / 0.05 (1.05) 5]

= 10,000 [0.27628 / 0.063814]

= 10,000 (4.32948)

= 43,294.80

For finding the future value of ordinary annuity the following formula can be used:

$$\textbf{FV of Ordinary Annuity} = \frac{\mathbf{C\,(\,1 + r\,)\ n - 1}}{\mathbf{Pr\,(\,1 + r\,)\ \hat{}\ n}}\ \textbf{Equation 2}$$

C = the cash flow per period

r = the rate of interest

n = number of payments

Illustration: Let us take the same example as cited in the above example under Present value of ordinary annuity.

where C = 10,000, r = 5% n = 5. Substituting the value in the above formula FV = 10000 [(1 + 0.05)5 - 1) / (0.05)5]

FV = 10000 × 5.52563
= 55256.30

Present Value of an Annuity Due

For the purpose of calculating the present value of an annuity due, we need to use the discounted formula for a period as payments are received in advance. It is very similar to receiving rent in advance. For this purpose, make use of the mathematical formula as given below:

PV of Annuity Due = $C \dfrac{(1+r)n-1}{r(1+r)n} \times (1+r)$ **Equation 3**

Note: The notations C, r and n carry the same meaning and value as in Equation 1.

Illustration:

It can be noticed that equations 1 and 3 are more or less the same except for the modifying factor of (1 + r). Talking the same values as mentioned in Example 1 if we substitute the same in Equation 3, the value works out as follows:

Then the PV of due = 10000 [(1 + 0.05)5 - 1) / 0.05(1.05)5] 1.05

= 10000 (0.27628) / 0.063814) × 1.05

= 10000 (4.32948) × 1.05

= 45459. 56

Future Value of an Annuity Due

Under this calculation as payments are received in advance, (that is to say earlier when compared to an ordinary annuity) they are held for a longer period than payment or receipts received at the end of the period. This is equal to receiving a payment on January 1 than receiving the same on December 31 of the same year. Under this circumstance we have to modify Equation 2 as under:

FV of Ordinary Annuity = $C \dfrac{(1+r)n-1}{r} \times (1+r)$ **Equation 4**

Substituting the values for C, r and n

Illustration:

FV Annuity Due = 10,000 [(1 + 0.05)5 - 1) / 0.05] (1.05)

= 10,000 5.52563 × 1.05

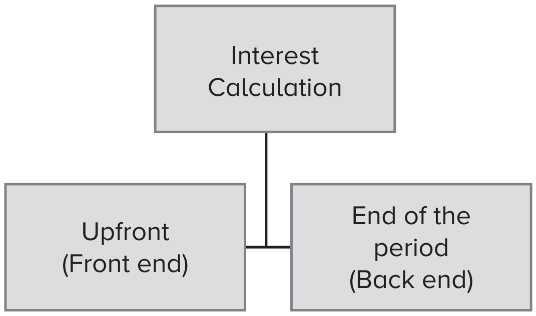
= 55256.30 1.05

= 58019. 12

Thus, it can be seen from illustrations given above that there is a difference in monetary terms, between payments made in advance and when payments are made in arrears.

Interest Calculation using Products / Balances

While making interest calculations on various credit facilities banks adopt the following methods of charging interest rates.



Upfront charging of interest

While discounting of bills such as Documentary Bills or Time bills banks charge interest rates for the period of the bill and only after deducting this amount along with other applicable charges such as postage, the balance amount is paid to the customer. This is known as upfront charging or front-end charging of interest.

Let us say the bill is for Rs. 1,85,000 of 3 months duration. Discount rate is 14% p.a. and the postage is Rs. 150.

Then the amount of credit that will be passed on to the customer is as below:

Amount of the bill	=	1,85,000
Less Discount	=	(6,475) [(1,85,000 x 0.14/4)]
Less Postage	=	150
Amount of credit to the customer	=	1,78,375

You will note that the bank will pass on the credit of Rs. 1,78,375 only after deducting discount and postage of Rs. 6,625.

End of the period charging of interest

On the contrary, when a term loan is extended or cash credits are extended, interest is charged at the end of the month or quarter as per the sanctioned terms. In the case of Cash Credit (CC) facility, the daily outstanding, in the form of closing balance is taken into account. The closing balance is multiplied by the number of days it was outstanding and products are arrived at. The product thus arrived is multiplied by the rate of interest specified for the account and divided by 365 days to arrive at the exact interest rate.

The following example will illustrate the concept of the end of the period or back-end charging of interest rate.

Let us assume the following debit balances remain outstanding in a CC account. The CC limit sanctioned is Rs.1,00,000 at an interest rate of 14% p.a. The interest is charged on monthly basis. Let us calculate products and interest for the entire month of July.

Limit: Rs. 1,00,000, Rate of Interest: 14% p.a.

Date (A)	Closing Balance (Dr)I (B)	No. of days outstanding (C)	Products (B) x (C) = (D)
1.7.2018	20,000	6	120000
7.7.2018	35,000	3	105000
10.7.2018	45000	5	225000

Date (A)	Closing Balance (Dr)| (B)	No. of days outstanding (C)	Products (B) x (C) = (D)
15.7.2018	52000	6	312000
21.7.2018	72000	7	504000
28.7.2018	44000	3	132000
31.7.2018	39000	1	39000
1.8.2018	55000	**	**

Closing balance of 55000 falls in the month of August. Hence it will be taken into account for the calculation of interest for August. Therefore, it will not be included in July products.

Calculation of interest:

The total of the product (D) above, works out to 14,37,000 Applicable interest rate is 14% p.a. = 14/100 = 0.14 Interest would be = (14,37,000 * 0.14) / 365

= Rs. 551.17

Interest applicable for the month of July = Rs. 551.17 and the same will be debited to the customer's account.

In the same manner, interest for a quarterly period can also be calculated.

The above methodology is also applicable in the case of Savings Bank too. However, the interest calculated for the Savings Bank account will be credited to the account of the customer as it is a deposit account.

AMORTISATION OF A DEBT

The word amortisation means spread over a period. It means "to gradually write off the initial cost of (an asset) over a period". The term is also used in the context of "to reduce or pay off (a debt) with regular payments."

The concept of amortization can be understood by the following example:

Mr. A has been granted a loan of Rs. 66,000 at an interest rate of 12% p.a. (i.e., 3% per quarter). The loan is to be amortised through a quarterly instalment payment of Rs. 5,000 each. Work out an amortization schedule for this loan.

The amortization schedule is as follows:

Instalment Nr.	Instalment	Int Quarterly 3% per quarter	Principal repaid	Principal Outstanding
1	5,000.00	1,980.00	3,020.00	62,980.00
2	5,000.00	1,889.40	3,110.60	59,869.40
3	5,000.00	1,796.07	3,203.93	56,665.47
4	5,000.00	1,699.95	3,300.05	53,365.42
5	5,000.00	1,600.95	3,399.05	49,966.37
6	5,000.00	1,498.98	3,501.02	46,465.35
7	5,000.00	1,393.95	3,606.05	42,859.30
8	5,000.00	1,285.77	3,714.23	39,145.07
9	5,000.00	1,174.35	3,825.65	35,319.42
10	5,000.00	1,059.57	3,940.43	31,378.99
11	5,000.00	941.34	4,058.66	27,320.33

Instalment Nr.	Instalment	Int Quarterly 3% per quarter	Principal repaid	Principal Outstanding
12	5,000.00	819.60	4,180.40	23,139.93
13	5,000.00	694.17	4,305.83	18,834.10
14	5,000.00	565.02	4,434.98	14,399.12
15	5,000.00	431.97	4,568.03	9,831.09
16	5,000.00	294.93	4,705.07	5,126.02
17	5,000.00	153.78	4,846.22	279.80
18	288.20	8.40	279.80	0.00
Total repaid	85288.20	19288.20	66000.00	

CONCEPT OF SINKING FUNDS

A sinking fund is a means of repaying funds borrowed through a bond issue through periodic payments to a trustee who retires part of the issue by purchasing the bonds in the open market. Rather than the issuer repaying the entire principal of a bond issue on the maturity date, another company buys back a portion of the issue annually and usually at a fixed par value or at the current market value of the bonds, whichever is less.

The sinking fund is an amount of money that is accumulated in a systematic way over a period of time to meet a future requirement or a contingency or cost of replacement of an asset. Since the amount of sinking fund needed is known in advance along with other parameters such as interest rate are known, it is easy to work out such a schedule. This is very similar to calculating the future value of annuity. The salient issue of the sinking fund is highlighted as follows:

- A sinking fund is an account containing money set aside to pay off a debt or bond.
- Sinking funds may help pay off the debt at maturity or assist in buying back bonds on the open market.
- Callable bonds with sinking funds may be called back early removing future interest payments from the investor.
- Paying off debt early via a sinking fund saves a company interest expense and prevents the company from being put in financial difficulties in the future.

Advantages and Disadvantages of a Sinking Fund

A sinking fund improves a corporation's creditworthiness, letting the business pay investors a lower interest rate. Because of the interest savings, the corporation has more net income and cash flow for funding operations. Also, businesses may deduct interest payments given to lenders from their taxes, helping increase cash flow as well. Corporations may use the savings for covering sinking fund payments or other obligations. In addition, investors appreciate the added protection a sinking fund provides, making investors more likely to lend company money. A business that is controlling its money is less likely to default on outstanding debt.

However, if interest rates decrease and bond prices increase, bonds may be called and investors may lose some of their interest payments, resulting in less long-term income. Also, investors may have to put their funds elsewhere at a lower interest rate, also missing out on potential long-term income.

The general formula for the future value of an annuity can be calculated by the formula is as below:

$$F = \frac{A\,[\,(1+r)^{n} - 1\,]}{r}$$

Here F is the future value of an annuity,

'A' is the amount borrowed,

'r' is the rate of interest,

n is the number of years or period of the loan.

The following examples illustrate the concept of sinking fund:

1. A student borrows a sum of Rs. 1,00,000 per year at an interest rate of 6% for a period of 5 years to complete a professional degree from a bank. How much money does the student owe to the bank at the end of 5 years?

   Substituting the values in the equation mentioned above

   $$= \frac{100000 \,[\,(1 + 0.06)^5 - 1}{r}$$

   $= 100000\ (0.34)/0.06$

   $= 566666.67$

   The amount of money owed by the student at the end of 5 years will be Rs. 5,66,666.67.

2. A civil engineering company wish to buy a generator costing Rs. 700000 in 5 years. How much money the company should save annually if the rate of interest on its return is 10%.?

   The value of F = 700000 n = 5, r = 0.10. If we substitute the same in the equation

   $$700000 = \frac{A\,[\,(1 + 0.10)^5 - 1}{0.10}$$

   $$\text{Solving for } A = \frac{700000 * 0.10}{0.61}$$

   $A = 114754.10$

   The company has to save a sum of Rs. 114754.10 per annum.

3. A company expects drilling machine of value 80,000 will last for 10 years' time with a salvage value of Rs. 8000. A new machine may cost Rs. 104000 at that point in time. The company wishes to set up a sinking fund with a return of 8%. What should be the annual savings by the company for contributing to the sinking fund?

   Here in the problem n = 10 r =0.08 F = (104000 – 8000) = 96000

   Substituting the value in equation and solving for A

   $$96000 = \frac{A\,[\,(1 - 0.08)^{10} - 1\,]}{0.08}$$

   $$A = \frac{96000 \times 0.08}{(2.16 - 1)}$$

   $A = 6620.68$

   The company should be contributing a sum of Rs. 6620.68 every year to the sinking fund in this case. estimation of annuity value of payment values over a period. A better understanding of these concepts will improve effectiveness while working in a bank or otherwise.

LESSON ROUND-UP

- Charging of interest is an essential part of operational banking. It also forms the income streams for banks. Banks pay interest on certain products on simple interest basis and on other products they also pay interest on compound interest basis. They also charge interest on loan products on simple and compound interest basis as applicable in each case.
- Banks also use Equated Monthly Instalment payment option while fixing loan repayment by borrowers mostly on term loans. Due to financial innovation, banks also offer a choice of fixed or floating interest basis on certain products based on specific terms and conditions.
- Banks also use the concept of annuities in interest calculations for offering the same to customers. For borrowers of certain products like bill discounting banks collect interest on front end basis while on facilities lime cash credit banks levy interest on daily product basis on a backend basis.
- Loan repayments involving quarterly or half yearly or annual basis are based on the principle of amortization. The concept of sinking fund is used both by banks and customers for estimation of annuity value of payment values over a period.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions is not to be submitted for evaluation)

1. State the difference between simple interest rate and compound interest rate.
2. Explain the concept of EMI and its effect on repayment of loans.
3. State different types of annuities and briefly explain the same.
4. What is amortization debt? How it is practically used in real life?
5. In how many years, the sum of Rs. 40,000 will become Rs. 43,681 if the rate of compound interest is 4.5% per annum?
6. The simple interest on a certain sum of money at 4% per annum for 4 years is Rs. 800 more than the interest on the same sum for 3 years at 5% per annum. Find the sum.
7. Mr. Raj planning to purchase a house property and want to take a loan Rs. 50,00,000 @ 10% from the Bank. Mr. Raj wants to know the EMI amount. Calculate the EMI and guide to Mr. Raj.
8. Find the present value of Rs. 50,000 required after 3 years at 6% p.a. compounded annually.
9. Calculate the needed amount that must be invested every year so that the total amount sums up to Rs. 3,00,000 by the end of 10 years. The rate of interest is 10%, compounded annually.

Performing & Non Performing Assets

Lesson 11

KEY CONCEPTS

■ Non-Performing Assets (NPA) ■ Corporate Debt Restructuring (CDR) ■ One Time Settlement (OTS) ■ Asset Reconstruction Companies (ACR)

Learning Objectives

To understand:

- Income Recognition
- Asset Classification
- Provisioning Norms
- CDR

Lesson Outline

- Introduction
- Income Recognition
- Asset Classification
- Provisioning Norms
- CDR
- Re-structuring of Stressed Assets
- One Time Settlement
- BIFR
- ARC
- DRT
- Enforcement of Security under SARFEASI
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Reserve Bank of India Act, 1934
- Banking Regulation Act, 1949
- Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

INTRODUCTION

Prior to the introduction of NPA norms in India in 1991-92, profits announced by banks were inflated and not real, as the interest debited in loan accounts where there was no possibility of its recovery was also included in the income; there was no provision made for the monies lent where the recovery of instalments were not forthcoming and no provision for the deterioration in the market value and realizable value of the security. The accounting practices followed amongst bankers were not uniform.

However, in line with the international practices and as per the recommendations made by the Committee on the Financial System (Narasimham Committee-1) the RBI has introduced, in a phased manner, prudential norms for income recognition, asset classification and provisioning for the advances portfolio of the banks so as to move towards greater consistency and transparency in the published accounts. Over the years Prudential norms and Asset classification have assumed lot of importance and every student of banking is expected to be aware of the same.

The policy of income recognition should be objective and based on record of recovery rather than any subjective considerations. The classification of assets of bank also has to be done objectively. The provisioning should be made on the basis of classification of assets based on the period for which the asset has remained non-performing and the availability of the security and its realizable value.

Banks have to ensure that while granting loans and advances, realistic repayment schedules are fixed on the basis of cash flows of borrowers. This would facilitate prompt repayment by the borrowers and there by improve the record of recovery. Banks also undertake debt restructuring exercise for corporates for the benefit of all stake holders knowledge of which will be useful. Banks also undertake financial inclusion on a large scale with the help of business correspondents and business facilitators with active use of technology for speedier, accurate and at affordable costs for helping rural poor. Mobile banking services are also being extended to customers as a part of digital banking initiatives. Banks are also involved in setting up of RSETIs for providing training and skill development in respect of rural below poverty line unemployed youth. A comprehensive exposure to these topics in this lesson will increase the awareness of a reader to the range of services provided by banks in this regard.

The contents are based principally on RBI Master Directions / Master circulars and will be useful in practical understanding of the concept of NPA, Income recognition, provisioning norms. The contents have been elaborated to the extent necessary to offer rationale for various norms adopted by banks in this regard.

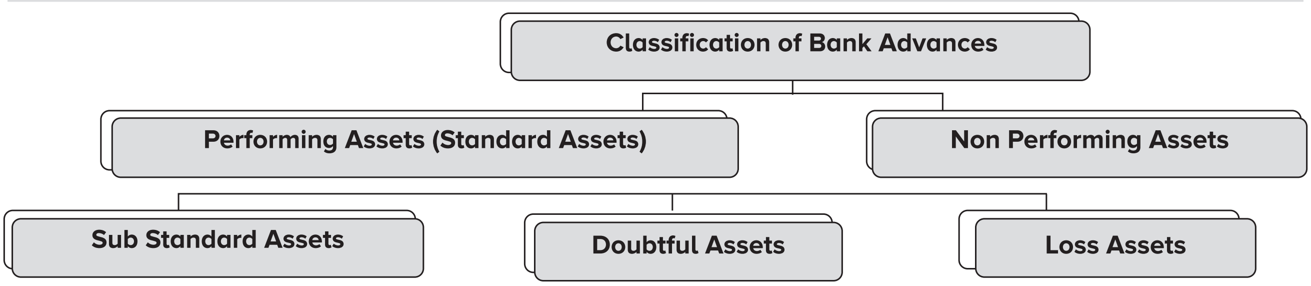
Classification of Bank Advances on basis of Performance

The Banks have to classify their advances into two broad groups:

1. Performing Assets; and
2. Non-Performing Assets.

Performing assets are also called as Standard Assets. The Non-Performing Assets are again classified into three categories and they are (i) sub-standard Assets (ii) doubtful assets & (iii) Loss Assets.

Classification of Bank Advances



PERFORMING ASSETS

Standard Assets - Standard asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. The operations in the loan account are satisfactory in terms of timely repayment of principal and interest, availability of security, no adverse features in the operations of the accounts etc.

NON-PERFORMING ASSET (NPA)

An asset, including a leased asset, when stops generating income for the bank, it becomes Non-performing. A loan or an advance is non-performing asset (NPA) where:

1. Interest and /or instalment of principal remain overdue for a period of more than 90 days in case of a term loan. In case of interest payments, banks should, classify an account as NPA only if the interest due and charged during any quarter is not serviced fully within 90 days from the end of the quarter.
2. The account remains “out of order” in case of cash credit / overdraft. An account should be treated as “out of order”, if the outstanding balance remains continuously in excess of the sanctioned limit / drawing power for 90 days. In case where the outstanding balance in the principal operating account is less than the sanctioned limit / drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as “out of order.”

   If the cash credit facility or ad hoc limit sanctioned remains unreviewed or unrenewed for 180 days from the due date or sanctioned date respectively, such account will be treated as NPA. Account with temporary deficiencies like non submission of stock statements, non-renewal of limits etc. will become NPA if such irregular drawings are permitted in the account for a continuous period of 90 days.
3. The bill (purchased / discounted) remains overdue for more than 90 days.
4. The amount of liquidity facility remains outstanding for more than 90 days, in respect of securitization transaction undertaken in terms of guidelines in the circular - Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021.
5. In respect of derivative transactions, the overdue receivables representing positive mark-to-market value of derivative contract, if remain unpaid for a period of 90 days from the specific due date for payment.
6. In case of Credit Cards, if minimum amount due, mentioned in monthly credit card statement, is not paid fully within 90 days from the payment due date.
7. In case of Agriculture loans if installment or the interest remains outstanding beyond due date for two crop seasons (crop maturing within one year) and one crop season (for crops maturing after one year) In other agricultural loans the norm is 90 days.
8. The availability of security or net worth of borrower / guarantor should not be taken into account for the purpose of treating an advance as NPA or otherwise.

Some other issues that are mentioned in the guidelines in respect of NPA, overdue account and ‘out of order’ status are detailed below.

- Advances against term deposits, NSCs eligible for surrender, Indira Vikas Patras and Life policies need not be treated as NPAs if adequate margin is available in the account. Advances against gold ornaments, government securities and other securities are not allowed this exemption.
- In case of consortium advances the classification can be different for different banks as it is based on the record of recovery with the individual member bank.
- On Account of GST implementation, standard MSME loan accounts up to Rs. 25 crores as on 31.08.2017 will be classified as standard, if payment due as on 01.09.2017 falling due up to 31.12 2018, not paid up to 180 days. 90 days norm to be apply from 1st January 2019.

- Any amount due to the bank under any credit facility is 'overdue' if it is not paid on the due date fixed by the bank. An account is treated as 'out of order' if the outstanding balance remains continuously in excess of the sanctioned limit/drawing power for 90 days. In cases where the outstanding balance in the principal operating account is less than the sanctioned limit/drawing power, but there are no credits continuously for 90 days as on the date of Balance Sheet or credits are not enough to cover the interest debited during the same period, these accounts should be treated as **'out of order'**.

INCOME RECOGNITION

Income Recognition Policy - Income from NPA is not recognized on accrual basis but is booked as income only when it is actually received. The bank should not charge and take to income account interest on any NPA. This will also apply to Government guaranteed accounts.

The other salient issues are as under:

- Interest on advances against Term Deposits, National Savings Certificates (NSC), Indira Vikas Patra (IVP), Kisan Vikas Patra (KVP) and Life insurance policies may be taken to income account on due date, provided adequate margin is available in the accounts.
- Fees and commissions earned by the banks as a result of renegotiations or rescheduling of outstanding debts should be recognized on an accrual basis over the period of time covered by the negotiated or rescheduled extension of credit.
- If any advance, including bills purchased or discounted, become NPA, the entire interest accrued and credited to income account in the past periods, should be reversed, if the same is not realized. This will apply to government guaranteed accounts also.
- In respect of NPAs, fees, commissions, and other income that have accrued should cease to accrue in the current period and should be reversed with respect to past periods, if uncollected.
- The finance charge component of finance income on the leased assets which has accrued and was credited to income account before the asset became non performing, and remaining unrealized should be reversed or provided for in the current accounting period.
- On an account turning in to NPA, the bank should stop further application of interest. However, may continue to record such accrued interest in a Memorandum account in their books. For the purpose of computing gross advances, interest recorded in the memorandum account should not be taken into account.
- Interest income in respect of restructured accounts classified as 'standard assets' may be recognized on accrual basis and that in respect of the restructured accounts classified as 'non-performing assets' shall be recognized on cash basis.
- In the case of additional finance in accounts where the pre-restructuring facilities were classified as NPA, the interest income shall be recognised only on cash basis except when the restructuring is accompanied by a change in ownership.
- Interest realised on NPAs may be taken to income account provided the credits in the accounts towards interest are not out of fresh/ additional credit facilities sanctioned to the borrower concerned.
- In the absence of a clear agreement between the bank and the borrower for the purpose of appropriation of recoveries in NPAs (i.e. towards principal or interest due), banks should adopt an accounting principle and exercise the right of appropriation of recoveries in a uniform and consistent manner.

ASSET CLASSIFICATION

Banks are required to classify assets into following three categories based on degree of well-defined credit weakness and the extent of dependence collateral security for realization of dues. The requirement of such classification is introduced to disclose the quality of assets in a transparent number. The three categories are:

1. *Sub-standard Assets* - a substandard asset would be one, which has remained NPA for a period less than or equal to 12 months. Such an asset will have well defined credit weaknesses that jeopardise the liquidation of the debt and are characterized by the distinct possibility that the banks will sustain some loss, if deficiencies are not corrected.
2. *Doubtful Assets* - an asset would be classified as doubtful if it has remained in the substandard category for a period of 12 months. A loan classified as doubtful has all the weaknesses inherent in assets that were classified as substandard, with the added characteristic that the weaknesses make collection or liquidation in full, – on the basis of currently known facts, conditions and values – highly questionable and improbable.
3. *Loss Assets* - A loss asset is one where loss has been identified by the bank or internal or external auditors or the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible and of such little value that its continuance as a bankable asset is not warranted although there may be some salvage or recovery value.

It may be noted that for the purpose of provisioning doubtful assets are classified in three categories as detailed below.

Doubtful 1- Any doubtful asset which remained in that category for first 12 months i.e., an account in the 2nd year after classification as NPA will fall under this category.

Doubtful 2- Any doubtful asset which remained in that category after being relegated in to that category after one year and up to three years i.e., an account in the 3rd to 5th year after classification as NPA will fall under this category.

Doubtful 3- Any doubtful asset which remained in that category after being relegated in to that category after three years i.e., an account beyond 5th year after classification as NPA will fall under this category.

Upgradation of accounts to the category of Standard Assets:

- When the borrower makes payment of entire due amount in a NPA account, from the date of such payment the account will be classified as standard asset.
- All restructured advances can be classified as Standard asset after satisfactory performance during a period of one year from the commencement of the first payment of interest or principal under the restructured terms.

A standard Asset which remained as irregular or out of order or overdue up to a period of 90 days will be treated as Special Mention Account (SMA) that is classified as per the following categories:

SMA Sub Categories	Basis for classification - Principal or interest payment or any other amount wholly or partly overdue between
SMA-0	01-30 days
SMA-1	31-60 days
SMA-2	61-90 days

In the case of revolving credit facilities like cash credit, the SMA subcategories will be as follows:

SMA Sub Categories	Basis for classification – Outstanding balance remains continuously in excess of the sanctioned limit or drawing power whichever is lower, for a period of:
SMA-0	01-30 days
SMA-1	31-60 days
SMA-2	61-90 days

Lenders shall report credit information, including classification of an account as SMA to Central Repository of Information on Large Credits (CRILC) on all borrower entities having aggregate exposure of Rs. 50 million and above with them. The CRILC-Main Report will now be required to be submitted on a monthly basis effective April 1, 2018. In addition, the lenders shall report to CRILC, all borrower entities in default (with aggregate exposure of Rs. 50 million and above), on a weekly basis, at the close of business on every Friday, or the preceding working day if Friday happens to be a holiday. The first such weekly report shall be submitted for the week ending February 23, 2018.

Illustration: A Term Loan disbursed on April 15, 2022 where the first instalment was due on June 15, 2022.

The borrower did not pay the instalment. Then -

From	To	Asset classification
15.04.2022	15.06.2022	Standard
16.06.2022	15.09.2022	Overdue (Special Mention Account 0, 1, 2)
16.09.2022	15.09.2022	Sub-standard
16.09.2023	15.09.2024	Doubtful - category 1
16.09.2024	15.06.2026	Doubtful - category 2
16.09.2026	Further	Doubtful - category 3

Classification of Assets as NPA- Major Issues

The classification of assets as NPA should be based on the record of recovery. Bank should not classify an advance as NPA merely due to the existence of some deficiencies which are temporary in nature such as non- availability of adequate drawing power based on the latest available stock statement, balance outstanding exceeding the limit temporarily, non-submission of stock statements, non-renewal of the limits on the due date etc.

- If arrears of interest and principal are paid by the borrower in case of loan accounts classified as NPAs, the account should no longer be treated as NPA and may be classified as 'standard'.
- The asset classification of borrowal accounts where a solitary or few credits are recorded before the balance sheet date should be handled with care and without scope for subjectivity.
- Asset classification should be borrower-wise and not facility-wise.
- Asset classification of accounts under consortium should be based on the record of recovery of the individual member banks.
- Accounts where there is erosion in the value of security / fraud committed by borrowers, the asset should be straightaway classified as doubtful (if realizable value of security is less than 50%) or loss (if realizable value of security assessed is less than 10%) asset.
- Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs and Life insurance policies need not be treated as NPAs. Advances against gold ornaments, government securities and all other securities are not covered by this exemption.
- A credit card account is treated as non-performing asset if the minimum amount due, as mentioned in the statement, is not paid fully within 90 days from the payment due date mentioned in the statement.
- In respect of agricultural advances as well as advances for other purposes granted by banks to PACS/ FSS under the on-lending system, only that particular credit facility granted to PACS/ FSS which is in default for a period of two crop seasons in case of short duration crops and one crop season in case of long duration crops, as the case may be, after it has become due will be classified as NPA and not all the credit facilities sanctioned to a PACS/ FSS. The other direct loans & advances, if any, granted by the bank to the member borrower of a PACS/ FSS outside the on-lending arrangement will become NPA even if one of the credit facilities granted to the same borrower becomes NPA.

- In case of bank finance given for industrial projects or for agricultural plantations etc. where moratorium is available for payment of interest, payment of interest becomes 'due' only after the moratorium or gestation period is over. Therefore, such amounts of interest do not become overdue and hence NPA, with reference to the date of debit of interest. They become overdue after due date for payment of interest, if uncollected.
- The credit facilities backed by guarantee of the Central Government though overdue may be treated as NPA only when the Government repudiates its guarantee when invoked. This exemption from classification of Government guaranteed advances as NPA is not for the purpose of recognition of income. Advances sanctioned against State Government guarantees should be classified as NPA in the normal course, if the guarantee is invoked and remains in default for more than 180 days.

There are various issues regarding asset classification that require involved judgment. RBI Guidelines are quite comprehensive and some important of them are discussed under the heads:

1. Projects under implementation.
2. Change of Ownership.

Change in Ownership

In case of change in ownership of the borrowing entities, credit facilities of the concerned borrowing entities may be continued/upgraded as 'standard' after the change in ownership is implemented, either under the Insolvency and Bankruptcy Code (IBC) or under this framework. If the change in ownership is implemented under this framework, then the classification as 'standard, shall be subject to the following conditions:

i. Banks shall conduct necessary due diligence in this regard and clearly establish that the acquirer is not a person disqualified in terms of Section 29A of the Insolvency and Bankruptcy Code, 2016.

ii. The new promoter shall have acquired at least 26 per cent of the paid up equity capital of the borrower entity and shall be the single largest shareholder of the borrower entity.

iii. The new promoter shall be in 'control' of the borrower entity as per the definition of 'control' in the Companies Act 2013 / regulations issued by the Securities and Exchange Board of India/any other applicable regulations / accounting standards as the case may be.

iv. The conditions for implementation of RP as per Section I-C of the covering circular are complied with. For such accounts to continue to be classified as standard, all the outstanding loans/credit facilities of the borrowing entity need to demonstrate satisfactory performance during the specified period. If the account fails to perform satisfactorily at any point of time during the specified period, the credit facilities shall be immediately downgraded as non-performing assets (NPAs) i.e., 'sub-standard'. Any future upgrade for such accounts shall be contingent on implementation of a fresh RP (either under IBC, wherever mandatory filings are applicable or initiated voluntarily by the lenders, or outside IBC) and demonstration of satisfactory performance thereafter. Further, the quantum of provisions held by the bank against the said account as on the date of change in ownership of the borrowing entities can be reversed only after satisfactory performance during the specified period.

PROVISIONING NORMS

The primary responsibility for making adequate provisions for deterioration of asset quality (due to credit worthiness of borrowers etc.) and for any diminution in the value of investment or other asset is that of the bank management and statutory auditors. RBI guidelines prescribe creation of provisions on the non-performing assets on the basis of classification of asset into prescribed categories. The probability of realisation time lag between an account becoming doubtful of recovery and the realisation etc. are taken into account in making such provisions.

RBI has prescribed following percentage of previsions in respect of NPA:

Sub-standard Secured	15%
Sub-standard Unsecured	25%
Sub-standard Unsecured (infrastructure)	20%
Doubtful up to 12 months (secured portion) (Doubtful 1)	25%
Secured doubtful -2	40%
Secured doubtful -3	100%
Doubtful up to 12 months (Unsecured portion) (Doubtful 1)	100%
Doubtful - more than 12 months up to 3 years (Unsecured portion) (Doubtful 2)	100%
Doubtful - more than 3 years (Unsecured portion) (Doubtful 3)	100%
Loss Assets	100%
Wilful Defaulters and Non-Cooperative Borrowers	
Secured sub-standard up to 6 months	15%
Secured sub-standard - above 6 months up to 12 months	25%
Unsecured sub-standard up to 6 months	25%
Unsecured sub-standard above 6 months to 12 months	40%
Doubtful up to 12 months (secured portion) (Doubtful 1)	25%
Doubtful up to 12 months (Unsecured portion) (Doubtful 1)	100%
Doubtful - more than 12 months up to 3 years (Secured portion) (Doubtful2)	40%
Doubtful - more than 12 months up to 3 years (Unsecured portion) (Doubtful2)	100%
Doubtful - more than 3 years (secured / unsecured) (Doubtful 3)	100%

Provisions on Standard Assets

Furthermore, banks are required to make general provisions for standard asset for the funded outstanding on global loan portfolio basis:

Farm Credit within Agriculture, Small and Micro- Enterprises (SME)sector and Individual housing loans (Standard Assets)	0.25%
Home Loans at Teaser rate (Standard Assets)*	2.00 %
Commercial Real Estate (Standard assets)- other than CRE- Residential Housing Sector	1.00%
Commercial Real Estate -Residential Housing Sector(CRE_RH) (Standard assets	0.75%
Other standard loans including Medium Enterprises	0.40%

** The provisioning on these assets would revert to 0.40 per cent after 1 year from the date on which the rates are reset at higher rates if the accounts remain 'standard'*

The provisions towards Standard Assets need not be netted from gross advances but shown separately as 'Contingent Provisions against Standard Assets' under 'Other Liabilities and Provisions Others'.

Some important issues on provisioning are as under.

A. Other Additional provisions for NPAs at higher than prescribed rates

Such higher rates are to be in the policy of the bank, approved by the board. The policy should be applied consistently from year to year. This provision amount can be netted off from the gross NPAs to arrive at net NPAs

B. Provisions under Special Circumstances

Advances against deposits/specific instruments

Advances against term deposits, NSCs eligible for surrender, IVPs, KVPs, gold ornaments, government & other securities and life insurance policies would attract provisioning requirements as applicable to their asset classification status.

Treatment of interest suspense account

Amounts held in Interest Suspense Account should not be reckoned as part of provisions. Amounts lying in the Interest Suspense Account should be deducted from the relative advances and thereafter, provisioning as per the norms, should be made on the balances after such deduction.

Advances covered by ECGC guarantee

In the case of advances classified as doubtful and guaranteed by ECGC, provision should be made only for the balance in excess of the amount guaranteed by the Corporation. Further, while arriving at the provision required to be made for doubtful assets, realisable value of the 34 securities should first be deducted from the outstanding balance in respect of the amount guaranteed by the Corporation and then provision made as illustrated hereunder:

Example:

Outstanding Balance	Rs.8 lakhs
ECGC Cover	50 percent
Period for which the advance has remained doubtful	More than 2 years remained doubtful (say as on March 31, 2022)
Value of security held	Rs.1.50 lakhs

Provision required to be made

Outstanding balance	Rs.8 lakhs
Less: Value of security held	Rs.3 lakhs
Unrealized balance	Rs.5 lakhs
Less: ECGC Cover (50% of unrealizable balance)	Rs.2.5 lakhs
Net unsecured balance	Rs.2.5 lakhs
Provision for unsecured portion of advance	Rs.2.5 lakhs
Provision for secured portion of advance (as on March 31, 2022)	Rs.1.2 lakhs
Total provision to be made	Rs.3.7 lakhs

D. Provisioning for Country Risk

Banks need to make provisions, on the net funded country exposures on a graded scale ranging from 0.25 to 100 percent according to the risk categories mentioned below.

Risk category	ECGC Classification	Provisioning Requirement (per cent)
Insignificant	**A1**	**0.25**
Low	**A2**	**0.25**
Moderate	**B1**	**5**
High	**B2**	**20**
Very high	**C1**	**25**
Restricted	**C2**	**100**
Off-credit	**D**	**100**

Banks are required to make provision for country risk in respect of a country where its net funded exposure is one per cent or more of its total assets.

The provisions required to be held according to the asset classification status of the asset. However, in the case of ‘loss assets’ and ‘doubtful assets’, provision held, including provision held for country risk, may not exceed 100% of the outstanding.

Banks may not make any provision for ‘home country’ exposures i.e. exposure to India. The exposures of foreign branches of Indian banks to the host country should be included. Foreign banks shall compute the country exposures of their Indian branches and shall hold appropriate provisions in their Indian books. However, their exposures to India will be excluded.

Provisioning norms for Liquidity facility provided for Securitisation transactions, the amount of liquidity facility drawn and outstanding for more than 90 days, in respect of securitisation transactions undertaken in terms of Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021, should be fully provided for.

Floating Provisions

Some banks make a “floating provision” over and above the specific provisions made in respect of accounts identified as NPAs. The floating provisions, wherever available, could be set-off against provisions required to be made as per above stated provisioning guidelines. Considering that higher loan loss provisioning adds to the overall financial strength of the banks and the stability of the financial sector, banks are urged to voluntarily set apart provisions much above the minimum prudential levels as a desirable practice.

Banks should adopt an accounting principle and exercise the right of appropriation of recoveries - towards principal and interest - in a uniform and consistent manner.

The floating provisions should not be used for making specific provisions as per the extant prudential guidelines in respect of non-performing assets or for making regulatory provisions for standard assets. The floating provisions can be used only for contingencies under extraordinary circumstances for making specific provisions in impaired accounts after obtaining board’s approval and with prior permission of RBI. The Boards of the banks should lay down an approved policy as to what circumstances would be considered extraordinary.

To facilitate banks’ Boards to evolve suitable policies in this regard, it is clarified that the extra-ordinary circumstances refer to losses which do not arise in the normal course of business and are exceptional and non-recurring in nature. These extra-ordinary circumstances could broadly fall under three categories viz. General, Market and Credit. Under general category, there can be situations where bank is put unexpectedly to loss due to events such as civil unrest or collapse of currency in a country. Natural calamities and pandemics may also be included in the general category. Market category would include events such as a general melt down in the markets, which affects the entire financial system. Among the credit category, only exceptional credit losses would be considered as an extra-ordinary circumstance.

For example, in order to mitigate the adverse impact of COVID 19 related stress on banks, as a measure to enable capital conservation, banks are allowed to utilise 100 per cent of floating provisions held by them as on December 31, 2020 for making specific provisions for nonperforming assets with prior approval of their Boards in order to mitigate the adverse impact of COVID 19 related stress on banks, as a measure to enable capital conservation, banks are allowed to utilise 100 per cent of floating provisions held by them as on December 31, 2020 for making specific provisions for nonperforming assets with prior approval of their Boards.

Floating provisions - Cannot be netted from Gross NPA to arrive at net NPAs but can be a part of Tier II capital subject to overall ceiling of 1.25% of Total Risk Weighted Assets.

Excess provision on sale of Standard Assets / NPAs

If sale proceeds of a standard asset are more than its book value the excess provision can be credited to profit and loss account. Excess provision in case of sale of NPA asset can be credited to Tier II capital subject to the overall ceiling of 1.25% of total Risk Weighted Assets.

Provision Coverage Ratio (PCR)

Provisioning Coverage Ratio (PCR) is essentially the ratio of provisioning to gross nonperforming assets and indicates the extent of funds a bank has kept aside to cover loan losses. From a macro-prudential perspective, banks should build up provisioning and capital buffers in good times i.e. when the profits are good, which can be used for absorbing losses in a downturn. This will enhance the soundness of individual banks, as also the stability of the financial sector. It was, therefore, decided that banks should augment their provisioning cushions consisting of specific provisions against NPAs as well as floating provisions, and ensure that their total provisioning coverage ratio, including floating provisions, is not less than 70 per cent.

It is calculated as under as per RBI formula

$$\frac{\textbf{Specific provisions for NPAs held/required + Provisions for diminution in fair value of the restructured accounts classified as NPAs + Technical write - off}}{\textbf{(Gross NPAs + Technical/Prudential Write}} \times \mathbf{100}$$

Gross NPAs = The principal dues of NPAs plus Funded Interest Term Loan (FITL) where the corresponding contra credit is parked in sundries account (interest capitalization - Restructured accounts), in respect of NPA accounts.

Net NPA = Gross NPA - (Balance in interest suspense account + DICGC / ECGC claims received and held Pending adjustment + Part payment received and kept in suspense account + Total provisions held).

PCR of 70% of gross NPAs was prescribed, as a macro prudential measure by RBI, with a view to augmenting provisioning buffer in a counter-cyclical manner when the banks were making good profits. Banks are advised that –

(i) the PCR of 70% may be with reference to the gross NPA position in banks as on September 2010,

(ii) the surplus of the provision under PCR vis-à- vis as required as per prudential norms should be segregated into an account styled as "countercyclical provisioning buffer",

(iii) this buffer will be allowed to be used by banks for making specific provisions for NPAs during periods of system wide downturn, with the prior approval of RBI.

CORPORATE DEBT RESTRUCTURING (CDR)

Corporate Debt Restructuring is mechanism to restructure in a transparent way the borrowings of sticky borrowal accounts of viable corporate entities outside the formal forums such as Board for Industrial and Financial Reconstruction, Debt Recovery Tribunals, and Courts so as to benefit all stake holders in the entity and was introduced in India as a result of recommendations of a Vepa Kamesam Committee and Mrs. Shyamala Gopinath Committees. The guidelines evolved by RBI on the basis of these recommendations are fine amended by RBI from time to time due to continuous developments in the banking scenario.

The Main features of CDR (Corporate Debt Restructuring) mechanism:

- The framework will aim at preserving viable corporate that are affected by certain internal and external factors and minimize the losses to the creditors and other stakeholders through an orderly, timely and coordinated restructuring program.
- CDR system in the country will have a three tier structure:
  - CDR standing Forum
  - CDR Empowered Group
  - CDR Cell

CDR Standing Forum would be the representative general body of all financial institutions and banks participating in CDR system. It will be a self-empowered body, which will lay down policies and guidelines, and monitor the progress of corporate debt restructuring. The Forum will provide an official platform for both the creditors and borrowers to amicably and collectively evolve policies and guidelines for working out debt restructuring plans in the interest of all concerned. The RBI will not be a member of the Forum and Core Group. Its role will be confined to providing broad guidelines. The Forum shall meet at least once every six months and would review and monitor the progress of corporate debt restructuring system. A CDR Core Group will be carved out of the Forum to assist the Forum in taking decisions relating to policy. The CDR Core Group would lay down the policies and guidelines to be followed by the CDR Empowered Group and CDR Cell for debt restructuring.

The individual cases of corporate debt restructuring shall be decided by CDR Empowered Group. In order to make the CDR Empowered Group effective and broad based and operate efficiently and smoothly, it would have to be ensured that participating institutions / banks approve a panel of senior officers to represent them in the CDR Empowered Group. There should be a general authorization by the respective Boards of the participating institutions / banks in favour of their representatives on the CDR Empowered Group, authorizing them to take decisions on behalf of their organization, regarding restructuring of debts of individual corporate. The Group will consider the preliminary report of all cases of requests of restructuring, submitted to it by the CDR Cell.

After the Group decides that restructuring of the company is prima-facie feasible and the enterprise is potentially viable in terms of the policies and guidelines evolved by the Forum, the detailed restructuring package will be worked out by the CDR Cell in conjunction with the Lead Institution.

The Group shall decide on the acceptable viability benchmark levels on the parameters, which may be applied on a case-by-case basis, based on the merits of each case - ROCE (Return on Capital Employed), DSCR (Debt Service Coverage Ratio), Gap between the Internal Rate of Return (IRR) and the Cost of Fund (CoF), Extent of sacrifice. The decisions of the Group shall be final. If restructuring is not found viable, the creditors would then be free to take necessary steps for immediate recovery of dues and / or liquidation or winding up of the company, collectively or individually.

The Forum and the Group will be assisted by CDR Cell in all their functions. The Cell will make the initial scrutiny of the proposals received from the borrowers / creditors, by calling the proposed rehabilitation plan and other information within one month. The Cell will prepare the restructuring plan in terms of the general policies and guidelines approved by Forum and place for consideration of Group within 30 days for decision.

Other features:

- The CDR mechanism will cover only multiple banking accounts / syndication /consortium accounts of corporate borrowers with outstanding fund-based and non-fund based exposure of Rs. 10 crores and above by banks and institutions.
- Category 1 CDR system will be applicable only to accounts classified as 'standard' and 'sub-standard'.
- The accounts where recovery suits have been filed by the creditors against company, may be eligible for consideration under the CDR system provided, the initiative to resolve the case under CDR system is taken by at least 75% of the creditors (by value) and 60% of creditors (by numbers).
- Cases involving frauds or diversion of funds with malafide intent are not covered.
- Reference to CDR System could be triggered by:

  (i) any or more of the creditor who have minimum 20% share in either working capital or term finance; or

  (ii) by the concerned corporate, if supported by a bank or financial institution having stake as in (i).
- CDR is a non-statutory mechanism which is a voluntary system based on Debtor - Creditor Agreement (DCA) and Inter-Creditor Agreement (ICA). The DCA and ICA will provide the legal basis to CDR mechanism.
- In order to improve effectiveness of the CDR mechanism a clause may be incorporated in loan agreements involving consortium / syndicate accounts where by all creditors, including those which are not members of the CDR mechanism, agree to be bound by the terms of the restructuring package that may be approved under the CDR mechanism, as and when restructuring may become necessary.
- One of the most important elements of Debtor - Creditor Agreement would be 'stand still' agreement binding for 90 days or 180 days by both sides. Under this clause, both the debtor and creditor(s) shall agree to a legally binding 'stand still' whereby both the parties commit themselves not to take

recourse to any other legal action during the 'stand still' period. This clause will be applicable only to any civil action and will not cover any criminal action.

- During the pendency of the case with CDR System, the usual asset classification norms would continue to apply.
- Additional finance, if any, is to be provided by all creditors of a 'standard' and 'substandard' account irrespective of whether they are working capital or term loan creditors, on pro rata basis. The additional finance may be treated as 'standard asset', up to a period of one year after the first interest / principal payment, whichever is earlier, falls due under the approved restructuring package.
- The lenders who wish to exit from the package would have the option to sell their existing share to either the existing lenders or fresh lenders, at an appropriate rate, mutually decided between the existing lender and taking over lender. One Time Settlement (OTS) can also be considered as a part of the restructuring package.
- The Group should decide on the issue regarding convertibility (into equity) option as a part of restructuring exercise.

  CDR 2 (Category 2 CDR System) was introduced for cases where the accounts have been classified as 'doubtful' in the books of creditors, and if minimum of 75% of creditors (by value) and 60% creditors (by number) satisfy themselves of the viability of the account and consent for such restructuring on two conditions –

  (i) the existing loans will only be restructured and it would be up to the promoter to firm up additional financial arrangement with new or existing creditors individually.

  (ii) all other norms of the CDR system will continue to apply to this category also.

- Restructuring of corporate debts under CDR system could take place in stages -

  (i) before commencement of commercial production,

  (ii) after commencement of commercial production but before the asset has been classified as 'substandard',

  (iii) after commencement of commercial production and the asset has been classified as 'substandard' or 'doubtful'.

A special Note

The Reserve Bank of India has issued various instructions aimed at resolution of stressed assets in the economy, including introduction of certain specific schemes at different points of time (It also includes CDR mechanism discussed above). However, in view of the enactment of the Insolvency and Bankruptcy Code, 2016 (IBC), the RBI had decided to substitute the then existing guidelines with a harmonised and simplified generic framework for resolution of stressed assets. Thereafter in exercise of the powers conferred by the Banking Regulation Act, 1949 and the Reserve Bank of India Act, 1934, the Reserve Bank, issued the directions entitled Reserve Bank of India (Prudential Framework for Resolution of Stressed Assets) Directions 2019. In 2021 these directions are consolidated in the Master Circular.

A summary of the requirements of the Master Circular are as follows:

Revised Framework

A. Early identification and reporting of stress

Lenders shall identify incipient stress in loan accounts, immediately on default, by classifying stressed assets as Special Mention Accounts (SMA) as per the following categories:

SMA Sub-categories	Basis for classification - Principal or interest payment or any other amount wholly or partly overdue between
SMA 0	01-30 days
SMA 1	31-60 days
SMA 2	61-90 days

In the case of revolving credit facilities like cash credit, the SMA subcategories will be as follows:

SMA Sub-categories	Basis for classification – Outstanding balance remains continuously in excess of the sanctioned limit or drawing power, whichever is lower, for a period of:
SMA 1	31-60 days
SMA 2	61-90 days

Lenders to report credit information, including classification of an account as SMA to Central Repository of Information on Large Credits (CRILC) on all borrower entities having aggregate exposure of Rs.50 million and above with them. The CRILC-Main Report will now be required to be submitted on a monthly basis effective April 1, 2018. In addition, the lenders shall report to CRILC, all borrower entities in default (with aggregate exposure of Rs. 50 million and above), on a weekly basis, at the close of business on every Friday, or the preceding working day if Friday happens to be a holiday.

B. Implementation of Resolution Plan (RP)

All lenders must put in place Board-approved policies for resolution of stressed assets, including the timelines for resolution. Since default with any lender is a lagging indicator of financial stress faced by the borrower, it is expected that the lenders initiate the process of implementing a Resolution Plan (RP) even before a default. Once a borrower is reported to be in default by any of the lenders, lenders shall undertake a prima facie review of the borrower account within thirty days from such default ("Review Period"). During this Review Period of thirty days, lenders may decide on the resolution strategy, including the nature of the RP, the approach for implementation of the RP, etc. The lenders may also choose to initiate legal proceedings for insolvency or recovery.

Timelines for Large Accounts to be Referred for Resolution

In respect of accounts with aggregate exposure above a threshold with the lenders, as indicated below, on or after the 'reference date', RP shall be implemented within 180 days from the end of Review Period. The Review Period shall commence not later than:

a. The reference date, if in default as on the reference date; or

b. The date of first default after the reference date.

The duration of the review period is 30 days from the date of default.

C. Implementation Conditions for RP

RPs involving restructuring / change in ownership in respect of 'large' accounts (i.e., accounts where the aggregate exposure of lenders is Rs. 1 billion and above), shall require independent credit evaluation (ICE) of the residual debt by Credit Rating Agencies (CRAs) specifically authorised by the Reserve Bank for this purpose. While accounts with aggregate exposure of Rs. 5 billion and above shall require two such ICEs, others shall require one ICE. Only such RPs which receives a credit opinion of RP4 or better for the residual debt from one or two CRAs, as the case may be, shall be considered for implementation.

Further, ICEs shall be subject to the following:

a. The CRAs shall be directly engaged by the lenders and the payment of fee for such assignments shall be made by the lenders.

b. If lenders obtain ICE from more than the required number of CRAs, all such ICE opinions shall be RP4 or better for the RP to be considered for implementation.

A RP in respect of borrower entities to whom the lenders continue to have credit exposure, shall be deemed to be 'implemented' only if the following conditions are met:

i. the borrower entity is no longer in default with any of the lenders, as on 180th day from the end of review period.

ii. if the resolution involves restructuring; then

iii. all related documentation, including execution of necessary agreements between lenders and borrower / creation of security charge / perfection of securities are completed by all lenders; and

iv. the new capital structure and/or changes in the terms of conditions of the existing loans

v. get duly reflected in the books of all the lenders and the borrower.

D. Delayed Implementation of RP

Where a viable RP in respect of a borrower is not implemented within the timelines given below, all lenders shall make additional provisions as under:

Timeline for implementation of viable RP	**Additional provisions to be made as a % of total outstanding (funded + non-funded), if RP not implemented within the timeline**
180 days from the end of Review Period	20%
365 days from the commencement of Review Period	15% (i.e. total additional provisioning of 35%)

Prudential Norms

In case of restructuring, the account classified as standard shall immediately downgraded as NPAs i.e., 'sub-standard' to begin with. The NPAs, upon restructuring (i.e., accounts already classified a NPAs before restructuring) would continue to have the same asset classification as prior to restructuring.

Conditions for Upgrade

Standard accounts classified as NPA and NPA accounts retained in the same category on restructuring by the lenders may be upgraded only when all the outstanding loan / facilities in the account demonstrate 'satisfactory performance' during the period from the date of implementation of RP up to the date by which at least 10 per cent of the sum of outstanding principal debt as per the RP and interest capitalization sanctioned as part of the restructuring, if any, is repaid ('monitoring period').

Provided that the account cannot be upgraded before one year from the commencement of the first payment of interest or principal (whichever is later) on the credit facility with longest period of moratorium under the terms of RP.

Additionally, for accounts where the aggregate exposure of lenders is Rs. 100 crores and above at the time of implementation of RP, to qualify for an upgrade, in addition to demonstration of satisfactory performance, the credit facilities of the borrower shall also be rated as investment grade (BBB- or better), at the time of upgrade, by Credit Rating Agencies accredited by the Reserve Bank for the purpose of bank loan ratings. While accounts with aggregate exposure of Rs. 500 crores and above shall require two ratings, those below Rs.500 crores shall require one rating. If the ratings are obtained from more than the required number of CRAs, all such ratings shall be investment grade for the account to qualify for an upgrade.

Provisions held on restructured assets may be reversed when the accounts are upgraded to standard category.

Provisioning Norms

Accounts restructured under the requirements of the Master Circular shall attract provisioning. In respect of accounts of debtors where a final RP, as approved by the Committee of Creditors, has been submitted by the Resolution Professional for approval of the Adjudicating Authority (in terms of section 30(6) of the Insolvency and Bankruptcy Code (IBC)), lenders may keep the provisions held as on the date of such submission of RP frozen for a period of six months from the date of submission of the plan or up to 90 days from the date of approval of the resolution plan by the Adjudicating Authority in terms of section 31 (1) of the IBC, whichever is earlier.

Income Recognition Norms

Interest income in respect of restructured accounts classified as 'standard assets' may be recognized on accrual basis and that in respect of restructured accounts classified as NPAs shall be recognized on cash basis.

Additional Finance

Any additional finance approved under the RP (including any resolution plan approved by the Adjudicating Authority under IBC) may be treated as 'standard asset' during the monitoring period under the approved RP, provided the account demonstrates satisfactory performance (as defined at footnote 16) during the monitoring period. If the restructured asset fails to perform satisfactorily during the monitoring period or does not qualify for upgradation at the end of the monitoring period, the additional finance shall be placed in the same asset classification category as the restructured debt.

Conversion of Principal into Debt / Equity and Unpaid Interest into 'Funded Interest Term Loan' (FITL)

An act of restructuring might create new securities issued by the borrower which would be held by the lenders in lieu of a portion of the pre-restructured exposure. The FITL / debt / equity instruments created by conversion of principal / unpaid interest, as the case may be, shall be placed in the same asset classification category in which the restructured advance has been classified.

The provisioning applicable to such instruments shall be the higher of:

a) The provisioning applicable to the asset classification category in which such instruments are held; or

b) The provisioning applicable based on the fair valuation of such instruments

These instruments shall be valued as per usual valuation norms and marked to market. Equity instruments, whether classified as standard or NPA, shall be valued at market value, if quoted, or else at break-up value (without considering the revaluation reserve, if any) as ascertained from the company's balance sheet as on March 31st of the immediate preceding financial year. In case balance sheet as on March 31st of the immediate preceding financial year is not available, the entire portfolio of equity shares of the company held by the bank shall be valued at Rs.1. Depreciation on these instruments shall not be offset against the appreciation in any other securities held under the AFS category.

The unrealized income represented by FITL / Debt or equity instrument can only be recognised in the profit and loss account as under:

a. FITL/debt instruments: only on sale or redemption, as the case may be;

b. Unquoted equity/ quoted equity (where classified as NPA): only on sale;

c. Quoted equity (where classified as standard): market value of the equity as on the date of upgradation, not exceeding the amount of unrealised income converted to such equity. Subsequent changes to value of the equity will be dealt as per the extant prudential norms on investment portfolio of banks.

Note - The unrealized income represented by FITL / Debt or equity instrument should have a corresponding credit in an account styled as "Sundry Liabilities Account (Interest Capitalization)".

Supervisory Review

Any failure on the part of lenders in meeting the prescribed timelines or any actions by lenders with an intent to conceal the actual status of accounts or evergreen the stressed accounts, will be subjected to stringent supervisory / enforcement actions as deemed appropriate by the Reserve Bank, including, but not limited to, higher provisioning on such accounts and monetary penalties.

Disclosure

Banks are to make appropriate disclosures in their financial statements, under 'Notes on Accounts', relating to resolution plans implemented as per detailed guidelines issued/ will be issued from time to time.

One Time Settlement (OTS)

It is a type of compromise settlement executed by the banks in order to recover NPAs. In OTS, the defaulter borrower proposes to settle all the dues at once and the bank agrees the amount lesser than what is actually due. The bank settles the loan and write offs against one-time instalment, compromising on a portion of its profits.

The RBI mandate states that banks must have a loan recovery policy for negotiations and settlement of non-performing assets. OTS schemes are available in banks but not every borrower is given this provision. The scheme is available at the sole discretion of the bank and not available to the willful defaulters.

The OTS affects the banks' profits in the form of interest cut down and quality of balance sheet. The benefits include prompt and speedy recovery of NPAs, increase in liquidity position, and easy flow of funds for lending process.

BIFR (Board for Industrial and Financial Reconstruction)

It was an agency of the Government of India, part of the Department of Financial Services of the Ministry of Finance. It was set up in January 1987 with objective to determine sickness of industrial companies and to assist in reviewing those that may be viable and shutting down the others. A new Industrial policy was tabled in Parliament aiming to maintain growth in productivity and gainful employment and to encourage the growth of entrepreneurship and upgrades to technology.

The Board has a Chairman and from two to fourteen other members, all to be qualified as High Court judges or to have at least fifteen years of relevant professional experience. The Board only handles large or medium-sized sick industrial companies in which large amounts have been sunk. Under the Sick Industrial Companies Act (SICA), its Board is legally obliged to report it to the BIFR, and the BIFR has the power to make whatever enquires are needed to determine if the company is in fact sick.

Among other objectives the act was to provide a way to revive sick industrial companies and release public funds. If a company is found to be sick, the BIFR can give the company reasonable time to regain health (bring total assets above total liabilities) or it can recommend other measures. The Board can take other actions including changes to management, amalgamation of the sick unit with a healthy one, sale or financial reconstruction. The Board can recommend a sick industrial company for winding up.

The BIFR was intended to bridge the legal gap between sickness and revival. It would impose time schedules for revival related activities to be completed, oversee their implementation and conduct periodic reviews of sick accounts. The BIFR would provide a forum for sharing views, coordinating efforts and developing a unified approach to dealing with sick companies, speeding up the start of corrective action.

BIFR has had mixed success. The BIFR in practice often became a way of prolonging the life of unviable companies for years at taxpayer expense.

The SARFAESI Act, 2002 placed corporate debt outside the purview of the BIFR. By preventing reference to the BIFR, which had become a heaven for the promoters of sick companies, the Act gives banks and financial institutions a better tool for recovering bad debts. It was complemented by the corporate debt restructuring package under which lenders and borrowers would meet to agree on a way of recasting stressed debt.

In January 2016 BIFR was dissolved and referred all proceedings to the National Company Law Tribunal (NCLT) and National Company Law Appellate Tribunal (NCLAT) as per provisions of Insolvency and Bankruptcy Code.

The NCLT and NCLAT would take over the functions of the BIFR and other bodies and speed up the process of winding down sick companies.

Asset Reconstruction Companies (ARCs)

An ARC is a company incorporated under Companies Act, 2013 to engage itself in the activity of financial asset reconstruction- such as securitization, takeover of management, sale of assets charged. Earlier they were called

as Securitization Companies (SCs) or Reconstruction Companies (RCs). To undertake such activity, the company has to get registered with RBL under provisions of SARFAESI Act. RBI can conduct audit / inspection / issue directives / levy penalties or remove directors of the company. As per RBL rules minimum net owned funds of the company should be Rs. 100 crores on an ongoing basis. ARCs should maintain capital adequacy ratio of minimum 15% of total risk weighted assets.

The term financial asset means the loans, advances and investments, made by the banks and the financial institutions.

ARCs acquire non-performing loans from banks and financial institutions at discount and take steps to recover these loans by way of securitization, reconstruction or sale of assets or in certain cases take over the management. Before bidding company may conduct due diligence within a period of minimum 2 weeks. The realization period can be 5 years which can be extended to 8 years.

For the purpose of take over of the loan, the ARC creates a Trust called Special Purpose Vehicle and ARC acts as a Trustee and managing agent for ultimate realisation of the financial asset. SPV holds the financial asset on strength of the security available. It issues Security Receipts (SRs) to the investors, mainly the Qualified Institutional Buyers (QIBs). The investors get cash on realization of the financial assets when the security receipts are redeemed. SRs are not debt instruments and currently not listed on Stock Exchange and not traded.

It is mandatory for ARCs to invest in and continue to hold minimum 15% stake of the outstanding amount of the security receipts issued by them till the redemption.

LESSON ROUND-UP

- RBI started implementing the prudential guidelines on asset classification, income recognition and provisioning on loan assets based on the recommendations of Narasimham Committee, in a phased manner commencing with the accounting year beginning from 01.04.1992 and modified the original guidelines on a number of occasions.
- Taking into account the time lag between an account becoming doubtful of recovery, its recognition as such, the realisation of security and the erosion over time in the value of security, provisions to be made are prescribed by RBI.
- CDR (Corporate Debt Restructuring) framework will aim at preserving viable corporate that are affected by certain internal and external factors and minimize the losses to the creditors and other stakeholders through an orderly and coordinated restructuring program. However, RBI has replaced the debt restructuring schemes with a simplified generic framework for resolution of stressed assets. RBI Master Circular covers comprehensively most of the aspects of Prudential Norms.

GLOSSARY

Corporate Debt Restructuring (CDR) : Corporate debt restructuring refers to the realignment of a business entity which is under fiscal distress due to its outstanding commitments and obligations and to infuse liquidity into business operations to keep it afloat. This process is generally done by the creditors and the management of the company, which is under distress.

One Time Settlement (OTS) : One-time settlement or OTS is a type of compromise settlement executed by the banks in order to recover non-performing assets (NPAs). OTS is a scheme where the borrower (the one who has defaulted) proposes to settle all the dues at once, and banks agree to accept an amount lesser than what was originally due.

Asset Reconstruction Companies (ARC) : An ARC is a company incorporated under Companies Act, 2013 to engage itself in the activity of financial asset reconstruction- such as securitization, takeover of management, sale of assets charged. Earlier they were called as Securitization Companies (SCs) or Reconstruction Companies (RCs).

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation).

1. What is Asset Classification in Banks?
2. What is One Time Settlement of Non-Performing Assets (NPA) in Banks?
3. Income from NPA is not recognized on accrual basis but is booked as income only when it is actually received. Why?
4. Once an account turns NPA cannot become a standard assets. Check the validity of this statement.
5. Corporate Debt Restructuring (CDR) is mechanism to restructure in a transparent way the borrowings of sticky borrowal accounts. What is CDR and how this transparent process?
6. Explain the concept of Provision Coverage Ratio (PCR).
7. Explain the procedure of recovery by banks through Asset Reconstruction Companies (ARC).
8. What is the role of Board for Industrial and Financial Reconstruction in Banking Sector?

LIST OF FURTHER READINGS

- RBI Master Circular /Directions on Income Recognition and Asset classification.

Analysis of Financial Statements of Banks

Lesson 12

KEY CONCEPTS

■ Ledgers ■ Registers ■ General Ledger ■ Revenue Reserves ■ Divergence ■ Financial Statements ■ Disclosure ■ Basel III

Learning Objectives

To understand:

- Features of Accounting System of Banks
- Requirements of Banking Companies as to Accounts and Audit
- Books of Account of Banks
- Presentation/formats of Financial statements
- Accounting Treatments of Various Items
- Disclosure Requirements of Banks
- Additional Disclosures prescribed by Reserve Bank of India (RBI)

Lesson Outline

- Introduction
- Requirements of Banking Companies as to Accounts and Audit
- Significant Features of Accounting
- Systems of Banks
- Principal Books of Accounts
- Preparation and Presentation of Financial Statements of Banks
- Comments on Profit and Loss Account
- Accounting Treatment of Specific Items
- Guidance on Specific Items w.r.t. Certain Accounting standards
- Important Items of Balance Sheet
- Disclosure Requirements of Banks
- Disclosures Prescribed by Reserve Bank of India (RBI)
- Disclosures required under BASEL Norms
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Reserve Bank of India Act, 1934
- Banking Regulation Act, 1949
- Companies Act, 2013
- Accounting Standards - ICAI (Accounting Policies issued by the Institute of Chartered Accountants of India).

INTRODUCTION

A financial statement is an organized collection of information or data prepared by a business entity (banking is a business) as per acceptable accounting norms and procedures. The major financial statements are the balance sheet and profit and loss account. These are supported by statements which include funds flow statement, cash flow statement, profit and loss appropriation account etc.

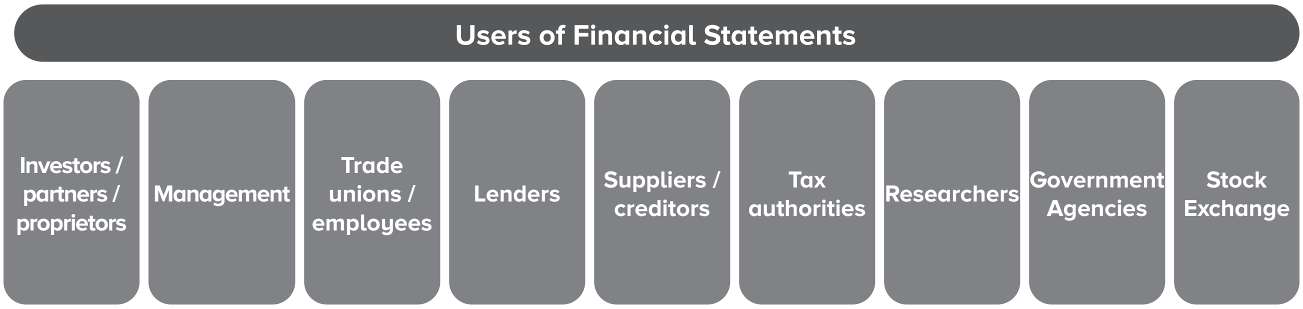
- Balance Sheet is a statement of financial position of the business entity as at a specified date (31st of March), which represents on one side (right) the assets position of the business entity and on other side (left) the liability position of the business entity.
- Assets are the resources owned by the firm / they the applications or the uses of the funds / they are the debit balances reflected in the General Ledger. Liabilities are the claims of various parties against the assets owned by the firm / they are the sources of the funds / they are the credit balances reflected in the General Ledger.
- Profit and Loss Account or Income Statement provides the information relating to income and expenditure of business entity over a period. It covers all the transactions that took place over a time period.
- Funds Flow Statement is the information which reflects the changes having taken place in the composition or quantum of all the funds (the assets and the liabilities or the revenue or expenditure) over time period of say a year. Within the said period it provides the information about various sources and their uses / applications.
- Cash Flow Statement offers information which reflects the changes in cash position (the term cash takes into account only cash and bank balances and not funds as in the case with funds flow statement) in a given period.

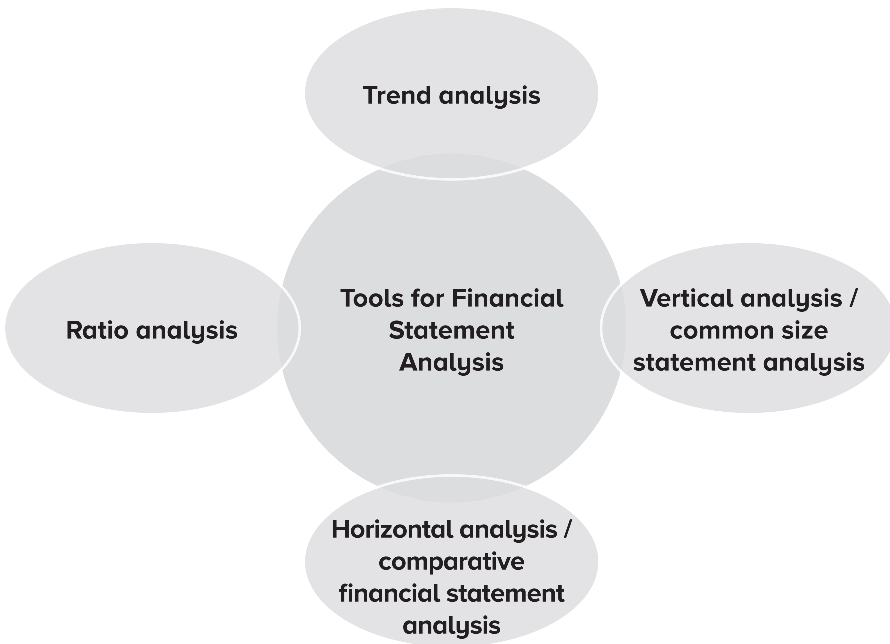
Objective of Financial Statement Analysis

- Profitability measurement - Whether adequate profits are generated on the capital employed in the business. The capacity of the business to pay interest, dividend and other obligations.
- Trend indicator - Regarding various types of expenses, purchases, sales, gross / operating and net profit etc.
- Assessment of growth potential.
- Comparative position with other firms which are having business.
- Assess overall financial strength.
- Assess solvency of the business entity.

Every banking company in India has to comply with provisions of Banking Regulation Act, 1949 as well as the Companies Act, 2013 apart from others. Under the Companies Act, 2013 a company has to prepare and submit financial statements as per Schedule III of the Act. However, banks under the Banking Regulation Act, 1949 have to prepare and submit their Balance Sheet, Profit & Loss Account in specified formats - Form A and t Form B. RBI has also notified detailed guidelines in this regard in respect of these including disclosure norms. As per Government of India guidelines every banking company has to close its books of account as on 31st March every year and therefore they prepare their financial statements as on this date. This lesson is therefore devoted to a detailed coverage on the final accounts of banking companies encompassing all topics with some practical examples for an easy understanding. The contents will reinforce the basic knowledge of banking as well as, how the accounts of banks are prepared and other technical inputs required preparing the same.

The contents are based on Banking Regulation Act, 1949, the Companies Act, 2013, RBI directions, Accounting Standards and other applicable provisions. This will be useful in practical understanding of accounts of banking companies.





REQUIREMENTS OF BANKING COMPANIES AS TO ACCOUNTS AND AUDIT

A banking company being a body corporate has statutory obligation to present annual financial statements in terms of formats prescribed under the Companies Act, 2013 / Banking Regulation Act, 1949. Section 29 to 34A of the Banking Regulation Act, 1949 deal with the accounts and audit of Banking Companies. Section 29 of the Banking Regulation Act, 1949 casts a responsibility on every Banking company incorporated / operating in India which are involved in transacting the business of banking through its branches, prepare and submit Balance Sheet and Profit & Loss account for the financial year, in the specified formats set out in the III Schedule of the Act, as on the last working day of that financial year. Such Balance Sheet and P&L Account should be signed by the Manager or the Principal officer and at least three directors if there are more than three directors and if only three directors all of them should sign the same. For a foreign bank operating in India the Manager or Principal officer of the concerned bank should sign. The central government has the powers to amend the formats of Balance Sheet and P&L Account as in Section 29 of the Banking Regulation Act, 1949.

According to Section 30 of the Banking Regulation Act, 1949, the Balance Sheet and P&L Account prepared are to be audited by a duly qualified person as per applicable law for the time being in force. Without prejudice to anything contained in the Companies Act, 2013 , or any other law for the time being in force, where the Reserve Bank is of opinion that it is necessary in the public interest or in the interest of the banking company or its depositors so to do, it may at any time by order direct that a special audit of the banking company's accounts, for any such transaction or class of transactions or for such period or periods as may be specified in the order, shall be conducted and may by the same or a different order either appoint a person duly qualified under any law for the time being in force to be an auditor of companies or direct the auditor of the banking company himself to conduct such special audit and the auditor shall comply with such directions and make a report of such audit to the Reserve Bank and forward a copy thereof to the company. Banking companies have to seek permission of RBI for appointing, re-appointing or removing any auditor.

As per Section 31 of the Banking Regulation Act, 1949 every banking company has to submit three copies of annual Accounts, Balance Sheet along with P&L Account prepared in accordance with Section 29 of Banking Regulation Act, 1949 together with Auditor's Report to RBI within three months from the end of the period to which they relate.

Under Section 32 of the Banking Regulation Act, 1949 a banking company (not other types of banking entities) has to submit three copies of Balance Sheet and P&L Account to the Registrar of Companies when it submits the same to RBI. Also with in a period of six months of from the date of Accounts and Auditors Report, publish the same in a newspaper which is widely circulated where the banking company has its principal place of business. This compliance has to be done according to Banking Companies Regulation (Rules) 1949. Also as per Section 33 of the Banking Regulation Act, 1949, in the case of foreign banks operating in India have to display a copy of audited Accounts and Balance sheet in a conspicuous place in their notice board for public display. This has to be done before 1st Monday in the month of August every year.

SIGNIFICANT FEATURES OF ACCOUNTING SYSTEMS OF BANKS

Like any other business entity banks also follow the mercantile system of accounting. However, there is a slight difference in methodology followed by banks when compared to other commercial entities. It arises on account of banks entering transactions of customers first, in ledgers (which are subsidiary books under conventional accounting) rather than in journals. This is so because, accounts of customers which are maintained in ledgers should be accurate and without any errors.

PRINCIPAL BOOKS OF ACCOUNT MAINTAINED BY BANKS

Banks in India maintain following main books of account.

(a) Ledgers of Savings Bank, Current Account, Cash Credit, Loans, Fixed Deposits Accounts, Recurring Deposit Accounts, Investment Ledgers, Bill discounted/purchase (Inland & Foreign) etc.

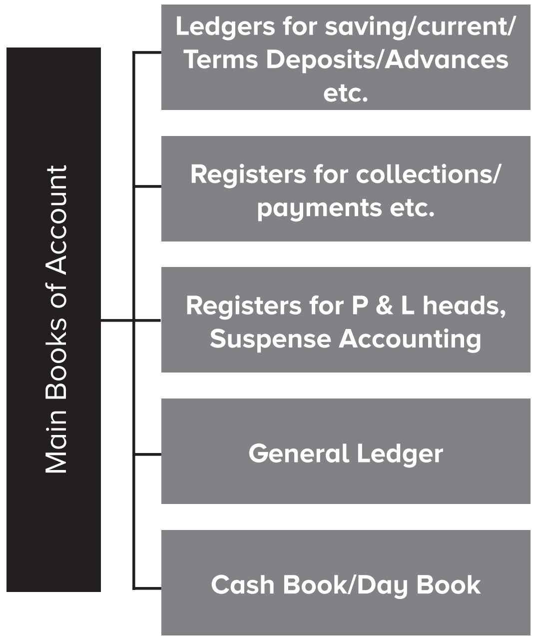
(b) Registers for Collection (inland & foreign), cash, clearing, Safe deposit lockers, DD/Pay order issued, DD's paid, Bank Guarantee issued, Bills Margin, Letter oc Credit issued, Clearing cheques returned, NEFT/RTGS issued etc. Pension payment, PPF accounts, Demat accounts, etc.

(c) Registers for P & L heads, Suspense accounting etc.

(d) General Ledger

(e) Cash book/Day Book

(f) P& L registers



Note: There are differing practices among banks in maintaining registers for various heads of accounts. However, under Core Banking Principal books of account are maintained in different software modules. However, considering the importance of books from bank accounting point of view we will learn about the them in detail.

General Ledger (GL)

The General Ledger is a summary of control accounts of various deposit, loan heads as well as Profit and Loss. The GL also contains balancing contra entry accounts for heads of accounts such as collection of bills (inland and foreign), contingent liabilities (such as bank guarantees, LCs) etc. purely for keeping a control over such transactions on a day-to-day basis.

Profit and Loss Account Registers

Some banks maintain a common control account in GL for P&L and maintain separate heads in individual registers and income items as well as expenditure heads. Some other banks also maintain important P & L heads separately also in GL.

Daily postings are done in P& L register heads through vouchers on account of various transactions or expenses. In certain cases P&L registers carry detailed heads, much more than what is summarized in GL and published accounts.

For example, under interest on deposit which is an expenditure head there could be specific subheads such as FD, Cash Certificates, RDs, CDs, etc. Similarly, there could be separate heads in Interest on Advances (which is an income head) which may carry sub-heads such as housing loans, personal loans, educational loans, Priority Sector advances etc. Also, in respect of establishment expenses such as Salaries, allowances, bonus payments etc. there could be different sub-heads.

Subsidiary Books - Ledgers

In operational banking, ledgers are the basic books of account whose balances are reflected in the control balances of GL.

In banks, subsidiary books in the form of ledgers are used for various deposit accounts and loans/cash credit accounts etc.

Sometimes separate registers are maintained in respect of various deposits such as call money, short term deposits, CDs etc. In respect of ledgers separate folios are allotted for each depositor. However, in registers there could be more than one depositor per folio. Folios in registers are formatted in such a way that all particulars in detail are entered in sections. Postings in ledgers as well as in registers are made directly from vouchers. All these vouchers after entry are entered in a separate journal (these journals are also known as 'sub-day book' in some banks). They are subsequently checked and their summarized total is conveyed to the Cash book (in some banks it is also known as 'Day Book') department to balance the day's transaction. Subsequently these figures are entered in GL to arrive at the control total. In the case ledgers relating to cash credit accounts limits or drawing power is mentioned along with other particulars such as stock value, margin, rate of interest, Limit sanctioned etc. Columns are also made available for putting products in respect of debit balances to enable calculation of interest. Similarly in loan registers columns are provided for entering name and address of borrower and guarantor, amount of loan sanctioned, rate of interest, balance outstanding, space for products, initials etc. are provided.

Subsidiary Books - Bills Register

Banks handle different transactions relating to bills. Bills are discounted, collected, purchased. Specific registers having different columns for entering various particulars such as serial no, Name of the drawer, Drawee, Amount of bill, discount charged, other charges, address of the drawee bank, particulars of documents, remarks/ special conditions, initial/signature of officials etc.

In respect of advances specific folios are allotted for different borrowers where in the respective folios the limit up to which bills can be discounted is also mentioned in the space provided for. Such bills after discounting are sent to the drawee bank for presentation and realization. Once such bills are realized by remittance from drawee bank they are rounded off and accordingly date of realization is mentioned after due checking. At the end of the day summary figures are arrived at and conveyed to cash book department for preparing cash book and subsequently preparing GL followed by trial balance.

Other Registers Maintained by Banks

1. Proposal Received Register including details of processing fees collected/share linkage/valuation;
2. Limit / Drawing Power Register;
3. Stock Statement Received Register;
4. Inspections Register (for field visit/stock verification/stock audit etc.);
5. Security register (For paper securities);
6. Documents register;
7. Title Deeds register;
8. Register of Service/ Maintenance contracts;
9. Register of Death Claims;
10. Missing Persons Claim Record Register;
11. Stop payment Register;
12. Duplicate FDR / Pay slips / DD / Passbook register;
13. Sensitive Stock Register;
14. Inward / Outward Cheque returned register;
15. Cheque passed against clearing register;

16. Cheque held for payment register;
17. Cheque Book stock/delivery register;
18. Pay slip / DD issued register;
19. Fixed Asset register;
20. Attendance Register;
21. IBC / OBC register;
22. Locker Register (Locker Rent Received, Locker Rent Due Date, Locker Issued / Surrendered Register, Locker Visit Register);
23. ATM Complaint Register;
24. Loose cheque leaves register;
25. Key register;
26. Vault Register;
27. Solvency Certificate Issued Register;
28. Complaint register;
29. Register of EDP Complaints;
30. Register for soiled notes;
31. Foreign LC Due Date register;
32. Forex A2 Currency Transaction register;
33. Other currency cheque collection register;
34. Bank Guarantee issuance register;
35. Margin money register;
36. Debit Cards/ATM card issued register etc.

From the registers listed above we will discuss a few, which are used on a day-to-day basis by banks. Many of the registers listed above may not constitute core part of books of account, but are in the nature of supporting in respect of agency services.

Registers linked to Advances

1. **Proposal Received Register including details of processing fees collected/share linkage/ valuation:** Under the directions issued by RBI bank branches are required to maintain registers in respect of credit proposals with particulars such as date of receipt of proposal, date of sanction, if rejected date of rejection and reason for rejection. Along with these particulars they also record the details of processing fee collected etc. In some banks they also note the collateral linkages to the proposal and value thereof of such securities.
2. **Limit / Drawing Power Register:** In respect of cash credit accounts granted against hypothecation of stock- in-trade, work-in-process, finished goods, debtors etc. the branch has to fix drawing power every month based on the value of these items less margin. This register is used for the purpose of recording drawing powers that would be allowed during the month which would be authenticated by concerned officials.

3. **Stock statements received register:** When banks allow cash credit limits based on stocks held by a borrower. The value of stock held by the customer has to be submitted by 10th of succeeding month to enable banks to fix drawing power for the current month. If they fail to submit by 10th of the month, penal interest will be levied from the 1st of the current month as per agreed sanction terms. To monitor submission of stock statements by a borrower such registers are maintained.

4. **Security register:** This register is used to record detailed particulars of securities tendered by a borrower while availing an advance.

5. **Document register:** In this register particulars of documents executed by a borrower are entered as separate record.

6. **Title deeds Register:** In this register documents of title given by borrowers are recorded and it is held in safe custody.

PREPARATION AND PRESENTATION OF FINANCIAL STATEMENTS OF BANK

Commercial Banks are required to prepare a Balance Sheet and Profit and Loss Account as on the last working day of the year or the period, as the case may be, in the Forms set out in the Third Schedule of the Banking Regulation Act, 1949. (Section 29 of the Banking Regulation Act, 1949). RBI Master Direction RBI/DOR/2021-22/83 DOR.ACC.REC.No.45/21.04.018/2021-22 dt. 30.8.2021 provides the general instructions for the compilation of Balance Sheet and Profit and Loss Account (Part A of Annexure II of the Direction).

- Banks are compliance with the Accounting Standards notified under the Companies (Accounting Standards) Rules, 2021, as amended from time to time, subject to Directions/Guidelines issued by the Reserve Bank of India. Presently, IND-As set of standards (IFRS converged set of Standards applicable to prescribed Indian entities) are not applicable to banks. Existing set of Accounting standards (AS) is to be followed. Part B of Annexure II specifies guidance with respect to relevant issues in the application of certain Accounting Standards for Commercial Banks.

- For uniformity, Notes to the Accounts are provided in the Schedule 17 and Schedule 18. Moreover, Significant Accounting Policies are required to be disclosed in compliance with the requirements of AS 1.

- In addition to standalone financial statements prepared as per the formats prescribed under section 29 of Banking Regulation Act, 1949, Commercial Banks (other than RRBs and LABs), whether listed or unlisted, are required to prepare and disclose Consolidated Financial Statements (CFS) in their Annual Reports, in the formats prescribed in Annexure IV of the Master Direction. The CFS shall normally include a consolidated balance sheet, consolidated statement of profit and loss, principal accounting policies, and notes to accounts. CFS shall be prepared in terms of the applicable accounting standards. For the purpose of financial reporting, the terms ‘parent’, ‘subsidiary’, ‘associate’, ‘joint venture’, ‘control’, and ‘group’ shall have the same meaning as ascribed to them in the applicable accounting standards. A parent presenting CFS shall consolidate all subsidiaries - domestic as well as foreign, except those specifically permitted to be excluded under the applicable accounting standards. However, the reasons for not consolidating a subsidiary shall be disclosed in the CFS. The responsibility of determining whether a particular entity shall be included or not for consolidation would be that of the Management of the parent entity. The Statutory Auditors shall mention in their audit report, if they are of the opinion that an entity which ought to have been consolidated has been omitted.

- **Window Dressing** – To avoid window dressing, Banks shall ensure that Balance Sheet and Profit and Loss Account reflects true and fair picture of its financial position. Instances of window dressing of financials, short provisioning, misclassification of NPAs, under-reporting/ incorrect computation of exposure/risk weight, incorrect capitalization of expenses, capitalization of interest on NPAs, deliberate inflation of asset and liabilities at the end of the financial year and subsequent reversal immediately in next financial year, etc. are viewed seriously by RBI and appropriate penal action in terms of the provisions of the Banking Regulation Act, 1949 are initiated.

As mentioned earlier, Banks are required to prepare and present their Balance Sheet and P&L Accounts in the following format under Schedule III.

FORM A :- Form of Balance Sheet
Balance Sheet of Bank xxxxxxxxx

Balance Sheet as on 31st March................ (Year)

Particulars	Schedule	As on 31-03-20XX (current year)	As on 31-03-20XX (previous year)
Liabilities			
Capital	1		
Reserve and Surplus	2		
Deposits	3		
Borrowings	4		
Other Liabilities and Provisions	5		
Total			
Assets			
Cash and Balances with Reserve Bank of India	6		
Balance with Banks and Money at Calls & Short Notice	7		
Investments	8		
Loans & Advances	9		
Fixed Assets	10		
Other Assets	11		
Total		xxxxx	xxxxx

Contingent liabilities **12**

Bills for Collection

SCHEDULES

While presenting the Balance Sheet following schedules are to be furnished by a banking company.

Schedule 1: Capital **(Rs.)**

I. For Nationalized Banks:

Capital (Fully owned by Central Government)

II. For Banks Incorporated Outside India:

(i) Capital (The amount brought in by banks by way of start-up capital as prescribed by RBI should be shown under this head).

(ii) Amount of deposit kept with the RBI under section 11(2) of the Banking Regulation Act, 1949

III. For Other Banks :

Authorized capital: (................ shares of Rs. each) x x x

	Issued capital (........................shares of Rs. each)		x x x
	Subscribed capital (........................shares of Rs. each)		x x x
	Called-up capital (........................share of Rs. each)		x x x
	Less: Calls unpaid		xx x
	Add: Forfeited shares		x x x
	Total		**x x x**

Schedule 2: Reserves and Surplus

I.	Statutory Reserves		
	Opening Balance	x x x	
	Additions during the year	x x x	
	Deductions during the year	x x x	x x x
II.	Capital Reserves		
	Opening balance	x x x	
	Additions during the year	x x x	
	Deductions during the year	x x x	x x x
III.	Share Premium		
	Opening balance	x x x	
	Additions during the year	x x x	
	Deductions during the year	x x x	x x x
IV.	Revenue and Other Reserves		
	Opening balance	x x x	
	Additions during the year	x x x	
	Deductions during the year	x x x	x x x
V.	Foreign Currency Transaction Reserves		
	Opening balance	x x x	
	Additions during the year	x x x	
	Deductions during the year	x x x	x x x
VI.	Investment Reserves		
	Opening balance	x x x	
	Additions during the year	x x x	
	Deductions during the year	x x x	x x x
VII.	Special Reserves under Income Tax		
	Opening balance	x x x	
	Additions during the year	x x x	
	Deductions during the year	x x x	x x x
VIII.	Balance in Profit and Loss Account		
	Total: [(I) +(II) + (III)+ (IV) + (V)+(VI)+(VII)]		**xxx**

Schedule 3: Deposits

A. I. Demand Deposits		
(i) From Banks	x x x	
(ii) From Others	x x x	x x x
● Savings Bank Deposits		xxx
● Term Deposits		
● From Banks	xxx	
● From Others	xxx	xxx
Total: [(i) + (ii) + (iii)]		**xxx**
B. (i) Deposits of branches in India	x x x	
(ii) Deposits of branches outside India	x x x	
Total [(i)+(ii)]		**xxx**
Total [(A)+(B)]		**x x x**

Schedule 4: Borrowings

I. Borrowings in India		
(i) Reserve Bank of India	xxx	
(ii) Other banks	xxx	
(iii) Other Institutions and Agencies	xxx	xxx
II. Borrowings outside India		xxx
Total (I + II)		**xxx**

Schedule 5: Other Liabilities and Provisions

I. Bills Payable	x x x	
II. Inter-office adjustments (net)	x x x	
III. Interests Accrued	x x x	
IV. Others (including provisions)	x x x	
Total [I+II+III+IV]		**xxx**

Schedule 6: Cash and Balances with Reserve Bank of India

I. Cash in hand (including foreign currency notes)	x x x	
II. Balances with Reserve Bank of India		
(i) in current account	x x x	
(ii) in other accounts	x x x	x x x
Total [(I) + (II)]		**xxx**

Schedule 7: Balances with Banks and Money at Call and Short Notices

I. In India		
(i) Balances with banks		
(a) in current accounts	x x x	
(b) in other deposit accounts	x x x	x x x
(ii) Money at call and short notice		
(a) with banks	x x x	
(b) with other institutions	x x x	x x x
Total [(i) + (ii)]		**xxx**

II.	Outside India		
	(i) in current accounts	x x x	
	(ii) in other deposit accounts	x x x	
	(iii) Money at call and short notice	x x x	x x x
	Total ((i) + (ii) +(iii))		**xxx**
Grand Total: (I + II)			**xxx**

Schedule 8: Investments

I.	Investment in India in		
	(i) Government securities	x x x	
	(ii) Other approved securities	x x x	
	(iii) Shares	x x x	
	(iv) Debentures and Bonds	x x x	
	(v) Subsidiaries and/or joint ventures	x x x	
	(vi) Other (to be specified)	x x x	
	Total : [(i)+(ii)+(iii)+(iv)+(v)+(vi)]		**xxx**
II.	Investment outside India in		
	(i) Government securities (including local authorities)	x x x	
	(ii) Subsidiaries and/or Joint Venture abroad	x x x	
	(iii) Other Investments (to be specified)	x x x	
	Total [(I)+(II)+(III)]		**xxx**
Grand Total: (I + II)			**x x x**

Schedule 9: Advances

I.	(i) Bills Purchased and Discounted		
	(ii) Cash Credits, Overdrafts and Loans Repayable on Demand		
	(iii) Term Loans		
	Total:		
II.	(i) Secured by Tangible Assets	x x x	
	(ii) Covered by Bank / Government Guarantees	x x x	
	(iii) Unsecured	x x x	
	Total:		**xxx**
III.	Advances in India		
	(i) Priority Sector	x x x	
	(ii) Public Sector	x x x	
	(iii) Banks	x x x	
	(iv) Others	x x x	
	Total:		**xxx**
IV.	Advances Outside India		
	(i) Due from Banks	xxx	
	(ii) Due from Others	xxx	

	(a) Bills Purchased and Discounted	xxx	
	(b) Syndicated Loans	x x x	
	(c) Others	x x x	
	Total [(i)+(ii)]		**xxx**
Grand Total (I + II + III + IV)			**x x x**

Schedule 10: Fixed Assets

I.	Premises		
	At cost on 31st March of the preceding Year	x x x	
	Additions during the year	x x x	
	Deductions during the year	x x x	
	Depreciation to date	x x x	
II.	Other fixed assets (including furniture and fixtures)		
	At cost as on 31st March of the preceding year	x x x	
	Addition during the year	x x x	
	Deductions during the year	x x x	
	Depreciation to date	x x x	
	Total (I+ II)		**xxx**

Schedule 11: Other Assets

I.	Inter Office Adjustment (net)	x x x	
II.	Interest Accrued	x x x	
III.	Tax paid in Advance	x x x	
IV.	Stationery and Stamps	x x x	
V.	Non-banking assets acquired in satisfaction of claims	xxx	
VI.	Others	x x x	
Total [I+II+III+IV+V+VI]			**xxx**

Note: In case there is any unadjusted balance of loss the same may be shown under this item with appropriate footnote

Schedule 12: Contingent Liabilities

I.	Claims against the bank not acknowledge as debts		x x x
II.	Liability for partly paid investments		x x x
III.	Liability on account of outstanding forward exchange contracts		x x x
IV.	Guarantee given on behalf of constituents		x x x
	(a) in India	x x x	
	(b) outside India	x x x	x x x
V.	Acceptances, endorsements and other Obligations		x x x
VI.	Other items for which the bank is liable		xxx
Total [I+II+III+IV+V+VI]			**xxx**

BALANCE SHEET ITEMS: NOTES, DETAILED COMMENTS AND INSTRUCTIONS

1. Capital

Capital includes the capital provided by Government, and public issue in case of public sector banks. In case of private banks, it comes from the promotors and through public issue.

a. **Nationalised Banks:** The Capital owned by Central Government as on the date of the Balance Sheet should be shown.

b. **Other Indian Banks:** In the case of other Indian banks, Authorised, Issued, Subscribed, and Called up capital should be given separately. Calls-in- arrears will be deducted from the called-up capital while the paid-up value of forfeited shares should be added thus arriving at the paid-up capital. Where necessary, items which can be combined should be shown under one head for instance 'Issued and Subscribed Capital'.

c. In the case of Banking Companies incorporated outside India, the amount of deposit kept with Reserve Bank of India, under sub-section 2 of section 11 of the Banking Regulation Act, 1949 should be shown under the head 'capital'; the amount, however, should not be extended to the outer column.

Notes - General: The changes in the above items, if any, during the year, say, fresh contribution made by the Government, fresh issue of capital, capitalisation of reserves, etc. may be explained in the notes.

2. Reserves

a. **Statutory Reserves:** Reserve created in terms of section 17 or any other section of Banking Regulation Act, 1949 must be separately disclosed.

b. **Capital Reserves:** The expression 'Capital Reserves' not to include any amount regarded as free for distribution through the profit & loss account. Surplus on revaluation or sale of fixed assets should be treated as capital reserves. However, surplus on translation of financial statements of foreign branches (including fixed assets of these branches) is not to be taken as revaluation reserve.

c. **Share Premium:** Premium on issue of share capital may be shown separately under this head.

d. **Revenue Reserves & Others:** The expression 'Revenue Reserves' shall mean any reserve other than Capital Reserve. This item will include all reserves, other than those separately classified. The expression 'reserve' shall not include any amount written off or retained by way of providing for depreciation, renewals or domination in value of assets or retained by way of providing for any known liability.

e. **Balance of Profit:** Includes balance of profit after appropriations. In case of loss the balance may be shown as a deduction.

Notes - General: Movements in various categories of reserves should be shown as indicated in the schedule.

3. Deposits:

A. Demand Deposits:

From banks: Includes all banks deposits repayable on demand.

From others: Includes all demand deposits of others. Credit balances in overdrafts, cash credit accounts, deposits payable at call, overdue deposits, inoperative current accounts, matured time deposits and cash certificates or certificates of deposit, etc. are to be included under this category.

Savings Bank: Includes all savings bank deposits including inoperative savings bank accounts.

Term Deposits From Banks: Includes all types of banks deposits repayable after a specified term.

Term Deposits From others: Includes all types of deposits of the nonbanking sector repayable after a specified term. Fixed deposits, cumulative and recurring deposits, cash certificates, annuity deposits, deposits mobilised under various schemes, ordinary staff deposits, foreign currency non- resident deposits accounts, etc. are to be included under this category.

B. Deposits from branches in India & Deposits from branches outside India.

The total of these two items (A & B) will agree with the total deposits.

Notes - General

(a) *Interest payable on deposits (whether accrued and due and accrued but not due) should not be included but shown in Schedule 5 under other liabilities. Deposits, repayment of which is subject to restrictions by its very nature, like margin deposits, security deposits from staff, etc., also should not be included under deposits but shown under 'Other Liabilities.'*

(b) Matured time deposits and cash certificates, etc., should be treated as demand deposits.

(c) *Deposits under special schemes should be included under term deposits if they are not payable on demand. When such deposits have matured for payments they should be shown under demand deposits.*

(d) *Deposits from banks will include deposits from the banking system in India, co-operative banks, foreign banks which may or may not have a presence in India.*

4. Borrowings: (Includes borrowings/refinance and rediscount obtained from)

In India:

From Reserve Bank of India, from Commercial banks (including co-operative banks), from IDBI, Exim Bank, NABARD, and other institutions/agencies (including liability against participation certificates, if any).

Outside India:

Includes borrowings and rediscounts of Indian branches abroad as well as borrowings of foreign branches.

Includes secured borrowings / refinance in India and outside India.

Notes - General

(i) Inter-office transactions should not be shown as borrowings.

(ii) Funds raised by foreign branches by way of certificates of deposits, notes, bonds, etc. should be classified, depending upon documentation, as 'Deposits', 'borrowings' etc.

(iii) Refinance obtained by banks from Reserve Bank of India and various institutions are being brought under the head 'Borrowings'. Hence advances will be shown at the gross amount on the asset side.

5. Other Liabilities and Provisions:

Bills payable: Includes drafts, telegraphic transfers, mail transfers payable, pay slip, banker's cheques, other miscellaneous items, etc. remaining uncashed.

Inter-office liabilities: The inter-office adjustments balance, if in credit, should be shown under this head. Only net position of inter-office accounts, inland as well as foreign should be shown here.

Interest accrued: Includes interest due and payable and interest accrued but not due on deposits and borrowings

Others : Includes net provision for income tax and other taxes like interest tax (less advance payment, tax deducted at source, etc.), surplus provisions in bad debts provision account, surplus provisions for depreciation in securities, contingency funds which are not disclosed as reserves but are actually in the nature of reserves, proposed dividend/transfer to Government, other liabilities which are not disclosed under any of the major heads such as unclaimed dividend, provisions and funds kept for specific purposes, unexpired discount, outstanding charges like rent, conveyance, etc. certain types of deposits like staff security deposits, margin deposits, etc. where the repayment is not free, should also be included under this head.

Notes - General

(i) *For arriving at the net balance of inter-office adjustments all connected inter-office accounts should be aggregated and the net balance only will be shown, representing mostly items in transit and unadjusted items,*

(ii) *The interest accruing on all deposits, whether the payment is due or not, should be treated as a liability,*

(iii) *It is proposed to show only pure deposits under the head 'deposits' and hence all surplus provisions for bad and doubtful debts contingency funds, secret reserves, etc. which are not netted off against the relative assets should be brought under the head 'Others' (including provisions).*

Note: As per RBI's guidelines on Capital and provisioning requirements for exposures to entities with Unhedged Foreign Currency Exposure (UFCE) issued on February 17, 2021 mandate that information on UFCE may be obtained by banks from entities on a quarterly basis, on self-certification basis, and preferably should be internally audited by the entity concerned.

6. Cash and balances with the Reserve Bank of India:

I. Cash in hand (including foreign currency notes) and also of foreign branches in the case of banks having such branches.

II. In Current Account with Reserve Bank of India (Includes the balance maintained with the Reserve Bank of India in Current Account).

7. Balances with banks in India and Money at call and short notice;

I. In India

(i) Balances with Reserve Bank of India (other than in current account) Includes balances held with the Reserve Bank of India other than in current accounts, if any.

(ii) Balances with other banks in India Current accounts Deposit accounts. Includes all balances with banks in India (including co-operative banks). Balances in current accounts and deposit accounts should be shown separately.

(iii) Money at call and short notice with banks and other institutions. Includes deposits repayable within 15 days or less than 15 days' notice lent in the inter-bank call money market.

(iv) Cash in hand including foreign currency notes.

II. Outside India

Usually classified in foreign countries as money at call Includes balances held by foreign branches and balances held by Indian branches of the banks outside India. Balances held with foreign branches by other branches of the bank should not be shown under this head but should be included in inter branch accounts. The amounts held in 'current accounts' and 'deposit accounts' should be shown separately. Includes deposits and short notice.

8. Investments:

I. Investments in India (Includes Central and State Government securities and Government treasury bills. Securities other than Government securities, which according to the Statutes are treated as approved securities, should be included here).

(i) Government securities.

(ii) Other approved Securities Investments in shares of companies and corporations not included in item (i) should be included here.

(iii) Shares.

(iv) Debentures and Bonds, Investments in debentures and bonds of companies and corporations not included in item (ii) should be included here.

(v) Investments in subsidiaries/ Associate companies: Investments in subsidiaries/ associate companies should be included here.

A company will be considered as an associate company for the purpose of this classification if more than 25% of the share capital of that company is held by the bank. Includes residual investments, if any, like gold.

(vi) Others.

II. Investments outside India:

(i) Government securities (including local authorities);

(ii) Others All foreign Government securities including securities issued by local authorities may be classified under this head. All other investments outside India may be shown under this head.

9. Advances:

A. (i) Bills purchased and discounted

(ii) Cash Credits, Overdrafts and Loans repayable on demand

(iii) Term loans

B. (i) Secured by tangible assets

(ii) Covered by bank/government guarantees

(iii) Unsecured

C. I. Advances in India

(i) Priority sectors

(ii) Public sector

(iii) Banks

(iv) Others

II. Advances outside India

(i) Due from banks

(ii) Due from others

(iii) Bills purchased and discounted

(iv) Syndicated loans

(v) Others

The item will include advances in India and outside India.

- Advances should be broadly classified into 'Advances in India' and 'Advances outside India'. Advances in India will be further classified on the sectoral basis as indicated.
- Advances to sectors which for the time being are classified as priority sectors according to the instructions of the Reserve Bank is to be classified under the head 'Priority Sector'.
- Advances to Central and State Governments and other Government undertakings including Government companies and corporations which are, according to the statutes, to be treated as 'public sector'.
- All advances to the banking sector including co-operative banks will come under the head 'Banks'.
- All the remaining advances will be included under this head 'Others' and typically this category will include non-priority advances to the private, joint and cooperative sector.
- A bank lends advances for various activities. Broadly, the advances it lends can be classified into priority segment lending; public segment lending and non-priority segment lending. The priority segment consists of such advances as specified by RBI in its Master circulars to banks and generally consist of agriculture, MSMEs and others.

Notes - General

(i) *The gross amount of advances including refinance but excluding provisions made to the satisfaction of auditors should be shown as advances.*

(ii) *Term loans will be loans not repayable on demand but over a period of time.*

(iii) *Consortium advances would be shown net of recoveries from other participating banks / institutions.*

(iv) *As per RBI's Monetary policy dated February 28, 2021, Scheduled commercial banks (SCBs) will be allowed to deduct credit disbursed to 'New MSME borrowers' from their NDTL for calculation of the CRR. Accordingly, the Reserve Bank on February 05, 2021 advised all SCBs to report the exemption availed at the end of a fortnight, in prescribed format.*

A. (i) **Bills purchased and discounted:** In classification under Section 'A', all outstanding - in India as well as outside - less provisions made, will be classified under three heads as indicated and both secured and unsecured advances will be included under these heads.

(ii) Cash credits, overdrafts and loans repayable on demand.

(iii) Term loans (All advances or part of advances which are secured by tangible assets may be shown here).

B. (i) Secured by tangible assets.

(ii) Covered by Bank/ Government Guarantee.

(iii) Unsecured.

C. I. **Advances in India**

(i) Priority sectors.

(ii) Public sector.

(iii) Banks.

(iv) Others.

II. Advances outside India (i) Due from banks (ii) Due from others

10. Fixed Assets:

These include premises and other fixed assets and are shown at cost on close of previous year, additions and deductions during the year and depreciation till close of the year.

I. Premises

II. Other Fixed Assets (including furniture and fixtures)

III. Capital work-in-progress or premises under construction

Premises wholly or partly owned by the banking company for the purpose of business including residential premises should be shown against 'Premises'.

In the case of premises and other fixed assets, the previous balance, additions thereto and deductions there from during the year as also the total depreciation written off should be shown. Where sums have been written off on reduction of capital or revaluation of assets, every balance sheet after the first balance sheet subsequent to the reduction or revaluation should show the revised figures for a period of five years with the date and amount of revision made. Motor vehicles and all other fixed assets other than premises but including furniture and fixtures should be shown under this head.

11. Other assets

I. *Inter-office adjustments (net):* The inter-office adjustments balance, if in debt, should be shown under this head. Only net position of inter- office accounts, inland as well as foreign, should be shown here. For arriving at the net balance of inter-office adjustment accounts, all connected inter-office accounts should be aggregated and the net balances, if in debit, only should be shown representing mostly items in transit and unadjusted items.

II. *Interest accrued:* Interest accrued but not due on investments and advances and interest due but not collected on investments will be the main components of this item. As banks normally debit the borrowers' account with interest due on the balance sheet date, usually there may not be any amount of interest due on advances. Only such interest as can be realised in the ordinary course should be shown under this head.

III. *Tax paid in advance/tax deducted at source:* The amount of tax deducted at source on securities, advance tax paid, etc. to the extent that these items are not set off against relative tax provisions should be shown against this item.

IV. *Stationery and stamps:* Only exceptional items of expenditure on stationery like bulk purchase of security paper, loose leaf or other ledgers, etc. which are shown as quasi-asset to be written off over a period of time should be shown here. The value should be on a realistic basis and cost escalation should not be taken into account, as these items are for internal use.

V. *Non-Banking Assets:* This will include properties/tangible assets acquired in satisfaction of claims to be shown. Others: Items like claims which have not been met, for instance, clearing items, debit items representing addition to assets or reduction in liabilities which have not been adjusted for technical reasons, want of particulars, etc. advances given to staff by a bank as employer and not as a banker, etc. Items, which are in the nature of expenses, which are pending adjustments, should be provided for and the provision netted against this item so that only realisable value is shown under this head. Accrued income other than interest may also be included here.

12. Contingent liabilities:

I. Claims against the Bank not acknowledged as debts.

II. Liability for partly paid investments.

III. Liability on account of outstanding forward exchange contracts.

IV. Guarantee given on behalf of constituents. (a) In India (b) Outside India.

V. Acceptances, endorsements and other obligations.

VI. Other items for which the bank is contingently liable Bills for collection: Bills and other items in the course of collection and not adjusted will be shown against this item in the summary.

The format for preparation of the Profit and Loss Account is given below as per Schedule III Form B of the Banking Regulation Act 1949.

FORM B

Profit and Loss Account of XXXX Bank

Profit and Loss Account for the year ended on 31st March (year)

	Particulars	Schedule No.	31-03-20......... (current year)	31-03-20....... (previous Year)
I.	**Income**			
	Interest earned	13		
	Other income	14		
	Total			
II.	**Expenditure**			
	Interest expended	15		
	Operating expenses	16		
	Provisions and contingencies			
	Total			
III.	**Profit / Loss**			
	Net profit / loss (-) for the year			
	Profit / loss (-) brought forward			
	Total			
IV.	**Appropriations**			
	Transfer to statutory reserves			
	Transfer to other reserves			
	Transfer to government/ Proposed dividend			
	Balance carried over to Balance sheet			
	Total			
	Details of Schedules			

Schedule 13 : Interest earned

I.	Interest/discount on advance/bills	xxx	
II.	Income on investments	xxx	
III.	Interest on balances with Reserve Bank of India and Other inter-bank funds	xxx	
IV.	Others	xxx	
Total (I+II+III+IV)			x x x

Schedule 14 : Other income

I. Commission, exchange and brokerage			x x x
II. Profit on sale of investments	x x x		
Less: Loss on sale of investments	(x x x)		x x x
III. Profit on revaluation of investments	x x x		
Less: Loss on revaluation of investments	(x x x)		x x x
IV. Profit on sale of land, buildings and other assets	x x x		
Less: Loss on sale of land, buildings and other assets	(x x x)		x x x
V. Profit on exchange transactions	x x x		
Less: Loss on exchange transactions	(x x x)		x x x
VI. Income earned by way of dividends, etc. from subsidiaries/ companies and/or joint ventures abroad/ in India			
VII. Miscellaneous income			
Total (I+II+III+IV+V+VI+VII)			

Note: Under items II to V loss figures may be shown in brackets.

Schedule 15: Interest expended

I.	Interest on deposits	xxx	
II.	Interest on Reserve Bank of India/Inter bank borrowings	xxx	
III.	Others	xxx	
	Total (I+II+III)		xxx

Schedule 16: Operating expenses

I.	Payment to and provisions of employees	x x x
II.	Rent, taxes and lighting	x x x
III.	Printing and stationery	x x x
IV.	Advertisement and publicity	x x x
V.	Depreciation on bank's property	x x x
VI.	Director's fees, allowances and expenses	x x x
VII.	Auditors' fees and expenses (including branch auditors)	x x x
VIII.	Law charges	x x x
IX.	Postages, Telegrams, Telephones, etc.	x x x

X.	Repairs and maintenance	x x x	
XI.	Insurance	x x x	
XII.	Other expenditure	x x x	
Total (I+II+III+IV+V+VI+VII+VIII+IX+X+XI+XII)			**xxx**

COMMENTS ON PROFIT AND LOSS ACCOUNT

Schedule 13: Interest earned: Includes interest, discount on all types of loans and advances, like Cash credit, demand loans, overdraft, term loans, export loans, domestic/foreign bills purchased/discounted (including those rediscounted), overdue interest and interest subsidy, if any relating to such advances.

I. **Income on investments:** Includes all income derived from investment portfolio by way interest and dividend.

II. **Interest on balances with Reserve Bank of India and other inter-bank funds:** Includes interest on balances with Reserve Bank of India and other banks, call loans, money market placements etc.

III. **Others:** Includes any other discount/interest not included in the above.

Schedule 14: Other Income:

I. **Commission, exchange and brokerage:** Includes commission on collection, on remittances, exchange on DDs, commission earned on letters of credit, bank guarantees, letting out lockers, Government business, agency business/consultancy services, brokerage on securities. Foreign exchange income is excluded.

II. **Profit on sale of investments:** From this reduce loss of sale of investments.

III. **Profit on revaluation of investments:** From this reduce loss on revaluation of investments.

IV. **Profit on sale of land, buildings and other assets:** Deduct loss of sale of land, buildings and other assets. Includes profit on sale of securities, furniture, land and buildings, motor vehicles, gold, silver etc. Net position should be only shown. If the net position is a loss, it should be shown as a deduction. Similarly net profit/loss on revaluation of assets may be shown under this.

V. **Profit on exchange transactions:** Includes profit/loss on foreign exchange, all income earned by exchange, commission and other charges on foreign exchange transactions excluding interest which will be shown under interest. Net position only to be shown. If the net position is a loss, it should be shown as a deduction.

VI. Income earned by way of dividends etc. from subsidiaries/companies and/or joint ventures abroad/ in India.

VII. **Miscellaneous income:** Includes charges recovered as go-down rents, income from bank's properties, security charges, insurance, other miscellaneous income. If any individual item exceeds more than 1% of the total income, particulars be given in the notes to accounts.

Schedule 15: Interest expended

I. **Interest on deposits:** All interest paid on deposits including banks and institutions to be included in this.

II. **Interest on Reserve Bank of India/ Inter-bank, borrowings:** Interest on all borrowings from banks as well as on refinance from RBI to be included.

III. Others: Includes interest/discount on all borrowings and refinance, penal interest paid.

Schedule 16: Operating Expenses

I. **Payment to and provisions of employees:** This head includes all salaries/wages, allowances including medical allowances, bonus, other staff benefits like provident fund, pension, gratuity, lave fare travel/ concession, staff welfare etc.

II. **Rent, taxes and lighting:** This head to include rent paid on building on rent, municipal taxes, other taxes (except income tax, interest tax), electricity and similar types of charges. House Rent allowance paid to staff should appear under, " Payments to and Provisions for Employees'.

III. **Printing and stationery:** This head to include books and stationery used/consumed by the bank, other printing charges (other than by way of publicity expenditure).

IV. **Advertisement and publicity:** Expenses incurred for publicity and advertising including printing charges on publicity materials to be included under this head.

V. **Depreciation on bank's property:** Depreciation bank's own property, motor cars, other vehicles, furniture, fixtures, electrical fittings, lockers, vaults, lease hold assets, other non-banking assets etc.

VI. **Director's fees, allowances and expenses:** Expenses like sitting fee, hotel charges, daily allowances, conveyance and other local expenditure incurred on behalf of directors to be included. Similarly, expenses incurred on account of local committee members to be also included. Though these expenses may be of reimbursable nature nevertheless these are to be included.

VII. **Auditors' fees and expenses:** This head should also include fees expenses relating to branch auditors. This expenditure fees and other expenses paid to statutory auditors for their professional services rendered and for performing their duties. Though in practice these are in the nature of reimbursement of such expenses. If external auditors are appointed for internal inspection, audit and other professional services such expenses should be included under this head but under 'other expenditure'.

VIII. **Law charges:** This head should include all legal expenses incurred including reimbursements expenses incurred for providing legal services.

IX. **Postages, Telegrams, Telephones, etc.:** All expenses incurred towards stamps, postage, telegrams, telephones etc. to be included.

X. **Repairs and maintenance:** Include expenses incurred for maintaining bank's property.

XI. **Insurance:** Includes insurance premium paid for banks property, premium paid to DICGC for deposit insurance/other loan which are not recovered from customers.

XII. **Other expenditure:** All other expenses which are not included in any of the above are included here. If any such expenditure exceeds 1% of the total income details are to be given in the notes to accounts.

Note: There may be slight variations in the heads of expenditure maintained by banks.

Notes/Instructions for compilation

1. *Formats of Balance Sheet and Profit and Loss account cover all items likely to appear in these statements. If a bank does not have any particular item to report, it may be omitted from formats.*

2. *Corresponding comparative figures for previous year are to be disclosed as indicated in the formats. The words 'Current year', 'Previous year' used in formats are only to indicate the order of presentation and may not appear in accounts.*

3. *Figures should be rounded off to nearest thousand rupees.*

4. *Unless otherwise indicated the banks in these statements will include banking companies, nationalized banks, State Bank of India and all other banks including cooperative banks carrying business of banking whether or not incorporated in India or not or operating in India.*

5. *The Hindi version of balance sheet will be a part of annual report wherever applicable.*

ACCOUNTING TREATMENT OF SPECIFIC ITEMS

The accounting treatments of certain specific items in Balance Sheet and Profit and Loss accounts are as follows: *Bad Debts and Provision for doubtful debts:* This will include bad debts and provision for doubtful debts are to be charged to "Provisions and Contingencies' in the P& L account. Advances shown in the Balance Sheet is net of bad debts and provisions for bad debts. Banks collect these details from their branches. The Schedule of Advances filled and submitted by branches include doubtful debts in respect of Cash credit, over drafts, unsecured loans as also bills purchased and discounted. However, at the Head office Advances figure shown is net of bad as well as doubtful debts.

Provision of Taxation: This is chargeable under the head '"Provisions and Contingencies' in the P & L account. However, this will be shown in the Balance Sheet under the heading 'Other Liabilities and Provisions' on the Liabilities side.

Rebate on Bills Discounted

Rebate on bills represents the discount collected for unexpired period in advance. Banks normally collect discount charges for the entire period of Bill of Exchange or Promissory Note.

For example, a Bill of Rs.1,00,000 payable 60 days at sight is discounted on say 23.03.2022. Let us also assume the bill will fall due for payment on 23.05.2022. Assume that total discount collected is Rs. 600 and other postage charges Rs.400 is levied.

At the time of discount as on 23.03.2022 following entries will be passed:

Dr. Bill Discounted A/c	1,00,000
Cr. Customer's A/c	99,000
Cr. Discount A/c	600
Cr. Postage charges A/c	400

As on 31st March for the purposes of preparing P & L account, the bank has collected Rs. 520 excess for the period of 1st April to 22nd May which falls in the next accounting year. The amount of Rs.520 is adjusted in the account of the branch in the following manner;

Dr. Discount A/c	520
Cr. Rebate on Bills Discounted	520

Rebate will appear under the head 'Liabilities' side in the balance sheet.

GUIDANCE ON SPECIFIC ISSUES WITH RESPECT TO CERTAIN ACCOUNTING STANDARDS

As mentioned, RBI Master Direction provides guidance regarding some specific issues so that requirements of accounting standards are applied uniformly. The Accounting Standards on which guidance have been provided are as under.

1. Accounting Standard 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies.
2. Accounting Standard 9 – Revenue Recognition
3. Accounting Standard 11 - The Effects of Changes in Foreign Exchange Rates
4. Accounting Standard 17 – Segment Reporting

5. Accounting Standard 18 – Related Party Disclosures

6. Accounting Standard 23 – Accounting for Investments in Associates in CFS

7. Accounting Standard 24 - Discontinuing operations

8. Accounting Standard 25 – Interim Financial Reporting

9. Accounting Standard 26 – Intangible asset

10. Accounting Standard 27 - Financial Reporting of Interests in Joint Ventures

11. Accounting Standard 28 – Impairment of assets

The Guidance deals with certain specific issues in relation with abovementioned standards. The summary of guidance on one such standard is provided as an example.

Accounting Standard 5 - Net Profit or Loss for the Period, Prior Period Items and Changes in Accounting Policies

This Standard requires the classification and disclosure of extraordinary and prior period items, and the disclosure of certain items within profit or loss from ordinary activities. It also specifies the accounting treatment for changes in accounting estimates and the disclosures to be made in the financial statements regarding changes in accounting policies. Regarding disclosure of Prior period items, material items needs to be disclosed. Since materiality is not objectively defined, it has been decided that all banks should ensure compliance with the provisions of the Accounting Standard in respect of any item of prior period income or prior period expenditure which exceeds one per cent of the total income/total expenditure of the bank if the income/expenditure is reckoned on a gross basis or one per cent of the net profit before taxes or net losses as the case may be if the income is reckoned net of costs. Since the format of the profit and loss accounts of banks prescribed in Form B under Third Schedule to the Banking Regulation Act, 1949 does not specifically provide for disclosure of the impact of prior period items on the current year's profit and loss, such disclosures, wherever warranted, are to be made in the 'Notes on Accounts' to the balance sheet of banks

IMPORTANT ITEMS OF BALANCE SHEET

Banks Balance Sheets contain certain unusual items when compared to others. We shall have an over view of the same.

Liabilities Side

1. **Share Capital:** Consist of Authorised, Issued, Subscribed and Paid-up share capital are shown separately. Under the head, Paid-up Capital, calls in arrears are reduced and forfeited share amount is added.

2. **Reserve Fund and others:** As under Banking Regulation Act, 1949 every bank which is incorporated in India has to transfer twenty percent of its profit before declaring dividend each year to the Reserve Fund.

3. **Deposits and other accounts:** Though it appears as a single head, it consists of Fixed Deposits (which are held for a fixed period), Savings Bank as well as Current Account balances (which are repayable on demand) and others.

Assets Side

1. **Money at call and short notice:** Money is borrowed by one bank from another usually for a short period of 1 to 14 days for meeting certain commitments. For a bank which lends this money it is an asset in the form of receivable. This type of transaction is known as inter-bank transaction. When banks have surplus funds they lend and when they have shortage they borrow. Banks also approach RBI and other primary dealers for the same purpose. Banks make use of 'Repo' facility for borrowing

with RBI. These are included under this head. The interest rates on such borrowings is charged as an expense. Rate of interest will depend on market demand and supply (except in the case of Repo transaction which will be depend on repo rate.)

2. **Advances:** The advances consist of Loans, Cash credit and overdraft. Loans are given a fixed period to customer repayable over a period of time by way of EMI or instalments. Cash credit facility is given for a period of one year by way of a hypothecation limit against securities in the form of current assets/ securities. Customers are permitted to draw money up to a limit sanctioned. It is a running account in which deposits will also be made. In case of Overdraft a customer will be allowed to draw money from current account against some collateral security like insurance policies, shares, NSC and other tangible securities.

3. **Bills receivable being Bills for collection as per contra:** Bills are given by customers for collection and subsequent credit to their accounts. Such bills are sent for collection and on realization these are credited to customers' account. During the year end when bills which remain outstanding for collection banks pass the following entries:

Bills received being bills for collection	Dr
To Bills for Collection being bills receivable account	Cr

The first entry indicates the amount receivable and it is taken on the assets side. The second entry denotes amount payable is taken on the liabilities side of the balance sheet. The amounts are identical and known as contra items.

4. **Acceptances, Endorsements and other obligations:** During the course of their business banks open letters of credit, issue bank guarantee, endorse promissory notes, accept or co-accept bills on behalf of customers. Under such actions a bank is liable to third parties on behalf of customers. In such cases banks obtain counter guarantees to protect themselves in case if liabilities devolve on them. Such counter guarantees represent an asset. For all such outstanding transactions contra entries are passed:

Constituent liability for Acceptances, Endorsements / other obligations	Dr
To Acceptances, Endorsements/other obligations	Cr

The former entry is taken in the assets side and the latter is taken on the liabilities side.

Non-Banking Assets: These are non-financial Assets and are tangible. e.g., machinery, equipment, real estate, inventory, vehicles. When a borrower is unable to repay the amount of the loan in cash and as a substitute offers to the bank an asset. This is known as a non-banking asset. This one is provided apart from the asset already given as collateral security to the bank to purchase so as to settle their dues. When these assets are purchased by the banks, they are known as non-banking assets. Banks are required to dispose off those assets within a specified timeframe as mandated by RBI. They also have the responsibility to finally convert these non-cash recoveries in to cash as recoveries. Profit or loss on disposal of such assets are to be disclosed in profit and loss of account of the bank.

Gold and Silver: Gold appears as a part of assets and appears under the head 'investments'. Silver appears under "Other assets".

Locker /Safe Deposit vaults: These are assets and as such are included under Furniture and fixtures.

Branch Adjustment Account: In a Bank there are many transactions take place. They may be between Head office and branches vice-versa, between branches. They are properly reconciled at periodical intervals. However at the year-end time there could be outstanding transactions pending reconciliation. Thus, there could be a balance in the inter-office. The inter-office adjustment balance, if in debit, should be shown under this head. Only net position of inter-office accounts inland as well as foreign should be shown here. For arriving at the net balance of inter-office adjustment accounts all connected inter-office accounts should be aggregated and the net balance, if in debit, only should be shown, representing mostly items in transit and unadjusted items. If the balance is in credit it is shown under liabilities side.

Illustration:

M/s Progressive Bank has given you the following information. Prepare Profit & Loss Account and Balance Sheet as at 31st March xx as per the forms under Banking Regulation Act, 1949.

Share Capital	3,00,000
Statutory Reserve Fund	1,80,000
Bad debts	19,313
Establishment Expenses	1,91,588
Current Deposits	20,47,841
Interest paid	11,22,660
Savings Bank Deposits	25,80,000
Acceptance for customer	71,250
Discount	7,42,500
Profit & Loss Account - credit	12,30,600
Fixed Deposits	13,12,500
Commission & Exchange	4,39,350
Premises	7,20,000
Cash in hand	975
Balance in RBI	33,000
Interest received	19,29,600
Interest in shares (Market Value 3,00,000)	1,38,750
Cash with banks	4,26,750
Term loans in India	15,00,000
CC Account - Hypothecation	18,96,000
CC Account - Pledge	14,16,000
Bill Purchased	24,00,000
Employee loans	61,155
Salaries, Allowances, PF	6,68,201
Government Securities	1,80,000
Dividend on investments	12,000

Other Notes

CEO Salary 60000 p.a. included in salaries

Directors fee & Allowances 12000 included in salaries & Allowances

Rebate on bills as at year end is Rs. 72000

Establishment Expenses include

Stamp papers	2,250
Revenue Stamps	600
Postage and Telegrams	6,900
Audit fees	12,000
Lighting	4,500
Rent	27,000
Stationery	94,500
Advertisements	15,000

A CC limit of Rs. 12000 needs to be fully provided for.

Taxation at 35%

Solution:

Progressive Bank Limited

Profit & Loss Account for the year ended on 31st March XX

		Schedule		Rs.
I	**Income**			
	Interest Earned	13	26,00,100	
	Other Income	14	4,51,350	
	Total			**30,51,450**
II	**Expenditure**	15	11,22,660	
	Interest Expended	16	8,59,789	
	Operating Expenses Provision for contingencies		3,94,504	
	Total			**23,76,953**
III	**Profit**			
	Net Profit			**6,74,497**
IV	**Appropriations**			
	Transfer to statutory reserves			1,34,899
	Carried Forward to Balance Sheet			**5,39,598**

Schedule 13: Interest Earned

Interest received		19,29,600
Discount	7,42,500	
Less: Rebate	(72,000)	6,70,500
Total		**26,00,100**

Schedule 14: Other income

Commission & Exchange	4,39,350
Dividend on investment	12,000
Total	**4,51,350**

Schedule 15: Interest Expended

Interest expended	11,22,660
Total	**11,22,660**

Schedule 16: Operating Expenses

Salaries & Allowances		6,56,201
Rent & Lighting		31,500
Printing & Stationery		94,500
Advertisement & Publicity		15,000
Directors Fees		12,000
Auditors Fees & Exp.		12,000
Stamp papers		2,250
Postage, Telegrams, Revenue Stamp		7,500
Other Expenses		28,838
Total		**8,59,789**
Working Notes :		
Establishment Expenses		1,91,588
Salaries Allowances etc.		6,68,201
Total		**8,59,789**
Other expenses is a balancing amount		
Income		26,00,100
Other income		4,51,350
Total		**30,51,450**
Less: Interest Expended	11,22,660	
Less: operating Expenses	8,59,789	
less; Bad debts provision	31,313	20,13,762
Profit Before Tax		**10,37,688**
Income Tax @35% on		3,63,191
Net Profit After Tax		**6,74,497**
To Statutory Reserves 20% of Net Profit		1,34,899
C/F to Balance sheet		**5,39,598**

Provision for contingencies	
Bad debts	19,313
Provision for bad debts	12,000
Provision for income tax	3,63,191
Total	**3,94,504**

Progressive Bank Limited
Balance Sheet as on 31st March 20XX

	Schedule No.	Rs.
Capital and Liabilities		
Capital	1	3,00,000
Reserves & Surplus	2	20,85,097
Deposits	3	59,40,341
Borrowings	4	–
Other Liabilities and Provisions	5	4,47,192
Total		**87,72,630**
Assets		
Cash and Balances with RBI	6	33,975
Balances with Banks and Money at Call and Short Notice	7	4,26,750
Investments	8	3,18,750
Advances	9	72,12,000
Fixed assets	10	7,20,000
Other Assets	11	61,155
Total		**87,72,630**
Contingent Liabilities	12	71,250

Schedule 1: Capital

		Rs.
A.	**Authorised Capital**	
	10000 shares of Rs. 100 each	10,00,000
	Issued Capital	
	3000 shares of Rs.100 each	3,00,000
	Subscribed Capital	
	3000 shares of Rs.100 each	3,00,000
	Called up and Paid up Capital	
	3000 shares of Rs.100 each	3,00,000

Schedule 2: Reserves & Surplus

I	Statutory reserve		
	Opening Balance	1,80,000	
	Add: Addition during the year	1,34,899	3,14,899
II	Capital Reserve	Nil	
III	Share Premium	Nil	
IV	Revenue & other Reserves	Nil	
V	Balance of Profit & Loss	17,70,198	17,70,198
Total			**20,85,097**

Schedule 3: Deposits

			Rs.
A	I.	Demand Deposits	
		From Banks	
		From Others	20,47,841
	II	Savings Bank Deposits	25,80,000
	III.	Term Deposits	
		From Banks	
		From Others	13,12,500
		Total (I+II+III)	
B.	I.	Deposits of Branches in India	**59,40,341**
	II.	Deposits of Branches outside India	0

Schedule 4: Borrowings

I.	Borrowings of branches in India	0
II.	Borrowings of branches outside India	

Schedule 5: Other Liabilities & Provisions

I.	Bills Payable	0
II.	Inter-office Adjustments	0
III.	Interest accrued	0
IV.	Others	**4,47,192**

Schedule 6: Cash and Balances with RBI

I.	Cash in hand	975
II.	Balance with RBI	33,000
Total		**33,975**

Schedule 7: Balances with Banks and Money at Call and Short Notice

I.	In India	4,26,750
II.	Outside India	0
		4,26,750

Schedule 8: Investments

I. Investments in India in

(i)	Government Securities	1,80,000
(ii)	Other Approved Securities	0
(iii)	Shares	1,38,750
(iv)	Debentures and Bonds	–
(v)	Subsidiaries and/or Joint ventures	–
(vi)	Others	–

II.	Investments outside India	–
		3,18,750

Schedule 9: Advances

		Rs.
I.	Bills Purchased and Discounted	24,00,000
II	Cash Credit, Overdrafts, Loans repayable on demand	33,12,000
III	Term Loans	15,00,000
		72,12,000

Schedule 10: Fixed assets

Premises	7,20,000
Other fixed assets	–
	7,20,000

Schedule 11: Other Assets

I.	Inter-office Adjustments	–
II.	Interest Accrued	–
III.	Stationery & Stamps	–
IV.	Taxes Paid in Advance & Deducted at Source	–
V.	Non-Banking Assets acquired in satisfaction of claims	–
VI.	Others- Loans to Employees	61,155
		61,155

Schedule 12: Contingent Liabilities

Acceptances, Endorsements and other obligations	71,250

DISCLOSURE REQUIREMENTS OF BANKS

In order to encourage market discipline, Reserve Bank has over the years developed a set of disclosure requirements, which allow the market participants to assess key pieces of information on capital adequacy, risk exposures, risk assessment processes and key business parameters, to provide a consistent and understandable disclosure framework that enhances comparability. Banks are also required to comply with the Accounting Standard 1 (AS 1) on Disclosure of Accounting Policies issued by the Institute of Chartered Accountants of India (ICAI). The enhanced disclosures have been achieved through revision of Balance Sheet and Profit & Loss Account of banks and enlarging the scope of disclosures to be made in 'Notes to Accounts'. In addition to the 16 detailed prescribed schedules to the balance sheet, banks are required to furnish the following information In 'Notes to Accounts'. A brief on the same is given below. As a standard practice and to bring in uniform reporting 'Summary of Significant Accounting Policies' and 'Notes to Accounts' are to be shown in Schedules 17 and 18 by banks.

As per RBI directions, the Banks are required to disclose the following:

1	**Regulatory Capital**
	1.1 Composition of Regulatory capital
	1.2 Draw down from Reserves

2	**Asset and Liability Management**
	2.1 Maturity pattern of certain items of asset and liabilities
	2.2 Liquidity coverage ratio (LCR)
	2.3 Net stable funding ratio (NSFR)
3	**Investments**
	3.1 Composition of investment portfolio
	3.2 Movement of provisions for depreciation and investment fluctuation reserve
	3.3 Sale and transfer to/ from HTM category / Permanent category
	3.4 Non-SLR investment portfolio
	3.5 Repo transactions (in face value terms)
4	**Asset Quality**
	4.1 Classification of advances and provisions held
	4.2 Sector wise Advances and Gross NPAs
	4.3 Overseas assets, NPAs and revenue
	4.4 Particulars of resolution plan and restructuring
	4.5 Divergence in asset classification and provisioning
	4.6 Disclosure of transfer of loan exposures
	4.7 Fraud accounts
	4.8 Disclosure under resolution framework for COVID-19 related stress
5	**Exposures**
	5.1 Exposure to real estate sector
	5.2 Exposure to capital Market
	5.3 Risk category wise country exposure
	5.4 Unsecured advances
	5.5 Factoring exposures
	5.6 Intra group exposures
	5.7 Unhedged foreign currency exposure
	5.8 Exposures of RCBs
6	**Concentration of deposits, advances, exposures and NAPs**
	6.1 Concentration of deposits
	6.2 Concentration of advances
	6.3 Concentration of exposures
	6.4 Concentration of NPAs
7	**Derivatives**
	7.1 Forward rate agreement / Interest rate swaps
	7.2 Exchange traded interest rate derivatives
	7.3 Disclosures on risk exposure in derivatives
	7.4 Credit default Swaps
8	**Disclosures relating to securitisation**

9	**Off balance sheet SPVs sponsored (which are required to be consolidated as per accounting norms)**
10	**Transfer to Depositor Education and Awareness Fund (DEA Fund)**
11	**Disclosure of complaints**
	11.1 Summery information of complaints received by the bank from customers and from the office of ombudsman
	11.2 Top 5 grounds of complaints received by the bank from customers
12	**Disclosure of penalties imposed by the RBI**
13	**Disclosure on remuneration**
14	**Other Disclosures**
	14.1 Business Ratios
	14.2 Bancassurance Business
	14.3 Marketing and Distribution
	14.4 Disclosures regarding Priority Sector Lending Certificates (PSLCs)
	14.5 Implementation of IFRS converged Indian Accounting Standards
	14.6 Payment of DICGC Insurance Premium
	14.7 Disclosure of facilities granted to directors and their relatives
	14.8 Disclosure on amortisation of expenditures on account of enhancement in family pension of employees of banks

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

As per RBI's directions banks should disclose the accounting policies regarding key areas of operations at one place (under Schedule 17) along with 'Notes to Accounts' in their financial statements. A suggestive list includes - Basis of Accounting, Transactions involving Foreign Exchange, Investments - Classification, Valuation, etc., Advances and Provisions thereon, Fixed Assets and Depreciation, Revenue Recognition, Employee Benefits, Provision for Taxation, Net Profit, etc.

The model formats of some of such disclosures are as follows:

1. **Basis of Accounting:** The accompanying financial statements have been prepared on the historical cost and conform to the statutory provisions and practices prevailing in the country.

2. **Transactions involving Foreign Exchange:**

   (a) Monetary assets and liabilities have been translated at the exchange rates, prevailing at the close of the year. Non-monetary assets have been carried in the books at the historical cost.

   (b) Income and expenditure items in respect of Indian branches have been translated at the exchange rates, ruling on the date of the transaction and in respect of overseas branches at the exchange rates prevailing at the close of the year.

   (c) Profit or loss on pending forward contracts have been accounted for.

3. **Investments:**

   (a) Investment in governments and other approved securities in India are valued at the lower of cost or market value.

   (b) Investments in subsidiary companies and associate have been accounted for on the historical cost basis.

   (c) All other investments are valued at the lower of cost or market value.

4. **Advances:**

   (a) Provisions for doubtful advances have been made to the satisfaction of the auditors:

      (i) In respect of identified advances, based on a periodic review of advances and after taking into account the portion of advance guaranteed by the Deposit Insurance and Credit Guarantee Corporation, the Export Credit and Guarantee Corporation and similar statutory bodies;

      (ii) In respect of general advances, as a percentage of total advances taking into account the guidelines issued by the Government of India and the Reserve Bank of India.

   (b) Provisions in respect of doubtful advances have been deducted from the advances to the extent necessary and the excess have been included under "Other Liabilities and Provisions".

   (c) Provisions have been made on a gross basis. Tax relief, which will be available when the advance is written-off, will be accounted for in the year of write-off.

5. **Fixed Assets:**

   (a) Premises and other fixed assets have been accounted for at their historical cost. Premises which have been revalued are accounted for at the value determined on the basis of such revaluation made by the professional values, profit arising on revaluation has been credited to Capital Reserve.

   (b) Depreciation has been provided for on the straight line/diminishing balance method.

   (c) In respect of revalued assets, depreciation is provided for on the revalued figures and an amount equal to the additional depreciation consequent of revaluation is transferred annually from the Capital Reserve to the General Reserve / Profit and Loss Account.

6. **Employee Benefits:** Provision for gratuity pension benefits to staff have been made on an accrual casual basis. Separate funds for gratuity / pension have been created.

7. **Net Profit:**

   (a) The net profit disclosed in the Profit and Loss Account in after:

      (i) provisions for taxes on income, in accordance with the statutory requirements.

      (ii) Provisions for doubtful advances.

      (iii) Adjustments to the value of "current investments" in government and other approved securities in India, valued at lower of cost of market value.

      (iv) Transfers to contingency funds.

      (v) Other usual or necessary provisions.

   (b) Contingency funds have been grouped in the Balance Sheet under the head "Other Liabilities and Provisions".

Some Special Transactions

Interest on Doubtful Debts: When a debt is found to be doubtful at the end of the accounting year, a question may arise whether the interest on that should be credited to interest Account or not. There is no doubt that interest has accrued; but it is equally clear that the realization of this interest is doubtful. Therefore, as prudent accounting policy, such interest should be transferred to Interest Suspense Account.

Inter-branch account - provisioning for net debit balance : Banks are required to segregate the credit entries outstanding for more than five years in the inter-branch account and transfer them to a separate 'Blocked Account' which should be shown under 'Other Liabilities and Provisions - Others' or in the case of Co-operative Banks, under 'Other Liabilities- Suspense'. Any adjustment from the Blocked Account is permitted only with the authorisation of two officials, one of whom should be from the Controlling/Head Office if the amount exceeds Rupees One lakh. The balance in Blocked Account shall be reckoned as a liability for the purpose of the maintenance of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).

Category-wise (head-wise) accounts for various types of transactions should be maintained in inter-branch accounts, so that the netting can be done category-wise. As on the balance sheet date, banks shall segregate the debit and credit entries remaining unreconciled for more than six months and arrive at the net position category-wise. The balance in the Blocked Account shall also be considered. Thereafter, the net debit under all the categories of inter-branch accounts shall be aggregated and a provision equivalent to 100 per cent of the aggregate net debit shall be made. While doing so, banks shall ensure that the net debit in one category is not set-off against net credit in another category.

ADDITIONAL DISCLOSURES PRESCRIBED BY RESERVE BANK OF INDIA (RBI)

There are major heads of disclosure as detailed elsewhere in this lesson all such major heads have some specific subheading of disclosure. In this section some important of those disclosure items are explained in brief.

1. Asset Quality

The particulars regarding the asset quality of banks need to be disclosed in specified format under the following subheadings as prescribed by RBI.

1.1 Classification of advances and provisions held

<table>
<tr><th rowspan="2"></th><th>Standard</th><th colspan="4">Non-Performing</th><th>Total</th></tr>
<tr><th>Total Standard Advances</th><th>Sub-standard</th><th>Doubtful</th><th>Loss</th><th>Total Non-Performing Advances</th><th></th></tr>
<tr><td>Gross Standard Advances and NPAs</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Opening Balance</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Add: Additions during the year</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Less: Reduction during the year</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Closing Balance</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Reduction in Gross NPA due to :</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>I. Upgradation
II. Recoveries(excluded recoveries from upgraded accounts
III. Technical / Prudential Write offs</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>IV. Write offs other than those under (III) above</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Provisions Excluding Floating provisions</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Opening Balance of Provisions held</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Add: Fresh Provisions made during the year</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Less: Excess Provisions Reversed</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td>Closing Balance of Provision held</td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
<tr><td></td><td></td><td></td><td></td><td></td><td></td><td></td></tr>
</table>

Net NPAs						
Opening Balance						
Add: Fresh additions during the year						
Less: Reduction during the year						
Closing Balance						
Floating Provisions						
Opening Balance						
Add: Additional provisions made during the year						
Less: Amount drawn down19 during the year						
Closing balance of floating provisions						
Technical write-offs and the recoveries made thereon						
Opening balance of Technical/ Prudential written-off accounts						
Add: Technical/ Prudential write-offs during the year						
Less: Recoveries made from previously technical/ prudential written-off accounts during the year						
Closing balance						

There are certain ratios that need to be disclosed under asset quality. These are mentioned below:

Ratios (in percent)	Current Year	Previous Year
Gross NPA to Gross Advances		
Net NPA to Net Advances		
Provision Coverage Ratio		

1.2 Sector-wise Advances and Gross NPAs

Sr. no.	Sector	Current Year			Previous Year		
		Outstanding Total Advances	Gross NPAs	Percentage of Gross NPAs to Total Advances in that sector	Outstanding Total Advances	Gross NPAs	Percentage of Gross NPAs to total Advances in that sector
1	**Priority Sector**						
A	Agriculture and allied activities						
B	Advances to industries sector eligible as priority sector lending						
C	Services						
D	Personal loans						
	Subtotal (1)						
2	**Non-priority Sector**						
A	Agriculture and allied activities						
B	Industry						
C	Services						
D	Personal loans						
	Sub-total (2)						
	Total						

**Banks shall also disclose in the format above, sub-sectors where the outstanding advances exceeds 10 percent of the outstanding total advances to that sector. For instance, if a bank's outstanding advances to the mining industry exceed 10 percent of the outstanding total advances to 'Industry' sector it shall disclose details of its outstanding advances to mining separately in the format above under the 'Industry' sector.*

1.3 Overseas assets, NPAs and Revenue

Particulars	Current Year	Previous Year
Total Assets		
Total NPAs		
Total Revenue		

1.4 Particulars of Resolution Plan and Restructuring

Under the cover of 'Prudential Framework for Resolution of Stressed Assets' banks are required to give appropriate disclosure on the resolution plans implemented by them. Disclosure needs to be done in the following format.

		Agriculture and allied activities		**Corporates (excluding MSME)**		**Micro, Small and Medium Enterprises (MSME)**		**Retail (excluding agriculture and MSME)**		**Total**	
		Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous Year	Current Year	Previous Year
Standard	Number of borrowers										
	Gross Amount (Rs. crore)										
	Provision held (Rs. crore)										
Substan-dard	Number of borrowers										
	Gross Amount (Rs. crore)										
	Provision held (Rs. crore)										
Doubtful	Number of borrowers										
	Gross Amount (Rs. crore)										
	Provision held (Rs. crore)										
Total	Number of borrowers										
	Gross Amount (Rs. crore)										
	Provision held (Rs. crore)										

1.5 Divergence in asset classification and provisioning

Any additional provisioning for NPAs assessed by Reserve Bank of India as part of its supervisory process needs to be disclosed in prescribed format this threshold will shall be reduced progressively in phased manner.

Sr. no.	Particulars	Amount (in Cr.)
1	Gross NPAs as on March 31, 20XX* as reported by the bank	
2	Gross NPAs as on March 31, 20XX as assessed by Reserve Bank of India	
3	Divergence in Gross NPAs (2-1)	
4	Net NPAs as on March 31, 20XX as reported by the bank	
5	Net NPAs as on March 31, 20XX as assessed by Reserve Bank of India	
6	Divergence in Net NPAs (5-4)	
7	Provisions for NPAs as on March 31, 20XX as reported by the bank	
8	Provisions for NPAs as on March 31, 20XX as assessed by Reserve Bank of India	
9	Divergence in provisioning (8-7)	
10	Reported Profit before Provisions and Contingencies for the year ended March 31, 20XX	
11	Reported Net Profit after Tax (PAT) for the year ended March 31, 20XX	
12	Adjusted (notional) Net Profit after Tax (PAT) for the year ended March 31, 20XX after considering the divergence in provisioning	

** March 31, 20XX is the close of the reference period in respect of which divergences were assessed.*

1.6 Disclosure of transfer of loan exposures

Banks as lenders should disclose the total amount loans that are not default, the stressed loans transferred and acquired from /to the entities in RBI prescribed format given below.

Details of stressed loans transferred during the year (to be made separately for loans classified as NPA and SMA)			
(all amounts in Rs. crore)	**To ARCs**	**To permitted transferees**	**To other transferees (please specify)**
No. of accounts			
Aggregate principal outstanding of loans transferred			
Weighted average residual tenor of the loans transferred			
Net book value of loans transferred (at the time of transfer)			
Aggregate consideration			
Additional consideration realized in respect of accounts transferred in earlier years			

Details of loans acquired during the year		
(all amounts in Rs. crore)	**From SCBs, RRBs, Co-operative Banks, AIFIs, SFBs and NBFCs including Housing Finance Companies (HFCs)**	**From ARCs**
Aggregate principal outstanding of loans acquired		

Aggregate consideration paid		
Weighted average residual tenor of loans acquired		

1.7 Fraud accounts

Banks are required to disclose the number and amount of frauds as well as the provisions made in given format.

	Current Year	Previous Year
Number of frauds reported		
Amount involved in fraud (Rs. crore)		
Amount of provision made for such frauds (Rs. crore)		
Amount of Unamortised provision debited from 'other reserves' as at the end of the year (Rs. crore)		

1.8 Disclosure under Resolution Framework for COVID-19-related Stress

Format for disclosures to be made half yearly starting September 30, 2021 (Amounts in Rs. crore)

Type of borrower	Exposure to accounts classified as Standard consequent to implementation of resolution plan– Position as at the end of the previous half-year (A)	Of (A), aggregate debt that slipped into NPA during the half-year	Of (A) amount written off during the half-year	Of (A) amount paid by the borrowers during the half- year	Exposure to accounts classified as Standard consequent to implementation of resolution plan – Position as at the end of this half-year
Personal Loans					
Corporate persons					
Of which MSMEs					
Others					
Total					

2. Movement of Provisions for Depreciation and Investment Fluctuation Reserve

Under the disclosure of Investments, one of the subcategory requires banks to disclose all details related to the depreciation and fluctuation reserve in the format given below.

Particulars	Current Year	Previous Year
Movement of provisions held towards depreciation on investments: a) Opening balance b) Add: Provisions made during the year c) Less: Write off / write back of excess provisions during the year d) Closing balance		

Movement of Investment Fluctuation Reserve : a) Opening balance b) Add: Amount transferred during the year c) Less: Drawdown d) Closing balance		
Closing balance in IFR as a percentage of closing balance of investments13 in AFS and HFT/Current category		

Quantitative disclosures (The quantitative disclosures should only cover Whole Time Directors/ Chief Executive Officer/ Material Risk Takers)	g	Number of meetings held by the Nomination and Remuneration Committee during the financial year and remuneration paid to its members.		
	h	(i) Number of employees having received a variable remuneration award during the financial year. (ii) Number and total amount of sign-on/joining bonus made during the financial year. (iii) Details of severance pay, in addition to accrued benefits, if any.		
	i	(i) Total amount of outstanding deferred remuneration, split into cash, shares and share linked instruments and other forms. (ii) Total amount of deferred remuneration paid out in the financial year.		
	j	Breakdown of amount of remuneration awards for the financial year to show fixed and variable, deferred and non-deferred.		
	k	(i) Total amount of outstanding deferred remuneration and retained remuneration exposed to ex post explicit and / or implicit adjustments. (ii) Total amount of reductions during the financial year due to ex post explicit adjustments. (iii) Total amount of reductions during the financial year due to ex post implicit adjustments.		
	l	Number of MRTs identified.		
	m	(i) Number of cases where malus has been exercised. (ii) Number of cases where clawback has been exercised. (iii) Number of cases where both malus and clawback have been exercised.		
General Quantitative Disclosure	n	The mean pay for the bank as a whole (excluding sub-staff) and the deviation of the pay of each of its WTDs from the mean pay.		

3. Disclosures on Remuneration (Applicable to Banking Companies, including Foreign Banks operating in India):

Remuneration of Whole Time Directors/ Chief Executive Officers/ Material Risk Takers is required to be disclosed at least once annually in the given format mentioning the current as well as previous year figures. In addition to this the private and foreign banks are also required to disclose additional information as per the requirements of the Circular. The details of such disclosure are as under.

Type of disclosure		**Information**
Qualitative	A	Information relating to the composition and mandate of the Nomination and Remuneration Committee.
	B	Information relating to the design and structure of remuneration processes and the key features and objectives of remuneration policy.
	C	Description of the ways in which current and future risks are taken into account in the remuneration processes. It should include the nature and type of the key measures used to take account of these risks
	D	Description of the ways in which the bank seeks to link performance during a performance measurement period with levels of remuneration
	E	A discussion of the bank's policy on deferral and vesting of variable remuneration and a discussion of the bank's policy and criteria for adjusting deferred remuneration before vesting and after vesting.
	F	Description of the different forms of variable remuneration (i.e., cash and types of share-linked instruments) that the bank utilizes and the rationale for using these different forms.

Private sector banks also need to disclose remuneration paid to the non-executive directors annually.

4. Asset Liability Management

Under asset and liability management the banks are required to disclose the maturity pattern of their assets and liabilities, liquidity positions and Net Stable Funding Ratios.

4.1 Maturity pattern of certain items of assets and liabilities

	Day 1	2 to 7 days	8 to 14 days	15 to 30 Day	31 days to 2 months	Over 2 months and to 3 months	Over 3 months and up to 6 Months	Over 6 months and up to 1 year	Over 1 year and up to 3 years	Over 3 years and up to 5 years	Over 5 years	**Total**
Deposits												
Advances												
Investments												
Borrowings												
Foreign Currency assets												
Foreign Currency liabilities												

4.2 Liquidity Coverage Ratio (LCR)

Liquidity Coverage Ratio (LCR) standard represents an unencumbered High Quality Liquid Assets (HQLAs) that can be converted into cash to meet its liquidity needs for a 30 calendar day time horizon under significantly severe liquidity stress scenario.

$$\textbf{LCR} = \frac{\textbf{(Stock of high-quality liquid assets (HQLAs)}}{\textbf{(Total net cash outflow over the next 30 calendar days)}}$$

Liquid assets comprise of high-quality assets that can be readily encashed or used as collateral to obtain cash in a range of stress scenarios. - There are two categories of assets included in the stock of HQLAs, viz. Level 1 and Level 2 assets. While Level 1 assets are with 0% haircut, Level 2A and Level 2 B assets are with 15% and 50% haircuts respectively. The total net cash outflow is the total expected cash outflows minus total expected cash inflows for the subsequent 30 calendar days. Total expected cash outflows are calculated by multiplying the outstanding balances of various categories or types of liabilities and off-balance sheet commitments by the rates at which they are expected to run off or be drawn down.

		Quarter ended (Similarly, there will be column of each of the four quarters)	
		Total Un-weighted Value (average)	**Total Weighted Value (average)**
High Quality Liquid Assets			
1	Total High-Quality Liquid Assets (HQLA)		
Cash Outflows			
2	Retail deposits and deposits from small business customers, of which:		
i)	Stable deposits		
ii)	Less stable deposits		
3	Unsecured wholesale funding, of which:		
i)	Operational deposits (all counterparties)		
ii)	Non-operational deposits (all counterparties)		
iii)	Unsecured debt		
4	Secured wholesale funding		
5	Additional requirements, of which		
i)	Outflows related to derivative exposures and other collateral requirements		
ii)	Outflows related to loss of funding on debt products		
iii)	Credit and liquidity facilities		
6	Other contractual funding obligations		
7	Other contingent funding obligations		
8	**Total Cash Outflows**		
Cash Inflows			
9	Secured lending (e.g. reverse repos)		
10	Inflows from fully performing exposures		

11	Other cash inflows		
12	**Total Cash Inflows**		
		Total Adjusted Value	
13	Total HQLA		
14	Total Net Cash Outflows		
15	Liquidity Coverage Ratio (%)		

1. Un-weighted values shall be calculated as outstanding balances maturing or callable within 30 days (for inflows and outflows) except where otherwise mentioned in the circular and LCR template.

2. Weighted values shall be calculated after the application of respective haircuts (for HQLA) or inflow and outflow rates (for inflows and outflows)

3. Adjusted values shall be calculated after the application of both

(i) Haircuts and inflow and outflow rates and

(ii) Any applicable caps (i.e. cap on Level 2B and Level 2 assets for HQLA and cap on inflows).

Under liquidity Coverage ratio (LCR) banks also need to provide sufficient discussion significant to LCR for proper understanding, such as

a) The main drivers of their LCR results and the evolution of the contribution of inputs to the LCR's calculation over time; `

b) Intra period changes as well as changes over time; c) the composition of HQLA; d) concentration of funding sources;

e) Derivative exposures and potential collateral calls;

f) Currency mismatch in the LCR;

g) A description of the degree of centralization of liquidity management and interaction between the group's units; and other inflows and outflows in the LCR calculation that are not captured in the LCR common template but which the institution considers to be relevant for its liquidity profile.

4.3 Net Stable Funding Ratio (NSFR)

Net Stable Funding Ratio (NSFR) guidelines ensure reduction in funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress. The NSFR is defined as the amount of Available Stable Funding relative to the amount of Required Stable Funding.

$$\textbf{NSFR} = \frac{\textbf{Available Stable Funding (ASF)}}{\textbf{Required Stable Funding (RSF)}} \geq \textbf{100\%}$$

Commercial banks are required to disclose their NSFR data quarterly or semiannually in the given format.

NSFR Disclosure Template						
(Rs. in Crore)		**Un-weighted value by residual maturity**				**Weighted value**
		No maturity	**< 6 months**	**6 months to < 1yr**	**≥ 1yr**	
ASF Item						
1	Capital: (2+3)					
2	Regulatory capital					
3	Other capital instruments					
4	Retail deposits and deposits from small business customers: (5+6)					
5	Stable deposits					

6	Less stable deposits					
7	Wholesale funding: (8+9)					
8	Operational deposits					
9	Other wholesale funding					
10	Other liabilities: (11+12)					
11	NSFR derivative liabilities					
12	All other liabilities and equity not included in the above categories					
13	**Total ASF (1+4+7+10)**					
RSF Item						
14	Total NSFR high-quality liquid assets (HQLA)					
15	Deposits held at other financial institutions for operational purposes					
16	Performing loans and securities: (17+18+19+21+23)					
17	Performing loans to financial institutions secured by Level 1 HQLA					
18	Performing loans to financial institutions secured by non-Level 1 HQLA and unsecured performing loans to financial institutions					
19	Performing loans to nonfinancial corporate clients, loans to retail and small business customers, and loans to sovereigns, central banks, and PSEs, of which:					
20	With a risk weight of less than or equal to 35% under the Basel II Standardised Approach for credit risk					
21	Performing residential mortgages, of which:					
22	With a risk weight of less than or equal to 35% under the Basel II Standardised Approach for credit risk					
23	Securities that are not in default and do not qualify as HQLA, including exchange traded equities					
24	Other assets: (sum of rows 25 to 29)					
25	Physical traded commodities, including gold					
26	Assets posted as initial margin for derivative contracts and contributions to default funds of CCPs					

27	NSFR derivative assets					
28	NSFR derivative liabilities before deduction of variation margin posted					
29	All other assets not included in the above categories					
30	Off-balance sheet items					
31	Total RSF (14+15+16+24+30)					
32	Net Stable Funding Ratio (%)					

** Items to be reported in the 'no maturity' time bucket do not have a stated maturity. These may include, but are not limited to, items such as capital with perpetual maturity, non-maturity deposits, short positions, open maturity positions, non-HQLA equities, and physical traded commodities.*

5. Concentration of Deposits, Advances, Exposures and NPAs

This major head contains the separate disclosures under deposits, advances, exposures and NPAs in tabular format.

5.1 Concentration of deposits (Amount in Rs. crore)

Particulars	**Current year**	**Previous Year**
Total deposits of the twenty largest depositors		
Percentage of deposits of twenty largest depositors to total deposits of the bank		

5.2 Concentration of advances (Amount in Rs. crore)

Particulars	**Current year**	**Previous Year**
Total advances to the twenty largest borrowers		
Percentage of advances to twenty largest borrowers to total advances of the bank		

**Advances shall be computed based on credit exposure i.e. funded and non-funded limits including derivative exposures where applicable. The sanctioned limits or outstanding, whichever are higher, shall be reckoned. However, in the case of fully drawn term loans, where there is no scope for re-drawal of any portion of the sanctioned limit, banks may reckon the outstanding as the credit exposure.*

5.3 Concentration of exposures (Amount in Rs. crore)

Particulars	**Current year**	**Previous Year**
Total exposure to the twenty largest borrowers/customers		
Percentage of exposures to the twenty largest borrowers/ customers to the total exposure of the bank on borrowers/ customers		

5.4 Concentration of NPAs

(Amount in Rs. crore)

Particulars	Current year	Previous Year
Total Exposure to the top twenty NPA accounts		
Percentage of exposures to the twenty largest NPA exposures to total Gross NPAs.		

6. Exposures

RBI guideline requires disclosure of exposures in sensitive sectors. It also requires disclosure of intra-group exposures. The sensitive sectors that are covered are Exposure to Real Estate, Exposure to Capital Market, Risk Category-wise Country exposure, Unsecured Advances, Factoring exposures, Un-hedged foreign currency exposure, Exposure of RCBs, Intra-group exposures. The formats of disclosure of few such exposures are detailed below:

6.1 Exposure to Real Estate Sector

(Amount in Rs. crore)

Sr. No.	Category	Current year	Previous Year
1	**Direct exposure**		
A.	Residential Mortgages – Lending fully secured by mortgages on residential property that is or will be occupied by the borrower or that is rented. Individual housing loans eligible for inclusion in priority sector advances shall be shown separately. Exposure would also include non-fund based (NFB) limits.		
B.	Commercial Real Estate – Lending secured by mortgages on commercial real estate (office buildings, retail space, multipurpose commercial premises, multifamily residential buildings, multi tenanted commercial premises, industrial or warehouse space, hotels, land acquisition, development and construction, etc.). Exposure would also include non-fund based (NFB) limits;		
C.	Investments in Mortgage-Backed Securities (MBS) and other securitized exposures – i) Residential ii) Commercial Real Estate		
2	**Indirect Exposure**		
	Fund based and non-fund-based exposures on National Housing Bank and Housing Finance Companies.		
Total Exposure to Real Estate Sector			

6.2 Exposure to Capital Market (Amount in Rs. crore)

Sr. no.	Particulars	Current Year	Previous Year
1	Direct investment in equity shares, convertible bonds, convertible debentures and units of equity oriented mutual funds the corpus of which is not exclusively invested in corporate debt;		
2	Advances against shares / bonds / debentures or other securities or on clean basis to individuals for investment in shares (including IPOs / ESOPs), convertible bonds, convertible debentures, and units of equity oriented mutual funds;		
3	Advances for any other purposes where shares or convertible bonds or convertible debentures or units of equity oriented mutual funds are taken as primary security;		
4	Advances for any other purposes to the extent secured by the collateral security of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds i.e. where the primary security other than shares / convertible bonds / convertible debentures / units of equity oriented mutual funds does not fully cover the advances;		
5	Secured and unsecured advances to stockbrokers and guarantees issued on behalf of stockbrokers and market makers;		
6	Loans sanctioned to Corporates against the security of shares / bonds / debentures or other securities or on clean basis for meeting promoter's contribution to the equity of new companies in anticipation of raising resources;		
7	Bridge loans to companies against expected equity flows / issues;		
8	Underwriting commitments taken up by the banks in respect of primary issue of shares or convertible bonds or convertible debentures or units of equity oriented mutual funds;		
9	Financing to stockbrokers for margin trading;		
10	All exposures to Venture Capital Funds (both registered and unregistered).		
Total exposure to capital market			
Note: For restructuring of dues in respect of listed companies, lenders may be ab initio compensated for their loss / sacrifice (diminution in fair value of account in net present value terms) by way of issuance of equities of the company upfront, subject to the extant regulations and statutory requirements. If such acquisition of equity shares results in exceeding the extant regulatory Capital Market Exposure (CME) limit, the same shall be disclosed in the 'Notes to Accounts' in the Annual Financial Statements. Banks shall separately disclose details of conversion of debt into equity as part of a strategic debt restructuring which are exempt from CME limits.			

6.3 Intra-group exposures (not applicable to Co-operative Banks)

Commercial Banks shall make the following disclosures for the current year with comparatives for the previous year:

i) Total amount of intra-group exposures

ii) Total amount of top 20 intra-group exposures

iii) Percentage of intra-group exposures to total exposure of the bank on borrowers/customers

iv) Details of breach of limits on intra-group exposures and regulatory action thereon, if any.

7. Disclosure on amortisation of expenditure on account of enhancement in family pension of employees of banks

It is applicable for all the banks covered under the 11th Bipartite Settlement and Joint Note dated November 11, 2020. It includes disclosure of the liability for enhancement of family pension. The expenditure not charged to P/L account will require to be amortised in next five years and the same is required to be disclosed. The amount of the unamortised expenditure and the resulting net profit after charging it to the P/L account needs to be disclosed properly under this section.

8. Off balance sheet SPVs sponsored (which are required to be consolidated as per accounting norms)

Both domestic and overseas sponsored SPVs are disclosed in this section in tabular format.

Name of the SPV sponsored	
Domestic	Overseas

9. Disclosure of Complaints

Complain disclosure contains details of the number of complaints received, pending, rejected, resolved as well as the ground for those complaints. These are disclosed in prescribed format under two subcategories given below.

9.1 Summary information on complaints received by the bank from customers and from the Offices of Ombudsman

Sr. no.	Particulars	Previous year	Current year
Complaints received by the bank from its customers			
1	Number of complaints pending at beginning of the year		
2	Number of complaints received during the year		
3	Number of complaints disposed during the year		
3.1	Of which, number of complaints rejected by the bank		
Maintainable complaints received by the bank from Office of Ombudsman			
4	Number of maintainable complaints received by the bank from Office of Ombudsman		
5	Number of maintainable complaints received by the bank from Office of Ombudsman		

5.1	Of 5, number of complaints resolved in favour of the bank by Office of Ombudsman		
5.2	Of 5, number of complaints resolved through conciliation/mediation/ advisories issued by Office of Ombudsman		
5.3	Of 5, number of complaints resolved after passing of Awards by Office of Ombudsman against the bank		
6	Number of Awards unimplemented within the stipulated time (other than those appealed)		
Note: Maintainable complaints refer to complaints on the grounds specifically mentioned in Integrated Ombudsman Scheme, 2021 (Previously Banking Ombudsman Scheme, 2006) and covered within the ambit of the Scheme.			

9.2 Top five grounds of complaints received by the bank from customers

Grounds of complaints, (i.e. complaints relating to)	**Number of complaints pending at the beginning of the year**	**Number of complaints received during the year**	**% increase/ decrease in the number of complaints received over the previous year**	**Number of complaints pending at the end of the year**	**Of 5, number of complaints pending beyond 30 days**
1	**2**	**3**	**4**	**5**	**6**
Current Year					
Ground 1					
Ground 2					
Ground 3					
Ground 4					
Ground 5					
Others					
Total					
Previous Year					
Ground 1					
Ground 2					
Ground 3					
Ground 4					
Ground 5					
Others					
Total					

10. Disclosures Relating to Securitisation

It is applicable to all Scheduled Commercial Banks (SCBs), Small SFBs but excluding RRBs. Requirement of disclosures relating to securitisation are originally specified in Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021. In case of any conflict between these Directions and Reserve Bank of India (Securitisation of Standard Assets) Directions, 2021, 2021 on disclosure requirements, the latter will prevail. The format for this disclosure is given below:

(Number/ Amounts in Rs. crore)

Sr. no.	Particulars	Mar 31 (Current Year)	Mar 31 (Previous Year)
1	No of SPEs holding assets for securitisation transactions originated by the originator (only the SPVs relating to outstanding securitization exposures to be reported here)		
2	Total amount of securitised assets as per books of the SPEs		
3	Total amount of exposures retained by the originator to comply with MRR as on the date of balance sheet		
3.1	Off-balance sheet exposures ● First loss ● Others		
3.2	On-balance sheet exposures ● First loss ● Others		
4	Amount of exposures to securitisation transactions other than MRR		
4.1	Off-balance sheet exposures i) Exposure to own securitisations ● First loss ● Others ii) Exposure to third party securitisations ● First loss ● Others		
4.2	On-balance sheet exposures i) Exposure to own securitisations ● First loss ● Others ii) Exposure to third party securitisations ● First loss ● Others		
5	Sale consideration received for the securitised assets and gain/loss on sale on account of securitisation		
6	Form and quantum (outstanding value) of services provided by way of, liquidity support, post-securitisation asset servicing, etc.		
7	Performance of facility provided. Please provide separately for each facility viz. Credit enhancement, liquidity support, servicing agent etc. Mention percent in bracket as of total value of facility provided		

	(a) Amount paid		
	(b) Repayment received		
	(c) Outstanding amount		
8	Average default rate of portfolios observed in the past. Please provide breakup separately for each asset class i.e. RMBS, Vehicle Loans etc.		(may mention average default rate of previous 5 years)
9	Amount and number of additional/top up loan given on same underlying asset. Please provide breakup separately for each asset class i.e. RMBS, Vehicle Loans, etc.		
10	Investor complaints		
	(a) Directly/Indirectly received and		
	(b) Complaints outstanding		

DISCLOSURES REQUIRED UNDER BASEL NORMS

In terms of Guidelines on Composition of Capital Disclosure Requirements issued vide circular DBOD. No. BP. BC.98/21.06.201/2012-13 dated May 28, 2013, Pillar 3 disclosures as introduced under Basel III have become effective from July 1, 2013. The first set of disclosures as required by these guidelines was to be made by banks as on September 30, 2013 (with the exception of the Post March 31, 2017 template.). It may be noted latest Master Circular dt. April 1, 2022 consolidates all previous circulars in this regard (DOR.CAP.REC.3/21.06.201/2022-23). Ensuring comparability of the capital adequacy of banks across jurisdictions is an important objective. Hence, it is important to disclose details of items of regulatory capital and various regulatory adjustments to it. Further, to improve consistency and ease of use of disclosures relating to the composition of capital and to mitigate the risk of inconsistent reporting format undermining the objective of enhanced disclosures, banks across Basel member jurisdictions are required to publish their capital positions according to common templates. Annexure 18 to the Master Circular provides all such templates of disclosure. Furthermore, banks are responsible for conveying their actual risk profile to market participants. The information banks disclose must be adequate to fulfill this objective.

Scope and Frequency of Disclosures

1. Pillar III applies at the top consolidated level of the banking group to which the Capital Adequacy Framework applies. Disclosures related to individual banks within the groups would not generally be required to be made by the parent bank. An exception to this arises in the disclosure of capital ratios by the top consolidated entity where an analysis of significant bank subsidiaries within the group is appropriate, in order to recognise the need for these subsidiaries to comply with the Framework and other applicable.

   limitations on the transfer of funds or capital within the group. Pillar III disclosures will be required to be made by the individual banks on a stand-alone basis when they are not the top consolidated entity in the banking group.

2. Banks are required to make Pillar III disclosures at least on a half yearly basis, irrespective of whether financial statements are audited, with the exception of following disclosures: (i) Capital Adequacy; (ii) Credit Risk: General Disclosures for All Banks; and (iii) Credit Risk: Disclosures for Portfolios Subject to the Standardised Approach. The disclosures as indicated at (i), (ii) and (iii) above will be made at least on a quarterly basis by banks.

All disclosures must either be included in a bank's published financial results / statements or, at a minimum, must be disclosed on bank's website. If a bank finds it operationally inconvenient to make these disclosures along with published financial results / statements, the bank must provide in these financial results / statements, a direct link to where the Pillar III disclosures can be found on the bank's website. The Pillar III disclosures should be made concurrent with publication of financial results / statements. That is to say Pillar III disclosures are required to be made by all banks including those which are not listed on stock exchanges and / or not required to publish financial results / statement. Therefore, such banks are also required to make Pillar III disclosures at least on their websites within reasonable period.

Banks are required to update these disclosures concurrently whenever a new capital instrument is issued and included in capital or whenever there is a redemption, conversion / write-down or other material change in the nature of an existing capital instrument.

Banks have to maintain a 'Regulatory Disclosures Section' on their websites, where all the information relating to disclosures will be made available to the market participants. The direct link to this page should be prominently provided on the home page of a bank's website and it should be easily accessible. This requirement is essentially to ensure that the relevance / benefit of Pillar III disclosures is not diminished by the challenge of finding the disclosure in the first place. An archive for at least three years of all templates relating to prior reporting periods should be made available by banks on their websites.

In addition to the specific disclosure requirements as set out in the guidelines, banks operating in India should also make additional disclosures in the following areas:

(i) Securitisation exposures in the trading book;

(ii) Sponsorship of off-balance sheet vehicles;

(iii) Valuation with regard to securitisation exposures; and

(iv) Pipeline and warehousing risks with regard to securitisation exposures.

In addition to the disclosure requirements set out in above paragraphs, banks are required to make the following disclosure in respect of the composition of capital:

(i) Full Terms and Conditions: banks are required to make available on their web sites the full terms and conditions of all instruments included in regulatory capital. The requirement for banks to make available the full terms and conditions of instruments on their websites will allow supervisors and market participants to investigate the specific features of individual capital instruments.

(ii) Banks are required to keep the terms and conditions of all capital instruments up-to-date Whenever there is a change in the terms and conditions of a capital instrument, banks should update them promptly and make publicly available such updated disclosure.

BANKS LISTED ON STOCK EXCHANGES

Banks which have been listed in stock exchanges in India and abroad have to comply with terms of listing agreement/ stock exchange rules under which they are listed including reporting and other compliances in a timely manner failing which they would face penal action including fines. As per the extant regulatory framework applicable to companies listed in Indian stock exchanges, certain disclosures are mandatory in terms of the provisions of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.

Important Ratios for Evaluation of Performance of Banks

The performance is evaluated by shareholders and Reserve Bank of India, with following important ratios.

- *Capital Adequacy Ratio (CAR)* - It is calculated as ratio of capital funds to risk weighted assets. Capital funds include Tier I capital and Tier II capital. The risk weightage has been assigned by RBI to various assets that range from 0% to 125% and may be more. The ratio indicates strength of the bank to meet unexpected losses.

- *Net NPAs to net advances ratio* - it indicates the quality of financial assets created by the bank. Lower ratio indicates better quality of advances and investments. A higher ratio is a cause for worry as it affects profit position in two ways - one non-recognition of interest income and provisions against gross NPAs.
- *Return on assets* - the ratio is calculated as net profit as percentage of average assets. It indicates efficiency of use of assets for generation of profits. With increase in assets the return on assets should increase. This ensures long time solvency of a bank.
- *Net Interest Margin (NIM)* - It is a ratio indicating average interest earning. It is calculated by dividing net interest income by average interest earning assets.
- *Cost Income Ratio (Efficiency Ratio)* - This ratio indicates charge of non-interest expenses on net total income. It is calculated by using the formula: **Non interest expenditure / Net Total Income * 100.**

Some terms used in Analysis of Bank Performance.

- Cash coverage ratio - (Cash divided by total business liabilities x 100). An upward trend indicates presence of more of idle investments.
- Total business growth ratio - (business of the year divided by previous year business). Increasing trend is desirable.
- Productivity indicators - (per employee Deposits / Advances / Profits) increasing trend shows improving productivity.
- Business - (Aggregate Deposits plus aggregate advances), Increasing trend is healthy, shows growth.
- Interest income - the sum total of discount, interest from loans, advances, investments and balances with other banks.
- Non-interest income - other income of the bank and includes commission, brokerage, gains on sales and revaluation of investments and fixed assets, profits from exchange transactions etc.
- Interest spread - excess of total interest earned over total interest paid. It has strong influence on bank's bottom line.
- Working funds - they are total resources - total liabilities or total assets.

LESSON ROUND-UP

- A Banking Company has to prepare Financial Statements in the specified formats under Banking Regulation Act. These statements are required to be prepared in accordance with specific guidelines issued by RBI and other authorities from the books of account maintained by banks, in which transactions are accounted. In doing so banks have to comply with standard practices/procedures prescribed.
- Banks have to maintain a 'Regulatory Disclosures Section' on their websites, where all the information relating to disclosures will be made available to the market participants.
- Banks which have been listed in stock exchanges in India and abroad have to comply with terms of listing agreement/stock exchange rules under which they are listed including reporting and other compliances in a timely manner failing which they would face penal action including fines.
- Disclosures related to individual banks within the groups would not generally be required to be made by the parent bank.

GLOSSARY

Ledgers : A ledger is a book containing accounts in which the classified and summarized information from the journals is posted as debits and credits.

Registers : The word "register" can convey many different meanings, in the finance industry, it usually refers to the process of inputting information into a record, or an official list, that creates a document of various useful data in an organized fashion.

General Ledger : A general ledger, or GL, is a means for keeping record of a company's total financial accounts. Accounts typically recorded in a general ledger include: assets, liabilities, equity, expenses, and income or revenue.

Revenue Reserves: Revenue reserve is created from the net profit generated from the company's core operations.

Divergence : Divergence is when the price of an asset is moving in the opposite direction of a technical indicator, such as an oscillator, or is moving contrary to other data. Divergence warns that the current price trend may be weakening, and in some cases may lead to the price changing direction.

Basel III: Basel III is a 2009 international regulatory accord that introduced a set of reforms designed to mitigate risk within the international banking sector, by requiring banks to maintain proper leverage ratios and keep certain levels of reserve capital on hand.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. What are financial statements banking companies are required to compile and present?
2. Mention the principal books account and subsidiary books of account a banking company is required to keep?
3. What are the contra entries passed by banks? Mention particulars of the some entries with examples.
4. Mention at least five of the disclosures to be made by banks.
5. What are the significant accounting policies to be followed by banks? Write briefly about the same.
6. Mention the Accounting Standards on which RBI Direction provides specific guidance. Write briefly about the guidance provided on application of Accounting Standard 5.

LIST OF FURTHER READINGS

- RBI Master circulars.
- Guidance note on Audit of Banks by ICAI.
- Stodging- Balance Sheet of Banks.
- The Banking Regulation Act, 1949.

Risk Management in Banks and Basel Accords

Lesson 13

KEY CONCEPTS

■ Liquidity Risk, ■ Market Risk ■ Basel Accords ■ Countercyclical Buffer ■ Capital Conservation ■ Liquidity Coverage Ratio ■ Net Stable Funding Ratio ■ Liquidity Coverage Ratio ■ RBIA

Learning Objectives

To understand:

- The concept of risk in Banking Industry
- The various types of Risks that impact the Banking Industry
- Analyse and study Management and Mitigation of Risks
- The about BASEL Norms

Lesson Outline

- Introduction to Risk Management
- Types of Risks in Banking Sector Reporting of Banking Risk
- Risk Adjusted Performance Evaluation
- Basel- I, II & III Accords
- Risk Weighted Assets
- Role of RBI in Risk Management in bank
- Risk Based Internal Audit in Banks (RBIA)
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Further Readings
- List of Other References

REGULATORY FRAMEWORK

- Banking Regulation Act, 1949

INTRODUCTION

In the assets' portfolio of a bank, the investments of banks have significant impact after the funds involved in loans and advances. The returns on investments are comparatively lower than the returns on loans and advances.

Every organization faces risks in their operations. Banking organizations too are prone to risks which need to be managed. Banks being financial sector organizations face risks - some originate within the organization and some outside the organization. If these risks are not properly managed, they have potential to destabilize not only a particular bank, but can create a system wide chaos. To manage these risks regulatory bodies have given directions and guidelines which need to be followed and implemented as applicable in the respective cases of each bank.

A student of banking therefore requires to be fully acquainted of this aspect of banking so that he/she remains knowledgeable so as to safeguard the interests of the organization and its customers should he choose to join banking later. Keeping this objective in mind the chapter covers areas of risks a bank faces and methods, tools to handle the same as per prescriptions of regulatory authorities including Basel norms. In view of its importance risk management has become a field of specialization for many professionals giving them a career path.

RISK MANAGEMENT

The Banking sector has a very important role in the development of an economy of any country. As one of the key drivers of economic growth of a country, banking sector plays a pivotal role in making use of idle funds for nation building. The foundation of a strong economy depends on how strong the Banking sector is and vice versa.

Banking is always considered to be a very risky business. In the context of Banking, 'Risk' can be defined as the potential loss from a banking transaction - in the form of a loan, or investment in securities or any other transaction that a bank undertakes for itself or for its customer. Banks are exposed to both, financial (e.g., monetary loss) as well as non-financial (e.g., reputation loss) risks. Basic function of any bank is to accept funds from public for the purpose of lending and investment. In case something goes wrong, banks can collapse and 'failure of one bank is sufficient to send shock waves right through the economy.' It is imperative that bank managements must be very careful in identifying the types as well as the degrees of risk exposure and mitigate them positively. Therefore, banks must recognise risk management as an ongoing and unavoidable activity with the active participation of the Board of Directors.

In economic / financial / business activities risk is directly proportional to returns, higher the risk a bank takes, it can expect to gain more profits. However, greater risk also increases the danger that the bank may incur big losses and can be out of the business and perhaps out of existence. In fact, today, a bank must run its operations with twin objectives in mind - generate profit and stay in business. However, banks must ensure that their risk taking decisions are measured, informed and prudent.

SOME IMPORTANT REQUIREMENTS

The following are some of the salient requirements in respect of risk management in banks:

- A comprehensive Risk Management Policy approved by the Board of Directors should be in place.
- A Training/Learning set up to inculcate and sensitize the risk management culture in the organization on an ongoing basis.
- Information Technology department should be fully geared up for generating Management Information System ('MIS'). MIS plays a vital role in mitigation of risk.
- Strong internal control systems should be in place. Audit department of a Bank plays a significant role in this.

Stages of Risk Management

1. Risk Identification

This is the first and the most important stage of risk management. The process starts with identifying the risks. Risk identification originates from where the problem starts. Risk identification can be objective based, scenario based, taxonomy based and common risk checking based. It will help the bank or any organization to take the corrective measures.

2. Risk Analysis (Risk measurement or quantification)

It includes analysing the risk and measuring its vulnerability and impact on the organisation. Frequency and severity of the risk can be analysed as well in this stage. Risk management can be both quantitative as well as qualitative. Numerically determining the probabilities of various adverse events and expected extent of losses if any unexpected event occurs, is termed as Quantitative Analysis whereas defining the various threats, devising counter-measures for mitigation and determining the extent of vulnerabilities is known as Qualitative Risk Analysis.

3. Risk Control (Risk mitigation)

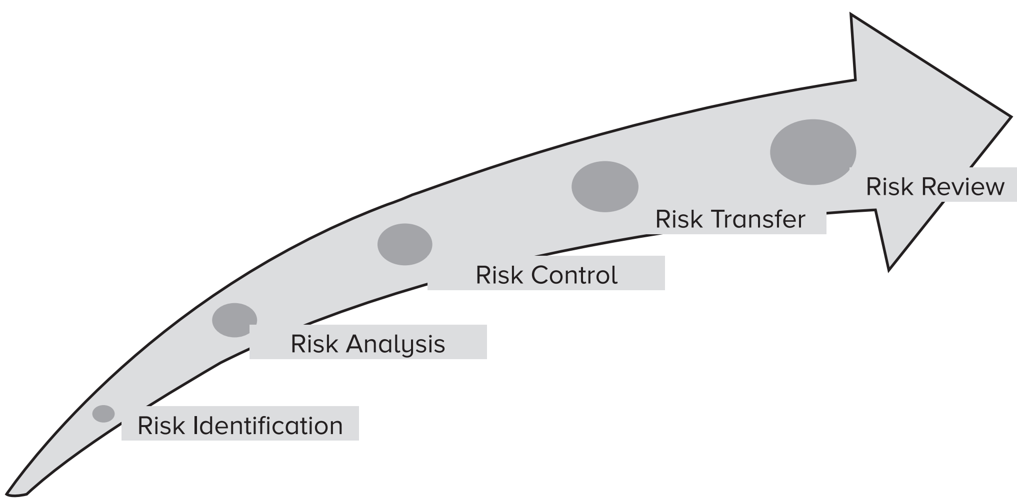
Only after properly analyzing the risk, a bank can decide as to how it can be controlled. If the risk can be controlled by in house efforts it is well and good; it can also seek professional help from outside. Risk control is the entire process of procedures, systems, policies an organization needs to manage prudently all risks which may arise.

4. Risk Transfer

If the risk is not manageable, one cannot retain that risk; then we have to transfer that risk to a third party. This is the stage where insurance comes in to play. Insurance will be willing to take on those risks which the organization can't handle. But it should also be understood that insurance alone is not a solution or a panacea for all risks.

5. Risk Review (Risk monitoring)

Risk review is the last stage in which all the foregoing steps are evaluated. Review must be regular and on a continuous basis, as conditions and circumstances of the business as well as organizations are dynamic. It should be monitored to see that the desired results of risk management are achieved. If not, then identifying as to where the problem occurred and subsequently reviewing all stages and making changes in the management of risk according to the scenario.



Types of Risks

Risks can be basically classified in to two types, viz., Financial and Non-Financial Risk. Financial risks would involve all those aspects which deal mainly with financial aspects of the bank.

- **Credit Risk:** It is also called as a default risk (borrower not meeting his obligations to pay instalments and or interest). It is prevalent in case of loans. A credit risk is the risk of default on a debt that may arise from inability of a borrower to make required payments as per commitments. In the first resort, the risk is that of the lender and includes lost principal and interest, disruption to cash flows, and increased collection costs. The loss may be complete or partial. In an efficient market, higher levels of credit risk will be associated with higher borrowing costs. Because of this, measures of borrowing costs such as yield spreads can be used to infer credit risk levels based on assessments by market participants.
- **Market Risk:** It is also called price risk. Market risk is the possibility of an investor experiencing losses due to external factors that affect the overall performance of financial markets in which he or she is involved. Market risk, also called "systematic risk," cannot be eliminated through diversification, though it can be hedged against. Sources of market risk include recessions, political turmoil, changes in interest rates, natural disasters and terrorist attacks. The 2008 sub-prime crisis of US is an example in this regard. The market risk arises due to adverse movement of value of the investments / trading portfolio during the period when the specific securities are held by the bank. The price risk arises when investments are to be sold before their maturity.
- **Interest Rate Risk:** Interest Rate Risk arises when the Net Interest Margin or the Market Value of Equity (MVE) of an institution is affected due to changes in the interest rates. IRR can be viewed in two ways - its impact is on the earnings of the bank or its impact on the economic value of the bank's assets, liabilities and Off-Balance Sheet (OBS) positions. Interest rate Risk can take different forms.
- **Currency Risk:** Currency risk is the risk where the fair value or future cash flows of a given financial instrument fluctuate as a result from changes in the currency exchange rates. Currency exchange rates can be subject to big and unexpected changes, and understanding and managing of the risk related to the currency exchange rates' volatility can be very complicated. Although it is important to acknowledge that currency exchange rates are definitely a market risk factor, the currency instruments' valuation usually requires knowledge about the behaviour of both spot currency exchange rates and interest rates. Each forward premium or value discount of a given foreign currency against the local one is determined to a great extent by the relative interest rates on the two national markets. Like all market risks, the currency risk evolves from both open and improperly balanced or hedged positions. The imperfect correlations between the currencies and the international interest markets put forward concrete challenges to the efficiency of the hedging currency strategies.
- **Operational Risk:** This risk arises due to failed internal processes, people, system, or from external events. It includes number of risks such as - fraud, communication, documentation, competence, legal, compliance etc. However, it will not include strategic risk or reputational risk. Operational risk is "the risk of a change in value caused by the fact that actual losses, incurred for inadequate or failed internal processes, people and systems, or from external events (including legal risk), differ from the expected losses". This definition, adopted by the European Union Solvency II Directive for insurers, is a variation from that adopted in the Basel II regulations for banks. In October 2014, the Basel Committee on Banking Supervision proposed a revision to its operational risk capital framework that sets out a new standardized approach to replace the basic indicator approach and the standardized approach for calculating operational risk capital, it can also include other classes of risk, such as fraud, security, privacy protection, legal risks, physical (e.g. infrastructure shutdown) or environmental risks. The study of operational risk is a broad discipline, close to good management and quality management.

- **Strategic Risk:** Strategic risks are those that arise from the fundamental / adverse decisions that directors take concerning an organisation's objectives / improper implementation of decisions. Essentially, strategic risks are the risks of failing to achieve these business objectives.
- **Reputation Risk:** It arises from negative public opinion about a bank / financial institution. It may lead to litigation, financial loss or decline in customer base.
- **Liquidity Risk:** A bank's inability to meet its payment obligations as and when they are demanded is known as Liquidity risk. Deposits of banks as liabilities and loans / advances as assets of the bank are the prominent items in a bank's balance sheet. Types of deposits held and the interest rates offered on them on the one hand and types of loans and advances sanctioned and interest rates charged on them on the other hand may not match. In view of this liquidity risk is encountered by the banks. It arises when bank funds long term assets by short term liabilities.
- **Political Risk:** Political risk is the risk faced by investors, corporations, and governments due to political decisions of Governments, events, or conditions. This will significantly affect the profitability of a business or the expected value of an economic move. Political risk can be understood and managed with reasoned anticipation and investment.
- **Legal Risk:** Legal risk is the risk of financial or reputational loss that can be caused to an organization from lack of awareness or misunderstanding of, ambiguity in, or reckless indifference to, the way law and regulation apply to a business, its relationships, processes, products and services. Some of the recent examples in the Indian context are - the Auditors of Satyam Infotech Limited had to face legal risk due to a reckless action of its personnel; Nestle India, faced the legal risk due to mislabelling over flavour enhancer MSG in Maggi Noodles produced by them.
- **Other Risks**

  Apart from the above-mentioned risks, following are the other risks confronted by Banks in the course of their business operations -

  - **Strategic Risk:** Strategic Risk is the risk arising from adverse business decisions, improper implementation of decisions or lack of responsiveness to industry changes.
  - **Reputation Risk:** Reputation Risk is the risk arising from negative public opinion. This risk may expose the institution to litigation, financial loss or decline in customer base.
  - **Systematic Risk:** It is a risk inherent to the entire market segment and is not sector specific it is also known as undiversifiable risk.
  - **Unsystematic Risk:** It is kind of specific risk which comes with the industry you invest in also referred to as diversifiable risk.

REPORTING OF BANKING RISK

The frequency of monitoring should reflect the risks involved and the frequency and nature of changes in the operating environment. Monitoring should be an integral part of a bank's activities. The results of these monitoring activities should be included in regular management and Board reports, as should compliance reviews performed by the internal audit and / or risk management functions. Reports generated by (and/or for) intermediate supervisory authorities may also inform the corporate monitoring unit which should likewise be reported internally to senior management and the Board, where appropriate. Senior management should receive regular reports from appropriate areas such as business units, group functions, the operational risk management unit and internal audit.

The operational risk reports should contain internal financial, operational, and compliance data, as well as external market information about events and conditions that are relevant to decision making. Reports should be sent to appropriate levels of management and to areas of the bank on which areas of concern may have an impact. Reports should fully reflect any identified problem areas and should motivate timely corrective action on outstanding issues. To ensure the usefulness and reliability of these risk reports and audit reports, management should regularly verify the timeliness, accuracy, and relevance of reporting systems and internal controls in general. Management may also use reports prepared by external sources (auditors, supervisors) to assess the usefulness and reliability of internal reports. Reports should be analysed with a view to improving existing risk management performance as well as developing new risk management policies, procedures and practices.

BASEL I, II AND III ACCORDS

Basel I

Since late 1970s, internationally several banks had experienced deterioration in their asset quality. More than 75% of IMF member countries were among them. Since assets have a direct linkage with profitability levels, the banking sector stability started suffering. In short credit risk was the trigger of the stability problems of banks. This in turn led to the question of stability and survival of banks. This problem engaged the attention of Bank of International Settlements (BIS) an apex body of Central banks in the world. A series of deliberations led to The Basel Capital Accord in 1988 proposed by Basel Committee of Bank Supervision (BCBS) which is a part of BIS.

The deliberation of BCBS focused on credit risk and prescribed a minimum Capital Risk Adjusted Ratio (CRAR) of 8% of risk weighted assets. Although it was originally meant for banks in G10 countries, it was adopted by more than 100 countries. This accord was known as Basel I, named after the town in Switzerland where BIS is based. As was expected Basel I covered the credit risk and its standards prescribed minimum capital in terms of risk weighted assets. It can be said the focus of Basel I was on capital and risk weighted assets.

India being a member of BIS since its inception, RBI had prescribed capital adequacy norms for the Indian banks in 1992. It was also the year in which NPA norms were introduced in India. Banks were asked to identify their Tier I and Tier-II capital and assign risk weights to the assets followed by an assessment of their Capital to Risk Weighted Assets Ratio (CRAR).

According to Basel 1 norms Capital (known as regulatory capital) is derived as a sum of Tier I and Tier II capital which a bank is required to maintain in relation to its risk-weighted assets. Under both Basel I (also later under Basel II), the regulatory definition of capital is comprised of three levels (or ‘tiers’) of capital. Tier 1 Capital (also called ‘core capital’) has only those elements which have the highest capacity for absorbing losses on an ongoing basis. Tier 2 Capital (also known as ‘supplementary capital’) is made up a mix of near equity components and hybrid capital / debt instruments, the total of which is restricted to 100 per cent of Tier 1 Capital. It is further divided into two categories: (i) Upper Tier 2 consisting of items very close to common equity, like perpetual subordinated debt; (ii) Lower Tier 2 consisting of items close to debt. It also includes various types of reserves whose values and/or availability are more uncertain than disclosed reserves. Tier 3 Capital (or ‘additional supplementary capital’) was added in 1996 and can only be used to meet capital requirements for market risk.

Tier-I Capital of banks in India consisted of

- Paid-up capital
- Statutory Reserves
- Disclosed free reserves
- Capital reserves representing surplus arising out of sale proceeds of assets [Equity investments in subsidiaries, intangible assets and losses in the current period and those brought forward from previous periods will be deducted from Tier I capital].

Elements of Additional Tier-I (AT-I) Capital (after making regulatory adjustments / deductions from total of 1 to 4 below)

1. PNCPS (Perpetual Non-Cumulative Preference Shares) which comply with regulatory requirements.

2. Share premium resulting from issue of instruments.
3. Debt Capital instruments, complying with regulatory requirements.
4. Any other instruments as notified by RBI.

Tier-II Capital

- Undisclosed Reserves and Cumulative Perpetual Preference Shares.
- Revaluation Reserves.
- General Provisions and Loss Reserves.

Risk weighting

Additionally BCBS Committee recommended a weighted risk ratio in which capital is linked with different categories of asset or off-balance-sheet exposure. The weighs were according to perceived broad categories of relative risk of each asset class as the preferred method for assessing the capital adequacy.

The risk weighted approach was chosen over simple gearing ratio approach due to "(i) it provides a fairer basis for making international comparisons between banking systems whose structures may differ; (ii) it allows off-balance-sheet exposures to be incorporated more easily into the measure; (iii) it does not deter banks from holding liquid or other assets which carry low risk."

Advantages and Disadvantages of Basel I norm

Basel 1 norms had their advantages as well as disadvantages. Advantages were discipline in managing capital, level playing field in competition among peer banks and the structure was simple. However, these norms had certain weaknesses also such as it had considered only credit risk/market risks (though there are many other risks a bank faces); market values were ignored in preference to book values; made no differentiation between different classes of debtors among others. These were addressed by an amendment in 1996 and the amended norms were brought for implementation.

The 1988 accord was amended in 1996. Under this frame work BCBS by removing trading positions in bonds, equities, foreign exchange and commodities from the credit risk framework and gave capital charges related to the bank's open position for each. Essentially this introduced the element of market risk as a factor to be considered for arriving at capital adequacy standards. The main purpose was to ensure "more level playing field" by ensuring banks build business volume with adequate capital.

Basel II

In June 2004, BCBS announced a revised frame work of capital adequacy norms titled as "International Convergence of Capital Measurement and Capital Standards: A revised Framework"- commonly known as Basel II Accord. Basel II took cognizance of, Operational Risk apart from Credit & Market Risk in computing Capital Adequacy Ratio.

In essence Basel II accord is based on the following norms. They are known as three Pillars structure as depicted in the following table:

Pillar I	Pillar II	Pillar III
Minimum Regulatory Capital • Credit Risk • Market Risk • Operational Risk	Supervisory Review Process	Market Discipline Pillar

Pillar 1: Minimum Regulatory Capital

The calculation of Minimum Regulatory Capital included operational risk also apart from Credit risk and Market risk. Basel 1 and Basel II differed in Risk Weighted Assets calculation.

Under Basel II, calculation of Capital to Risk (Weighted) Asset Ratio (CRAR), the formulae are similar to Basel 1.

$$\textbf{Total CRAR} = \frac{[\textbf{ Eligible total Captial Funds }]}{[\textbf{ Credit RWA* + Market RWA +Operational RWA }]} \textbf{ X 100}$$

$$\textbf{Tier I CRAR} = \frac{[\textbf{ Eligible Tier I Capital Funds }]}{[\textbf{ Credit RWA* + Market RWA +Operational RWA }]} \textbf{ X 100}$$

BCBS had recommended at least 8% CRAR and 4% for Tier 1 CRAR signifying core capital should be at least 50% of total CRAR. However, in India RBI stipulated a stringent higher level of overall CRAR of 9% and Tier 1 CRAR of 6%.

It can be seen that CRAR is supported by 1. Eligible Capital Funds (Core Capital) 2. Risk Weighted Assets (Additional or Supporting) capital.

The components that formed Tier 1 & Tier 2 capital of banks are as follows:

Tier I Capital items	Tier II Capital items
1. Paid up Capital, Statutory Reserves, disclosed free reserves	1. Revaluation Reserve (at a discount of 55%)
2. Capital Reserve (E.g., Surplus from sales of assets)	2. General Provision & Loss Reserves
3. Eligible Innovative Perpetual Debt Instruments (IPDI)- up to 15% of Tier 1 Capital	3. Hybrid Debt Capital Instruments: E.g., Perpetual Cumulative Preference Shares, Redeemable Non-Cumulative Preference Share, Redeemable Cumulative Preference Share
4. Perpetual Non-Cumulative Preference Shares (PNPS) - 3 & 4 can be max 40% of Tier 1	4. Subordinate Debt: fully paid up, unsecured, subordinated to other creditors, free of restrictive clauses
	5. Remaining IPDI & PNPS from Tier 1 Capital (i.e.,Surplus)

Basel III

In December 2010 Basel III guidelines were released by Basel Committee on Banking Supervision (BCBS), in the aftermath of global financial crisis triggered by sub-prime crisis of the United States. It will not be an exaggeration to say that the sub-prime crisis was the trigger point for announcement of Basel III guidelines.

The Basel III capital regulations were implemented in India with effect from April 1, 2013 and have been fully implemented as on October 1, 2021. Banks have to comply with the regulatory limits and minima as prescribed under Basel III capital regulations, on an ongoing basis.

Objectives:

a. To improve banking sector's ability to absorb shocks arising from financial and economic stress.

b. To reduce the risk of spill over from the financial sector to the real economy.

Scope:

The banks are to comply with the Capital Adequacy Ratio (CAR) requirements at two levels - (a) the consolidated ("Group") level capital adequacy ratio requirements, which measure the capital adequacy of a bank based on its capital strength and risk profile after consolidating the assets and liabilities of its subsidiaries / joint ventures / associates etc. except those engaged in insurance and any non-financial activities; and (b) the standalone ("Solo") level capital adequacy ratio requirements, which measure the capital adequacy of a bank based on its standalone capital strength and risk profile.

Basel III framework is based on 3 components called 3 pillars as under:

Pillar 1 - Minimum Capital Requirements- which prescribes a risk-sensitive calculation of capital requirements that, for the first time, explicitly includes operational risk in addition to market and credit risk.

Pillar 2 - Supervisory Review Process (SRP) - which envisages the establishment of suitable risk management systems in banks and their review by the supervisory authority.

Pillar 3 - Market Discipline - which seeks to achieve increased transparency through expanded disclosure requirements for banks.

Composition of Regulatory Capital: Banks shall maintain a minimum Pillar 1 Capital to Risk-weighted Assets Ratio (CRAR) of 9% on an on-going basis (other than capital conservation buffer and countercyclical capital buffer etc.). The Reserve Bank will take into account the relevant risk factors and the internal capital adequacy assessments of each bank to ensure that the capital held by a bank is commensurate with the bank's overall risk profile. This would include, among others, the effectiveness of the bank's risk management systems in identifying, assessing / measuring, monitoring and managing various risks including interest rate risk in the banking book, liquidity risk, concentration risk and residual risk. Accordingly, the Reserve Bank will consider prescribing a higher level of minimum capital ratio for each bank under the Pillar 2 framework on the basis of their respective risk profiles and their risk management systems. Further, in terms of the Pillar 2 requirements, banks are expected to operate at a level well above the minimum requirement. A bank should compute Basel III capital ratios in the following manner:

$$\textbf{Common Equity Tier 1 Capital Ratio} = \frac{\textbf{Common Equity Tier 1 capital}}{\textbf{Credit Risk RWA* + Market Risk RWA + Operational Risk RWA}}$$

$$\textbf{Tier 1 Capital Ratio} = \frac{\textbf{Eligible Tier 1 capital}}{\textbf{Credit Risk RWA + Market Risk RWA + Operational Risk RWA}}$$

$$\textbf{Total Capital (CRAR\#)} = \frac{\textbf{Eligible Total Capital}}{\textbf{Credit Risk RWA + Market Risk RWA + Operational Risk RWA}}$$

*Risk Weight Assets

#Capital to Risk Weighted Assets Ratio

Components of Capital

Total Regulatory Capital will consist of the sum of the following categories:

(i) Tier 1 Capital (going-concern capital)5

(a) Common Equity Tier 1

(b) Additional Tier 1

(ii) Tier 2 Capital (gone-concern capital)

Limits and Minima

(i) The Scheduled Commercial Banks operating in India shall maintain a Minimum Total Capital (MTC) of 9% of total Risk Weighted Assets (RWAs) i.e., Capital to Risk Weighted Assets (CRAR).

(ii) Common Equity Tier 1 (CET1) capital must be at least 5.5% of risk-weighted assets (RWAs) i.e., for credit risk + market risk + operational risk on an ongoing basis.

(iii) Tier 1 capital must be at least 7% of RWAs on an ongoing basis. Thus, within the minimum Tier 1 capital, Additional Tier 1 capital can be admitted maximum at 1.5% of RWAs.

(iv) Total Capital (Tier 1 Capital plus Tier 2 Capital) must be at least 9% of RWAs on an ongoing basis. Thus, within the minimum CRAR of 9%, Tier 2 capital can be admitted maximum up to 2%.

(v) If a bank has complied with the minimum Common Equity Tier 1 and Tier 1 capital ratios, then the excess Additional Tier 1 capital can be admitted for compliance with the minimum CRAR of 9% of RWAs.

(vi) In addition to the minimum Common Equity Tier 1 capital of 5.5% of RWAs, banks are also required to maintain a capital conservation buffer (CCB) of 2.5% of RWAs6 in the form of Common Equity Tier 1 capital.

RISK WEIGHTED ASSETS

Another Important dimension in calculation of CRAR is Risk weighted assets. Basel II seems to give an advantage for banks with better asset quality as it reduces capital requirements which in turn results assigning of lesser weights. In this regard RBI has suggested options for arriving at risk weighted assets. These are as follows:

Risks Approaches	Credit Risk	Market Risk	Operational Risk
1*	Standardised Approach	Standardized Approach Internal Model Approach	Basic Indicator Approach
2**	Foundation Internal Rating Based Approach	Advanced Internal Rating Based Approach	Standardized Approach
3***	Advanced Internal Rating Based Approach	–	Advanced Measurement Approach

* Represents Simple method,

** Intermediate method,

*** Sophisticated & Advanced method.

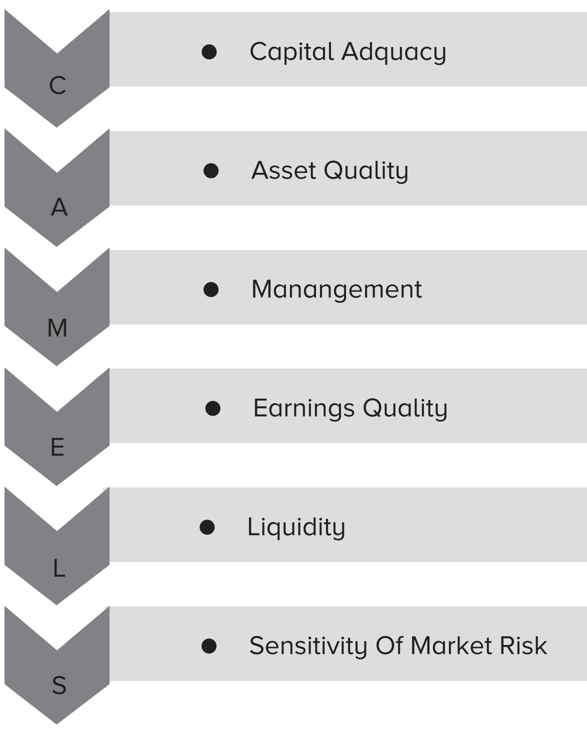
Credit Risk Assessment: Under Basel II BCBS had devised three approaches for calculation of credit risk weighted assets:

1. **Standardized Approach to Credit Risk (SACR):** The standardized approach has fixed risk weights which vary from 0 to 150%, corresponding to various risk categories based on ratings of approved external credit rating agencies. Loans which are unrated carry 100% risk weight. This approach has widened risk sensitivity by taking in to account a broad range of collateral, guarantees and credit derivatives. The residential mortgage exposure carries a lesser risk weight vis-a -vis Basel I.

2. **Foundation Internal Rating Based Approach (FIRBA):** Credit risk under this approach is based on internal ratings of a bank instead of external credit rating agencies. The ratings correspond to risk characteristics of borrower and the transaction. Expected loss arrived at based on Probability of Default (PD) of borrower, Loss Given Default (LGD), Bank's Exposure at Default (EAD) and remaining Maturity (M) of exposure.
   - Probability of Default is a measure of (PD) the likelihood that a borrowers default over a time horizon.
   - Loss Given Default (LGD) computes the proportion of the exposure that will be lost if Default occurs.
   - Exposure at Default (EAD) gives an estimate of loan amount outstanding at the time of default.
   - Maturity (M) measures the remaining economic maturity of the exposure.
3. **Advanced Internal Rating Based Approach (FIRBA) :** It is an improved version of FIRBA. Under this LGD, EAD, M are estimated based on historical data by the bank itself.
4. **Advanced Measurement Approach ('AMA'):** Under this approach the regulatory capital requirement equals the risk measure generated by the bank's internal Operational Risk Measurement System (ORMS). After satisfying these criteria the required operational risk capital charge is derived from the unexpected loss of Value at Risk (VaR) at the 99.9 percent confidence level, across a one year time horizon subject to the expected loss is taken care through provisions.

ROLE OF RBI IN RISK MANAGEMENT IN BANK

Here, we will discuss the role of RBI in Risk Management and how the tools called CAMELS was used by RBI to evaluate the financial soundness of the Banks. CAMELS is the collective tool of six components namely



Ratings are given from 1 (best) to 5 (worst) point scale of A to E in each of the above categories. Each of these components is weighed on a scale of 1 to 100 and contains several sub parameters with individual weightages.

A - Basically sound in every respect.

B - Fundamentally sound but with moderate weakness.

C - Financial, operational, compliance weaknesses that give cause for supervisory concern.

D - Serious finance, operational and managerial weaknesses that could impair future viability.

E - Critical financial weaknesses that render the possibility of failure high in near future.

In India, for supervision (inspection) of banks an extended framework is used which is names - C A M E L S C where the alphabets C A M E L stand for what is mentioned above but S means System (like Management Information System - MIS) and C mean Compliance to various rules, regulations Acts etc.

The CAMEL was recommended for the financial soundness of a bank in 1988 while the sixth component called sensitivity to market risk (S) was added to CAMEL in 1997.

In India, the focus of the statutory regulation of commercial banks by RBI until the early 1990s was mainly on licensing, administration of minimum capital requirements, pricing of services including administration of interest rates on deposits as well as credit, reserves and liquid asset requirements.

RBI in 1999 recognised the need for an appropriate risk management and issued guidelines to banks regarding assets liability management, management of credit, market and operational risks. The entire supervisory mechanism has been realigned since 1994 under the directions of a newly constituted Board for Financial Supervision (BFS), which functions under the aegis of the RBI, to suit the demanding needs of a strong and stable financial system. A process of rating of banks on the basis of CAMELS in respect of Indian banks and CACS (Capital, Asset Quality, Compliance and Systems & Control) in respect of foreign banks has been put in place from 1999.

RISK-BASED INTERNAL AUDIT (RBIA)

An effective Risk-Based Internal Audit (RBIA) is an audit methodology that links an organisation's overall risk management framework and provides an assurance to the Board of Directors and the Senior Management on the quality and effectiveness of the organisation's internal controls, risk management and governance related systems and processes.

In year 2002 the Reserve Bank of India mandated the RBIA system to Schedule Commercial Banks (SCBs) with guidelines in respect thereof which were supplemented from time to time with the changing trends of banking business and frauds. Later on, in year 2021, considering the increase in the trend of frauds in banking sectors, the RBI has mandated the RBIA system to all deposit taking Non-Banking Financial Companies (NBFCs) irrespective of their size, on-deposit taking NBFCs (including Core Investment Companies) with asset size of Rs 5,000 crore and above and Primary (Urban) Co-operative Banks (UCBs) with asset size of Rs 500 crore and above.

To bring uniformity in approach followed by the banks, as also to align the expectations on Internal Audit Function with the best practices, banks are advised as under:

a. *Authority, Stature and Independence* - The internal audit function must have sufficient authority, stature, independence and resources within the bank, thereby enabling internal auditors to carry out their assignments with objectivity. Accordingly, the Head of Internal Audit (HIA) shall be a senior executive of the bank who shall have the ability to exercise independent judgement. The HIA as well as the internal audit function shall have the authority to communicate with any staff member and have access to all records or files that are necessary to carry out the entrusted responsibilities.

b. *Competence* - Requisite professional competence, knowledge and experience of each internal auditor is essential for the effectiveness of the bank's internal audit function. The desired areas of knowledge and experience may include banking operations, accounting, information technology, data analytics and forensic investigation, among others. Banks should ensure that internal audit function has the requisite skills to audit all areas of the bank.

c. *Staff Rotation* - Except for the entities where the internal audit function is a specialised function and managed by career internal auditors, the Board should prescribe a minimum period of service for staff in the Internal Audit function. The Board may also examine the feasibility of prescribing at least one stint of service in the internal audit function for those staff possessing specialized knowledge useful for the audit function, but who are posted in other departments, so as to have adequate skills for the staff in the Internal Audit function.

d. *Tenor for appointment of Head of Internal Audit* - Except for the entities where the internal audit function is a specialised function and managed by career internal auditors, the HIA shall be appointed for a reasonably long period, preferably for a minimum of three years.

e. *Reporting Line* - The HIA shall directly report to either the Audit Committee of the Board (ACB) / MD & CEO or Whole Time Director (WTD). Should the Board of Directors decide to allow the MD & CEO or a WTD to be the 'reporting authority' of the HIA, then the 'reviewing authority' shall be with the ACB and the 'accepting authority' shall be with the Board in matters of performance appraisal of the HIA. Further, in such cases, the ACB shall meet the HIA at least once in a quarter, without the presence of the senior management, including the MD & CEO/WTD. The HIA shall not have any reporting relationship with the business verticals of the bank and shall not be given any business targets. In foreign banks operating in India as branches, the HIA shall report to the internal audit function in the controlling office / head office.

f. *Remuneration* - The independence and objectivity of the internal audit function could be undermined if the remuneration of internal audit staff is linked to the financial performance of the business lines for which they exercise audit responsibilities. Thus, the remuneration policies should be structured in a way that it avoids creating conflict of interest and compromising audit's independence and objectivity.

LESSON ROUND-UP

- A risk is indispensable for banking business, proper assessment of risk is an integral part of a bank's risk management system. Banks are focusing on the magnitude of their risk exposure and formulating strategies to tackle those effectively. In the context of risk management practices, the introduction of Basel II norms and its subsequent adoption by RBI is a significant measure that promises to promote sound risk management practices.

- BASEL II seeks to enhance the risk sensitivity of capital requirements, promote a comprehensive coverage of risks, offer a more flexible approach through a menu of options, and is intended to be applied to banks worldwide. Moreover, the RBI has adopted a series of steps to ensure that individual banks tackle risks effectively by setting up risk management cells and also through internal assessment of their risk exposure.

- Apart from this, RBI has opted for on-site and off-site surveillance methods for effective risk management in the Indian Banking sector, so that systemic risk and financial turmoil can be averted in the country.

- The Basel III capital regulations were implemented in India with effect from April 1, 2013 and have been fully implemented as on October 1, 2021.

- The CAMEL was recommended for the financial soundness of a bank in 1988 while the sixth component called sensitivity to market risk (S) was added to CAMEL in 1997.

- An effective Risk-Based Internal Audit (RBIA) is an audit methodology that links an organisation's overall risk management framework and provides an assurance to the Board of Directors and the Senior Management on the quality and effectiveness of the organisation's internal controls, risk management and governance related systems and processes.

GLOSSARY

Organizational Structure: An organizational structure is a system that outlines how certain activities are directed in order to achieve the goals of an organization. These activities can include rules, roles, and responsibilities.

Liquidity Risk: Liquidity risk is the inability of a bank to meet such obligations as they become due, without adversely affecting the bank's financial condition.

Market Risk: Market risk is the risk of price fluctuation of a financial instrument, as a result of market price changes, irrespective of whether these changes are caused by factors typical for individual instruments or their issuer (counterparty), or by factors pertaining to all the instruments traded on the market.

Liquidity Coverage Ratio: The Liquidity Coverage Ratio (LCR) refers to the proportion of highly liquid assets held by financial institutions, to ensure their ongoing ability to meet short-term obligations. This ratio is essentially a generic stress test that aims to anticipate market-wide shocks and make sure that financial institutions possess suitable capital preservation, to ride out any short-term liquidity disruptions, that may plague the market.

Net Stable Funding Ratio: The net stable funding ratio is a liquidity standard requiring banks to hold enough stable funding to cover the duration of their long-term assets.

Risk-Based Internal Audit (RBIA): An effective Risk-Based Internal Audit (RBIA) is an audit methodology that links an organisation's overall risk management framework and provides an assurance to the Board of Directors and the Senior Management on the quality and effectiveness of the organisation's internal controls, risk management and governance related systems and processes.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Discuss briefly stages of Risk Management.
2. Discuss briefly different types of risks a bank faces.
3. What is Liquidity Risk? How it is managed?
4. How operational risks are measured?
5. What are the features of Basel III accord?
6. Explain the role of RBI in Risk Management in Banks.
7. What is Risk-Based Internal Audit (RBIA)?

LIST OF FURTHER READINGS

- https: // www.rbi.org.in/Script/BS ViewMasCirculationdetails.aspx?id=12504
- https: // www.rbi.org.in/script/NotificationUser.aspx?id=12504&Mode=0

LIST OF OTHER REFERENCES

- Operational risk management in Financial Institutions- researchgate.net
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- Guidance note on credit risk management, RBI.
- AIMA Journal of Management & Research, May 2013, volume 7, issue 2/4.

PART II

INSURANCE LAWS

Concept of Insurance

Lesson 14

KEY CONCEPTS

■ Insurance ■ Policy Holder ■ Sum Assured ■ Insurance Contract ■ Life Insurance ■ General Insurance ■ Health Insurance ■ Underwriting

Learning Objectives

To understand:

- The Concept of Insurance
- How the Regulation of Insurance business in India takes place?
- What are the different Insurance Products?
- Basic Insurance Terminologies

Lesson Outline

- Introduction
- Concept of Insurance
- Insurance Terminologies
- History of Insurance
- Insurance Contract
- Insurance Products
- Life Insurance Products
- General Insurance Products
- Lesson Round-Up
- Test Yourself

REGULATORY FRAMEWORK

Acts / Regulations Governing Both Life & General Insurance Business in India

The following Acts regulate the Insurance Business in India:

- Insurance Act, 1938
- IRDA Act, 1999 & Regulations passed thereunder
- Insurance Amendment Act, 2002
- Exchange Control Regulations (FEMA)
- Indian Stamp Act, 1899
- Consumer Protection Act, 1986
- Insurance Ombudsman Rules, 2017
- Labour Law legislations

Regulations Governing/Affecting Life Insurance Business in India

The following Acts govern/regulate the life insurance business in India:

- LIC Act, 1956
- Amendments to LIC Act.

Regulations affecting General Insurance Business in India

The following Acts affect, circumscribe or regulate in some way or the other, some aspect of the General Insurance Business in India:

- General Insurance Nationalization Act, 1972
- Amendments to GIN Act, 1972
- Multi-Modal Transportation Act, 1993
- Motor Vehicles Act, 1988
- Inland Steam Vessels Amendment Act, 1977
- Marine Insurance Act, 1963
- Carriage of Goods by Sea Act, 1925
- Merchant Shipping Act, 1958
- Bill of Lading Act, 1855
- Indian Ports (Major Ports) Act, 1963
- Indian Railways Act, 1989
- Carriers Act, 1865
- Indian Post Office Act, 1898
- Carriage by Air Act, 1972
- Public Liability Insurance Act, 1991
- Employee State Insurance Act, 1948
- Aircraft Act, 1934

INTRODUCTION

Insurance is form of contract or an arrangement where one party agrees in return for a consideration to pay an agreed amount of money to another party to make good the loss, damage or injury to something of value in which the insured has an interest. Being a contract of indemnity, it is based on the principle of utmost good faith. In today's world, insurance companies offer retail insurance policies of varied nature including life, health, fire, marine, etc. Individuals purchase such policies either in their individual capacity or the employee friendly organizations may extend such cover as perks of the employment.

The business of insurance extends to protection of the economic value of assets. The owner of an asset attaches a value to the property since it gives them some benefit in the form of income or the loss of which could cause irreparable loss to the owner.

For example, owning a car for self-use may not give any monetary benefit but it is more for the pleasure of comfort it provides to the owner. If the vehicle is damaged due to say, water logging due to heavy rains, the car will have only scrap value - a need for covering this risk arises in such unforeseen situations.

The basic principle of insurance is that an entity will choose to spend small periodic amounts of money against a possibility of a huge unexpected loss. Basically, all the policyholders pool their risks together. Any loss that they suffer will be paid out of their premiums which they pay.

Alternatively, a Company which is in the business of transportation may own a fleet of lorries which are given on lease for others who want to transport goods. In this scenario, there could be a reduction on the revenue if there is an accident to the lorry due to which the transportation business is affected - need for insurance as a risk management tool arises.

> Insurance is a tool of risk management to cover the uncertainties - the risk of loss of assets or human life.

Similarly, disablement – permanent or temporary nature or a death of a sole breadwinner in a family may bring down the standard of living of the family.

Therefore, there is a need to give financial protection in the form of monetary compensation on disablement or death of the breadwinner to the members of the family – need for life insurance arises.

In all the above scenarios, the beneficiary (owner himself or the nominee in the case of life insurance) would be compensated.

Insurance Terminologies

Proposal (or) Proposal form denotes the application for insurance contains which solicits information from the proposer.

Proposer to enable the Insurer to take a decision on whether to accept the risk or not.

Proposer is the person who submits Proposal form for insurance to the insurance company and who is interested in taking an Insurance Policy.

Underwriting is the process of assessment of risk on a proposal by the Insurance company and arriving at the decision (to accept, reject, rate-up, postpone) and the terms and conditions upon which an insurance contract may be accepted.

Policyholder is the person who is issued an Insurance Policy document by the Insurance Company consequent to underwriting and issuance of Insurance Policy to cover the risk stated in the Proposal form on such terms and conditions as mentioned in the Insurance Policy document issued by the Insurer to the Policyholder.

Insurance Policy document (or) Policy document (or) Policy constitutes the contract between the Insurance company and the Policyholder, stating the terms and conditions of the Insurance coverage provided by the Insurance company to the Policyholder.

Subject matter of insurance is the Person or object upon whose loss or upon the loss of which object the insurance company agrees to pay a specified sum as the compensation to the Policyholder.

Life insured (or) Life assured under a Life insurance Policy is the subject matter of insurance on whose death a specified sum of money is paid by the Life insurance company.

A Policyholder and Life assured may be the same person or different persons. Where a person takes a Policy on his own life, both Policyholder and Life assured constitute the same person. Where a Policyholder takes a Policy on another's person's life (on whom the Policyholder has insurable interest), the Policyholder and Life assured can be different persons.

Sum Assured (or) Sum Insured means the amount promised to be paid by the Insurer upon the death of the Life insured.

Nominee is the person appointed, only for Policies taken on one's own Life, by the Policyholder to receive the Sum Assured or any other policy benefit upon death of the Life assured.

Where Policyholder and Life assured are different persons, upon death of the Life assured, the Policyholder is the person entitled to receive the Sum assured or other Policy benefits.

In general insurance, since the subject matter of insurance can be anything other than one's life, the Policyholder always receives the benefit upon loss or damage to the subject matter of insurance, subject to establishing the insurable interest at the time of claim.

Counter offer denotes the extra premium proposed by the Insurer upon underwriting the proposal to accommodate for the extra risk taken by the insurance company on a Proposal.

Benefits illustration is the document provided to the Policyholder at the point of sale giving the details of premiums payable by the Policyholder year-wise along with the benefits payable at the end of each Policy year. This is provided to Policyholder before a sale is completed and signed by the Policyholder in confirmation of his/her understanding of the Policy benefits.

Assignment is transfer of Insurance Policies to another person with or without consideration.

Mortality is the rate of death of the population. It is usually calculated for every thousand of population. The Mortality Table of Indian Assured lives is published based on the investigation of mortality of Indian lives and this Table forms the basis for calculation of premiums for Life insurance Policies.

Morbidity measures the rate of contraction of illnesses by the population and serves as the basis for calculation of premiums under Health insurance policies and Critical illness benefits.

Annuity is a series of regular and periodic payment payable in consideration of usually a lump sum. For example, under Pension Policies, upon the attainment of superannuation age, the corpus available is utilised to purchase a Single premium (lump sum) Annuity Policy under which the Policyholder gets a periodic payout on a monthly basis till his survival.

Annuities are also life insurance policies as they cover the risk of living longer and the continuation of benefits payable is contingent upon human life.

Participating products (With profits products) are Life insurance products which are eligible for Policyholder bonus as and when declared. A bonus is declared to Policyholder if there is a surplus which emerges from the Participating line of business and is decided by the Appointed Actuary. If a Policyholder takes a Life insurance product which is eligible for bonus, he/she is eligible, along with other such Policyholders, to a share in the surplus – not less than 90% of the Surplus emerging in Participating business shall be distributed as Bonus and the balance 10% goes to the Shareholders as their share in the business. While such bonuses are declared every year, a

Reversionary bonus is payable only upon death or maturity. However, a Life insurer may declare an Interim cash bonus as well.

Under Participating products, share in the surplus mentioned above, are in addition to the guaranteed benefits payable (upon death or maturity, as the case may be).

Non participating products (without profits products) are those Life insurance products which are not eligible for any surplus and are eligible only for the guaranteed benefits payable upon death, survival etc.

Linked Insurance products are those life insurance products which combine a Term insurance policy with investments. Under Linked insurance products, the benefits payable are a Sum Assured on death plus the marked- to-market value of the investments made on behalf of the Policyholder by the Life Insurance Company. The risk on investments portion is borne by the Policyholder and not by the Life Insurance Company.

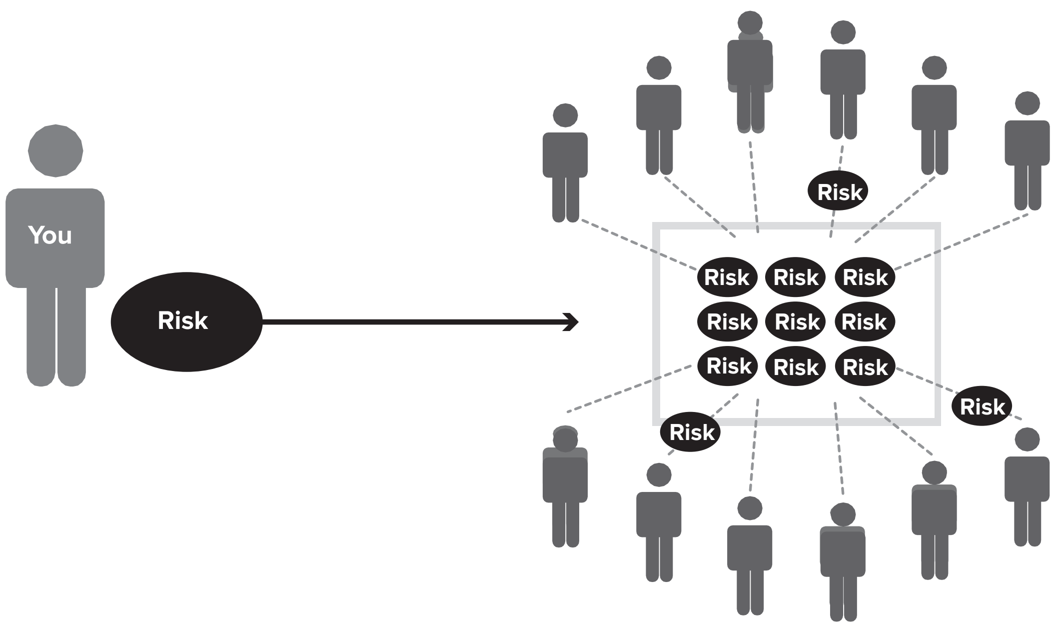
Individual insurance products are Insurance Policy contracts entered into directly by the Individual Policyholder with the Insurance Company. This can be compared for example, with equity shares directly purchased in the secondary market by an Investor.

Group insurance products are Insurance Policy contracts entered into by an Organisation with the Insurance Company. The organisation covers the members of the Group under the Group insurance policy by contributing premiums to the Insurance Company who in turn provides benefits upon death or other contingencies covered under the Group Policy, to the Nominee or beneficiary.

For example, a Bank, as a Lender, may take a Group insurance policy with a Life insurer for covering all the borrowers to whom it has lent money. Upon death of the borrower, the Sum assured to the extent of outstanding loan is paid to the Bank, and the balance, if any, is paid to the Nominee of the deceased borrower.

EVOLUTION OF INSURANCE

The idea of insurance took birth thousands of years ago. Insurance practices in earlier days used to be based on the concept of 'pooling of risks'. A common fund were created, often at the Village Panchayat or equivalent levels into which small contributions from many people was pooled and the amount so collected be used to compensate for the loss suffered by the unfortunate few out of those who contributed. The contribution to be made by each person is determined on the assumption that while it may not be possible to tell beforehand which person will suffer, it will be possible to tell, on the basis of past experiences, how many persons on an average may suffer losses.



For example, in a Village, there are 500 houses, each valued at Rs. 2,00,000. Every year, on an average 4 houses get burnt, resulting into a loss of Rs. 8,00,000. If all the 500 house-owners come together and contribute Rs. 1,600 each, that will be sufficient to cover the risk of up to 4 houses getting damaged on fire. Thus the risk of 4 house owners gets distributed to 500 house-owners.

In other words, the risk of suffering an economic loss and its consequence could be transferred from one individual to many, through the mechanism of pooling. Thus, insurance is often described as a Risk Transfer through Risk Pooling.

There is an element of uncertainty in life as well as business. Human beings are exposed to various risks such as risk of contracting illnesses, risk of dying through accident or normal death etc. Similarly, a business is also exposed to risks such as destruction of assets by fire and other natural causes, risk of damage to goods during transportation of goods, etc. Therefore insurance evolved as a Risk transfer mechanism to person/entities who have the capacity to undertake the risk.

The Babylonians, the Greeks and the Roman were first to use insurance. In the beginning of the 14th century, practice of marine insurance started in Italy. In the year 1393, one company in Genoa took up to 80 insurance contracts. Most of the phraseologies of insurance have been developed in Italy.

Marine insurance spread from Italy to Spain in 1435, and for regulating business of insurance a law was passed in Barcelona. The year 1536 is remembered for writing of the first life insurance policy.

The Hammurabi Code was one of the first forms of written laws. The basic insurance gave the Babylonian traders protection against loss of cargo. If a merchant received a loan to fund his shipment, he would pay the lender an additional sum in exchange for the lender's guarantee to cancel the loan should the shipment be stolen or lost at sea.

The law of general average is a legal principle of maritime law according to which all parties in a sea venture proportionally share any losses resulting from a voluntary sacrifice of part of the ship or cargo to save the whole in an emergency.

For instance, when the crew throws some cargo overboard to lighten the ship in a storm. The first codification of general average was the York Antwerp Rules of 1890. American companies accepted in 1949. General average requires 3 elements as follows:

(i) A common danger in which a vessel, cargo and crew all participate – a danger which is imminent or inevitable, except by voluntarily incurring the loss of a portion of the whole to save the remainder.

(ii) There must be a voluntary jettison, jactus or casting away of some portion of the joint concern for the purpose of avoiding the imminent peril.

(iii) Attempts to avoid the imminent common peril must be successful.

In 1666, the Great Fire of London destroyed more than 13,000 houses. To counter such events in future, Fire Office, the first insurance company was started in 1680.

Traders in London used to gather at Lloyd's Coffee House and agree to share losses of goods due to piracy or the ship sinking due to bad weather or other reasons. Edward Lloyds coffee house became recognised as the place for obtaining marine insurance this is where the Lloyds as an Insurance market began. From those beginnings in a coffee house in 1688, Lloyds has been a pioneer in insurance and has grown over 332 years to become the world's leading market for specialist insurance. A contract of insurance is an agreement whereby one party, called the insurer, undertakes, in return for an agreed consideration, called the premium, to pay the other party, namely the insured, a sum of money or its equivalent in kind, upon the occurrence of a specified event resulting in a loss to him. The policy is a document, containing the terms and conditions, which is an evidence of the contract of insurance.

As per Anson, a contract is an agreement enforceable at law made between two or more persons by which rights are acquired by one or more persons to certain acts or forbearance on the part of other or others.

HISTORY OF INSURANCE IN INDIA

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. The journey of insurance in India can be divide in five phases which are given below in detail.

First Phase (1818-1870)

Insurance law in India had its origins in the United Kingdom with the establishment of a British firm, the Oriental Life Insurance Company in 1818 in Calcutta. Unfortunately, in 1834, this company failed in its operations and way changed to "New Oriental". With the span of time, certain other companies foam United Kingdom started the business of insurance in India. By the end of 1871, seven Indian and Eight foreign companies were working in India. In this period, insurance was only given on the lives of Europeans or descendants of Europeans born in India. The premium charged from Indians on life insurance was much higher in comparison to Europeans. This period witnessed the all possible attempt to propagate insurance in India on the lines of British Model. I was a period of trial as many Indian and English Companies came for doing insurance business in India.

Second Phase (1870-1900)

This phase is highlighted by the slow and steady progress of life insurance business in India. This period witnessed the establishment of two life insurance companies, i.e., the Bombay Mutual Life Insurance Society in 1871 and Orient Government Security Life Insurance Company Limited in 1874. This period embarked by the growth and development in trade, communication and increase in number of industries preparing a big platform for running of insurance business in India. Press also played a pivotal role in the development of insurance business during this period. During this period, government applied no control over foreign companies and no rules and regulations were laid down for the working of foreign companies in India. These companies were governed by regulations of their own countries. This aspect draws the attention of mi foreign companies and they started their business in India.

This period will be remembered for the infancy of the Indian Life Insurance. In this period the roots of insurance business were firmly laid down and gradually ripening for a strong edifice to be erected. With the tremendous improvement in medical and sanitation facilities, the lives of people in rapidly improved. However, unfortunately, the plague of 1896-97 put a strain on the life insurance business but all Indian insurers successfully got their c because of caution policy followed by them.

Third Phase (1900-1912)

1900-1912 was most developed period for insurance sector. During this phase, middle class of the country, i.e., clerks, doctors, lawyers, teachers, etc., was attracted towards the insurance business, because it provided them protection after retirement. Demands during this period were very high for endowment policy as it provided them land for agriculture, when they returned to the village at a very low cost and provided them protection against the risk of immature death. This factor led to increase in insurance business in the country. The Swadeshi Movement provided the much needed tonic to the Indian Insurance Companies and gradually their sales volume increased. Many of the important companies working at present in India are the outcome of third phase. Division of Insurance was one of the most significant features of Indian insurance during this phase. In order to monitor insurance business in the country, the Government in public interest passed two legislations in 1912, firstly the Indian Insurance Companies Act and secondly, Provident Insurance Act, on the lines of Acts in England. In this period, General Insurance took birth in the country. In 1907, Indian Mercantile Insurance Ltd. was set up as the first company to transact all classes of general insurance business.

Fourth Phase (1912-1930)

In third phase two new insurances acts were passed and resulting of that many English Companies wrote off their insurance business from India, as those two acts made it mandatory to submit their working report to the Government of India. Another impact of these two Acts was that it made it obligatory for the companies to pay dividends to shareholders out of actual profits earned during an accounting year. Before those two acts were passed, the insurance companies used to pay dividend irrespective of profits actually earned by companies. Annual Return's submissions were made mandatory for the companies working in insurance business in the India. In 1916, insurance business was at the lowest level due to the effect of First World War (1914) and there were no other adverse consequences of First World War on the insurance business. Many insurance companies emerged after the end of First World War. The Non-Cooperation Movement in 1920-21 also played a significant role in the financial development of Indian insurance companies. In 1928, the Government made amendment in the Indian Life Insurance Companies Act of 1912 to collect statistical information on both life and non-life insurance business in the country. In 1930, the civil disobedience movement and spirit of Swadeshism paved way for the overall development of Indian insurance companies.

During this period endowment insurance was at its peak in the country, Further, the Indian insurance companies contributed near about 90% of their surplus to the policyholders in the form of bonus. This period is highlighted by the stiff competition between Indian and foreign companies. Soon Government came up with legislation in 1927 to protect Indian Companies i.e. the Indian Life Insurance officers Association. This Association helped the Companies by telling their defects and providing them remedies.

Fifth Phase (1930-1938)

In Fifth Phase, a large number of Indian insurance companies were established. This phase also witnessed a very tough and unfair competition between Indian and foreign insurance companies, though Indian insurance companies had many weak points. A witnessing all this, credit must be given to old and established Indian insurance companies for controlling over 85% of the total business and creating good reserves working on a sound business policy. Even feelings of nationalism and regular development were not able to provide much needed help against, unfair foreign competition and national agitation grew for legislative protection.

PRINCIPLES OF INSURANCE

Insurance business is conducted on certain fundamental principles which are applicable to all types of insurance viz., life, fire, marine, and which are and contracts, with exception of principle of indemnity. The principle or indemnity is the life for other insurance except for lie insurance. The important principles are:

1. Principle of co-operation.
2. Principle of probability.
3. Principle of insurable interest.
4. Principle of utmost good faith.
5. Principle of warranties.
6. Principle of indemnity.
7. Principle of subrogation.
8. Principle of contribution.
9. Principle of causa proxima.
10. Principle of Mitigation of Loss.

(1) Principle of Co-operation

Principle of co-operation is the first principle of insurance. Insurance involves sharing of risks and uncertainties collectively on the basis of co-operation. Insurance is based on the ideology of common interest and welfare. Co-operation is based on the co-operative principle. It is said, "One for all and all for one". Thus, in true sense the origin and development of insurance are based on co-operation.

Insurance is the business of covering risks for which contribution of a large number of people for creating common fund by way of payment of premium. This common fund generated by the people by contribution is paid to the aggrieved person (insured) in case of maturity of risk. This way the contribution made by one for all and the contribution of all are used for compensation of any one of them.'

Co-operation is other name of insurance. In ancient times and today as well, people create funds to indemnify each other on happening of any calamity. This is an evidence that the foundation of insurance was based Co-operation. Insurance may also be maned as security assistance in case of happening of contingencies. In the words of Regal, miller and William," Insurance represents in the highest degree of co-operation for mutual benefits".

(2) Principle of Probability

Business of insurance is risk and there may be probability of risk which may happen or may not happen as there is uncertainties of quantum of risk (compensation). The premium of an insurance policy depends on the probabilities of quantum of risk which may be high or low. Premium is the value of insurance and an important factor of insurance cost. The rate of premium depends on the quantum of risk and probability of risk. The rate of premium will be high where the quantum of risk and its probability are high.

Probability throws light on the uncertain events. It is a mathematical assumption that there will be probability of happenings which had happened in the past. It is necessary for the insurer to ascertain the probability of happenings and risk thereof. The past happening may be indicator of that. It is the probability principle on the basis of which insurer accepts the risk of insured in consideration of premium.

(3) Principle of Insurable interest

The most significant principle as well as legal requirement of a valid contract of insurance, is insurable interest. It means the assured must have an actual interest in the subject matter of insurance. Any person may said to have an interest in the subject matter of insurance who may be injured by the risks to which the subject matter is exposed.

Insurable interest is a basic requirement of any contract of insurance whether life, fire, marine, etc. unless it can be and is, lawfully waived. As a general rule, this means that the party to the insurance contract who is insured or policy-holder must have a particular relationship with the subject matter of the insurance whether that be a life or property or a liability to which he might be exposed. The absence of the required relationship will render the contract illegal or void depending on the type of insurance.

Thus, for a contract of insurance to be valid, it is not enough that it is made with free consent of the parties competent to contract for lawful consideration. It is necessary that in addition to the above, the insured must have insurable interest. In absence of insurable interest it will amount to wager and will be void with the effect of Section 30 of Indian Contract Act. Especially in fire, marine and life insurances the question of insurable interest is more important.

The concept of insurable interest' is a subsequent development because under general principle of common law that every contract entered into by the parties is enforceable at their instance irrespective of its subject matter

(4) Principle of utmost good faith (Uberrimae fide)

Principle of uberrimae fide is the very basic and primary principle of insurance. A contract of insurance is a contract of uberrimae fide, i.e., a contract of utmost good faith, and if the utmost good faith is not observed by either party, the contract may be avoided by the other party. It is now well settled principle that an insurance contract is a contract of utmost good faith and therefore, the contracting parties are placed under a special duty towards each other, not only to refrain from active misrepresentation but to make full disclosure of all material facts within their knowledge. It has been said that there is no class of documents to which the strictest good faith is more rightly required in courts of law than policies of insurance.' The principle of uberrimae fide applies to all types of insurance contract.

(5) Principles of Warranties

The term Warranty has been used in different branches of law like Sale of Goods Act. Section 12 of the Act says that stipulation as to subject matter of the sale may be essential for the purpose of the contract or collateral.

The stipulation which is essential may be condition and stipulation which is collateral may be warranty for the contract. Warranty has been defined as a stipulation collateral to the main purpose of the contracts the breach of which gives rise only to a claim for damages but not avoid the contract altogether. But in Marine Insurance Warranty is taken as a condition [Sec. 35(3)]

In contract of insurance particularly of marine insurance the term 'warranty is important aspect as to interpretation of for determination of loss under the contract.

Section 35 of the Marine Insurance Act, 1963 defines warranty as :

1. A warranty, in the following sections relating to warranties, means a promissory warranty, that is to say a warranty by which the assured undertakes that some particular thing shall or shall not be done, or that some condition shall be fulfilled, or whereby he affirms or negatives the existence of a particular state of facts.

2. A warranty may be express or implied.

3. A warranty, as above defined, is a condition which must be exactly complied with, whether it be material to the risk or not.

   If it be not so complied with, then, subject to any express provision in the policy the insurer is discharged from liability as from the date of the breach of warranty but without prejudice to any liability incurred by him before that date.

Sub-section (1) of Section 35 defines warranty in relation to marine insurance, sub-section (2) says it may be express or implied and sub-section (3) provides as to compliance of warranty. Warranty as condition must be exactly complied with and if it is not so complied with, the insurer is discharged from liability.

(6) Principles of Indemnity

Whether insurance is a contract of indemnity?

Indemnity is the guiding principle of Insurance although it is not a contract of indemnity. Section 124 of the Contract Act defines contract of indemnity as:

"Contract by which one party promises to save the other from caused to him by the conduct of the promisor himself or by or conduct of any other person is called a contract of indemnity".

Indian law confines the contract of indemnity for loss arising out of human conduct. Therefore, all the insurance contracts are contingent contract and not indemnity contract. Here we find a fundamental difference with English law. Under English law except life insurance al the contract of insurance are indemnity contract because under English law contract of indemnity is defined as:

" promise to save another harmless from loss caused as a result of a transaction entered into at the instance of the promisor" thus a contract of insurance is a contract of indemnity and life insurance is like Indian law contingent contract.

Principle of indemnity is applied to all insurance contract except life, personal and sickness insurance. It means principles of indemnity applies to fire, marine, burglary or any other policy. A contract of insurance however, ceases to be a contract of indemnity if the insurer promises to pay a fixed sum on the happening of the event insured against whether the assured has suffered any loss or not. Even it is so in case of contract of fire, marine or burglary or any other where the insurer agrees to pay a certain fixed sum irrespective of the loss.

In general insurance contract the insurer undertakes to indemnify the insured against loss suffered under the contract by him. Literally, indemnity means, 'make good the loss'. This means the assured, in the case of loss against which the policy has been made shall be indemnified subject to the value of the policy. But a contract of insurance however ceases to be a contract of indemnity if the insurer promises to pay a fixed sum on the happening of the event insured against whether the assured has suffered any loss or not.

The very purpose of indemnity is to restore the insured to the same financial position on happening of loss as he enjoyed immediately prior to the loss or damage. This is in confirmity with the basic concept of insurance, whereby an insurer is required to compensate the unfortunate people for the loss sustained, but does not allow a person to earn profit from any misfortune.

Fundamental function of insurance is to shift the loss suffered by a sole individual to a willing and capable professional risk-bearer in consideration of a comparatively small contribution called the premium.

(7) Principle of Subrogation

Subrogation is an equitable doctrine now assumed statutory recognition, 'Subrogation' comes from Roman law which means substitution. In Roman Law, a creditor who lent money to the debtor for the purpose of payment of a mortgage on condition that he was to be substituted in place of the mortgagee, was entitled to claim the benefit of the security discharged with his money. Now this law of Roman System has now been recognized in all modern system.

In a leading case *Yorkshire Insurance Co. vs. Nisbet Shipping Co. Diplock J.* observed:

"Although often referred to as in 'equity' 'subrogation' is not an exclusively equitable doctrine. It was applied by the common law courts in insurance cases long before the fusion of law and equity, although the powers of the common law courts might in some cases require to be supplemented by those of a court of equity in order to give full effect to the doctrine for example, by compelling an assured to allow his name to be used by the insurer for the purpose of enforcing the assured's remedies against third parties in respect of the subject matter of the loss."

The doctrine of subrogation is an essential attribute of a contract of indemnity since general insurance, e.g., fire, marine etc. are akin to the contract of indemnity, therefore, is applicable to contract of fire and marine insurance.

In insurance law subrogation is the name given to the right of the insurer who has paid a loss to be put in the place of the assured so that he can take advantage of any means available to the assured to extinguish or diminish the loss for which the insurer has indemnified the assured.

Subrogation means substitution of one person for another. The doctrine of subrogation confers upon the insurer the right to receive the benefit of such rights and remedies as the assured has against third parties in regard to the loss to the extent that the insurer has indemnified the loss and made it good.

(8) Principle of Contribution

Doctrine of subrogation is incidence of rule of indemnity and contribution is incidence of doctrine of subrogation. This is also a corollary of the doctrine of indemnity.

This rule is of ancient origin and was recognised by the Chancery Courts in *North British and Mercantile vs. Liverpool and London Glob.* It was held that the contribution exists where the thing is done by the same person against the same loss, and to prevent a man first of all.

(1) recovering more than the whole loss; or

(2) if he recovers the whole loss from one which he could have recovered from the other, then to make the parties contribute rateably.

Principle of contribution has application where there is the person insuring the same interests with more than one office. The genesis of contribution lies in liberty of the assured to insure the same property with more than one insurer which is called 'double insurance'.

Contribution in relation is insurance has been defined as :

"Contribution is the right of an insurer who has paid a loss under a policy, to recover a proportionate amount from other insurer who are liable for the loss."

This principle insures equitable distribution of losses between different insurers. A policy-holder is not entitled to claim from each insurer more than the rateable proportion of the loss to which one is liable.

(9) Principle of Maxim of 'Causa Proxima' (Proximate Cause)

Measuring the quantum of damage from loss is another significant aspect for all kinds of insurance. The loss must be caused by the peril insured against, i.e., cause of loss. Hence insurance contracts the rule of proximate cause', the maxim 'causa proxima non remota spectator which means that proximate and not the remote cause shall be a taken as the cause of the loss.

It means the immediate and not the remote cause is to be considered in measuring the damages. This rule of causa proxima, i.e., proximate cause and Torts. In Torts the defendant (person committing wrong) is liable only for those consequences which are not too remote from his conduct. No defendant can be made liable ad infinitum for all the consequences which follow his wrongful act. On practical grounds, a line must be drawn somewhere, and certain kinds or types of losses, though a direct result of defendant's conduct may remain uncompensated. The same principle is applicable in insurance contracts.

(10) Principle of Mitigation of Loss

In all kinds of insurances, it is the duty of the insured not to do anything which will accelerate the happening of the risk. He should not only refrain from accelerating the risk but there is a positive duty on the assured to prevent the happening of the risk if possible and where the risk takes place, it is the duty of the assured to minimise the loss or damage.

The principle of mitigation of loss literally means "to make less severe, violent or painful.

This principle places a duty on the insured to make every effort and to take all such steps, in the event of some mishap to the insured property, to mitigate or minimise the loss, as would have been taken by an uninsured person. This is obviously included in order to check the insured to become careless and inactive in the event of the mishap merely because the property which is getting damaged is already insured. He is not expected to be a silent spectator and must take such steps as he considers prudent and he must do everything in his power to minimise the loss and to save whatever is left.

The duty to mitigate loss is a general principle applicable to all branches of law and it is also applied to the law of insurance especially having in view of the fact that insurance is a contract of indemnity. Insurance company generally provides such clause in the policy to take all due care and steps to minimise the loss and save the property from being damaged. No person is entitled to look on and let his property be lost just because it is insured. Therefore, one who has insured his house cannot himself set fire to it and claim indemnity under the policy or aggravate the loss in order to claim heavy damages. Thus, the assured is bound to take all reasonable steps to prevent damage as well minimize damages.

PURPOSE AND NEED OF INSURANCE

All assets have some economic value attached to them. There is also a possibility that these assets may get damaged/destroyed or become non-operational due to risks like breakdowns, fire, floods, earthquake etc.

Different assets are exposed to different types of risks like a car has a risk of theft or meeting an accident, a house is exposed to risk of catching fire, a human is exposed to risk of death/accident. There many reasons and purposes for insurance, some of the reasns are as follows:

- Insurance acts as an important tool in providing a sense of security to the society on a whole. In case the bread-earner of a family dies, the family suffers from direct financial loss as family's income ceases. Life insurance is one alternate arrangement that offers some respite to the family from future financial distress.
- The basic need of insurance arises as risks are uncertain and unpredictable in nature. Getting insurance for an asset does not mean that the asset is protected against risks or its exposure to risk is reduced,

but it actually implies that in case the asset suffers any loss in value due to such risk, the insurance company bears the loss and compensates the insured by making payment.

- Insurance acts as a useful instrument in promoting savings and investments, particularly within the lower income and middle income families. These savings are used as investments to fuel economic growth.
- As from drop to drop becomes an ocean, so with such small savings become a huge fund which may be used for economic development of the country.

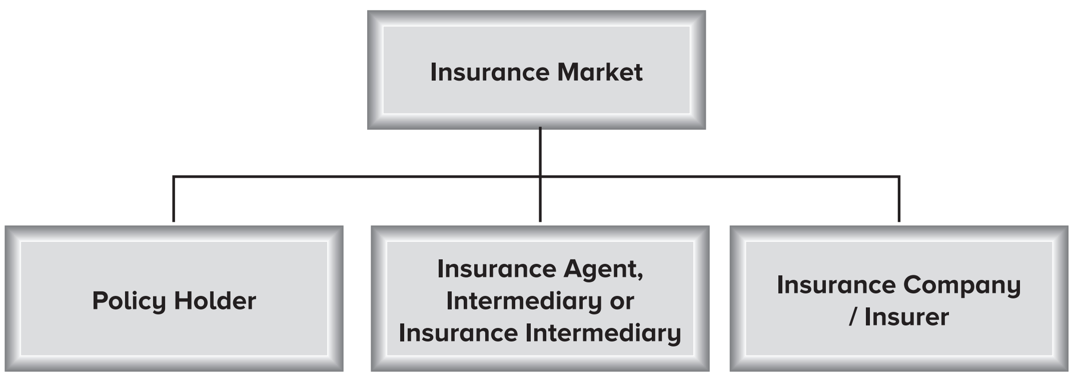
INSURANCE AS A SOCIAL SECURITY TOOL

Insurance today has several implications for people from different economic backgrounds, however the basic concept of life insurance still remains the same and universal – to provide for unforeseen contingencies of death and disability of a working or earning member of the family.

Financial Implications: Life Insurance is a financial arrangement, which redistributes the costs of unexpected loss of life among the members of the pool. The pool is a collection of people facing common risks. All members contribute a fixed amount towards a pool called premium. In exchange for the premium payment, the person gets an assurance that a certain sum of money is to be paid to him or his nominees on the happening of the event insured against

The Insurance Market

An Insurance Marketing typically comprises of the following three stakeholders:



Policy Holder

Policyholder is the Customer to whom the Policy is issued. The Policyholder can be an Individual Policyholder or a Corporate Policyholder. Individual Policyholders are also called the Retail segment and constitutes the biggest chunk of Customers Corporate Policyholders comprise of Business entities that purchase insurance cover for various business needs. In the Life insurance segment it can be Group Term Life Insurance policies, Group Superannuation Policies, Group Credit Life Policies.

Insurance Agent, Intermediary or Insurance Intermediary

Insurance intermediaries serve as a bridge between consumers (seeking to buy insurance policies) and insurance companies (seeking to sell those policies). Insurance brokers are licensed by the IRDA and governed by the Insurance Regulatory and Development Authority (Insurance Brokers) Regulations, 2002. Individual insurance agents and corporate agents are also licensed by the IRDA and governed by the Insurance Regulatory and Development Authority (licensing of Individual Insurance Agents) Regulations, 2000 and the Insurance Regulatory and Development Authority (Licensing of Corporate Agents) Regulations, 2002, respectively.

Insurance Companies/Insurers

Insurance companies provide the service of insurance coverage to the Policyholders. They accept the premiums from the Policyholders who take Insurance Policies through the registered intermediaries and provide the Insurance cover by issuing Insurance Policy documents, which constitute the contract between the Insurance companies and the Policyholders. Insurance Policy specifies various terms and conditions governing the insurance coverage.

Upon happening of the insured event, the Claim amount is paid to the Policyholder.

For example, in the case of a Life Insurance Policy, upon death of the Life assured (the person whose life is covered), the Sum Assured (which is a lump sum) is paid to the Nominee (who is appointed at the time of making application for insurance by the Policyholder).

Similarly, in the case of Vehicle Insurance (also called Motor insurance), upon accident to say, the Motor car, an assessment of the loss is undertaken, and the actual amount of loss in terms of the policy conditions is reimbursed as per the Policy document.

In case of a Motor Third Party Claim (A Motor vehicle hitting another third person), the Claim is paid to the injured person or the nominee in case of the accident results in death of the third person.

INSURANCE CUSTOMERS

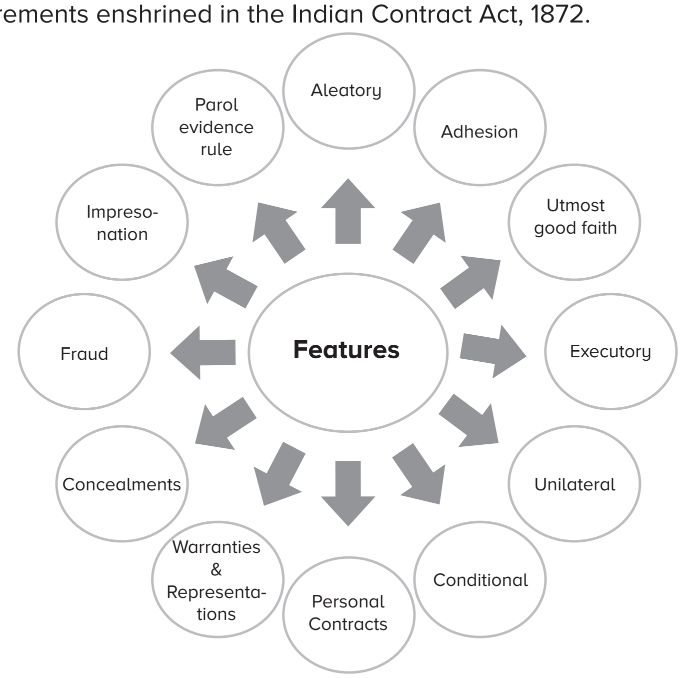
Insurance Contract

A contract of insurance is an agreement whereby one party, called the insurer, undertakes, in return for an agreed consideration, called the premium, to pay the other party, namely the insured, a sum of money or its equivalent in kind, upon the occurrence of a specified event resulting in a loss to him. The policy is a document which is an evidence of the contract of insurance.

The Indian Contract Act, 1872, sets forth the basic requirements of a Contract. As per Section 10 of the Act:

- "All agreements are contracts if they are made by the free consent of parties competent to contract, for a lawful consideration and with a lawful object, and are not hereby expressly declared to be void".
- An Insurance policy is also a contract entered into between two parties, viz., the Insurance Company and the Policyholder and fulfills the requirements enshrined in the Indian Contract Act, 1872.

Features of an Insurance Contract



Though all contracts share fundamental concepts and basic elements, insurance contracts typically possess a number of characteristics not widely found in other types of contractual agreements. The most common of these features are listed here:

(a) Aleatory

If one party to a contract might receive considerably more in value than he or she gives up under the terms of the agreement, the contract is said to be aleatory. Insurance contracts are of this type because, depending upon chance or any number of uncertain outcomes, the insured (or his or her beneficiaries) may receive substantially more in claim proceeds than was paid to the insurance company in premium. On the other hand, the insurer could ultimately receive significantly more money than the insured party if a claim is never filed. However, Insurance contracts are based on the concept of "pooling of risks". While Insurance companies may pay claim in some cases, it may not pay claim in many other cases. On an overall basis, if the Premiums received are sufficient to cover the remuneration paid to intermediaries, expenses, management expenses, profit-margins as well as Claims, insurance business would be viable.

(b) Adhesion

In a contract of adhesion, one party draws up the contract in its entirety and presents it to the other party on a 'take it or leave it' basis; the receiving party does not have the option of negotiating, revising, or deleting any part or provision of the document. Insurance contracts are of this type, because the insurer writes the contract and the insured either 'adheres' to it or is denied coverage. In a court of law, when legal determinations must be made because of ambiguity in a contract of adhesion, the court will render its interpretation against the party that wrote the contract. Typically, the court will grant any reasonable expectation on the part of the insured (or his or her beneficiaries) arising from an insurer-prepared contract.

(c) Utmost good faith

Although all contracts ideally should be executed in good faith, insurance contracts are held to an even higher standard, requiring the utmost of this quality between the parties. Due to the nature of an insurance agreement, each party needs - and is legally entitled - to rely upon the representations and declarations of the other. Each party must have a reasonable expectation that the other party is not attempting to defraud, mislead, or conceal information and are indeed conducting themselves in good faith. In a contract of utmost good faith, each party has a duty to reveal all material information (that is, information that would likely influence a party's decision to either enter into or decline the contract), and if any such data is not disclosed, the other party will usually have the right to void the agreement.

(d) Executory

An executory contract is one in which the covenants of one or more parties to the contract remain partially or completely unfulfilled. Insurance contracts necessarily fall under this strict definition; of course, it's stated in the insurance and agreement that the insurer will only perform its obligation after certain events take place (in other words, losses occur).

(e) Unilateral

A contract may either be bilateral or unilateral. In a bilateral contract, each party exchanges a promise for a promise. However, in a unilateral contract, the promise of one party is exchanged for a specific act of the other party. Insurance contracts are unilateral in nature.

The insured performs the act of paying the policy premium, and the insurer promises to reimburse the insured for any covered losses that may occur. It must be noted that once the insured has paid the policy premium, nothing else is required on his or her part; no other promises of performance were made. Only the insurer has covenanted any further action, and only the insurer can be held liable for breach of contract.

(f) Conditional

A condition is a provision of a contract which limits the rights provided by the contract. In addition to being executory, aleatory, adhesive, and of the utmost good faith, insurance contracts are also conditional. Even when a loss is suffered, certain conditions must be met before the contract can be legally enforced.

For example, the insured individual or beneficiary must satisfy the condition of submitting to the insurance company sufficient proof of loss, or prove that he or she has an insurable interest in the person insured.

There are two basic types of conditions:

(a) conditions precedent; and

(b) conditions subsequent.

A condition precedent is any event or act that must take place or be performed before the contractual right will be granted. For instance, before an insured individual can collect medical benefits, he or she must become sick or injured. Further, before a beneficiary will be paid a death benefit, the insured must actually become deceased. A condition subsequent is an event or act that serves to cancel a contractual right. A suicide clause is an example of such a condition. Typical suicide clauses cancel the right of payment of the death benefit.

(g) Personal Contracts

Insurance contracts are usually personal agreements between the insurance company and the insured individual, and are not transferable to another person without the insurer's consent. (Life insurance and some maritime insurance policies are notable exceptions to this standard.)

As an illustration, if the owner of a car sells the vehicle and no provision is made for the buyer to continue the existing car insurance (which, in actuality, would simply be the writing of the new policy), then coverage will cease with the transfer of title to the new owner.

(h) Warranties and Representations

A warranty is a statement that is considered guaranteed to be true and, once declared, becomes an actual part of the contract. Typically, a breach of warranty provides sufficient grounds for the contract to be voided. Conversely, a representation is a statement that is believed to be true to the best of the other party's knowledge. In order to void a contract based on a misrepresentation, a party must prove that the information misrepresented is indeed material to the agreement. According to the laws of most states and in most circumstances, the responses that a person gives on an insurance application are considered to be a representations, and not warranties.

As an example, consider an individual seeking life insurance coverage. He or she would routinely be required to complete an application, on which the applicant's sex and age would be requested. The accuracy of this information is necessary for the insurer to correctly ascertain its risk and determine the policy premium. If the applicant gives these responses incorrectly, they would likely be deemed (in the absence of outright fraud) as misrepresentations, and could possibly be used by the insurance company as grounds for voiding the policy.

There is, however, a difference between the representation (or misrepresentation) of a fact and the expression of an opinion.

Take, for instance, a common insurance application question such as, "To the best of your knowledge, do you now believe yourself to be in good health?"

An applicant answering 'yes' while knowing that he or she suffers from a particular condition would be guilty of misrepresenting an actual fact.

However, if the applicant had no symptoms of any kind that would be recognizable to an average person and no doctor's opinion to the contrary, he or she would simply be stating an opinion and not making a misrepresentation.

(i) Misrepresentations and Concealments

A misrepresentation is a statement, whether written or oral, that is false. Generally speaking, in order for an insurance company to void a contract because of misrepresented information, the information in question must be material to the decision to extend coverage.

Concealment, on the other hand, is the failure to disclose information that one clearly knows about. To void a contract on the grounds of concealment, the insurer typically must prove that the applicant willfully and intentionally concealed information that was of a material nature.

(j) Fraud

Fraud is the intentional attempt to persuade, deceive, or trick someone in an effort to gain something of value. Although misrepresentations or concealments may be used to perpetrate fraud, by no means are all misrepresentations and concealments acts of fraud.

For instance, if an insurance applicant intentionally lies in order to obtain coverage or make a false claim, it could very well be grounds for the charge of fraud. However, if an applicant misrepresents some piece of information with no intent for gain (such as, for example, failing to disclose a medical treatment that the applicant is personally embarrassed to discuss), then no fraud has occurred.

(k) Impersonation (false pretenses)

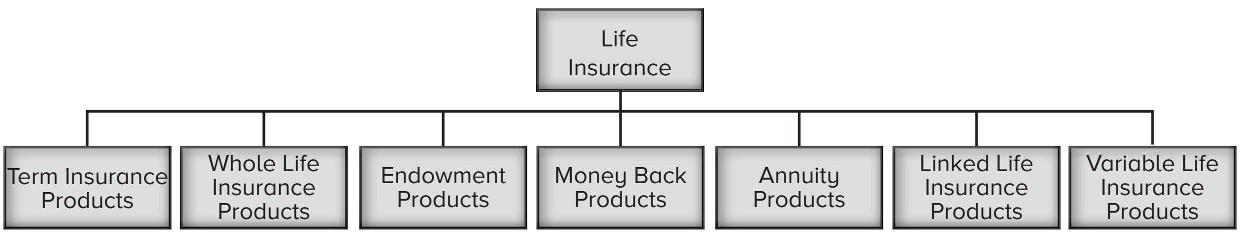
When one person assumes the identity of another for the purpose of committing a fraud, that person is guilty of the offense of impersonation (also known as false pretenses). For instance, an individual that would likely be turned down for insurance coverage due to questionable health might request a friend to stand in for him (or her) in order to complete a physical examination.

(l) Parol (or Oral) evidence rule

This principle limits the effects that oral statements made before a contract's execution can have on the contract. The assumption here is that any oral agreements made before the contract was written were automatically incorporated into the drafting of the contract. Once the contract is executed, any prior oral statements will therefore not be allowed in a court of law to alter or counter the contract.

BROAD CATEGORIES OF INSURANCE

Life Insurance Products



Term Insurance Product

These are pure life insurance products where the benefit (lump sum) is payable only on the happening of death during the term of the life insurance policy. These policies cover the risk of dying early and provide a lump sum to the Nominee (usually a Family member) to take care of their future needs.

Term Plan

In case the Life assured survives the Term of the Policy, nothing is payable. However, there are options available for return of premiums paid in case the Life assured survives the term of the Policy. These Policies are taken for a fixed term.

Premiums under Term insurance products are relatively the lowest as they do not have any savings component. This is the cheapest of all the Life insurance policies. Premium depends upon the age of the life insured. Higher the age, higher the premium, as the risk taken by the life insurance company increases with age.

Term insurance policies are still not popular as the level of insurance awareness in India is very low. Generally, Policyholders expect a benefit payable during their lifetime. Since Term insurance products do not provide any benefit during survival of the Life assured (except for Return of premiums upon survival till the end of the term of the Policy), these products are still unpopular.

Whole Life Insurance Products

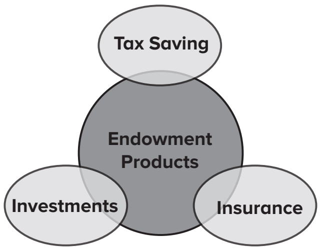
As the name suggests, whole life insurance products cover the risk of dying early till the person's death, as compared to a Term where the risk coverage is available only till the expiry of the term mentioned in the Policy, say 5 years, 10 years, 15 years etc., as chosen by the Policyholder.

Essentially, Whole Life insurance products are extensions of Term insurance products and also provide benefits (usually lump sum) payable only on the death of the life assured. But the coverage is available through out the life. However, generally across various life insurance companies, where the life assured attains the age of 85, the Sum assured is paid to the Policyholder if he/she survives age 85. In case of Participating products, bonuses are also paid.

For the reasons mentioned under Term insurance products, even Whole Life insurance products are also not popular.

Endowment Products

Under Endowment products, the benefits (Sum assured) are payable either upon death during the term of the Policy or if the Life assured survives the maturity of the Policy, upon maturity of the policy, whichever is earlier. Therefore, at the end of the Policy term, in case the Life assured survives, the Policyholder gets a lump sum benefit. In case of Participating products, the Bonuses declared are also paid upon the death or maturity (reversionary bonuses).



Money Back Products

These are extensions of Endowment products where under, the Policyholder is entitled to periodic payouts, if he survives specified terms during the tenure of the Policy. For example, if the Life assured survives 10 years from the date of taking the Policy, 25% of the Sum Assured shall be paid, 50% at the end of 15 years and the balance on Maturity. Under these products, the Sum Assured, instead of being paid only upon survival on maturity, is accelerated and paid in installments. However, in the event of death anytime during the term of the Policy, full Sum Assured is paid, irrespective of the installments that may have been paid already.

Annuity Products

Annuities are periodic (usually monthly) payouts made in consideration of a lump sum amount deposited in the beginning of the Policy. Annuity products come in handy for Pension Policies which are used to plan postretirement income.

For example, under the New Pension Scheme run by Pension Funds Regulatory and Development Authority, a member of the Scheme saves money through the Scheme by making periodic contribution which is invested by NPS in market-linked instruments and the corpus grows like a mutual fund. Upon the member attaining the age of Superannuation, NPS utilizes the entire lump sum (or up to 2/3rds, if the member wants to commute 1/3 of the corpus) to purchase an annuity policy from a Life insurance company. Thereafter, the Life insurer starts paying an immediate annuity to the purchaser till his/her death (or after his/her death to Spouse etc., depending upon the nature of annuity option).

Linked Life Insurance Products

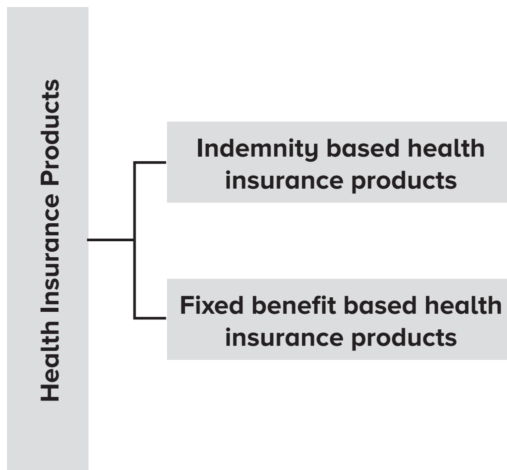
These are Life insurance products which are a combination of Term insurance plus Investments. Under Linked insurance products, after deducting the premium towards mortality (risk premium) for covering the benefit payable on death, the Life insurer allocates the balance premium available for investments in market-linked instruments (like Mutual fund) and declare Net Asset Value of the investment portion. Life insurer is eligible to deduct charges like Premium allocation charges, Policy administration charges, Fund management charges etc., for administering and managing the investment portion of the premium. On death, the Nominee usually gets the Sum Assured + Fund value on date of death. However, there are other options available. Upon maturity, usually only the Fund value is paid.

Variable Life Insurance Products

These are also called Universal Life Products, which provide a guaranteed interest credits (like a Bank account) in addition to Life insurance cover. These are in the nature of Deposit-linked-life insurance products. However these products are not popular in India.

Health Insurance Products

Health insurance products cover the risk of hospitalisation and provide financial support upon hospitalisation of the life assured. There are 2 types of health insurance products:



Indemnity based health insurance products are sold by Non-life insurance companies and Standalone health insurance companies. Under these products, the actual amount spent by the Life assured is paid by the Insurance Company within the limits of the Sum assured selected. Either the amount is reimbursed to the Life assured or the amount is paid directly to the Hospital (Cashless scheme) by the Insurance Company.

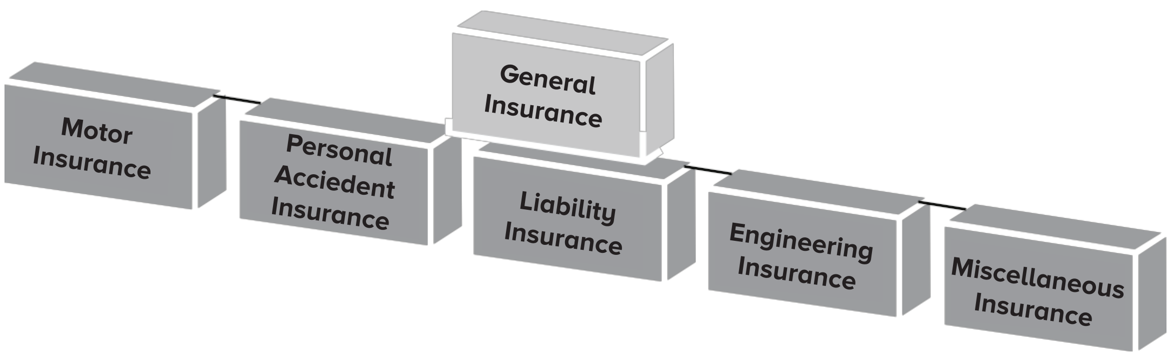
Fixed benefit based health insurance products are usually critical illness policies under which a fixed amount is paid to the Life insured upon proof of hospitalisation and the proof of having spent the money for diagnosis, medicines etc., is usually not insisted.

By definition, Travel insurance is also included in the definition of health insurance products.

General Insurance Products

Fire insurance policies cover the risk of loss arising out of unforeseen fire accidents with the limit of the Sum assured. These products are more popular in Corporates than with individuals. They are designed to provide financial protection for property against loss or damage by fire and other specified perils. Reinstatement value clauses are attached to Fire policies under which the amount payable is the cost of reinstating property of the same kind or type, by new property.

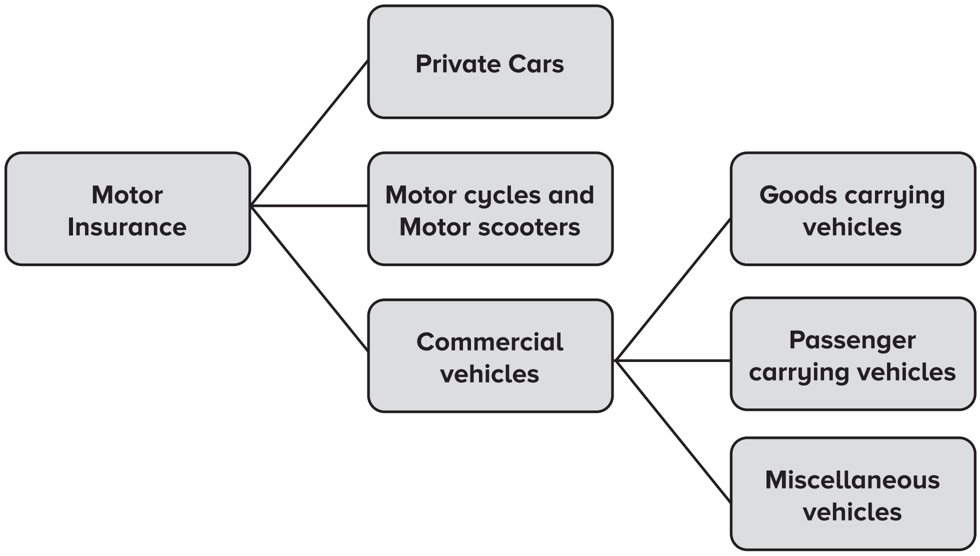
General Insurance Products



Marine insurance policies comprise of Cargo insurance and hull insurance. Cargo insurance provides insurance cover in respect of loss of or damage to goods during transit by rail, road, sea or air. Hull insurance on the other hand, concerns the insurance of ships (hull, machinery etc.).

Motor Insurance

Motor insurance, as the name suggests, is insurance of motor vehicles and are broadly classified as follows:



Insurance of Motor Vehicles are covered under the Motor Vehicles Act, 1939. Insurance of motor vehicles against damage is not made compulsory, but the insurance against third party liability arising out of the use of motor vehicles in public places is made compulsory. Insurance Cover against damage is known as "Own Damages" and against injury or death to a third party is known as "Third Party" claim. No motor vehicle can ply in a public place without such insurance. Recently, pursuant to a Supreme Court decision, all Insurers are mandated to issue Long term policy for Third Party risks- Three years for new private cars and five years for new two wheelers.

Personal Accident Insurance

The Policy provides that, if the insured shall sustain any bodily injury resulting solely and directly from accident caused by external, violent and visible means, then the Insurance company shall pay to the insured or his legal personal representative(s), as the case may be, a Sum assured under the Policy. The Policy covers the contingency of death, loss of body parts and Permanent and Temporary disablements.

Liability Insurance

The purpose of liability insurance is to provide indemnity in respect of damages payable under law for personal liability of any nature. This legal liability may arise under the common law on the basis of negligence or under statutory law (e.g. Public Liability Insurance Act or Workman's Compensation Act) on 'no fault basis', i.e., even when there is no negligence.

Engineering Insurance

Engineering insurance covers the various risks in a manufacturing organisation, especially plants. The various categories of Engineering insurance are as follows:

(a) **Contractors All Risks Policy** – designed to protect the interests of contractors and principals in respect of civil engineering projects like buildings, bridges, tunnels etc.

(b) **Erection All Risks Policy** – is concerned with erection of electrical plant and machinery and equipment and structures involving no or very little civil engineering work.

(c) **Marine-cum-erection Policy** – concerns with the delivery of the first consignment of plant and machinery at the site of erection.

(d) **Machinery breakdown Policy** – Insurable property include boilers, electrical, mechanical and lifting equipment.

(e) **Contractors Plant & Machinery Policy** – Policy given to a Contractor who may be using his plant and machinery at different projects during the course of the year.

(f) Boiler & Pressure Plant Policy.

(g) **Machinery Loss of Profits Policy** or Machinery insurance indemnify an insured against material damage resulting from breakdown or explosion or collapse of machinery – such damage may also result in business interruption at the Insured's premises.

(h) **Advance Loss of Profits Policy** – risk of delay of project due to accidental damage to project materials.

(i) **Deterioration of Stock Policy** – covers loss due to breakdown of refrigeration.

(j) **Electronic Equipment Policy** - physical loss or damage necessitating repairs or replacement.

(k) **External Data Media** – covers cost of replacing damaged external storage media.

(l) **Increased cost of working** – indemnifies against all additional cost incurred to ensure continued data processing on substitute equipment if such costs are incurred as an unavoidable consequence of loss or damage indemnifiable under material damage section of the policy.

Miscellaneous Insurance

Miscellaneous Insurance products include the following products:

(a) Burglary insurance

(b) Householders' Insurance

(c) Shopkeepers' Insurance

(d) Bankers' Blanket Policies

(e) Jewellers' Block Policies

(f) Blood Stock (Horse) Insurance

(g) All Risks Insurance Policy – includes jewellery, valuables, antiques, paintings, watches, cameras etc.

(h) Money insurance – covers the risk of loss of money in transit

(i) Fidelity guarantees – covers the risk of arising out of dishonesty of employees

(j) Television insurance

(k) Pedal cycle insurance

(l) Plate Glass insurance – breakage of plain glass

(m) Neon sign insurance

Rural Insurance

Rural insurance includes the following categories of products:

(a) Cattle Insurance
(b) Sheep and Goat Insurance
(c) Poultry Insurance
(d) Dog Insurance
(e) Silk Worm Insurance
(f) Honey Bee Insurance
(g) Horticulture/Plantation Insurance Scheme
(h) Comprehensive Floriculture Insurance
(i) Agriculture Pump set Policy
(j) Salt Works Insurance
(k) Cycle Rickshaw Policy
(l) Animal Driven Cart Insurance
(m) Gobar Gas Insurance
(n) Hut Insurance
(o) Weather/Crop Insurance

ROLE OF INSURANCE IN ECONOMIC DEVELOPMENT

- **Provides Safety and Security to Individuals and Businesses:** Insurance provides financial support and reduces uncertainties that individuals and businesses face at every step of their lifecycles. Insurance provides an ideal risk mitigation mechanism against events that can potentially cause financial distress to individuals and businesses). For example, these days cost of any medical treatment is increased as compared to earlier days due to better facilities. Without medical insurance a simple medical procedures cost enough to disturb a family's well-calculated budget, but a Health Insurance would ensure financial security for the family. In case of business insurance, financial compensation is provided against financial loss due to fire, theft, mishaps related to marine activities, other accidents etc.

- **Generates Long-term Financial Resources:** The Insurance sector generates funds by way of premiums from millions of policyholders. Due to the long-term nature of these funds, these are invested in building long-term infrastructure assets (such as roads, ports, power plants, dams, etc.) that are significant to nation-building. Employment opportunities are increased by big investments leading to capital formation in the economy.

- **Promotes Economic Growth:** The Insurance sector makes a significant impact on the overall economy of the Country by mobilizing domestic savings. Insurance convert the accumulated capital collected as premium ito productive investments. Insurance also enables mitigation of losses, financial stability and promotes trade and commerce activities those results into sustainable economic growth and development. Thus, insurance plays a crucial role in the sustainable growth of an economy of the Country.

- **Provides Support to Families during Medical Emergencies:** Good health of family members is very important for a family. From elderly parents to newborn children, medication and hospitalization play important role while ensuring well-being of families. Increased medical treatment costs and soaring medicine prices are enough to make whole in the pocket of the family if the family is not well prepared for medical treatment of any family member. Anyone can fall victim to critical illnesses (such as heart attack, stroke, cancer etc.) unexpectedly. Medical Insurance is a policy that protects individuals financially against different type of health risks. With a Health Insurance policy, an insured gets financial support in case of medical emergency.

- **Spreads Risk:** The risk of loss is transferred from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large population gets insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of corpus of funds collected from the millions of policyholders.

LESSON ROUND-UP

- Insurance is a form of contract or an arrangement where one party agrees in return for a consideration to pay an agreed amount of money to another party to make good the loss, damage or injury to something of value in which the insured has an interest.
- In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra).
- Year 1818 saw the advent of life insurance business in India with the establishment of the Oriental Life Insurance Company in Calcutta.
- General Insurance in India has its roots in the establishment of Triton Insurance Company Ltd., in the year 1850 in Calcutta by the British. In 1907, the Indian Mercantile Insurance Ltd., was set up. This was the first company to transact all classes of general insurance business.
- In 1972 with the passing of the General Insurance Business (Nationalisation) Act, general insurance business was nationalised with effect from 1st January, 1973.
- 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd.
- In 1999, the Insurance Regulatory and Development Authority (IRDA) was constituted as an autonomous body to regulate and develop the insurance industry. The IRDA was incorporated as a statutory body in April, 2000.
- Important Acts/Rules/Regulations governing Insurance Companies:
  - Insurance Act, 1938 and Insurance Laws (Amendment) Act, 2015
  - Insurance Rules, 1939
  - IRDA Act, 1999 Insurance Amendment Act, 2002
  - Rules and Regulations Framed under Insurance Regulatory and Development Authority IIRDAI) Act, 1999
- Insurance Regulatory and Development Authority of India ('IRDAI') is the Regulator for Insurance Companies operating in India. The mission of IRDAI is to protect the interests of Policyholders and to promote orderly growth of the Indian insurance industry.
- Main stakeholders in Insurance are (i) Policyholder (ii) Insurance Intermediary and (iii) The Insurance Company/Insurer.
- Insurance Policy specifies various terms and conditions governing the insurance coverage
- Essentials of Valid Insurance Contract:
  - Proposal
  - Acceptance
  - Consideration
  - Competency to contract
  - Consensus ad idem
  - Lawful object
- Types of Life Insurance Products:
  - Term Insurance Product
  - Whole life Insurance Product

  - Endowment Product
  - Money back product
  - Annuity Product
  - Linked Life Product
  - Variable Life Insurance Product
- Types of Health Insurance Product:
  - Indemnity based health Insurance Product
  - Fixed benefit health Insurance Product
- Types of General Insurance Product:
  - Fire Insurance Product
  - Marine Insurance Product
  - Motor Insurance Product
    - Private Cars
    - Motor Cycles and Motor Scooters
  - Commercial Vehicles:
    - Goods Carrying Vehicles
    - Passenger Carrying Vehicles
    - Miscellaneous Vehicles
  - Personal Accident Insurance
  - Liability Insurance
  - Engineering Insurance
  - Miscellaneous Insurance
  - Rural Insurance

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation).

1. What are the essentials of a valid insurance contract?
2. IRDAI is regulator of Insurance sector in India. Explain the role of IRDAI in regulating Insurance Companies' in India.
3. Insurance is risk mitigation tool. Explain this statement with the help of example.
4. What is the differences between Life Insurance and General Insurance Companies?
5. Insurance is a security tool. Explain.

Regulatory Framework in Insurance

Lesson 15

KEY CONCEPTS

■ Policyholder ■ Statutes ■ Regulations ■ FDI ■ FEMA ■ Reinsurance ■ Solvency Margin ■ Foreign Control

Learning Objectives

To understand:

- The overall structure of the Indian Insurance Market
- The Need for Regulating the Insurance Market
- The broad nature of the regulated Insurance Market
- The extent of powers of the Regulator
- Various Stakeholders in the Insurance Market & their interplay

Lesson Outline

- Introduction
- The Insurance Act, 1938
- IRDAI Act, 1999 – Constitution
- Role & Powers of IRDAI
- FDI and FEMA provisions pertaining to Insurance Sector
- Registration of Insurance & Reinsurance Companies
- Appointment of MD/WTD/CEO
- Restriction on the common directorship
- Requirement of Solvency Margin
- Advance receipt of Premium
- Prohibition on Rebates
- Rural & Social Obligations of Insurer
- Lesson Round-Up
- Test Yourself
- List of Further Readings

INTRODUCTION

Insurance business, essentially, involves financial protection against unforeseen events arising out of known risks affecting lives and properties of individuals and groups of individuals. Those seeking such protection are called Insureds or policyholders and those offering such protection are referred to as Insurers. The process of such protection, that is Insurance, thus requires payment of consideration money, called premium, by the policyholder/Insured for buying the Insurance and collection/maintenance of requisite funds, out of such premiums, by the Insurer to be able to indemnify the Insured in the event of an unforeseen event arising out of an insured risk, called 'Claim', taking place. The unforeseen events (also referred to as 'perils' in insurance parlance) against which the protection of insurance is sought, include fire, flood, earthquake, storm, typhoon, cyclone, etc., and some of these events could be catastrophic in nature, requiring the insurers to pay out huge amounts of claims to the affected insureds, threatening the very existence and solvency of the insurer. And, every insurer has to remain in a state of readiness to face such situations on perpetual basis as occurrence of such catastrophes cannot be predicted with any degree of certainty. The insurers manage their funds and reserves accordingly, while, at the same time, sharing large part of their actuarially estimated liabilities with global reinsurers, to minimize/limit their exposure within their capacity.

Apart from managing the catastrophic losses and protecting its solvency while facing the catastrophic losses at any point of time, an insurer is also required to manage its day to day affairs, including pricing of its products, distribution of its product, commission structure of its distributors (agents, brokers etc.), facing the competition in the market while aiming the requisite growth, management expenses for efficient servicing of the business necessary for the growth, investment of policyholders' funds, fair and just payment of claims to the claimant policyholders, and judicious declaration of dividends to the shareholders, in such a manner that the insurer is able to survive and grow in a solvent manner at all times, protecting the bonafide interests of its policyholders.

Availability of adequate insurance protection to its citizen is an objective that every government of the country aspires for welfare of its citizens, since the tool of insurance enables unlocking of individual reserve capital for productive purposes, while, at the same time, the investible funds available with the insurers serve to provide requisite capital for growth of industry and other segments of the economy. Presence of a healthy and strong insurance market and continuous growth thereof is of vital importance to economic growth of a country.

This, in turn, brings the role and responsibility of the State to create, and maintain, an appropriate Statutory and regulatory environment for the Insurance Sector that, on one hand, seeks to protect the interests of the policyholders, and, on the other hand, builds a system of requisite checks and balances for orderly, healthy, and solvent growth of the insurers and reinsurers.

In this Lesson we shall be studying about the statutory and regulatory environment created in India for the Insurance Sector, with particular reference to the role & powers of the regulator, and the regulations/statutory provisions governing the registration of insurers/reinsurers, FDI and FEMA provisions pertaining to Insurance Sector, Appointment of MD/WTD/CEO, Restriction on the common directorship, Advance receipt of Premium, Prohibition on Rebates, Requirement of Solvency Margin and Rural & Social Obligations of Insurers.

THE INSURANCE ACT, 1938

While Life Insurance business in modern India had commenced in the beginning of the 19^{th} century, with the establishment of the Oriental Life Insurance Company in 1818 in Calcutta leading to the presence of around 20 Life Insurance Companies by the end of the 19^{th} century, the General Insurance Business has its roots in the establishment of Triton Insurance Company in 1850 in Calcutta, though the growth of general insurance business picked up only in the early 20^{th} century with the birth of National Insurance Company in 1906 in Calcutta (the oldest general insurance Company surviving in the Country as on date) followed by the Indian Mercantile Insurance Company in 1907.

By the end of the first decade of the 20^{th} century, the number of players in the insurance market in India had grown substantially to warrant statutory regulation by the State for an orderly and healthy conduct of business and growth of the market. And accordingly, initial attempts in this direction were made by the government by enacting the Indian Insurance Companies Act and Provident Insurance Act in1912. However, soon both these legislations were found to be inadequate to serve the purpose they were meant for, and, in 1938, the government brought in a new comprehensive legislation on Insurance, known as the Insurance Act, 1938.

The Insurance Act, 1938 that received its assent on 26th February, 1938, and came into force on 01-07-1939 is surviving till date having been amended 28 times since inception. The first major amendment to the Insurance Act, 1938 was brought in 1968, the next one in the year 2000 vide the IRDA Act, 1999 effective from 19.04.2000, and the latest major amendment vide The Insurance Laws (Amendment) Act, 2015 effective from 26-12-2014.

While a detailed study or discussion on the Insurance Act, 1938, as amended till date, may neither be necessary nor feasible within the scope of this Study Course, it is advisable for the student to have an overall view and perspective of certain important provisions of this Act, and this is what we propose to do in this part of the Study Course.

Spread over Seven Parts, the Insurance Act, 1938 has 154 Sections, as under:

Part I – Preliminary (S. 1 to 2B) – 4 Sections

Part II – Provisions Applicable to Insurers (S.2C to 64) – 98 Sections

Part IIA – Life Insurance & General Insurance Councils (S.64C to 64R) – 12 Sections

Part IIB – Tariff Advisory Committee & Surveyors (S.64ULA & UM) – 2 Sections

Part IIC – Solvency Margin, Advance Premium (S.64V to VC) – 4 Sections

Part IVA – Reinsurance (S.101A to C) – 3 Sections

Part V – Miscellaneous (S.102 to 120) – 31 Sections

Part I of the Insurance Act, apart from describing the Short title, extent and commencement, deals with Definitions, Interpretation of certain words and expressions & Appointment of Authority of Insurance.

Part II of the Insurance Act, 1938 contains, inter alia, provisions regarding:

S. 2C: Prohibition of transaction of insurance business by certain persons;

S. 2CB: Properties in India not to be insured with foreign insurers except with the permission of Authority;

S.3: Certificate of registration for the particular class of insurance business;

S.6: Requirement as to Capital;

S.10: Separation of accounts and funds;

S.11&12: Accounts, balancesheet & Audit;

S.13, 14 & 15: Actuarial report, Records & Returns;

S.21, 22 & 25: Powers of IRDAI & Returns' publication;

S.27: Investment of Assets;

S.29: Prohibition of Loans to managers etc.;

S.31B: Power to restrict payment of excessive remuneration;

S.32A: Prohibition of common officers and requirement as to whole time officers;

S.32B: Insurance business in rural or social sector;

32C: Obligations of insurer in respect of rural or unorganized sector and backward classes;

32D: Motor TP Risk Obligations;

S.33 & 34: Power of Investigation & Directions by the Authority;

S.34B: Power of Authority to remove managerial persons from office;

S.34C: Power of Authority to appoint additional directors;

S.34D: Sections 34B and 34C to override other laws;

S. 34H: IRDAI's Powers for Search & Seizure;

S.35 & 37A: Amalgamation of Insurers;

S. 38 & 39: Assignments & Nominations of Policies;

S. 40, 40B & 40C: Limits of Expenses of Insurers;

S.41: Prohibition of rebates;

S.42: Appointment of insurance agents;

S.42A: Prohibition of insurance business through principal agent, special agent and multilevel marketing;

S. 42D, 42E & 43: Intermediary & Insurance Intermediary;

S.45: Policy not to be called in question on ground of misstatement after three years;

S.48A: Insurance agent or intermediary or insurance intermediary not to be director in insurance company;

S.50: Notice of options available to the assured on the lapsing of a policy;

S.51: Supply of copies of proposals and medical reports;

S.52: Appointment of Administrator by the Authority & his powers;

S.53: Winding up by NCLT;

S.54: Voluntary winding up – restrictions;

S.58A: Schemes for partial windingup of insurance companies.

Part IIA of the Insurance Act, 1938 contains, inter alia, provisions regarding:

S.64C & 64E: Life Insurance Council & General Insurance Council;

S.64J: Functions of EC of LI Council;

S.64L: Functions of EC of GI Council.

Part IIB of the Insurance Act, 1938 contains, inter alia, provisions regarding:

S.64UM: Surveyors or Loss Assessors.

Part IIC of the Insurance Act, 1938 contains, inter alia, provisions regarding:

S.64V & VA: Sufficiency & Valuation of Assets & Liabilities;

S.64VB: No risk to be Assumed without advance Payment of Premium;

S.64VC: Restrictions on the Opening of New Place of Business.

Part IVA of the Insurance Act, 1938 contains, inter alia, provisions regarding:

S.101A: Obligatory Cession under Re-Insurance;

S.101C: Examination of reinsurance treaties by the Authority.

Part V of the Insurance Act, 1938 contains, inter alia, provisions regarding:

S.102: Penalty for general default in complying with or violating this Act;

S.105C: Authority's Power to Adjudicate;

S.110: Appeal to Securities Appellate Tribunal;

S.110C: Authority's Power to call for any information from the insurer;

S.114, 114A & 116: Powers of central Govt. & IRDAI to make Rules & Exemptions.

Some of the more important provisions of the Insurance Act, 1938 shall be discussed in greater detail in this Lesson later on.

IRDAI ACT, 1999 – CONSTITUTION

The Insurance Act, 1938, as discussed above, is a comprehensive piece of legislation that has stood the test of time by keeping pace with the changes in the Insurance Sector with the requisite amendments from time to time since its original enactment till date. In particular, it took care of the requirement of the Insurance Sector from 1938 till 1956 (the year in which the Life Insurance Business was nationalized and LIC of India was incorporated) when the entire Insurance market was in private hands, then from 1956 till 1972 (the year in which the General Insurance business was nationalized) when the life insurance business was in nationalized sector and the general Insurance market remained in the private sector, and then from 1972 till 1999 (the year in which the Insurance Sector was opened up) when the entire insurance business in India was in the hands of the Government.

However, once the Government of India decided in 1999 to open up the Insurance business to private players, both Indian and foreign (allowing foreign investment capped at 26% holding in the Indian insurance companies), for creating a competitive market, it was necessary to not only bring in major amendments in the Insurance Act, 1938 to cater to the requirements and challenges of the changed market scenario comprising of both public and private sector players (Indian as well as foreign-collaborated), but also to create a well-equipped market Regulator to regulate the players' conduct and the market so emerging for which enacting a separate legislation was desirable. In fact, even before formal opening of the Insurance market in 1999, an interim Insurance Regulatory Authority (IRA) was set up by the Government in January, 1996 comprising of experts from the Insurance Sector, like Mr. KC Mittal (former CMD, Oriental Insurance, and later on Chairman, GIC), for drafting the legislation to govern the working of the proposed Insurance Regulator, and based on the recommendations of the said IRA, the IRDA Act, 1999 was passed by the Parliament, receiving the assent of the President of India on the 29th December, 1999.

The IRDAI Act, 1999, apart from establishing the Insurance Regulatory and Development Authority of India also introduced major consequential amendments in the Insurance Act, 1938, and minor similar amendments to the LIC Act, 1956 and General Insurance Business (Nationalization) Act, 1972, (in short, GIBNA Act, 1972) to make way for the private players, in addition to the existing nationalized players, in the Insurance Sector in India.

As in the case of Insurance Act, 1938, while a detailed study or discussion on the IRDAI Act, 1999 may neither be necessary nor feasible within the scope of this Study Course, it is advisable for the student to have an overall view and perspective of certain important provisions of this Act, and this is what we propose to do in this part of the Study Course.

The IRDAI Act, 1999 has 33 Sections spread over 6 Chapters, as follows:

Chapter I (Preliminary) carries 2 Sections containing 'Short title, extent and commencement' and 'Definitions'.

Chapter II (Insurance Regulatory And Development Authority) carries 10 Sections describing provisions relating to Establishment and incorporation of Authority (S.3), Composition of Authority (S.4), Tenure of office of Chairperson and other members (S.5), their Removal from office (S.6), Salary and allowances of Chairperson and members (S.7), Bar on future employment of members (S.8), Administrative powers of Chairperson (S.9.), Meetings and proceedings of Authority (S.10 &11), and Officers and employees of Authority (S.12).

Chapter III has only one Section (S.13) containing provisions regarding Transfer of assets, liabilities, etc., of Interim Insurance Regulatory Authority.

Chapter IV also has only one Section (S.14) containing provisions regarding Duties, powers and functions of Authority.

Chapter V (Finance, Accounts and Audit) carries 3 Sections describing provisions relating to Grants by Central Government to the Authority (S.15), Constitution of Fund of the Authority (S.16) and Accounts and audit of the Authority (S.17).

Chapter VI (Miscellaneous) carries the remaining 16 Sections, covering the following topics:

S.18. Power of Central Government to issued directions to the Authority;

S.19. Power of Central Government to supersede Authority in exceptional circumstances;

S.20. Furnishing of returns, etc., by the Authority to Central Government;

S.21. Chairperson, members, officers and other employees of Authority to be public servants;

S.22. Protection of action taken in good faith by Members, officers & employees of the Authority;

S.23. Delegation of powers by the Authority;

S.23A. Powers of Authority not to apply to International Financial Services Centre;

S.24. Power of Central Government to make rules;

S.25. Establishment of Insurance Advisory Committee by the Authority;

S.26. Power of the Authority to make regulations;

S.27. Rules made by the Government and regulations made by the Authority under this Act to be laid before Parliament;

S.28. Application of other laws not barred;

S.29. Power of Central Government to remove difficulties;

S.30. Consequential Amendments to the Insurance Act, 1938;

S.31. Consequential Amendment to the LIC Act, 1956;

S.32. Consequential Amendment to GIBNA Act, 1972.

Some of the more important provisions of the IRDAI Act, 1999 are discussed in greater detail in this Lesson in the subsequent paragraphs.

ROLE & POWERS OF IRDAI

The role and powers of IRDAI are derived from various Sections of the Insurance Act, 1938 and the IRDAI act, 1999.

Of all such Sections, Section 14 of the IRDAI Act describes the duties, powers and functions of the Authority in the most general terms. While subsection (1) of Section 14 requires the Authority to perform the duty to regulate, promote and ensure orderly growth of the insurance business and re-insurance business, subsection (2) empowers the Authority to perform the following functions:

(a) Issue to the applicant a certificate of registration, renew, modify, withdraw, suspend or cancel such registration;

(b) Protection of the interests of the policy holders in matters concerning assigning of policy, nomination by policy holders, insurable interest, settlement of insurance claim, surrender value of policy and other terms and conditions of contracts of insurance;

(c) Specifying requisite qualifications, code of conduct and practical training for intermediary or insurance intermediaries and agents;

(d) Specifying the code of conduct for surveyors and loss assessors;

(e) Promoting efficiency in the conduct of insurance business;

(f) Promoting and regulating professional organizations connected with the insurance and re-insurance business;

(g) Levying fees and other charges for carrying out the purposes of the Act;

(h) Calling for information from, undertaking inspection of, conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business;

(i) Control and regulation of the rates, advantages, terms and conditions that may be offered by insurers in respect of general insurance business not so controlled and regulated by the Tariff Advisory Committee under section 64U of the Insurance Act, 1938 (4 of 1938);

(j) Specifying the form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other insurance intermediaries;

(k) Regulating investment of funds by insurance companies;

(l) Regulating maintenance of margin of solvency;

(m) Adjudication of disputes between insurers and intermediaries or insurance intermediaries;

(n) Supervising the functioning of the Tariff Advisory Committee;

(o) Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations referred to in clause (f);

(p) Specifying the percentage of life insurance business and general insurance business to be undertaken by the insurer in the rural or social sector; and

(q) Exercising such other powers as may be prescribed.

Section 26 of the IRDAI Act grants power to the Authority to make Regulations consistent with the Act and the rules made thereunder to carry out the various purposes of the Act.

In addition to this, the Insurance Act, 1938 also confers the following powers upon the Authority as per its various Sections indicated herein below:

S.2CB: Power to Grant permission for insurance of a Property in India with foreign insurers;

S.33 & 34: Power of Investigation & Directions by the Authority;

S.34B: Power of Authority to remove managerial persons of an insurer from office;

S.34C: Power of Authority to appoint additional directors of an insurer;

S. 34H: Powers for Search & Seizure in any entities it is required to regulate under the Insurance Act & the IRDAI Act;

S.35 & 37A: Power to approve and frame scheme of Amalgamation of Insurers;

S.52A: Power to appoint an Administrator of an insurer for management of insurance business;

S.53: Power to approach the NCLT for Winding up of an insurer by the Tribunal;

S.101A: Power to specify percentage of the sum assured on each policy every insurer is required to re insure with Indian reinsurers;

S.101C: Power of Examination of reinsurance treaties and other reinsurance contracts entered into by the insurer;

S.105C: Power to Adjudicate under various sections of the Act;

S.114A: Power of Authority to make regulations consistent with the Insurance Act and the rules made there under, to carry out the purposes of the Act.

FDI AND FEMA PROVISIONS PERTAINING TO INSURANCE SECTOR

The Life Insurance Business in India was nationalized in 1956 and the General Insurance Business was nationalized in 1972. Before nationalization of the respective class of Insurance, there were both Indian and foreign private insurers operating in India, but, after nationalization, that is, since 1956 in Life Insurance and since 1972 in General Insurance, till 1999, there were no private players (whether Indian or foreign) operating in the Indian Insurance Market.

However, once the Government of India decided to open up the Insurance Sector in India in 1999 (as a sequel to, and part of, the New Economic Policy-1991), the opening up of the sector was not confined to only Indian private sector, and the foreign players were also envisaged to enter the Indian Insurance Market. Accordingly, the IRDA Act, 1999, brought in essentially to create the framework and infrastructure necessary for opening up of Insurance Sector in India, provided for requisite amendments in Insurance Act, 1938. In particular, Clause 7A was inserted in Section 2(Definitions) of the Insurance Act, 1938, to define an Indian Insurance Company as one "in which the aggregate holdings of equity shares by a foreign company, either by itself or through its subsidiary companies or its nominees, do not exceed ***twenty-six per cent*** of the paid up equity capital of such Indian insurance company".

The 26% level of FDI allowed in the Insurance Sector in 1999 was in conformity with the level of FDI prevailing in other sectors of Indian Economy in 1999, particularly to begin with. And, a number of foreign insurers (AIG, Allianz, Prudential, Lombard, Ergo, Tokio Marine, etc.) entered the Indian Insurance market with 26% FDI in an Indian Insurance Company from 2000 onwards. The entry of private players, particularly with the foreign collaboration, resulted in expected positive impact on the insurance market in India, ranging from changed marketing practices, customer awareness, servicing and expectations, technological innovations etc. and the public sector insurance Companies gearing up themselves in competition with ultimate benefit going to the customer.

One argument that has always been given in favor of FDI in India, apart from the international commitments, is capital requirement of the market (most relevant in the context of Insurance, which is a capital intensive business), technological advancements, availability of new products and international best practices in service standards for the benefit of Indian customer. At the same time, excessive FDI is fraught with many apprehensions, including issues of national economic sovereignty, protection of Indian market from global economic volatility (as seen in the Sub-prime Crisis of 2008), etc. Having regard to all the relevant aspects in this regard, and striking an overall balance amongst the conflicting interests, the Central Government, through the 2015 Amendment in the Insurance Act, increased the FDI limit in Insurance Sector from 26% to 49%, with adequate Indian control as a safeguard, by replacing Clause 7A in Section 2, with the following:

"(7A) "Indian insurance company" means any insurer, being a company which is limited by shares, and,—

(a) which is formed and registered under the Companies Act, 2013 as a public company or is converted into such a company within one year of the commencement of the Insurance Laws (Amendment) Act, 2015;

(b) in which the aggregate holdings of equity shares by foreign investors, including portfolio investors, do not exceed ***forty-nine per cent*** *of the paid up equity capital of such Indian insurance company, which is Indian owned and controlled, in such manner as may be prescribed.*

Explanation.—For the purposes of this sub-clause, the expression "control" shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements;

(c) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business or health insurance business;"

In the revised definition of an Indian Insurance Company, and in the context of increase in the FDI from 26% to 49% in the Insurance Sector, it is important to see the introduction of the explanation of the word "control" while talking of Indian ownership and control therein, as narrated above.

Simultaneous with the increase in the FDI from 26% to 49% in the Insurance Sector, the Government also published, on 19th February, 2015, the *"Indian Insurance Companies (Foreign Investment) Rules, 2015"* in exercise of the powers vested in it by the Insurance Act, 1938 and the IRDA Act, 1999, so as to facilitate implementation of the revised provision without any hassles therein. These Rules, inter alia, provide clarification on the meaning of key words, like "Control", "equity share capital", "FIPB", "Foreign Direct Investment", "Foreign Investors", "Foreign Portfolio Investment", "Indian Company", "Indian Control of an Indian Insurance Company", "Indian Ownership", "Non-resident Entity", "Public Financial Institution", "Resident Indian Citizen", and "Total Foreign Investment" and the manner of computation of foreign holding of Indian promoter or Indian Investor Company.

Broadly, these Rules, apart from mandating that no Indian insurance company shall allow the aggregate holdings by way of Total Foreign Investment in its equity shares by Foreign Investors, including portfolio investors, to exceed forty-nine percent of its paid up equity capital, requires an Indian Insurance Company to ensure that its ownership and control shall remain at all times in the hands of resident Indian entities as defined therein. The Rules further provide for the Foreign Direct Investment proposals upto 26 per cent of the total paid up equity of the Indian Insurance Company to be allowed on the automatic route, while the FDI proposals which take the total Foreign Investment in the Indian Insurance Company above 26 per cent and upto the cap of 49 per cent shall be on the FIPB route, and shall require FIPB approval subject to compliance of the provisions of the Act.

These Rules also provide that the Foreign Portfolio Investment in an Indian Insurance Company shall be governed by the provisions contained in sub-regulations (2), (2A), (3) and (8) of regulation 5 of FEMA Regulations, 2000 and provisions of the Securities Exchange Board of India (Foreign Portfolio Investors) Regulations, while any increase of foreign investment of an Indian insurance company shall be in accordance with the pricing guidelines specified by Reserve Bank of India under the FEMA.

Lastly, these Rules stipulate that the foreign equity investment cap of 49 per cent shall apply on the same terms as above to Insurance Brokers, Third Party Administrators, Surveyors and Loss Assessors and other insurance intermediaries appointed under the provisions of the IRDA Act, 1999. Further, in the case of an entity like a Bank, whose primary business is outside the insurance area, and which is allowed by the Authority to function as an insurance intermediary, the foreign equity investment caps applicable in that sector shall continue to apply, subject to the condition that the revenues of such entities from their primary (i.e. non-insurance related) business must remain above 50 per cent of their total revenues in any financial year.

After experiencing the effect of increasing the FDI from 26% to 49%, the Central Government, vide Amendment Notification dated 19th May, 2021, has further increased the limit of FDI in Insurance Sector from 49% to 74%. However, while doing so, it has further tightened the norms of Indian ownership and control in an Insurance Company by substituting Rule (4) of the principal Rules, Indian Insurance Companies (Foreign Investment) Rules, 2015, by the following:

> *"4. (1) In an Indian Insurance Company having foreign investment,—*
>
> > *(a) a majority of its directors,*
> >
> > *(b) a majority of its Key Management Persons, and*
> >
> > *(c) at least one among the chairperson of its Board, its managing director and its Chief Executive Officer, shall be Resident Indian Citizens.*
>
> *Explanation - For the purposes of this rule and rule 9, the expression "Key Management Person" shall have the same meaning as assigned to it in guidelines made by the Authority on corporate governance for insurers in India.*
>
> *(2) Every Indian Insurance Company having foreign investment, existing on or before the date of commencement of the Indian Insurance Companies (Foreign Investment) Amendment Rules, 2021, shall within one year from such commencement, comply with the requirements of the provisions of sub-rule (1).*

4A. In an Indian Insurance Company having foreign investment exceeding forty-nine per cent—

(a) for a financial year for which dividend is paid on equity shares and for which at any time the solvency margin is less than 1.2 times the control level of solvency, not less than fifty per cent. Of the net profit for the financial year shall be retained in general reserve; and

(b) not less than fifty per cent of its directors shall be independent directors, unless the chairperson of its Board is an independent director, in which case at least one-third of its Board shall comprise of independent directors.".

As a consequence of notification of Indian Insurance Companies (Foreign Investment) Rules, 2015, the RBI has also reviewed and revised the regulations issued under the Foreign Exchange Management (Insurance) Regulations, 2000 and the said Regulations have been repealed and superseded by the Foreign Exchange Management (Insurance) Regulations, 2015 notified vide G.S.R. No. 1007(E) dated December 29, 2015. The revised notification has come into force with effect from December 29, 2015.

The FEM (Insurance) Regulations, 2015, in the case of General/Health Insurance contain provisions relating to Payment of insurance premium in foreign exchange, General/ Health Insurance policies from Insurers outside India, Settlement of claims in foreign currency if arising outside India under General/ Health Insurance policies taken by Indian Residents, General/Health Insurance policies by Residents outside India, Transaction in Nepal and Bhutan, Settlement of claims in foreign currency, Remittances falling due under Re-Insurance, Remittance of Reinsurance Premium by IRDAI licensed brokers, Insurance Balances in Foreign Currency Accounts Held Abroad and Investments by General/health insurers Abroad.

Similarly, the FEM (Insurance) Regulations, 2015, in the case of Life Insurance contain provisions relating to Life insurance policy from insurer outside India by Residents in India, apart from issuance of policies and collection of premium in foreign currency to resident persons of Indian nationality or origin who have returned to India after being resident outside India, to foreign nationals not permanently resident in India, and to Indian nationals and persons of Indian origin resident abroad, settlement of claims in foreign currency on life insurance policies in favor of claimants resident outside India on Life insurance policies by insurer in India, payment of Commission to overseas Agents, Remittances falling due under Re-Insurance, Insurance Balances in Foreign Currency Accounts Held Abroad and Investments by Life insurers Abroad, and Utilization of Foreign Currency Funds by Insurer.

REGISTRATION OF INSURANCE & REINSURANCE COMPANIES

As per Section 3 of the Insurance Act, 1938, no person can carry on any class of insurance business in India unless he has obtained a certificate of registration for the particular class of insurance business from IRDAI as per its Regulations. The Regulations made in this behalf by the IRDAI are in exercise of the powers conferred on it by various Sections of the Insurance Act, 1938 and the IRDA Act, 1999.

The first such Regulations, known as the Insurance Regulatory and Development Authority of India (Registration of Indian Insurance Companies) Regulations, 2000, were notified by it under Section 114A of the Insurance Act, 1938 read with section 26 of the Insurance Regulatory and Development Authority Act, 1999 and came in to force with effect from 19.07.2000. These Regulations stood the test of time for over 20 years, having undergone 8 amendments in between, including the major amendment (7^{th} amendment) dated 22.02.2016 following the 2015 amendment to the Insurance Act, 1938, that increased the FDI limit in Insurance Sector from 26% to 49%.

However, once the FDI in Insurance Sector was increased from 49% to 74% in May, 2021, these Regulations required repeal and replacement by fresh set of Regulations in this regard so as to address the situation arising from such increase in the FDI and safeguard the interests of policyholders as well as reflect the provisions accompanying such increase in the FDI more effectively. It was also felt that to promote growth of insurance sector and to promote ease of doing business it was necessary to simplify the process of registration of Indian insurance companies.

Accordingly, in exercise of the powers conferred on it by Section 114A of the Insurance Act, 1938, section 3, section 3A and section 6A of the Insurance Act, 1938 and section 26 of the Insurance Regulatory and Development

Authority Act, 1999, the IRDAI, vide Notification dated 5th December, 2022, published the Insurance Regulatory and Development Authority of India (Registration of Indian Insurance Companies) Regulations, 2022 (hereinafter referred to as the 2022-Regulations), repealing the existing Regulations of 19.07.2000. In what follows in this Section, we shall be discussing some of the salient provisions of these 2022-Regulations.

The 2022-Regulations on Registration of Indian Insurance Companies, apart from defining terms like Foreign Investors, Foreign Promoter, Indian Investors, Indian promoter, Investors, Key Management Person, Preliminary Expenses, PE Fund, Promoter, Shareholding Pattern, SPV and Transfer of Shares, in so far as these are used in compliance of the Regulations, contain provisions on the following main issues:

- Permissible Classes of Insurance Business for which requisition for registration application may be made (Reg. 3);
- Disqualifications for Applicant (Reg. 4);
- Procedure for registration (Reg. 5);
- Compliance Requirement (Reg. 6);
- Manner of calculation of equity capital held by foreign promoter and foreign investor (Reg. 7);
- Requirement of Resident Indian citizenship for Directors, Key Management Persons (Reg. 8);
- Requirements for foreign investment exceeding forty-nine percent (Reg. 9);
- Annual Fee (Reg. 10);
- Issue of duplicate certificate (Reg. 11);
- Suspension or Cancellation of Certificate of Registration (Reg. 12);
- Power to issue clarifications (Reg. 13);
- Interpretation (Reg. 14).

Out of these, we consider it desirable to describe here in some detail the procedure for Registration of an Indian Insurance/Reinsurance Company as provided for in Regulation 5.

As per Regulation 5, the first stage in the process pf Registration is obtaining a No-objection Certificate from the Authority. No company or co-operative society can be incorporated in India with a name that contains words ‘insurance’ or ‘assurance’ or ‘reinsurance’ without obtaining a No-objection Certificate from the Authority. The No-objection Certificate issued to the applicant shall be valid for a period of 6 months (unless extended by a further period of 3 months) within which the applicant shall file application for issuance of requisition for registration application i.e. Form IRDAI/R1.

The second stage is the R-1 stage at which the Authority, upon receipt of application for issuance of Form IRDAI/R1 and after examining the matters considered relevant to its satisfaction, shall issue the Form IRDAI/R1 which shall be valid for a period of three months (unless extended by a further period of 3 months) within which the applicant shall submit the duly filled Form IRDAI/R1 to the Authority for its consideration. Along with the Form IRDAI/R1, the applicant is required to submit a copy of The certificate of incorporation issued by Registrar of Companies in case of a company, a certified copy of the Memorandum of Association and Articles of Association, where the applicant is a company and incorporated under the Companies Act, 2013 or a certified copy of the legislation of Parliament setting up the statutory body to carry on insurance business, the name, address and the occupation of the directors of the promoter and the applicant, a certified copy of the annual report of promoter(s) for up to the last five years, as applicable, a certified copy of the shareholders’ agreement, as applicable, between promoter(s) and investor(s) of the applicant, Projection of business for five years duly approved by the Board of Directors of the applicant along with a certificate from a fellow actuary that the projections are reasonable and workable, Proof in support of payment of non-refundable fee of rupees five lakh along with applicable taxes towards processing the form IRDAI/R1 through any of the recognized modes of electronic fund transfer.

While processing the Form IRDAI/R1, the Authority shall take into account such matters as may be considered relevant including the general track record of conduct and performance of each of the promoters and investors in the fields of business or profession they are engaged in, the record of conduct and performance of the directors and persons in management of the promoters, investors and the applicant, the financial strength of the promoters, investors and the applicant, the capital structure of the promoters, investors and the applicant, the sources of meeting the capital requirements of the applicant, shareholding pattern of the applicant and its promoter(s), the ability of the applicant and its promoters to meet the obligation to provide life insurance or general insurance or health insurance to the persons residing in the rural sector, workers in the unorganized sector or informal sector or for economically vulnerable or backward classes of the society and other categories of persons specified by the Authority, the ability to meet the obligation to underwrite insurance business in third party risks of motor vehicles as specified by the Authority, the planned infrastructure of the applicant, the proposed business expansion plan for five succeeding years, including establishment of place of business in rural areas, to effectively carry out the insurance business, and other relevant matters for carrying out the provisions of the Act.

After examining the matters considered relevant and upon its satisfaction, The Chairperson of the Authority, shall issue the "R1" Approval subject to the conditions as may be specified in the said approval letter. Along with the said approval letter, the applicant shall be issued the application for registration i.e. Form IRDAI/R2. The "R1" approval shall be valid for a period of three months from the date of the said approval (unless extended by a further period of 3 months), within which the applicant shall submit duly filled Form IRDAI/R2 for consideration of the Authority.

The third stage is the R2 Approval stage. At this stage, the application in the Form IRDAI/R2 as per the specified format is submitted by the Applicant along with an affidavit by the applicant and its promoters that the paid-up share capital of the applicant, after deducting the preliminary expenses, shall be adequate to comply with the requirements of Capital as per section 6 of the Act, a statement indicating the shareholding pattern of the applicant as on the date of the application, an affidavit by the managing director or chief executive officer or whole-time director of the promoters and the investors of the applicant certifying that the holding of foreign paid-up equity capital, referred to in sub-clause (b) of clause (7A) of Section 2 of the Act, is calculated in accordance with Indian Insurance Companies (Foreign Investment) Rules, 2015 read with these Regulation and does not exceed seventy four percent of the total paid-up capital of the applicant, in case the applicant has foreign investment, an affidavit by the Managing Director or Chief Executive Officer or Whole-Time Director and the Promoter(s) of the applicant certifying that the requirement of regulation 8 shall be complied with, in case the applicant has foreign investment exceeding forty nine percent, an affidavit by the Managing Director or Chief Executive Officer or Whole-Time Director and the Promoters of the applicant certifying that the requirement of regulation 9 shall be complied with, a certified copy of the standard forms of the applicant and statements of the assured rates, advantages, terms and conditions to be offered in connection with insurance policies together with a certificate by an actuary in case of life insurance business that such rates, advantages, terms and conditions are workable and sound, a certified copy of the Memorandum of Understanding or Management Agreement or Shareholders Agreement or Voting Rights Agreements or any other agreements in whatsoever form entered into, between the promoters and the investors, if any, or amongst the promoters as a whole including copies of the support or comfort letters exchanged between the parties, a certificate from a practicing chartered accountant or a practicing company secretary certifying that all the requirements relating to registration fees, equity share capital, foreign investment limits and other requirements of laws for the time being in force including the Act have been complied with by the applicant, apart from proof in support of payment of non-refundable fee of rupees five lakh along with applicable taxes towards processing the Form IRDAI/R2 through any of the recognized modes of electronic fund transfer.

Upon completion of the processing of the Form IRDAI/R2 but prior to its approval by the Authority, the applicant is also required to submit evidence of applicant having received equity share application money in accordance with section 6 of the Act and complied with conditions of R1 approval granted by the Authority and an affidavit by the applicant, promoters and the investors that upon grant of Certificate of Registration, the said share application money shall be converted into paid-up equity share capital of the applicant.

While processing the form IRDAI/R2, the Authority takes into account the matters, as may be considered relevant, including the nature of insurance products proposed to be offered by the applicant, the level of actuarial, accounting and other professional expertise within the management of the applicant, the organizational structure of the applicant to carry on all functions in respect of the insurance business including management of the investments within its own organization, whether the applicant is eligible, and in its opinion, is likely to meet effectively its obligations imposed under the Act, the financial condition of the promoters, investors and the general character of the management of the applicant are sound, the volume of business likely to be available to, and whether the capital structure and earning prospects of the applicant will be adequate, the interests of the general public will be served if the certificate of registration is granted to the applicant in respect of the class of insurance business specified in the application, that the applicant has complied with the provisions of sections 2C, 5 and 31A of the Act and has fulfilled all the requirements of these sections applicable to it, and all other relevant matters for carrying out the provisions of the Act.

After examining the matters considered relevant and upon its satisfaction, the Authority, at its discretion, issues the "R2" Approval subject to the conditions as may be specified in the said approval letter.

The fourth stage is the R3 stage that is Grant of Certificate of Registration. After examining the matters considered relevant and upon its satisfaction, the applicant may be registered as an insurer for the class of business for which the applicant is found suitable and the chairperson of the Authority may grant the applicant the Certificate of Registration in Form IRDAI/R3 subject to the conditions as may be specified therein.

Once the Certificate of Registration under these Regulations has been granted, the applicant is required to commence insurance business, for which it has been authorized, within 12 months from the grant of Certificate of Registration. In case, the applicant fails to commence business within the stipulated time, the certificate of registration shall not be valid after expiry of stipulated time. However, in case the applicant is not in a position to commence the insurance business within the specified period of 12 months, it can before the time limit expires, seek an extension from the Authority through a written application highlighting the reasons for not being able to commence business within the specified period of 12 months, and requisite extension of time can be granted by the Authority but not beyond 24 months from the date of grant of Certificate of Registration.

An applicant aggrieved by the decision of the Authority, at any stage under these regulations, may appeal before the Securities Appellate Tribunal as per the provisions of the Act.

APPOINTMENT OF MD/WTD/CEO

The Insurance Act, 1938 confers upon the Authority vast powers in relation to appointment of Managing Directors (MDs), Whole Time Directors (WTDs) and Chief Executive Officers (CEOs).

Section 34A requires any provision relating to the appointment, reappointment, termination of appointment or remuneration of a managing or wholetime director, or of a manager or a chief executive officer, by whatever name called, whether that provision be contained in the insurer's memorandum or articles of associations, or in an agreement entered into by him, or in any resolution passed by the insurer in general meeting or by his Board of Directors not to have effect unless approved by the Authority. It further states that no appointment, reappointment or termination of appointment of a Managing or WholeTime Director, or a manager or a Chief Executive Officer, by whatever name called, shall have effect unless such appointment, reappointment or termination of appointment is made with the previous approval of the Authority.

Section 34B vests in the Authority the Power to remove managerial persons from office. As per Section 34B, where the Authority is satisfied that in the public interest or for preventing the affairs of an insurer being conducted in a manner detrimental to the interests of the policyholders or for securing the proper management of any insurer it is necessary so to do, it may, for reasons to be recorded in writing, by order, remove from office, with effect from such date as may be specified in the order, any director or the chief executive officer, by whatever name called, of the insurer. Of course, no such order shall be made unless the director or chief executive officer concerned has been given a reasonable opportunity of making a representation to the Authority against the proposed order.

Further, Section 34C speaks of the Power of Authority to appoint additional directors. As per this Section. if the Authority is of opinion that in the public interest or in the interest of an insurer or his policyholders it is necessary so to do, it may, from time to time, by order in writing, appoint, in consultation with the Central Government with effect from such date as may be specified in the order, one or more persons to hold office as additional directors of the insurer, subject to that the number of additional directors so appointed shall not, at any time, exceed five or one-third of the maximum strength fixed for the Board by the articles of association of the insurer, whichever is less.

It is important to note that the powers of the Authority under Section 34B and 34C have overriding effect upon anything to the contrary contained in this regard in the Companies Act, 2013, or any other law for the time being in force or in any contract or any other instrument.

RESTRICTION ON THE COMMON DIRECTORSHIP

Protection of the interests of the policyholders is at the heart of the Insurance Act, 1938 and the IRDA act, 1999. In congruence with this obligation, the Insurance Act has Section 32A, Sections 48A and Section 48B incorporated therein.

Section 32A prohibits a managing director of an insurer carrying on life insurance business from being a managing director of any other insurer carrying on life insurance business or of a banking company or of an investment company, without the permission of the Authority, which may permit such managing director to be a managing director of any other insurer carrying on life insurance business for the purpose of amalgamating the business of the two insurers or transferring the business of one insurer to the other.

Section 48A mandates that no Insurance agent or intermediary or insurance intermediary (or, director therein) can be a director in insurance company unless the Authority decides to permit him to be on the Board of an insurance company subject to such conditions or restrictions as it may impose to protect the interest of policyholders or to avoid conflict of interest.

Further, Section 48B prohibits an insurer specified in sub-clause (b) of clause (9) of section 2 (that is “a statutory body established by an Act of Parliament to carry on insurance business”) and carrying on life insurance business from having a common director with another such insurer. However, it also allows the Authority, for such period, to such extent and subject to such conditions as it may specify, to exempt from the operation of this prohibition,

(a) any insurer, who is a subsidiary company of another insurer, or,

(b) two or more insurers, for the purpose of facilitating their amalgamation or the transfer of business of one insurer to the other.

REQUIREMENT OF SOLVENCY MARGIN

Solvency of an insurer is sine qua non to protecting the interests of the policyholders, and Part II-C of the Insurance Act, 1938 is concerned with this subject. In particular, Section 64V and Section 64VA provide broad directions to these provisions, while leaving detailed Regulations in this regard to be framed by the Authority. For ascertaining the solvency of an insurer, proper valuation of its assets and liabilities is a must and Section 64V tells us the way for such valuation. As regards the assets, it says that the same shall be valued at value not exceeding their market or realizable value and certain assets may be excluded by the Authority in the manner as may be specified by the regulations made in this behalf while a proper value is required to be placed on every item of liability of the insurer in the manner as may be specified by the regulations made in this behalf.

By solvency, we essentially mean the sufficiency (excess) of assets over liabilities. Section 64VA specifies the manner in which such solvency or sufficiency of assets of an insurer over its liabilities is required to be measured and maintained. Broadly, it provides as under:

(1) Every insurer and re-insurer to maintain, at all times, an excess of value of assets over the amount of liabilities of, not less than fifty per cent of the amount of minimum capital as stated under section 6 and arrived at in the manner specified by the regulations. An insurer or re-insurer, as the case may be, who does not comply with this stipulation, is deemed to be insolvent and may be wound-up by the court on an application made by the Authority.

(2) The Authority, by way of regulation made for the purpose, has specified a level of solvency margin known as control level of solvency on the breach of which the Authority shall take action against the insurer unless the Authority is satisfied that either by reason of an unfavorable claim experience or because of a sharp increase in the volume of new business, or for any other reason, compliance with the stipulated level of solvency shall cause undue hardship to the insurer, in which event, it may direct that for such period and subject to such conditions as it may specify, the stipulated provisions shall apply to that insurer with such modifications but such modifications shall not result in the control level of solvency being less than what is stipulated under (1) above.

(3) If, at any time, an insurer or re-insurer does not maintain the required control level of solvency margin, he shall, in accordance with the directions issued by the Authority, submit a financial plan to the Authority, indicating a plan of action to correct the deficiency within a specified period not exceeding six months. The Authority shall propose modifications to the plan, if the Authority considers the same inadequate, and in such an eventuality, the Authority shall give directions, as may be deemed necessary, including direction in regard to transacting any new business, or, appointment of an administrator or both.

(4) An insurer or re-insurer, as the case may be, who does not comply with the above provisions is deemed to have made default in complying with the requirements of this section.

(5) The Authority is entitled at any time to take such steps as it may consider necessary for the inspection or verification of the assets and liabilities of any insurer or re-insurer, or for securing the particulars necessary to establish that the requirements of this section have been complied with as on any date, and the insurer or re-insurer, as the case may be, shall comply with any requisition made in this behalf by the Authority, and in the event of any failure to do so within two months from the receipt of the requisition, the insurer or re-insurer, as the case may be, shall be deemed to have made default in complying with the requirements of this section.

(6) Every insurer is required to furnish to the Authority return giving details of solvency margin in such form, time, and manner including its authentication as may be specified by the regulations.

The Authority, as required and empowered by the Act in this behalf, has framed Solvency Regulations both for Life Insurers and General Insurers, as under:

Insurance Regulatory and Development Authority of India (Assets, Liabilities, and Solvency Margin of Life Insurance Business) Regulations, 2016, notified on 13th April, 2016, and effective from 1st April, 2016.

Insurance Regulatory and Development Authority of India (Assets, Liabilities, and Solvency Margin of General Insurance business) Regulations, 2016 notified on 7th April, 2016 and effective from 1st April, 2016, which has been further amended by notification dated 6th December, 2022.

ADVANCE RECEIPT OF PREMIUM

Chapter IIC of the Insurance Act, 1938 that deals essentially with the provisions of solvency of the insurers also contain an important Section 64VB, mandating that no risk can be assumed by an insurer unless premium is received in advance. The purpose of this section is twofold – on one hand it ensures that the solvency of an insurer is not adversely affected to an extent that it is found wanting in payment of claims to its policyholders due to non-availability of funds resulting from default in payment of premiums from its policyholders thereby defeating the very purpose of insurance, and, at the same time, it ensures that only serious seekers of insurance are entertained by an insurer in entering into the insurance contract. Section 64VB provides as under:

> *"64VB. (1) No insurer shall assume any risk in India in respect of any insurance business on which premium is not ordinarily payable outside India unless and until the premium payable is received by him or is guaranteed to be paid by such person in such manner and within such time as may be prescribed or unless and until deposit of such amount as may be prescribed, is made in advance in the prescribed manner.*
>
> *(2) For the purposes of this section, in the case of risks for which premium can be ascertained in advance, the risk may be assumed not earlier than the date on which the premium has been paid in cash or by cheque to the insurer.*
>
> *Explanation: Where the premium is tendered by postal money-order or cheque sent by post, the risk may be assumed on the date on which the money-order is booked or the cheque is posted, as the case may be.*
>
> ....
> ....
> ....
>
> *(4) Where an insurance agent collects a premium on a policy of insurance on behalf of an insurer, he shall deposit with, or dispatch by post to, the insurer, the premium so collected in full without deduction of his commission within twenty-four hours of the collections excluding bank and postal holidays.*
>
> *(5) The Central Government may, by rules, relax the requirements of sub-section (1) in respect of particular categories in insurance policies."*

Further, Rule 58 and 59 of the Insurance Rules, 1939 contain the provisions under which, and the conditions subject to which, the requirement of advance premium before assuming the risk could be relaxed in the manner and to the extent stated therein. These include furnishing Bank Guarantee/Cash Deposit by the insured to the insurer to cover the payment of premium, or policies where the exact/total premium cannot be ascertained in advance due to the very nature of the cover sought or policies for a period longer than a year (like project insurance), or policies covering a floating group, etc.

Violation of Section 64VB (such as dishonor of cheque given by a policyholder towards premium to the insurer for issuance of the policy, and failure to pay it in cash subsequently before a claim arises under the policy) is a prominent defence available to an insurer to disown liability under a policy and repudiate claims thereunder. There are a number of judgments of the Supreme Court upholding the right of the insurer to repudiate its liability under a policy which is issued in violation of Section 64VB. This explains the importance of Section 64VB in helping the insurer comply with the solvency norms.

PROHIBITION ON REBATES

Another important tool to support the cause of solvency of an insurer available in the Insurance Act, 1938 is to ensure availability of full/adequate premium with the insurer for coverage of a risk. Section 41 of the Insurance Act, 1938 seeks to achieve this by providing as under:

> *"41. Prohibition of rebates: (1) No person shall allow or offer to allow, either directly or indirectly, as an inducement to any person to take or renew or continue an insurance in respect of any kind of risk relating to lives or property in India, any rebate of the whole or part of the commission payable or any rebate of the premium shown on the policy, nor shall any person taking out or renewing or continuing a policy accept any rebate, except such rebate as may be allowed in accordance with the published prospectuses or tables of the insurer:*
>
> *Provided that acceptance by an insurance agent of commission in connection with a policy of life insurance taken out by himself on his own life shall not be deemed to be acceptance of a rebate of*

premium within the meaning of this sub-section if at the time of such acceptance the insurance agent satisfies the prescribed conditions establishing that he is a bona fide insurance agent employed by the insurer.

(2) Any person making default in complying with the provisions of this section shall be liable for a penalty which may extend to ten lakh rupees."

Every insurer, in its published prospectus, indicates details (such as coverages and pricing) of various insurance products offered and sold by it as approved by IRDAI. The pricing of a product as filed by an insurer before the Authority is based on actuarial calculations submitted by it and the Authority, while approving the product so filed by an insurer, takes into account the actuarial pricing selling below which it would not only be lossmaking for the insurer but would also, in the long run, be detrimental to its solvency, which is so essential for protecting the interests of the policy holders. This Section, apart from ensuring that the insurer gets its due pricing for the products sold by it and does not lose its solvency due to underpricing, also serves the purpose of disciplining the market by curbing the unhealthy practice of undercutting of prices for grabbing the business from other players.

RURAL & SOCIAL OBLIGATIONS OF INSURER

As stated in Para 4.1 of this Lesson, availability of adequate insurance protection to all its citizen is an objective that every government of the country aspires for welfare of its citizens, and the role and responsibility of the State include creating, and maintaining, an appropriate Statutory and regulatory environment for the Insurance Sector that, on one hand, seeks to protect the interests of the policyholders, and, on the other hand, builds a system of requisite checks and balances for orderly, healthy, and solvent growth of the insurers and reinsurers. In 1956, when the Life Insurance sector was nationalized by the Government, and in 1972, when the General Insurance Sector was nationalized, one of the main purposes of such nationalization was to spread the message of insurance in all the nooks and corners of the country, and prevent concentration of wealth in few hands for equitable distribution of fruits of economic justice. The nationalized insurance sector did fulfil this objective of the nationalization to a large extent by not only devising insurance products for the weaker and rural segment of the population but also creating reasonably strong distribution network in smaller cities, towns and semi-urban/rural areas.

In 1999, when the Government decided to open up the insurance sector to private players, including foreign players, it was the concern of the government that the expansion of the insurance market by entry of the private players should not dilute the share of spread of insurance in the rural/socially weaker section of the population, that is, the new players should not concentrate in big cities only for the sake of maximizing their profit (since operating in larger cities is relatively less expensive) neglecting the rural/socially weaker segments (which involves high cost of distribution and therefore less profit making). Accordingly, while opening up the insurance sector to private players in 1999, the Government introduced requisite safeguards in the Insurance Act, 1938 by inserting specific provisions therein in this regard through the IRDA Act, 1999. Sections 32B and 32C of the Insurance Act, 1938 inserted vide IRDA Act, 1999 provide as under:

"32B. Insurance business in rural or social sector: Every insurer shall, after the commencement of the Insurance Regulatory and Development Authority Act, 1999, undertake such percentages of life insurance business and general insurance business in the rural and social sectors, as may be specified, in the Official Gazette by the Authority, in this behalf.

32C. Obligations of insurer in respect of rural or unorganized sector and backward classes: Every insurer shall, after the commencement of the Insurance Regulatory and Development Authority act, 1999 discharge the obligations specified under section 32B to provide life insurance or general insurance policies to the persons residing in the rural sector, workers in the unorganized or informal sector or for economically vulnerable or backward classes of the society and other categories of persons as may be specified by regulations made by the Authority and such insurance policies shall include insurance for crops."

The Authority also published the Insurance Regulatory and Development Authority (Obligations of Insurers to Rural or Social Sectors) Regulations, 2002 in this regard, and these Regulations remained in force till 2015-16.

On 24th August, 2015, the Authority published the Insurance Regulatory and Development Authority of India (Obligations of Insurers to Rural and Social Sectors) Regulations, 2015, which have come into force from financial year 2016-17, repealing the 2002-Regulations.

These Regulations, apart from defining "Rural Sector", "Social Sector", "Unorganized Sector", "Economically Vulnerable or Backward Classes", "Other Categories of Persons", and "Informal Sector" covered by these Regulations, specify the obligations on each insurer, in terms of percentage of its business or number of lives required to be mandatorily covered by it, in respect of each of these classes of population, every year, starting from the year of its inception, and the degree/quantum of such mandatory obligation increases gradually with the age of the insurer. For details, these Regulations can be referred to.

LESSON ROUND-UP

- Insurance business, essentially, involves financial protection against unforeseen events arising out of known risks affecting lives and properties of individuals and groups of individuals. Those seeking such protection are called Insureds or policyholders and those offering such protection are referred to as Insurers.
- The Insurance Act, 1938 that received its assent on 26th February, 1938, and came into force on 01-07-1939 is surviving till date having been amended 28 times since inception.
- The role and powers of IRDAI are derived from various Sections of the Insurance Act, 1938 and the IRDAI act, 1999.
- The Life Insurance Business in India was nationalized in 1956 and the General Insurance Business was nationalized in 1972.
- After experiencing the effect of increasing the FDI from 26% to 49%, the Central Government, vide Amendment Notification dated 19th May, 2021, has further increased the limit of FDI in Insurance Sector from 49% to 74%.
- As per Section 3 of the Insurance Act, 1938, no person can carry on any class of insurance business in India unless he has obtained a certificate of registration for the particular class of insurance business from IRDAI as per its Regulations.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What is the role of the State in existence of a healthy, solvent and vibrant insurance market and what is need for regulating it? What are the areas of an insurance sector requiring such regulation?
2. Write a short Note on the Constitution of the IRDAI Act, 1999, and list out some of the salient features of the Act.
3. What is the main duty/function of the IRDAI, and what are the powers available to it in discharge of these duties under the Insurance Act, 1938 and the IRDAI Act, 1999?
4. Write a short Note on evolution of FDI provisions & norms in the Insurance Sector in India.
5. Describe the salient features of the Indian Insurance Companies (Foreign Investment) Rules, 2015. What are the subjects covered by the FEM (Insurance Regulations), 2015 published by the RBI?
6. Describe the process of Registration of Insurance Company in India as per the IRDA Regulations in this regard. What are the factors looked into by the Regulator at various stages of this process?
7. What is the role of the Regulator in appointments of MD/WTD/CEO of an Insurance Company as per the Insurance Act, 1938? What are the restrictions on the common directorship in an insurer, as per the Act?
8. What are the provisions of the Insurance Act, 1938 in regard to requirement of Solvency Margin of an insurer?

9. What are the provisions regarding advance receipt of premium as per the Insurance Act, 1938 and what are the relaxations in this regard as per the Insurance Rules, 1939?
10. Explain the provisions regarding prohibition on rebates in insurance as per the Insurance Act, 1938.
11. Write a short Note on the obligations of an Insurer in the Rural and Social Sector as per the Statute and the Regulations in this regard?

LIST OF FURTHER READINGS

- The Insurance Act, 1938
- The IRDAI Act, 1999
- The Insurance Rules, 1939
- Indian Insurance Companies (Foreign Investment) Rules, 2015
- Foreign Exchange Management (Insurance) Regulations, 2015
- Insurance Regulatory and Development Authority of India (Registration of Indian Insurance Companies) Regulations, 2022
- Insurance Regulatory and Development Authority of India (Assets, Liabilities, and Solvency Margin of Life Insurance Business) Regulations, 2016
- Insurance Regulatory and Development Authority of India (Assets, Liabilities, and Solvency Margin of General Insurance Business) Regulations, 2016
- Insurance Regulatory and Development Authority of India (Obligations of Insurers to Rural and Social Sectors) Regulations, 2015, and,
- Report of the Select Committee on the Insurance Laws (Amendment) Bill, 2008 presented to the Rajya Sabha on 10th December, 2014.
- IRDAI website www.https://irdai.gov.in/

Life Insurance

Lesson 16

KEY CONCEPTS

■ Life Insurance ■ Premium ■ Bonuses ■ Annuities ■ Group Insurance ■ Policy Lapse ■ Policy Revival ■ Assignment ■ Nomination of Policy ■ Surrender of Policy ■ Policy Claims ■ Underwriting

Learning Objectives

To understand:

- The concept of Premiums & Bonuses
- The different plans of Life Insurance
- What is policy lapse and how policy can be revived
- How to Surrender a Policy
- How to apply for a Claim
- What is underwriting of policy

Lesson Outline

REGULATORY FRAMEWORK

- Insurance Act, 1938

INTRODUCTION

Economic Survey 2022-2023 observes that India is poised to emerge as one of the fastest-growing insurance markets in the coming decade. Life insurance penetration in India was 3.2 per cent in 2021, almost twice more than the emerging markets and slightly above the global average. The life insurance premium registered YoY growth of 10.2 per cent in FY22, with new businesses contributing 45.5 per cent of the total premiums received by the life insurers.

During FY22, the gross direct premium of non-Life insurers (within and outside India) registered YoY growth of 10.8 per cent, primarily driven by health and motor segments. The net incurred claims of non-Life insurers stood at ₹1.4 lakh crore in FY22, primarily driven by rising per capita income, product innovations and customization, development of strong distribution channels, and rising financial literacy.

In FY21, 10.7 lakh new micro-insurance policies were issued to individuals with a new business premium of ₹355.3 crore (in the life-insurance segment), and 53,046 new micro-insurance policies were issued in the general insurance segment (excluding standalone health insurers). Government's flagship schemes like Pradhan Mantri Fasal Bima Yojana (PMFBY), have led to significant growth in the premium income for crop insurance, while Ayushman Bharat (Pradhan Mantri Jan Arogya Yojana) (AB PM-JAY) has also driven insurance adoption and penetration in its segment.

68% of India's population is young and 55% of its population is in the age group of 20-59 (working population) in the year 2020 and is estimated to reach 56% of the total population by 2025. These point towards a young insurable population in India. By 2030, India will add 140 Mn middle-income and 21 Mn high-income households which will drive the demand and growth of Indian insurance sector.

Customers are now starting to prefer digital modes for their insurance needs - 73%/62% of customers preferred the online mode for GI/HI products (2020). Agents' ease with digital tools has also grown, with 63% of agents comfortable with video-calling clients and >50% amenable to virtual renewals. India is the 2nd largest Internet user market. 1 Bn Internet Users by 2026.

AB PM-JAY (world's largest health assurance scheme): 230+ Mn beneficiaries have been provided Ayushman cards, and over 44 Mn hospital admissions have been authorised through a network of 25,969 empanelled healthcare providers, including 11,700 private hospitals (9th March 2023) Pradhan Mantri Suraksha Bima Yojana: 313 Mn beneficiaries have been enrolled under the scheme, and more than 1 lakh claims have been disbursed (30 Nov'22) Pradhan Mantri Jeevan Jyoti Bima Yojana: 144 Mn beneficiaries have been enrolled under the scheme, and more than 6 lakh claims have been disbursed (30 Nov'22) Pradhan Mantri Fasal Bima Yojana (risk coverage against crop damage), is the world's number one crop insurance scheme in terms of farmer applications enrolled and is also the world's 3rd largest crop insurance scheme in terms of gross premium. Between 2016 and 2022, 276 Mn applications were received under the scheme, and claims of about $ 16.7 Bn (INR 1.28 lakh crore) have been paid to the farmers.

LIFE INSURANCE ORGANIZATION

As per Section 2 (7A) of the Insurance Act, 1938,an Indian insurance company means any insurer, being a company which is limited by shares, and, —

(a) which is formed and registered under the Companies Act, 2013 (18 of 2013) as a public company or is converted into such a company within one year of the commencement of the Insurance Laws (Amendment) Act, 2015 (5 of 2015);

(b) in which the aggregate holdings of equity shares by foreign investors, including portfolio investors, do not exceed seventy-four per cent. of the paid up equity capital of such Indian insurance company, and the foreign investment in which shall be subject to such conditions and manner, as may be prescribed;

(c) whose sole purpose is to carry on life insurance business or general insurance business or re-insurance business or health insurance business;]

As per Section 2 (11) of the Insurance Act, 1938, life insurance business" means the business of effecting contracts of insurance upon human life, including any contract whereby the payment of money is assured on death (except death by accident only) or the happening of any contingency dependent on human life, and any contract which is subject to payment of premiums for a term dependent on human life and shall be deemed to include—

(a) the granting of disability and double or triple indemnity accident benefits, if so provided in the contract of insurance;

(b) the granting of annuities upon human life; and

(c) the granting of superannuation allowances and 1 [benefit payable out of any fund] applicable solely to the relief and maintenance of persons engaged or who have been engaged in any particular profession, trade or employment or of the dependents of such persons.

[*Explanation*. — For the removal of doubts, it is hereby declared that "life insurance business" shall include any unit linked insurance policy or scrips or any such instrument or unit, by whatever name called, which provides a component of investment and a component of insurance issued by an insurer referred to in clause (*9*) of this section.]

Life Insurance Organization comprises various functions, departments, processes, within a Life Insurance organization. Before we go into the organizational aspects it is important to understand the workflow within a Life insurance company. Typically, the following workflows can be seen in any Life insurance company on the core business of solicitation and servicing insurance:

(1) Solicitation of insurance business by an Insurance Agent or Registered Intermediaries ('Distributor')

(2) Form-filling by the Distributors

(3) Registration of New Business in a Branch office of an Insurer

(4) Scrutiny of Proposal forms and documents annexed thereto

(5) Data-entry of information contained in Proposal form in Insurer's Policyholder Administration System

(6) Underwriting of Proposals

(7) Issue of Policy Insurance contracts

(8) Collection of Renewal Premiums of Policies issued

(9) Policy servicing activities, including Surrenders, Loans etc.

(10) Claims processing.

While the above activities constitute core day-to-day work for a Life insurance company, there are various other support functions which enable the above core activities. Based on the above, broadly the functions within a Life Insurance Organization are classified as follows:

(1) Human Resources;

(2) Finance & Accounts;

(3) Investments;

(4) Actuarial & Products;

(5) Distribution:

   a. Individual Agency

   b. Third Party Distribution - Corporate Agent, Broking etc.

   c. Direct Distribution including Online Business

   d. Rural Business

   e. Sales Training.

(6) Marketing;

(7) Information Technology;

(8) Operations:

   a. New Business & Underwriting

   b. Policy Servicing

   c. Persistency & Renewal Premiums Management

   d. Claims

   e. Handling Customer Grievances

   f. Distributor Appointment, Training and Termination

   g. Branch Operations.

(9) Legal & Compliance;

(10) Risk Management;

(11) Internal audit;

(12) Infrastructure & General Administration.

Each one of the above functions is generally headed by a Senior Management Person who normally reports to the CEO. However, for the sake of operational convenience, some of the functions may be combined in a Life insurance company. However, under such circumstances, there should not be any conflicts of interest.

PREMIUMS AND BONUSES

Premium is the consideration money that a policyholder has to pay in lieu of the benefit that the insurer promises to confer on the happening of the scheduled eventuality. Insurance is a contract and the policyholder / insured and the insurer are the two parties to the contract. Both parties have rights and obligations. Premium forms the obligation on the part of the insured. The premium that you have to pay for a life insurance policy depends on various factors like age, total coverage (sum assured), your medical history, gender, lifestyle, and job.

No benefit can be secured without paying for it. When a person is desirous of having protection for his family in case of death, he has to pay for it. Mode of payment of the cost can always be arranged according to the convenience of the person seeking the benefit.

He may pay the full cost of the benefit straightaway in which case it is called a single premium. The cost of benefit can be paid in equal yearly installments for life, if it is a benefit payable at the time of death. These installments are called annual premiums. On the other hand, it can be paid equal annual installments over a selected period or till the death of life assured, if earlier. Instead of paying the cost of assurance benefit by yearly installments, half-yearly, quarterly or monthly installments can also be arranged. These are yearly, quarterly or monthly premiums.

Premiums are considerations for insurance benefits. They are always payable in advance. A single premium is paid at the commencement of insurance (only once during the entire Policy period). A yearly premium is paid at the beginning of each (Policy) year. A half-yearly premium is paid at the beginning of each half-year.

Bonuses are the additional sum that the policyholder will get during the term of the insurance plan or at maturity of the plan, provided he has paid all premium amounts due for a specified minimum number of years. Bonus is the amount added to the basic sum assured under a with-profit life insurance policy.

Mortality Tables - basis for fixing the premiums by Insurers

Premiums are therefore the selling price charged by the insurers for providing the service of insurance covers. In any business, the selling price is determined based on the cost of inputs plus a margin of a profit for the businessman. In insurance as well, there are direct costs, indirect costs and overheads which have to be factored into the pricing. The following are basic elements of premiums for an insurer:

Basic Elements of Premium

- Mortality / Morbidity Costs
- Other Direct Costs
- Indirect Costs
- Cost of Bonus
- Profit Margins

(a) **Mortality / Morbidity Costs** - this is the fundamental element of estimating how many persons out of the insured lives will die and therefore what would be outgo on account of claims for a life insurer. Morbidity costs determine the probability of Lives covered contracting illnesses - relevant for health insurance policies.

(b) **Other Direct Costs** - like payment of commission for the Policies procured by distributors, Stamp duty on policies etc. which are directly linked to the business sourced. This would also include Charges in Unit linked Life Insurance Policies which are directly attributable to the Polices, such as Premium allocation charges, Policy administration charges etc.

(c) **Indirect Costs** - cost of administration of an insurance company like payment of salaries to employees, infrastructure costs etc.

(d) **Cost of Bonus** - In the case of Participating policies, the cost of distribution of surplus to Participating Policyholders.

(e) **Profit Margins** - also called Value of New Business margins which are the loading on account of profit margins expected by a Shareholder from the Insurance business.

Out of all the above, Mortality costs or loading is the fundamental cost. This is unique to life insurance business and is based on the Statistical probability theorems. The fundamental principle of life insurance business is distribution of risk of paying claims to a few out of the total population which gets insured. In other words, it operates on the principle of sharing of risks. Therefore, the basic data required for calculating premiums are the Mortality Tables which give the number of persons dying and living at age out of the total population. The probability of death at each age becomes the basis for assumptions by a life insurer in calculating their premiums and thus becomes the basis for determining the estimated claim payouts on account of death and the discounted value of estimated claims becomes an integral component in calculating the premiums.

Therefore, the insurer while fixing the premium rates has to make certain assumptions regarding interest rates, mortality rates and expenses which will be experienced in the years to come. It is important to have a correct estimate of these factors as otherwise the results deduced from the assumptions made may not be reasonably close to the actual experience of the insurer.

Mortality experience of the general population which is commonly known as census mortality is not directly of much use to an insurer whose main interest is to find out of the mortality that its insured lives are likely to experience. The insurer depends upon the mortality experience of the insured lives observed in the recent past as a basis for estimating the probabilities of survival and deaths.

If it is observed that out of 10,000 lives all aged 35, 18 die within one year, i.e., before attaining age 36, the observed mortality rate at age 35 works out to 18/10,000 = 0.0018.

The mortality rates at various ages are determined in the above manner, by using the data of recent past by the insurer. The observed rates of mortality, say from age 15 till extreme age, are then subjected to a process of graduation. The process of graduation enables the insurer to find the limiting values of the mortality rates, when the data is increased infinitely. These graduated values of mortality are used for constructing a mortality table which contains mortality functions for successive ages.

Therefore, Mortality Tables showing the mortality rates (number of persons dying at each age) is essential for generating mortality assumptions for calculating Premiums. The various stages involved in the process of constructing a Mortality table are as follows:

(1) Deciding upon the data to be used

(2) Choosing the period of investigation

(3) Deciding the unit of investigation

(4) Deciding the method of investigation to be followed

(5) Determination of “Exposed to risk” and enumeration of deaths

(6) Obtaining observed rates of mortality

(7) Graduation of observed death rates

(8) Constructing the mortality table from the graduated rate.

Categories of Mortality Tables		
Those prepared from population	**Those preparedm from life insurance data**	**Those prepared from life annuitant’s data**

Examples of Mortality Investigation Tables:

(a) LIC Mortality Investigation (1994-96).

(b) Indian Assured Lives Mortality (1994-96) (Modified).

(c) Northampton Table (UK).

(d) English Life Tables (ELT).

(e) British Tables on Annuitant lives.

Schemes of insurance operate on the assumption that a large number of persons desiring insurance benefits would insure their lives.

Consider that 1,000 persons all aged 40 years are insured for Rs.10,000 each for one year. If the rate of mortality is 0.003 per 1,000 lives at the age 40, the expected number of claims will be 0.003 ×1,000 = 3 and the amount of claim payable would be Rs. 30,000. Therefore, the insurer should charge a single premium of 30,000/1,000, i.e., Rs.30 to each person for insurance.

Thus, the premium required to be charged is independent of the number of persons taking insurance, provided that the rate of mortality remains the same.

Insurance started in the form of sharing the loss of a few by many. Thus, in the above example, the calamity on 3 families is shared by 1,000 persons (through insurer) to the extent of providing relief of Rs.10,000 to the family of each deceased person.

Simple Mortality table

The table given below is an example of a Simple Mortality Table giving the number of survivors and deaths from ages 35 to 44 based on a mortality investigation:

Age	Number of persons surviving	Number of persons dying
35	10,000	28
36	9,972	31
37	9,941	34
38	9,907	38
39	9,869	42
40	9,827	47
41	9,780	52
42	9,728	57
43	9,671	63
44	9,608	70
Total		462

Total expected number of deaths among 10,000 persons all aged 35, before they attain age 45, is 462.

Therefore, total expected claim amount, if the claim amount payable on death of each individual covered is Rs.1,000, works out to Rs.46,20,000 (462 x 1,000)

If single premium (in one instalment) is to be charged to each of the 10,000 persons for securing an insurance cover of Rs.10,000 each for 10 years, the premium works out to:

46,20,000/10,000 = Rs. 462 per person

The insurance cover described above is called a temporary assurance for a period of 10 years wherein the benefit is payable only in case of death of a person during the given period. The person whose life is insured is known as life assured.

We have not taken into account the interest and expense factors. Since the deaths occur each year the claim payable varies year after year and the present value of claims payable at the end of each year has to be calculated and then divided among the 10,000 persons. Assuming expenses of insurer are 'nil', the present value factors are applied to find out the present values of claim payable every year.

The above example gives a fair idea as to how the mortality tables are designed as the fundamental basis for calculation of premium. There are loadings on account of expenses and profit margins for the Shareholders. All these form part of the "file and use" document for every product which has to be filed by the Appointed Actuary of Insurance Company with IRDAI for their approval before a Product is launched for sale to the public.

Risk, Net / Pure Premium

Risk Premium

The pure premium needed to cover the expected risks but with no allowance for expenses, commission or contingencies is to be made. Thus, the cost to meet the risk of death for one year at a particular age is known as risk premium. The risk premium is based on the probabilities of death at various ages.

Net Premium or Pure Premium

A net premium is the premium calculated on the basis of the valuation assumptions to provide the contractual benefits at outset. Its calculation only allows explicitly for interest and mortality. Thus, the net premium covers the risk factor as well as interest earned on investment of fund by the insurers. Net premium is always less than the risk premium.

Loading

As explained before the administrative expenses of the insurer have to be borne out of the premium received from the insured. The amount added to the pure premium to cover the administrative expenses is known as loading. When these expenses are added to the net/pure premium it becomes the gross premium/office premium which is actually charged from the customer.

Level Premium

Premium keeps on increasing as the age increases and this is the natural premium paying system but it is impractical because the insurer cannot ask the insured to pay extra premium every year and moreover in the latter years the cost of insurance would become unaffordable resulting in lapse of policies. In view of this insurers charge a level premium and the cost is distributed evenly over the period during which premiums are paid. The premium remains the same, and is more than the actual cost of protection in the earlier years of the policy and less than the actual cost in the latter years. The excess paid in the early years builds up the reserve.

Actuarial valuation

As discussed before premium is calculated based on some assumptions. The experience in future may not be exactly as assessed. So, the process of checking the validity of assumptions from time to time is known as actuarial valuation. The main objects of conducting the valuations being: -

Future projections to be made on the basis of past experience:

- Determine the long-term consequences.
- The analysis should always be as thorough as the information allows and not based on superficial appearances.
- Using Mathematical modeling for handling the interactions of probability and investment return.
- Further experience should be fed back to aid the subsequent development of the model and the assumptions.
- In India the Insurance Act requires actuarial valuations to be done every year.

Calculation of Age

The rate table as published by Insurers gives the rate of premium per thousand sums assured, for different ages nearer birthday. The tabular premium is also different for different premium payment terms. In case of whole life policies, as the premium has to be paid for the whole life, the premium is mentioned only for various ages nearer birthday.

Age nearer birthday means that if the actual age is up to 21 years 5 months 29 days the age for the purpose of calculation of premium is to be treated as 21 years only. However, if the age is 21 years 6 months or more it is to be taken as 22 years. In other words, if the age is 21 years 11 months and 29 days the age is taken as 22 years.

The method for calculation of age is explained by an example:

	Day	Month	Year
Date of Calculation	21	08	2000
Date of Birth	02	01	1964
	19	07	36

Age is 36 years 7 months and 19 days. Therefore, the age last birthday is 36, the age nearer birthday is 37 and the age next birthday is also 37.

Another Example

	Day	Month	Year
Date of Calculation	02	03	2000
Date of Birth	19	09	1964
	13	05	35

Age is 35 years 5 months and 13 days. Therefore, the age last birthday is 35, the age nearer birthday is 35 and the age next birthday is 36.

Computation of extra premium

Mortality as explained above relates to the death rate of a very large group of people of different ages over a long period of time. These people are usually selected people, who are also called standard lives. A separate mortality study is done for people who are rated substandard. In other words, these rated people suffer from some disease or other physical deformity because of which the expected mortality rate for these people would be higher than what is expected of standard lives.

This special study by actuarial method thus leads to an estimation of extra premium which shall adequately take care of the extra mortality in this substandard group. In view of such study, extra premium is imposed on people suffering from diabetes or blood pressure etc. It is true that in view of the progress made in the medical science, these diseases are gradually not considered as dreadful as they used to be. Most insurers, therefore, keep on updating their experience relating to mortality of different groups and revise the rates of extra premium also.

Rider premiums

There are also extra premiums, for conferring extra benefits, to the insured. For example, a prospect wants to get double the sum assured, in case of a death due to accident. This benefit is allowed by charging an extra premium.

The insurers usually charge extra premium for riders attached to the policy. One can opt to take death benefit five or even ten times of the basic sum assured and may pay for such extra term rider benefit.

Suppose a Life Insurance Company is providing the following riders

- Term Cover
- Accident Death Benefit

The extra premium for Term cover rider is Rs.400 and the Accident benefit is Rs.300. The premium under the policy is Rs.2,050. So, the premium payable by the insured will be Rs.2,050 + Rs. 300 + Rs. 400 = Rs.2,750.

Thus, the rider premiums are payable separately under the policy.

Not all life insurance policies are entitled to receive the bonus amount. Only participating (with-profit) policies qualify for the bonus and the policyholders holding a participating life insurance policy will only qualify for the bonus payout. The participating policies take part in the investment profits of the insurance company which is shared with the policyholders in the form of bonus payment. The amount of bonus payable is not fixed and it may vary depending on the amount of investment income earned by the insurance company.

The bonuses are a percentage of the sum assured and these are declared at the end of every financial year. When declared, it becomes guaranteed. The insurance company has the discretion to decide on the rates of bonus. In Life insurance, there is line of business called Participating business. Under this line, the Products approved by IRDAI as "With profits" Products are eligible for a share in the profits arising from the Participating line of business, besides the amounts guaranteed to be paid as per the Policy contract. The surplus arising from the Participating line of business is distributable as follows:

(a) Not less than 90% of the surplus is distributed to the Policyholders as Bonus.

(b) Not more than 10% of the surplus is distributed to the Shareholders as their share of the Surplus.

Bonuses are not guaranteed and depends on the actual performance of the Participating line of business. In some years, there may not be surplus at all. This happens usually in the initial years of a life insurance business, when the expenses are more than the income. Under such circumstances, a Life insurance company cannot normally declare any bonus. However, given the intense competition in the life insurance segment, the IRDAI regulations permit a Life insurer to declare a bonus even if there is no surplus, provided an amount equal to the deficit is transferred from Shareholders account to Policyholders account. Further the cost of bonus shall also be funded by the Shareholders. After doing the above, the Life insurers are permitted to declare bonus to Policyholders.

As per the IRDAI (Non-linked Insurance Products) Regulations, 2013, every Life insurer shall constitute a "With Profits Committee" which shall comprise of the Appointed Actuary, an Independent Practicing Actuary, an Independent Director. The purpose of this Committee is to determine the asset share for the Participating segment, the investment income and decide the appropriateness. This Committee is intended to take care of the interests of the Participating Policyholders.

Interim Bonus

Bonus is normally declared on a valuation date say for 31.3.2007 the valuation may be declared sometimes in October 2007. In case of policies which result into claim after 31.3.2007 but before the declaration of the bonus would not get the benefit of the bonus. Hence to resolve such situation companies declare interim bonus for policies which become claims during two valuation dates.

As any premium rate decided today, remains constant for the entire duration of the policy which can be up to 50 years or more, the insurer normally takes a very conservative outlook and provides for substantial reserves to take care of any adverse deviation from the originally assumed standard.

Terminal Bonus

Terminal bonus (final bonus) is declared and added only for policies, which attain maturity. This bonus is offered to the policyholders for keeping the policy till its maturity date. This bonus thus will not be payable for policies which have been surrendered or for policies which have acquired paid-up value.

Bonus under ULIP Policies

In case of Unit Linked Plans, the policyholders get the fund accumulated in their account. The NAV of the fund multiplied by the number of units, the policyholder has, is known as Fund Value. In ULIP policies, the policyholders are not entitled to bonus. As in endowment policies these kinds of policies are not entitled to bonus. However, the company may pay the policyholder a loyalty bonus at the end of the policy.

PLANS OF LIFE INSURANCE

Term Insurance

Under the Term Insurance plans, the Sum Assured is paid only on the happening of the insured event which is death of the life assured. There is an option to return the premium if the Life assured survives the term of the

Policy. The Term of the Policy may be 5 years, 10 years, 15 years etc. as selected by the Policyholder. This is the cheapest form of life insurance available as only the mortality risk (risk of dying early) is covered.

Term Insurance is a unique product for life insurance in the financial services products' portfolio as no other Service provider can provide a pure life insurance risk cover.

Whole Life Insurance

Whole life insurance is an extension of Term Insurance. Unlike a Term Insurance plan which covers the insured event only if it happens within the term of 5 years, 10 years etc., a Whole life insurance product covers the risk till death without any term restriction. This is the most ideal plan for someone who wants to take care of risk cover forever. Whole life is also a pure life insurance policy and some of the Whole life insurance products come with an option of participation in bonus (With Profits Policies).

Both term insurance and whole life insurance are not popular because of the low insurance awareness in India. Generally, there is a tendency to avoid pure life insurance policies as the Customer does not see any benefit during his survival. There is little appreciation of the Human life value and the lump-sum benefit which family gets upon death of the breadwinner - which will help a family to survive.

Endowment Policies

In order to facilitate some payment during survival of the life assured at the end of the term (maturity of the policy), an Endowment Policy provides a Sum Assured either on death or on maturity of the policy, whichever is earlier. Some of these Products also have the option of participation in bonus (With Profits Policies).

This gives the Policyholder an option to get a defined benefit in case he survives the maturity which is normally equal to the Sum Assured which is payable on death.

In view of the Survival benefit on maturity, the premiums payable for Endowment Polices are relatively higher.

Money Back Policies

Money Back Policies are a variant of Endowment Policies in as much as there are periodic benefits (instead of lump sum maturity benefit) payable at the end of say, 5th year, 10th year, 15th year and 20th year. For example, if the Life assured survives 5th year, 25% of Sum assured is paid, at the end of 10th year another 25%, at the end of 15th year another 25% and the balance 25% on maturity. However, if death happens any time during the term of the Policy, full Sum assured is paid without deducting any survival benefits which have been paid prior to death.

These plans also carry relatively higher premiums.

Children's Benefit Policies

These Policies are generally built on Endowment Policies platform in such a way that the lump sum benefit is payable to take care of the needs of Children's education, marriage needs etc. Under these policies, the life assured is usually the child and the Policyholder is the Parent. Upon the child attaining the majority, usually there is an option of automatic vesting, under which the ownership of the Policy gets transferred to the child-life assured. Thereafter it becomes an own life Policy on the life of the child which has attained the age of majority.

There are benefits of Premium Waiver, as per which if the Parent dies, the future premiums are waived and the Policy continues to be in force for full benefit which is payable to the Child as specified in the Policy document.

Pension and Annuity Policies

A Pension Policy helps a person to plan his retirement by building a corpus during a person's active life, which will be utilized to buy an annuity policy under which periodic benefit is paid (usually monthly) to the Policyholder till his life time (life annuity option). If a Pension Policy is taken, say, at the age of 30 for a period of 28 years, the premiums are usually paid during these 28 years to build the corpus (also called the deferment period). On attaining age 58, the Policy matures for payment. Out of the corpus available at that time, the Policyholder is allowed to commute (withdraw as lump sum) up to 1/3rd of the corpus and the remaining 2/3rd is utilized to purchase an annuity under an Immediate Annuity Policy.

Under the Immediate Annuity Policy, the lump sum is paid as a Single Premium and the annuity payment starts immediately thereafter every month. There are various annuity options like Life annuity option, Annuity certain for, say 5 years, Widow's Pension, Annuity with return of corpus on death etc. Under Life annuity option, the annuity is paid as long as the person lives while under Annuity certain for, say 5 years, even if the Annuitant dies any time within 5 years from the start of the annuity policy, the annuity amount is payable for the remainder period till completion of 5 years and then the annuity will stop. Under Widow's Pension, after the annuitant's death, the annuity payments will continue to be paid to wife till her death. Lastly, under the Annuity with return of corpus option, upon death of the annuitant, the corpus invested as a lump sum. The quantum of benefit will vary depending on the type of annuity option selected.

Health Insurance Plans

Health insurance plans are of two types - indemnity-based health insurance products which are offered only by Non- life and Standalone health insurance companies and secondly, fixed benefit-based health insurance plans offered by Life insurance companies.

All non-life insurance contracts are contract of indemnities and the benefits paid cannot exceed the exact loss incurred. Life insurance contracts are not contracting of indemnity - only a fixed amount is paid which more or less will compensate the life assured. Therefore, under Medi-claim Policies offered by Non-life and Standalone health insurance companies, upon hospitalization and treatment, the exact amount of bills payable will be paid, subject to the overall sum assured limits. However, in the case life insurance companies, for example, a Critical illness Rider, a fixed amount of Sum assured is paid on proof of hospitalization. Proof of actual amount spent is not necessary.

Group Insurance Policies

As distinguished from individual policies, which are a contract between an individual policyholder and a life insurance company and covers the risk on the life only the individual, under Group insurance policies, a group of lives are covered under an umbrella Group insurance policy taken by an organization of which lives assured are members.

For example, the borrowers of a Bank can be covered under a Group Life insurance policy taken by the Bank with a Life insurance company. Upon death of the borrower, the outstanding loan amount is paid by the Life insurance company to the Bank and the balance amount is paid to the Nominee. By doing so, the Asset (e.g., House) against which a loan was taken becomes encumbrance-free for the Nominee.

Premiums under Group insurance policies are cheaper since the risk assessment of the overall profile of the customers insured is taken into consideration, rather than individual's risk assessment under Individual contracts. Therefore, even a sub-standard life can get the benefit of an average premium fixed based on the overall risk profile of the group.

There has to be a subsisting relationship between the organization taking the Group insurance policy and the lives covered under a Group insurance policy.

Premiums can be contributory or non-contributory. Under the contributory schemes, the premiums are shared between the Group policyholder and the life assured whereas under the non-contributory schemes, the entire premium is paid by the Life assured.

A Group policyholder can act as the servicing point for the lives covered under a Group policy taken by them. They are allowed to render data management services, Premium collections, claims assistance etc. on behalf of the Life Insurance Company and can collect a small fee as a consideration for the services rendered to the Life insurer.

While a Group Master Policy is issued to the Group Policyholder (Organization), the individual lives covered under the Group Policy are issued a "Certificate of insurance" which is an evidence of insurance cover provided by the Life insurer. This is equivalent of a Policy document issued under an individual Policy contract. Normally only the Life insurer is allowed to issue Certificate of insurance. However, the service of issuance of a Certificate of insurance can also be performed by the Group policyholder (especially larger Groups under which the lives assured are spread across various geographical locations). However, the control over issue of Certificates of insurance lies with the Life insurer who is expected to conduct inspection of the Group policyholders to check adherence to the guidelines of IRDAI on Group insurance as applicable to Group policyholders.

Linked Life Insurance Policies

Also called Unit Linked Life Insurance Policies (ULIPs), these Policies combine a Term insurance with an investment option. Under ULIPs, out of the Premiums collected from the Policyholder, after deducting the charges applicable towards risk cover and charges for administration and management of investments, the balance amount is invested in market linked instruments.

Therefore, the Customer has 2 benefits - a Sum assured payable upon death plus the marked to market value of the investments made on behalf of the Policyholder by the Life Insurance Company.

Under ULIPs, the risk on investment portion is borne by the Policyholder. The investment portion of ULIPs works like a Mutual fund as follows:

(1) Customer selects the fund option - Equity based, Debt based, balanced fund etc.

(2) Life insurance company invests in instruments as per the option selected in (1) above.

(3) Units are created to represent the investments made.

(4) Daily Net asset value (NAV) is declared which will reflect the marked-to-market value of the units.

(5) On death or maturity, the units are sold and the marked-to-market value is paid. Usually, the following typical benefit option is available to the Policyholder upon death:

   (a) Get the Sum Assured + Fund value (Marked-to-market value of the units).

(6) Higher of Sum Assured (or) Fund Value. Risk premium (also called mortality charges) is usually calculated on a daily basis and deducted by selling appropriate units.

Following are the charges generally applicable in ULIPs:

(1) Charges deducted from Premium:

   a. Premium allocation charges - under which a percentage of premium is deducted upfront from the premiums paid

(2) Charges deducted by cancellation of units:

   a. Policy administration charges - which is usually a fixed amount per month (e.g., Rs.40 per month)

   b. Mortality charges - represents the risk premium

   c. Surrender or discontinuance charges - payable upon surrender or exit from an ULIP contract

   d. Switching charges - where the Policyholder is allowed to switch from one fund to another fund

   e. Rider charges - to cover the risk coverage provided under a Rider benefit

   f. Partial withdrawal charges - leviable whenever a Policyholder withdraws an amount from his unit linked fund

(3) Charges appropriated from Fund value:

a. Fund management charges - which will not exceed 1.35% and is adjusted from NAV

b. Guarantee charges - cost of any guarantees given on the ULIPs - also adjusted from NAV

POLICY DOCUMENTS

Policy document is a detailed document and it is the Evidence of the insurance contract which mentions all the terms and conditions of the insurance. The insured buys not the policy contract, but the right to the sum of money and its future delivery. The insurer on its part promises to pay a sum of money, provided of course the insured keeps its part of promise of paying the installments of premium as scheduled.

The preamble to the insurance contract makes the above statement clear and states that this policy is issued subject to the conditions and privileges printed on the back of the policy. The endorsements placed on the policy shall also be part of the policy and it also makes a reference to the proposal form saying that the statements given in the proposal form are the basis of the contract.

The schedule which is printed on the policy document identifies the office which has issued the policy. It states the name of the policyholder, the date of commencement of the policy, an identification number of the policy called policy number. This number is extremely useful for making any reference to the insurer relating to this policy. This shall avoid needless delay.

It is necessary to check that it is correct and any mistake should be immediately pointed out for correction. A mistake in the address may misdirect the premium notices and any other future correspondence. It also states the name of the nominee and the date up to which premium has to be paid. The schedule goes on to mention, the type of policy, on the happening of which, the sum assured is payable and to whom it is payable. It of course also mentions when and how long the premium is to be paid.

The policy document is signed by an official of the insurer and dated and stamped as per the provision of the Stamp Act to make it a completely legally enforceable document.

PREMIUM PAYMENT

Premiums are payable in advance at the end of every month, quarter, half-year and year, depending on the mode of payment of premium. Under Single premium contracts, the amount is paid only once at the time of commencement of Policy. A Policy document can be in physical form or electronic form. Electronic policies are issued through an Insurance Repository who is like a Depository Participating for holding shares in electronic form. In the case of Insurance Repository, the Insurance policies are held in electronic form and the Customer can access the Policy document online.

POLICY LAPSE AND REVIVAL

If the Policy-holder does not pay the premium even after the days of grace, the Policy lapses. Upon lapsation, the full benefits are not payable. If the Policy lapses within 3 years and which have not acquired surrender value (other than ULIP Policies), normally nothing is payable. Some Policies acquire Surrender value within 2 years as well. If the Policy lapses after acquiring surrender value and if the Policy is not revived and there is a death claim, pro-rata sum assured is paid. This is called Paid up value. Under Participating Policies, where annual reversionary bonuses are declared, the bonuses accrue only whilst the Policy is in force. Such vested bonuses are also payable. Under Unit linked life insurance policies which lapse within 5 years, as discussed earlier, the fund value is moved to a discontinuance fund and the proceeds are paid at the expiry of 5 policy years.

Policyholders have the option to revive reinstate a Life insurance Policy, during the revival period. For Unit Linked Life Insurance Policies, as stated earlier, 2-year period is given reinstatement. For other Policies, a 3-year period from the date of first unpaid premium is given for reinstating a Policy. If the Policy is reinstated within 6 months of Unpaid premium, normally, only a Declaration of Good health by the Life assured is required. For Policies which are reinstated after a period of one year from the date of first unpaid premium, a Full Medical

Report from a Medical Examiner is normally insisted and only if the Medical report and Declaration of Good health do not have any adverse findings, the Policy is reinstated or reinstated with appropriate extra premiums.

ASSIGNMENT, NOMINATION AND SURRENDER OF POLICY

Assignments and Nominations

In life insurance, insurable interest not necessarily once policy is issued. Therefore, a Life insurance policy can be assigned (transferred) after issuance of policy. An assignment is transfer of rights under a Life insurance policy to another person for a valid consideration. However, no consideration is required for transfer out of love and affection between parties standing in close relation to each other.

Life Insurance company vested with powers to refuse assignments if against Policyholder/Public interest or if such assignment results in trading in insurance policies. The transfer or assignment shall be complete and effectual upon the execution of such endorsement or instrument duly attested but except where the transfer or assignment is in favor of the insurer shall not be operative as against an Insurer and shall not confer upon the transferee or assignee, or his legal representative, any right to sue for the amount of such policy or the moneys secured thereby until a notice in writing of the transfer or assignment if and either the said endorsement or instrument itself or a copy thereof certified to be correct by both transferor and transferee or their duly authorized agents have been delivered to the insurer. Therefore, until and unless the assignment is registered by the insurer and an endorsement is placed on the Policy document, an assignment is ineffective.

Conditional assignment is a scenario where a Life insurance Policy is assigned to another person on the condition that the Policy will be re-assigned upon happening of an event during the life time of the Life assured.

KYC of assignee mandatory for registration. Partial assignments of life insurance policies have also been recognized.

Nominations are made when the Proposal for Life insurance is submitted by the Proposer. Only a person who has taken a Policy on his own life can affect Nomination. In Life insurance, Nominees act as "Trustees" accountable to the legal heirs. However, Parents, Spouse and Children recognized as Beneficial Nominees and are entitled to the Policy benefits to the exclusion of other legal heirs.

A minor can be appointed as a Nominee. However, under such circumstances, an Appointee shall be named in the Proposal form, who shall be entitled to receive the Policy benefits upon death of the Life assured during the minority of the Nominee.

Nomination made in proposal can be changed subsequently

Assignment automatically cancels nomination, except where the Policy is assigned for the purpose of securing a loan. In such cases, the nominee's interest is impacted only to the extent of the outstanding loan. Upon re-assignment, the nomination stands automatically reinstated.

Under the Life Insurance Policies taken under Section 6 of the Married Women's Property Act (which gives special protection to Married Women), the Nominee can only be the named Wife or Children. Husband's Creditors cannot attach a Life insurance Policy taken under Section 6 of the above Act as this is a special dispensation provided to Women.

SURRENDER OF A POLICY

Surrender is voluntary termination of a Policy contract only by the Policyholder. If the Policy has acquired surrender value, then surrender value is paid to the Policyholder and the Contract comes to an end.

Under Traditional products, the rules for Surrender value are as follows:

(a) No Surrender Value for Term, Health & Immediate Annuity products.

(b) Surrender value gets acquired after 2 years consecutive premium.

(c) Minimum amount payable as Guaranteed Surrender value (Non-single):

- 30% of premiums paid (less survival benefits paid) if surrendered in second policy year
- 35% of premiums paid (less survival benefits paid) if surrendered in third policy year
- 50% if surrendered between fourth and seventh
- 90% of surrendered in last 2 years (for less than 7 year)
- Beyond 7-year term, to be decided in file & use document (which gives the product features including policy benefits and premiums payable) to be filed by the Life insurer with the Regulator.

Generally, Surrender Value is a loss to the Policyholder - the reason being life insurance are long term contracts and there would be a loss to the insurer if surrender value is higher in initial years given the higher cost in the first policy year.

Under Unit linked life insurance policies, since the term insurance component does not carry any surrender value, only the fund value is payable as surrender value after deducting surrender charges.

Paid-up value

Where a policy lapses after acquisition of surrender value, but is not surrendered, the policy does not lose all its benefits. Sum assured shall be reduced in the same ratio as the number of years the premiums actually paid bears to the total number of years for which premiums are payable. Subsisting bonus already declared shall attach - however, no eligibility for future bonuses. Yearly intimation of bonus accrual to Participating Policyholders.

POLICY CLAIMS

A Claim for death sum assured shall be raised by the Nominee with the Life insurance company along with the basic documents like Intimation of death, Death certificate, attending Doctor's certificate etc. Additional documents may be called for by the Life insurance company. If the Life insurer has additional pending documents to be submitted by the Nominee, the requirements must be raised within 15 days of receipt of intimation of death.

Depending on whether the claim is early claim or not an investigation of the claim is normally conducted. Any death claim which is submitted within 2 years of date of commencement of the policy is referred to as early claims. In all such cases, most life insurers invariably conduct an investigation which is done either a senior employee of the life insurer or outsourced to an independent outside investigator. The reason for referring such cases to investigation is to rule out the possibility of any moral hazard of non-disclosure of any pre- existing illnesses or treatments taken by the part of the life assured when the policy was taken. The investigator conducts enquiries with the neighborhood of the place where the life assured had lived, visits hospitals and Doctors to check whether the life assured had taken any treatment. They procure copies of medical reports and submit to the Life insurance company. They also check the authenticity of the Death claim certificate by verifying with the issuing authorities. Also, the KYC documents submitted by the Life assured/Nominee are also verified to rule out frauds.

It is not surprising that life insurance industry has faced serious frauds by persons taking life insurance policy on persons who are not in good health by giving false declarations. In all such cases, death usually happens soon after the Policy is taken. In extreme cases, Life insurance companies have also faced cases of taking life insurance policies on the lives of persons who were already dead even before the Policy was taken, by forging documents. Therefore, claim investigation is very important especially in the case of early claims.

Claims which are not investigated shall be paid or rejected or repudiated within 30 days of receipt of receipt of all papers & clarifications from the Nominee.

Life insurer has a time limit of 90 days for completion of investigation. Once the investigation report is received, the claim to be decided within 30 days of receipt of investigation report. For delays in settlement of claims, interest @ 2% above bank rate shall be payable from the date of receipt of last necessary document. For disputes in title, payment can be made to Court (Section 47). Except claims under Section 47, where claim cannot be paid for want of identification of payee, interest at bank rate payable from the date when claim is ready for payment, in case of delay by the insurer in payment of claim.

Where nominee not traceable, claim cannot be written back. Any claim which cannot be paid for any reason such as want of proper title, disputes between legal heirs etc. will have to be moved to a separate account called "Unclaimed account" which will be invested as per IRDAI's guidelines for the benefit of the Claimant. If even after 10 years from the date of claim intimation, the claim amount is not settled, the proceeds shall be transferred to Senior Citizens Welfare Scheme. After 25 years from the date of such transfer, the proceeds shall be forfeited to Central Government.

If death of the life assured happens due to suicide committed by the Life assured within 12 months from the date of commencement of the Policy or date of revival, Sum Assured shall not be paid. However, 80% of the premiums paid payable (for reinstated cases, higher of 80% or surrender value whichever is higher; for ULIPs fund value) to the Nominee in such cases.

Where, as a result of the investigation conducted by the Life insurer, it is established that a material fact which was critical for assessment of the risk was not disclosed at the time of application in the Proposal form, the Life insurance company has the right to re-assess the underwriting keeping in mind the facts revealed by the Investigation Report. For example, if the investigation report reveals that the Life assured had taken treatment for say, 3 years prior to taking the Policy, for some ailment in a Hospital, the Life insurance company shall re- assess the underwriting keeping in mind this fact. Had this fact been revealed to the insurance company at the time of submitting the Proposal form -what would have been the impact of underwriting (decision to accept the risk and issue a Policy) where fraud or misrepresentation is established, surrender value shall be paid.

As per Section 45 of the Insurance Act, 1938, no claim shall be repudiated on any reason such as non-disclosure or misstatement in the Proposal form, after a period of 3 years from the date of commencement of policy or after 3 years from the date of reinstatement of a Policy. However, this does not preclude an insurer from rejecting a claim where the Policy is in a lapsed condition or covered by exclusions specified in the Policy document, e.g. Suicide exclusion (seen earlier). Therefore, the Life insurer is expected to conduct due diligence at the time of underwriting or at any time within 3 years from the date of commencement of the Policy. A policy also can be cancelled within 3 years, if the Life insurer is able to establish fraud or misrepresentation or misstatements in the Proposal form (even if there is no claim).

For maturity/survival benefits, settlement to be made on or before the due date (i.e., date of maturity or due date for survival benefit as per Policy document). For delays interest at Bank rate+2% from due date or date of receipt of last necessary document from insured/claimant, whichever is later. For delays in processing Freelook cancellations, Surrender, Withdrawal, request for refund of Proposal deposit, refund of Proposal deposit, interest at Bank rate+2% from date of receipt of request or receipt of last necessary document, if any, whichever is later, is payable. Usually for settlement of a claim, a Discharge Voucher (which lists down the claim amount paid along with the break up - giving additions and deductions) signed by the Claimant is insisted. However, if the customer expresses reluctance or does not submit, Discharge voucher cannot be insisted as a precondition to settlement of claims.

In Group Credit Life Policies (Lender-Borrower Groups), payment of claim amount to the extent of outstanding loan amount as per the books of the Lender (Group Policyholder) and balance amount should be paid to the Nominee.

LIFE INSURANCE UNDERWRITING

Underwriting is the process of evaluating the risk of insuring a home, car, driver or individual in the case of life insurance or health insurance, to determine if it's profitable for the insurance company to take the chance on providing insurance. After determining "risk", the underwriter sets a price and establishes the insurance premium that will be charged in exchange for taking on that risk.

Insurance underwriters work for insurance companies. An insurance underwriter's role is to choose who and what the insurance company will insure based on risk assessment. Underwriting is the "behind the scenes" work in an insurance company.

What Does an Insurance Underwrite Do?

Reviews specific information to determine what the actual risk is	Determines what kind of policy coverage or what perils the insurance company agrees to insure and under what conditions	May restrict of alter coverage by endorsement	Looks for proactive solutions that may reduce or eliminate the risk of future insurance claims	May negotiate with your agent or broker to find ways to insure to insure you when the issue isn't so clear-cut or there are insurance issues

Underwriters are trained insurance professionals who understand risks and how to prevent them. They have specialized knowledge in risk assessment and use this knowledge to determine whether they will insure something or someone, and at what cost the insurance underwriter is the insurance company's appointed risk taker, the one who decides to take on the financial responsibility to the insured if he believes in the risk. He or she reviews all the information your agent provides and decides if the company is willing to take a gamble on you.

An underwriter might get involved when intervention or additional assessment is required like when:

- There are multiple claims.
- Cases of first insurance.
- Payment issues, among many other factors.

MORTALITY & MORBIDITY RISKS

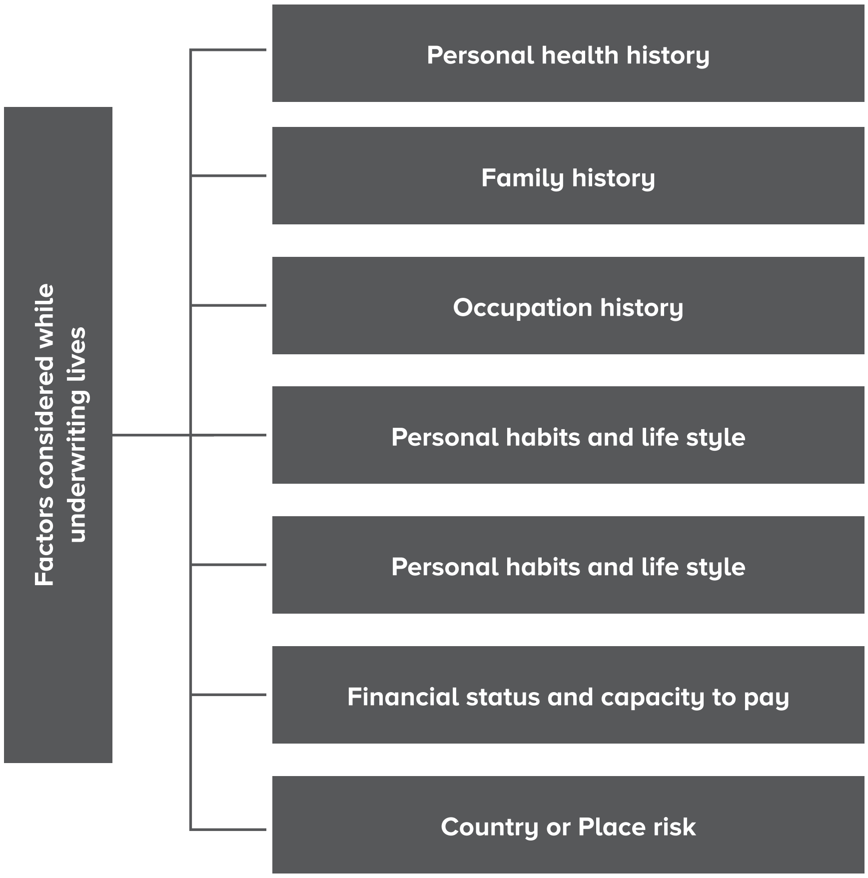
Mortality denotes the death rate which is the risk of persons dying at each age. It is relevant for Term, Whole Life and Endowment Policies or any other life insurance policy where a Sum assured is payable on death.

While mortality denotes the risk of dying early, morbidity denotes the risk of contracting illness - which is relevant for Critical illnesses and hospitalization under Medi-claim Policies. Morbidity is defined as expected number of people becoming ill or sick over a defined period, usually a year. It also means the frequency with which a disease appears in a population. Morbidity rates help insures predict the likelihood that an insured will contract or develop any number of specified diseases. The morbidity tables used by actuaries for pricing insurance products are prepared separately for males, females and children and for different ages.

Concept of Standard lives & Sub-standard lives

A Standard life is one which exposes to the insurer to a normal risk, i.e., the predictive morality on the life does not deviate significantly when compared to the mortality indicated in the mortality table. A mortality table is one which gives the statistics on number of persons dying at each age which is used as the basis for calculating the base premiums.

However, if the individual life which is considered by the insurer, shows a higher mortality than the standard lives in the mortality table, it would be termed as a Sub-standard life and the insurer takes extra risk and will have to therefore put additional risk controls like imposing extra premiums etc. Under certain circumstances, risk under Sub-standard lives can also be postponed and in extreme cases can also be declined if the risk is adverse.



FACTORS CONSIDERED WHILE UNDERWRITING LIVES

- **Personal health history** - This is the most important factor which directly impacts the underwriting. This section in the Proposal form comprises of whole list of questions concerning the various Systems in the human body and whether the Life assured has undergone any treatment or taking medicines or underwent diagnostic test or is aware of any abnormality etc. This section must be carefully answered by the Life assured.

- **Family history** - Medically, it has been proved that genes play an important role in certain lifestyle related ailments and Family history assumes significance in assessing mortality. Details include the age at death of the parents and siblings and whether there has been any medical history for these close relatives.

- **Occupation history** - Occupational hazards play an important role in mortality assessments. Since a Person majority of his time during his life in his workplace, the hazards related to occupation have an important bearing on mortality. For example, persons who are engaged in professional sports like Motor car racing, are exposed to higher risks.

- **Personal habits and life style** - Habits like Smoking and Drinking have an impact. Therefore, information on these habits are also solicited in the Proposal form.

- **Financial status and capacity to pay** - Also called Financial underwriting, this aspect reviews the capacity of the Customer to repay the Premiums over the Premium paying period. Though not as stricter as assessment of repaying capacity for a Loan, it is a factor considered based on a simple formula - under which Sum Assured is calculated as a multiple to Annual income of the Proposer - to check over-insurance. Further, the Premium paying capacity is measured by dividing the Annualized

Premium under all Life insurance policies (including the proposed one) by Total Annual Income of the Proposer. If the ratio is more than 50%, additional income proofs solicited by the Insurer.

- **Country or Place risk** - Persons residing in high risk locations face higher mortality risks. Therefore, countries which are prone to frequent wars, civil commotions, riots etc. could attract higher premium. In addition, the location of the Life insured in a high-risk location also becomes important. Of late, Private Life insurance companies are facing the risk of persons residing in certain pockets which is known for persons with high mortality risks and who seek life insurance cover and the death claim is filed very soon after taking the Policy. There are instances of even seeking life insurance covers on dead persons by forging signatures and documents in certain pockets. Therefore, Life insurers have banned certain locations for giving insurance cover.

UNDERWRITING PROCESS

Step 1	• Application quality check
Step 2	• Paramedical exam
Step 3	• Attendind physician statement
Step 4	• Medical information Bureau check
Step 5	• Prescription check
Step 6	• Motor vehicle report
Step 7	• Actuarial tables
Step 8	• Credit system
Step 9	• Your final rating

Step 1: Application quality check

Before life insurance underwriting even begins, the carrier will go through your application to make sure all of the correct information is there. Your application is the first step in actually getting life insurance, so it's something you want to get right.

It's not uncommon for applications to be accidentally incomplete. The carrier is looking to make sure that all of the information is accurate and completely filled out. Fortunately, unless the missing information is related to medical history, most changes that need to be made to an application won't slow down the underwriting process.

Step 2: Paramedical exam

Next step in underwriting process involves looking at the results of your paramedical exam.

The medical exam is like a checkup with your doctor, except it's free to you. A medical technician will perform the exam at a lab or your home or work.

After the paramedical exam, the results will be sent to the underwriter. The information an underwriter uses falls into three main categories:

- **Basic measurements.** Height, weight, blood pressure - the boring things that you get a report on at a typical physical. Your height-to-weight ratio plays a big role in how you'll be classified and, ultimately, what you'll pay for your life insurance policy. High blood pressure, which becomes a particular concern as you get older, is also required for setting your rates.
- **Blood test.** You can get a lot of information on potentially risky health concerns with a simple blood test. Heart disease, stroke, diabetes, blood-borne illnesses, and more can all be found out with a few vials of blood.
- **Drug test.** A urine test for a full drug panel will alert the carrier to the use of drugs like amphetamines, cocaine, barbiturates, and more. Generally speaking, drug use makes you riskier to insure and raises your premiums (unless it's marijuana, which is in a legal, social, and insurance grey area at the moment).

You can reuse the results of your paramedical exam to apply for other types of insurance, like disability insurance, or even for life insurance from another carrier. You're under no obligation to go with a particular life insurance company just because they paid for your medical exam.

Step 3: Attending physician statement

If there are red flags coming out of your paramedical exam, the underwriter will order an APS to answer some remaining questions.

An APS is a summary of your medical history from your doctor's point of view. It provides the status of each condition your doctor is treating and information about the condition, such as how long you've been treating it, how long symptoms have been present, and your prognosis.

Say you're showing signs of high blood pressure. An APS can let an underwriter know that the high blood pressure is a temporary side effect of medication you're taking and not necessarily indicative of a larger problem. In that way, it complements the paramedical exam by getting into the finer details of your health.

This step can skew the timeline for the life insurance underwriting process, adding anywhere from a few days to a few months, depending on how long it takes for a doctor's office to comply with the request.

Step 4: Medical Information Bureau check

The Medical Information Bureau (MIB) is a trade group that helps insurers share medical data, which helps a carrier fend off fraud by seeing where and when you've previously applied for life insurance in a general window of six months.

It's not a bad thing if you've applied for life insurance with different carriers in the past, but the MIB will let carriers see what sort of information you've been disclosing on some applications that you may have accidentally left off others. Tested positive for drug use on a previous test but failed to disclose it on your current application?

Step 5: Prescription check

The underwriter will check all the medication prescribed to you over the past five to seven years. As with the paramedical exam and APS, the prescription check will confirm the information in your application: the prescriptions you say you're on or if you've omitted any medication up to this point.

Whether your underwriter requires this step depends on what they find in other areas of investigation. Life insurance policies with higher coverage amounts may also require a prescription check.

Step 6: Motor vehicle report

The underwriter will receive a motor vehicle report, or MVR, detailing your driving history. Just like your health history, your driving history plays a role in your life insurance rates because it helps determine how risky you are to insure.

An MVR notes driving violations like traffic citations (think speeding or reckless driving tickets), vehicular crimes, accident reports, driving record points, and DUI convictions. It can look as far back as five to seven years.

If you have a tendency to speed, drink and drive, or engage in other dangerous driving habits, you're riskier, and your rates will be higher than someone who's not.

Step 7: Actuarial tables

Underwriters use a number of different actuarial tables to determine what risk you pose to the insurer and how much the insurer needs to charge to offset that risk.

- **Mortality table.** This table shows the mortality probability for a given population, usually based on age and gender and assuming all other things being equal. Think of it as a baseline for when, statistically speaking, you're most likely to die.
- **Build table.** This table takes your body mass index (BMI) based on your height and weight and translates it into information that's relevant to setting your insurance classification. A poor build can automatically set your classification to Standard, meaning you'll pay more for your life insurance policy than someone with a Preferred classification.

Step 8: Credit system

After the underwriter has gone through all of the tests, tools, and checks needed to set your insurance classification, the last thing he or she may do is use a credit system to give you a little bump to help you get better rates.

If a chronic illness results in a Standard (substandard) classification, the underwriter's credit system can make your premium more affordable if you're actively taking steps to improve your health and undergoing preventative care.

The APS and prescription check will let an underwriter know what you're doing to keep health problems from getting worse, which can be a boost to both your health and your wallet.

Step 9: Your final rating

Once underwriting is complete, you're now the proud owner of a life insurance policy. The whole process can take anywhere from three to eight weeks, and relying on outside sources - like a doctor's office for an APS - can add time. All that's left is to confirm the premium rate, sign the policy to put it in force, and your family is protected.

LESSON ROUND-UP

- Premium is consideration money for the benefit of a lump sum payment by the insurer on the happening of a specified event. The amount of premium is dependent upon age of the prospect, the policy conditions, the term etc. Premium is calculated separately in each case when a proposal is submitted. For extra benefits, extra premium is charged.
- The basic premium is, however, decided on the basis of three factors - mortality, expenses and yield on nvestment. While mortality and expenses increase the premium, investment yield reduces the premium.
- All life insurance companies charge level premium, i.e., the same premium throughout the duration of policy. This practice leads to the generation of some surplus in the initial period of the policy. Hence a portion of this surplus can be paid to a policyholder if he wants to surrender the policy before the maturity date.

- Life insurance being a legally enforceable contract needs to be documented with details of the rights and obligations of the parties to the contract. Proposal form duly filled in and signed by the proposer is the first document which forms the basis of the contract.
- Every time, the insured pays the premium, he receives a premium receipt. The premium needs to be paid in time, non-payment of premium leads to policy-lapses. Re-instatement of the cover is called revival of the policy.
- If the policy is not revived, the policy can become a paid-up policy for a reduced sum assured under certain conditions.
- The policy document mentions in detail all the rights and obligations of the policyholder. The agent is advised to explain the various provisions of the policy to the policyholder.
- Revival is a need whenever the policy has lapsed for nonpayment of premium. The process of revival is kept easy subject to necessary caution.
- Assignment is a procedure to transfer the ownership of the policy, which is a property, to another for a consideration. It is free of normal hassles usual to transfer of property.
- The value which is now payable in cancellation of the policy contract is called the Surrender Value.
- Group insurance is a contract of insurance with a company, or association covering a group of people who are engaged in the similar occupations. The group should be such that there would be continuous flow of new members while old members would retire. Individual members do not have to sign any papers and the benefit would be available uniformly to the entire group.

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.)

1. What are the different stages where documentation is required?
2. Which document evidences the contract of insurance?
3. Discuss the provisions of sending renewal notices.
4. Which are non-standard age proofs?
5. When the maturity claim is payable?
6. Which policies are eligible for Bonuses?
7. Discuss the underwriting process under life insurance.

LIST OF FURTHER READINGS

- K.S.N. Murthy, K.V.S. Samra, 2013, Modern Law of Insurance in India, Fifth Edition, Published By Lexis Nexis.
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- K.C Mishra, C.S Kumar, Life Insurance: Principles and Practice, Cengage Learning.

General and Health Insurance

Lesson 17

KEY CONCEPTS

■ General Insurance ■ Workmen Compensation ■ Professional Indemnity ■ Underwriting ■ Health Insurance ■ Claim

Learning Objectives

To understand:

- Principles governing insurance contracts
- Various documents related to General insurance business
- Different types of General insurance
- Health Insurance in India and what is health financing model
- Underwriting in General insurance & Health Insurance

Lesson Outline

General Insurance

- Various sub-classes of General Insurance
- Professional Indemnit
- Directors & Officers Liability
- Other miscellaneous lines of business
- Policy Documents and Forms
- Underwriting
- Ratings and Premiums
- Claims under General Insurance

Health Insurance

- Health Insurance and Health system in India
- Health Financing in India
- Health Insurance Products
- Health Insurance Underwriting
- Health Insurance Policy Forms and Clauses Health Insurance Pricing and Reserving
- Customer Service in Health Insurance
- Lesson Round-Up
- Glossary
- Test Yourself
- List of Futher Readings

REGULATORY FRAMEWORK

- Insurance Act, 1938
- General Insurance Business (Nationalization) Act, 1972
- Indian Contract Act, 1872
- IRDAI Act, 1999
- Employees Compensation Act, 2009

GENERAL INSURANCE

A popular or generally accepted idea is that all insurance other than life is non-life or general insurance. General Insurance is:

- A policy or agreement between the policyholder and the insurer which is considered only after realization of the premium.
- The premium is paid by the insured who has a financial interest in the asset covered.
- The insurer will protect the insured from the financial liability in case of loss.

It is generally said that General Insurance protects the person and not the property. In other words, it means that any property is inherently exposed to risk and like to be damaged. Therefore, general insurance protects the financial loss of the policyholder and compensates as far as money can for all the insured losses. General Insurance comprises of insurance of property against fire, burglary and natural calamities like floods and earthquakes etc., personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities. There are also other covers such as Errors and Omissions insurance for professionals, credit insurance, agricultural insurance, etc.

The non-life insurers also offer Engineering insurance, and marine insurance policies covering machinery against breakdown, and the hull of ships and so on. A marine cargo policy covers goods in transit including by sea, air and road. Further, Motor insurance convers insurance of motor vehicles against damages and theft forms a major chunk of non-life insurance business. In respect of insurance of property, it is important that the cover is taken for the actual value of the property to avoid being imposed a penalty for under insurance should there be a claim.

Insurance business is one of the most highly regulated businesses globally for reasons of equity and efficiency. It has a well-defined regulatory and legislative framework to operate. Insurance law by itself is both unique and comprehensive because it operates within the limitations of all the other governing legislations and ensures the legal provisions by incorporating the same in its various policies.

INSURANCE POLICY CONTRACT

Q. In a contract of Insurance, who makes the offer and which party is accepting?

A. The applicant for insurance is making the offer of his risk and the insurance company is accepting the risk, if the proposed risk is more than average degree of risk, the insurance company may either accept conditionally or reject the application. Hence, in India the application for insurance is called as a Proposal form.

An insurance policy is like any contract, a legal document and enforceable in a court; the provisions of the Indian Contracts Act, 1872 are applicable to insurance contracts as well.

The essentials elements of a valid contract of insurance would be

i. Offer and acceptance

ii. Capacity to contract

iii. Consideration

iv. Legality of object

Q. Can a Minor enter into a contract of insurance ?

A. No a minor cannot enter into a contract of insurance on his own. However, he can a beneficiary under a contract of insurance.

An offer, intended to create legal relations, must be communicated to the offeree either by words or by conduct.

The phrase reinsurance is the subject matter of solicitation' is very commonly seen and heard -what this indicates is that insurance is to be sought by the person who wants to buy it from the insurer. It is advisory in nature. It should not be forced. Customer must not be threatened or coerced to buy insurance. It is to be solicited or purchased by the consumer. It must be remembered that "Customer's participation in availing the insurance products and services are purely on voluntary basis.

This means that the insurance company is providing you insurance against a risk on your request/solicitation, i.e. the company has agreed to sell you its insurance policy after you solicited or asked for such a sale. In legal terms, insurance is a product that should not be pushed or sold by a seller, but should be pulled or bought by a buyer.

The proposal is made by the insured and accepted by the insurer.

1. **Agreement between the Parties.** The acceptance of the proposal by the insurer together with the premium is expressed in the form of a contract, the insurance policy; together with the clauses is the basis of the agreement between the parties.

2. There must be Evidence of the Intention of the parties to enter into a contractual relation. This may be provided by the formal procedure of making the promise under seal, or it may be by the existence of consideration.

3. **Consideration.** The premium paid by the insured for the contract is the consideration.

4. The parties must be recognized by the law as having the Capacity to Contract. All aspects regarding the capacity to contract, age, mental capacity and understanding etc. as defined in the Indian Contracts Act, 1872 is applicable.

5. The consent of the parties must be mutual and in consensus that is to say, the parties must not have been threatened, unduly influenced, deceived or misled in a manner which would nullify their agreement.

6. The subject-matter of the contract must be Legal and possible of performance.

If one of these essentials is missing, the contract is void, voidable or unenforceable, depending upon the circumstances. A void "contract" is a contradiction in terms for it never can be a contract. A voidable contract is valid but, at the option of one of the parties.

An insurance policy is also governed by the principles of insurance as discussed in the earlier chapters.

POLICY DOCUMENTS AND FORMS

Proposals

As has been mentioned earlier, insurance is the subject matter of solicitation, i.e, the offer or proposal for insurance has to come from the insured. It is also said that a proposal is the basis of insurance. In other words, the facts mentioned in the proposal form becomes the basis for the insurance policy cover. The proposal forms for most products have been designed, over the years, to conveniently and comprehensively, obtain information from the insured which would be material to underwriting the policy.

The basic principle of utmost good faith comes into operation here. The insured should at the start of the contract divulge all material information about the subject matter; this would enable the insurer to decide the terms of cover and the rating and help avoid any disputes in the future in the event of a claim.

The owner's pecuniary interest in the subject matter of insurance establishes that the loss if any would adversely affect him financially; this serves to prove the insurable interest that the proposer has in the property to be insured.

The policy of insurance is a personal contract, and thus if the insured wants to transfer the interest in the policy, he can only do so with the consent of the insurer. The transfer of rights can be made through assignment of the policy. Assignment means transfer of the rights to another person usually made through a written document.

When the property on which insurance has been obtained, is sold the existing policy might be transferred to the buyer of the policy, with the permission of the insurer. However, marine cargo policies are freely assignable as together with the invoice and contract of affreightment i.e., - B/L, AWB. GCN or RR they form negotiable instruments that can be discounted at banks.

The proposal form is therefore the foundation of the insurance contract. It contains all the relevant information about-

1. Generic details about the insured/proposer - name, address etc. Important not only for incorporating on the policy form but also checking KYC diligences under the antimoney laundering laws and for checking moral hazards etc.

2. Specific details about the subject matter to be insured-this may be a line or two, if a single machinery, or a single shipment of goods by road; it may run into pages in case it contains details about projects which are to be insured-eg.hydro electric project, oil rigging platform etc.

3. Details regarding the value to be sum insured; duration of insurance covered required.

Almost all general insurance policies are for 1 year; specific voyage policies can be shorter for the transit duration only. Project polices can be longer than 1 year - till the project is commissioned and operative.

Policy Schedule

The policy schedule is the document which together with various clauses, warranties and conditions forms the contract.

Naturally, this would include such details as name address, nature of business, policy number etc. Other more particular information detailed in the policy schedule would be:

1. Full details and description of the subject matter to be insured.

2. Sum insured based on value of the sum insured. The basis of valuation and the adequacy of the sum insured is to be measured and specified clearly to avoid dispute in future in the event of a claim.

3. Period of insurance.

4. Premium.

5. The terms and conditions which details the actual cover e.g., in marine cargo policies whether the cover is under ICC (A) or ICC (B) or ICC (C) etc.

6. The various clauses which attach to the policy schedule and which are applicable to the contract would be listed on the policy schedule as well to clearly specify the nature and extent of the cover which is being issued.

It is advisable to discuss with the insured, especially in case of insurance of high value risks, the exact words and clauses which attach to the policy and that define the cover. e.g., in case of project policies etc.- it may be necessary to clarify what is testing period. It may be necessary to advise that when the plan becomes operational, post testing period, project insurance cover should be replaced by operational cover like fire policy.

Certificates of Insurance

These are usually given in marine transit insurance under open policies and also for motor insurance. In motor insurance they are mandatory as it confirms that there is insurance cover existing for the vehicle plying on public roads. They are less detailed than a policy and not stamped, but essentially give the same information regarding insurance.

Cover note

These are documents that are issued immediately to prove that insurance cover is existing and valid for 60 days from the date of issue. Mostly used in motor insurance and transit insurance, particularly for import covers by sea. The cover note in marine insurance would be valid for duration of transit. The cover note is valid for a maximum period of 60 days.

Endorsements

There may be instances, when during the currency of the policy, certain changes may be advised by the customer. E.g., Change in location, correction of name or other details of subject matter insured. There may be instances of increase in the value to be insured, inclusion of extra covers or deletion of covers etc.

In such cases, the insurer would, on being so solicited by the insured customer, issue an endorsement which would reflect the changes or amendments and would thereafter form part of the policy document. This is particularly relevant, in the event of a claim, as the damaged property may have been the subject matter of the endorsement- which details would not be available in the original policy.

Generally, endorsements are issued for such alterations as:

1. Change in insurable interest.
2. Cancellation of insurance.
3. Change in the value at risk.
4. Change in the location or situation of risk.
5. Reduction or addition to the risk.
6. Change of the insured as when a transfer of interest or assignment of interest is made.

Sometimes an endorsement is also issued to correct a typographical error in the policy already issued.

Renewal Notice

While it is not obligatory to issue renewal notices reminding insured that the policy is due for renewal, it is recommendatory as an excellent customer service initiative.

It is well known that getting a new customer is much more difficult and time consuming than retaining an old one With much less effort one can cash in on their loyalty and ensure that policies are renewed year after year.

Warranties

Warranties are an extension of the terms and conditions contained in the clauses which attach to the policy schedule. As explained, the insured proposes insurance of a particular property and completes a proposal.

Based on the same and customary trade conditions and practices, as well as underwriting experience the insurer would stipulate certain warranties or conditions, which help the minimize chances of loss.

Warranty is a statement by which the insured undertakes to do/not do a particular thing or fulfil a condition, or whereby he affirms or negates the existence of a particular state of facts which affect the incidence of a claim.

Warranties can either relate to facts existing at the time of the contract or relate to the future. It is an undertaking given by the insured either voluntarily or at the instance of the insurer about something that will determine the insurability of the risk.

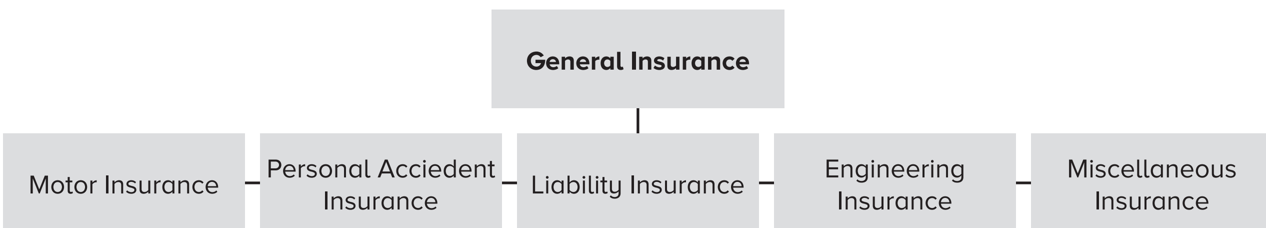
For example, in a Marine Cargo policy, a warranty may read “Warranted that the consignments are transported in closed trucks covered by tarpaulins” - in case goods are being moved during monsoons.

GENERAL INSURANCE PRODUCTS

Fire insurance policies cover the risk of loss arising out of unforeseen fire accidents with the limit of the Sum assured. These products are more popular in Corporates than with individuals. They are designed to provide financial protection for property against loss or damage by fire and other specified perils. Reinstatement value clauses are attached to Fire policies under which the amount payable is the cost of reinstating property of the same kind or type, by new property.

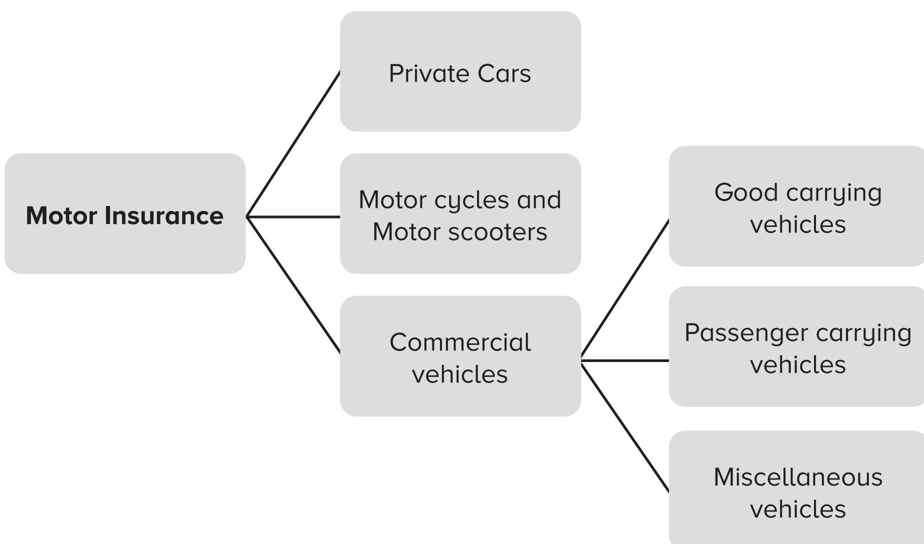
Marine insurance policies comprise of Cargo insurance and hull insurance. Cargo insurance provides insurance cover in respect of loss of or damage to goods during transit by rail, road, sea or air. Hull insurance on the other hand, concerns the insurance of ships (hull, machinery etc.).

General Insurance Products



Motor Insurance

Motor insurance, as the name suggests, is insurance of motor vehicles and are broadly classified as follows:



Insurance of Motor Vehicles are covered under the Motor Vehicles Act, 1939. Insurance of motor vehicles against damage is not made compulsory, but the insurance against third party liability arising out of the use of motor vehicles in public places is made compulsory. Insurance Cover against damage is known as “Own Damages” and against injury or death to a third party is known as “Third Party” claim. No motor vehicle can ply in a public place without such insurance. Recently, pursuant to a Supreme Court decision, all Insurers are mandated to issue Long term policy for Third Party risks- Three years for new private cars and five years for new two wheelers.

Personal Accident Insurance

The Policy provides that, if the insured shall sustain any bodily injury resulting solely and directly from accident caused by external, violent and visible means, then the Insurance company shall pay to the insured or his legal personal representative(s), as the case may be, a Sum assured under the Policy. The Policy covers the contingency of death, loss of body parts and Permanent and Temporary disablements.

Liability Insurance

The purpose of liability insurance is to provide indemnity in respect of damages payable under law for personal liability of any nature. This legal liability may arise under the common law on the basis of negligence or under statutory law (e.g. Public Liability Insurance Act or Workman’s Compensation Act) on ‘no fault basis’, i.e., even when there is no negligence.

Engineering Insurance

Engineering insurance covers the various risks in a manufacturing organisation, especially plants. The various categories of Engineering insurance are as follows:

(a) **Contractors All Risks Policy –** designed to protect the interests of contractors and principals in respect of civil engineering projects like buildings, bridges, tunnels etc.

(b) **Erection All Risks Policy –** is concerned with erection of electrical plant and machinery and equipment and structures involving no or very little civil engineering work.

(c) **Marine-cum-erection Policy –** concerns with the delivery of the first consignment of plant and machinery at the site of erection.

(d) **Machinery breakdown Policy –** Insurable property include boilers, electrical, mechanical and lifting equipment.

(e) **Contractors Plant & Machinery Policy –** Policy given to a Contractor who may be using his plant and machinery at different projects during the course of the year.

(f) **Boiler & Pressure Plant Policy.**

(g) **Machinery Loss of Profits Policy** or Machinery insurance indemnify an insured against material damage resulting from breakdown or explosion or collapse of machinery – such damage may also result in business interruption at the Insured’s premises.

(h) **Advance Loss of Profits Policy –** risk of delay of project due to accidental damage to project materials.

(i) **Deterioration of Stock Policy –** covers loss due to breakdown of refrigeration.

(j) **Electronic Equipment Policy -** physical loss or damage necessitating repairs or replacement.

(k) **External Data Media –** covers cost of replacing damaged external storage media.

(l) **Increased cost of working –** indemnifies against all additional cost incurred to ensure continued data processing on substitute equipment if such costs are incurred as an unavoidable consequence of loss or damage indemnifiable under material damage section of the policy.

Miscellaneous Insurance

Miscellaneous Insurance products include the following products:

(a) Burglary insurance

(b) Householders' Insurance

(c) Shopkeepers' Insurance

(d) Bankers' Blanket Policies

(e) Jewellers' Block Policies

(f) Blood Stock (Horse) Insurance

(g) All Risks Insurance Policy – includes jewellery, valuables, antiques, paintings, watches, cameras etc.

(h) Money insurance – covers the risk of loss of money in transit

(i) Fidelity guarantees – covers the risk of arising out of dishonesty of employees

(j) Television insurance

(k) Pedal cycle insurance

(l) Plate Glass insurance – breakage of plain glass

(m) Neon sign insurance.

Rural Insurance

Rural insurance includes the following categories of products:

(a) Cattle Insurance

(b) Sheep and Goat Insurance

(c) Poultry Insurance

(d) Dog Insurance

(e) Silk Worm Insurance

(f) Honey Bee Insurance

(g) Horticulture/Plantation Insurance Scheme

(h) Comprehensive Floriculture Insurance

(i) Agriculture Pump set Policy

(j) Salt Works Insurance

(k) Cycle Rickshaw Policy

(l) Animal Driven Cart Insurance

(m) Gobar Gas Insurance

(n) Hut Insurance

(o) Weather/Crop Insurance.

Workmen Compensation

The policy protects the employers against their legal liability for payment of compensation arising as a result of death of disablement of the employees arising out of and in the course of employment. The policy provides indemnity against legal liability under the Workmen's Compensation Act, Fatal Accidents Act and Common Law.

The policy does not specify any sum insured because the amounts of compensation stipulated in the Act(s) or awarded by a Court of Law determine the limits of liability of the insurers.

The total earnings of the employees cannot be accurately computed at the commencement of the policy. An estimate of the total earnings is made and a deposit premium is charged. The premium is finally adjusted after the expiry of the policy, on the basis of the actual total earnings of the employees during the period.

Professional Indemnity Policies

Professional indemnities are designed to provide insurance protection to professional people against their legal liability to pay damages arising out of negligence in the performance of their professional duties.

Such policies are available to Doctors, Medical establishments, Engineers, Architects and Interior decorators, Chartered Accountants, Financial Consultants including Insurance Agents and Brokers, Management Consultants, and Lawyers etc.

Professional risks fall into the following two broad groups:

(a) Where professional negligence may result in bodily injuries (fatal or otherwise). Doctors, Dentists etc., fall into this group.

(b) Where professional negligence may result in financial loss. Chartered Accountants, Lawyers etc. fall into this group.

Directors and Officers Liability Policy

This is a specialised insurance policy introduced to cover the liabilities of Directors or Officers of a Company. Since they hold positions of trust and responsibility, they may become liable to pay damages, due to acts of omission or commission.

It is a type of liability insurance which covers the directors and officers against the claims made by-

- Employees
- Suppliers
- Competitors
- Regulators
- Customers
- Shareholders
- Other stakeholders.

For wrongful acts committed by them in the supervision and management of the affairs of the Company. Besides the Company itself may be liable. The policy is designed to provide protection to the Company as well as its Directors and Officers against their personal civil liability.

INSURANCE UNDERWRITING

Objectives of Underwriting

1. To reduce the possibility of adverse selection against the insurer.

2. Prudent underwriting reduces the chances of Physical, Moral, and Morale hazards.
3. Underwriting helps in determining the expected loss potential of the proposed insured and selecting a price in line with this expected loss.
4. To ensure a profitable book of business for the insurer.

Underwriting Process

Underwriting is the heart of insurance operations. Underwriters are like gate-keepers of insurance company. They are the people who decide whether to issue a policy of insurance to an applicant or not. Therefore, Underwriting is defined as assumption of liability. It is a continuous process of risk selection and risk classification. The underwriting process follows a series of stages, at the end of which the status of a risk is decided. It is only after the risk has been weighed and all possible alternatives evaluated that the final underwriting is done. When a proposal for insurance is received, the underwriter has four possible courses of action:

- Accept the risk at standard rates,
- Charge extra premium depending on the risk factor,
- Impose special conditions,
- Reject the risk.

There are different types of hazard which can influence his decision to accept or reject a risk ?

1. **Physical hazards**

   These are hazards that affect the physical characteristics of whatever is being insured. For example a building made of wood represents a higher level of physical hazard than one made of brick.

2. **Moral hazards**

   These hazards refer to the defects that exist in a person's character that may increase the frequency or the severity of loss. Such a character may tend to increase the loss for the company e.g., taking a policy of insurance with an intention to cheat or commit fraud.

3. **Financial hazards**

   If the value of the risk is beyond the capacity of the insurer he may reject the risk, or share the same.

4. **Morale hazard**

   This hazard refers to the attitude of the insured which is reflected through his behaviour because of existence of insurance towards his belongings. For example, an insured may take minimum precaution of safety because he knows he has insurance policy. For example, leaving the house unlocked, leaving the keys in the car, reflects carelessness or indifference to loss due to existence of insurance policy.

   Therefore, the Underwriter has the following choices:

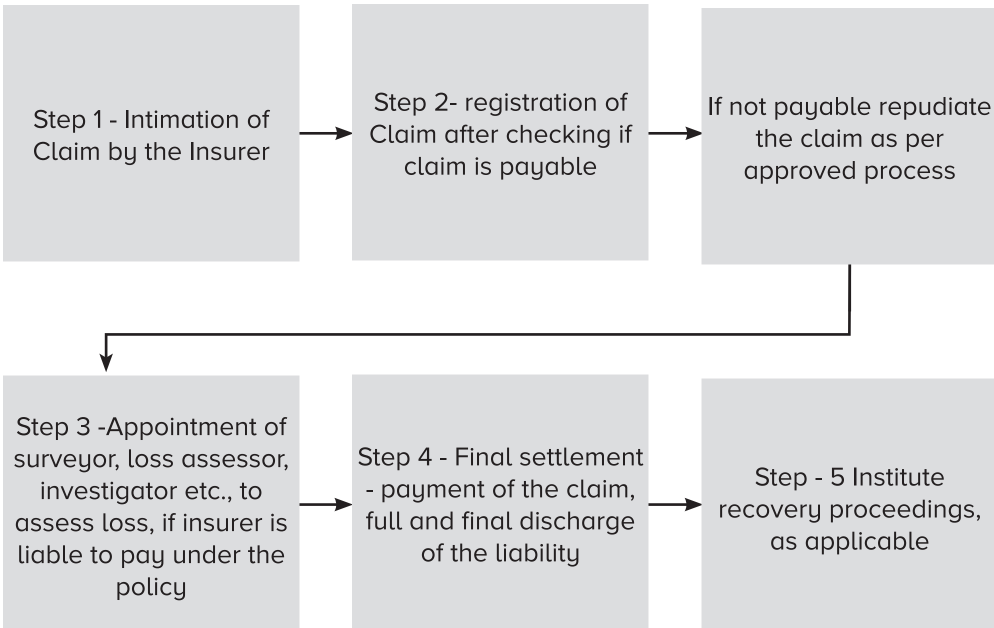
   The underwriter can accept a proposal, reject it or accept it with certain modifications. Some of the modifications that can be made are:

   - Hazard incidence can be reduced: For loss prevention and minimisation, underwriters can recommend certain changes that will safeguard against physical hazards. For example, installing sprinkler systems and better fire-fighting equipment in offices will reduce damages in case of fire.
   - Changing rating plans and policy terms: Sometimes a proposal that seems unacceptable at one rate may become a desirable business under another rating plan or with Special Conditions such as 'compulsory excess'.

CLAIMS IN GENERAL INSURANCE

General Procedure for Claim Settlement

The general procedure for seeking claim settlement is same in most forms of General Insurance. The graphical presentation of claim settlement is as given below:



Step 1 – Intimation/Submission of the Claim by the Insured

The insured would intimate the insurance company of the occurrence of a peril or risk which has caused loss of or damage to the insured property.

Step 2 – Evaluation/Registration of Claim

The insurer would briefly initiate process check -

(i) Whether the policy has been issued by the insurer.

(ii) Whether the policy is in existence.

(iii) Whether correct premium has been received by the insurer.

(iv) Whether the peril causing loss/damage is an insured peril.

If the insurer is not satisfied and the necessary elements of insurance are not present, it may repudiate the insurance claim and intimate the insurer about the repudiation. In some cases, the insurer may ask for some other inputs about the insurance claim which he thinks necessary for processing the claim further. If on receipt of the additional input, the insurer is not satisfied, he may repudiate the claim and intimate the insured about the repudiation of claim. Only after getting satisfied about the claim, the insurer initiates the next step for claim processing.

Step 3 – Appointment of Surveyor / Loss Assessor / Investigator etc.

The insurer would immediately arrange for surveyor to be appointed who would look into the circumstances of the loss, assess the actual loss suffered in money terms and that which can be indemnified in terms of the contract, advise the insurer regarding compliance of the various terms, conditions and warranties under the contract etc.

The loss assessor has also to advise the client on various aspects of loss mitigation, limitation, salvage. Loss investigation including forensic investigation and analysis may also come under the purview of a professional investigator.

Acid tests applied by the surveyor of the various principles - insurable interest, utmost good faith, proximate cause and of course contribution, help in deciding ultimately, if a claim is payable as well as quantum payable.

If the claim is not paid within the same financial year in which it occurred, then the surveyor's assessment would enable the adequate provisioning for the claim in its financials.

Step 4 – Settlement of Claims

The insurer would ensure claims are settled on the receipt of the final report from the surveyor, generally within the TAT (Turn Around Time) stipulated by various regulations and committed by the insurance company.

Step 5 – Recovery

The next step for the insurance company, in certain cases is initiating process for recovery from the third person who is party - e.g., in marine cargo transit claims - recovery proceedings, as per applicable statutes are initiated against carriers. In motor third party liability claims - awards are settled with victims of any motor accident and action instituted against the owner of the vehicle for recovery.

Claim Procedure for Motor Insurance

(a) Vehicle Accident Claims

After the insured submit his claim form and the relevant documents, the insurer appoints a surveyor to inspect the vehicle and submit his/her report to the insurance company. Insured also get the details of the surveyor's report. In case of major damage to the vehicle, the insurer arranges for a spot survey at the site of accident.

The insured can undertake repairs only on completion of the survey. Once the vehicle is repaired, the insured should submit duly signed bills/cash memos to the insurance company. In some cases, companies have the surveyor re-inspect the vehicle after repairs. In such a scenario, the insured should pay the workshop/garage and obtain a proof of release document (this is an authenticated document signed by you to release the vehicle from the garage after it is checked and repaired).

Once the vehicle has been released, insured should submit the original bill, proof of release, and cash receipt from the garage to the surveyor. The surveyor sends the claim file to the insurance company for settlement along with all the documents and finally, the insurance company reimburses the insured.

In case of an accident, the insurance company pays for the replacement of the damaged parts and the labor fees.

The costs that the insured has to bear include:

A. The amount of depreciation as per the rate prescribed.

B. Reasonable value of salvage.

C. Voluntary deductions under the policy, if the insured have opted for any.

A man, his wife and her brother went Kadavu to Pollachi at night. Three people were travelling in a two-wheeler and they met with an accident. The Wife and her brother died in the accident. The insurer refused to pay the accident benefit sum assured since the accident was caused due to breach of law.

Do you think the insurer is justified in repudiating the claim?

Since, as per the MV Act only two persons are permitted, there is a breach of law. The accident has happened and death occurred due to breach of law and therefore, insurer is correct in repudiating the Accident Benefit SA.

D. Compulsory excesses levied by the insurer.

If the insured uses the cashless rep air facility, the claim money is paid directly to the workshop or garage. Otherwise, the amount of claim is paid to the insured.

(b) Third Party Insurance Claim

In the event of a third party claim, the insured should notify the insurance company in writing along with a copy of the notice and the insurance certificate. The insured should not offer to make an out-of-court settlement or promise payment to any party without the written consent of the insurance company. The insurance company has a right to refuse liabilities arising out of such promises.

The insurance company will issue a claim form that has to be filled and submitted along with:

(a) Copy of the Registration Certificate.

(b) Driving license.

(c) First information report (FIR).

After verification, the insurance company will appoint a lawyer in the defense of insurer and the insurer should cooperate with the insurance company, providing evidence during court proceedings. If the court orders compensation, the insurance company will then do it directly.

(c) Vehicle Theft Claims

In the event of theft of vehicle, the insured should lodge the First Information Report (FIR) with a police station immediately, inform the insurance company and provide them with a copy of the FIR. He should also submit the Final Police Report to the insurance company as soon as it is received and extend full cooperation to the surveyor or investigator appointed by the company. After the claim is approved, the Registration Certificate of the stolen vehicle has to be transferred in the name of the company and the insured needs to submit the duplicate keys of the vehicle along with a letter of subrogation and an indemnity on stamp paper (duly notarized) to the insurance company.

If there is a dispute regarding the claim settlement between the insured and the insurer, how is the dispute resolved?

The most common form of dispute that arises between the insured and the insurer is about admission of liability or the size of the claim. Disputes regarding claim amounts, where the insurer has agreed to cover the claim under the policy, are referred to an arbitrator. If the decision of the arbitrator is disputed by either party, the Consumer Forum or the Civil Court could be approached. There is a special designated court namely Motor Accident Claims Tribunal (MACT) which settles all disputes related to Third Party Liability cases.

Claim Settling Process (Fire and Marine Insurance)

(1) Intimation to Insurance Company: The insured must give immediate intimation to the insurance company regarding the loss. The necessary details like the day, date, time and causes of fire and in case of marine insurance, ship and voyage taken should be mentioned.

(2) Assessment of the loss: The insured makes an assessment of the actual loss. Such assessment is required to fill the claim forms correctly in respect of the loss of goods or property.

(3) Submission of the claim form: the insured must fill all possible details in the claim form. He must lodge the claim form within 15 days of the fire to claim compensation. In case of marine insurance, the insured should lodge a claim with the following documents:

1. Original Insurance Policy,

2. Copy of Bill of Lading,
3. A copy of commercial Invoice,
4. A copy of packing list,
5. Survey repot,
6. Claim Bill.

Delay in submission of claim form may result in non-acceptance of the claim.

(4) Evidence of Claim: Along with the claim form, the insured must send certain proof of fire and other records, if available and if necessary. The evidence should enable the insurance company to determine the amount of loss.

(5) Verification of Form: The claim form along with the supporting evidence is verified by the insurance company.

The insurance company then appoints the surveyors to conduct an assessment of the actual loss.

(6) Survey: After the receipt of the form, and necessary verification, the insurance company appoints the surveyors to assess the actual loss. The surveyors conduct the necessary investigations. They investigate into the cause of fire, the actual amount of property lost and other relevant details. The surveyors then make the report of their findings and assessment of the loss.

(7) Landing Remarks: In case of marine insurance, the insured should obtain landing remarks, from the port authorities, if survey report is not obtained.

(8) Appointment of the arbitrator: There may be a dispute regarding the amount of claim. In such a case, an arbitrator is appointed, acceptable to both the parties, to settle the amount of the loss.

(9) Settlement of Claims: If there is no dispute between the two parties, as to the amount of loss, the insurance company then makes necessary payment to the insured. In case of marine insurance, the amount of money is paid to India Exporter in Indian rupees. If the claimant is not a resident of India, payment maybe made in foreign currency.

Health Insurance Claim Settlement Procedure

In Health insurance mainly two types of claims are raised

1. Claims pertaining to cash less,
2. Reimbursement of medical expenses.

Claim Procedure for Cashless Health Insurance

1. For availing the cashless facility, first the insured visit the hospitals which are covered in the network of insurance Company.
2. Hospital obtains details from the customer and verifies the details along with the insurance details and send the intimation to the insurance company.
3. On receiving the intimation from the hospital, the insurance company approve the claim and authorise the hospital to carry out the treatment under cash less scheme. In some cases, the insurance company may ask for some additional information and even deny for the claim.
4. After getting the necessary authority from the insurance company, the hospital carry out the treatment without any deposit and get the settlement of bills from the insurance bills. Here it is pertinent to mention that the liability of insurance company is limited only the amount insured and if the bill for treatment is more than the amount insured, the balance needs to be recovered from the customer.

Claim for Reimbursement of medical expenses

In the cases where the customer does not use the cashless health insurance, he raises the claim for reimbursement of medical expenses incurred.

CASE LAWS

1. **Chennai Ombudsman Centre Case No. 11.05.1146 / 2004-2005 *Mrs. J. Ammunisa vs. The Oriental Insurance Co Ltd. Award Dated 09.11.2004***

   Mr. Saffiulla was covered under individual JPA for the period 26.4.1999 to 25.4.2004 for Rs 1,00,000 / and his wife Mr. Ammunisa was a nominee. It was reported that on 28.10.2003. while Mr. Saffiulla was doing some eletrical work was electrocuted and died on the spot. The incident was not reported to Police and consequently no postmortem was done. The Insurer appointed M / s M.J.S.Associates to investigate the matter. The Insurer repudiated the claim on 27.2.2004 on the ground that the death was not reported to the Police and no postmortem was done. The insured produced the death certificate issued by Thippusultan Mosque Muslim Sunnath Jamaath Committee confirming that the insured died due to eletric shock and his body was burried in the muslim grave yard The Investigator appointed by the Insurance Company contacted the doctor (Government Hospital, Namakkal) and also made discrete enquiries with the local people and neighbours. Finally he concluded that the said Mr. Saffiulla while doing some electrical work died due to electrical shock. From the condition of the PA policy, it is noted that the postmortem and FIR are not prerequisite for settling the PA death claim. Whatever the papers submitted by the Insurer did not suspect or doubt the genuinenity of the claim but only confirm the genuineness of the claim.

   The Forum cited instances where the Insurance Companies settled the death claims based on circumstantial evidence including investigation report, doctor's certificate, etc., without relying solely on PM and FIR. Under the circumstances, the complaint was allowed and the Insurer was directed to settle the claim.

2. ***Shri Sasanka Sekhar Maity Vs. The National Insurance Co. Ltd. Award Dated : 26.10.2004* Facts / Submissions**

   The complainant, Shri Sasanka. Sekhar Maity stated that his son. Late Swapan Maity died of accident on 17.06.2002 being run over by train. His claim for Rs 2,00,000/- was turned down by the Insurer on the ground that the death was due to suicide. The complainant stated that the Insurance Co. repudiated the claim without considering the P.M. report and other relevant documents in support of his contention that the death was due to accident and the claim was covered by JPA Policy. The Insurance Co. stated that Late Swapan Maity took a JPA Policy on 01.02.2001 for a sum assured of Rs 2,00,000/- from National Insurance Co. through M/s G.T.F.S. He died on 17.06.2002. As per Inquest Report the dead body was found cut in two pieces from the waist. The final police report revealed that the case might be accepted and filed as an accidental and run over case. The Post Mortem Report stated that "as per inquest report and P.M. findings the option. regarding the cause of death goes in favour of shock and haemorrhage due to accidental run over by the train. The Insurance Co. engaged an Investigator to find out the actual cause of Death. According to his report along with Inquest Report which was made by the Investigator the actual cause of death was found to be suicide. Suicide was specially excluded under JPA Policy and hence the claim was repudiated.

HEALTH INSURANCE

Right to Good health is now recognized as an inalienable fundamental right enshrined in the Constitution. Robust health presupposes that one is in the right frame to grow, develop and be able to achieve every goal and milestone, with a reasonable amount of strength and perseverance. Health as the old saying goes is indeed Wealth! Indirectly. With good health and a fit frame of mind, one can use the money saved on hospitals and doctors' treatment etc. to good use in pursuits which give us a huge satisfaction.

Good health of a nation translates into greater economic development, much greater levels of productivity, high levels of nutritional strength and overall public health. Hence Between 2000 and 2019, major gains in health have occurred at global level, resulting in the increase in life expectancy and healthy life expectancy at birth, with the fastest improvements in low income countries, reflecting predominantly the remarkable progress made in reducing child mortality and major communicable diseases. There has also been a steady decrease in mortality from suicide, homicide, unintentional poisoning and road traffic with men at higher risk of dying due to injuries globally.

Since 2020, the COVID-19 pandemic threatens to derail the progress made towards the (sustainable development goals) SDGs over the last 20 years while underscoring existing inequalities in health within and between countries.

Health insurance from being a 'good to have' financial tool is now a 'Must have' for every person, considering the sky rocketing cost of medical treatment (both physiological and psychological).

Early documented healthcare systems reveal that ancient Babylon had promulgated laws for taking care of healthcare matters including access to health care services, payment for care and quality control.

Health insurance history in India began with an Employee's State Insurance Scheme (ESIS) in 1948, and was conceived as an umbrella of social security for blue-collar workers of the organized sector. It provides health care services through a network of dispensaries and hospitals that were impaneled with ESIS.

The Indian health system is one of the largest in the world, with the number of people it covers - nearly 1.3 billion potential beneficiaries. The health industry in India has rapidly become one of the most important sectors in the country in terms of income and job creation.

In Budget 2021, India's public expenditure on healthcare stood at 1.2% as a percentage of the GDP. Health insurance is gaining momentum in India. Gross direct premium income underwritten by health insurance grew 17.16% y-o-y to Rs. 51,637.84 crore (US$ 7.39 billion) in FY20.

As earlier mentioned the right to good health and the obligation to provide it is enshrined in the Fundamental rights and the directive principles of state policy in the Constitution. The Indian government has also launched a variety of health insurance schemes that have low premiums and offer a significant sum insured in the hope to make good healthcare available to all.

What is a Government Health Insurance Scheme?

A Government health insurance scheme is a health insurance policy sponsored by a state or the central government. The aim of such schemes is to offer affordable health insurance to the common man and improve healthcare facilities in different strata of society. The names of several such are listed below-

1) Aam Aadmi Bima Yojana.

2) Ayushman Bharat Scheme.

3) Awaz Health Insurance Scheme.

4) Central Government Health Scheme (CGHS).

5) Chief Minister's Comprehensive Insurance Scheme.

6) Bhamashah Swasthya Bima Yojana.

7) Employees State Insurance Scheme.

Whilst this is the need of the hour for those who may not be able to afford separate health insurance, it must be mentioned that a number of health insurance plans are now offered by stand alone health insurers and also be non life / general insurance companies. Individuals as well as employees of companies are covered under individual / group health insurance plans.

All insurance presupposes an element of risk - that is the outcome is not inevitable; the probability of a peril operating or a risk undergone may result in 50% chances of loss and 50% in gain - hence the outcome is fortuitous. Health Insurance operates under the same concept as other general or non life insurance- where the outcome is a probability.

A health insurance policy or a plan is a contract between an insurance provider (e.g. an insurance company or a government) and an individual or his/her sponsor (e.g. an employer or a community organization). Usually health insurance polices are renewable after 1 year though there are certain products offered by insurers which may have a term extending beyond one year. The type and amount of health care costs that will be covered by the health insurance provider are specified in writing, in a policy schedule and contract or "Evidence of Coverage". Generally, in case of health insurance schemes provided by the governments, membership of the particular community insured (e.g. Fisherfolk Or MNREGA card holders, or of a particular village or taluk) is not evidenced by a separate contract, as the terms and conditions are much more simplified and standardized.

The very basic principle of insurance is pooling of risks, contribution of premium by many, to help to pay the losses of the unfortunate few. Accordingly common terms have been coined in insurance parlance.

The individual insured person's obligations may take several forms:

- **Premium:** The amount the policy-holder or their sponsor (e.g. an employer) pays to the health plan to purchase health coverage.

- **Deductible:** The amount that the insured must payout-of-pocket before the health insurer pays its share. For example, policy-holders might have to pay a Rs. 500 deductible per year, before any of their health care is covered by the health insurer. It may take several doctor's visits or prescription refills before the insured person reaches the deductible and the insurance company starts to pay for care. Furthermore, most policies do not apply co-pays for doctor's visits or prescriptions against your deductible.

- **Co-payment:** The amount that the insured person must pay out of pocket before the health insurer pays for a particular visit or service. For example, an insured person might pay a Rs. 45 co-payment for a doctor's visit, or to obtain a prescription. A co-payment must be paid each time a particular service is obtained.

- **Coinsurance:** Instead of, or in addition to, paying a fixed amount up front (a co-payment), the co-insurance is a percentage of the total cost that insured person may also pay. For example, the member might have to pay 20% of the cost of a surgery over and above a co-payment, while the insurance company pays the other 80%. If there is an upper limit on coinsurance, the policy-holder could end up owing very little, or a great deal, depending on the actual costs of the services they obtain.

- **Exclusions:** Not all services are covered. Billed items like use-and-throw, taxes, etc. are excluded from admissible claim. The insured are generally expected to pay the full cost of non-covered services out of their own pockets.
- **Coverage limits:** Some health insurance policies only pay for health care up to a certain dollar amount. The insured person may be expected to pay any charges in excess of the health plan's maximum payment for a specific service. In addition, some insurance company schemes have annual or lifetime coverage maxima. In these cases, the health plan will stop payment when they reach the benefit maximum, and the policy-holder must pay all remaining costs.
- **Out-of-pocket maxima:** Similar to coverage limits, except that in this case, the insured person's payment obligation ends when they reach the out-of-pocket maximum, and health insurance pays all further covered costs. Out-of-pocket maxima can be limited to a specific benefit category (such as prescription drugs) or can apply to all coverage provided during a specific benefit year.
- **Capitation:** An amount paid by an insurer to a health care provider, for which the provider agrees to treat all members of the insurer.
- **In-Network Provider:** A health care provider on a list of providers pre-selected by the insurer. The insurer will offer discounted coinsurance or co-payments, or additional benefits, to a plan member to see an in-network provider. Generally, providers in network are providers who have a contract with the insurer to accept rates further discounted from the "usual and customary" charges the insurer pays to out-of-network providers.
- **Prior Authorization:** A certification or authorization that an insurer provides prior to medical service occurring. Obtaining an authorization means that the insurer is obligated to pay for the service, assuming it matches what was authorized. Many smaller, routine services do not require authorization.
- **Explanation of Benefits:** A document that may be sent by an insurer to a patient explaining what was covered for a medical service, and how payment amount and patient responsibility amount were determined.

Health Insurance In India

Health Insurance in India is a growing segment of India's economy. In 2020 the health segment overall growth was 9.2% yoy. It might be due to COVID 19 ravaged throughout India. In 2011, 3.9% of India's gross domestic product was spent in the health sector. According to the World Health Organisation (WHO), this is among the lowest of the BRICS (Brazil, Russia, India, China, South Africa) economies. Policies are available that offer both individual and family cover. Out of this 3.9%, health insurance accounts for 5-10% of expenditure, employers account for around 9% while personal expenditure amounts to an astounding 82%. In the year 2016, the NSSO released the report "Key Indicators of Social Consumption in India: Health" based on its 71st round of surveys. The survey carried out in the year 2014 found out that, more than 80% of Indians are not covered under any health insurance plan, and only 18% (government funded 12%) of the urban population and 14% (government funded 13%) of the rural population was covered under any form of health insurance.

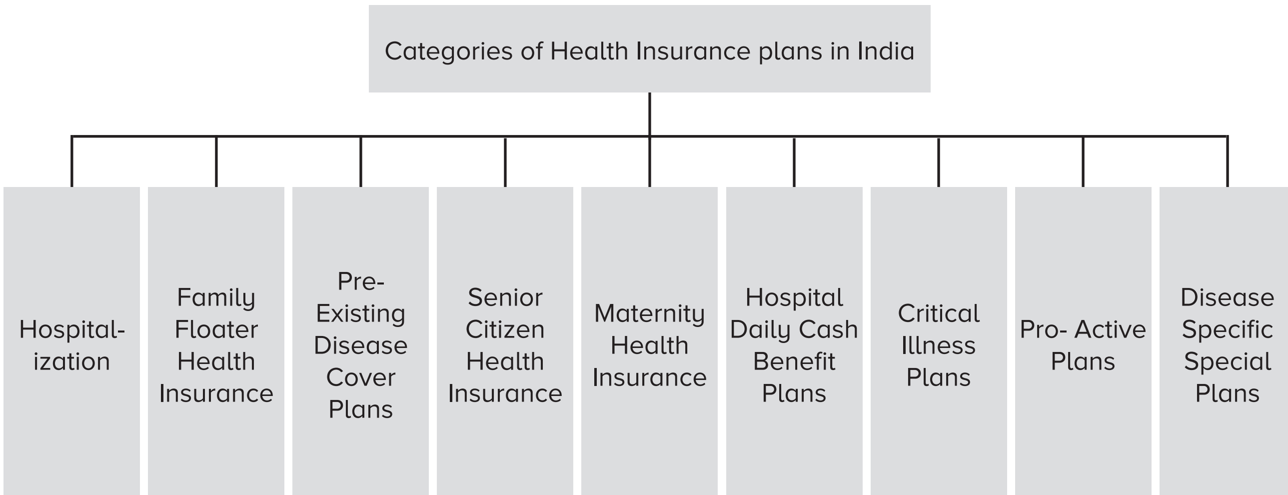
Launched in 1986, the health insurance industry has grown significantly mainly due to liberalization of economy and general awareness. According to the World Bank, by 2010, more than 25% of India's population had access to some form of health insurance. There are standalone health insurers along with government sponsored health insurance providers. Until recently, to improve the awareness and reduce the procrastination for buying health insurance, the General Insurance Corporation of India and the Insurance Regulatory and Development Authority (IRDA) had launched an awareness campaign for all segments of the population.

Health insurance in India typically pays for only inpatient hospitalization and for treatment at hospitals in India. Outpatient services were not payable under health policies in India. The first health policies in India were

Mediclaim Policies. In Year 2000, Government of India liberalized insurance and allowed private players into the insurance sector. The advent of private insurers in India saw the introduction of many innovative products like family floater plans, top-up plans, critical illness plans, hospital cash and top up policies.

The health insurance sector hovers around 10% in density calculations. One of the main reasons for the low penetration and coverage of health insurance is the lack of competition in the sector. IRDA which is responsible for insurance policies in India can create health circles, similar to telecom circles to promote competition.

Health insurance plans in India today can be broadly classified into these categories:



Hospitalization

Hospitalization plans are indemnity plans that pay cost of hospitalization and medical costs of the insured subject to the sum insured. The sum insured can be applied on a per member basis in case of individual health policies or on a floater basis in case of family floater policies. In case of floater policies, the sum insured can be utilized by any of the members insured under the plan. These policies do not normally pay any cash benefit. In addition to hospitalization benefits, specific policies may offer a number of additional benefits like maternity and newborn coverage, day care procedures for specific procedures, pre and posthospitalization care, domiciliary benefits where patients cannot be moved to a hospital, daily cash, and convalescence.

There is another type of hospitalization policy called a top-up policy. Top up policies have a high deductible typically set a level of existing cover. This policy is targeted at people who have some amount of insurance from their employer. If the employer provided cover is not enough people can supplement their cover with the top-up policy. However, this is subject to deduction on every claim reported for every member on the final amount payable.

Family Floater Health Insurance

Family health insurance plan covers entire family in one health insurance plan. It works under assumption that not all member of a family will suffer from illness in one time. It covers hospital expense which can be pre and post. Most of health insurance companies in India offering family insurance have good network of hospitals to benefit the insurer in time of emergency.

Pre-Existing Disease Cover Plans

It offers covers against disease that policyholder had before buying health policy. Pre-Existing Disease Cover Plans offers cover against pre-existing disease e.g., diabetes, kidney failure and many more. After Waiting period of 2 to 4 years it gives all covers to insurer.

Senior Citizen Health Insurance

As name suggests these kinds of health insurance plans are for older people in the family. It provides covers and protection from health issues during old age. According to IRDA guidelines, each insurer should provide cover up to the age of 65 years.

Maternity Health Insurance

Maternity health insurance ensures coverage for maternity and other additional expenses. It takes care of both pre and post natal care, baby delivery (either normal or caesarean). Like other Insurance, the maternity insurance provider has wide range of network hospitals and takes care of ambulance expense.

Hospital Daily Cash Benefit Plans

Daily cash benefits are a defined benefit policy that pays a defined sum of money for every day of hospitalization. The payments for a defined number of days in the policy year and may be subject to a deductible of few days.

Critical Illness Plans

These are benefit based policies which pay a lump-sum (fixed) benefit amount on diagnosis of covered critical illness and medical procedures. These illnesses are generally specific and high severity and low frequency in nature that cost high when compared to day to day medical / treatment need. e.g., heart attack, cancer, stroke etc. Now some insurers have come up with option of staggered payment of claims in combination to upfront lump-sum payment.

Pro Active Plans

Some companies like Cigna TTK offer Pro-active living programs. These are designed keeping in mind the Indian market and provide assistance based on medical, behavioural and lifestyle factors associated with chronic conditions. These services aim to help customers understand and manage their health better.

Disease Specific Special Plans

Some companies offer specially designed disease specific plans like Dengue Care. These are designed keeping in mind the growing occurrence of viral diseases like Dengue in India which has become a cause of concern and thus provide assistance based on medical needs, behavioural and lifestyle factors associated with such conditions. These plans aim to help customers manage their unexpected health expenses better and at a very minimal cost.

Healthcare has become one of India's largest sectors - both in terms of revenue and employment. Healthcare comprises hospitals, medical devices, clinical trials, outsourcing, telemedicine, medical tourism, health insurance and medical equipment. The Indian healthcare sector is growing at a brisk pace due to its strengthening coverage, services and increasing expenditure by public as well private players.

Indian healthcare delivery system is categorised into two major components - public and private. The Government, i.e., public healthcare system comprises limited secondary and tertiary care institutions in key cities and focuses on providing basic healthcare facilities in the form of Primary Healthcare Centres (PHCs) in rural areas. The private sector provides majority of secondary, tertiary and quaternary care institutions with a major concentration in metros, tier I and tier II cities. India's competitive advantage lies in its large pool of well-trained medical professionals. India is also cost competitive compared to its peers in Asia and Western countries. The cost of surgery in India is about one-tenth of that in the US or Western Europe.

Market Size

The healthcare market can increase three-fold to Rs. 8.6 trillion (US$ 133.44 billion) by 2022. There is a significant scope for enhancing healthcare services considering that healthcare spending as a percentage of Gross Domestic Product (GDP) is rising. Rural India, which accounts for over 70 per cent of the population, is set to emerge as a potential demand source. In 2017, the Government of India has provided grant-in-aid for setting up of AYUSH educational institutions in States and Union Territories.

Investment

The hospital and diagnostic centers attracted Foreign Direct Investment (FDI) worth US$ 4.99 billion between April 2000 and December 2017, according to data released by the Department of Industrial Policy and Promotion (DIPP). Some of the recent investments in the Indian healthcare industry are as follows:

- India and Cuba have signed a Memorandum of Understanding (MoU) to increase cooperation in the areas of health and medicine, according to Ministry of Health and Family Welfare, Government of India.
- Fortis Healthcare has approved the de-merger of its hospital business with Manipal Hospital Enterprises. TPG and Dr. Ranjan Pal could invest Rs. 3,900 crore (US$ 602.41 million) in Manipal Hospital Enterprise.

Government Initiatives

Some of the major initiatives taken by the Government of India to promote Indian healthcare industry are as follows:

- India's first ever 'Air Dispensary', which is based in a helicopter, will be launched in the Northeast and the Ministry of Development of Northeast Region (DONER) has already contributed Rs. 25 crore (US$ 3.82 million) for its funding.
- The Intensified Mission Indra Dhanush (IMI) has been launched by the Government of India with the aim of improving coverage of immunisation in the country and reaches every child under two years of age and all the pregnant women who have not been part of the routine immunisation programme.
- The Union Cabinet approved setting up of National Nutrition Mission (NNM) with a three year budget of Rs 9,046.17 crore (US$ 1.40 billion) to monitor, supervise, fix targets and guide the nutrition related interventions across the Ministries.
- The Government of India aims to increase the total health expenditure to 2.5 percent of Gross Domestic Product (GDP) by 2025 from the current 1.15 percent.

Road Ahead

India is a land full of opportunities for players in the medical devices industry. India's healthcare industry is one of the fastest growing sectors and in the coming 10 years it is expected to reach $300 billion. The country has also become one of the leading destinations for high-end diagnostic services with tremendous capital investment for advanced diagnostic facilities, thus catering to a greater proportion of population. Besides, Indian medical service consumers have become more conscious towards their healthcare upkeep.

Indian healthcare sector is much diversified and is full of opportunities in every segment which includes providers, payers and medical technology. With the increase in the competition, businesses are looking to explore for the latest dynamics and trends which will have positive impact on their business.

India's competitive advantage also lies in the increased success rate of Indian companies in getting Abbreviated New Drug Application (ANDA) approvals. India also offers vast opportunities in R & D as well as medical tourism. To sum up, there are vast opportunities for investment in healthcare infrastructure in both urban and rural India.

HEALTH FINANCING MODELS AND HEALTH FINANCING IN INDIA

The has been seen that in recent years there has been a greater focus on health in recent years resulting in larger allocation to the sector especially in the context of the National Rural Health Mission. The provision of flexible funds to State governments under NRHM Flexi-Pool has provided an opportunity for States to develop and implement innovative programmes. Other NRHM financing strategies such as untied funds to institutions, financing of NGO sector for public health goals and risk pooling where money follows patient, has the potential to strengthen and widen the reach of public health care services. Key concerns with regard to financing of the public sector include:

1. Budget formulation by and large continues to be incremental and normative, even though current policy favors outcome budgeting and need based allocation, Mechanisms for using decentralized planning as tool for identifying local requirements and involving communities in developing need based programmes as envisaged under NRHM are yet to be institutionalized.

2. Budget documents are complex and not user friendly. They are technical documents and it is difficult for the average person to identify key fiscal trends or expenditure priorities. Complexity of budget on account of multiplicity of central and state schemes and multiple provisions to the same entity arises from a complex budget classification system that is followed in the government. While, the 19 digit classification system currently followed by the government meets the needs of legislative sanction and oversight, it is quite dysfunctional when it comes to the requirements of the administrator as the budget is prepared neither by function nor by the provider. A particular function is provided under many providers as also a provider serves many functions. As a result, if one wants to get an idea of budget by a function or provider, it will have to be obtained by going through the entire budget, a task that is complex and confusing even for trained finance specialist.

3. NRHM is often seen as an entirely new programme bringing with it fresh allocation of funds. However, NRHM funds also subsume existing allocation for RCH and other disease control programmes. There is need for better clarity on the resource envelope for NRHM, pooling of resources and the process of budgeting under NRHM.

4. Funds flow to the district from the state budget which also comprises of central funds for national programmes and through off-budget mechanisms under NRHM and NACP. Funds under NRHM are provided under different programmes through different mechanisms at the level of district and below. The variety of funds flow mechanisms makes lower level budgets confusing. There is need for greater clarity regarding allocation for districts and who provides for it.

5. There is need to systematically track and study flow of funds from the centre to state and then to district and below, right up to the level of the beneficiary. In the absence of which, an assessment of impact and efficiency of health spending cannot be done. In the context of NRHM it would be particularly useful to have an idea of the impact of NRHM financing strategies such as provision of flexible funds.

6. The central government is committed to increasing budget allocation by about 30% annually in moving towards the National Health Policy goal of increasing public spending on health to around 2-3% of the GDP. However, there is lack of an evidence based resource envelope for health. A key constraint has been the lack of data on financial costs. The National Commission of Macroeconomics and Health has made a key contribution in providing estimates of unit costs of facilities and costing of programmes at the national level. However, there is requirement for more disaggregate data on financial costs for managing diseases and conditions and prevalence rates at district level for arriving at a more meaningful resource envelope. There is a need to develop methodologies for collecting such financial data on a regular basis.

7. While working towards developing methodologies for collecting disaggregate data on financial costs, it would be useful to study data that is currently available. Costing studies have been carried out in the country and sharing of reports on a website could be a good option for pooling of such data. Care should be taken to see that the data is used properly, including acknowledgement of data source.

8. Most states have not been able to satisfactorily utilize funds allocated under NRHM. Given the available evidence to justify significant allocation of public funds to the health sector, the inability to spend allocated funds is a matter of deep concern especially for the poorly performing states.

9. Weak absorption capacity in the public sector is linked to systemic and institutional issues as well as poor designing of expenditure items. Lack of stability and flexibility in the budgetary processes has been a major reason for the government to adopt the society mode of funding the health sector, as in the case of NRHM. Potential areas which could have an impact on under spending of NRHM funds and requires studying were identified by the group. They include:

   - NRHM financing is linked to strategies such as decentralized planning and implementation; integration of health programmes with the general health services; inter-sectoral convergence; central role of Panchayati Raj Institutions (PRIs) in planning, managing and monitoring public health services; and promotion of nonprofit sector in health service delivery. Efforts towards operationalizing these strategies are still in rudimentary stages in many States.

   - Capacity for planning and programme management has been generally weak in the health services. Further, the NRHM framework requires development of capacities in health departments for effectively managing coordination within the health services, collaboration with departments having complementary functions and building partnerships.

   - Lack of clear guidelines in managing flexible funds. While flexible funds are meant for use as per local requirements, key personnel and oversight committees are not yet empowered with capacities to prioritize and plan for requirements.

   - Weak financial capabilities within health services. Capacity in budgeting and accounting functions is deficient not only in numbers but also in quality. At the State level, financial management is generally vested with few officers and support staff. In the district offices the accounts are being maintained mostly by junior assistants and senior assistants who do not have relevant educational qualification or formal training in maintaining accounts. In health facilities, the departmental personnel manage the finance functions as drawing & disbursing officers (DDOs) and are often vested with accounting functions also. They are in many instances medical officers with no training in management of financial systems.

   - Use of information technology in maintenance of accounts and monitoring of spending is generally weak.

Health Insurance Regulations Applicable to Insurance Companies

IRDAI (Health Insurance) Regulations, 2016 provides the governing framework for health insurance policies. Let us study the regulatory framework applicable to Health insurance policies in the following paragraphs.

Definition of Health Insurance

It is important to first know the components of Health insurance policies. Section 2(6C) of the Insurance Act, 1938, defines Health insurance business to include Policies providing the following benefits:

(a) Sickness benefits, medical benefits, hospital benefits, surgical benefits (both in-patient as well as out-patient benefits).

(b) Travel insurance.

(c) Personal accident cover.

Two Types of Medical Insurance Policies

(a) Policies providing indemnity benefits - under indemnity contracts only the actual amount of loss is reimbursed,

(b) Policies providing fixed medical benefits.

As per the general principles of insurance contracts, while a general insurance is a contract of indemnity, a Life insurance is not a contract of indemnity. Therefore, only general insurance companies and Standalone health insurance companies can provide indemnity based health insurance covers.

Life insurance companies can provide fixed health insurance benefit cover, under which a defined certain amount (Sum insured) can be paid upon hospitalisation without considering into the actual amount spent by the Policyholder. For example, Critical illness covers are offered by Life insurance companies fall under this category. These are fixed amounts paid by the Life insurance companies upon the Life assured contracting any of the illnesses covered under the Policy contract. Life insurance companies cannot offer Travel insurance or Personal accident cover. However, Accident death benefit can be provided as a rider by Life insurance companies, i.e. upon death due to accident, an additional sum assured is paid to the Nominee. Under Personal accident cover by General insurance companies, upon accident any cost incurred by the Policyholder including stoppage of income, disablement benefits etc. are offered.

Note: A General insurance company can insure anything from pin to plane, other than human life, including health insurance products, whereas a Standalone health insurance company is a Specialised General insurance company allowed to sell only Health insurance products.

Policy Term (coverage period) of Health Insurance Policies

(a) *Individual Policies* - under individual health insurance policies, General insurance companies and Standalone health insurance companies can provide insurance cover for a minimum period of 1 year and maximum period of 3 years. However, Life insurance companies can provide only for a minimum Policy term of 5 years. This is because Life insurance contracts, by nature, are long-term contracts.

(b) *Premium guarantee* - No premium can be changed during the Policy period. However, for a Life insurer, premiums cannot be changed for a minimum period of 3 years.

(c) *Group Policies* - these are one year renewable Policies, except for Group Health policies under lender- borrower groups (Group credit linked products), where the term can be extended up to 5 years. A minimum group size of 7 has been prescribed for issuing the Group policies.

(d) *Personal accident and Travel covers* - may be offered for a term of less than 1 year as well.

Health Insurance Underwriting Policy

Underwriting in insurance means acceptance of risk on a Proposal for insurance cover. It is the decision of the insurer to accept or reject or postpone or make a counter-offer after assessment of the risk on the Proposal for insurance cover submitted by a Customer.

An insurance company selling health insurance products shall have a Board approved Health insurance Underwriting Policy which shall provide the broad framework for underwriting of health insurance proposals. Among other things, the Policy shall include the parameters for risk categorisation and approach towards disposing of Proposals from Standard and Sub-standard lives. A Standard Life denotes a Customer whose risk parameters are normal and who can be offered normal premium rates and terms and conditions, whereas, a Sub-standard Life denotes a Customer whose risk parameters are adverse and therefore will have to be offered special premium rates and terms and conditions, subject to further assessment of risk based on Medical examination. In extreme cases, a Proposal for insurance cover may be denied by the insurer and in such cases, the reasons shall be communicated by the Insurer to the Customer.

Health Insurance Policy Forms and Clauses

The standardised clauses of Health Insurance Policy (commonly known as "Policy Wordings) are as under:

Title	Description	Refer To Policy Clause Number
Product Name	**Optima Restore**	
What am I covered for	a) In-Patient Treatment - covers hospitalisation expenses for period more than 24 hrs.	Section [1(a)]
	b) Pre-Hospitalisation - medical expenses incurred in 60 days before the Hospitalisation.	Section [1(b)]
	c) Post-Hospitalisation - medical expenses incurred in 180 days after the hospitalisation.	Section [1(c)]
	d) Day-Care Procedures - medical expenses for day care procedures.	Section [1(d)]
	e) Domicillary Treatment - medical expenses incurred for availing medical treatment at home which would otherwise have required hospitalisation.	Section [1(e)]
	f) Organ Donor - medical expenses on harvesting the organ from the donor for organ transplantation.	Section [1(f)]
	g) Ambulance Cover - upto Rs. 2,000 per hospitalisation for utlizing ambulance service for transporting insured person to hospital in case of an emergency.	Secti on [1(g)]
	h) Daily Cash for choosing shared accommodation - Daily cash amount if hospitalized in shared accommodation in network hospital and hospitalisation exceeds 48 hrs.	Section [1(h)]
	i) E-Opinion in respect of a critical Illness - Second opinion by a Medical Practitioner from our panel for a Critical Illness suffered during the policy period.	Section [1(i)]
	j) Emergency Air Ambulance Cover - Covers expenses for ambulance transportation in an airplane or helicopter for emergency life threatening health conditions.	Section [1(i)]
	k) Restore Benefit - Instant addition of 100% Basic Sum insured on complete or partial utilization of your existing Policy Sum insured and Multiplier Benefit if applicable, during the Policy Year. The Restore Sum insured can be used for all claims under inpatient Benefit if the Restore Sum Insured is not utilized in a Policy Year, it will expire.	Section [1(k)]

Title	Description	Refer To Policy Clause Number
Product Name	**Optima Restore**	
What are the major exclusions in the policy	Following is a partial list of the policy exclusions. Please refer to the policy wording for the complete list of exclusions. War or any act of war nuclear, chemical and biological weapons, radiation of any kind, breach of law with criminal intent, intentional or attempted suicide, participation or involvement in naval, military or air force operation, racing, diving, aviation, scuba diving, parachuting, hang gliding, rock or mountain climbing, abuse of intoxicants or hallucinogenic substances such as intoxicating drugs and alcohol treatment of obesity and any weight control program, Psychiatric, mental disorders, congenital external disease or anomalies, sleep apneas expenses arising from HIV or AIDS and related diseases, sterility treatment to effect or to treat infertility or any fertility, sub-fertility, surrogate or vicarious pregnancy, birth control or circumscions, treatment for correction of refractive error, plastic surgery or cosmetic surgery, unless required due to an Accident, Cancer or Burns, any non-allopathic treatment.	Section V(c)
Waiting period	● 30 days for all illness (except accident) in the first year and is not applicable in subsequent renewals. ● 24 months for specific illness and treatments in the first two years and is not applicable in subsequent renewals. ● Pre-existing Diseases will be covered after a waiting period of 36 months.	Section (VAi) Section (VAii) Section (VAiii)
Payout Basis	Payout on indemnity payment basis	Section I
Cost Sharing	Not Applicable	–
Renewal Conditions	● Policy is ordinarily life-long renewal subject to application for renewal and the renewal premium in full has been received by the due dates and the realisation of premium. ● Grace period of 30 days for renewing the policy is provided. To avoid any confusion any claim incurred during break-in period will not be payable under this policy.	Section (VIn)
Renewal benefits	**Multiplier Benefits-** 50% increase in your basic sum insured for every claim free year, subject to a maximum of 100% in case a claim is made during a policy year, the limit under this benefit would be reduced by 50% of the sum insured in the following year. However, this reduction will not reduce the basic Sum Insured of the policy.	Section IV

Title	Description	Refer To Policy Clause Number
Product Name	**Optima Restore**	
Cancellation	This policy will be cancelled on the grounds of misrepresentation, fraud, non- disclosure of material facts or non-cooperation by any Insured Person, upon giving 30 days notice.	Section VI
How to Claim	Please contact us at least 7 days prior to an event which might give rise to a claim. For any emergency situations kindly contact us within 24 hours of the event. For any claim related query, information or assistance you can also contact our toll free line at 1800-102-0333 or visit our website www. apollomunichinsurance. com or e-mail us at customerservice@ apollomunichinsurance.com.	Section VIII

Note:

For Pre-Policy Check-up at our network may be required based upon the age and Basic Sum Insured. We will reimburse 100% of the expenses incurred on the acceptance of the proposal. The medical reports are valid for a period of 90 days from the date of Pre-Policy Check-up.

In order to be eligible for portability benefits you may apply 45 days in advance of the policy renewal date. The standardised contents in the Application Form ("Proposal Form") are as under:

1. Proposer Details: Name, Date of Birth, Address, etc. of Proposer of the policy.
2. Plan Details: The details of plan opted.
3. Proposed Insured(S) Details: Name, Date of Birth, Address, Photo etc. of Insured of the policy.
4. Nominee Details: Name, Address, etc. of the nominee and Relationship with insured.
5. Existing/Previous Insurance Details: Details of existing policy with the proposed insurance company as well as other Insurance company.
6. Medical And Life Style Information: All past medical history and complete questionnaire.
7. Payment Details: Details of payment of insurance premium.
8. General Exclusions (Under the policy) for more details please refer to the policy wordings.
9. Declaration & Warranty on behalf of all persons proposed to be insured.
10. Agent's Declaration.
11. Checklist.
12. NEFT Details attendance.

Regulating Third Party Administrators

The Insurance Regulatory and Development Authority set up a working committee in 2000 to suggest regulations for this new type of intermediary dealing with the administration of health insurance. The Committee was made up of representatives of the existing Third Party Administrators, several public and private sector insurance companies (non-life) and members of the Insurance Regulatory and Development Authority. The committee deliberated on a white paper that was circulated by Insurance Regulatory and Development Authority and the result of these deliberations, over a period of one year, was a set of regulations notified as the Insurance Regulatory and Development Authority (Third Party Administrators - Health Services) Regulations 2001, on September 17, 2001. The regulations stipulated the eligibility, scope of services, capital requirements, solvency margins, operating guidelines and code of conduct for Third Party Administrators. The regulations also maintained that TPAs were indeed intermediaries as per the scope of the Insurance Regulatory and Development Authority Act, 1999, and therefore were fully under the jurisdiction of the Insurance Regulatory and Development Authority.

To date, this is the only Insurance Regulatory and Development Authority regulation specific to health insurance. This regulation established Third Party Administrators (TPA), and the rules for their licensing as intermediaries in rendering healthcare for insured beneficiaries and promoting a "cashless system" with easier access to and faster settlement of covered benefits of medical expense covers. The regulation prescribes high educational and practice standards of individuals, operating and managing a Third Party Administrator and requires adherence to a prescribed Code of Conducts. The salient features are as follows:

- Only an organization registered under the Companies Act, 1956 / 2013 with a share capital of at least Rs.10 million (1 crore) in equity shares can set up a Third Party Administrator in health services.
- Third Party Administrator will be required to start with a minimum working capital of Rs 10 million at any point of functioning.
- Foreign equity in Third Party Administrator is 100 per cent. In case of any share transfer, exceeding 5 per cent of paidup capital, IRDA has to be informed within 15 days of such transfer.
- The primary object of the company should be to carryon business in India as a Third Party Administrator in health services. It should not engage itself in any other business.
- At least one of the directors shall be a qualified medical doctor registered with the Medical Council of India.
- The CEO or CAO of the Third Party Administrator should have successfully undergone a course in hospital management from an institution recognized by Insurance Regulatory and Development Authority and have passed · the licentiate examination conducted by the Insurance Institute of India, Mumbai. Apart from this, he should have undergone practical training of at least three months in the field of health management.
- TPAs should have access to competent medical professionals to advise insurance companies and clients on various matters.
- TPAs should obtain license from Insurance Regulatory and Development Authority to function. The application fee is Rs. 20,000 and once the application is approved, another Rs. 30,000 has to be paid as licensing fee. The license will be renewed every third year by Insurance Regulatory and Development Authority, if the application is rejected, Third Party Administrator is not entitled to apply again within two years. The Third Party Administrator should furnish all documents including the agreement with the insurance company while applying for license. This agreement should contain details of the remuneration that may be payable to the Third Party Administrator by the insurance company.
- The Third Party Administrator will be allowed to enter into an agreement with more than one insurer, and similarly insurance companies can engage more than one Third Party Administrators.

- The Third Party Administrator has to spell out the scope of services that it will deliver, while entering into an agreement with a insurance company.
- Third Party Administrators shall not charge any fee from the clients.
- Insurance Regulatory and Development Authority guidelines do not permit marketing of health insurance policies by the Third Party Administrator.
- Third Party Administrators would also have to maintain and report to Insurance Regulatory and Development Authority on transactions carried out on behalf of the insurer. The Authority expects Third Party Administrators to maintain all records properly and maintain professional confidentiality between the parties. The authority holds the power to monitor and check the performance of Third Party Administrators from time to time. Third Party Administrator are expected to furnish to the insurance company and the 'authority an annual report and any other return as may be required by the Authority.
- The Insurance Regulatory and Development Authority has drawn up a code of conduct for the Third Party Administrators, refraining them from trading in information, submitting wrong information to insurers, and making advertisements without prior approval of the insurer, among other things. Their license will be revoked under such instances.

While this regulation has prompted expanded consumer interest and confidence in medical expenses insurance, many believe that the regulation needs to be revisited and updated considering the changes occurring in the industry and the imperatives to provide quality healthcare. Moreover, there is growing evidence that the Third Party Administrator System has not been effective in promoting quality of healthcare and in containing healthcare costs. Third Party Administrator business practices are quite often cited as one of the causes of the very high loss ratios in the current health insurance business.

Insurance Regulatory and Development Authority regulations place stringent conditions for licensing Third Party Administrators. Current regulation requires Third Party Administrators to meet a minimum equity capital of Rs.1 0 million. The capital requirements for entering into this sector are not stringent. As a result, there may be a proliferation of players, not all of the best quality. A large number of players will mean pressure on margins. Besides this, Third Party Administrators need to set up infrastructure which would involve large investments, the payback period of which is likely to be long. Third Party Administrators face high operating risk of obtaining economies of scale necessary to break even. Volumes are critical because the revenue generation of Third Party Administrators is linked to the number of policies, they undertake to administer.

The Authority publishes a list of approved TPAs from time to time, which is the final IRDAI approved list. Its advisable for all insurers, corporate clients and other health insurance enabling services, such as networked hospitals and diagnostic clinics, to review the same to ensure that the deal with approved and regulated TPAs. These entities, as well as all other regulated intermediaries, have their licensing requirements reviewed periodically at regular intervals, and if found lacking do not have their licenses renewed by IRDAI insurance.

Judicial Branch

The judiciary interprets the law, both primary and secondary legislation. It hears and decides disputes between insurers and the policyholders, protects the insuring public by imposing civil fines or criminal penalties for violation of the insurance laws and protects insurers, their agents and intermediaries by overturning arbitrary or unconstitutional legislation, rules, regulations or orders promulgated by the insurance regulator. The Supreme Court is the highest court in India, and its judgment is final in all respects.

The legal and regulatory framework for private health insurance, because it operates in the voluntary market, should continually balance competing goals of access, affordability and quality of healthcare and providing health covers to a larger fraction of the population with varying risk characteristics and ability to pay. Regulations, aside from being solely aimed at providing protection of health insurance policyholders and beneficiaries, can be potent tools to promote access to healthcare control pricing of health covers vis-a-vis healthcare providers and enhance the quality of healthcare.

CLAIMS

Insurance claims are subject to waiting period and exclusions clauses included in Policy contracts, as per approval under product specifications ("File & use") by IRDAI.

A waiting period is the period which starts after issue of the health insurance policy, during which the risk cover is not available. A clause on waiting period is generally imposed as a counter measure to adverse selection in health insurance policies. For example, if a customer whose is expecting himself to be hospitalised shortly may take a Health insurance policy to seek reimbursement of hospitalisation expenses. This is an example of anti- selection. Insurers cannot run health insurance business if anti-selection is high.

Waiting period can be defined, as say, 6 months for the entire policy during which no insurance cover will be available or could be specific only to certain illnesses during the waiting period. Another category.

Similarly pre-existing illnesses may or may not be covered under health insurance policy for a specific period. A pre-existing illness is a condition where the customer taking the policy has already contracted an illness. Depending on the terms of the Policy, a pre-existing illness may or may not be covered or may not be covered only for a specific period.

An exclusion is a policy condition which provides for circumstances under which a claim is not payable. For example, in the case of persons engaged in hazardous occupations or persons engaged in war - any claim under such circumstances is excluded. These are time-bound exclusions, meaning claims are not paid only if they arises under the above circumstances.

An exclusion may also be event-specific without any limitation of time. For example, cosmetic dental surgeries or cosmetic surgeries may be excluded as treatments which are not covered at all. Any claim for these treatments are exclusions and are not payable.

Where the Customer holds multiple health insurance policies with different insurers, settlement of claims will be as per the following conditions:

(a) Where the Customer holds multiple fixed benefit health insurance policies issued by the Life insurers, all Life insurers shall pay the benefit to the Customer as per the terms and conditions of their respective Policies.

(b) Where the Customer holds multiple indemnity-based health insurance policies issued by different General insurance or Health insurance companies, the Customer can seek settlement of claim only once from any of such insurers of his choice. Indemnity cannot be more than once. However, where the claim settled by one such insurer is insufficient to indemnify the Customer in toto, the balance amount(s) can be claimed from other insurers. Selection of such insurer for the purpose of claims settlement is the choice of the Customer.

In the case of cashless claims, a Pre-authorisation to the Network Providers shall be issued by the TPA or the Insurer for commencement of treatment in the Network Hospital where the life covered wants to undergo the medical treatment. All lives covered under the health insurance policy, which may include the Family members of the Customer, shall be issued an identity card (Smart card with Quick Response, Magnetic reader facilities) giving the details of the life covered, date of birth and other necessary details for the purpose of availing the cashless facility.

A health insurance claim shall be decided within a period of 30 days of receipt of all necessary documents from the Customer, except in cases where frauds and misrepresentations on the part of the customer.

Normal documents required for settlement of a health insurance claim shall be mentioned in the Policy document issued to the Customer. However, if there are any further documents required by the Insurer at the time of claim, such documents shall be called for together and not on piecemeal basis.

Insurers shall specify a period with which the Customer shall file the claim documents. However, where there is a delay the Insurer shall not reject the claim if there are valid reasons for the delay. No claim can be closed in the books of the insurer.

For delays in settlement of claims, insurers shall pay penal interest at the rate of Bank rate + 2% p.a.

Every insurer shall enter into an agreement with the TPA for the purpose of claims settlement and shall also publish detailed claims guidelines to enable TPAs to properly service the Customers. Payment of claims shall be made by Insurer either directly or through the TPAs.

Claims shall be decided only by the Insurer and not the TPAs. Acceptance or rejection or part acceptance of the claim shall be communicated only by the Insurer to the Customer.

DISCLOSURES TO CUSTOMERS

Every Customer taking a Health insurance policy shall be provided with a Customer information sheet by the Insurer.

Website disclosures

Website of the Insurer shall disclose the following information:

(a) Product-wise and Geography-wise location of TPAs.

(b) Product-wise cashless services offered.

In Policy document, the following details shall be disclosed:

(a) Portability clauses (in Policy documents as well as brochures, pamphlets).

(b) Procedure for Claims submission and timelines.

(c) Sub-limits for any of the insurance covers.

(d) Penal interest provisions.

(e) TPA details.

In respect of Pilot products (Products which are launched on a test basis by an Insurer with the approval of IRDAI for a limited period), the product brochures, leaflets, pamphlets etc. shall specifically disclose the period up to which the Product will be available for sale and option to migrate to another product upon discontinuance of Pilot product.

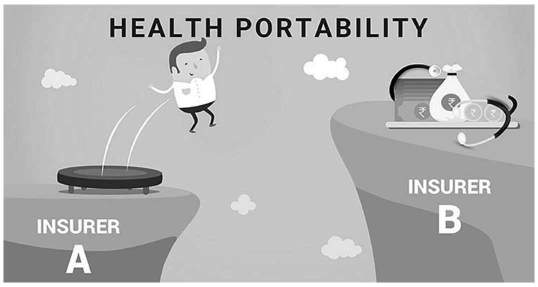
PORTABILITY OF HEALTH INSURANCE POLICIES

Portability is the right accorded to the Policyholder to transfer the credit gained for pre-existing conditions and time-bound exclusions from one insurer to another insurer or from one plan to another plan of the same insurer.

In simple words, it is the right conferred on a Policyholder who decides to move from one General or Health insurer to another or to another plan of the same General or Health insurer.

Portability is not applicable to fixed benefits payable under Health insurance policies issued by a Life insurer. The advantage of portability is the carry forward of the credits accrued on account of having a Policy with the previous Insurer.

Portability form shall be submitted to the old insurer who shall send it through a portal to the new Insurer. New insurer may request the claims history and other details from the previous insurer who shall submit the required details within a period of 7 days from the date of receipt of request.



An insurer may reject the request for portability if the Policyholder approaches 60 days before or within 45 days of the date of expiry of the insurance policy. However, an insurer may at their option consider the request for renewal even outside the above period.

New insurer is under obligation to accept or reject within a period of 15 days from the date of receipt of the Portability form. If the new insurer does not convey any decision with the aforesaid 15 days, the new insurer is deemed to have accepted the request for portability. No charges for portability can be levied either by the previous insurer of the new insurer.

No commission shall be paid to any Agent or Intermediary for the policy which is ported from one insurer to another insurer.

PRODUCT MANAGEMENT COMMITTEE (APPLICABLE TO GENERAL AND STANDALONE HEALTH INSURANCE COMPANIES)

A Product Management Committee shall be formed by both the above category of Insurers and the Terms of Reference of the Committee are as follows:

(a) Reviewing Products to avoid duplication of Products within an insurance company.

(b) Annual Plan for filing of new Products and modification of existing Products.

(c) Launching products cleared under "File and use" or "Use and file" under applicable Guidelines of IRDAI.

(d) Designing and filing of 'Pilot products' - these are innovative products which an insurer wants to launch on a test basis.

(e) Product Performance and review.

Non-Life and Health Package Products

General or Stand alone Health insurers can offer a combination of Health, including Personal Accident and/or Travel Insurance covers with other Non-life insurance products, with Health insurance being the predominant coverage.

Specialized Insurance Covers

The COVID Pandemic has created a paradigm shift in the health insurance industry; due to the highly virulent nature of each wave of the virus and the fatality rate , as well as the extremely prohibitive costs of treatment, IRDAI has stipulated a number of specialized products especially for availing Corona insurance cover.

The IRDAI had issued guidelines on Standard Health Insurance Policy called Arogya Sanjeevani in the context of outbreak of COVID 19 pandemic, it is clarified to the Public, that indemnity based health insurance products that cover the treatment costs of hospitalization treatment on account of COVID -19. All insurers have been advised by the Authority vide Circular dated 30th March, 2020 insurers to expedite settlement of COVID 19 related claims. They have also been advised to display FAQs on COVID 19 claims in their respective websites.

IRDAI also introduced two Standard Covid specific health insurance products "Corona Kavach Policy" and "Corona Rakshak Policy" These two products were also permitted to be offered till 31.03.2021;however, taking the prevailing Covid situation into consideration, it is decided to allow all insurers to offer and renew short term Covid specific health policies including “Corona Kavach Policy” and “Corona Rakshak Policy” up to 30.9.2021.

Standard Personal Accident Insurance

The Insurance Regulatory and Development Authority of India (IRDAI) has mandated general and health insurers to offer Standard Personal Accident Insurance product from April 1, 2021. The standard product, whose basic mandatory cover features and policy wordings are uniform would be termed Saral Suraksha Bima, and cost, is likely to vary with the regulator allowing insurers to determine premium.

The minimum sum insured under the standard policy will be Rs 2.5 lakh and maximum Rs. 1 crore. The tenure will be one year and the policy can be renewed. It is for those aged between 18-70 years and can be offered as a family cover too.

Standard Domestic Travel Insurance Product

Bharat Yatra Suraksha, the, that will provide coverage for hospitalization expenses, death, permanent complete or partial disablement due to an accident, for travel through taxi, bus, train, ship, and airplane in the country.

The base cover will provide coverage for hospitalization expenses ranging from Rs. 1 lakh to Rs. 10 lakh and an accidental death benefit ranging from Rs. 1 lakh to Rs. 1 crore. Optional covers include coverage for missed flight connections, loss of checked-in baggage, trip delays beyond three hours, and cancellations.

Mental illness and Health Insurance

As per the Mental Healthcare Act, mental illness means a substantial disorder of thinking, mood, perception, orientation or memory that grossly impairs judgement, behaviour, capacity to recognise reality or ability to meet the ordinary demands of life. It also includes mental conditions associated with the abuse of alcohol and drugs, but does not include mental retardation which is a condition of arrested or incomplete development of mind of a person. The Act further states that every person with mental illness will be treated as equal to persons with physical illness when it comes to healthcare, including health insurance.

IRDAI has taken cognisance of the law, and asked insurance companies to implement its provisions. One of the rationales of the Act is to not discriminate between mental illness and physical illness in coverage. Now, if an alcohol- induced physical illness leading to hospitalisation like in the case of cirrhosis is not covered, in a similar manner alcohol-induced mental illness too will also not be covered. A point to be remembered, is the circular only states that there should be no discrimination between the two illnesses, mental and physical. That doesn’t change anything for the insurers in terms of their underwriting decision.

Even now, the insurer can altogether deny health insurance to a person suffering from a physical illness, say cancer or heart disease, as per its underwriting norms. The same underwriting criteria should apply to individuals with a pre-existing mental illness. However, if the insurer agrees to insure them, then after the waiting period on pre- existing ailment, these conditions would need to be covered.

LESSON ROUND-UP

- General Insurance comprises of insurance of property against fire, burglary and natural calamities like floods and earthquakes etc., personal insurance such as Accident and Health Insurance, and liability insurance which covers legal liabilities.
- Most general insurance covers are annual contracts and indemnity in nature, and governed under
- Proposal is the basis of insurance. The proposal form needs be filled correctly and completely, as this is the offer and first step of the insurance contract.
- Insurance business is one of the most highly regulated businesses globally for reasons of equity and efficiency.
- An insurance policy is like any contract, a legal document and enforceable in a court; the provisions of the Indian Contracts Act, 1872 are applicable to insurance contracts as well.

- The insurance contract is evidenced by a policy, however, the offer having come from the proposer in the form of a proposal
- A policy structure comprises of:
  - Heading
  - Preamble
  - Signature
  - Operative or insuring clause.
- The policy schedule is the document which together with various clauses, warranties and conditions forms the contract.
- Certificates of insurance are less detailed than a policy and not stamped, but essentially give the same information regarding insurance.
- Endorsements would reflect the changes or amendments and would thereafter form part of the policy document. Generally endorsements are issued for such alterations as:
  - Change in insurable interest
  - Cancellation of insurance
  - Change in the value at risk
  - Change in the location or situation of risk
  - Reduction or addition to the risk
  - Change of the insured as when a transfer of interest or assignment of interest is made.
- Underwriting is defined as assumption of liability. It is a continuous process of risk selection and risk classification and includes:
  - Accept the risk at standard rates
  - Charge extra premium depending on the risk factor
  - Impose special conditions
  - Reject the risk.
  - Health insurance is insurance that covers the whole or a part of the risk of a person incurring medical expenses, spreading the risk over a large number of persons.
  - A health insurance policy is a contract between an insurance provider (e.g. an insurance company or a government) and an individual or his/her sponsor (e.g. an employer or a community organization).
  - Healthcare has become one of India's largest sectors - both in terms of revenue and employment. Healthcare comprises hospitals, medical devices, clinical trials, outsourcing, telemedicine, medical tourism, health insurance and medical equipment.
- Claims settlement is one of the challenging functions of the insurer where in the insured would intimate the insurance company of the occurrence of a peril or risk which has caused loss of or damage to the insured property.

GLOSSARY

Health Insurance: Health Insurance covers the whole or a part of the risk of a person incurring medical expenses, spreading the risk over a large number of persons.

Premium: The amount the policy-holder or their sponsor (e.g., an employer) pays to the health plan to purchase health coverage.

Deductible: The amount that the insured must payout-of-pocket before the health insurer pays its share.

Co-payment: The amount that the insured person must pay out of pocket before the health insurer pays for a particular visit or service.

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation.)

1. Why is it said that “proposal is the basis of Insurance”?
2. Discuss the salient features of an Insurance Policy with all important components.
3. Define the following:
   i. Reinstatement value
   ii. Cover note
   iii. Certificate of insurance
   iv. Endorsement
   v. Underinsurance
   vi. Underwriting
   vii. Salvage
4. Discuss the steps followed in the General Insurance claims settlement process.
5. What is meant by recovery? Discuss the various modes of recovery followed in a general insurance claims settlement process.
6. Briefly discuss the different categories of Health Insurances plans?
7. What are government initiatives to promote Health Insurance in India?

LIST OF FURTHER READINGS

- M. N. Srinivasan : Principles of Insurance Law, Wadhwa & Co.
- Rajiv Jain : Insurance Law and Practice, Vidhi Publication Private Limited
- Taxmann : Insurance Manual, Taxmann Publication Private Limited
- Bharat : Manual of insurance Laws, Bharat Publication Private limited
- Dr. Avtar Singh : Law of Insurance, Universal Publication Pvt. Limited
- IRDA Journal : www.irdaindia.org
- Understanding Insurance of Health – P C Jame

Functions in Insurance & Compliance Related Thereto: (Part – I)

Lesson 18

KEY CONCEPTS

■ Product Pricing ■ Reserving ■ Product Review ■ Actuarial Valuations ■ Review of Financial Condition ■ Underwriting ■ Risk selection ■ Risk Tolerance ■ Rating

Learning Objectives

To understand:

- The Concept of Appointment & Role of Appointed Actuary
- How the Product Design & Filings is done in Insurance
- What is the process of underwriting in insurance?

Lesson Outline

- Appointment of Appointed Actuary
- Role of Appointed Actuary
- Product Pricing
- Reserving
- Product Review
- Actuarial Valuations
- Review of Financial Condition
- Underwriting
- Risk Selection
- Risk Tolerance
- Rating
- Lesson Round-Up
- Test Yourself

REGULATORY FRAMEWORK

- Companies Act, 2013
- Insurance Act, 1938
- Insurance Regulatory and Development Authority Act, 1999
- Foreign Exchange Management Act, 1999
- Actuaries Act, 2006

FUNCTIONS IN INSURANCE & COMPLIANCE

Concept

Several insurance businesses concentrated their risk and compliance strategies on safeguarding themselves against downside risks and adhering to constantly changing regulatory requirements in the past years between the global financial crisis and the COVID-19 pandemic. Insurers are currently undergoing a tremendous shift as a result of the multiyear realities of COVID-19, higher levels of unpredictability, efficiency constraints, and the need to remain resilient and relevant by pursuing new sources of revenue. In addition to continuing to safeguard insurance businesses from negative risks, the risk and compliance responsibilities are anticipated to transition to offering them strategic guidance to promote growth and change (such as company-wide cost and tech transformations).

Moreover, second-line risk management must be handled by the risk and compliance functions, reviews and to assist the company, the ultimate risk owner, in making connections between important issues. Business decisions can be influenced by in-depth analyses of business performance, such as unexpected claim patterns or higher-than-expected client retention rates. Also, regular stress testing and forward-looking metrics for financial and nonfinancial risks are crucial to ensuring that the company is operationally resilient and operating in a safe, sound manner across a wide range of risk and compliance environments.

Chief Risk Officers and Chief Compliance Officers (CROs and CCOs) are finding it difficult to come up with solutions given the magnitude of these expectations. In response, several insurance companies are starting to significantly restructure these services so they can better carry out their new responsibilities.

IRDA COMPLIANCE FOR INSURANCE COMPANIES

When a business is established in India, it must adhere to numerous legal requirements. Together with complying, businesses must submit Government-mandated annual returns and filings. Companies must register with numerous authorities and adhere to various regulations. An insurance firm is first created as a business. It is necessary to register the company with the Registrar of Companies (ROC). In addition to this, there will be numerous compliances with various rules and regulations once the insurance business starts operating.

All insurance firms must adhere to Insurance Regulatory and Development Authority (IRDA) Compliance for Insurance Companies. Depending on the regulatory standards governing insurance, an insurance firm that specializes in life insurance or general insurance would have different compliances. For a business to function in the insurance industry, IRDA compliance for insurance businesses is necessary.

IRDA Compliance for Insurance Companies

01 Companies Act 2013

02 Insurance Act 1938 and the Insurance Regulation and Development Act 1999

03 Guidelines for E-Commerce Insurance Business

04 Foreign Exchange Management Act 1999

05 Audit and Other Filings

Why is IRDA Compliance for Insurance Companies Required?

IRDA compliance for Insurance companies is required so that the company can follow the rules and bye-laws which are laid down by the authority. Apart from this, IRDAI compliance is required for the following reasons:

- To ensure that the insurance company is registered as per the requirements of the authority.
- To settle claims and grievances related to policyholders.
- To ensure that the insurance companies act in the best interests of policyholders.
- To ensure that there is a proper system of monitoring insurance companies.
- Foreign exchange is allowed in insurance. Compliance with the rules related to FEMA would ensure that the company is following procedures.

Who Regulates IRDA Compliance for Insurance Companies?

The primary regulatory authority for the IRDA compliance for insurance companies in India is the Insurance Regulatory and Development Authority of India (IRDAI). The law related to insurance is present under the Insurance Act, 1938 and the Insurance Regulatory and Development Authority Act 1999.

Apart from this, there are different regulatory authorities and laws that insurance companies have to be compliant with. IRDA Compliance for insurance companies comes under the following authorities:

- For setting up a company, the compliance would be under the Companies Act, 2013 and previous company law.
- The insurance company would have to deal with the Ministry of Corporate Affairs (MCA) and the Registrar of Companies (ROC) for setting up a company.
- Foreign Exchange Management Compliance- The insurance company would have to comply with the laws related to Foreign Exchange Management Act, 1999 (FEMA). Foreign exchange management regulations are developed by the Reserve Bank of India (RBI).

Eligibility criteria- IRDA Compliance for Insurance Companies

The company which wants to conduct the business of insurance must be established as a company under the companies act.

- The insurance company has to be registered as a public company under the Companies Act, 2013.
- The company has to be compliant with Insurance Laws and Insurance Act, 1938 for being registered with the IRDAI and has the minimum capital requirements.
  a) Minimum Capital Requirements for an Insurance Company- 100 Crores.
  b) Minimum Capital Requirements for Reinsurance Company- 200 Crores.
- Insurance Laws Compliance
  a) File Annual Reports
- FEMA Compliance
  a) Reporting amount of inward inflow and outward inflow that occurs in an Insurance company having a specific amount of foreign investment.
- E-Commerce Compliance by an Insurance Company
  a) The insurance business must register as an e-Commerce company when dealing with internet insurance.

b) The company must ensure that the website is according to the guidelines as per issued by the IRDAI.

c) The company must ensure that the price of the products complies with the IRDAI.

d) The Company must ensure that all policyholders are provided with information on the website

Process / Procedure for IRDA Compliance for Insurance Companies

There are different IRDA compliance for insurance companies. The following have to be considered by an insurance company.

Setting up of an Insurance Company and Corporate Governance Norms

- The company must incorporate as a public company under the Companies Act, 2013 or previous company law.
- Insurance Company needs to be registered as a public company under the Companies Act or Previous company law.
- Filing of resolutions to the Ministry of Corporate Affairs, the declaration from directors, appointment of directors and auditors, annual filings are required to be followed by companies.
- Insurance companies registered under this Act are required to file numerous board resolutions related to topics such as resignation or appointment of directors, appointment of auditors, problems related to shares, etc. with the ROC.
- The filing of the balance sheet in XBRL is exempted from the insurance company. Also, the annual return they file in AOC-4, and MGT-7 needs to be filed within 60 days of the AGM (Annual General Meeting).
- Corporate Governance Guidelines is another provision that is issued by the IRDAI for the insurance companies. The company is required to strictly follow the regulations and also should strictly abide by the rules prescribed in these guidelines while forming the committees.

E-Commerce – Internet Compliance for Insurance Company

- The applicant has to set up an independent ISNP (Insurance Self Network Platform).
- Prior permission is required from the authority to set up such a platform.
- Application must be made in Form-ISNP-1 to set up an internet e-commerce platform in India to conduct e-Commerce activities.
- The applicant has to pay a non-refundable fee of Rs. 10,000.
- The application form has to fill with details as per the requirements, and the authority will return within 15 days.
- The authority would give the permission to secure the license.

Conditions taken by the authority before granting permission

- The interests of the policyholders will be taken into consideration.
- Before granting permission, the authority will see the prospects of internet-based insurance activities.
- The company must not have breached guidelines issued by the authority.
- The applicant does not violate the provisions of the Insurance Act, 1938, IRDA Act, 1999, Insurance Rules, Regulations Guidelines, circulars, orders, notices, etc. issued by the authority.

Compliance under Insurance Regulatory and Development Authority - Audit

Insurance companies have to file the following reports:

- Quarterly Reports;
- Monthly reports;
- Annual Reports;
- Monthly informational reports of policy grievances, business information. This would also apply to quarterly reports; and
- The insurance company are required to put forth their overall performance and which involves the risks related topics and how they deal with particular risks along with the details of the policyholder and management details.

Insurance companies have to maintain a solvency margin ratio regularly and must prepare their accounts according to the prescribed authority.

The annual return must be submitted in four copies to the authorities within six months of the financial year's end. This is a crucial requirement of the company. If the business is conducted outside of India, this time frame is a little bit longer by three months. This Annual Report shall be signed by the Principal Officer, two of the Directors and the Chairman.

Reports of Businesses outside India

For those insurers who have their business established outside India need to file four certified copies to the authority in the English language for each of the balance sheet, account, statement, abstract and report.

Additionally, it should be indicated that an auditor or competent individual audited in accordance with the laws of the insurer's nation must be provided. This declaration should include information about all the assets the insurer owned in India as of the date stated in any of the balance sheets.

They have to supply a separate abstract of the valuation report to the authority before the due date is prescribed.

Compliance Requirements under FEMA

These provisions are specially designed and imposed for those insurance companies that possess foreign investments or have foreign promoters. They must abide by the guidelines as prescribed by the FEMA.

The FEMA-accredited insurance businesses are required to submit an annual report to the RBI in accordance with the established procedures and time frames. Hence, in accordance with the rules established for various insurance firms, these companies must follow by the terms of these regulations for the organization's smooth operation.

Certain requirements apply to foreign stock holdings for insurance businesses. Insurance company investments by foreign investors are permitted. The insurance industry is open to foreign direct investment. For exterior and inward investment pertaining to an insurance company, there is a special compliance.

APPOINTMENT & ROLE OF APPOINTED ACTUARY

An appointed actuary is an actuary appointed by a life insurance company, whose main role is to carry out a regular valuation of the reserves held to pay future policy benefits.

The appointed actuary is required to produce a report attesting to the fact that a company has created reserves satisfying the minimum reserve requirements.

The IRDAI published a notification on December 5, 2022, on the appointment of an appointed actuary, with a focus on the qualifications and hiring process as well as the roles and responsibilities of the appointed actuary and the insurer.

Procedure for Appointment of an Appointed Actuary

The detailed procedure for the appointment of an appointed actuary is provided below-

It shall be appointed by an insurer registered to carry on insurance business in India subject to Regulation 3(B), and Regulation would be called an appointed actuary.

Eligibility Criteria to be appointed as an Appointed Actuary for an Insurer

The person should fulfill the below-mentioned criteria for qualifying for the post.

- The Person must be an ordinarily resident of India;
- A Fellow member as per the Actuaries Act, 2006;
- Institute of Actuaries of India's (IAI) member, satisfying the following requirements in the case of a Life Insurer:
  - o Minimum 12 years of experience in the area of Life Insurance and out of which a minimum of 7 years shall be the post-fellowship experience.
  - o However, 2 yrs. from the yrs. as mentioned above of experience can be reduced in cases where the applicant has passed the Specialist Application or Advanced Specialist level subject in Life Insurance from the IAIA or from any other institute or body having Mutual Recognition Agreement, the experience criteria including post-fellowship experience.
  - o Minimum 3yrs of experience post fellowship experience out of 7 or 5 years, depending upon the applicability provided under Regulation 3B(iii)(a), would be in the review or product pricing or preparation of annual statutory valuation of an Indian Life Insurer.
  - o Despite the above-mentioned experience, a person having experience in the area of Life Insurance as an Independent or Panel Actuary, Peer Reviewer, Actuary certifying the reinsurance returns for the Life reinsurance business or experience in actuarial consultancy in the Life Insurance business or sufficient experience with the Authority would also be considered.
- In the case of a General Insurer, a member of the (IAI), fulfilling the below-mentioned requirements –
  - o Minimum 9 years' experience in the subject of General Insurance and out of which minimum of 4 years shall be post-fellowship experience.
  - o If the applicant has qualified the Specialist Application or Advanced Specialist level subject in such Insurance from IAI or from any other institute or body having Mutual Recognition Agreement with IAI, the experience criteria, including post-fellowship experience the 9 years' experience, shall be reduced by 2 yrs.
  - o Minimum 2 years post-fellowship experience out of 4 years or 2 years as applicable, as specified under the above-mentioned regulation, shall be in preparing or reviewing the annual statutory valuation or product pricing of an Indian General Insurer.
  - o Notwithstanding the above, experience in the subject of General Insurance as a Peer Reviewer or Panel Actuary or Actuary certifying reinsurance returns for the General reinsurance business or experience in actuarial consultancy in the General Insurance business or relevant experience with the Authority shall also be considered.
  - o Minimum 3 years experience in the role of middle or senior-level management.
- In the case of a Health Insurer: the Institute of Actuaries of India's (IAI) must satisfy the same conditions and experience level as of General Insurance mentioned along with such experience in Health Insurance as well.

- o A full-time basis employee of the insurer.
- o A person devoid of any professional or other misconduct.
- o Isn't an Appointed Actuary of any other insurer in India.
- o A person possessing a COP issued by the Institute of Actuaries of India.
- o Not over the age of 70 years.
- o It must be noted that the existing Appointed Actuaries, as of the date of notification of these Regulations, shall be eligible to continue as Appointed Actuaries of the respective insurer.
- o An insurer needs to submit an application in the prescribed format for seeking the approval of the Authority for the appointment of an Appointed Actuary, which shall either be accepted or rejected by the authority within thirty days.
- o In case the application is rejected by the authority, it shall not be done without providing the insurer with an opportunity to be heard.

In case of the inability of the insurer to appoint the same as per Regulation 3 (B), an application is required to be made by the insurer seeking the relaxation of any of the eligibility criteria. The Authority may provide the relaxation of the eligibility criteria except the conditions provided in Regulation 3(B)(ii), 3(B)(vii) & 3(B)(ix). The appointment of an Appointed Actuary would effectuate on or subsequent to the date of approval by the Authority.

Effect of Rejection of the Application

In case the application of the insurer is rejected by the Authority, another application can be filed by the insurer for appointing any other actuary other than the one rejected by the authority.

Carrying on Business without an Appointed Actuary

The insurer is not allowed to carry out the insurance or reinsurance business without an Appointed Actuary. Any non-compliance in respect of the same would attract appropriate actions as per the relevant provisions of the Insurance Act of 1938.

Upon the request of the insurer, the authority may grant the relaxation for a time period as deemed fit by the authority, but the same shall not exceed a period of more than 1 year.

Circular(s) in respect of the transitory provisions for consideration of relaxation provided under Regulation 5(b) above shall be issued by the Chairperson from time to time.

Cessation of Appointment of Appointed Actuary

- The notice of withdrawal of the approval can be served to the Appointed Actuary on the following grounds:
  - o Cessation of their eligibility as per the Regulation 3(B)
  - o Failure in respect of performing its duties and obligations under his Regulations.
- The Appointed Actuary shall be provided with a chance of being heard by the Authority after being served with the above-mentioned notice, after which the Authority shall issue appropriate order either withdrawing approval or revocation the notice so issued.
- If anyone ceases to be an Appointed Actuary of an insurer except the grounds provided in Regulation 6(A), the insurer & Appointed Actuary shall inform the Authority of the reasons for the same within one week of such cessation.

- The insurer, in consultation with the Appointed Actuary, shall work towards avoiding delay in the submission of annual statutory returns arising from the cessation of services of the Appointed Actuary.

Powers of Appointed Actuary

- An Appointed Actuary shall have access to all information and documents in possession or under control, of the insurer if such access is necessary for the proper and effective performance of the functions and duties of the Appointed Actuary.
- The Appointed Actuary may seek any information for the purpose of sub-regulation(A)of this regulation from any officer or employee of the insurer.
- The Appointed Actuary shall be entitled:

  i. to attend, —
     - o all meetings of the management including meeting of the directors of the insurer;
     - o any meeting of the shareholders or the policyholders of the insurer;

  ii. to speak and discuss on any matter, at such meeting, —
     - o that relates to the actuarial advice given to the directors;
     - o that may affect the solvency of the insurer;
     - o that may affect the ability of the insurer to meet the reasonable expectations of policyholders; or
     - o on which actuarial advice is necessary.

Duties and Obligations of the Appointed Actuary

An Appointed Actuary of an insurer has the following duties and obligations.

- Ensure that all the requirements are available to him for conducting the actuarial valuation of liabilities and assets of the insurer;
- Render the actuarial advice to the management of the insurer on the subject of product design and pricing, insurance contract wording, investments and reinsurance, particularly;
- Identify and monitor the risks regarding the ability of the insurer towards maintaining solvency at all times;
- Report those risks to the Board of the insurer where the Appointed Actuary is of the opinion that there exist material concerns that has a possibility of adversely affecting the solvency of the insurer with recommendations on actions for rectifying of solvency position and informing the Authority in the event of failure of the insurer take necessary steps to rectify the situation;
- Comply with the provisions of section 64V and VA of the Act in respect of certification of the assets and liabilities valued in the manner required under the said section; and maintaining the required control level of solvency margin in the manner required under the said section, respectively;
- Notify the management of the insurer regarding any matter which, in his opinion, may require the action of the insurer to avoid any contravention of the Act that may affect the interests of the policyholders;
- Comply with the Authority's directions from time to time;
- Ensure that the overall pricing policy of the insurer is in tune with the overall underwriting and claims management policy of the insurer;

- Ensure adequacy of reinsurance arrangements;
- Contribute towards the effective implementation of the risk management system;
- Comply with the provisions of section 21 of the Act regarding further information required by the Authority;
- Stop acting as per this role upon being disqualified;
- Respect the generally accepted actuarial principles and practices; perform his or her duties and obligations;
- Intimate the Authority of any disciplinary proceedings initiated against them by any entity within 7 days from the date of such initiation;
- Inform the following Authority through a written opinion within a reasonable time;
- Any contravention with respect to the Act or any other acts committed by the insurer of such a nature that is likely to affect the interests of either the Policyholders or beneficiaries of policies granted by the insurer; in a significant manner;
- If there has been a failure on the part of the directors in taking such action as is reasonably necessary for enabling them to exercise their duties and obligations under these Regulations; or
- If an officer or employee of the insurer has engaged in conduct order to for preventing them from exercising his or her duties and obligations under these Regulations.

Absolute Privilege of Appointed Actuary

a. An Appointed Actuary shall enjoy absolute privilege to make any statement, oral or written for the purpose of the performance of his or her functions as Appointed Actuary. This is in addition to any other privilege conferred upon an Appointed Actuary under any other Regulations;

b. Any provision of the letter of appointment of the Appointed Actuary, which restricts or prevents his duties, obligations and privileges under these regulations, shall be void.

Conflict of interest

a. The Appointed Actuary shall function in accordance with these regulations, and he or she shall not function in any other capacity which could result in conflict of interest in performing his or her role as Appointed Actuary in accordance with these Regulations;

b. The insurer and the Appointed Actuary shall comply with the provisions of sub regulation (a) above at all times during his or her tenure as Appointed Actuary.

Obligations of the insurer

a. The insurer shall provide adequate resources to the Appointed Actuary;

b. In order to build up or develop sufficient actuarial expertise, the insurer shall have at least two actuaries apart from Appointed Actuary for pricing and valuation purposes by not later than 31st March 2023;

c. The insurer shall ensure that different functions of the insurer provide adequate support to the Appointed Actuary in discharging his or her duties and obligations;

d. The insurer shall ensure that the Appointed Actuary does not perform any other role like Chief Risk Officer of the insurer defined as per the extant provisions of corporate governance guidelines issued by the Authority. The Chief Risk Officer however may preferably be an Actuary independent of the Appointed Actuary.

e. The insurer shall ensure that the Appointed Actuary reports directly to Chief Executive Officer of the insurer.

Any company aims to set prices to maximize its profits. This is also referred to as optimal pricing. It is not different in the insurance sector. Ideal pricing (or premium in insurance terminology) must cover:

- Variable costs
- Operating expenses
- Profits

Setting an optimal price depends on understanding costs, price elasticity's, consumer preferences, and the strategic actions of competitors.

To Offer Best Price Insurers must:

Improve underwriting capabilities with AI/ML Models & IoT

Prevent Fraud with Analtics & Automated Claims Processing with Chatbots

Use Digital Mediums and Apps to reduce expenses

Why is optimal insurance pricing important?

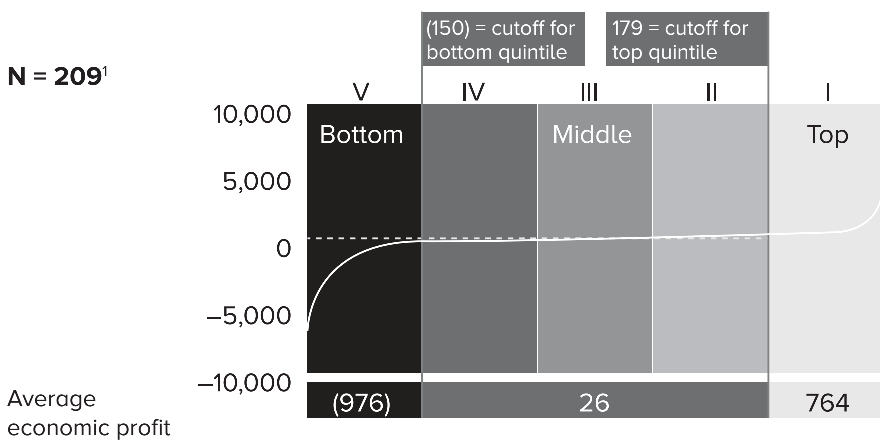
Setting an optimal premium price provides a competitive advantage for the firms.

As in any industry, the price is subject to the law of demand and supply. Since getting the best price is the top priority for insurance customers, even a small percentage change in premium prices causes many customers to switch providers. Therefore, optimal pricing in the insurance sector enables profit maximization by allowing operators to gain market share in segments of their choice (e.g. more profitable segments).

McKinsey's study supports this argument. As the below chart demonstrates, average profit distribution in the insurance sector varies significantly. McKinsey argues that the most profitable insurance companies use technology-enabled underwriting processes to effectively set premiums.

The power curve: Profit is distributed unevenly among global insurers.

Average economic profit, 2013-17, $, million



Source: McKinsey

Top 6 ways of achieving optimal insurance pricing

As mentioned earlier, determining the optimal premium involves minimizing variable costs, operating costs, and optimizing the desired profit margin. For insurance practice, this means:

1. Increase the efficiency of the underwriting process (minimizing variable costs).
2. Detecting fraudulent claims more effectively (minimizing variable costs).
3. Minimizing the customer service, rent and other expenses.
4. Realizing the realistic profit margin that does not lead to a reduction in the customer satisfaction. (Respect the law of supply and demand).

Minimizing Variable Costs

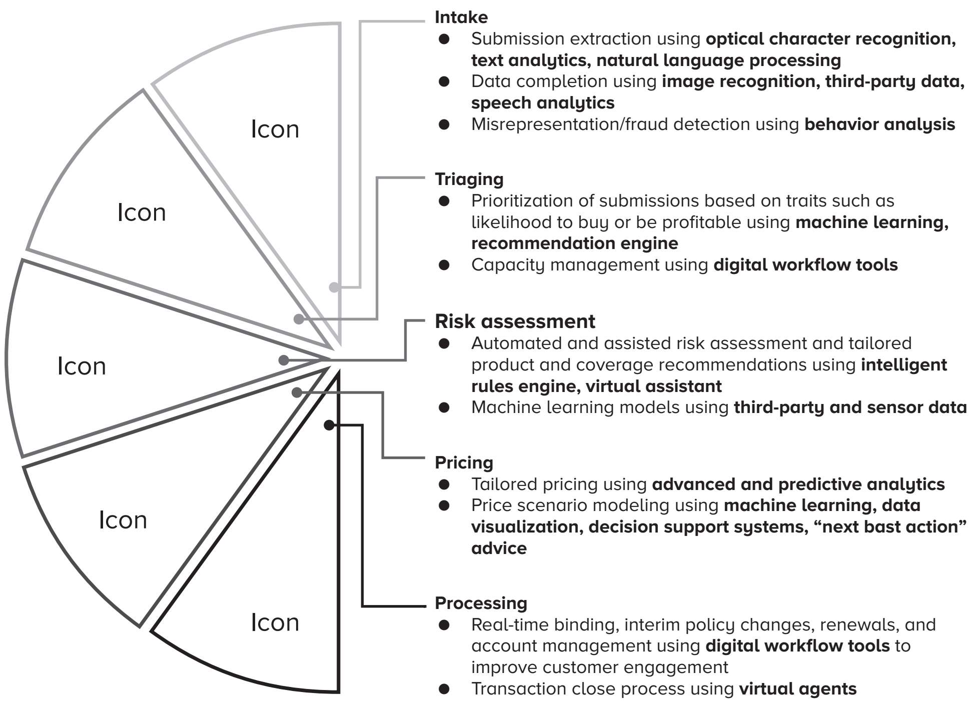
1. Minimizing the cost of risk bearing service (more effective underwriting)

The most important variable cost for insurance companies is the determination of the cost of risk.

Each insurance policy can be thought of as a risk-for-cash transaction. The variable cost of the insurance industry is thus represented by each realized claim, which is more challenging to calculate than the variable costs of other industries. Manufacturers, for instance, have more predictable variable costs like raw materials, which makes it simpler to reduce them. On the other hand, variable costs in the insurance industry follow a probabilistic distribution. Thus, it is difficult to decrease.

In order to evaluate the risk, insurers check some statistical data about the person or company applying for the insurance (subject variables) or about the object to be insured (object variables). For example, in car insurance, insurers evaluate variables such as the segment of the car, the age of the policyholder, the mileage and previous penalties of the policyholder, etc. The idea is that there is a relationship between these variables and the expected damage that would cost the insurance company.

Using exponential data and technology to reimagine the underwriting value chain



Source: Deloitte

2. Detecting Fraudulent Claims

Fraud is a factor that increases the costs for insurance companies and thus increases the premium prices. Therefore, detecting fraudulent claims more effectively can be used either to increase profits or market share.

Using behavioral analytics increases the probability of foreseeing some fraudulent claims before they occur. For instance, analyzing customers' habits, companies can determine whether their behavior is consistent or not. If there is any suspicion, companies can investigate further.

3. Minimizing the operating expenses

Various business expenses such as customer service, rent and other expenses can be decreased thanks to technological advancements. This can help insurers give more flexibility in pricing.

4. Optimizing customer service

Insurance chatbots and omnichannel engagement with clients can significantly reduce customer service-related expenses and increase customer satisfaction due to:

- Optimized customer care response times.
- Engaging with customers via variety of platforms such as
  - o WhatsApp
  - o Mobile App
  - o Website
- Task automation.
- Allocating workforce to tasks that yield greater value.

Also, predictive analytics, can assist insurance companies to prioritize their customers who need immediate claims processing, which in turn lowers operating expenses.

5. Reducing rent expenses

Due to digital technologies and applications insurance companies and brokers can benefit from this recent trend and reduce the number of branches. This means lower expenses and more room for maneuver in terms of pricing strategy.

6. Reducing other operating expenses

One of the cost drivers in commercial insurance is inspections. Plants and equipment need to be inspected for validating their current status and identifying relevant risks. Companies can outsource these inspections, lowering their costs.

7. Determine a realistic profit margin

This is definitely relevant in the insurance industry as identified in surveys. Venture funded companies are embracing that paradigm to set aggressive prices and gain market share. Their goal would be to dominate the market and set more profitable prices in the future when they have achieved substantial scale.

INSURANCE RESERVES

A claims reserve is an account, an insurance company establishes to pay future claims. When it settles a claim, it pays the policyholder from the claims reserve.

In order to anticipate how much cash they will need in claims reserves, insurers employ sophisticated techniques that rely on data and statistical computations. To reduce the risk of higher-than-expected claims and claims that policyholders have not yet reported, they also use various types of claim reserves. The amount of money a provider allots to a claims reserve may have an effect on the premiums paid by policyholders.

In the insurance company the funding of a claim reserve is based on the projection amount which is required to pay unsettled claims or unreported claims.

For Example: If Mr. Ram has taken an insurance policy for his house and due to some instance a fire destroys his kitchen. He files an insurance claim to recover his losses. Then the insurance company deputes a surveyor to assess the loss. A claims reserve is money an insurance company must set aside to pay claims. So, if the surveyor approves your claim then the company will pay the amount from the claim reserve.

Key Takeaways

- Claims reserves in the insurance companies help to manage risk.
- Reserves ensure that they can meet the claims obligations.
- Actuaries determine how much to fund claims reserves by creating forecasts of future claims.
- High reserves can lead to higher premiums.
- Low reserves can put an insurance company at risk of insolvency.

Types of Claims Reserves

Insurers use three types of claims reserves:

- **Outstanding Claims Reserve (OCR):** Money set aside to pay unsettled claims that can include only reported claims or all unsettled claims.
- **Incurred But Not Enough Reported Reserve Provision (IBNER):** Funds reserved to cover potential excess claims as further information becomes known on open claims.
- **Incurred But Not Reported Reserve Provision (IBNR):** Funds allocated for covered losses not yet reported by policyholder.

PRODUCT REVIEW

In the insurance industry, it is crucial to be proactive in anticipating what the needs of the current client are, analysing the insurance products as a result, and developing new products in line with those needs. The insurance company employs a group of specialists and product design analysts that have the experience and skills to anticipate future needs and build products. While reviewing the product the company should monitor:

- Identify events that could materially affect the main features.
- Risk Coverage.
- Guarantees of those products offered.
- Assess whether the insurance products remain consistent with the needs, characteristics and objectives of the identified target market.

Taking into account the size, scope, contractual duration, complexity, and respective distribution channels of those insurance products, as well as any pertinent external factors, such as changes to the applicable legal requirements, technological advancements, or alterations in the market environment, the insurance company shall determine the appropriate intervals for the regular review of the insurance products.

All situations relating to an insurance product during its lifetime that could have a negative impact on the client should be identified by the insurance company, who should then take the necessary steps to address the problem and stop it from happening again. Concerned insurance distributors and clients will be promptly informed of the corrective action taken.

ACTUARIAL VALUATIONS

An actuarial valuation is an analysis performed by an actuary that compares the assets and liabilities of a pension plan. Actuarial valuations are necessary to assess the long-term sustainability of a defined benefit pension plan and can serve as a decision-making tool for plan sponsors.

Companies selling insurance, such as life, car, and health insurance, must employ actuarial valuation techniques to determine their reserves. Actuaries base their calculations on assumptions and estimates. They develop valuation models using these presumptions and projections in order to assess if the reserve value is adequate to meet expenditures and policy claims that the company expects paying in the future. In an insurance company, valuation takes into account the source of earnings after calculating the amount of reserves the company has. Actuaries compare model predictions to actual policies within a certain time period to determine the reserve value.

The professionals who work for Actuarial Valuations are:

- Business Analysts
- Risk Analysts
- Credit Analysts
- Insurance Agents
- Investment Planners
- Portfolio Analyst
- Statisticians
- Actuarial Managers
- Financial Advisers
- Chief Financial Officers

REVIEW OF FINANCIAL CONDITION/ ECONOMIC CONDITION

When reviewing the financial and economic condition of India Insurance market it stands at $131 Bn as of FY22. The Indian insurance industry grew at a CAGR of 17% over the last two decades and is expected to continue its commendable growth trajectory in the future years.

The key highlights of financial and economic condition of insurance sector are as follows:

- There are 58 insurance companies in India's insurance sector, including 34 non-life insurers (25 general insurers, 7 standalone health, 2 specialized insurers). Over the past two decades, the insurance market in India has experienced exceptional growth, thanks to increased private sector involvement, better distribution capacities, and significant increases in operational efficiency.
- Private Life Insurers are expected to grow their retail APE at a CAGR of over 17% between 2021-23, and new retail term premiums are expected to double in 5 years. The Private Non-Life insurance segment is forecasted to grow at 16% in FY22 and 14% in FY23. Standalone Health Insurers are expected to grow by over 25% in FY22 due to the increased focus on healthcare.
- In India, the insurance market is anticipated to grow at a 12.5% CAGR over the next ten years, from 2020 to 2030, driven by specialized products like protection and annuities. The New Business Premium for Life Insurers has increased at a CAGR of 14% over FY14–20 due to the financialization of savings and new product launches.
- Non-life insurer's Collective gross direct premium underwritten for non-life insurance companies grew 22.99% y-o-y to INR 54,491.27 cr for the first quarter this fiscal from INR 44,303.91 cr for the same period last fiscal.
- India's insurance penetration was pegged at 4.2% in FY21 (from 3.76% in 2019-20), with life insurance penetration at 3.2% and non-life insurance penetration at 1%
- The market share of private sector companies in the non-life insurance market rose from 15% in FY2004 to 49.3% in FY2021.
- In terms of the size of insurance industry in India, the share of life insurance in total premium in India is 75.24% and the share of non-life premium is 24.76% (2020).
- Life insurers recorded new business premium of INR 2.78 tn ($38 bn) in FY21 growing at 7.49% over the last year with private life insurers growing at 16.29%. Private Life Insurers account for 33.8% of the industry's new business premium (FY21) with the rest being accounted for by the Life Insurance Corporation of India (LIC).
- The Life Insurance Industry in India recorded a total premium of INR 5.73 tn ($81.3 bn) in FY20 witnessing a growth of 12.75% over the previous year and the private insurers accounted for 33.7% of

total premium underwritten by the industry. New business premium contributed 45.25% of the total premium and witnessed a strong growth of 20.59% over FY19. 60% of the new business premium was derived from single premium with remaining 40% accounted for by first year premiums.

- The traditional (non-linked) products accounted for 85% of the total premium written in FY20 and share of ULIPs (linked products) in the total premium stood at 15%.
- During the last year (FY20), life insurers issued 288.47 lakh new individual policies, out of which LIC issued 75.9% of policies and the private life insurers issued 24.1% of policies.
- In FY21, non-life insurers (comprising general insurers, standalone health insurers and specialized insurers) recorded a 5.19% growth in gross direct premiums.
- Motor insurance accounted for 34.1% of the non-life insurance premiums earned, followed by health insurance at 29.5%, in FY21 Post-Covid rising demand for personal mobility space is leading to a shift in vehicle ownership patterns and may create an opportunity for motor insurers.
- Health insurance witnessed 13.3% growth in GDPI in FY21, while fire insurance and liability insurance observed 28.1% and 16.4% growth respectively in the same period.
- Government programmes and initiatives to promote financial inclusion should have aided in accelerating uptake and penetration across all categories. Crop insurance premium income has significantly increased as a result of the government's flagship programme, PMFBY, which now covers more than 55 million farmer applicants annually. Over 70 lakh farmers have benefited from it, and claims worth INR 87.4 billion ($1.2 billion) have been transferred to the beneficiaries, even throughout the COVID-19 shutdown period.
- AB PM-JAY is an entitlement-based scheme under Ayushman Bharat and is fully funded by the Government. It is the largest health assurance scheme in the world and aims at providing a health cover of INR 500,000 ($6,900) per family per year for secondary and tertiary care hospitalization to over 107 mn vulnerable families (approximately 500 mn beneficiaries).
- The insurance regulator IRDAI has also undertaken various initiatives towards boosting the insurance penetration, such as permitting insurers to conduct video-based KYC, launching standardized insurance products and allowing insurers to offer rewards for low-risk behaviour.
- Going forward, general insurance companies will be key beneficiaries of the opening-up of economies, especially with improved trade activity increasing demand for motor and health insurance. Strong growth in the automotive industry over the next decade is expected to boost the motor insurance market. Meanwhile, the life insurance sector will benefit from a steep yield curve, with low short-term rates and higher long-term rates.
- Digital issuance and online channels are expected to witness continued growth, the share of web aggregators within digital insurance has been constantly increasing and web-aggregators currently originate 30-40% of digital insurance.
- The total mortality protection gap in India stands at $16.5 tn (as of 2019) with an estimated protection gap of 83% of total protection need. This offers a huge opportunity to life insurers with an estimated additional life premium opportunity of average $78.2 bn annually over 2020-30.
- The retail protection sum assured is estimated to grow 8X by over 2020-30, implying 23% premium CAGR.
- India is the 2nd largest InsurTech market in the APAC region, accounting for 35% of the $3.66 bn capital invested in this region. The online individual insurance market opportunity is estimated to be $1.25 bn by FY25 more than tripling from $365 mn in FY20.

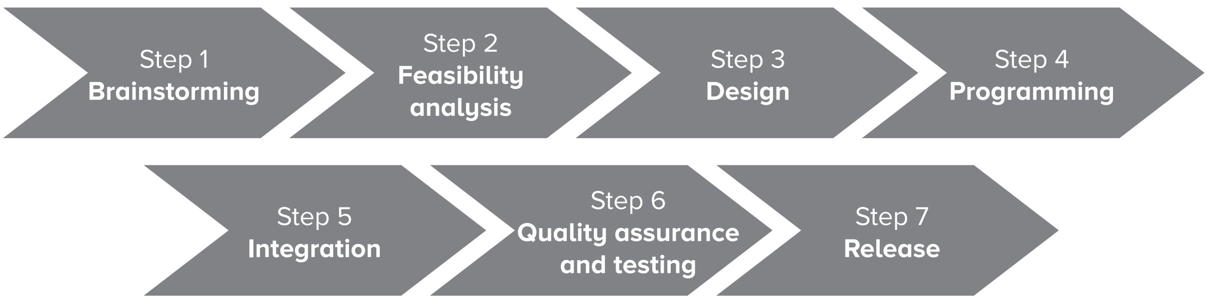
- Significant government initiatives, robust democratic elements, a supportive regulatory framework, expanded alliances, product innovations, and active distribution channels all contribute to the expansion of the insurance sector.
- The Union Budget's announcement to expand FDI in insurance from 49% to 74% will further contribute to increased penetration and coverage by opening up new channels for the capital support needed to grow the Indian insurance market.

PRODUCT DESIGN & FILINGS

Today's life insurance providers frequently offer top-notch services supported by reliable software. Today's population is too busy to spend time contacting, emailing, or visiting their agents. They require technologies that are simple to use and allow them to access important services online. Companies upgrade or create brand-new insurtech platforms as a result, along with new policies, products, and pricing.

Product design should include: defining the target group; identifying insurable risks; determining key product features; establishing payment capabilities. Affordability and product design preferences should be investigated together to provide real value to clients.

Insurance Product Development Process



Step 1 – Brainstorming

A team must compile all the preliminary needs and generate creative ideas at the first step. Senior team members with substantial experience in developing comparable goods in a certain industry carry out this analysis. The team can start working on the plan and feasibility analysis once all the information has been gathered.

Step 2 – Feasibility analysis

Every stakeholder should do a feasibility analysis at the second stage. An in-depth analysis can show how profitable a project might be. It also takes into account every element that influences development. Risqué in the economy and technology are among these factors. All team members should provide their estimates of the time, money, and resources required to complete the project as a result of the feasibility analysis.

Step 3 – Design

The group creates thorough SRS documentation based on the original requirements (software requirements and specifications). It forms the foundation for the product architecture and is frequently closely related to the Design Document Specification (DDS). The optimum design strategy for the product is chosen based on a number of factors, including risk assessment, product robustness, design modularity, budget, and time restrictions. The product's architectural modules, as well as the communication and data flow representation with external and third-party modules, are all explicitly defined by the design methodology.

Step 4 – Programming

During this stage, developers write code according to DDS. The team follows the coding guidelines defined beforehand. The tools and programming languages, which actually make up the technology stack, are also selected in advance.

Step 5 – Integration

Doing system integration testing during this step is meant to make sure that the developed systems adhere to all specifications with the components and subsystems integrated. Depending on the size and complexity of the requirements, the system test may need any number of additional tests; examples include security, compliance, accessibility, performance, stress, compatibility, and regression testing.

Step 6 – Quality assurance and testing

This stage is usually a subset of all the stages. However, it refers to the testing-only stage of the product where product defects are reported, tracked, fixed, and retested until the product reaches the quality standards defined in the SRS.

Step 7 – Release

It all revolves around introducing a new product to a target market. It may occasionally be an MVP or a beta version of the product. Key features going live can help developers assess performance and gather useful input from the product's initial consumers.

Although there is no "one size fits all" answer, when building an insurance product, the insurer must take into account the customer's needs, preferences, proper distribution systems, legal requirements, and understanding of local and global conditions. Relevantly, financial gain or social good must unquestionably be a constant consideration for insurers to be successful in their launches. Technology is crucial in determining premiums and benefits in order to achieve this. Some of the elements that go into the design of an insurance policy, as well as some crucial inquiries that help to better qualify the product.

1. How comprehensive are the features?
2. Adequate data analyzed?
3. Scientific reason established why the existence of the products required?
4. Do distributors need special training to sell?
5. Are sales illustrations clear to laypersons?
6. Could distributors explain other products in the market and how these differ from the insurer's products?

Significant Factors to Consider for an Insurance Product Design

Target market: It is highly advisable to determine the target market and the needs of the target audience. For instance, people who live in rural areas will have different needs than people who live in metropolitan areas. To execute the same, consumer segmentation in data science can be widely used. Early segmentation and target definition will help product engineers to anticipate the ROI closer to the accuracy rate of 95%.

1. **Eligibility to buy:** To purchase insurance, certain conditions must be fulfilled for a potential customer to be eligible to buy insurance. These are:
   - **Age:** Insurance companies offer plans for Infants to Super seniors. In some cases, minimum age and maximum age are the constraints for certain exclusions or loadings.
   - **Income:** The insurer may ask for income proof based on the declarations and the amount of insurance coverage asked by the customer.
   - **Health:** The insurer may ask for medical examinations and reports, wherever necessary, wherever necessary, based on declarations—the amount of insurance coverage. However, nowadays, tailor-made coverage is updated on a needed basis.
   - Laying good provisions of benefits.
   - Clear demarcation of the beneficiaries.
   - Remedies available in case of any problem or litigation.

FILE & USE AND USE & FILE

- In life insurance, 'use and file' means that life insurance companies will be able to launch the product immediately. It would be possible to bring life insurance products without the approval of the regulator.
- The approval of the regulator will not be necessary before launching the product.

"Use and File procedure essentially means that insurers can introduce their products to the market on filing with the regulator thus avoiding a longer waiting duration in offering innovative insurance solutions to customers in order to help address the dynamic environment.

Now, insurers must file the product and acquire a UIN within 7 days of its introduction. All items, including pilot and combi products, fall under this. The new regulations will help the sector introduce products more quickly. While the regulator has granted the industry latitude, it will also expect insurers to behave more responsibly.

What are the advantages of 'Use and File'? Customers will have more alternatives in the life insurance policy thanks to "Use and File." For example, new product categories will emerge in response to consumer wants; new technologies, such as incorporated insurance; shorter lead times for new products; and more. It should be remembered that product approval often takes six to twelve months.

The Revised Guidelines set out detailed "guiding principles" for product design and rating which include the following:

- The product should be a genuine insurance product covering an insurable risk with a real risk transfer;
- All products should go through "appropriate due diligence" to ensure compliance with the regulations;
- Products should be fair and non-discriminatory to all stakeholders and should take care of the policyholders' reasonable expectations. Insurance product design should ensure "*transparency and clarity in wordings, terms, coverage, exclusions and conditions in order to devise a fair and balanced risk transfer mechanism through insurance*";
- Products must be need-based so that "*unnecessary and superfluous coverage are not added and the necessary ones are not excluded*";
- All product literature is meant to be in simple language and technical terminology should be sufficiently clarified such that it can be understood by laymen;
- If Insurers intend to introduce products used in foreign jurisdictions, then those products must be examined and modified in terms of the local regulatory requirements and Indian policyholder requirements;
- Insurers are required to use similar wordings across products for describing the same cover or similar requirements (such as clauses on renewal, basis of insurance, due diligence, cancellation, arbitration and claims reporting).

In terms of procedures for introducing products, the Revised Guidelines specify that:

- Retail products are to be filed under the File & Use procedure set out under the Revised Guidelines. Broadly, the Insurer cannot market the product unless the IRDAI has confirmed in writing that the contents of the product have been noted and a Unique Identification Number (UIN) has been allotted for the product. The File & Use procedure appears to be aimed at being time-bound.
- Commercial products are to be filed under the Use & File procedure set out under the Revised Guidelines. This procedure is meant to be "self governing process" where the Insurer's Product Management Committee (PMC) will play a pivotal role. Broadly, the once the product is scrutinized, reviewed and recommended by the PMC (without any exceptions to the Insurer's Board approved underwriting policy) and accepted by the Insurers, the product documents will be uploaded on the IRDAI's website and a UIN will be allotted. The Insurer can market the product thereafter. The Revised Guidelines make it clear that the IRDAI may check the documentation in detail and if it finds that the

product is not in the interests of the policyholders or in conformance with the regulations, it may direct for the product to be suspended, withdrawn or even filed under the File & Use procedure.

UNDERWRITING

What is underwriting in insurance?

Underwriting is the process insurers use to determine the risks of insuring your small business. It involves the insurance company determining whether your firm poses an acceptable risk and, if it does, calculating a fair price for your coverage.

What is an underwriter?

An insurance underwriter is someone who manages the insurance underwriting process. As an insurance company employee, an underwriter represents the insurer, not the customer, in the purchase transaction.

Does underwriting apply to all forms of insurance?

Insurance underwriting is central to all forms of insurance. By definition, insurance involves individuals or businesses transferring their risks to an insurer, which charges a fee to provide financial assistance should a loss occur.

However, before an insurance policy is provided, insurers must understand the nature and scope of the level of risk they're taking on, which requires underwriting. Underwriting applies to all forms of small business insurance, including:

- General liability insurance
- Business owner's policy (BOP)
- Umbrella / excess liability insurance
- Workers' compensation insurance
- Commercial auto insurance

How does the underwriting process work?

Underwriting in insurance involves assessing the factors that determine a potential customer's risk profile. The specific factors depend on the type of insurance you're applying for. These are the most common factors:

- Type of business;
- Age of business;
- Financial characteristics (size, sales, assets);
- Prior financial behavior (credit score, bankruptcies);
- Condition of property;
- Prior insurance claims;
- Safety / security systems;
- Loss-prevention practices.

> Underwriting is the selection of risk for the insurer and determination in what amount and what terms acceptable risk will be insured.
>
> **By: Frank Joseph Angel**

Once an underwriter understands these factors, he or she will seek to determine whether your company has risk factors affecting your desirability as a purchaser of a specific insurance type. For example:

- **If you're buying general liability insurance**, have you been sued before and for what reasons?
- **If you're buying a business owner's policy**, do you have security alarms and is your building's roof in good condition?

- **If you're seeking insurance for your business vehicles**, how many times have you filed accident claims in the past?

The point is, underwriters assess diverse types of customer data to determine whether their company should do business with you and at what price.

If the outcome of the analysis is unfavorable, then the underwriter might offer you options to take some risk "off the table." For example, the person might suggest amending the coverage by endorsement to prevent you from filing certain kinds of claims. Although this makes the insurance less useful, it might be a better solution than going uninsured.

How does an underwriter differ from an insurance agent or broker?

Insurance underwriters, along with the actuaries who create statistical models of future losses, create the underwriting system that determines to whom an insurer will offer coverage.

Insurance agents and brokers are the field representatives of this system. Duties they perform include:

- Help you understand the types of insurance you might qualify for.
- Help you complete an insurance application form.
- Help the underwriters interpret information about your firm.
- Negotiate with underwriters.
- Educate you about the insurance you bought.

In one sense, insurance agents (not brokers) do a form of underwriting. When you meet an insurer's risk requirements, your agent can provide you with immediate insurance coverage, a process called binding.

RISK SELECTION

The process through which insurance companies evaluate insurance applicants is known as risk selection. For each distinct applicant for the insurance policy, this screening procedure is utilized to determine what the insurer should cover and what they should exclude. It entails categorising applicants using underwriting principles and figuring out how much premium to offer a specific applicant.

This is the standard screening procedure utilised in the insurance sector. What the insurance should cover and what they should exclude is decided by the underwriter. Also, they classify the applicant into a group based on the risk they represent to the insurance provider. The basic groups are:

- **Standard:** the applicant is offered the basic rate.
- **Substandard:** the applicant is deemed a higher than usual risk and is offered a more expensive premium.
- **Preferred:** the applicant is considered a low risk and is offered a premium discount accordingly.

Purpose of selection of Risk or Underwriting

From the above definitions, it is quite clear that the selection of risk is aimed at finding out those lives:

1. Who can be offered life assurance, and
2. Who are un-insurable and are to be declined. The method applied by the insurer in this process is very scientific which aims to assess the longevity of the proposer.

Sources of Risk Information

Before evolution of risk, it is necessary to collect the information about risk in a proper manner. Risk information is collected from various sources as given below:

1. Application form or proposal

Each company has its own format. But the information called for includes:

1. Name, residence, occupation, income and identification of the proponent;
2. Nature of insurance sought;
3. Duration of insurance;
4. Purpose of insurance;
5. Previous insurance history;
6. Family history;
7. Personal history of illnesses, accidents, hospitalization or treatment taken;
8. Habits, especially intake of alcohol, etc.

2. Agent's Report

The agent who has canvassed the case gives information about the proponent's condition of health, habits, details of previous life insurance policies held by the proponent, financial condition, agent's recommendation, etc.

3. Medical Examiner's Report

The medical examiner who conducts the examination of the proponent primarily discusses the proponent's build, blood pressure reading, the state of various bodily systems, any illnesses experienced, operations (surgeries), hospitalisations, etc., as well as his personal judgement of the proponent. The business frequently takes on risks without the need for a medical exam. Such a business is referred to as non-medical business. In certain circumstances, the application includes additional questions, particularly those pertaining to the build (height and weight).

4. Physician's Report

This is a report obtained, in some cases of high risks, from the doctor who is the usual medical attendant of the applicant.

5. Special Medical Reports

The insurance provider may request specific medical records, such as an ECG, reports on the central nervous system, survey results, etc. in cases where the applicant is requesting high risk coverage or when the applicant is proposing high risk coverage to people who are older or have substandard lives.

6. Inspection Report

This is generally obtained whenever moral hazard is suspected, mostly from the officials of the company about the health, financial position, habits, insurable interest, etc. of the applicant.

7. Inter-Company Data Bank

All the companies maintain a record of lives which were accepted with certain modified terms or declined. To avoid foul play, a company at times accesses information from the above data bank.

RISK TOLERANCE

Risk Tolerance is **the willingness of an organization to incur risk to gain future reward**. In insurance, risk tolerance may be evidenced by a willingness of the insured to increase deductibles or self-insured retentions (SIRs).

Although the word "risk tolerance" is frequently used when discussing matters such as investment portfolios and business transactions, it has a very specific connotation when it comes to insurance. So when you talk about insurance, what does risk tolerance mean? What exactly is risk tolerance? In the context of insurance, risk refers to the possibility that something negative or unexpected will occur, and risk tolerance refers to how willing you are as a company or service provider to bear the consequences of such an event.

These concepts don't exactly apply to insurance, though they are comparable. In investing, higher risk tolerance is defined as being willing to lose money in exchange for potentially better results, and lower risk tolerance is defined as choosing investments that keep the initial investment. Risk tolerance can be defined as the willingness of a company, organization, or person to take risks in exchange for a potential payoff. This term can be applied to insurance by suggesting that it can be seen of as the readiness to raise deductibles or SIRS (self-insured retentions) in exchange for cheaper premium payments, or as the ability to simply prepare to pay higher deductibles in the event that an event really occurs.

Another way to describe risk tolerance is how much risk a customer is willing to accept as a service provider, a business, or a homeowner. Risk transfer and risk tolerance are related concepts. What kinds of deductibles are you prepared to pay for, and how much do you want to give your insurance provider? Together with other precautions like security, insurance serves as a means of transferring risk. Although it may sound complicated, moving a pure risk from one party to another is the most straightforward way to put it. When you buy an insurance policy, you're giving your insurer the risk of certain losses that are specified in your policy instead of yourself, the policyholder. Several kinds of risk transfers exist.

Consider that you are the owner of a restaurant, where spills and damp floors can provide a number of hazards or risks. You can lower the chances of slips and falls by investing in non-slip floor mats or mandating that personnel wear non-slip shoes as part of their uniform. You also obtain a more comprehensive insurance policy, and if you are ever sued, your policy mandates that your insurer would take care of the defence, the claim payment, and other related costs, sparing you from having to pay for them out of pocket. You've shifted the risks from yourself to your insurance as a result.

The dangers are different for professionals and service providers. Risks vary for accountants, real estate agents, engineers, marketers, and even other insurance brokers. They confront a different set of worries than someone who slips and falls, including the possibility of being sued for apparent negligence or bad counsel. The level of risk that a service professional is willing to accept in relation to the work being done is what is meant by "risk tolerance." Would they rather buy an insurance policy that transfers that risk to the insurer so that the insurer is protected from out-of-pocket costs in the event that they are required to defend themselves in court?

There are a variety of factors to take into account when figuring out your risk tolerance as a policyholder. Every company and service provider has unique requirements. How big is your company? What kind of organisation does your company have? How many personnel must you take into account, together with the types of income you are working with? These elements all affect the level of risk that your company is exposed to. For instance, service industry workers must consider a wider range of issues, including the types of data and information they manage, the clients they work with, and the dangers these clients provide.. In order to make the best choice for their business, prospective policyholders and the insurance experts they engage with will ultimately require access to a wide range of data.

A collection of policies may be included in the typical insurance package for a service professional. A professional liability policy, a general liability policy, a cyber-liability policy, a workers' compensation policy, and possibly some criminal coverage might be included in an insurance package, for instance, if we utilize an accounting office. The accounting department may then take a look at the rates and decide that it would be more prudent to spend half as much on insurance. So they reduce some of that coverage and decide to merely take on general liability and professional liability. They've determined that they are willing to take on the risks associated with not having those additional policies.

In this case, if the accounting office suffers a cyber-breach, they will bear the costs involved directly rather than potentially transferring the risk. In the end, companies and professionals must decide whether to invest in insurance policies, extra risk transfers such security upgrades or better business procedures, or they must take a financial risk and incur the costs of lawsuits and other consequences.

Ultimately, prospective policyholders should spend time talking about their requirements, risk tolerance, and expectations with an insurance expert who can assist them in gathering the information required to make an informed choice about insurance.

Factors that Influence Risk Tolerance

1. Timeline

Depending on their investing intentions, each investor will choose a different time horizon. In general, if there is more time, greater risk can be taken. A person who needs a specific amount of money in fifteen years is able to accept more risk than someone who needs the same amount in five years. It's because the market has exhibited an upward trend over time. In the short term, there are persistent lows.

2. Goals

Each has different financial objectives. Financial planning is not always done with the intention of amassing as much cash as possible. Calculating the amount needed to accomplish specific objectives allows for the pursuit of an investment strategy that will produce those returns. As a result, depending on their goals, each person will adopt a varied level of risk tolerance.

3. Age

Young people should typically be able to take more risks than elderly people. Young people have the potential to earn more money at work and have more free time to respond to changes in the market.

SUMMARY

1. Risk tolerance is the maximum amount of loss an investor may tolerate while choosing an investment.
2. Depending on how much risk they are willing to take, investors are typically divided into three basic types. They range from aggressive to conservative and from moderate.
3. Understanding one's level of risk tolerance aids in portfolio planning and influences investment decisions.

4. Portfolio size

Risk tolerance increases with portfolio size. A portfolio size of $50 million will allow an investor to take on more risk than one of $5 million. In the event of a value decline, a larger portfolio will experience a considerably lower percentage loss than a smaller one.

5. Investor comfort level

Every investor approaches risk in a unique way. Investors vary in their comfort level with taking risks. Some are more at ease than others. On the other hand, for some investors, market volatility can be incredibly distressing. So, the degree to which an investor feels at ease taking risks is closely correlated with their risk tolerance.

Types of Risk Tolerance

Investors are usually classified into three main categories based on how much risk they can tolerate. The categories are based on many factors, few of which have been discussed above. The three categories are:

1. Aggressive

Investors that take big risks and invest aggressively are knowledgeable about the market. Such investors are accustomed to their portfolios experiencing significant increases and decreases. It is common knowledge that aggressive investors are well-off, knowledgeable, and typically have a diverse portfolio.

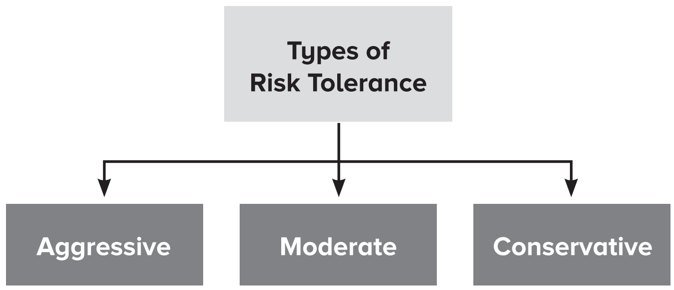
They like asset classes with volatile price movements, like stocks. They naturally experience significant losses when the market performs poorly because of the amount of risk they take, but they also benefit greatly when the market performs well. They do not, however, panic sell during market crises because they are accustomed to volatility on a regular basis.

2. Moderate

When compared to investors who take on aggressive risks, moderate risk takers exhibit a lower level of risk tolerance. They assume some risk and often decide what portion of losses they can take. Between hazardous and safe asset classes, they strike a balance with their investments. When the market is doing well, they earn less money than investors who take a more aggressive approach, but they do not experience significant losses when the market is down.

3. Conservative

The least risky investors in the market are the cautious ones. They choose the solutions they believe to be the safest and never engage in risky investments. They place preventing losses above achieving benefits. They only invest in a select few asset types where their capital is safe, like FD and PPF



Ignoring Risk Tolerance

Investing without taking into account risk tolerance could be deadly. When investments lose value, an investor needs to know what to do. Several investors leave the market, which results in low prices being sold. But, a market downturn might also be a terrific opportunity to invest. Consequently, knowing one's risk tolerance aids in making wise judgements rather than rash ones.

UNDERWRITING AND RATING

Auto insurance costs are based on two criteria. These variables examine the traits and establish the risk pose.

Underwriting is the first consideration. Insurance firms use underwriting to evaluate the risk posed by applicants, classify them with other risks of a similar nature, and determine whether or not to accept their applications.

Rating is the second component. The rating provides a price depending on what the insurer thinks it will cost to bear the financial responsibility for the applicant's prospective claim based on the outcomes of the underwriting procedure.

Underwriting's goal is to organise applicants into subgroups that represent comparable risks, then decide whether to accept, deny, or limit coverage for each subgroup. Your grouping with other applicants and policyholders who share comparable risk-related traits is what this signifies for you. As a result, if you can reduce your risk, you can be grouped with others who have lower risks.

Based on the claims paid by the insurer for members of each group, a rate will be established for that group. The rates for a group are higher the bigger their average losses are. Hence, being in a low-risk group has benefits for you.

How do Insurers Underwrite?

Information from your policy application is used by insurers. A number of questions will be asked of you when you apply for insurance. These inquiries are meant to determine how likely it is that you will make a claim.

Your driving history will be requested by insurers. Additionally, insurance companies need to know specific details about you in order to compare you to other drivers. Insurers look at your group's claim history to predict future claims.

Age and gender are two of these traits that are out of your control. Some factors can be changed, but they are more challenging to change because they are directly related to one's way of life or income. Geographical location and vehicle use are examples of these traits. The third set of characteristics, such as the brand and type of car the buyer wants to buy and insure, are quite controllable. The likelihood of excessive claims is higher for a car with few safety features and a strong engine than for a less sporty one. The decision to purchase a high-risk car is mostly in the hands of the consumer.

Insurers also consider lifestyle characteristics in the underwriting process. These characteristics include marital status and employment history. From prior claims data, insurers know that married persons tend to have lower claim levels than unmarried. Other statistics show that persons who work in the same place for a long time tend to have lower claims.

RATING

The second factor that governs the cost of your auto insurance is rating. Like underwriting guidelines, each company adopts its own rating system, although there are general guidelines that all companies follow.

Commonly asked questions related to loss history include:

- **Driving Record.** On the policy application you will be asked about your driving record. Insurers will ask about accidents and traffic violations for any driver covered by the policy for preceding 3-5 years. Drivers with previous violations or at fault accidents are considered to be a higher risk and may be charged a higher rate.
- **Territory.** The claims experience of people in your area will also affect your rates. Applications include a question that asks for the address where the vehicle will be garaged. From this information insurers can tell a great deal about your risk of financial loss. From your claims experience, insurers know that more claims are made from urban areas than rural areas (busy traffic, thefts, vandalism, etc.).
- **Gender and Age.** Statistically, males still have more accidents than females. For that reason, young men may tend to pay more for insurance than young women. (A small number of states have prohibited insurers from using gender as a factor in underwriting.) Insurers also have statistics that show a higher number of claims for some age groups than for others.
- **Marital Status.** Insurance company claims statistics show a lower rate of auto insurance claims among married policyholders.
- **Prior Insurance Coverage.** In some states insurers may ask you if you had insurance coverage previously. If you have previously been cancelled for non-payment of premiums, insurers want to know. If you have had insurance, your new insurer may ask your prior company about your claims history. Different insurance companies specialize in particular classes of business. Large insurers may form subsidiaries for preferred (low risk), standard and non-standard (high risk) business.
- **Vehicle Use.** You will be asked on the application about how often and how far you drive the vehicle you want to insure. Higher annual mileage will generally result in higher premiums because of the higher exposure to risk.
- **Make and Model of Vehicle.** The type of car you drive will directly affect the cost of your automobile insurance. A make or model of car that has a high number of claims or higher claims cost will be charged a higher premium for comprehensive and collision coverage.

The single greatest influence on the rating process is claim frequency. This does not mean how many times you specifically have made an insurance claim, although that will have an additional effect. Claim frequency measures how often an insured event occurs within a group relative to the number of policies contained in that group. Persons sharing characteristics with high-claims groups will be charged more for insurance coverage. At the same time persons who share characteristics with low claims groups will be charged lower rates. In addition, insurance companies offer discounts to individuals who exhibit certain characteristics.

DISCOUNTS

Because the insurance provider considers you to be a "better risk," discounts are given. Before purchasing auto insurance, you should be informed of the savings that various providers are offering. Not all states allow the same discounts to be used. Here are some discounts you should look for:

- **Multiple Vehicles.** Most insurance companies offer a discount to consumers that insure more than one car with their company. Companies offer these discounts not only because they want all of your business, but also because it is easier for them to under-write individuals that they know; thus, reducing their risk and saving the company money. In addition, industry statistics show that individuals and families that insure more than one car have a better than average claims experience. Through this discount companies pass along some of their savings to you.
- **Driver Education Courses.** Discounts for driver education courses are targeted primarily at younger and older drivers.
- **Good Student.** Insurers have found that students who are responsible enough to earn a B average or better tend to be more responsible drivers. For that reason, many companies offer a «Good Student Discount.»
- **Safety Devices.** Automobile safety devices can lower insurers› costs by preventing accidents or limiting their severity. These savings are passed along to the policyholder through discounts for safety equipment. This equipment includes air bags, automatic seat belts and anti-lock brakes.
- **Anti-theft Devices.** Devices or systems that deter theft or vandalism also lower claims costs. Many companies offer discounts for anti-theft devices.
- **Low Mileage.** The fewer miles you drive the less chance you have of getting into an accident. Insurers recognize this fact and generally offer discounts for low mileage drivers. Some companies also offer discounts for drivers that participate in car-pools.
- **Good Driver/Renewal.** Some insurers offer discounts to drivers who maintain a good driving record and renew their policy with the same insurer.
- **Auto/Home Package.** Some insurers offer a discount on one or both policies if an individual buys a homeowner policy and an auto policy from the same insurer.
- **Dividends**. If an insurer sells auto insurance and makes a profit, some insurers, especially mutual insurers, will pay dividends to policyholders. Following the conclusion of the policy term, dividends are announced and paid.

  Coupons help businesses compete with one another and keep customers by doing more than just attracting new ones. Hence, when you shop, inquire how much you save in addition to whether a discount is available. Savings can vary from business to business. Customers should also make sure they get the discounts for which they are eligible. Compare the final price after any savings when comparing insurance prices across various providers.

LESSON ROUND-UP

- All insurance firms must adhere to IRDA Compliance for Insurance Companies. Depending on the regulatory standards governing insurance, an insurance firm that specializes in life insurance or general insurance would have different compliances.
- IRDA compliance for Insurance companies is required so that the company can follow the rules and bye-laws which are laid down by the authority.
- The primary regulatory authority for the IRDA compliance for insurance companies in India is the Insurance Regulatory and Development Authority of India (IRDAI).

- E-Commerce Compliance by an Insurance Company:
  a) The insurance business must register as an e-Commerce company when dealing with internet insurance.
  b) The company must ensure that the website is according to the guidelines as per issued by the IRDAI.
  c) The company must ensure that the price of the products complies with the IRDAI.
  d) The Company must ensure that all policyholders are provided with information on the website.
- Insurance companies have to file the following reports:
  - o Quarterly Reports;
  - o Monthly reports;
  - o Annual Reports;
- An appointed actuary is an actuary appointed by a life insurance company, whose main role is to carry out a regular valuation of the reserves held to pay future policy benefits.
- The insurer is not allowed to carry out the insurance or reinsurance business without an Appointed Actuary. Any non-compliance in respect of the same would attract appropriate actions as per the relevant provisions of the Insurance Act of 1938.
- An Appointed Actuary shall enjoy absolute privilege to make any statement, oral or written for the purpose of the performance of his or her functions as Appointed Actuary. This is in addition to any other privilege conferred upon an Appointed Actuary under any other Regulations.
- Each insurance policy can be thought of as a risk-for-cash transaction. The variable cost of the insurance industry is thus represented by each realized claim, which is more challenging to calculate than the variable costs of other industries.
- A claims reserve is an account an insurance company establishes to pay future claims. When it settles a claim, it pays the policyholder from the claims reserve.
- The insurance company employs a group of specialists and product design analysts that have the experience and skills to anticipate future needs and build products.
- An actuarial valuation is an analysis performed by an actuary that compares the assets and liabilities of a pension plan.
- When reviewing the financial and economic condition of India Insurance market it stands at $131 Bn as of FY22. The Indian insurance industry grew at a CAGR of 17% over the last two decades and is expected to continue its commendable growth trajectory in the future years.
  1. Insurance Product Development Process
  2. Brainstorming
  3. Feasibility analysis
  4. Design
  5. Programming
  6. Integration
  7. Quality assurance and testing
  8. Release.

- Underwriting is the process insurers use to determine the risks of insuring your small business. It involves the insurance company determining whether your firm poses an acceptable risk and, if it does, calculating a fair price for your coverage.
- The process through which insurance companies evaluate insurance applicants is known as risk selection. For each distinct applicant for the insurance policy, this screening procedure is utilized to determine what the insurer should cover and what they should exclude.
- Risk Tolerance is **the willingness of an organization to incur risk to gain future reward**. In insurance, risk tolerance may be evidenced by a willingness of the insured to increase deductibles or self-insured retentions (SIRs).

TEST YOURSELF

(There are meant for recapitalation only. Answer to these questions are not to be submitted for evaluation.)

1. What are the top 6 ways of achieving optimal insurance pricing?
2. Discuss the concept of product pricing.
3. What is the Procedure for Appointment of an Appointed Actuary?
4. What are the IRDA Compliance for Insurance Companies?
5. Why is IRDA Compliance for Insurance Companies Required?
6. Who Regulates IRDA Compliance for Insurance Companies?
7. What is the Eligibility criteria- IRDA Compliance for Insurance Companies?
8. What is the Process / Procedure for IRDA Compliance for Insurance Companies?
9. Why is optimal insurance pricing important?
10. In order to anticipate how much cash they will need in claims reserves, insurers employ sophisticated techniques that rely on data and statistical computations. Explain.
11. While reviewing the product what should the company monitor?
12. When reviewing the financial and economic condition of India Insurance market it stands at $131 Bn as of FY22. The Indian insurance industry grew at a CAGR of 17% over the last two decades and is expected to continue its commendable growth trajectory in the future years. Discuss.

Functions in Insurance & Compliance Related Thereto: (Part – II)

Lesson 19

KEY CONCEPTS

■ Individual Agency ■ Web Aggregator ■ Corporate Agency ■ Insurance Brokers ■ Insurance Marketing ■ Underwriting ■ E-commerce ■ Commission ■ Grievance ■ Insurance Repositories

Learning Objectives

To understand:

- The Concept of Marketing & Distribution Channels of Insurance Products
- How the Individual Agency, Corporate Agency plays an important role in distribution channel of Insurance products?
- How Web Aggregator play an important role in distribution channel in insurance products?
- What are Remuneration & Rewards to Insurance Agents & Intermediaries?
- What are the other Insurance participants?
- What are the claims and customer services in Insurance?
- How the Grievance Management done in Insurance?

Lesson Outline

- Insurance Brokers
- POSP (Point of Sales Person)
- Web Aggregator
- Common Public Service Centres (CPSC)
- Motor Insurance Service Providers (MISPs)
- E-commerce Platform
- Remuneration & Rewards to Insurance Agents & Intermediaries
- Other Insurance Participants
- Claims & Customer Services
- Grievance Management
- Lesson Round-Up
- Test Yourself
- List of Further Readings
- List of Other References

MARKETING & DISTRIBUTION CHANNELS OF INSURANCE PRODUCTS

Insurance Distribution Channel-Introduction

In a business environment that is changing quickly, exploring insurance distribution channels has become more and more important for insurance firms. While the transition to digital has been a natural process for the majority of global companies in recent years, it has not been simple for the insurance sector.

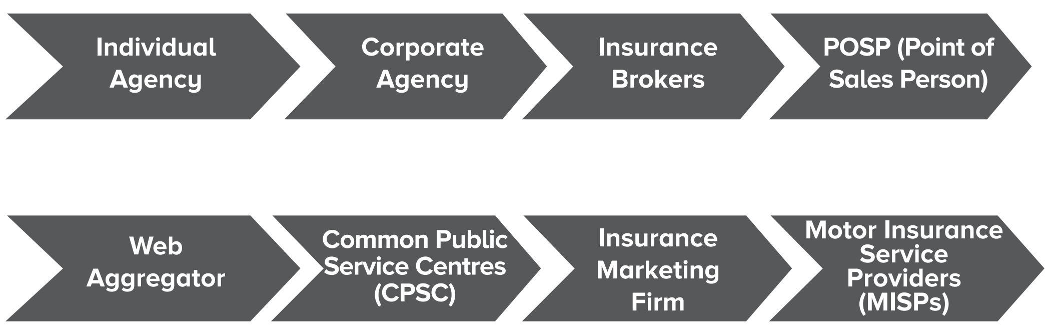
Insurance has always been sold by brokers and agents who know their clients well. It is a trusting relationship, particularly when it comes to life and health insurance. In terms of premium, more than 99% of life insurance plans are sold in-person or through intermediaries. Only the final 1% are sold via other methods, including web aggregators.

Delivering your goods or services to your target markets is known as distribution. All insurance firms must succeed through their distribution channels. They make sure that the insurers' goods and services are delivered in the most direct and economical way possible to their intended clients. There are numerous distribution channels on the market, each with a different positioning and strategy. The two types of distribution channels are as follows:

1. *Direct Channels:* Using these platforms, customers and insurers can communicate directly. With the direct channel, the insurer has complete control over how the product is marketed and sold.
2. *Indirect Channels:* There is no direct interaction between insurers and clients through indirect means. Affinity groups, peer-to-peer broker networks, aggregators, financial institutions, independent financial advisers, managing general agents, retail organisations are all included.

Depending on their goals, an insurance agency/company can explore different channels of distribution, both digital and offline.

INSURANCE PRODUCT DISTRIBUTION CHANNELS



INDIVIDUAL AGENCY

An individual agent represents an insurance firm and sells insurance policies to customers through the individual agency distribution channel for insurance products. The individual agent is self-employed and receives commissions from the insurance plans they sell.

At an independent agency, marketing mostly entails establishing and maintaining connections with potential clients. The insurance agent needs to establish oneself as a reliable and informed source of information. They might promote themselves by way of word-of-mouth, networking with friends and relatives, and involvement in neighbourhood events.

Also, the agent may advertise their services using a variety of marketing tools like brochures, flyers, and business cards. To reach a larger audience, they might use online advertising and social media.

The agent is in charge of selling insurance plans to clients in terms of distribution. They often visit with prospective clients to learn about their insurance needs and present them with options for plans that satisfy those needs. The representative will go over the features and advantages of the policy, address any queries the client may have, and assist the client in completing the application.

After the policy is sold, the agent is in charge of maintaining it and continuing to service the client. This can entail managing claims, responding to inquiries regarding the policy, and implementing any necessary policy adjustments.

Both independent and captive or exclusive agents fall under this category. Independent agents may work for a variety of insurance companies and earn commission as a result. On the other hand, there are captive agents that work solely for one particular insurance company and promote their products.

Seven Reasons to Choose an Independent Agent

1. **They give you a choice:** Independent agents represent a wide range of insurance providers with various levels of coverage and cost possibilities. Most typically represent five to eight different insurance providers. You don't have to accept a quote from a certain business, and you don't have to spend a lot of time completing numerous online forms to compare quotes. Agents may frequently find a better bargain for your insurance than you might find by looking on your own thanks to their contacts and market expertise.

2. **They are licensed experts:** Independents can provide straightforward explanations of the intricacies of insurance, assisting you in making deft choices. They make a living by determining the insurance needs of their clients and matching them with the insurer best able to cover those needs at a cost the client can pay.

3. **They are personal advisers:** Agents ensure sure you are appropriately covered in addition to finding you cheap prices. Your agent, who works with you face-to-face, transforms into your personal advisor and takes the time to pay attention to your needs.

4. **They are your advocate:** Your agent can act as your advocate when dealing with the insurance company if you have a billing or claim issue or need to adjust your coverage.

> *In summary, individual agencies are a marketing and distribution method for insurance goods that rely on close bonds and mutual trust between the agent and the client. The agent is in charge of selling and maintaining insurance policies, as well as marketing themselves and their services.*

5. **They are right around the corner:** Your neighbours are independent agents. They appreciate your interest in your neighbourhood and are aware of both its advantages and disadvantages. They frequently take an active role in the community by sponsoring young sports teams, supporting neighbourhood businesses, assisting educational institutions, and participating in monthly Chamber of Commerce meetings.

6. **They offer one-stop shopping:** With the carriers they work with, independent agents may frequently fulfil all of your insurance requirements for vehicle, house, renter's, and business coverage. Many also provide life and health insurance.

7. **They are consultants for a lifetime:** Periodically, independent agents examine your insurance. Whether you're changing from renting an apartment to buying a home, establishing a business, getting married, remodelling your home, adding a young driver to your auto policy, or looking to insure that retirement condo, they are there to support you through all the transitions in your life.

CORPORATE AGENCY

A Corporate Agency, like a bank or a retail establishment, is appointed by an insurance company to sell insurance policies on its behalf through the corporate agency distribution channel for insurance products. The corporation sells insurance products on behalf of the insurance provider and receives commissions for doing so.

Promoting insurance goods to the clientele of the corporate entity is marketing at a corporate agency. For the purpose of assisting the corporate entity in the sale of insurance policies, the insurance company may offer training and marketing assistance. By offering insurance policies as a package deal or cross-selling insurance to clients who buy other goods or services, the corporate entity can market insurance products by leveraging its current brand and customer base.

> *To sum up, corporate agency is a marketing and distribution channel for insurance goods that makes use of a corporate entity's client base and brand to sell insurance policies on the company's behalf. While the insurance business is in charge of servicing policies, answering customer questions about them, and dealing with claims, the corporate entity is in charge of marketing and selling insurance policies.*

The insurance firm may also use direct marketing strategies, such as delivering email or direct mail campaigns to the clientele of the corporate entity. In order to draw in new clients, they might also employ digital marketing strategies like search engine optimization or social media advertising.

The business body is in charge of selling insurance plans to its clients in terms of distribution. At the point of sale, such as a bank branch or the website of a retail business, they often present insurance plans in either a physical form or a digital format. The business entity may have a separate team for selling insurance or they may incorporate the sale of insurance plans within their current customer service duties.

After the policy is purchased, the insurance provider is in charge of maintaining it and giving the client ongoing support. The corporate entity may aid with customer support tasks like responding to general inquiries regarding the policy or assisting clients in filing a claim. Nonetheless, resolving questions and claims relating to policies ultimately falls under the purview of the insurance carrier.

INSURANCE BROKERS

Insurance brokers serve as a bridge between customers and insurance firms, serving as a distribution channel for insurance products. The best insurance policies to meet their demands are sought after by insurance brokers on behalf of their clients.

> *In summary, insurance brokers serve as a marketing and distribution channel for insurance products and serve as a liaison between customers and insurance providers. In order to find their clients the greatest insurance coverage, insurance brokers advertise themselves to potential customers. After the policy is sold, they continue to act as brokers, helping clients with issues relating to the policy and receiving commission payments from the insurance firms they work with.*

The marketing process for an insurance brokerage entails establishing and maintaining connections with potential customers. The broker needs to establish oneself as a reliable and knowledgeable source for information about insurance. They might promote their services through networking, word-of-mouth, and involvement in neighbourhood events. Additionally, they might advertise their services using a variety of marketing tactics like leaflets, brochures, and business cards.

To get the greatest coverage for their clients in terms of distribution, insurance brokers consult with a number of different insurance providers. They ask clients about their insurance requirements and preferences, then investigate the policies provided by various insurance providers to determine which one is the most appropriate. After that, the broker will show the client their options and assist them in choosing the one that best suits their needs.

After the policy is purchased, the insurance broker keeps serving as a go-between for the client and the insurance provider. The broker may explain the client's policy to them, respond to any inquiries they may have, and help with any problems that arise that are related to the insurance, such claims.

The majority of the time, the insurance firms that work with insurance brokers pay them a commission. As their payment is based on the cost of the policy sold, this remuneration structure encourages brokers to discover the best coverage for their clients.

Categories of Insurance Brokers[1]

There are five categories of Insurance Brokers which have been listed as follows:

1. Direct Broker (Life)
2. Direct Broker (General)
3. Direct Broker (Life & General)
4. Reinsurance Broker
5. Composite Broker.

Direct Broker

A registered insurance broker with India's Insurance Regulation and Development Authority (IRDA) is simply referred to as a direct broker. For soliciting and arranging insurance business for his clients with insurance located in India, the direct broker requests compensation or levies a fee. Additionally, he offers risk management services, claim consulting, and other services of a similar nature that are permitted by the IRDAI (Insurance Brokers) Rules, 2018.

What are the functions of Direct Brokers?

Following are the functions that an insurance broker needs to perform:

- To obtain details of client's business and risk management philosophy;
- To familiarize himself with client's business and underwrite information which can be explained to an insurer and others;
- To render advice on appropriate insurance claims and terms;
- To maintain detailed knowledge of available insurance markets, the ones who are applicable;
- To submit quotes received from insurers for consideration of a client;
- Provide requisite underwriting information required by an insurer in assessing risk to decide the pricing terms and conditions for cover;
- Act in a prompt manner on client's instructions and provide written acknowledgements and progress reports;
- To assist clients in paying premium u/s 64VB of Insurance Act, 1938;
- To assist in negotiation of claims;
- To maintain proper records of claims;
- To assist in opening of e-insurance accounts;
- To assist in issuing e-insurance policies;
- Any other function which the authority may specify.

Reinsurance Brokers

Reinsurance Brokers are included in the various subcategories of insurance brokers. A registered insurance broker with India's Insurance Regulation and Development Authority (IRDAI) is a reinsurance broker. For soliciting and arranging re-insurance business for his clients with insurers or reinsurers with reinsurers who are located either in India or overseas, the reinsurance broker requests compensation or levies a fee. Additionally, he offers risk management services, claim consulting, and other services of a similar nature that are permitted by the IRDAI (Insurance Brokers) Rules, 2018.

[1] https://irdai.gov.in/requirements-for-license-as-a-broker

What are the functions of Reinsurance Brokers?

Following are the functions that a Reinsurance broker needs to perform:

- The reinsurance broker must be familiarized with the client's business and its risk retention philosophy;
- Maintain proper records of the insurer's business so that the same can be used to assist the reinsurer(s) or other;
- To render advice based on technical data on the reinsurance covers which is available in the international markets of insurance and reinsurance;
- To maintain a database of available reinsurance markets which includes solvency ratings of the individual reinsurers;
- To render risk management services for the purpose of reinsurance;
- Select or recommend a reinsurer or a group of reinsurers;
- To negotiate with a reinsurer on behalf of client;
- To assist in case of commutation of reinsurance contract placed by them;
- Act in a prompt manner on client's instructions and provide written acknowledgements and progress reports;
- Collect and remit premiums and claims/refunds within the time as agreed upon;
- Maintain proper records of claims;
- Assisting in negotiations and settlement of claims;
- To exercise diligence and due care at the time of selecting reinsurers and international insurance; brokers with regard to their respective security rating and establish respective responsibilities at the time of engaging their services;
- To create market capacity and facility for stresses, new and existing businesses and asset class for and from both direct insurers and reinsurers;
- Rendering preliminary loss advice within a reasonable period of time;
- Separate norms have to be followed for both Inward and Outward business based on the nature of business.

A. Inward business

1. The broker needs to have specific knowledge of the country whose business is being offered in terms of political stability, tax laws, local regulations, economic position etc.
2. Introducing new business/ products on the basis of reinsurers' business plan and risk appetite.

B. Outward business

1. Market credibility and rating of the insurer:
    - Ensuring prompt collection and remittance of funds, following up for funds before the due dates for settlement from cedant to reinsurer and from reinsurer to cedant.
    - To comply with the relevant laws and other requirements of local jurisdiction at the time of arranging insurance/ reinsurance for clients/ insurance companies that based outside India.
    - Any other function which the authority may specify.

Composite *Broker*[2]

An insurance broker who has registered with India's Insurance Regulation and Development Authority is simply referred to as a composite broker. For soliciting and arranging insurance and/or reinsurance business on behalf of his clients with insurers and/or reinsurers based in India and/or overseas, the composite broker requests compensation or levies a fee. Additionally, he offers risk management services, claim consulting, and other services of a similar nature that are permitted by the IRDAI (Insurance Brokers) Rules, 2018.

What are the functions of Composite Brokers?

Following are the functions that a composite broker needs to perform:

1. All the functions performed by both the direct brokers and reinsurance brokers;
2. Where a composite broker has been appointed by the client to act as a direct insurance broker, then he shall not influence the concerned insurer to appoint him as reinsurance broker for arranging reinsurance on the same contract. However, if the insurer follows a due and transparent process, then he can appoint the composite broker as a reinsurance broker for arranging the reinsurance on the same risk on which the composite broker acted as a direct broker. In order to ensure that the interests of the clients and insurers are not harmed, the composite will see to it that proper systems and controls are in place.

How someone can registered as a Broker?

Eligibility Criteria: The Government has prescribed minimum requirements for securing an Insurance broker license as mentioned below. Apart from this, the broker has to ensure to get registered with the IRDAI where in applicant is required to register in the portal and username and password would be generated by the system and sent to the user in the registered email id. Subsequently, an application can be submitted online by accessing the website www.irdabap.org.in. The application for new broker's registration shall be accepted only through on-line mode.

Corporate Structure: The following can be registered under the Insurance Broker License:

- Company that is established under the Companies Act 2013 or the previous Company Law 1956;
- A partnership that is registered under the Limited Liability Partnership Act, 2008;
- A cooperative society which is registered under the Co-operative society act 1912; and
- Any other individual or company that is allowed to conduct the business related to an Insurance Broker.

Capital Requirements: *The applicant must satisfy the capital requirements for applying for a Broker's License:*

- Direct Broker- 75 Lakhs.
- Re-insurance Broker- 4 Crore.
- Composite Broker-5 Crore.

Net Worth Requirements: Explanation: For the purposes of these regulations, "net worth" shall have the meaning assigned to it in the Companies Act, 2013 and as amended from to time 50 Lakhs/200 Lakhs/250 Lakhs for Direct/Reinsurance/Composite Brokers.

- The net-worth of an Insurance Broker shall at no time during the period of certificate of registration fall below:
  - o 50 Lakh Rupees for a Direct Broker;
  - o 50% of the minimum capital requirements or contribution or equivalent specified under Regulation 19(1) for reinsurance / composite broker.

[2]ibid

- In case of non-compliance of sub-regulation (1) above, the Insurance Broker shall immediately restore the net worth to the limits given in (1) above and report compliance of the same.
- The Insurance Broker shall submit to the Authority a net worth certificate duly certified by an Auditor every half-year.

Net worth requirement after Registration

Deposit Requirements: Every insurer (applicant) before the commencement of the insurance broker business must ensure that the deposit has been maintained with the scheduled bank. The sum which has to be deposited is as follows:

- 10 Lakh Rupees for a Direct Broker; and
- 10% of the minimum capital/ contribution is required for re-insurance / composite broker. Fixed deposit shall not be released to them without the prior written permission of the Authority.

Office Space/ Facilities: The applicant applying for an Insurance Broker License must also satisfy necessary infrastructure such as adequate office space, equipment, trained manpower, and IT infrastructure to effectively discharge its activities.

Qualification:

- The applicant must ensure that at least two qualified persons are present who have the necessary training to function as insurance brokers. This is required to conduct the business of the insurance broker. If the applicant is carrying out insurance broker business related to life insurance and general insurance, then the applicant has to make sure that the two qualified individuals have relevant and necessary qualifications in both life and general insurance.
- The principal officer of the business must also have requisite qualifications. He must possess the necessary certificate and skills for carrying out the insurance broker business.
- Principal Officer must be a key management executive of the company, whole-time director, partner, or office, which requisite experience.

Purpose of the Business:

- The applicant should ensure that the main objects of the business is insurance brokering. These must be mentioned in the objects clause of the Articles of Association (AOA) and the Memorandum of Association (MOA).
- Foreign investors are also allowed to invest in an insurance brokers business.

Professional Indemnity Insurance:

- Every insurance broker shall take out and maintain at all times a professional indemnity insurance cover throughout the validity of the period of the Certificate of Registration issued to them by the Authority, as specified in Schedule II – Form S of the IRDAI (Insurance Brokers) regulations.
- Provided that the Authority shall in appropriate cases allow a newly registered insurance broker to produce such a policy within twelve months from the date of issue of certificate of registration.

Procedure for Applying for an Insurance Broker License

Application for Grant of Certificate of Registration:

- The applicant should make an application regarding the type of insurance broker business.
- The application for an Insurance Broker License must be made in FORM B- Schedule I of the IRDAI (Insurance Brokers) regulations.
- The application must be submitted with documents mentioned in FORM-C Schedule I of the IRDAI (Insurance Brokers) regulations.

- For granting the certificate of registration, an application must be submitted along with the fees specified in FORM D- Schedule I of the IRDAI (Insurance Brokers) Regulations. The fees that has to be paid for application for an insurance broker is as follows:
  - Direct broker Rs.25,000.
  - Re-insurance broker Rs.50,000.
  - Composite broker Rs.75,000.
- Apart from this, there are mandatory fees that has to be paid for the registration requirements:
  - Direct Broker- Rs. 50,000/- after granting of an in-principal approval where the application is new. In case of renewal of registration, the fees will be Rs 1,00,000/- for a period of 3 years.
  - Re-insurance Broker- Rs. 1,50,000/- after granting of an in-principal approval where the application is new. If there is a renewal of registration, then the fee to be paid for renewal is Rs. 3,00,000/- for 3 years.
  - Composite Broker- Rs.2,50,000/- after granting of an in-principal approval where the application is new. If there is a renewal of registration, then the fee to be paid for renewal is Rs. 5,00,000/- for 3 years.
- The fee payable as the mandatory fee would be for the validity period of the certificate of registration.
- Fees must be paid through electronic means or Demand Draft (DD) payable in favor of the Insurance Regulatory and Development Authority of India, Hyderabad.

Clarification/ Further Information

- The applicant can be asked to furnish further information by the authority.
- If required, the applicant has to submit these documents within 30 days from receiving the intimation from the authority.

Procedure for Issuing Insurance Broker License (registration)

- If the authority feels that all the requisite information complies with the Insurance broker license, then an in-principal approval would be provided to the applicant for complying with the requirements related to the certificate of registration.
- The authority will grant the certificate if the applicant has complied with the laws and regulations.
- The certificate of registration as an Insurance Broker License would be given to the applicant when the applicant satisfies that the code of conduct would be adhered to.
- The broker applying for a certificate of registration can also apply for any other registrations under the IRDAI. Such other registration would only be granted to the applicant after issuing the certificate of registration for the first instance.
- An applicant can make a new application if the certificate of registration has been canceled/ repealed due to a change in law or held by a Securities Appellate Tribunal or any court of law. An application under this can only be made after one year to the concerned authority.

Rejection

- An application for starting an insurance business can be rejected if the authority feels that the applicant has not fulfilled the necessary requirements.
- The authority must communicate the refusal to grant the application for an Insurance broker license within 30 days of communication of the rejection.
- An applicant can make a new application after one year of rejection of the application.

Conditions for Granting the Insurance Broker License

The IRDAI makes certain conditions before granting the insurance brokers license:

- The insurance broker must conduct the business according to the rules of the IRDAI.
- If the insurance broker business has provided false or misleading information regarding the particulars of the business, then the same must be intimated to the authority.
- Insurance broker business must handle all grievance procedures of clients within 14 days of receiving the complaint. The business must keep information regarding the number of complaints received from customers.
- Insurance brokers must reasonably conduct their business under the rules laid down by the IRDAI.
- The insurance broker must maintain books of accounts.
- Insurance broker should not conduct multi-level marketing or solicitation.

Documents required for Insurance Broker License

- Submission of relevant information as required in the Schedule I – Form B.
- Copy of the Memorandum of Association and Articles of Association should be according to the requirements of the Companies Act 2013.
- Remittance of the Fee for the particular category of Insurance broker license.
- Training for the employees starting an insurance broker business.
- Schedule-I Form F should have the relevant data of the principal officer.
- Fit and Proper certification, which is required as per Schedule-I Form G.
- Declaration submitted by a key management executive, principal officer, director of the company that they are not having any form of disqualification under the Act.
- Details of Directors/ Partners, Promoter and Key Management Personnel are to be provided in the Form.

> *Example: Nima is seeking a new homeowner's insurance plan. Henrietta, her insurance broker, begins the procedure by inquiring about Nima's residence. She is curious about the house's size, building date, and a host of other information. With the aid of these facts, she will find Nima the greatest insurance option.*
>
> *Nima has a lot of expensive possessions within her small but nonetheless very spacious home. Nima is an art collector who owns valuable, rare works that total approximately $100,000. Not all home insurance companies are ready to cover such risks, at least not without charging exorbitant prices. Henrietta requests the appraisal records for the artwork from Nima. With the help of such papers, she will look for an insurance provider ready to cover the cost of insuring Nima's home and art collection.*

- Schedule I- Form F- List of qualified persons responsible for managing and procuring brokerage business along with their qualifications.
- Details of statutory auditors and Principal Bankers along with the Bank Account Number of the applicant. Details of infrastructure, including IT infrastructure along with supporting evidence thereof like ownership or lease agreement evidencing that sufficient space is present for managing the brokering business.

Validity for Certificate of Registration for Insurance Brokers License

- A certificate granted by the IRDAI would be valid for three years from the date of issue. This would be subject to the order from the authority.

- An insurance broker would not be permitted to do the Insurance Broker business without possessing a proper certificate and registered with the authority.

Insurance Broker License Renewal

- Applications for renewing an insurance broker license must be made to the relevant authority 30 days before the expiry of the license. The application must be made in FORM K of Schedule –I of the regulations.
- If an application is made after the expiry of the above period, but before the actual expiry of the certificate, then a payment of Rs. 100/- must be made with the application.
- If there is a delay in making an application for renewal of registration, then the same must be made by the applicant. If this is within 60 days of the expiry of the certificate of registration, the applicant would have to pay Rs. 750/-.
- Any application which is received after the expiry of the 60 days would be considered only after 1 year. In the one year, the insurer must not conduct any business or solicit any form of business.
- An Insurance broker cannot apply for renewal after 90 from the expiry of the certificate.
- Insurance brokers cannot business of brokering after the expiry of the certificate except serve existing policyholders.
- The application for renewal of certificate for broker insurance would be the same as the new application.
- If the application or renewal is rejected, the same has to be notified to the applicant.

POSP (POINT OF SALES PERSON)

A POSP, or Point of Sales Person, is someone who is allowed to sell insurance policies on behalf of an insurance company. These people might be independent contractors or retail agents. POSPs are paid through a commission-based payment structure and are qualified to market particular insurance products.

With POSP, marketing mostly entails establishing a personal connection with potential clients. POSPs can promote themselves by taking use of personal recommendations, via social media, or by taking part in neighbourhood events. Additionally, they might advertise their services using a variety of marketing tactics like leaflets, brochures, and business cards.

To sell their insurance plans, POSPs collaborate with a certain insurance provider in terms of distribution. The POSP is in charge of outlining the features and advantages of the policy to the client, assisting them in submitting the application, and obtaining the premium payment. At the point of sale, such as a retail location or an online platform, POSPs may offer insurance plans in either physical or digital form.

In conclusion, POSP is a channel for marketing and distributing insurance goods that depends on close bonds and mutual trust between the POSP and the client. On behalf of an insurance business, POSPs promote themselves and sell insurance coverage. The insurance company is ultimately in charge of maintaining the policy and dealing with any concerns pertaining to the policy; nevertheless, they are reimbursed through a commission-based payment structure and may offer assistance with basic policy-related questions.

After the policy is sold, the POSP may offer assistance with straightforward policy-related issues, like responding to inquiries regarding the policy. Nonetheless, the insurance provider is ultimately in charge of maintaining the contract and dealing with contract-related problems like claims.

POSPs are paid through a commission-based payment structure, whereby they receive a portion of the premium that the client has already paid. This pay system encourages POSPs to sell policies and uphold a high standard of customer service.

- **The "Point of Sales Person" can sell Life Insurance Products filed with and approved by the Authority, which may be**
  - o Pure Term Insurance product with or without return of premium.
  - o Non-linked (Non-Participating) Endowment product.
  - o Immediate Annuity Product.
  - o Any other product / product category, if permitted by the Authority.
- **The "Point of Sales Person-Non Life" can sell only the following pre-underwritten product.**
  - o Motor Comprehensive Insurance Package Policy for Two-wheeler, Private Car and Commercial Vehicles.
  - o Third party liability (Act only) Policy for Two-wheeler, Private Car and Commercial Vehicles.
  - o Indemnity Health Insurance (Sum Insured upto Rs. 5 lacs).
  - o Personal Accident Policy.
  - o Travel Insurance Policy.
  - o Home Insurance Policy.
  - o Any other Policy specifically approved by the Authority.

WEB AGGREGATOR

Web Aggregators are online resources that give users a simple method to compare insurance plans offered by different insurance providers. They assist clients in locating the greatest insurance plan for their requirements and price range. Because of its usability and simplicity, web aggregators are a marketing and distribution platform for insurance products that have grown in popularity in recent years.

With numerous digital marketing channels, including search engine optimization, social media advertising, and email marketing, online aggregators can attract new users to their platform. To assist users in locating the best coverage for their needs, the web aggregator may offer features like online insurance calculators, comparison tools, and quote generators.

Web aggregators do not directly offer insurance plans in terms of distribution. Instead, they serve as a middleman between clients and insurance providers. A customer is routed to the insurance company's website to finalise the transaction after choosing a policy on the web aggregator platform. The insurance provider is in charge of maintaining the contract and resolving any contract-related difficulties.

By commission payments from the insurance firms whose policies are advertised on the site, web aggregators make money. The commission is normally paid as a percentage of the premium that the customer paid for the sold insurance policy.

- Insurance Web Aggregator is an insurance intermediary who maintains a website for providing interface to the insurance prospects for price comparison and information of products of different insurers and other related matters.
- IRDAI (Insurance Web Aggregators) Regulations, 2017 notified by the Authority with effect from 13th April 2017 is the regulations to supervise and monitor Web Aggregators.

In conclusion, web aggregators are a marketing and distribution platform for insurance products that give clients a simple way to evaluate insurance plans from different insurance providers. Online aggregators provide customers with resources like comparison tools and quotation generators while selling their platform through various digital marketing channels. They serve as a middleman between clients and insurance providers rather than directly selling policies. By commissions received from insurance firms whose policies are posted on the marketplace, they make money.

- A no objection certificate is a document that the Authority, upon request from the Insurance Online Aggregator applicant, issues. The Insurance Web Aggregator can utilise this certificate to register the proposed Web Aggregator firm name with the Registrar of Companies (RoC). The Insurance Web Aggregator applicant must submit the following basic documents together with the authorization for NOC.
  - o Address verification,
  - o Pan Card, and
  - o Name(s) of the proposed directors.
- The applicant must complete the steps below in order to obtain a CoR (Certificate of Registration):
  - o To serve as an insurance web aggregator and to become acquainted with the 2017 IRDAI (Insurance Online Aggregators) Rules.
  - o To send the Authority the application in Form A.
  - o Send the ten thousand rupee non-refundable application fee to IRDAI using a demand draught drawn in Hyderabad in favour of "Insurance Regulatory and Development Authority of India" or via an authorised electronic fund transfer.
  - o As instructed in form B and the rules, submit all required documents and declarations.
- An application, submitted by the Applicant that is not complete in all respects and/or not conforming to the instructions specified in application form and/or not complying with the requirements and/or directions of the Authority, may be rejected. Provided that, before rejecting any such application, the Applicant shall be given a reasonable opportunity to complete the application in all respects and rectify the errors, if any.
- The minimum paid up capital for Insurance Web Aggregator is Rupees Twenty-Five Lakh.
- The net-worth of an Insurance Web Aggregator shall at no time during the period of certificate fall below 100% of the minimum capital requirements.
- FDI is allowed in Insurance Web Aggregation business, the aggregate holdings of equity shares or contribution of the Insurance Web Aggregator by foreign investors, including portfolio investors, shall not exceed fortynine per cent of paid-up equity capital of Insurance Web Aggregator at any time or such foreign investment limit as prescribed by the Central Government.

Name of few Insurance Web Aggregator

1. Covernest Insurance Web Aggregator Private Limited
2. Ramakumaaran Digital Insurance web aggregator LLP
3. Online policy house insurance Web Aggregator Private Limited
4. Securesmarter Insurance Web Aggregator Private Limited
5. Guide2Protect Insurance Web Aggregator Private Limited
6. Check Your Premium Insurance Web Aggregator Private Limited
7. InstantCover Insurance Web Aggregator Private Limited
8. Vivaan Insurance Web Aggregator Private Limited

COMMON PUBLIC SERVICE CENTRES (CPSC)

The Government established Common Public Service Centers (CPSCs) as physical locations where a variety of services, including insurance products, are provided to the public. Those who live in remote or underserved areas can acquire insurance goods more easily thanks to CPSCs, which serve as a marketing and distribution channel for insurance products.

Marketing in CPSCs entails informing prospective clients of the benefits and availability of insurance policies. The government may advertise the availability of insurance products through CPSCs using a variety of media, including print, radio, and television. To ensure that they are prepared to inform and help potential consumers with their insurance needs, they may also train the personnel at CPSCs.

Insurance firms collaborate with CPSCs to distribute their insurance products to customers. Customers can learn about the various insurance options offered and purchase policies in person at CPSC locations. Depending on the policy, customers can also be able to submit insurance claims at CPSCs.

Commission fees from the insurance companies whose policies are marketed through their service centres are how CPSCs make money. The commission is normally paid as a percentage of the premium that the customer paid for the sold insurance policy.

The main objective of IRDA of India is to regulate insurance related services offered by CPSC-SPV that are incorporated by Central & State Governments.

The Insurance Regulatory and Development Authority of India (Insurance Services by Common Public Service Centres) Regulations, 2019, may be used to refer to these regulations. These regulations will replace the Insurance Regulatory and Development Authority of India (Insurance Services by Common Service Centres) Regulations, 2015. On the day they are published in the Official Gazette, these Regulations will take effect.

Definations :

Act: "Act" refers to the Insurance Act of 1938 (Act No. 4 of 1938), as revised from time to time.

The Insurance Regulatory and Development Authority of India, constituted in accordance with Section 3 of the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999), is referred to as the "Authority" in this context. For the purposes of these Regulations, "CPSC" (Common Public Service Centre) refers to the "Common Service Centre" established under the Government of India's Digital India Programme and implemented by M/s CSC e-Governance Services India Limited, as well as comparable centres established by the Special Purpose Vehicle of the relevant State Governments.

"CPSC-SPV" refers to the following entities: i) M/s CSC e-Governance Services India Limited, the Special Purpose Vehicle (SPV) established by the Government of India for carrying out the CSC scheme; ii) the Special Purpose Vehicle of the relevant State Government incorporated to facilitate delivery of government, private, and social sector services to citizens of India through the Common Service Centres (CSCs) network or its equivalent, and who for compensation

Any organisation authorised by the Authority to hold exams for the Principal Officer and **Rural Authorised Persons** (RAPs) of the CPSC-SPV is referred to as a "Examination Agency"; this includes the **National Institute of Electronics and Information Technology** (NIELIT), an independent scientific society run by the Department of Electronics and Information Technology of the Government of India.

A person employed by CPSC-SPV and chosen by it to serve as the Principal Officer of CPSC-SPV is referred to as the "Principal Officer of CPSC-SPV".

An individual **Village Level Entrepreneur** (VLE) who has successfully completed training, an examination, and certification by the examination agency, as stipulated in Part IV of Schedule I, is referred to as a "**Rural Authorised Person**" (RAP).

For the purposes of these Regulations, "solicitation" refers to the approach made to a prospect by a RAP or VLE-Ins with the intention of enabling the prospect to purchase an insurance policy, including offering support should the prospect elect to do so.

A "**Village Level Entrepreneur**" (VLE) is a person who has registered with and been granted permission by the CPSC-SPV to run the Common Public Service Centre and is in charge of managing the CPSC's day-to-day activities.

Application for grant of Certificate of Registration:

The CPSC-SPV applicant who wishes to become a registered insurance intermediary must fulfil the steps outlined below: -

(a) Submit an application in the Form - A as outlined in these Regulations to the Authority.

(b) Include $10,000 in non-refundable application fees with your request for registration approval.

(c) Submit all the required paperwork listed on Application Form A along with a letter from the principal officer attesting that you meet the fit and appropriate requirements listed in Schedule-I (Part-I).

The Authority may reject an application if it is not entirely complete, does not follow the instructions on the application form, does not adhere to its requirements, or does not follow its instructions. If the CPSC-SPV considers all relevant factors before denying any such application.

Grant of Registration to the CPSC-SPV:

The Authority will award a registration in Form B and notify the CPSC-SPV of it after it is satisfied that the applicant satisfies all requirements for registration grant.

The registration will only be granted if the CPSC-SPV abides by the terms and codes of conduct listed in Schedule-IV.

The CSC-SPV must apply for registration renewal in accordance with Regulation 6 below once the registration granted to it under the Insurance Regulatory and Development Authority of India (Insurance Services by Common Service Centres) Regulations, 2015 expires.

Period of Validity of Registration of the CPSC-SPV:

The registration granted in accordance with these Regulations shall be valid for three years following the date of issuance. After the registration expires, the CPSC-SPV cannot continue to operate in that capacity unless the Authority renews the registration. The policyholders will be taken care of by the appropriate insurers in the event that the CPSC-SPV's registration is not renewed, suspended, or cancelled.

Procedure for the Renewal of Registration of CPSC-SPV:

At least thirty days before the registration expires, CPSC-SPV must submit the Authority with Form - A the application for renewal of registration. However, the CPSC-SPV is allowed to submit a renewal application 90 days prior to the registration's expiration.

The renewal Application Form - A specifies the materials that must be submitted by the CPSC-SPV with the application form.

The renewal charge for registration is merely two thousand rupees, and it must be given with the renewal application. With the caveat that the applicant must pay the Authority an additional cost of Rs. 100 only if the application for renewal of the registration is submitted to the Authority outside of the time frame specified above. Furthermore, the Authority may accept a renewal application received beyond the date the registration expires provided the applicant provides the Authority with adequate justification in writing, in exchange for the CPSC-SPV paying an additional price of 750 rupees only.

The Authority may request from the CPSC-SPV any additional information or documentation that it deems necessary for processing the renewal application.

Issue of a duplicate certificate of registration

In the event that a certificate of registration is misplaced, destroyed, or damaged, CPSC-SPV is required to submit an application in the format specified in Form B1 to the Authority, along with a fee of Rs. 1,000, asking for the issuance of a duplicate certificate of registration and a declaration outlining all the circumstances surrounding the issuance of the certificate of registration and its misplacement, destruction, or damage. The Authority will issue a duplicate certificate of registration in the format specified in Form B2 with an annotation that it is a duplicate once it has determined that the original certificate of registration has been misplaced, destroyed, or damaged. However, if the misplaced certificate is found, it must be turned over to the Authority.

INSURANCE MARKETING FIRM

Insurance Marketing firm is an organisation that has been authorised by the Authority to solicit or procure insurance products as specified in regulation 3(a) of the Insurance Regulatory and Development Authority of India (Registration of Insurance Marketing Firm) Regulations, 2015, to carry out insurance service activities as specified in regulation 3(b) of these regulations, and to distribute other financial products as specified in regulation 3(c) of these regulations by employing individuals with licences.

A specialised marketing company that offers marketing services to insurance firms is known as an insurance marketing firm. A marketing and distribution channel for insurance products, insurance marketing businesses provide a range of services to aid insurance companies in promoting and selling their goods.

Creating marketing strategies and approaches that are uniquely suited to the insurance business is part of marketing at an insurance marketing agency. Market research, brand building, advertising campaigns, direct marketing, and digital marketing are a few examples of these tactics. The marketing strategy aims to raise brand recognition, provide leads, and ultimately boost revenue for the insurance provider.

To design and develop insurance products that are aimed at particular market categories, insurance marketing organisations may collaborate with insurance companies in terms of distribution. They might also provide insurance consumers with customer care and support, guiding them through the claims process and assisting them in understanding the benefits of their policies.

Insurance marketing companies make money using a variety of cost structures, including as commission payments, project-based fees, and retainer fees. The commission payment structure is based on a portion of the client premium for the sold insurance policy.

Functions and Responsibilities of Insurance Marketing Firm Department

IRDAI (Registration of Insurance Marketing Firm) Regulations, 2015 (IMF Regulations) were notified in the Gazette on 21.01.2015. The Authority launched an online portal on 26th May, 2015 for facilitating the applicants to submit their applications through portal. The basic functions of the department are as follows.

1. Issuance of No Objection Certificate for the proposed name of the IMF to enable the entity to get registered with Registrar of Companies (RoC).
2. Processing of the application in the IMF portal and issuance of registration.
3. Post registration activities such as, permission for change of shareholding, Principal Officer, address of IMF etc.
4. Organising meetings, workshops and other development activities, as may be necessary from time to time, for improvement of the channel.

An Insurance Marketing Firm provides the following categories of services:

1. **Procuring and Soliciting insurance policies**: Per the IRDA regulations, an Insurance Marketing Firm has permission to procure and solicit insurance services. There is virtually no limit to the number of insurers - insurance companies that it can engage with. As a marketing firm, the IMF can act as an intermediary, acting as a broker of insurance policies to act as a mediator between the insured and the insurer.

2. **Providing Insurance Services**: Insurance marketing firms have a unique power that allows them to establish strategic alliances with other insurance intermediaries such as surveyors and loss assessors, Insurance repositories, TPAs, and more. By doing so, the insurance IMF can provide a plethora of other services that some might consider are beyond its domain. other services that it provides are as follows:

   - Providing back-office assistance as per the IRDA IMF guidelines.
   - Acting as an approved person for Insurance repositories.
   - Providing surveying and loss assessment services by inducting surveyors and loss assessors in their company.
   - Providing other insurance-related services as per the directions of the IRDA.

3. **Marketing Financial Products:** Now this is where the marketing part of their services comes in. Being a marketing firm, IMF has the power to market the following financial products as per the directions of the IMF license:

   - Mutual Funds of SEBI-regulated companies;
   - Pension products under the regulations of PFRDA;
   - Other financial products under the regulations of SEBI-licensed investment advisors in India;
   - Banking/Financial products sold by the NBFC under the regulations of RBI;
   - Non-Insurance products provided by the Department of Posts, Government of India;
   - And Other financial products under the regulations of the Insurance Regulatory Development Authority of India.

What are the different benefits of the Insurance marketing firm?

One can categorize the benefits of an insurance marketing firm into the following:

- More services
- More clients
- Online market

Insurance marketing firm benefits:

1. **Access to multiple insurance services**: if you don't want to limit your services to only certain facilities, procuring an IMF license is the best choice for you.
2. **Wide variety of clientele:** Because the Insurance Marketing Firm Guidelines allow an insurance marketing firm to provide a plethora of insurance and financial services, you will get access to a wide variety of clientele.
3. **Access to an online market**: Because most people are more interested in getting insurance services online, IMF can make lucrative profits in the market.

   It is because of these benefits that becoming a top insurance marketing firm in India is not a difficult task - provided you follow all the guidelines carefully.

Eligibility Criteria to start an Insurance marketing firm in India

The applicant should be a registered business entity under the Ministry of Corporate Affairs. It means that the applicant should either be an LLP, an OPC, or a private limited company.

- The applicant organization should have a qualified principal officer.
- The applicant organization should have a qualified Financial Service Executive.
- The applicant organization should have an Insurance Sales Person.
- The applicant organization's net worth should be at least 5 lakh rupees to open a single branch of IMF. For multiple branches, the net worth should be at least 10 lakh rupees.
- The name of the applicant's organization name should include the term IMF or Insurance Marketing Firm.

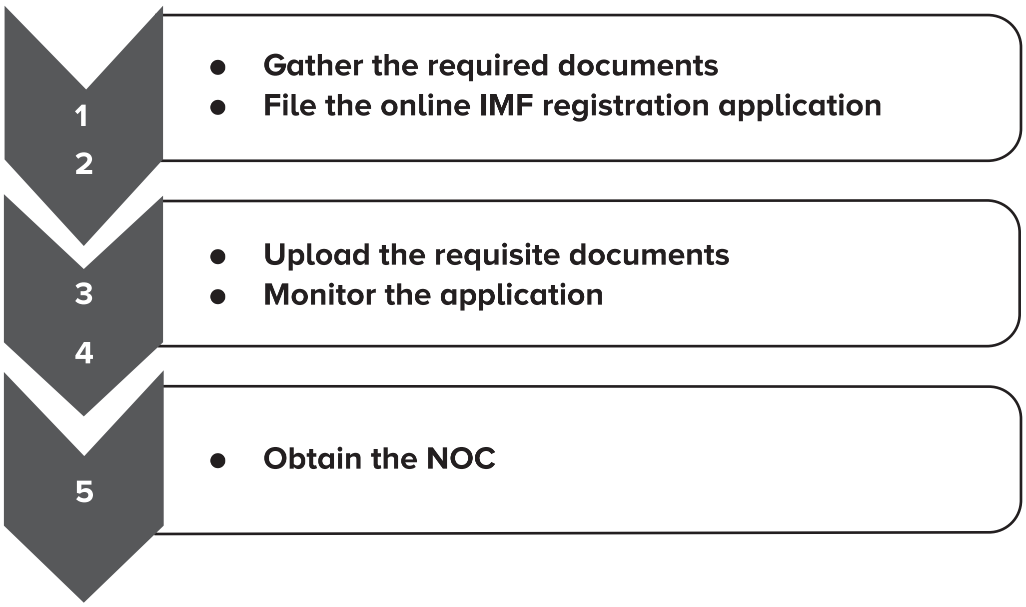
In order to prove that the applicant meets the aforementioned eligibility criteria, it is important to furnish the precise documents for the Insurance marketing firm license.

Documents required to start an Insurance Marketing Firm in India

- Certificate of incorporation: It proves that the applicant is a registered business entity.
- Memorandum of Association: The memorandum of association is the document stating the objective of the company - it has to be precise and should explicitly state that the company provides.
- Articles of Association: it specifies the rules and regulations that the company adheres to.
- LLP agreement of the applicant is an LLP: A critical document for the applicant who is applying as a Limited Liability partnership.
- Qualification and details of the principal officer: Provide the qualification details of the principal officer.
- Qualification and details of the Financial Service Executive(s): Every IMF that has hired an FSE, must provide their details.
- Qualification and details of the Insurance Sale Person(s): The Insurance sale Person must also have cleared the IRDA examination.
- Net worth certificate of the business entity: The net worth of the applicant must meet the requisite.
- Bank account statement: The bank account statement of the applicant entity must reflect the net worth.
- Three-year business plan: The applicant must have a three-year business plan to sustain the business.
- Details of the IMF infrastructure: Provide a complete organogram of the management infrastructure of the Insurance marketing firm.
- Undertaking by the principal officer: The principal officer must undertake that all the information he has provided is without any faults. That is the only way to procure the Insurance Marketing Firm license.
- Photographs of equipment and manpower: Provide photographic proof of all the manpower and equipment that you have.
- Consent letter from the insurance companies Consent letter from insurance companies that the applicant proposes to work with.

In regards to an insurance marketing firm, IRDA has put forth strict standards when it comes to documents. Therefore, you must ensure that all the documents that we have mentioned are precise and as per the rules and regulations of the department.

The process to register an Insurance Marketing firm in India



Explanation of these steps

First, you have to gather the required documents and get them certified by an appropriate signatory.

Fill out the application for Insurance Marketing Firm registration. The process can be conducted online via the official portal.

Uploading the requisite documents is required for submission. However, care must be taken to ensure that the quality of the uploaded attachments isn't bad.

Once your application has been submitted, you have to monitor it thoroughly to ensure that you can deal with any discrepancies that arise during the application's processing.

Get the certificate of registration.

MOTOR INSURANCE SERVICE PROVIDERS (MISPS)

In collaboration with insurance firms, institutions known as Motor Insurance Service Providers (MISPs) provide motor insurance products. A variety of services are provided by MISPs, a marketing and distribution channel for insurance goods, to assist clients in selecting and maintaining their auto insurance coverage.

Marketing in MISPs include informing prospective clients of the benefits and availability of automobile insurance packages. MISPs may advertise their automobile insurance products through a variety of media, including print, radio, and television. To assist customers in locating the best coverage for their needs, they might also provide online tools like insurance calculators, comparison tools, and quote generators.

To provide consumers motor insurance plans, MISPs collaborate with insurance providers in terms of distribution. Direct vehicle insurance policy purchases can be made by customers from MISPs through their physical locations or online. MISPs might also offer extra services like aid with claims and reminders for insurance renewals.

With commissions received from the insurance firms whose policies are marketed on their platform, MISPs make money. The commission is normally paid as a percentage of the premium that the customer paid for the sold insurance policy.

Ultimately, on 31st August 2017, the IRDAI notified the "Guidelines on Motor Insurance Service Providers" (MISP Guidelines) to identify and regulate the role of the automobile dealers in distributing and servicing motor insurance products.

The key features of the MISP Guidelines are as follows:

- An automobile dealer designated by the insurer or an insurance intermediary to distribute and/or service motor insurance policies on vehicles sold via that dealer is referred to as a "motor insurance service provider" (MISP). As a result, a MISP is limited to selling and supporting auto insurance plans. Receiving instructions from consumers for amendment, endorsement, modification, renewal, and cancellation of motor insurance policies, as well as guiding and assisting clients on insurance claims, has been classified as "servicing of insurance business."
- The term "automobile dealer" includes authorised dealers or sub-dealers of automobile manufacturers selling new or used automobile vehicles.
- When soliciting and maintaining insurance policies, the MISP must adhere to the Code of Conduct outlined in the MISP Guidelines. A "Designated Person" must be named by a MISP in order to guarantee compliance. All individuals requesting and obtaining insurance for the MISP, including the Designated Person, must have completed their 12th grade and be trained and certified by the insurer or insurance intermediary that is facilitating the MISP. It's noteworthy that a MISP and the insurer or insurance intermediary who hired the MISP share joint responsibility for the actions and inactions of the MISP, nevertheless.
- Insurers/insurance intermediaries that seek to enter into an arrangement with an MISP are required to enter into a written agreement with the MISP. Further, the Insurer/insurance intermediary engaging the MISP is required to upload the relevant data of the MISP on the Insurance Information Bureau portal.
- The MISP Guidelines prescribe the maximum Distribution Fees that can be paid to the MISP for soliciting insurance business by the Insurer or insurance intermediary engaging the MISP. Further, apart from the restrictions on the amount of Distribution Fee payable.
- The Insurer's cannot pay any remuneration or reward to an insurance agent or insurance intermediary on any policy which has been solicited by a MISP and in respect of which the MISP is being paid Distribution Fees.
- MISPs and their associate companies have been strictly prohibited from directly or indirectly receiving from Insurers any payment by whatever name called, other than the Distribution Fee permitted under the MISP Guidelines.
- A monthly audit of the compensation paid by an insurer to an insurance intermediary or a MISP is necessary to determine if it complies with the MISP Guidelines, and the report of the independent auditor must be presented to the insurer's audit committee. Insurers and insurance intermediaries must also set up procedures for constantly keeping an eye on all the MISPs they have hired.
- Any automobile dealers already having an insurance intermediary license/certificate are required to surrender their existing certificate of registration/license and necessarily become MISPs in compliance with the terms of the MISP Guidelines.
- The IRDAI's decision to acknowledge the involvement of car dealers through the MISP Guidelines legitimises the current practises of enlisting car dealers in the solicitation and servicing of motor insurance. It's interesting to note that the MISP Guidelines allow both insurers and insurance intermediaries to work with MISPs, thus if insurers decide to work directly with MISPs, their use of other insurance intermediaries may be minimised when seeking and obtaining motor insurance products. The other existing structures and practises relating to auto dealers will also need to be eliminated with the implementation of the POSP Guidelines, the MISP Guidelines, and the legitimization of insurance distribution through auto dealers.

E-COMMERCE PLATFORM

A digital platform known as an e-commerce platform allows clients to buy insurance products online. The ability to compare, buy, and manage insurance policies from the comfort of one's home or workplace is made possible by e-commerce platforms.

The promotion of insurance products to potential clients through various digital channels, such as search engines, social media, email marketing, and online advertising, is known as marketing on e-commerce platforms. In order to comprehend customer preferences and behaviour and to tailor the buying experience for each customer, e-commerce platforms also use data analytics.

E-commerce platforms directly sell insurance products to customers through their online portals in terms of distribution. Consumers can look through various insurance options, evaluate features and costs, and purchase plans that suit their requirements. A variety of insurance products, such as life insurance, health insurance, auto insurance, and travel insurance, are frequently offered through e-commerce platforms in collaboration with insurance providers.

By commission payments from the insurance firms whose policies are sold on their platform, e-commerce platforms make money. The commission is normally paid as a percentage of the premium that the customer paid for the sold insurance policy.

One benefit of e-commerce platforms is that they make it simple and quick for customers to buy insurance goods without having to go see an insurance agent or broker. However, customers could not receive the assistance and direction that a broker or agent can offer, especially in the case of complicated insurance products or specialised insurance solutions.

How much does e-commerce insurance cost?

The cost of your business insurance will depend on a variety of factors, such as:

- Number of policies you need.
- Extent of your coverage and your policy limits.
- Business location.
- Products or services you offer.
- Number of employees you have.
- Your business assets.
- Previous claims history.

Costs will often be higher for organisations with higher risks and those that require more insurance coverage. As a result, a home-based e-commerce firm with little foot traffic from customers will probably have considerably cheaper costs than an online company with many workers or one that does business through a separate warehouse.

How to get e-commerce business insurance

To get business insurance for your e-commerce store, you can follow these six steps:

1. **Evaluate your risks**. What kind of mishaps, dangers, catastrophes, or legal actions offer the most risk to your company? Is your online shop headquartered at home? Do you employ people? How do you get your merchandise to customers? Where do you store it? You can determine the risks your company faces by providing answers to questions like these.
2. **Decide which types of policies you need**. You can choose which e-commerce insurance plans will best cover your company based on the dangers you've identified. For the majority of online shops, general liability and product liability coverage can be useful places to start, but other policies, such cybersecurity insurance, professional liability insurance, and commercial property insurance, can also be helpful.

3. **Choose how to shop**. When selecting how to purchase for insurance for your e-commerce firm, you have a variety of possibilities. You can speak with insurance providers directly, negotiate with a broker, or shop online. The latter two methods, which can be considerably speedier and more hands-on than dealing with a broker, may be easier for online retailers to choose.

4. **Pick a provider**. NerdWallet recommends getting quotes from multiple insurance providers before making a decision. In order to choose the provider that's best for your business, you'll want to look at factors such as:

   - Policy coverage.
   - Liability limits.
   - Cost.
   - Provider reviews and complaints.
   - Customer service.

5. **Buy your policies.** You're prepared to get your e-commerce business insurance once you've decided which supplier best suits your needs. If accessible, you can set up your online account after purchasing your coverage, schedule monthly payments, and find out how to submit a claim.

6. **Keep your policies up to date.** Every year, you should update your e-commerce insurance. You can reassess your risks when your policies are up for renewal to see whether you need to modify or adapt your coverage. But, you can reconsider your insurance coverage at that time if your online store sees a significant shift before your policy is up for renewal, such as hiring your first employee.

CEILING OF COMMISSION

The maximum percentage of premium that an insurance company may allocate for commission payments to its intermediaries, including agents, brokers, web aggregators, and other channels of distribution, is referred to as the ceiling of commission. To prevent the insurance company's premiums from being disproportionately burdened with high commission costs, the cap on commission is intended to limit the amount of commission that intermediaries can earn on the sale of insurance products.

The maximum commission varies depending on the type of insurance policy, the type of intermediary, and the rules established by the Insurance Regulatory and Development Authority (IRDA). For life insurance, health insurance, auto insurance, and other types of insurance products, the IRDA might establish various commission ceilings. Similar to this, the maximum commission rate for agents, brokers, web aggregators, and other distribution channels.

The Insurance Regulatory and Development Authority of India (IRDAI) is proposing a 20% ceiling on the commissions given to insurance agents and requires insurers to have a board-approved policy on commissions, rewards, and remunerations paid to agents.

IRDAI has issued draft guidelines on the payment of commission and reward to insurance agents in which it has proposed to reduce first year commission of life insurance agents on regular premium paying policies from 35% of the net premium payment to 20% of the net premium payment including rewards.

However, the insurance regulator has proposed to increase renewal premium to 10% in the subsequent years instead of 7.5% in the second and third year and 5% in the subsequent years.

Another interesting move is introduction of longevity incentive i.e. additional commission will be given to life agents and intermediaries if their clients remain insured for 5, 10 and 15 years.

Here are other key highlights of the draft regulations:

- If the annual expense of management does not exceed 70% of the total allowable limits, the insurers can also offer commission in accordance with the board approval.

- Maximum commission in general and health policies will be 20% including rewards.
- In addition, life insurers can also pay additional commission of 2% of the total premiums paid each time at the end of 5th, 10th and 15th year.
- Commission on single premium life policies remains intact at 2%.
- For group fund policies i.e. annuity policies, the commission is capped at 0.5%.
- Just like direct plans in mutual funds, insurers can offer policies directly to costumer with discounts.
- Insurers will have to make a written policy for payment of commission or reward to insurance agents and get it approved by its board. The board has to review such policies annually.
- Insurers may offer additional rewards to agents and intermediaries based on their performance.
- Performance of insurance agents should be evaluated based on their contribution towards increasing insurance penetration and density, if they work in the interest of policyholders, if they comply with regulatory norms and commensurate with business strategy of the insurer, their efforts to bring down cost to conduct business and simplify systems and so on.
- This new commission structure, if implemented, will be applicable for a period of 3 years from the date of implementation.

Proposed commission structure on regular premium life policies like term, whole life, money back and endowment policies:

	Existing Commission Structure	*Existing Renewal Commission*	*Existing Reward*	*Proposed Commission structure including reward*	*Renewal Commision*	*Additional Incentive*
Regular Premium paying Life policies	35% of first year net premium	7.5% in 2nd & 3rd year & 5% in subsequent year	20% of first year commision	20% of first year net premium	10% of renewal premium	2% each in 5th,10th & 15th year

Proposed commission structure on non-life and health policies:

	Existing Commission Structure	*Reward*	*Proposed Commission structure including reward*
Non Life	15% of net premium	30% of total commission	20% of net premium
Health	15% of net premium	30% of total commission	20% of net premium

REMUNERATION & REWARDS TO INSURANCE AGENTS & INTERMEDIARIES

The regulation of commission or remuneration or rewards payable to insurance agents and insurance intermediaries had been relegated to the Insurance Regulatory and Development Authority of India (IRDAI) after the Insurance Laws Amendment Act, 2015. Pursuant to which, the Insurance Regulatory and Development Authority of India notified the exposure draft called the Insurance Regulatory & Development Authority of India (Payment of Commission/Remuneration/Reward to Insurance Agents & Insurance Intermediaries) Regulations, 2022 [Draft Regulations, 2022] on 23 August 2022, to provide more autonomy to insurance companies in regulating and providing commissions or remunerations to its insurance agents and intermediaries on the basis of a board policy which has been approved by the Board of Directors (BoDs) of the insurance company. These regulations aim to remove the strict restrictions imposed on such commissions or restrictions which are payable to insurance agents and insurance intermediaries under the Insurance Regulatory & Development Authority of India (Payment of Commission or Remuneration or Reward to Insurance Agents and Insurance Intermediaries) Regulations, 2016.

The objective of the Insurance Regulatory & Development Authority of India (Payment of Commission or Remuneration or Reward to Insurance Agents and Intermediaries) Regulations, 2022 is "to enhance responsiveness to market innovation, to facilitate the insurers in the development of new business models, products or items, strategies & internal processes & enable in easy compliance with the regulations while fulfilling the regulatory objectives; to provide the insurers the flexibility to manage their expenses based on their growth aspirations & the ever-changing insurance needs with an objective to improve insurance penetration".

The insurance intermediaries shall include corporate agents, web aggregators, insurance marketing firms, insurance brokers, common public service centers and other entities as may be specified by the IRDAI.

The Draft Regulations 2022 have merged the definitions of Commission and Remuneration into one to include "compensation paid by an insurer & received by an insurance agent/an insurance intermediary for securing and procuring an insurance policy".

The Draft Regulations, 2022 clearly state that the Insurance Regulatory and Development Authority of India (Payment of Commission or Remuneration or Reward to Insurance Agents and Insurance Intermediaries) Regulations, 2016 shall stand repealed from the date on which the Draft Regulations, 2022 come into force.

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Applicability of the Insurance Regulatory & Development Authority of India (Payment of Commission/ Remuneration/Reward to Insurance Agents and Insurance Intermediaries) Regulations, 2022

The Draft Regulations mention it would be applicable to insurance products except the ones mentioned under the Insurance Regulatory and Development Authority of India (Micro Insurance) Regulations, 2015 and other insurance products as similarly specified by IRDAI. Moreover, where the insurer procures the policy directly, the insurance agents or insurance intermediaries shall not be paid any commission or remuneration. The insurers are to provide the necessary discounts in the premium to such policyholders as maybe be provided in the board policy.

Board Approved Policy for Payment of Commission/Remuneration/Reward to Insurance Agents and Insurance Intermediaries

The insurer is mandated to have an "explicitly written policy" for payment of commission or remuneration, or rewards to its insurance agents and insurance intermediaries and the same must be approved by the Board of Directors of the company. This policy must be renewed annually.

The policy for Payment of Commission/Remuneration/Reward to Insurance Agents and Intermediaries shall be drafted in a manner to improve the performance of such agents and intermediaries. The policy should be such that it is in tune with the business strategy of the company and with the interests of the policyholders, brings cost efficiency to the administration and conduct of the insurance business and should increase insurance density and penetration in the country.

The draft Regulations also mandate that the policy should clearly mention:

- The conditions and manner of commission or remuneration or reward payable to the insurance agents and intermediaries.
- The manner and conditions of payment of renewal commissions to insurance agents after agency termination and in the event of the death of an insurance agent, a hereditary commission to the heirs of the deceased insurance agent.
- A schedule mentioning the maximum commission or remuneration or reward payable to the insurance agents and intermediaries as a percentage of premium under each business line.
- Conditions and manners of transfer of orphan policies.
- Manner and grounds of suspension, termination of insurance agents and insurance intermediaries and cancellation of appointments thereof.
- Restrictions, if any, on the products sold by the insurance agents and insurance intermediaries.

Commissions or Remuneration or Reward to Individual Insurance Agents and Insurance Intermediaries by Insurers

The Insurance Regulatory and Development Authority of India (Payment of Commission or Remuneration or Reward to Insurance Agents and Insurance Intermediaries) Regulations, 2022 have laid down certain parameters for the insurers while paying commission or remuneration or rewards to insurance agents and intermediaries. Insurers must follow the below-laid parameters while paying their agents:

- The Board policy shall be the basis of commission or remuneration, or reward payable by the insurer to the insurance agents and intermediaries.
- In cases of Life Insurance, including health insurance, offered by the insurer, the maximum commission or remuneration, or reward payable shall be as follows:
  - o Where the Expenses of Management do not exceed 70 % of the Expenses of Management limits allowable in the previous fiscal year, the insurer must follow the limits mentioned under Schedule-1 of the Draft Regulations, 2022 while deciding the maximum or following the policy approved by the Board.
  - o Where the Expenses of Management exceed 70 % of the Expenses of Management limits allowable in the previous fiscal year, then the insurer must follow the limits mentioned under Schedule-1 of the Draft Regulations, 2022 while deciding the maximum.

- In cases of General insurance, including health insurance which might be offered by such general insurers, the maximum commission or remuneration or reward payable must not exceed 20 % of the gross premium of the fiscal year, written in India.
- For health insurance which might be offered by such individual insurers, the maximum commission or remuneration, or reward payable must not exceed 20 % of the gross premium of the fiscal year, written in India.

Obligation on Insurers to Prepare Returns on Payment of Commission or Remuneration or Reward to the Insurance Agents and Insurance Intermediaries

According to the Insurance Regulatory and Development Authority of India (Payment of Commission or Remuneration or Reward to Insurance Agents and Insurance Intermediaries) Regulations, 2022, insurers must prepare and maintain returns on payments of commission or remuneration/reward to insurance agents and intermediaries within 45 days of the fiscal year's end and report those returns to IRDAI. Before submitting the returns for approval to the insurer's Board of Directors, an Audit Committee must evaluate and approve them.

OTHER INSURANCE PARTICIPANTS

Network Hospitals

The hospitals that are mentioned in the agreement while getting the insurance from the insurance company are called the network hospitals. These are the hospitals at which you can avail cashless health insurance service in case you get treatment which is subject to the terms and conditions associated with the policy.

The biggest benefit of availing treatment at a network hospital is that the insured does has to run to different places in order to make financial arrangements and all expenses are borne by the insurer.

A hospital that has an agreement with the insurance company and offers cashless treatment to the insured is known as a network hospital. If you undergo treatment at a network hospital, then the insurance company will directly settle the bills for you.

HCA Healthcare is the largest health system in the US with 175 affiliated hospitals.

What are Cashless Network Hospitals?

Each health insurance provider has contracts with a number of hospitals to offer cashless care to subscribers. These are referred to as network hospitals and are a crucial component of your medical insurance plan.

Your medical insurance provider will offer cashless coverage for hospital bills and expenses incurred before and after hospitalization, depending on the policy. This only functions if you receive care from a network hospital. It is crucial that you list the hospitals in your area that are part of the health insurance network.

How to Make Cashless Claims at Your Nearby Network Hospital?

The insured can make a cashless claim following a few easy steps:

1. Planned hospitalisation
   - Find the nearest network hospital from the list.
   - Download the pre-authorization form from the TPA's website. You can also find it in the network hospital's TPA counter.
   - Fill up the form and submit it to the insurer of your chosen network hospital.
   - You will receive approval with the coverage details.

- Present your health insurance card or your policy number on the day of hospitalisation. Submit your authorization form along with it.
- Make sure that you submit the form within the time period of validity.

2. Emergency treatment
   - Fill up and submit the pre-authorisation form within 24 hours of hospitalisation.
   - The insurance desk stationed at the hospital will send your form across.
   - The insurer will likely approve your claim within a few hours.
   - Ideally, you should wait for the TPA's approval. However, in case of urgency, you can pay the bills at that moment. Later, you can apply for reimbursement.

Documents Required for Making Claims at Network Hospitals

The various documents required to make claims during network hospital bill payments include:

- Duly filled and properly signed claim form
- Health card
- Medical certificates
- Valid ID proofs
- Hospital discharge summary
- All bills and receipts
- Test reports like blood tests
- In case of accident copy of an FIR

How do Network Hospitals Work?

1. A health insurance company checks the efficiency and expertise of medical services provided before collaborating with a hospital.
2. Following this, they prepare a network hospital list and provide it to the policyholders.
3. This list changes from time to time depending on the quality of service provided by these hospitals.
4. Individuals covered under cashless insurance will have to submit a form to the Third Party Administrator (TPA) before getting hospitalised.
5. In case of an emergency, the claim process can be started 24 hours after hospitalisation.
6. The insurance company will cover the expenses mentioned in the insurance policy. You will only have to pay for services that the policy does not cover.

Role of Network Hospitals While Seeking Health Insurance

When claiming health insurance benefits, network hospitals are important. It facilitates the procedure better. Also, it will ensure that the patient won't be overcharged by the hospital for the therapy and other medical costs. Additionally, network hospitals guarantee that the patient receives the highest level of comfort while they are hospitalised. When a patient chooses to receive treatment at one of the network hospitals, the billing and mediclaim processes are also made simpler.

THIRD PARTY SERVICE PROVIDERS (TPA)

Insurance companies use Third Party Administrators (TPAs) to handle health insurance claims on their behalf. TPAs serve as a middleman between the insurance carrier, the insured, and the healthcare facilities like hospitals and clinics.

Depending on the type of services rendered and the conditions of the contract between the TPA and the insurance company, the compensation and benefits for TPAs may change. TPAs typically get payment through a fee-for-service arrangement. This indicates that they are paid a certain amount for each claim they process on the insurance company's behalf.

In addition to the fee-for-service model, TPAs could also be paid extra money in the form of bonuses or incentives for achieving specific performance goals, like lowering claim processing times, lowering fraud and mistake rates, and raising customer satisfaction.

To enhance TPAs' performance and make sure they adhere to legal standards, insurance firms may also offer them training and support. This could entail granting access to specialised software platforms, educational initiatives, and regular performance reviews.

To sum up, Third Party Administrators (TPAs) are businesses that insurance companies contract to handle their health insurance claims. TPAs often get a fixed charge for each claim they process as part of a fee-for-service agreement that governs their compensation and benefits. Insurance companies may offer training and support to TPAs to enhance their performance and compliance. TPAs may also get bonuses or incentives for achieving performance goals.

Need for Third Party Administrators

TPAs can bring in the following changes:

- Greater efficiency/quality (delivery of services)
- Improved standardization (procedures and due diligence)
- Increase knowledge base of healthcare services
- New management system
- Greater penetration of health insurance
- Minimize costs/expenditure
- Develop protocols to streamline investigation and avoid unnecessary delays

Revenue model of Third Party Administrators

- There is a belief that the structure and method of generating revenue used by TPAs will determine how successful they are. The IRDA has established fees or commissions on premium as the primary source of income for TPA. The following are some of the TPAs' additional revenue sources:
- Benefit management
- Provider network management
- Data management
- Medical management
- Claim administration

What is the role of TPA in Health Insurance

The role of TPA in health insurance can be understood by the following points:

1. Link between insurance company and policyholder: In most of the hospitaliation claim cases, the policyholder directly or indirectly meets the TPA. The TPA provides the policyholder with Unique Identification Number and ID card which aids in claim settlement.

2. Record maintenance: TPA helps in maintaining crucial records related to policyholders when they are admitted as patients.

3. Claim settlement: TPA ensures smooth co-ordination between the hospital and insurance company during cashless claim settlement. The back-end support is offered by TPA in such cases.

4. Full-time support: Most of the TPAs have a 24x7 customer support system where the policyholders can raise their queries and get feedback.

5. Additional services: Most of the TPA also provide additional services like extra beds, ambulances, medical supplies, etc. to policyholders.

SURVEYORS AND LOSS ASSESSORS

Independent professionals known as surveyors and loss assessors are hired by insurance firms to look into and evaluate damages that policyholders have suffered. By offering an unbiased evaluation of the magnitude of the loss and the price of repairing or replacing the damaged property, they play a crucial role in the claims process.

A fee-for-service agreement normally governs the compensation and benefits for surveyors and loss assessors, who are paid a set amount for each claim they examine and evaluate. A fixed cost for each stage of the claims procedure, such as the initial assessment, damage verification, and final settlement, or a percentage of the overall claim amount may be used to determine the price.

Insurance firms may additionally provide incentives or awards to surveyors and loss assessors in addition to the fee-for-service model for achieving performance goals, such as lowering the time it takes to process claims, lowering errors and inconsistencies, and raising customer satisfaction. The insurance company's network of surveyors and loss assessors may be recognised and promoted in addition to receiving bonuses or other benefits for meeting or exceeding performance goals.

To help surveyors and loss assessors develop their technical skills, understanding of industry standards and best practises, and compliance with legal requirements, insurance firms may offer training and support.

Every Licensed Surveyor and Loss Assessor shall be responsible for investigating, managing, quantifying, validating, and dealing with losses (whether insured or not) resulting from any contingency and reporting thereon to the insurer or insured, as applicable. All licenced surveyors and loss assessors are required to carry out the aforementioned duties with professionalism, objectivity, and integrity while adhering sternly to the code of behaviour outlined in these Regulations.

- **Duties and Responsibilities of a Surveyor and Loss Assessor:-**

  1. Declaring whether he has any interest in the subject-matter in question or whether it pertains to any of his relatives, business partners or through material shareholding; Explanation: For the purpose of this clause 'relatives' shall mean any of the relatives as defined in Subsection (77) of Section 2 of the Companies Act, 2013;

  2. Bringing to the notice of the Authority, any change in the information or particulars furnished at the time of issuance of license, within a period not exceeding fifteen days from the date of occurrence of such change, that has a bearing on the license granted by the Authority;

  3. Maintaining confidentiality and neutrality without jeopardising the liability of the insurer and claim of the insured;

  4. Conducting inspection and re-inspection of the property in question suffering a loss;

  5. Examining, inquiring, investigating, verifying and checking upon the causes and the circumstances of the loss in question including extent of loss, nature of ownership and insurable interest;

  6. Conducting spot and final surveys, as and when necessary and comment upon franchise, excess/ under insurance and any other related matter;

7. Estimating, measuring and determining the quantum and description of the subject under loss;
8. Advising the insurer and the insured about loss minimisation, loss control, security and safety measures, wherever appropriate, to avoid further losses;
9. Commenting on the admissibility of the loss as also observance of warranty conditions under the policy contract;
10. Surveying and assessing the loss on behalf of insurer or insured;
11. Assessing liability under the contract of insurance;
12. Pointing out discrepancy, if any, in the policy wordings;
13. Satisfying queries of the insured/insurer and of persons connected thereto in respect of the claim/loss;
14. Recommending applicability of depreciation, percentage and quantum of depreciation;
15. Giving reasons for repudiation of claim, in case the claim is not covered by policy terms and conditions;
16. Taking expert opinion, wherever required;
17. Commenting on salvage and its disposal wherever necessary.

   - Whether appointed by the insurer or the insured, a surveyor or loss assessor must submit his report to the insurer as quickly as possible but no later than 30 days after his appointment. He must also provide the insured with a copy of the report and include his comments on the insured's consent or other considerations regarding the assessment of loss in the report. When there are unique circumstances surrounding the case, either because of its unique and problematic nature, the surveyor shall notify the insured and request an extension from the insurer for the submission of his report, in any event not exceeding six months.
   - In cases where the Survey report is pending due to non completion of documents, the surveyor may issue the final survey report independently based on the available documents on record, giving minimum three reminders in writing to the insured.
   - Whenever an insurer receives a survey report and discovers that it is lacking in any way, he or she must notify the surveyor to provide a supplementary report on the missing information. Within 15 days of receiving the initial survey report, the insurer may submit such a request. As long as the option of asking the insurer for an additional report is not used more than once in the case of a claim.
   - The surveyor on receipt of this communication shall furnish an additional report within three weeks of the date of receipt of communication from the insurer.

FORENSIC INVESTIGATORS

Insurance firms hire forensic investigators, trained individuals, to look into and ascertain the origin and scope of losses or damages sustained by policyholders. By offering an unbiased review of the circumstances surrounding the loss or damage and assessing if the claim is legitimate, they play a crucial role in the claims process.

Depending on the type of services rendered and the conditions of the contract between the investigator and the insurance company, forensic investigators may get a range of compensation and benefits. Forensic investigators typically receive a fixed fee for each investigation they carry out on behalf of the insurance company as part of a fee-for-service agreement.

Insurance companies may also provide incentives or awards to forensic investigators in addition to the fee-for-service model if they accomplish performance goals, such as reducing investigation time, limiting errors and fraud, and raising client satisfaction. This could be recognition and advancement within the network of forensic investigators employed by the insurance firm, bonuses or other prizes for hitting or exceeding performance goals, etc.

To help forensic investigators develop their technical skills, understanding of industry standards and best practises, and adherence to legal obligations, insurance firms may also offer training and support.

PRE-INSPECTION AGENCIES

Insurance firms hire pre-inspection organisations to do inspections on assets and properties that are up for consideration for insurance coverage. They are essential to the underwriting process because they offer an unbiased evaluation of the state and risk involved with the asset or property.

Depending on the kind of services rendered and the conditions of the contract between the agency and the insurance company, the compensation and benefits for pre-inspection agencies may change. Pre-inspection companies typically earn a fixed charge for each inspection they carry out on the insurance company's behalf as part of a fee-for-service agreement.

Insurance companies may also provide incentives or rewards to pre-inspection agencies in addition to the fee-for-service arrangement if they meet performance goals, such as completing inspections within a certain timeframe, maintaining a high level of accuracy and quality, and enhancing customer satisfaction. The insurance company's network of pre-inspection agencies may offer bonuses or other benefits for meeting or exceeding performance goals, as well as recognition and advancement opportunities.

Pre-inspection organisations may also receive training and support from insurance companies to help them become more technically proficient, knowledgeable about industry standards and best practises, and compliant with legal and regulatory requirements.

In conclusion, pre-inspection companies are essential to the underwriting process since they offer an unbiased evaluation of the state and risk of the asset or property. Pre-inspection agencies normally earn a fixed price for each inspection they undertake as compensation and benefits under a fee-for-service system. In addition, insurance companies may provide training and support to pre-inspection firms to enhance their technical proficiency and compliance, as well as incentives or prizes for fulfilling performance goals.

INSURANCE REPOSITORIES

IRDAI has introduced the IR system to provide policyholders a facility to keep insurance policies in electronic form and to undertake changes, modifications and revisions in the insurance policy with speed and accuracy in order to bring about efficiency, transparency and cost reduction in the issuance and maintenance of insurance policies.

IRDAI has introduced the concept of insurance repository in the year 2011.

IRDAI has issued Guidelines on Insurance Repositories and electronic issuance of insurance policies dated 29th April 2011, Circular for Procedure for appointment of Approved Persons dated 18th July 2013 and revised guidelines on Insurance Repositories and electronic issuance of insurance policies dated 29th May 2015.

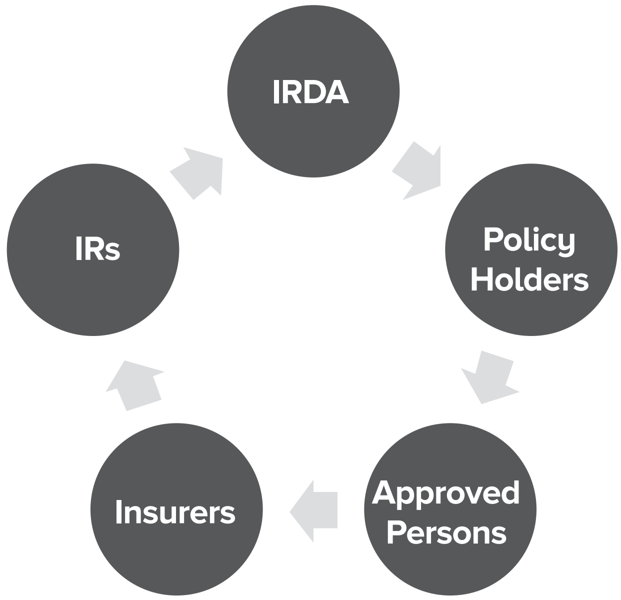
Key Features of Insurance Repository:

- e-Insurance Account (eIA): e-Insurance Account facilitates the policyholders to hold all insurance policies life, general and Group Health. eIA can be accessed online anytime, anywhere. Moreover, all the transaction pertaining to insurance can be viewed under the e-Insurance Account (eIA)
- e-Insurance Policy: A policy which is a valid insurance contract issued by insurance company and maintained through Insurance Repository in electronic form.
- e-Insurance Account Holder or eIA Holder: e-Insurance Account Holder is a person who has an unique e-Insurance Account in his/her name with an Insurance Repository.
- Approved Person: "Approved Person" means an entity appointed by an insurance repository viz SHCIL Projects Ltd. (SHCIL IR) as its agent to perform certain assigned tasks in relation to and incidental to the functions of insurance repository

- Authorized Representative (AR): An Authorized Representative is a person appointed by an eIA holder at the time of eIA opening or later. On demise or incapability of eIA holder, AR will intimate the same to the Insurance Repository and their upon access the eIA to settle claims as per policy level nomination(s) or as the case may be.

Insurance Repository System:

Entities involved in Insurance Repository System



CLAIMS & CUSTOMER SERVICES, GRIEVANCE MANAGEMENT

Representatives of the insurance business who work in customer service offer a crucial link between buyers and sellers of insurance policies. They are responsible for resolving any client inquiries and complaints. Also, they offer thorough information on the company's products to potential buyers.

PROTECTION OF POLICYHOLDERS' INTEREST, REGULATION 2017

Objective

1. To ensure that interests of insurance policyholders' are protected.
2. To ensure that insurers, distribution channels and other regulated entities fulfil their obligations towards policyholders and have in place standard procedures and best practices in sale and service of insurance policies.
3. To ensure policyholder-centric governance by insurers with emphasis on grievance redressal.

Definitions

In these regulations, unless the context otherwise requires:

1. "Act" means the Insurance Act, 1938 (4 of 1938);
2. "Authority" means the Insurance Regulatory and Development Authority of India established under the provisions of section 3 of the Insurance Regulatory and development Authority Act, 1999 (41 of 1999);

3. "Bank Rate" means "Bank rate fixed by the Reserve Bank of India (RBI) at the beginning of the financial year in which claim has fallen due";

4. "Complaint" or "Grievance" means written expression (includes communication in the form of electronic mail or other electronic scripts), of dissatisfaction by a complainant with insurer, distribution channels, intermediaries, insurance intermediaries or other regulated entities about an action or lack of action about the standard of service or deficiency of service of such insurer, distribution channels, intermediaries, insurance intermediaries or other regulated entities;

   Explanation: An inquiry or request would not fall within the definition of the "complaint" or "grievance";

5. "Complainant" means a policyholder or prospect or any beneficiary of an insurance policy who has filed a complaint or grievance against an insurer or a distribution channel;

6. "Cover" means an insurance contract whether in the form of a policy or a cover note or a Certificate of Insurance or any other form as approved by the Authority to evidence the existence of an insurance contract;

7. "Distribution Channels" means persons and entities authorised by the Authority to involve in sale and service of insurance products;

8. "Proposal form" means a form to be filled in by the prospect in written or electronic or any other format as approved by the Authority, for furnishing all material information as requir ed by the insurer in respect of a risk, in order to enable the insurer to take informed decision in the context of underwriting the risk, and in the event of acceptance of the risk, to determine the rates, advantages, terms and conditions of the cover to be granted;

9. "Prospect" means any person who is a potential customer of an insurer and likely to enter into an insurance contract either directly with the insurer or through a distribution channel;

10. "Prospectus": means a document either in physical or electronic or any other format issued by the insurer to sell or promote the insurance products;

11. Words and expressions used and not defined in these regulations, but defined in the Act, or the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999) or the Insurance Rules, 1939 or any other regulations issued by the Authority shall have the meanings respectively assigned to them in those Acts or Rules or Regulations.

BOARD APPROVED POLICY FOR PROTECTION OF INTERESTS OF POLICYHOLDERS:

1. Every insurer shall have in place a board approved policy for protection of policyholders'interests which shall at the minimum, include:

   (i) steps to be taken for enhancing Insurance Awareness so as to educate prospects and policyholders about insurance products, benefits and their rights and responsibilities.

   (ii) service parameters including turnaround times for various services rendered.

   (iii) procedure for expeditious resolution of complaints.

   (iv) steps to be taken to prevent mis-selling and unfair business practices at point of sale and service.

   (v) steps to be taken to ensure that during policy solicitation and sale stages, the prospects are fully informed and made aware of the benefits of the product being sold vis-a-vis the product features attached thereto and the terms and conditions of the product so that the benefits / returns of the product are not mis-stated / mis-represented.

2. Every insurer shall display the service parameters and turnaround times as approved by the Board in its website and keep the same updated as and when the service parameters are revised by the Board.

Point of Sale (PoS):

1. A prospectus of any insurance product shall clearly state:

   (i) (a) the Unique Identification Number (UIN) allotted by the Authority for the concerned insurance product;

   (b) the scope of benefits;

   (c) the extent of insurance cover;

   (d) warranties, exclusions/exceptions and conditions of the insurance cover along with explanations.

   (ii) (a) a description of the contingency or contingencies to be covered by insurance;

   (b) the class or classes of lives or property eligible for insurance under the terms of such prospectus;

   (c) a full statement of the circumstances, if any, in which rebates of the premiums quoted in the prospectus or table shall be allowed on the effecting or renewal of a policy, together with the rates of rebate applicable to each case; and

   (d) a copy of Sec. 41 of the Act but not including the proviso to sub-section (1) thereof.

   (iii) the allowable riders or add-on covers on the insurance products shall be clearly spelt out with regard to their scope of benefits.

   (iv) the premium pertaining to health related or critical illness riders shall not exceed 100% of premium under the basic product, the premiums under all other life insurance riders put together shall not exceed 30% of premiums under the basic product and any benefit arising under each of the above mentioned riders shall not exceed the sum assured under the basic product.

   (v) in case of life insurance, whether the product is participating (with-profits) or nonparticipating (without-profits).

2. An insurer or its agent or other intermediary shall provide all material information in respect of a proposed cover to the prospect to enable the prospect to decide on the best cover that would be in his or her interest.

3. Where the prospect depends upon the advice of the insurer or his agent or an insurance intermediary, such a person must advise the prospect dispassionately.

4. Where for any reason, the proposal and other connected papers are not filled in by the prospect, the insurer or the distribution channel shall explain the contents of the form, and a certificate shall be incorporated at the end of the proposal form from the prospect that the contents of the proposal form and connected documents have been fully explained to him and he has fully understood the significance of the proposed contract.

5. The Insurers shall ensure, that a sale executed over distance-marketing modes such as Internet, SMS, Tele Marketing, interactive electronic medium etc., shall be undertaken by authorized and qualified sales persons who are specified in this behalf by the Authority. It is mandatory that the consent of the prospect be obtained before canvassing. Care should be exercised to ensure that the prospect contacted has clarity as to the identity of the insurer, the distribution channel, the product, benefits and conditions of offer etc. The canvassing so made shall not involve compulsion, inconvenience or nuisance of any kind to the prospect.

GRIEVANCE MANAGEMENT

The Grievance Redressal Cell in the Policyholder's Protection & Grievance Redressal Department of the Insurance Regulatory and Development Authority of India looks into complaints/grievances from policyholders. This Cell takes up the grievances with the respective insurers for redressal.

Policyholders who have complaints against insurers are required to first approach the Complaints/Grievance Redressal Cell of the insurer concerned. Click here for the mail ids of the Grievance Redressal Officers of the insurers. If they do not receive a response from the insurer within a reasonable period of time or are dissatisfied with the response of the company, they may approach the Grievance Redressal Cell in the Policyholder's Protection & Grievance Redressal Department of the IRDAI.

Only complaints from the insured or the claimants shall be entertained. The Cell shall not entertain complaints written on behalf of policyholders by advocates or agents or by any third parties.

Complainants are requested to submit complete details of the complaint as required in the complaint registration form put on the IRDAI website – policyholder.gov.in (http://www.policyholder.gov.in/Report.aspx#). Click here to download the Complaint Registration Form. Without the required information called for in the Complaint Registration Form, IRDAI will not be in a position to register the complaint.

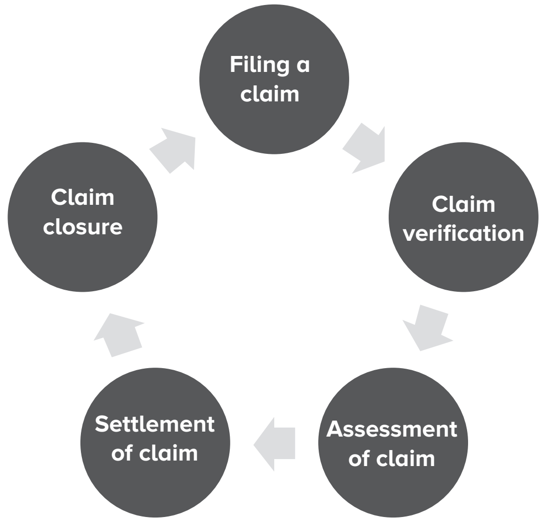
Registration of Complaints with the IRDAI by Policyholders:

1. Can make use of the Bima Bharosa system - IRDAI Portal at https://bimabharosa.irdai.gov.in/ for registering the complaints themselves and to monitor the status of the complaints.
2. Can send the complaint through Email to complaints@irdai.gov.in.
3. Can call Toll Free No. 155255 or 1800 4254 732.
4. Apart from the above options, if it is felt necessary by the complainant to send the communication in physical form, the same may be sent to IRDAI office.

CLAIM SETTLEMENT PROCESS

An essential component of the insurance sector is the claim settlement process, which entails the evaluation and resolution of policyholder claims. Policyholders can file a claim with their insurance company in the case of a loss or damage to insured assets or property to receive compensation in accordance with the terms and conditions of their insurance policy.

The steps involved in the claim settlement process in the insurance industry:



1. Filing a claim: The first step in the claim settlement process is for the policyholder to file a claim with their insurance provider. This can be done through the company's website, mobile app, or by visiting the nearest branch office.

2. Claim verification: Once the claim is filed, the insurance provider will verify the details of the claim, including the extent of the damage or loss and the policy coverage.

3. Assessment of claim: After the claim is verified, the insurance provider will assess the claim and determine the amount of compensation that the policyholder is entitled to as per the terms and conditions of the policy.

4. Settlement of claim: Once the claim is assessed, the insurance provider will settle the claim by providing the policyholder with the agreed-upon compensation.

5. Claim closure: After the claim is settled, the insurance provider will close the claim and update their records accordingly.

It's crucial to remember that the procedure for settling claims can differ depending on the kind of insurance policy and the insurer. The nature and complexity of the claim will determine how long it takes to settle, as well as the schedule.

Guidelines have been established by the Insurance Regulatory and Development Authority of India (IRDAI) to make sure that insurance companies resolve claims quickly and effectively and that policyholders are compensated fairly and promptly. In order to keep policyholders updated at all times on the status of their claim, the rules further stress the significance of openness and communication throughout the claim settlement process.

In conclusion, the claim settlement process, which entails the evaluation and settlement of policyholder claims, is a crucial component of the insurance sector. The procedure normally entails the claim submission, claim verification, claim evaluation, claim settlement, and claim closure. Insurance companies must settle claims quickly, effectively, and transparently, according to rules laid forth by the IRDAI.

REPORTING

Reporting in the insurance sector refers to the procedure of gathering, examining, and presenting data pertaining to various business-related elements. An enormous amount of data, such as information about policyholders, claim data, financial data, and other operational data, is produced by and used by insurance companies.

Key areas where reporting is essential in the insurance industry:

1. Financial reporting: Insurance companies are required to prepare financial reports on a regular basis to provide a snapshot of the company's financial performance. These reports typically include information on the company's revenue, expenses, assets, liabilities, and profits.

2. Regulatory reporting: Insurance companies are also required to submit regulatory reports to regulatory bodies such as the Insurance Regulatory and Development Authority of India (IRDAI). These reports provide information on the company's compliance with regulatory requirements and are essential for ensuring the financial stability and soundness of the industry.

3. Operational reporting: Insurance companies also generate operational reports to monitor and improve their day-to-day operations. These reports may include information on policy sales, claims processing, customer service, and other key performance indicators.

4. Business intelligence reporting: Insurance companies also use business intelligence reporting to analyze data and gain insights into customer behavior, market trends, and other factors that impact the business. These insights can help insurance companies make informed decisions about product development, marketing, and other strategic initiatives.

MANAGEMENT OF UNCLAIMED AMOUNT OF POLICYHOLDERS

In the insurance sector, "unclaimed sums" refers to benefits under policies or other payments that are owed to policyholders but have not yet been claimed or paid out. Unclaimed funds can be the consequence of a number of things, such as inactive policyholders, changes in contact information, or beneficiaries who are unaware of their rights.

The Insurance Regulatory and Development Authority of India (IRDAI) has provided standards for insurers to adhere to in order to guarantee that unclaimed funds are managed correctly and policyholders' interests are safeguarded. The following are some essential criteria for handling policyholder unclaimed amounts:

1. Identification of unclaimed amounts: Insurers are required to regularly identify unclaimed amounts in their records, including policy benefits, maturity proceeds, or other amounts payable to policyholders or their beneficiaries.
2. Record keeping and reporting: Insurers must maintain accurate records of unclaimed amounts and report them to the IRDAI on a regular basis.
3. Communication with policyholders: Insurers are required to make reasonable efforts to locate policyholders or beneficiaries whose contact information is outdated or incomplete. This includes sending reminders and notices to policyholders or their representatives regarding unclaimed amounts.
4. Establishment of a dedicated fund: Insurers must establish a dedicated fund for unclaimed amounts, which should be maintained in a separate account from other company funds. The fund should be invested in government securities, as per IRDAI guidelines.
5. Transfer of unclaimed amounts to the fund: Insurers are required to transfer unclaimed amounts to the dedicated fund after a specified period of time, as per IRDAI guidelines. The time period may vary depending on the type of policy and the amount of the claim.

Provisions governing the Unclaimed Amounts:

1. No insurer shall appropriate or write back any part of the Unclaimed amounts belonging to the policyholders/ beneficiaries under any circumstances;
2. (i) The Policyholder Protection Committee of the Board of every insurer shall oversee the timely payout of the dues to policyholders. A detailed agenda item covering the following shall be placed before the Committee on a quarterly basis:
   a) Aging analysis of the unclaimed amounts at the end of the quarter in the Form A as contained in Schedule I to this Master Circular;
   b) Progress of settlement of unclaimed amounts with details of number and amounts of claims, during a quarter, in the Form B as contained in Schedule I to this Master Circular;
   c) Steps taken by the insurer to reduce unclaimed amount by identifying the policyholders or beneficiaries, creating awareness, etc. in terms of the standard procedures and policy on customer service approved by the Board.

   (ii) Every insurer shall furnish the details of the action taken and status of the unclaimed amount to the Authority, along with a certified copy of the minutes of the meeting of the Policyholder Protection Committee on half- yearly basis, within 60 days from 30th September and 31st March, every year. The minutes shall be duly signed by the Chairman of the Committee.
3. The Audit Committee of the Board of every insurer shall oversee the compliance of the provisions of this Master Circular while examining the quarterly financial statements.

4. (i) Every Insurer shall display the information about any unclaimed amount of Rs. 1000/-or more on their respective web-sites. Such display of information of unclaimed amounts shall continue even after completion of ten years.

(ii) A facility shall be provided on the website of the insurer to enable Policyholders or beneficiaries or dependents to find out whether any unclaimed amounts due to them are lying with the insurer. For this purpose, the Policyholder/ beneficiary may be allowed to enter the following fields in a window provided on the website for this purpose:

a) Policy Number

b) PAN of the Policyholder

c) Name of the Policyholder

d) Date of birth of the Policyholder Name of the Policyholder and Date of Birth shall be mandatory fields to enter, while others may be optional fields.

(iii) Based on the above information entered, the insurer's website shall, on matching of the mandatory two fields, confirm the name of the Policyholder, address, Policy No. and amount lying unclaimed with the insurer.

(iv) The information regarding unclaimed amounts shall be updated by the insurers on their respective websites on half yearly basis – as on 31s1 March and 30th September every year.

Such updation shall be done within 60 days from the end of the half year. A certification to that effect shall be furnished to the Authority by the CEO and Compliance Officer as a part of Form B giving details of Total Number of cases with outstanding more than Rs 1000/- and Total Amount of cases corresponding to them.

5. Policyholders/ beneficiaries shall be eligible to claim the dues under their policies up to 25 years from the date of transfer of the same to the Senior Citizen's Welfare Fund (SCWF) by the concerned insurer. If no claim is made up to a period of 25 years after transfer to the SCWF, such amounts shall escheat to the Central Government, in terms of Section 126 of the Finance Act, 2015.

ADVERTISEMENTS

The latest master circular on insurance advertisements from the IRDAI (Insurance Regulatory and Development Authority of India) states: "In order to maintain the public's trust, insurers are expected to conduct themselves in a fair, honest, and open manner in the marketplace. As it may be difficult for the public to understand and evaluate the inherent details in the various insurance products, it is of paramount importance that the publicity material is relevant, fair and in simple language enabling informed decision making about whether or not to buy a specific insurance product."

Insurance buyers need to be aware that insurance companies are required to follow certain norms in advertising their policies. Some of the important advertising rules that are required to be followed by insurance companies are:

1. Terms and conditions related to guaranteed returns should be disclosed. Clear disclosure of the underlying conditions under which the guarantee operates must be disclosed, where relevant, whenever any insurance advertisement highlights the advantage of guarantees. All of the terms (including the price of the guarantee and any fees) under which the guarantee operates must be clearly stated in all such instances.

2. 'Conditions apply' text must be of specified size to ensure that buyers notice it. When the underlying circumstances are complex, the guarantee's text or language must be followed by the words "Conditions Apply" in a typeface that is at least 50% larger than the guarantee's font. These terms must be stated clearly below in a readable font, separate from any other applicable disclosures.

3. Benefit illustrations provided in insurance policies must be with both scenarios. Investment returns of 4% per year and 8% per year, with equal prominence in font size, at the same location, and on the same page (or as otherwise specified from time to time by IRDAI).

4. Asset mix of ULIP fund's investments must be disclosed to the customer half yearly. It is important to note that the following information is provided for informational purposes only. This investment update information is provided to make sure that prospects have access to accurate, timely, and clear information so they can make wise financial decisions.

5. In ULIPs, premium invested vs mortality charges has to mentioned clearly. With a Unit Linked Insurance Plan (ULIP), the insurer must clearly specify the proportion of premium that will be invested for the buyer in the benefit illustration offered at the time of buying the policy. The remaining portion of the premium is used to cover the insurer's different fees, including administrative and mortality expenses.

6. Insurers cannot claim to hold any particular rank in the market. No claim of ranking by an insurer regarding its position in the insurance market, based on any criteria (like premium income or a number of policies or branches or claims settlements etc.,) is authorised in any of the advertisements, as per the circular.

OMBUDSMAN RULES

The Government on 2nd March 2021 notified comprehensive amendments to the Insurance Ombudsman Rules, 2017, with a view to improve the working of the Insurance Ombudsman mechanism to facilitate resolution of complaints regarding deficiencies in insurance services in a timely, cost-effective and impartial manner.

The amended rules have enlarged the scope of complaints to Ombudsmen from only disputes earlier to deficiencies in service on the part of insurers, agents, brokers and other intermediaries. Further, insurance brokers have been brought within the ambit of the Ombudsman mechanism, by empowering the Ombudsmen to pass awards against insurance brokers as well. Under the amended rules, the timeliness and cost-effectiveness of the mechanism has been substantially strengthened.

Policyholders will now be enabled for making complaints electronically to the Ombudsman and a complaints management system will be created to enable policyholders to track the status of their complaints online. Further, the Ombudsman may use video-conferencing for hearings. To enable access to relief through the Ombudsman mechanism even when there is vacancy in the office of a particular Ombudsman, provision has been made for giving additional charge to another Ombudsman, pending the filling of the vacancy.

A number of amendments have been made for securing the independence and integrity of the Ombudsman selection process, while also building in safeguards to secure the independence and impartiality of the appointed persons while serving as Ombudsmen. Further, the selection committee will now include an individual with a track record of promoting consumer rights or advancing the cause of consumer protection in the insurance sector. The Ombudsman mechanism was administered by the Executive Council of Insurers, which has been renamed as the Council for Insurance Ombudsmen.

CONSUMER FORUMS

Consumer forums, also known as consumer courts or consumer dispute redressal forums, are specialised legal bodies in India that provide a platform for consumers to seek justice for grievances related to the goods and services they have purchased. These forums were established under the Consumer Protection Act of 1986, which was enacted to provide a simple, inexpensive, and speedy redressal mechanism for consumer disputes

There are three levels of consumer forums in India, each with a different jurisdiction and authority to hear and decide on consumer complaints:

1. District Consumer Disputes Redressal Forum: This is the first level of consumer forum, and it is established at the district level. It can hear complaints involving the value of goods or services up to Rs. 50 lakh.

2. State Consumer Disputes Redressal Commission: This is the second level of consumer forum, and it is established at the state level. It can hear complaints involving the value of goods or services between Rs. 50 lakh and Rs. 2 crore.

3. National Consumer Disputes Redressal Commission: This is the highest level of consumer forum, and it is established at the national level. It can hear complaints involving the value of goods or services exceeding Rs. 2 crore.

To file a complaint with a consumer forum, the complainant must provide relevant documents and evidence to support their claim, such as bills, receipts, agreements, and correspondence with the service provider. The forum will then issue a notice to the service provider and hear both parties before making a decision.

If the consumer forum rules in favour of the complainant, it can direct the service provider to refund the money, replace the items or supply the service, and make compensation to the customer for any damages or losses suffered. Non-compliance with the forum's decision can result in penalties and legal action against the service provider.

Consumer rights are protected and fair and ethical business practises are promoted by consumer forums, which offer a convenient and effective way for consumers to file complaints about products and services.

LESSON ROUND-UP

- All insurance firms must succeed through their distribution channels. They make sure that the insurers' goods and services are delivered in the most direct and economical way possible to their intended clients.
- An individual agent represents an insurance firm and sells insurance policies to customers through the individual agency distribution channel for insurance products.
- A corporate Agency, like a bank or a retail establishment, is appointed by an insurance company to sell insurance policies on its behalf through the corporate agency distribution channel for insurance products.
- A Corporate Agent registered as Corporate Agent (Life) may have tie up with three life insurers. On the same lines, a Corporate Agent (General) and Corporate Agent (Health) may have arrangements with a maximum of three insurers in their respective lines of business.
- Insurance brokers serve as a bridge between customers and insurance firms, serving as a distribution channel for insurance products.
- An insurance broker who has registered with India's Insurance Regulation and Development Authority is simply referred to as a composite broker (IRDAI).
- A POSP, or Point of Sales Person, is someone who is allowed to sell insurance policies on behalf of an insurance company. These people might be independent contractors or retail agents. POSPs are paid through a commission-based payment structure and are qualified to market particular insurance products.
- Web aggregators are online resources that give users a simple method to compare insurance plans offered by different insurance providers.
- The government established Common Public Service Centers (CPSCs) as physical locations where a variety of services, including insurance products, are provided to the public
- Insurance Marketing firm is an organisation that has been authorised by the Authority to solicit or procure insurance products as specified in regulation 3(a) of the Insurance Regulatory and Development Authority of India (Registration of Insurance Marketing Firm) Regulations, 2015, to carry out insurance service activities as specified in regulation 3(b) of these regulations, and to distribute other financial products as specified in regulation 3(c) of these regulations by employing individuals with licences.
- A digital platform known as an e-commerce platform allows clients to buy insurance products online. The ability to compare, buy, and manage insurance policies from the comfort of one's home or workplace is made possible by e-commerce platforms.

- The regulation of commission or remuneration or rewards payable to insurance agents and insurance intermediaries had been relegated to the Insurance Regulatory and Development Authority of India (IRDAI) after the Insurance Laws Amendment Act, 2015.
- The hospitals that are mentioned in the agreement while getting the insurance from the insurance company are called the network hospitals. These are the hospitals at which you can avail cashless health insurance service in case you get treatment which is subject to the terms and conditions associated with the policy.
- Insurance companies use Third Party Administrators (TPAs) to handle health insurance claims on their behalf. TPAs serve as a middleman between the insurance carrier, the insured, and the healthcare facilities like hospitals and clinics.
- Independent professionals known as surveyors and loss assessors are hired by insurance firms to look into and evaluate damages that policyholders have suffered. By offering an unbiased evaluation of the magnitude of the loss and the price of repairing or replacing the damaged property, they play a crucial role in the claims process.
- Insurance firms hire forensic investigators, trained individuals, to look into and ascertain the origin and scope of losses or damages sustained by policyholders. By offering an unbiased review of the circumstances surrounding the loss or damage and assessing if the claim is legitimate, they play a crucial role in the claims process.
- IRDAI has introduced the IR system to provide policyholders a facility to keep insurance policies in electronic form and to undertake changes, modifications and revisions in the insurance policy with speed and accuracy in order to bring about efficiency, transparency and cost reduction in the issuance and maintenance of insurance policies.
- Reporting in the insurance sector refers to the procedure of gathering, examining, and presenting data pertaining to various business-related elements. An enormous amount of data, such as information about policyholders, claim data, financial data, and other operational data, is produced by and used by insurance companies.
- In the insurance sector, "unclaimed sums" refers to benefits under policies or other payments that are owed to policyholders but have not yet been claimed or paid out. Unclaimed funds can be the consequence of a number of things, such as inactive policyholders, changes in contact information, or beneficiaries who are unaware of their rights.
- Consumer forums, also known as consumer courts or consumer dispute redressal forums, are specialised legal bodies in India that provide a platform for consumers to seek justice for grievances related to the goods and services they have purchased.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Discuss the Insurance product distribution channel.
2. What are the Categories of Insurance Brokers?
3. What are the functions of Composite Brokers?
4. Mr. Anil Want to get registered as Insurance Broker. Explain the detailed procedure of registration as insurance broker.
5. What Functions and Responsibilities of Insurance Marketing Firm Department?
6. What are the Remuneration & Rewards to Insurance Agents & Intermediaries?
7. How to Make Cashless Claims at Your Nearby Network Hospital?
8. What is the Revenue model of Third Party Administrators? What is the role of TPA in Health Insurance?

9. Duties and Responsibilities of a Surveyor and Loss Assessor?
10. How to get e-commerce business insurance? Explain with example.
11. What are the essential criteria for handling policyholder unclaimed amounts?
12. What are the different benefits of the Insurance marketing firm?
13. Write Short notes on the following:
    i. Claim Settlement Process:
    ii. POSP (Point of Sales Person)
    iii. Web Aggregator:
    iv. Forensic Investigators
    v. Common Public Service Centres (CPSC)

LIST OF FURTHER READINGS

- https://irdai.gov.in/requirements-for-license-as-a-broker
- https://irdai.gov.in/insurance-web-aggregators

LIST OF OTHER REFERENCES

- https://callhub.io/insurance-distribution-channels/
- https://irdai.gov.in/requirements-for-license-as-a-corporate-agent
- https://www.paybima.com/blog/miscellaneous/list-of-top-10-largest-insurance-brokers-in-india/
- https://enterslice.com/learning/concept-of-reinsurance-broker-how-they-differ-from-direct-brokers/
- https://www.njinsure.in/clearpospexam/index.fin
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Functions in Insurance & Compliance Related Thereto: (Part – III)

Lesson 20

KEY CONCEPTS

■ Insurance Investments ■ Insurance Accounting ■ Re-insurance ■ Co-Insurance ■ Insurance Information Technology ■ Data Security ■ Stewardship Codes ■ Reserving Techniques

Learning Objectives

To understand:

- Insurance Investments regulations,
- Classifications of Insurance Investments
- Functions of Insurance Intermediaries
- Insurance Accounting Concepts and Analysis of Financial Statements
- Information technology and security issues and procedures

Lesson Outline

- **Investments**
  - IRDAI Regulations on Investments
  - Classification of Investment categories
  - Investment of Assets of Insurers carrying life insurance business
  - Investment of Assets of Insurers carrying General insurance business
  - Decision making for Investment of Funds
  - Investments Brokers Role
  - Investing in Capital Markets
  - Stewardship Codes
- **Accounting**
  - IRDAI Regulations on preparation of Financial Statements
  - Analysing the Financial Statement
  - Accounting of Direct, Re-insurance, Co-Insurance and Investment Transactions
  - Expense of Management
  - Reserving techniques (UPR, PDR, IBNR & IBNER)
- IT, Cyber security & Data Protection Compliances
- Lesson Round-Up
- Test Yourself
- List of Further Readings

REGULATORY FRAMEWORK

- Insurance Act, 1938

INTRODUCTION

Insurance business is globally regulated for reasons of equity and efficiency. Insurance companies receive huge amounts of cash in the form of premiums. These premiums are again invested by Fund Managers in the Insurance Company as per the guidelines of the Insurance Regulatory and Development Authority of India (IRDAI). The investments are regulated as they are made out of the money contributed by the policyholders.

In this lesson, the important regulations pertaining to Investments of Life and General insurance companies are discussed in depth.

A. Regulations on Investments of Life Insurance Companies

The regulations pertaining to insurance investments as defined under Section 27, 27A, 27B, 27C, and 28 of Insurance Act, 1938, and as per clause (i) subsection (2) of Section 114A of Insurance Regulatory and Development Authority (Investment) Regulations, 2016 are as under:

These regulations are called the Insurance Regulatory and Development Authority of India (Investment) Regulations, 2016.

Definitions

In the context of the investment regulations,

- **"Act"** means the Insurance Act, 1938.
- **"Accretion of funds"** means investment income, gains / loss on sale/redemption of existing investment and operating surplus.
- **"Approved Investments"** means Investments made as per Regulation 3 (a) and (b) read with Schedule I and Schedule II of this regulation.
- **"Assets"** means assets in India, held by an Insurer in accordance with the provisions of Section 31 of the Act.
- **"Authority"** means the Insurance Regulatory and Development Authority of India established under sub-section (1) of section 3 of the Insurance Regulatory and Development Authority Act, 1999.
- **"Financial Derivatives"** means a derivative as defined under clause (ac) of section 2 of the Securities Contracts (Regulation) Act, 1956, and includes a contract which derives its value from interest rates of underlying debt securities and such other derivative contracts as may be stipulated by the Authority, from time to time.
- **"Infrastructure facility"** means, the 'Harmonized Master list of Infrastructure sub-sectors' as per Gazette Notification Dt. 14th October, 2014 of Department of Economic Affairs, as amended from time to time, and shall also include the following:
  - a road, including toll road, a bridge or a rail system;
  - a highway project including other activities being an integral part of the highway project;
  - a port, airport, inland waterway or inland port and associated railway sidings;
  - a water supply project, irrigation project, water treatment system, sanitation and sewerage system or solid waste management system;

- **"Investment Assets"** mean all investments made out of:

  A. In the case of Life Insurer

  i. shareholders' funds representing solvency margin, non-unit reserves of unit linked insurance business, participating and non-participating funds of policyholders, funds of variable insurance products including One Year Renewable pure Group Term Assurance Business (OYRGTA) at their carrying value.

  ii. policyholders' funds of Pension, Annuity business and Group business including funds of variable insurance products at their carrying value.

  iii. policyholders' unit reserves of unit linked insurance business including funds of variable insurance products at their market value as per guidelines issued under these regulations, from time to time.

  B. In the case of General Insurer

  An insurer carrying on business of re-insurance or health insurance or in case of a branch of a foreign company engaged in the business of re-insurance, funds maintained in its head office account, shareholders' funds representing solvency margin and policyholders' funds at their carrying value as shown in its balance sheet prepared in accordance with any regulations issued in that behalf for the time being in force, by IRDAI (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations.

- **"Money Market Instruments"** Money Market Instruments shall comprise of Short term investments with maturity not more than one year comprising of the following instruments:

  1. Certificate of deposit rated by a credit rating agency registered under SEBI (Credit Rating Agencies) Regulations, 1999.
  2. Commercial paper rated by a credit rating agency registered under SEBI (Credit Rating Agencies) Regulations, 1999.
  3. Reverse Repo.
  4. Treasury Bills (including Cash Management Bills).
  5. Call, Notice, Term Money.
  6. CBLO as per Schedules I and II of these Regulations.
  7. Any other instrument as may be prescribed by the Authority.

- **"Promoter"** means a promoter as defined under Regulation 2 (1) (x) of IRDAI (Issuance of Capital by Indian Insurance Companies transacting life insurance business) Regulations.

- **"Principal Officer"** means any person connected with the management of an insurer or any other person upon whom the Authority has served notice of its intention of treating him as the principal officer thereof.

Approved Investments

a. No insurer shall invest or keep invested any part of its Controlled Fund, as defined under Section 27A / Assets as defined under Section 27 (2) of the Act, read together with Section 27E of the Act, otherwise than in approved securities, as per Section 2(3) of Insurance Act, 1938, as amended from time to time and in any of the following approved investments, namely:—

   1. debentures secured by a first charge on any immoveable property plant or equipment of any company which has paid interest in full;

2. debentures secured by a first charge on any immovable property, plant or equipment of any company where either the book value or the market value, whichever is less, of such property, plant or equipment is more than three times the value of such debentures;
3. first debentures secured by a floating charge on all its assets of any company which has paid dividends on its equity shares;
4. preference shares of any company which has paid dividends on its equity shares for at least two consecutive years immediately preceding;
5. equity shares of any listed company on which not less than ten percent dividends have been paid for at least two consecutive years immediately preceding;
6. immovable property situated in India, provided that the property is free of all encumbrances;
7. loans on policies of life insurance within their surrender values issued by him or by an insurer whose business he has acquired and in respect of which business he has assumed liability;
8. Fixed Deposits with banks included for the time being in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934) and such other investments as the Authority may, by notification in the Official Gazette, declare to be Approved Investments.

Investments Deemed as Approved Investments

1. All rated debentures (including bonds) and other rated & secured debt instruments as per Note appended to Regulations 4 to 9. Equity shares, preference shares and debt instruments issued by All India Financial Institutions recognized as such by Reserve Bank of India – investments shall be made in terms of investment policy guidelines, benchmarks and exposure norms, limits approved by the Board of Directors of the insurer.
2. Bonds or debentures issued by companies, rated not less than AA or its equivalent and A1 or equivalent ratings for short term bonds, debentures, certificate of deposits and commercial papers by a credit rating agency, registered under SEBI (Credit Rating Agencies) Regulations 1999.
3. Subject to norms and limits approved by the Board of Directors of the insurer's deposits [including fixed deposits as per Regulation 3 (a) (8)] with banks (e.g. in current account, call deposits, notice deposits, certificate of deposits etc.) included for the time being in the Second Schedule to Reserve Bank of India Act, 1934 (2 of 1934) and deposits with primary dealers duly recognized by Reserve Bank of India as such.
4. Collateralized Borrowing & Lending Obligations (CBLO) created by the Clearing Corporation of India Ltd and recognized by the Reserve Bank of India and exposure to Gilt, G Sec and liquid mutual fund forming part of Approved Investments as per Mutual Fund Guidelines issued under these regulations and money market instrument / investment.
5. Asset Backed Securities with underlying Housing loans or having infrastructure assets as underlying as defined under 'infrastructure facility' in Regulation 2 (h) as amended from time to time.
6. Commercial papers issued by All India Financial Institutions recognized as such by Reserve Bank of India having a credit rating of A1 by a credit rating agency registered SEBI (Credit Rating Agencies) Regulations 1999.
7. Money Market instruments as defined in Regulation 2(j) of this Regulation, subject to provisions of approved investments.

   Explanation: All conditions mentioned in the 'note' appended to Regulation 4 to 9 shall be complied with.

The board of the insurer, to comply with the provisions of Section 27A (2) (ii) of the Act, may delegate to Investment Committee, for investments already made and the continuance of such investments from controlled fund / assets, in otherwise than in an approved investments, and in All India Financial Institutions recognized as such by RBI for investments carrying a rating of less than AA and being part of Approved Investment. The investment committee shall be responsible for the details, analysis and review of non-performing assets of investments on a quarterly periodicity. The insurer shall report compliance of this provision to the Authority through Form 4. Unless specifically permitted by the Authority, no investment shall be made in any entity not formed under laws relating to companies in India and in any private limited company or one-person company or a company formed under section 8 of the Companies Act, 2013 or erstwhile Section 25 of the Companies Act, 1956.

Regulation of Investments – Life Insurer

A life insurer, for the purpose of these Regulations, shall invest and at all times keep invested, the Investment Assets forming part of the Controlled Fund as under:

a. all funds (excluding Shareholders' funds held beyond solvency margin, held in a separate custody account) of Life insurance business and One Year Renewable pure Group Term Assurance Business (OYRGTA), and non -unit reserves of all categories of Unit linked life insurance business, as per Regulation 5;

b. all funds of Pension, Annuity and Group Business [as defined under Regulation 2 (1)(e) of IRDAI (Actuarial Report and Abstract for life insurance business) Regulations] as per Regulation 6; and

c. the unit reserves portion of all categories of Unit linked funds, as per Regulation 7".

I. Without prejudice to Sections 10 (2AA), 27 or 27A of the Act and any provisions of these Regulations, every insurer carrying on the business of Life Insurance, shall invest and at all times keep invested its Investment Assets as defined in Regulation 4 (a) (other than funds relating to Pension & General Annuity and Group Business and unit reserves of all categories of Unit Linked Business) in the following manner:

Life Insurance Investments Framework

No.	Type of Investments	Percentage to funds as under Regulation 4 (a)
(i)	Central Government Securities	Not less than 25%
(ii)	Central Government Securities, State Government Securities or other Approved Securities	Not less than 50% (incl (i) above)
(iii)	Approved investments as specified in Regulation 3 (a), b), and Other Investments as specified in Section 27A (2) and Schedule I as these Regulations, (all taken together) subject to Exposure / Prudential Norms as specified in Regulation 9:	Not exceeding 50%
(iv)	Other Investments as specified in Section 27 A (2), subject to Exposure / Prudential Norms as specified in Regulation 9:	Not exceeding 15%
(v)	Investment in housing and infrastructure by way of subscription or purchase of:	Total Investment in housing and infrastructure (i.e.) investment in categories (i), (ii), (iii) and (iv) above taken together shall not be less than 15% of the fund under Regulation 4 (a)
	A. Investment in Housing	
	a. Bonds / debentures of HUDCO and National Housing Bank	
	b. Bonds / debentures of Housing Finance Companies either duly accredited by National Housing Banks, for house building activities, or duly guaranteed by Government or carrying current rating of not less than 'AA' by a credit rating agency registered under SEBI (Credit Rating Agencies) Regulations, 1999	

	c. Asset Backed Securities with underlying housing loans, satisfying the norms specifies in the guidelines issued under these regulations from time to time.	
	B. Investments in Infrastructure	
	(Explanation: Subscription or purchase of Bonds / Debentures, Equity and Asset Backed Securities with underlying assets would qualify for the purpose of this requirement.	
	'Infrastructure facility' shall have the meaning as given in Regulation 2 (h) as amended from time to time.	
	Note: Investments made under category (i) and (ii) above may be considered as investments in housing and infrastructure, provided the respective government issues such as security specifically to meet the needs of any of the sectors specified as 'infrastructure facility	

II. As per the provisions of Sections 10 (2AA), 27 or 27A of the Act and any provisions of these Regulations every insurer carrying on Pension, Annuity and Group Business [as defined under Regulation 2 (1) (e) of IRDAI (Actuarial Report and Abstract for life insurance business) Regulations] shall invest and at all times keep invested its Investment Assets of Pension, Annuity and Group business in the following manner:

Pension, Annuity and Group Business Investment Framework

No.	Type of Investments	Percentage to funds as under Regulation 4 (b)
(i)	Central Government Securities	Not less than 20%
(ii)	Central Government Securities, State Government Securities or Other Approved Securities	Not less than 40% (i ncl (i) above)
(iii)	Balance to be invested in Approved Investments, as specified in Schedule I, subject to Exposure / Prudential norms as specified in Regulation 9.	Not exceeding 60%

Unit Linked Insurance Business

a. Without prejudice to Sections 10 (2AA), 27 or 27A of the Act and any provisions of these Regulations every insurer shall invest and at all times keep invested its segregated fund(s) under Regulation 4(c) (with underlying securities at custodian level) of Unit linked business as per pattern of investment offered to and subscribed to by the policyholders where the units are linked to categories of assets which are both marketable and readily realizable within the approved pattern as per the product regulations. However, the investment in Approved Investments shall not be less than 75% of such fund(s) in each such segregated fund.

b. All prudential and exposure norms under Regulation 9, shall be applicable at the level of individual segregated fund at SFIN level.

c. Insurer shall, as per circular / guidelines issued, from time to time, disclose on their website, the minimum information required for the benefit of policyholders.

Regulation of investments - general insurer including an insurer carrying on business of re-insurance or health insurance

Without prejudice to Sections 10 (2AA), 27, or 27B of the Act and any provisions of these regulations, an insurer carrying on the business of General Insurance including an insurer carrying on business of re-insurance or health insurance shall invest and at all times keep invested its investment assets in the manner set out below:

General Insurance Investment Framework

No.	Type of Investments	Percentage to Investment Assets
(i)	Central Government Securities.	Not less than 20%.
(ii)	Central Government Securities, State Government Securities or other Approved Securities.	Not less than 30% (incl (i) above).
(iii)	Approved investments as specified in Regulation 3 (a), (b), and Other Investments as specified in Section 27A (2) and Schedule II as these Regulations, (all taken together) subject to Exposure / Prudential Norms as specified in Regulation 9.	Not exceeding 70%.
(iv)	Other Investments as specified in Section 27 A (2), subject to Exposure / Prudential Norms as specified in Regulation 9.	Not exceeding 15%.
(v)	Investment in housing and infrastructure by way of subscription or purchase of:	Total Investment in housing and infrastructure (i.e.) investment in categories (i), (ii), (iii) and (iv) above taken together shall not be less than 15% of the Investment Assets.
	A. Investment in Housing	
	a. Bonds / debentures of HUDCO and National Housing Bank.	
	b. Bonds / debentures of Housing Finance Companies either duly accredited by National Housing Banks, for house building activities, or duly guaranteed by Government or carrying current rating of not less than 'AA' by a credit rating agency registered under SEBI (Credit Rating Agencies) Regulations, 1999.	
	c. Asset Backed Securities with underlying Housing loans, satisfying the norms specifies in the guidelines issued under these regulations from time to time	
	B. Investments in Infrastructure	
	(Explanation: Subscription or purchase of Bonds / Debentures, Equity and Asset Backed Securities with underlying assets would qualify for the purpose of this requirement.	
	'Infrastructure facility' shall have the meaning as given in Regulation 2 (h) as amended from time to time.	
	Note: Investments made under category (i) and (ii) above may be considered as investments in housing and infrastructure, provided the respective government issues such as security specifically to meet the needs of any of the sectors specified as 'infrastructure facility.	

1. **Applicability of Pattern of Investment**

   Pattern of Investment will not be applicable for Shareholders' funds held in business beyond required solvency margin, and not taken in calculation of solvency margin. Such excess shall be:

   i. made after fully complying with investment in Central Government Securities, State Government and Other Approved Securities and in Housing & Infrastructure Investments from funds representing solvency margin.

   ii. such excess of Shareholder's funds, held beyond Solvency Margin requirement, shall be held in a separate custody account with identified scrips.

iii. such excess funds shall be determined only after Actuarial Valuation, certified by Appointed Actuary and such valuation is filed with the Authority.

iv. such transfer made between quarters, shall be certified by the Concurrent Auditor to have complied with points (i), (ii) and (iii) above.

v. Exposure Norms of 'investee company', 'group', 'promoter group' and 'industry sector' shall be applicable to both funds representing solvency margin [FRSM] and funds held in excess of required solvency margin.

2. All investment in assets or instruments, which are capable of being rated as per market practice, shall be made on the basis of credit rating of such assets or instruments. No approved investment shall be made in instruments, if such instruments are capable of being rated, but are not rated.

3. The rating should be done by a credit rating agency registered under SEBI (Credit Rating Agencies) Regulations, 1999.

4. Corporate bonds or debentures rated not less than AA or its equivalent and A1 or equivalent ratings for short term bonds, debentures, certificate of deposit and commercial paper, by a credit rating agency, registered under SEBI (Credit Rating Agencies) Regulations, 1999 would be considered as 'Approved Investments'.

5. Approved Investments under regulations 5, 6, 7 and 8 which are downgraded below the minimum rating prescribed or not continuing to satisfy dividend criteria should be automatically re-classified under 'Other Investments' and specifically identified under a category which shall be valued at marked to market on a quarterly basis, for the purpose of pattern of investment.

6. Investments in equity shares listed on a registered stock exchange should be made in actively traded and liquid instruments viz., equity shares other than those defined as thinly traded as per SEBI Regulations and guidelines governing mutual funds issued by SEBI from time to time.

7. Notwithstanding the above, it is emphasized that rating should not replace appropriate risk analysis and management on the part of the Insurer. The Insurer should conduct risk analysis commensurate with the complexity of the product(s) and the materiality of their holding, or could also refrain from such investments.

2. Exposure / Prudential Norms

Without prejudice to anything contained in Sections 10(2AA), 27, 27A, 27B and 27C of the Act every insurer shall limit its investment of controlled funds / all assets as per the following exposure norms:

A. Exposure norms for:

1. i. all funds of Life insurance business and One Year Renewable pure Group Term Assurance Business (OYRGTA), and non-unit reserves of all categories of Unit linked life insurance business.

ii. all funds of Pension, Annuity and Group Business [as defined under Regulation 2 (1) (e) of IRDAI (Actuarial Report and Abstract for life insurance business) Regulations].

iii. the unit reserves portion of all categories of Unit linked funds, as per Regulation 7, Life, Pension, Annuity and Group business and each segregated fund within Unit Linked Insurance business (except for promoter group exposure).

2. *General insurance business.*

3. *Re-insurance business.*

4. *Health insurance business.*

For both Approved Investments as per Regulation 3 (a), Schedule I and Schedule II of these Regulations, and Other Investments as permitted under Section 27A (2) shall be as under.

B. *The maximum exposure limit for a single 'investee' company (equity, debt and other investments taken together) from all investment assets under point (A.1.a, A.1.b, A.1.c all taken together), (A.2), (A.3) and (A.4) mentioned above, shall not exceed the lower of the following;*

a. *an amount of 10% of investment assets as under Regulation 2 (i) (1), Regulation 2 (i) (2) excluding fair value change of investment assets under Regulation 4 (a), 4 (b) and Regulation 2(i)*

b. *an **aggregate** of amount calculated under point (a) **and** (b) **of the following table***

Type of Investment (1)	Limit for Investee Company (2)*	Limit for Entire Group the Investee Company (3)	Limit for industry Sector to which Investee Company belongs (4)
a. Investment in Equity, Preference Shares, Convertible Debentures	10% of Outstanding Equity Shares (Face Value) or 10% of the amount under point or A.I. (a) or A.I. (b) or A.I. (c) [segregated fund] above considered separately in the case of Life insurers/ amount under A.2 or A.3 or A. 4 in the case of general insurer including an insurer carrying on business of re-insurance or health insurance whichever is lower	Not more than 15% of the amount under point A. I.(a) or A.I. (b) or A.I. (c) or A.2 or A.3 or A.4. Exposure to Investments made in companies belonging to Promoter Group shall be made as per Point 7 under notes to Regulation 9	Investment by the insurer in any industrial should not exceed 15% of the amount under point A.l.(a) or A.I. (b) or A.l.(c) A.2 or A.3 or A.4 Note: Industrial sector shall be classified in the lines of National Industrial Classification (All Economic Activities) - 2008 (NIC) for all the sector. Exposure shall be calculated at Division level from A to R for financial and insurance Activities sector Exposure shall be at Sectional Level.
b. Investment in Debt, (incl. CPs) / Loans and any other permitted Investments as per Act Regulation other than item 'a' above	10% of the Paid-up Share capital Free reserves (excluding revolution reserve) and Debentures / Bonds / (incl.CPs) of the "Investee" company or 10% of the amount under AH25paint A.I. (a) or A.l. (b) or A.I.(c) [segregated fund] above considered separately in the case of Life insurers/ amount under A.2 or A. 3 or A. 4 in the case of general insurer including an insurer carrying on business of re-insurance or health insurance whichever is lower		

**In the case of insurers having investment assets within the meaning of Regulation 2 (i) (1) and Regulation 2 (i) (2) of the under mentioned size, the (*) marked limit in the above table for investment in equity, preference shares, convertible debentures, debt, loans or any other permitted investment under the Regulations, shall stand substituted as under:*

Investment Assets	Limit for investee company	
	Equity	Debt
Rs. 250000 crores or more	15% of outstanding equity shares (face value)	15% of paid up shares capital, free reserves (excluding revaluation reserves) & debentures/ bonds
Rs. 50000 crores but less than Rs. 250000 crores	12% of outstanding equity shares (face value)	12% of paid up share capital, free reserves (excluding revaluation reserves) & debentures/ bonds
	Limit for investee company	
Investment Assets	**Equity**	**Debt**
Less than Rs. 50000 crores	10% of outstanding equity shares (face value)	10% of paid up share capital, free reserves (excluding revaluation reserves) & debentures/ bonds

Provisions on Investment Management

A. Constitution of Investment Committee

Every insurer shall constitute an Investment Committee which shall consist of a minimum of two non-executive directors of the Insurer, the Chief Executive Officer, Chief of Finance, Chief Risk Officer, Chief of Investment division, and the Appointed Actuary. The Board of the Insurer shall ensure that Chief of Finance, Chief of Investment and the Chief Risk Officer, shall fulfil the minimum qualification requirements specified in the regulations / guidelines issued by the Authority. The decisions taken by the Investment Committee shall be recorded and be open to inspection by the officers of the Authority.

B. Investment Policy

1. Every Insurer shall draw up, an Investment Policy (IP) (fund wise IP in the case of Unit Linked Insurance Business) and place the same before its Board of Directors for its approval.

2. Every insurer shall have a model code of conduct to prevent insider / personal trading of Officers involved in various levels of Investment Operations in compliance with SEBI (Prohibition of Insider Trading) Regulation, 1992 as amended from time to time and place the same before its Board of Directors for its approval.

3. While framing the Investment Policy, the Board shall ensure compliance with the following:

   i. Issues relating to liquidity, prudential norms, exposure limits, stop loss limits including securities trading, management of all investment risks, management of assets liabilities mismatch, Scope of Internal or Concurrent audit of Investments, criteria form empanelment and review of investment brokers, investment statistics and all other internal controls of investment operations, the provisions of the Insurance Act, 1938 and IRDAI (Investment) Regulations, Guidelines and Circulars made there under.

   ii. Ensuring adequate return on policyholders and shareholders' funds consistent with the protection, safety and liquidity of such fund(s).

4. The investment policy of Life, General Insurer including an insurer carrying on business of re-insurance or health insurance, as approved by the Board shall be implemented by the investment committee. The Board shall review on a quarterly basis the monitoring of fund wise and in respect of each product (both participating and nonparticipating products in the case of life insurers) the following minimum:

(a) Life Insurers:

i. new business scale planned versus actual at the end of the period1 to maturity.

ii. expenses projected versus actual.

iii. persistency / renewal premium streams projected versus actual.

iv. claims - projected versus actual.

v. actual yield versus projected yield or returns.

vi. action plan and follow up status.

(b) General Insurer including an insurer carrying on business of re-insurance or health insurance (at line of business level):

i. gross level of premium income projected vs actual along with reasons for negative growth if any.

ii. steps to correct the business achieved as planned in case of under achievement of gross written premium.

iii. underwriting results planned vs achieved along with reasons for negative deviations.

iv. claims outgo projected versus actual - major reasons for increase / decrease in loss ratio and corrective steps planned for future.

v. expenses including acquisition cost planned vs actuals- in case of excess over permitted limits, reasons for such excess along with plan to comply limits.

vi. overall incremental investments projected vs actual - reason for deviation from the planned accretion and steps planned to correct the trend if the same is negative.

5. The Board shall review the investment policy and its implementation on a half-yearly basis or at such short intervals as it may decide and make such modification to the investment policy as is necessary to bring it in line with the investment provisions laid down in the Act and Regulations made there under, keeping in mind protection of policyholders' interest and pattern of investment laid down in these regulations or in terms of the agreement entered into with the policyholders in the case of unit linked insurance business.

C. Investment Operations

i. The funds of the insurer shall be invested and continued to be invested in equity shares, equity related instruments and debt instruments rated as per Note below Regulations 4 to 8 by a credit rating agency, registered under SEBI (Credit Rating Agencies) Regulations, 1999. The Board shall lay down norms for investing in 'Other Investments' as specified in section 27A(2) of the Insurance Act, 1938 by the investment committee, taking into account the safety and liquidity of the policyholders' funds and protection of their interest.

ii. As required under Chapter II, Regulation 7 (3) (b) of IRDAI (Registration of Indian Insurance Companies) Regulations, to ensure proper internal control of investment functions and operations the insurer shall clearly segregate the functions and operations of front, mid and back office (as provided in the Guidance note on Internal / Concurrent Audit of Investment functions of Insurance Companies issued by the Institute of Chartered Accountants of India) and no function falling under Front, Mid and Back Office Investment function(s), shall be outsourced. Also, the primary data server of the computer application used for investment management shall remain within the country.

iii. The Board of the Insurer shall appoint a Custodian to carry out the custodial service for its Investments, who shall not be an entity under its promoter 'Group' unless permitted otherwise by the Authority.

D. Risk Management Systems and Its Review

a. The Board shall implement the Investment Risk Management Systems and Process, mandated by the Authority. The implementation shall be certified by a Chartered Accountant firm, as per the procedure laid down in the "Guidance note on Review and Certification of Investment Risk Management Systems and Process of Insurance Companies", issued by the Institute of Chartered Accountants of India, as amended from time to time.

b. The Investment Risk Management Systems and Process shall be reviewed once in two financial years or such shorter frequency as decided by the Board of the Insurer (the gap between two such audits should not be more than two years), by a Chartered Accountant firm and file the certificate issued by such Chartered Accountant, with the Authority along with the first quarter returns.

c. The appointment of Chartered Accountant firm to certify implementation and review of Investment Risk Management Systems and Process shall be as per the circular issued under these regulations.

E. Audit and Reporting to Management

1. Every Insurer shall constitute an Audit Committee of the Board, headed by an individual, as per the IRDAI Corporate Governance Guidelines and such person, shall not be the Chairman of Investment Committee.

2. The Insurer shall have the investment transactions covering both Shareholders and Policyholders funds be audited through Internal or Concurrent Auditor as per the circular issued under this regulation.

3. The quarterly internal / concurrent audit report, covering investments of both shareholders as well as policyholders, shall be as per the "Guidance note on Internal / Concurrent Audit of Investment functions of Insurance Companies" issued by the Institute of Chartered Accountants of India, as amended from time to time.

4. The Details of Investment Policy, implementation status of Investment Risk Management Systems and Process or its review shall be made available to the internal or concurrent auditor. The auditor shall comment on implementation status, review and its impact on the investment operations, systems and process in their report to be placed before the Board's Audit Committee.

5. The Statutory Auditor of the Insurer shall, on a quarterly basis, confirm compliance to Regulation 13(B)(4)(a, b) and such confirmation, shall be filed by the insurer along with periodical investment returns.

F. Category of Investments

Every Insurer shall invest its controlled fund as defined under Section 27A / all assets as defined under Section 27(2) of the Insurance Act, 1938 as amended from time to time, only within the exhaustive category of investments listed in the guidelines issued by the Authority.

G. Dealing in Financial Derivatives

Every Insurer carrying on the business of life insurance or general insurance or health insurance business may deal in financial derivatives only to the extent permitted and in accordance with the guidelines issued by the Authority in this regard from time to time.

H. Fund Management

1. In the case of (a) Life fund, (b) Pension, Annuity & Group funds, the insurer shall maintain separate sub-custody account with identifiable securities for participating and non-participating funds.

2. Every insurer shall have a separate fund manager for debt and equity up to a fund size (for both shareholder and policyholder funds taken together) of Rs. 10000 Crores. When the fund size, for the first time, is Rs.10000 Crores, every fund [(a) Life fund (b) Pension, Annuity & Group fund (c) Unit linked segregated fund(s)] shall have identifiable fund manager.

FUNCTIONS AND RESPONSIBILITIES OF INVESTMENT DEPARTMENT

As per the mandated IRDAI (Investment) Regulations, 2016 along with Master Circular and guidelines amended from time to time regulate Insurers' Investments, the IRDAI Investment department performs the following functions:

1. Compliance to Investment Regulations.
2. Confirming filing of periodical Investment returns.
3. Issue of Circulars and guidelines on investment related matters.
4. Providing comments on inspection observations on investment related issues.
5. To process Insurers' requests for clearing funds under ULIP business.
6. Replying to queries of Ministry of Finance (MoF), Parliament questions (PQs) & Right to Information (RTIs) matters pertaining to Investment department.

LATEST AMENDMENTS OF IRDAI WITH REGARDS TO INVESTMENTS

The Authority under Section 14 (2) (k) of IRDA Act, 1999, issues the following amendment to Master Circular – Investments, 2016, are summarized as under:

A. Investment in Units of "Real Estate Investment Trusts (REIT) &Infrastructure Investment Trusts (InvIT)"

1. Insurers can invest in Units of REITs / InvITs which conform to the following:
   - i. The REIT /InvIT rated **not less than "AA"**shall form part of **Approved Investments**. REIT / InvIT rated **less than AA** shall form part of **Other Investments**.
   - ii. An Insurer can invest not more than **3%** of respective **fund size of the Insurer**(or) not more than **5% of** the Units issued by a **single REIT / InvIT,** whichever is lower.
   - iii. **No** investment shall be made in REIT /InvIT where the Sponsor is under the **Promoter Group** of the Insurer.
   - iv. Investment in Units of InvIT will form part of "Infrastructure Investments", for the purpose of Pattern of Investments under IRDAI (Investment) Regulations.
   - v. Investment in Units of REIT will form part of "Investment property"as per Note 6 to the Regulation 9 of IRDAI (Investment) Regulations, 2016 read along with Master Circular – Investments.
2. The Investment in Units of REIT / InvITs shall be valued at Market Value (last Quoted price should not be later than 30 days). Where Market Quote is not available for the last 30 days, the Units shall be valued as per the latest NAV (not more than 6 months old) of the Units published by the trust.
3. The Category Codes (COI) applicable for Investment in the Units of REITs and InvITs are:

   Units of REITs / InvITs- Approved Investments

   D40: Units of Real Estate Investment Trust (REITs) - ERIT

   D41: Units of InvIT - EIIT

Units of REITs / InvITs- Other Investments

E29: Units of Real Estate Investment Trust (REITs) - ORIT

E30: Units of InvIT - OIIT

4. The Concurrent Auditor in his Quarterly Report to the Audit Committee / Board of the Insurer shall confirm compliance to the above norms and disclosure requirements.

B. Investment in Alternative Investment Fund (Aifs)

The conditions and provisions applicable for Investment in Alternative Investment Fund (AIF) is as follows:

a. No investment is permitted into AIFs which undertake leverage or borrowing other than to meet day-to-day operational requirements and as permitted under **SEBI (Alternative Investment Funds) Regulations, 2012.**

b. Insurer shall invest **only** into Fund of Funds (FoF) which comply requirement of Section 27E of the Insurance Act, 1938.

c. Insurer shall ensure compliance with Section 27E by a clause in the Fund Offer Documents executed by FoF to restrain such FoF investing into AIFs which invest in overseas companies/ funds.

d. No Insurer shall invest in an AIF, which in turn has exposure to a FoF, in which the Insurer has taken an exposure.

e. The Insurer on a quarterly basis, obtain a certificate issued by the Concurrent Auditor on the compliance of the above conditions and file the same along with quarterly periodical returns.”

C. Guidelines for Investment in Debt Etfs With Cpse Bonds as Underlying

The IRDAI (Investment) Regulations, 2016 read along with Investments - Master Circular Dt.3rd May, 2017 issued thereunder, permits Insurers to invest in the various exhaustive Asset categories. The IRDAI hereby permits Debt ETFs with underlying Debt Securities of Central Public Sector Enterprises (CPSEs) herein after referred to **as Debt ETFs** proposed to be launched in India, as eligible class of Investment, and as a part of “Mutual Fund” exposure.

The IRDAI as per the provisions of Investment regulations,2016, and 2017, now permits Insurers to invest in the various exhaustive Asset categories, such as Debt ETFs with underlying Debt Securities of Central Public Sector Enterprises (CPSEs), also referred to as Debt ETFs as per the conditions mentioned as under:

1. The Debt ETFs shall be issued by Mutual Funds registered with SEBI and governed by SEBI (Mutual Funds) Regulations, 1996, as amended from time to time.

2. The Debt ETF shall invest in a basket of Securities issued by CPSEs which are part of constituents’ of a publicly available index.

3. The minimum investment by the Insurer shall not be less than Creation Unit size and it shall not be reduced to below Creation Unit Size.

4. **“All”** Securities in the Index shall be complied with rating criteria as per Regulation 3 of IRDAI (Investment) Regulations, 2016 for it to part of “Approved Investment”. If any of the underlying securities gets downgraded below “AA”, the Debt ETF shall be automatically reclassified under “Other Investment”.

5. The following Category of Investment **(COI)** Codes shall apply for investment in Debt ETFs:

No	Investment Category Head	CAT Code	Market Value - for FORM - 3A, 3B
D 42	Debt ETFs - "Approved Investments"	EDTF	Traded Price or at NAV as on the reporting date
E 31	Debt ETFs - "Other Investments"	ODTF	Traded Price or at NAV as on the reporting date

D. Investments in Green Bonds (Sgrrs)

The IRDAI now permits the insurance companies to invest in Green bonds as its latest 2023 investments provisions. This initiative is a part of the Paris Climate Change Accord, 2015. With the objective of de-concentration and diversification of the infrastructure investment portfolio of the insurers and from the perspective of participation in Environmental, Social and Governance (ESG) initiatives and for proactive participation in sustainable development and in preventing environment degradation, insurers are encouraged to investing in Sovereign Green Bonds. Investment in Sovereign Green Bonds shall be treated as "Investment in Infrastructure" and shall be classified as "Central Government Securities" under the following Category Code:

No.	Investment Category Heads	CAT Code
A05	Sovereign Green Bonds	CSGB

IRDAI GUIDELINES ON STEWARDSHIP CODE

Insurance companies are significant institutional investors in listed companies and the investments are held by them as custodians of policyholders' funds. The state of governance of the investee companies is an important aspect and insurance companies must ensure that investee companies maintain corporate governance standards at high level. Therefore, insurance companies should play an active role in the general meetings of investee companies and engage with the managements at a greater level to improve their governance. This will result in informed decisions by the parties and improve the return on investments of insurers which will ultimately benefit the policyholders. In this regard, the Authority had issued a code for stewardship for the insurance companies in year 2017.

The code was in the form of a set of principles which the insurance companies needed to adopt and made applicable from FY 2017-18. Guidelines for each principle under the code had also been prescribed by the Authority. As per the code, insurer should have a board approved stewardship policy which should identify and define the stewardship responsibilities that the insurer wishes to undertake and how the policy intends to fulfill the responsibilities to enhance the wealth of its policyholders who are ultimate beneficiaries. It has been decided to review the existing guidelines on stewardship code based on the experience in implementation, compliance by the insurers and the recent developments in this regard. Accordingly, a revised guidance on stewardship code has been prepared and placed herewith as Revised Guidelines on Stewardship Code for Insurers in India.

All the insurers need to review and update their existing stewardship policy based on the Revised Guidelines on Stewardship Code for Insurers in India within 3 months from the date of issue of the same and the updated stewardship policy needs to be approved by the Board of Directors. The updated policy should be disclosed on the website within 30 days of approval by the Board by all insurers, alongside the public disclosures. Any subsequent change / modification to the stewardship policy should be specifically disclosed at the time of updating the policy document on the website.

A. Revised Guidelines on Stewardship Code for Insurers in India

Insurers should formulate a policy for Stewardship based on the principles indicated in these guidelines and get the approval of their Boards for implementation of the same. The principles and the guidance for the implementation are given below:

Stewardship Principles

- **Principle 1**

  Insurers should formulate a policy on the discharge of their stewardship responsibilities and publicly disclose it.

  Guidance

  Stewardship activities include monitoring and engaging with investee companies on matters such as strategy, performance, risk, capital structure, and corporate governance, including culture and remuneration. The Stewardship policy should identify and define the stewardship responsibilities that the insurer wishes to undertake and how it intends to fulfill the same to enhance the wealth of its clients. The policy should address all the aspects relating to stewardship activity like Managing conflict of interest, Training of personnel, Monitoring of investee companies, Intervention in investee companies, Collaboration with other institutional investors and Voting activities. The policy should be approved by the Board of the insurer and should bring out how the insurer applies stewardship with the aim of enhancing and protecting the value for the ultimate beneficiary or client. While the Boards of an insurer could decide to engage in all cases, it may also decide to selectively intervene based on its extent or level of investment. In such case, the policy should clearly identify the threshold (level of investment or any other criteria as may be determined by the Board) for intervention. The policy should clearly state whether the insurer intends to use the services of external service providers such as institutional advisors. In case services of any external service providers are used, the policy should provide for the mechanism to ensure that in such cases, stewardship responsibilities are exercised diligently. Though core function of investment cannot be outsourced, professional advices to arrive at voting decisions and research reports like Market survey data, Industry wide analysis, Business valuation, etc. may be sought from external agencies. The policy should clearly provide that the ultimate stewardship responsibilities shall be discharged by the insurer. The policy should be reviewed and updated periodically and the updated policy should be publicly disclosed on the insurer's website.

- **Principle 2**

  Insurers should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.

  Guidance

  The stewardship policy put in place by the insurers should also cover the aspects of identifying and managing conflicts of interest with the aim of taking all reasonable steps to put the interests of their client or beneficiary first. The policy should identify scenarios of likely conflict of interest as envisaged by the Board and should also address how matters are handled when the interests of clients or beneficiaries diverge from each other.

  Aspects covered in the stewardship policy with regard to conflict of interest may, among other issues, address the following:

  1. Identifying possible situations where conflict of interest may arise. E.g. in case of investee companies being associates of the entity.

  2. Procedures put in place by the entity in case such conflicts of interest situations arise which may, inter alia, include:

     i. Blanket bans on investments in certain cases.

     ii. Referring such matters to Audit Committee.

     iii. Clear segregation of voting function and client relations / sales functions.

iv. Policy for persons to recuse from decision making in case of the person having any actual / potential conflict of interest in the transaction.

v. Maintenance of records of minutes of decisions taken to address such conflicts.

- **Principle 3**

  Insurers should monitor their investee companies.

  Guidance

  Insurers should have mechanisms for regular monitoring of their investee companies in respect of their performance, leadership effectiveness, succession planning, corporate governance, reporting and other parameters they consider important. Insurers may or may not wish to have more participation through nominations on the Board for active involvement with the investee companies. An insurer who may be willing to have nominations on the Board of an investee company should indicate in its stewardship statement the willingness to do so, and the mechanism by which this could be done.

  Aspects covered in the stewardship policy with regard to monitoring shall address the following:

  1. Different levels of monitoring in different investee companies. E.g. companies where larger investments are made may involve higher levels of monitoring vis-a-vis companies where amount invested is insignificant from the point of view of its assets under management (AUM).

  2. Areas of monitoring which shall, inter-alia, include:

     i. Company strategy and performance - operational and financial.

     ii. Industry level monitoring and possible impact on the investee companies.

     iii. Quality of company management and Board, leadership.

     iv. Corporate governance including remuneration, structure of the Board (including Board diversity and independent directors) and related party transactions.

     v. Risks including Environmental, Social and Governance (ESG) risks.

     vi. Shareholder rights and their grievances.

  3. Identification of situations which may trigger communication of insider information and the procedures adopted to ensure SEBI (Prohibition of Insider Trading) Regulations, 2015 as amended time to time are complied with in such cases.

- **Principle 4**

  Insurers should have a clear policy on intervention in their investee companies.

  Guidance

  Insurers may decide their own engagement strategy and the stewardship policy should clearly set out the criteria/ circumstances in which they will actively intervene. The policy should provide for regular assessment of the outcomes of intervention by the insurer. Intervention should be considered regardless of whether an active or a passive investment policy is followed. Circumstances for intervention may, inter alia, include but not limited to, poor financial performance of the company, corporate governance related practices, remuneration, strategy, Environmental, Social and Governance (ESG) risks, leadership issues and litigations. The mechanisms for intervention may include meetings / discussions with the management for constructive resolution of the issue and in case of escalation thereof, meetings with the Boards, collaboration with other investors and voting against decisions. Various levels of intervention and circumstances in which escalation is required may be identified and disclosed in the stewardship policy. This may also include interaction with the companies through the insurance councils in case of any industry level issues. Investment Committee of the insurer has to consider which mechanism to be opted and escalation of matters in specified cases.

- **Principle 5**

  Insurers should have a clear policy for collaboration with other institutional investors, where required, to preserve the interests of the policyholders (ultimate investors), which should be disclosed.

  Guidance

  For issues that require larger engagement with the investee company, insurers may choose to act collectively with other institutional investors in order to safeguard the interests of their investors. In such situations, the stewardship policy should guide their actions and extent of engagement.

- **Principle 6**

  Insurers should have a clear policy on voting and disclosure of voting activity.

  Guidance

  Insurers should exercise their own independent judgment as regards voting decisions on resolutions and should not automatically support the proposals of the Board of the investee company. The decisions should be aimed at promoting the overall growth of the investee companies and, in turn, enhance the value of their investors. The stewardship policy should cover the aspects of voting activity. Audit Committee will monitor oversight on voting mechanism. Insurers should disclose their approach to stock lending and recalling lent stock in their stewardship policy.

  Insurers should mandatorily undertake active participation and voting on resolutions/proposals of the investee companies under the following circumstances:

Size of AUM of the Insurer (Rs. Cr.)	Compulsory voting required. If the insurer's holding of the paid up capital of investee company (in percentage) is
Up to 2,50,000	3% and above
Above 2,50,000	5% and above

  In other cases, insurers may voluntarily participate and vote if such resolutions/proposals are considered significant and may have an impact on the value of investments of the insurer. Disclosures have to be made by the insurers regarding the voting activity in the investee companies in which the insurers have actively participated and voted on resolutions/proposals. The disclosures will form part of Public Disclosures on website and have to be made on quarterly basis as per the timelines prescribed for quarterly public disclosures on website.

- **Principle 7**

  Insurers should report periodically on their stewardship activities.

  Guidance

  In addition to the regular fulfillment of their stewardship activities, insurers should also provide a periodic report to their ultimate beneficiaries (policyholders) of how they have discharged their responsibilities, in a format which is easy to understand, as a part of public disclosures.

  Compliance and Reporting:

  The compliance with the aforesaid principles does not constitute an invitation to manage the affairs of a company or preclude a decision to sell a holding when this is considered in the best interest of clients or beneficiaries. The Board shall ensure that there is effective oversight on the insurer's stewardship activities and the Audit Committee of the Board shall exercise the same.

All insurers shall comply with all the principles given in the guidelines and submit an Annual Certificate of Compliance approved by the Board to the Authority as per Annexure B duly certified by CEO and Compliance Officer on or before 30 June every year.

B. Accounting Financial Statements Regulations As Per IRDAI Regulations For Life & Non-Life Insurancecompanies

Annexure

FORM A-RA

Name of the Insurer:

Registration No. and Date of Registration with the IRDAI

REVENUE ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 20____.

Policyholders' Account (Technical Account)

Particulars	Schedule	Current Year (Rs.,000)	Previous Year (Rs.,000)
Premiums earned – net			
(a) Premium (b) Reinsurance ceded (c) Reinsurance accepted-	1		
Income from Investments			
(a) Interest, Dividends & Rent – Gross (b) Profit on sale/redemption of investments (c) (Loss on sale/ redemption of investments) (d) Transfer/Gain on revaluation/change in fair Value*			
Other Income (to be specified)			
TOTAL (A)			
Commission	2		
Operating Expenses related to Insurance Business	3		
Other Expenses (to be specified)			
Provisions (other than taxation)			
(a) For diminution in the value of investments (Net) (b) Others (to be specified)			
TOTAL (B)			
Benefits Paid (Net)	4		
Interim Bonuses Paid			
Change in valuation of liability against life policies in force			

Particulars	Schedule	Current Year (Rs.,000)	Previous Year (Rs.,000)
(a) Gross** (b) Amount ceded in Reinsurance (c) Amount accepted in Reinsurance			
TOTAL (C)			
SURPLUS/ (DEFICIT) (D) =(A)-(B)-(C)			
APPROPRIATIONS			
Transfer to Shareholders' Account			
Transfer to Other Reserves (to be specified)			
Balance being Funds for Future Appropriations			
TOTAL (D)			

Notes:

*Represents the deemed realized gain as per norms specified by the Authority.

**Represents Mathematical Reserves after allocation of bonus.

The total surplus shall be disclosed separately with the following details:

(a) Interim Bonuses Paid:

(b) Allocation of Bonus to policyholders:

(c) Surplus shown in the Revenue Account:

(d) Total Surplus: [(a)+(b)+(c)]

Annexure

FORM A-PL

Name of the Insurer:

Registration No. and Date of Registration with the IRDAI

PROFIT & LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 20___.

Shareholders' Account (Non-technical Account)

Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
Amounts transferred from / to the Policyholders Account (Technical Account)			
Income From Investments (a) Interest, Dividends & Rent – Gross (b) Profit on sale/redemption of investments (c) (Loss on sale/ redemption of investments)			
Other Income (To be specified)			

Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
TOTAL (A)			
Expense other than those directly related to the insurance business			
Bad debts written off			
Provisions (Other than taxation)			
(a) For diminution in the value of investments (Net) (b) Provisions for doubtful debts (c) Others (to be specified)			
TOTAL (B)			
Profit/(Loss) before tax			
Provision for Taxation			
Profit/(Loss) after tax			
APPROPRIATIONS (a) Brought forward Reserve/Surplus from the Balance Sheet (b) Interim dividends paid during the year (c) Proposed final dividend (d) Dividend distribution on tax (e) Transfer to reserves/other accounts (to be specified)			
Profit carried forward to the Balance Sheet			

Notes:

(a) Premium income received from business concluded in and outside India shall be separately disclosed.

(b) Reinsurance premiums whether on business ceded or accepted are to be brought into account gross (i.e., before deducting commissions) under the head reinsurance premiums.

(c) Claims incurred shall comprise claims paid, settlement costs wherever applicable and change in the outstanding provision for claims at the year-end.

(d) Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs.5,00,000 whichever is higher, shall be shown as a separate line item.

(e) Fees and expenses connected with claims shall be included in claims.

(f) Under the sub-head "Others" shall be included items like foreign exchange gains or losses and other items.

(g) Interest, dividends and rentals receivable in connection with an investment should be stated as gross amount, the amount of income tax deducted at source being included under 'advance taxes paid and taxes deducted at source".

(h) Income from rent shall include only the realised rent. It shall not include any notional rent.

Annexure

FORM A-BS

Name of the Insurer:

Registration No. and Date of Registration with the IRDAI

BALANCE SHEET AS AT 31ST MARCH, 20___.

Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
Sources of Funds			
Shareholders' Funds:			
Share Capital	**5**		
Reserves And Surplus	**6**		
Credit/[Debit] Fair Value Change Account			
Sub-total			
Borrowings	**7**		
Policyholders' Funds:			
Credit/[Debit] Fair Value Change Account			
Policy Liabilities			
Insurance Reserves			
Provision for linked liabilities			
Sub-total			
Funds for future appropriations			
Total			
Application of Funds			
Investments			
Shareholders'	**8**		
Policyholders'	**8A**		
Assets held to cover linked liabilities	**8B**		
Loans	**9**		
Fixed Assets	**10**		
Current Assets			
Cash and Bank Balances	**11**		
Advances and Other Assets	**12**		
Sub-total (A)			
Current Liabilities	**13**		
Provisions	**14**		
Sub-total (B)			
Net Current Assets (C) = (A – B)			

Particulars	Schedule	Current Year (Rs.'000)	Previous Year (Rs.'000)
Miscellaneous Expenditure (to the extent not written off or adjusted)	**15**		
Debit Balance in Profit & Loss Account (Shareholders' Account)			
Total			

CONTINGENT LIABILITIES

	Particulars	Current Year(Rs.'000)	Previous Year (Rs.'000)
1.	Partly paid-up investments		
2	Claims, other than against policies, not acknowledged as debts by the Company		
3.	Underwriting commitments outstanding (in respect of shares and securities)		
4.	Guarantees given by or on behalf of the Company		
5.	Statutory demands/ liabilities in dispute, not provided for		
6.	Reinsurance obligations to the extent not provided for in accounts		
7.	Others (to be specified)		
	TOTAL		

Annexure

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS

SCHEDULE – 1

PREMIUM

	Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1	First year premiums		
2	Renewal Premiums		
3	Single Premiums		
	TOTAL PREMIUM		

Annexure

SCHEDULE – 2

COMMISSION EXPENSES

Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
Commission paid		
Direct – First year premiums – Renewal premiums		

Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
– Single premiums Add: Commission on Re-insurance Accepted Less: Commission on Re-insurance Ceded		
Net Commission		

Note:

The profit/commission, if any, are to be combined with the Re-insurance accepted or Re-insurance ceded figures.

SCHEDULE – 3

OPERATING EXPENSES RELATED TO INSURANCE BUSINESS

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Employees' remuneration & welfare benefits		
2.	Travel, conveyance and vehicle running expenses		
3.	Training Expenses		
4.	Rents, rates & taxes		
5.	Repairs		
6.	Printing & stationery		
7.	Communication expenses		
8.	Legal & professional charges		
9.	Medical fees		
10.	Auditors' fees, expenses etc.		
	a) as auditor b) as adviser or in any other capacity, in respect of (i) Taxation matters (ii) Insurance matters (iii) Management services; and c) in any other capacity		
11.	Advertisement and publicity		
12.	Interest & Bank Charges		
13.	Others (to be specified)		
14.	Depreciation		
	TOTAL		

Note:

Items of expenses and income in excess of one percent of the total premiums (less reinsurance) or Rs. 5,00,000 whichever is higher, shall be shown as a separate line item.

Annexure

SCHEDULE – 4

BENEFITS PAID [NET]

Particulars	Current Year (Rs.'000)	Previous Year (Rs.'000)
1. Insurance Claims:		
(a) Claims by Death,		
(b) Claims by Maturity,		
(c) Annuities/Pensions in payment,		
(d) Other benefits, specify		
2. (Amount ceded in reinsurance):		
(a) Claims by Death,		
(b) Claims by Maturity,		
(c) Annuities/Pensions in payment,		
(d) Other benefits, specify		
3. Amount accepted in reinsurance:		
(a) Claims by Death,		
(b) Claims by Maturity,		
(c) Annuities/Pensions in payment,		
(d) Other benefits, specify		
TOTAL		

Notes:

(a) Claims include claims settlement costs, wherever applicable.

(b) The legal and other fees and expenses shall also form part of the claims cost, wherever applicable.

Annexure

SCHEDULE – 5

SHARE CAPITAL

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Authorised Capital		
	Equity Shares of Rs..... each		
2.	Issued Capital		
	Equity Shares of Rs. .....each		
3.	Subscribed Capital		
	Equity Shares of Rs.......each		
4.	Called-up Capital		

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
	Equity Shares of Rs. .....each		
5.	Less: Calls unpaid		
	Add: Shares forfeited (Amount originally paid up)		
	Less: Par value of Equity Shares bought back		
	Less: Preliminary Expenses Expenses including commission or brokerage on Underwriting or subscription of shares		
	TOTAL		

Notes:

(a) Particulars of the different classes of capital should be separately stated.

(b) The amount capitalised on account of issue of bonus shares should be disclosed.

(c) In case any part of the capital is held by a holding company, the same should be separately disclosed.

Annexure

SCHEDULE – 5A

PATTERN OF SHAREHOLDING

[As certified by the Management]

Shareholder	Current Year		Previous Year	
	Number of Shares	% of Holding	Number of Shares	% of Holding
Promoters • Indian • Foreign				
Others				
TOTAL				

Annexure

SCHEDULE – 6

RESERVES AND SURPLUS

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Capital Reserve		
2.	Capital Redemption Reserve		
3.	Share Premium		
4.	Revaluation Reserve		
5.	General Reserves Less: Debit balance in Profit and Loss Account, if any		

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
	Less: Amount utilized for Buy-back		
6.	Catastrophe Reserve		
7.	Other Reserves (to be specified)		
8.	Balance of profit in Profit and Loss Account		
	TOTAL		

Note: Additions to and deductions from the reserves should be disclosed under each of the specified heads.

Annexure

SCHEDULE – 7

BORROWINGS

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Debentures/Bonds		
2.	Banks		
3.	Financial Institutions		
4.	Others (to be specified)		
	TOTAL		

Notes:

(a) The extent to which the borrowings are secured shall be separately disclosed stating the nature of the security under each sub-head.

(b) Amounts due within 12 months from the date of Balance Sheet should be shown separately

Annexure

SCHEDULE – 8

INVESTMENTS – SHAREHOLDERS

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
	LONG TERM INVESTMENTS		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other Approved Securities		
3.	Other Investments		
	(a) Shares (aa) Equity (bb) Preference (b) Mutual Funds (c) Derivative Instruments		

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
	(d) Debentures/Bonds (e) Other Securities (to be specified) (f) Subsidiaries (g) Investment Properties – Real Estate		
4.	Investment in Infrastructure and Social Sector		
5.	Other than Approved Investments		
	SHORT TERM INVESTMENTS		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other Approved Securities		
3.	Other Investments (a) Shares (aa) Equity (bb) Preference (b) Mutual Funds (c) Derivative Instruments (d) Debentures/Bonds (e) Other Securities (to be specified) (f) Subsidiaries (g) Investment Properties - Real Estate		
4.	Investments in Infrastructural and Social Sector		
5.	Other than Approved Investments		
	TOTAL		

Note: Refer notes under Schedule 8B

Annexure

SCHEDULE – 8A

INVESTMENTS – POLICYHOLDERS

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
	LONG TERM INVESTMENTS		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other Approved Securities		
3.	(a) Shares (aa) Equity (bb) Preference (b) Mutual Funds (c) Derivative Instruments		

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
	(d) Debentures/Bonds (e) Other Securities (to be specified) (f) Subsidiaries (g) Investment Properties - Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than Approved Investments		
	SHORT TERM INVESTMENTS		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other Approved Securities		
3.	(a) Shares (aa) Equity (bb) Preference (b) Mutual Funds (c) Derivative Instruments (d) Debentures/Bonds (e) Other Securities (to be specified) (f) Subsidiaries (g) Investment Properties - Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than Approved Investments		
	SHORT TERM INVESTMENTS		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other Approved Securities		
3.	(a) Shares (aa) Equity (bb) Preference (b) Mutual Funds (c) Derivative Instruments (d) Debentures/Bonds (e) Other Securities (to be specified) (f) Subsidiaries (g) Investment Properties - Real Estate		
4.	Investments in Infrastructure and Social Sector		
5.	Other than Approved Investments		
	TOTAL		

Notes: (applicable to Schedules 8, 8A and 8B)

(a) Investments in subsidiary/holding companies, joint ventures and associates shall be separately disclosed, at cost.

i. Holding company and subsidiary shall be construed as defined in the Companies Act, 1956.

ii. Joint Venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

iii. Joint control – is the contractually agreed sharing of power to govern the financial and operating policies of an economic activity to obtain benefits from it.

iv. Associate – is an enterprise in which the company has significant influence and which is neither a subsidiary nor a joint venture of the company.

v. Significant influence (for the purpose of this schedule) – means participation in the financial and operating policy decisions of a company, but not control of those policies.

vi. Significant influence may be exercised in several ways, for example, by representation on the board of directors, participation in the policy making process, material inter-company transactions, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiaries, 20 percent or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20 percent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence is clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

(b) Aggregate amount of company's investments other than listed equity securities and derivative instruments and also the market value thereof shall be disclosed.

(c) Investments made out of Catastrophe reserve should be shown separately

(d) Debt securities will be considered as "held to maturity" securities and will be measured at historical costs subject to amortization

(e) Investment Property means a property [land or building or part of a building or both] held to earn rental income or for capital appreciation or for both, rather than for use in services or for administrative purposes.

(f) Investment maturing within twelve months from balance sheet date and investments made with the specific intention to dispose of within twelve months from balance sheet date shall be classified as short-term investments.

Annexure

SCHEDULE – 9

LOANS

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
1.	**SECURITY-WISE CLASSIFICATION**		
	Secured		
	(a) On mortgage of property (aa) In India (bb) Outside India		
	(b) On Shares, Bonds, Govt. Securities, etc.		
	(c) Loans against policies		
	(d) Others (to be specified)		
	Unsecured		
	TOTAL		

2.	**BORROWER-WISE CLASSIFICATION**		
	(a) Central and State Governments		
	(b) Banks and Financial Institutions		
	(c) Subsidiaries		
	(d) Companies		
	(e) Loans against policies		
	(f) Others (to be specified)		
	TOTAL		
3.	**PERFORMANCE-WISE CLASSIFICATION**		
	(a) Loans classified as standard (aa) In India (bb) Outside India		
	(b) Non-standard loans less provisions (aa) In India (bb) Outside India		
	TOTAL		
4.	**MATURITY-WISE CLASSIFICATION**		
	(a) Short Term		
	(b) Long Term		
	TOTAL		

Notes:

(a) Short-term loans shall include those, which are repayable within 12 months from the date of balance sheet. Long term loans shall be the loans other than short term loans.

(b) Provisions against non-performing loans shall be shown separately.

(c) The nature of the security in case of all long term secured loans shall be specified in each case. Secured loans for the purposes of this schedule, means loans secured wholly or partly against an asset of the company.

(d) Loans considered doubtful and the amount of provision created against such loans shall be disclosed.

Annexure

SCHEDULE – 10

FIXED ASSETS

(Rs.'000)

Particulars	**Cost/ Gross Block**				**Depreciation**				**Net Block**	
	Opening	Additions	Deductions	Closing	Up to Last Year	For The Year	On Sales/ Adjustments	To Date	As at year end	Previous year
Goodwill										
Intangibles (specify)										

Particulars	Cost/ Gross Block				Depreciation				Net Block	
	Opening	Additions	Deductions	Closing	Up to Last Year	For The Year	On Sales/ Adjustments	To Date	As at year end	Previous year
Land – Freehold										
Leasehold Property										
Buildings										
Furniture & Fittings										
Information Technology Equipment										
Vehicles										
Office Equipment										
Others (Specify nature)										
TOTAL										
Work-in-Progress										
Grand Total										
Previous Year										

Note:

Assets included in land, property and building above exclude Investment Properties as defined in note (e) to Schedule 8.

Annexure

SCHEDULE – 11

CASH AND BANK BALANCES

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Cash (including cheques, drafts and stamps)		
2.	Bank Balances		
	(a) Deposit Accounts (aa) Short-term (due within 12 months of the date of Balance Sheet) (bb) Others (b) Current Accounts (c) Others (to be specified)		
3.	Money at Call and Short Notice (a With Banks (b) With other Institutions		

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
4.	Others (to be specified)		
	TOTAL		
	Balances with non-scheduled banks included in 2 and 3 above		
	CASH & BANK BALANCES		
1.	In India		
2.	Outside India		
	TOTAL		

Note: Bank balance may include remittances in transit. If so, the nature and amount should be separately stated.

Annexure

SCHEDULE – 12

ADVANCES AND OTHER ASSETS

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
	ADVANCES		
1.	Reserve deposits with ceding companies		
2.	Advances to ceding companies		
3.	Application money for investments		
4	Prepayments		
5.	Advances to Officers/ Directors		
6.	Advance tax paid and taxes deducted at source		
7.	Others (to be specified)		
	TOTAL (A)		
	OTHER ASSETS		
1.	Income accrued on investments		
2.	Outstanding Premiums		
3.	Agents' Balances		
4.	Foreign Agencies' Balances		
5.	Due from other entities carrying on insurance business		
6.	Due from subsidiaries/ holding company		
7.	Deposit with Reserve Bank of India [Pursuant to section 7 of Insurance Act, 1938]		
8.	Others (to be specified)		
	TOTAL (B)		
	TOTAL (A+B)		

Notes:

(a) The items under the above heads shall not be shown net of provisions for doubtful amounts. The amount of provision against each head should be shown separately.

(b) The term 'officer' should conform to the definition of the word 'officer' under the Companies Act, 1956.

(c) Sundry debtors will be shown under item 8 (others)

Annexure

SCHEDULE – 13

CURRENT LIABILITIES

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
1.	Agents' Balances		
2.	Balances due to other insurance companies		
3.	Advances from Treaty Companies		
4	Deposits held on re-insurance ceded		
5.	Premiums received in advance		
6.	Sundry creditors		
7.	Due to subsidiaries/holding company		
8	Claims Outstanding		
9	Annuities Due		
10.	Due to Officers/Directors		
11.	Others (to be specified)		
	TOTAL		

Annexure

SCHEDULE – 14

PROVISIONS

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
1.	For taxation (less payments and taxes deducted at source)		
2.	For proposed dividends		
3.	For dividend distribution tax		
4	Others (to be specified)		
	TOTAL		

Annexure

SCHEDULE – 15

MISCELLANEOUS EXPENDITURE

(To the extent not written off or adjusted)

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1	Discount Allowed in issue of shares/debentures		
2.	Others (to be specified)		
	TOTAL		

Notes:

1. No item shall be included under the head "Miscellaneous Expenditure" and carried forward unless:
    a. Some benefit from the expenditure can reasonably be expected to be received, and
    b. The amount of such benefit is reasonably determinable.
2. The amount to be carried forward in respect of any item included under the head "Miscellaneous Expenditure" shall not exceed the expected future revenue/other benefits related to the expenditure.

GENERAL INSURANCE COMPANIES

An insurer carrying on general insurance business, after the commencement of these Regulations, shall comply with the requirements of Schedule B:

SCHEDULE B

NON-LIFE INSURANCE BUSINESS

Accounting principles for preparation of financial statements

1. Applicability of Accounting Standards – Every Balance Sheet, Receipts and Payments Account [Cash Flow statement] and Profit and Loss Account [Shareholders' Account] of the insurer shall be in conformity with the Accounting Standards (AS) issued by the ICAI, to the extent applicable to the insurers carrying on general insurance business, except that:
    i. Accounting Standard 3 (AS 3) – Cash Flow Statements – Cash Flow Statement shall be prepared only under the Direct Method.
    ii. Accounting Standard 13 (AS 13) – Accounting for Investments, shall not be applicable.
    iii. Accounting Standard 17 (AS 17) – Segment Reporting – shall apply irrespective of whether the securities of the insurer are traded publicly or not.

Preparation of Financial Statements

(1) An insurer shall prepare the Revenue Account, Profit and Loss Account [Shareholders' Account] and the Balance Sheet in Form B-RA, Form B-PL, and Form B-BS, or as near thereto as the circumstances permit.

Provided that an insurer shall prepare Revenue Account separately for fire, Marine, and Miscellaneous insurance business.

(2) An insurer shall prepare separate Receipts and Payments Account in accordance with the Direct Method prescribed in AS 3 – "Cash Flow Statement" issued by the ICAI.

FORM B-RA

Name of the Insurer:
Registration No. and Date of Registration with the IRDA

REVENUE ACCOUNT FOR THE YEAR ENDED

31ST MARCH, 20___.

(To be prepared separately fire, marine, and miscellaneous insurance)

	Particulars	Schedule	Current Year (Rs.'000).	Previous Year (Rs.'000)
1.	Premiums earned (Net)	1		
2.	Profit/Loss on Sale/ redemption of Investments			
3.	Others (to be specified)			
4.	Interest, Dividend & Rent – Gross			
	TOTAL (A)			
1.	Claims Incurred (Net)	2		
2.	Commission	3		
3.	Operating Expenses related to Insurance Business	4		
	TOTAL (B)			
	Operating Profit/(Loss) from Fire/Marine/Miscellaneous Business C = (A – B)			
	APPROPRIATIONS			
	Transfer to Shareholders' Account			
	Transfer to Catastrophe Reserves			
	Transfer to Other Reserves (to be specified)			

FORM B-PL

Name of the Insurer:

Registration No. and Date of Registration with the IRDA

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST MARCH, 20___.

	Particulars	**Schedule**	**Current Year (Rs.'000)**	**Previous Year (Rs.'000)**
1.	Operating Profit/(Loss)			
	(a) Fire Insurance (b) Marine Insurance (c) Miscellaneous Insurance			
2	Income From Investments			
	(a) Interest, Dividend & Rent – Gross (b) Profit on sale of investments Less: Loss on sale of investments			
3.	Other Income (To be specified)			
	Total (A)			
4.	PROVISIONS (Other than taxation)			
	(a) For diminution in the value of investments (b) For doubtful debts (c) Others (to be specified)			
5.	Other Expenses			
	(a) Expenses other than those related to Insurance Business (b) Bad debts written off (c) Others (To be specified)			
	Total (B)			
	Profit Before Tax			
	Provision for Taxation			
	Appropriations			
	(a) Interim dividends paid during the year (b) Proposed final dividend (c) Dividend distribution tax (d) Transfer to any Reserves or Other Accounts (to be specified)			
	Balance of profit/ loss brought forward from last year			
	Balance carried forward to Balance Sheet			

Form B-BL

Name of the Insurer:
Registration No. and Date of Registration with the IRDA

Balance Sheet As At 31st March, 20__.

	Schedule	Current Year (Rs.'000).	Previous Year (Rs.'000).
Sources Of Funds			
Share Capital	5		
Reserves And Surplus	6		
Fair Value Change Account			
Borrowings	7		
TOTAL			
Application Of Funds			
Investments	8		
Loans	9		
Fixed Assets	10		
Current Assets			
Cash and Bank Balances	11		
Advances and Other Assets	12		
Sub-Total (A)			
Current Liabilities	13		
Provisions	14		
Sub-Total (B)			
Net Current Assets (C) = (A - B)			
Miscellaneous Expenditure (to the extent not written off or adjusted)	15		
Debit Balance In Profit And Loss Account			
TOTAL			

CONTINGENT LIABILITIES

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Partly paid-up investments		
2.	Claims, other than against policies, not acknowledged as debts by the company		
3.	Underwriting commitments outstanding		
4.	Guarantees given by or on behalf of the Company		
5.	Statutory demands/ liabilities in dispute, not provided for		

6.	Reinsurance obligations to the extent not provided for in accounts		
7.	Others (to be specified)		
	Total		

SCHEDULES FORMING PART OF FINANCIAL STATEMENTS
Schedule – 1
PREMIUM EARNED [NET]

Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
Premium from direct business written Add: Premium on reinsurance accepted Less: Premium on reinsurance ceded Net Premium Adjustment for change in reserve for unexpired risks		
Total Premium Earned (Net)		

Notes: Reinsurance premiums whether on business ceded or accepted are to be brought into account, before deducting commission, under the head of reinsurance premiums.

Schedule

Claims Incurred [Net]

Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
Claims paid		
Direct Add: Re-insurance accepted Less: Re-insurance Ceded Net Claims paid		
Add: Claims Outstanding at the end of the year		
Less: Claims Outstanding at the beginning		
TOTAL CLAIMS INCURRED		

Notes:

a) Incurred But Not Reported (IBNR), Incurred but not enough reported [IBNER] claims should be included in the amount for outstanding claims.

b) Claims includes specific claims settlement cost but not expenses of management.

c) The surveyor fees, legal and other expenses shall also form part of claims cost.

d) Claims cost should be adjusted for estimated salvage value if there is a sufficient certainty of its realisation.

Schedule

Commission

Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
Commission paid		
Direct Add: Re-insurance Accepted Less: Commission on Re-Insurance Ceded		
Net Commission		

Note:

The profit/commission, if any, are to be combined with the Re-insurance accepted or Re-insurance ceded figures.

Schedule

Operating Expenses Related To Insurance Business

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Employees' remuneration & welfare benefits		
2.	Travel, conveyance and vehicle running expenses		
3.	Training expenses		
4.	Rents, rates & taxes		
5.	Repairs		
6.	Printing & stationery		
7.	Communication		
8	Legal & professional charges		
9.	Auditors' fees, expenses etc.		
	(a) as auditor (b) as adviser or in any other capacity, in respect of (i) Taxation matters (ii) Insurance matters (iii) Management services; and (c) in any other capacity		
10.	Advertisement and publicity		
11.	Interest & Bank Charges		
12.	Others (to be specified)		
13.	Depreciation		
	TOTAL		

Notes:

Items of expenses in excess of one percent of the total premium (less reinsurance) or Rs.5,00,000 whichever is higher, shall be shown as a separate line item.

Schedule

Share Capital

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Authorized Capital		
	Equity Shares of Rs..... each		
2	Issued Capital		
	Equity Shares of Rs. .....each		
3.	Subscribed Capital		
	Equity Shares of Rs.......each		
4.	Called-up Capital		
	Equity Shares of Rs. .....each		
5.	Less: Calls unpaid		
	Add: Equity Shares forfeited (Amount originally paid up)		
	Less: Preliminary Expenses Expenses including commission or brokerage on Underwriting or subscription of shares		
	Total		

Notes:

(a) Particulars of the different classes of capital should be separately stated.

(b) The amount capitalised on account of issue of bonus shares should be disclosed.

(c) In case any part of the capital is held by a holding company, the same should be separately disclosed.

Schedule

Share Capital

Pattern of Shareholding

[As certified by the Management]

Shareholder	Current year		Previous year	
	Number of Shares	**% of Holding**	**Number of Share**	**% of Holding**
Promoters ● Indian ● Foreign				
Others				
Total				

Schedule

Reserves and Surplus

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
1.	Capital Reserve		
2.	Capital Redemption Reserve		
3.	Share Premium		
4.	General Reserves Less: Debit balance in Profit and Loss Account Less: Amount utilized for Buy-back		
5.	Catastrophe Reserve		
6.	Other Reserves (to be specified)		
7.	Balance of Profit in Profit & Loss Account		
	Total		

Note:

Additions to and deductions from the reserves should be disclosed under each of the specified heads.

Schedule

Borrowings

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000)**
1.	Debentures/Bonds		
2.	Banks		
3.	Financial Institutions		
4.	Others (to be specified)		
	Total		

Notes:

i. The extent to which the borrowings are secured shall be separately disclosed stating the nature of the security under each sub-head.

ii. Amounts due within 12 months from the date of Balance Sheet should be shown separately.

Schedule

Investments

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
	Long Term Investments		
1.	Government securities and Government guaranteed bonds including Treasury Bills		

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
2.	Other Approved Securities		
3.	Other Investments		
	(a) Shares (aa) Equity (bb) Preference (b) Mutual Funds (c) Derivative Instruments		
	(d) Debentures/Bonds (e) Other Securities (to be specified) (f) Subsidiaries (g) Investment Properties - Real Estate		
	Short Term Investments		
1.	Government securities and Government guaranteed bonds including Treasury Bills		
2.	Other Approved Securities		
3.	Other Investments		
	(a) Shares (aa) Equity (bb) Preference (b) Mutual Funds (a) Derivative Instruments (b) Debentures/Bonds (c) Other Securities (to be specified) (d) Subsidiaries (g) Investment Properties - Real Estate		
4	Investment in Infrastructure and Social Sector		
	Total		

Notes:

(a) Investments in subsidiary/holding companies, joint ventures and associates shall be separately disclosed, at cost.

i. Holding company and subsidiary shall be construed as defined in the Companies Act, 1956 / 2013.

ii. Joint Venture is a contractual arrangement whereby two or more parties undertake an economic activity, which is subject to joint control.

iii. Joint control – is the contractually agreed sharing of power to govern the financial and operating policies of an economic activity to obtain benefits from it.

iv. Associate – is an enterprise in which the company has significant influence and which is neither a subsidiary nor a joint venture of the company.

v. Significant influence (for the purpose of this Schedule) – means participation in the financial and operating policy decisions of a company, but not necessarily control of those policies personnel or dependence on technical information. Significant influence may be gained by share ownership, statute or agreement. As regards share ownership, if an investor holds, directly or indirectly through subsidiaries, 20 percent or more of the voting power of the investee, it is presumed that the investor does have significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20 percent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence is clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

(b) Aggregate amount of company's investments other than listed equity securities and derivative instruments and also the market value thereof shall be disclosed.

(c) Investments made out of Catastrophe reserve should be shown separately.

(d) Debt securities will be considered as "held to maturity" securities and will be measured at historical cost subject to amortisation.

(e) Investment Property means a property [land or building or part of a building or both] held to earn rental income or for capital appreciation or for both, rather than for use in services or for administrative purposes.

(f) Investments maturing within twelve months from balance sheet date and investments made with the specific intention to dispose of within twelve months from balance sheet date shall be classified as short-term investments.

Schedule

Loans

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
1.	**Security-Wise Classification**		
	Secured		
	(a) On mortgage of property (aa) In India (bb) Outside India (b) On Shares, Bonds, Govt. Securities (c) Others (to be specified) Unsecured		
	Total		
2.	Borrower-Wise Classification		
	(a) Central and State Governments		
	(b) Banks and Financial Institutions		
	(c) Subsidiaries		
	(d) Industrial Undertakings		
	(e) Others (to be specified)		
	Total		
3.	Performance-Wise Classification		

	(a) Loans classified as standard (aa) In India (bb) Outside India		
	(b) Non-performing loans less provisions (aa) In India (bb) Outside India		
	Total		
4.	Maturity-Wise Classification		
	(a) Short-Term		
	(b) Long-Term		
	Total		

Notes:

a. Short-term loans shall include those, which are repayable within 12 months of the balance sheet date. Long term loans shall be the loans other than short-term loans.

b. Provisions against non-performing loans shall be shown separately.

c. The nature of the security in case of all long term secured loans shall be specified in each case.

d. Secured loans for the purposes of this schedule, means loans secured wholly or partly against an asset of the company.

e. Loans considered doubtful and the amount of provision created against such loans shall be disclosed.

Schedule

Fixed Assets

(Rs.'000)

Particulars	Cost /Gross Block/ Depreciation				Net Block					
	Opening	Additions	Deductions	Closing	Upto Last Year	For the Year	On Sales/ Adjustment	To Date	As at year end	Previous Year
Goodwill										
Intangible (specify)										
Land-Freehold										
Leasehold Property										
Buildings										
Furniture & Fittings										
Information Technology Equipment										
Vehicles										
Office Equipment										
Others (Specify nature)										
TOTAL										

Work-in-progress										
Grand Total										
Previousyear										

Note:

Assets included in land, building and property above exclude Investment Properties as defined in note (e) to Schedule 8.

Schedule

Cash And Bank Balances

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
1.	Cash (including cheques, drafts and stamps)		
2.	Bank Balances		
	(a) Deposit Accounts (aa) Short-term (due within 12 months) (bb) Others (b) Current Accounts (c) Others (to be specified)		
3.	Money at Call and Short Notice		
	(a With Banks (b) With other Institutions		
4.	Others (to be specified)		
	Total		
	Balances with non-scheduled banks included in 2 and 3 above		

Notes:

Bank balance may include remittances in transit. If so, the nature and amount should be separately stated.

Schedule

Advances And Other Assets

	Particulars	Current Year (Rs.'000).	Previous Year (Rs.'000).
	Advances		
1.	Reserve deposits with ceding companies		
2	Application money for investments		
3.	Prepayments		
4.	Advance tax paid and taxes deducted at source (Net of Provision for taxation)		
5.	Others (to be specified)		
	Total (A)		

	Other Assets		
1.	Income accrued on investments		
2.	Outstanding Premiums		
3.	Agents' Balances		
4.	Foreign Agencies' Balances		
5.	Due from other Entities carrying an Insurance Business (Including reinsurance)		
6.	Due from subsidiaries/ holding		
7.	Deposit with Reserve Bank of India [Pursuant to section 7 of Insurance Act, 1938]		
8.	Others (to be specified)		
	Total (B)		
	Total (A+B)		

Notes:

i. The items under the above heads shall not be shown net of provisions for doubtful amounts. The amount of provision against each head should be shown separately.

ii. The term 'officer' should conform to the definition of the word 'officer' given under the Companies Act, 2013.

iii. Sundry Debtors will be shown under item 9 (Other)

Schedule

Current Liabilities

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000)**
1.	Agents' Balances		
2.	Balances due to other insurance companies		
3.	Deposits held on re-insurance ceded		
4.	Premiums received in advance		
5.	Unallocated Premium		
6.	Sundry creditors		
7.	Due to subsidiaries/holding company		
8.	Claims Outstanding		
9.	Due to Officers/Directors		
10.	Others (to be specified)		
	TOTAL		

Schedule

Provisions

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
1.	Reserve for Unexpired risk		
2.	For taxation (less advance tax paid and taxes deducted at source)		
3.	For proposed dividends		
4.	For dividend distribution tax		
5.	Others (to be specified)		
	TOTAL		

Schedule – 15

Miscellaneous Expenditure

(To the extent not written off or adjusted)

	Particulars	**Current Year (Rs.'000).**	**Previous Year (Rs.'000).**
1.	Discount Allowed in issue of shares/ debentures		
2.	Others (to be specified)		
	Total		

Notes:

a. No item shall be included under the head "Miscellaneous Expenditure" and carried forward unless:

1. Some benefit from the expenditure can reasonably be expected to be received in future, and
2. the amount of such benefit is reasonably determinable.

b. The amount to be carried forward in respect of any item included under the head "Miscellaneous Expenditure" shall not exceed the expected future revenue/other benefits related to the expenditure.

Additional schedule for General Insurance Company (The formats given above pertain to Non-Life Insurance companies or General Insurance companies only)

Schedule

Auditor's Report

The report of the auditors on the financial statements of every insurer shall deal with the matters specified herein:

1. (a) That they have obtained all the information and explanations which, to the best of their knowledge and belief were necessary for the purposes of their audit and whether they have found them satisfactory;

(b) Whether proper books of account have been maintained by the insurer so far as appears from an examination of those books;

(c) Whether proper returns, audited or unaudited, from branches and other offices have been received and whether they were adequate for the purpose of audit;

(d) Whether the Balance sheet, Revenue account, Profit and Loss account and Receipts and Payments Account dealt with by the report are in agreement with the books of account and returns;

(e) Whether the actuarial valuation of liabilities is duly certified by the appointed actuary including to the effect that the assumptions for such valuation are in accordance with the guidelines and norms, if any, issued by the Authority, and/or the Actuarial Society of India in concurrence with the Authority.

2. The auditors shall express their opinion on:

i. Whether the balance sheet gives a true and fair view of the insurer's affairs as at the end of the financial year/period;

ii. Whether the revenue account gives a true and fair view of the surplus or the deficit for the financial year/period;

iii. Whether the profit and loss account gives a true and fair view of the Profitor loss for the financial year/period;

iv. Whether the receipts and payments account gives a true and fair view of the receipts and payments for the financial year/period;

v. The financial statements stated at (a) above are prepared in accordance with the requirements of the Insurance Act, 1938 (4 of 1938), the Insurance Regulatory and Development Authority Act, 1999 (41 of 1999) and the Companies Act, 2013 to the extent applicable and in the manner so required;

vi. Investments have been valued in accordance with the provisions of the Act and these Regulations;

vii. The accounting policies selected by the insurer are appropriate and are in compliance with the applicable Accounting Standards and with the accounting principles, as prescribed in these Regulations or any order or direction issued by the Authority in this behalf.

3. The auditors shall further certify that:

(a) they have reviewed the management report and there is no apparent mistake or material inconsistencies with the financial statements;

(b) the insurer has complied with the terms and conditions of the registration stipulated by the Authority.

4. A certificate signed by the auditors [which shall be in addition to any other certificate or report which is required by law to be given with respect to the balance sheet]certifying that:–

a. they have verified the cash balances and the securities relating to the insurer's loans, reversions and life interests (in the case of life insurers) and investments;

b. to what extent, if any, they have verified the investments and transactions;

c. relating to any trusts undertaken by the insurer as trustee; and

d. no part of the assets of the policyholders' funds has been directly or indirectly applied in contravention of the provisions of the Insurance Act, 1938 (4 of 1938) relating to the application and investments of the policyholders' funds.

Annexure – 1

Asset Classification Of Investments Of Icici Prudential Life Insurance Company

All investments are made in accordance with the regulatory norms, Investment Policy, fund objectives of unit linked funds, asset liability management guidelines and risk profile of the respective fund.

The portfolio mix of assets of the Company at March 31, 2018 is as follows:

Asset class	Linked funds	Non-Linked funds	Shareholders' funds	Total	Amount (₹ billion)
Equity shares^	59.4%	16.5%	20.4%	46.7%	651.50
Government securities	12.4%	58.5%	34.5%	25.0%	348.27
Debentures and bonds*	16.4%	15.4%	28.5%	16.8%	234.96
Money market instruments	8.4%	1.8%	3.2%	6.5%	90.66
Fixed deposits	0.1%	0.9%	3.1%	0.5%	6.32
Mutual funds	2.3%	4.2%	3.4%	2.8%	39.08
Investment property	0.0%	0.2%	4.9%	0.3%	4.67
Loan against policies	0.0%	0.4%	0.0%	0.1%	1.45
Net current assets and other investments	1.0%	2.1%	2.0%	1.3%	18.41
Total	**975.02**	**341.41**	**78.89**	**100.0%**	**1,229.19**
Fund mix (%)	**69.9%**	**24.5%**	**5.6%**	**100.0%**	**-**

^ includes investment of ₹ 3.82 billion in equity exchange traded funds in linked line of business and ₹ 0.29 billion in investment in subsidiary in Shareholder line of business

* includes convertible preference shares.

Source: *https://www.iciciprulife.com/content/dam/icicipru/about-us/FinancialInformation/AnnualReports/FY2022-AnnualReport.pdf*

Annexure – 2

Asset Classification of Investments Of ICICI Lombard General Insurance Company

PERIODIC DISCLOSURES
FORM NL-12 & 12A-INVESTMENT SCHEDULE

Name of the Insurer: ICICI Lombard General Insurance Company Limited

Registration No. 115 dated August 03, 2001
CIN: L67200MH2000PLC129408

INVESTMENT SCHEDULE (₹ lakhs)

		NL-12 Shareholders			NL-12A Policyholders			Total		
	Particulars	At June 30, 2022	At March 31, 2022	At June 30, 2021	At June 30, 2022	At March 31, 2022	At June 30, 2021	At June 30, 2022	At March 31, 2022	At June 30, 2021
	LONG TERM INVESTMENTS									
1	Government securities and Government guaranteed bonds including Treasury Bills	384,697	356,758	323,192	1,401,441	1,229,921	1,119,579	1,786,138	1,586,679	1,442,771
2	Other Approved Securities	-	-	-	-	-	-	-	-	-
3	Other Investments									
	(a) Shares									
	(aa) Equity (notes 1 and 6 below)	98,039	91,809	81,842	318,382	305,379	283,510	416,401	397,188	365,352
	(bb) Preference	777	763	739	2,523	2,537	2,561	3,300	3,300	3,300
	(b) Mutual Funds	-	-	-	-	-	-	-	-	-
	(c) Derivative Instruments	-	-	-	-	-	-	-	-	-
	(d) Debentures/ Bonds (notes 2 and 7 below)	67,457	77,053	90,844	219,051	256,297	314,697	286,508	333,350	405,541
	(e) Other Securities	28,415	30,624	29,220	84,886	94,293	93,340	113,301	124,917	122,560
	(f) Subsidiaries	-	-	-	-	-	-	-	-	-
	(g) Investment Properties-Real Estate (notes 3 and 8 below)	8,836	8,648	6,009	28,694	28,767	20,816	37,530	37,415	26,825
4	Investments in Infrastructure and Housing	191,407	196,540	187,686	621,557	653,736	650,169	812,964	850,276	837,855
5	Other than Approved Investments	-	-	-	-	-	-	-	-	-
	TOTAL	**779,628**	**762,195**	**719,532**	**2,676,514**	**2,570,930**	**2,484,672**	**3,456,142**	**3,333,125**	**3,204,204**
	SHORT TERM INVESTMENTS									
1	Government securities and Government guaranteed bonds including Treasury Bills	33,095	11,052	8,051	107,469	36,761	27,888	140,564	47,813	35,939
2	Other Approved Securities (notes 4 and 9 below)	24,130	20,047	14,906	78,357	66,680	51,637	102,487	86,727	66,543
3	Other Investments									
	(a) Shares									
	(aa) Equity	-	-	-	-	-	-	-	-	-
	(bb) Preference	-	-	30	-	-	104	-	-	134
	(b) Mutual Funds	24,609	24,488	22,568	66,723	66,310	73,121	91,332	90,798	95,689
	(c) Derivative Instruments	-	-	-	-	-	-	-	-	-
	(d) Debentures/ Bonds	26,123	23,034	38,267	84,830	76,617	132,563	110,953	99,651	170,830
	(e) Other Securities	-	33,264	14,663	-	110,642	50,794	-	143,906	65,457
	(f) Subsidiaries	-	-	-	-	-	-	-	-	-
	(g) Investment Properties-Real Estate	-	-	-	-	-	-	-	-	-
4	Investments in Infrastructure and Housing	19,285	17,707	16,117	62,624	58,897	55,833	81,909	76,604	71,950
5	Other than Approved Investments	-	-	-	-	-	-	-	-	-
	TOTAL	**127,242**	**129,992**	**114,802**	**400,003**	**415,907**	**391,940**	**527,245**	**545,499**	**506,542**
	GRAND TOTAL	**906,870**	**891,787**	**834,134**	**3,076,517**	**2,986,837**	**2,876,612**	**3,983,387**	**3,878,624**	**3,710,746**

A) Aggregate value of Investments other than Listed Equity Securities and Derivative Instruments (₹ lakhs)

	Particulars	Shareholders			Policyholders			Total		
		At June 30, 2022	At March 31, 2022	At June 30, 2021	At June 30, 2022	At March 31, 2022	At June 30, 2021	At June 30, 2022	At March 31, 2022	At June 30, 2021
	Long Term Investments -									
	Book Value	676,025	656,780	627,823	2,340,084	2,220,294	2,166,290	3,016,109	2,877,074	2,793,913
	Market Value	682,705	667,205	644,506	2,290,948	2,253,939	2,224,772	2,953,653	2,921,144	2,869,278
	Short Term Investments -									
	Book Value	127,177	129,584	114,536	399,911	415,884	391,727	527,088	545,468	506,263
	Market Value	127,411	130,459	115,784	400,553	418,792	396,035	527,964	549,251	511,819

Investments - Shareholders
1. Includes investments in Perpetual Bonds of ₹ 4,001 lakh (previous year : ₹ 33,264 lakh and corresponding previous period : ₹ 38,497 lakh)
2. Investment Properties-Real Estate includes investments in immovable real estate properties of ₹ 2,373 lakh (previous year: ₹ 2,345 lakh and corresponding previous period : ₹ 2,316 lakh) (disclosed at cost less accumulated depreciation of ₹ 429 lakh (previous year: ₹ 406 lakh and corresponding previous period : ₹ 350 lakh)). The fair value of Real Estate is ₹ 3,081 lakh (previous year: ₹ 3,005 lakh and corresponding previous period : ₹ 2,912 lakh) which is based on a valuation report and Real Estate Investment Trust units at fair value of ₹ 6,463 lakh (previous year: ₹ 6,303 lakh and corresponding previous period : ₹ 3,693 lakh).
3. Short term other approved securities includes Certificate of Deposits amounting to ₹ 10,382 lakhs, Fixed deposits amounting to ₹ NIL, Commercial Paper amounting to ₹ 6,355 lakh and TREPS amounting to ₹ 7,391 lakh (previous year: Certificate of Deposits amounting to ₹ 3,361 lakh, Fixed deposits amounting to ₹ 1,156 lakh, Commercial Paper amounting to ₹ 6,767 lakh and TREPS amounting to ₹ 8,762 lakh and corresponding previous period : Certificate of Deposits amounting to ₹ 560 lakh, Fixed deposits amounting to ₹ 3,360 lakh, Commercial Paper amounting to ₹ 4,374 lakh and TREPS amounting to ₹ 6,613 lakh).
4. Investment assets have been allocated in the ratio of policyholders and shareholders funds

Investments - Policyholders
5. Includes investments in Perpetual Bonds of ₹ 12,991 lakh (previous year : ₹ 110,642 lakh and corresponding previous period : ₹ 133,359 lakh).
6. Investment Properties-Real Estate includes investments in immovable real estate properties of ₹ 7,707 lakh (previous year: ₹ 7,800 lakh and corresponding previous period : ₹ 8,024 lakh) (disclosed at cost less accumulated depreciation of ₹ 1,393 lakh (previous year: ₹ 1,351 lakh and corresponding previous period : ₹ 1,213 lakh)). The fair value of Real Estate is ₹ 9,939 lakh (previous year: ₹ 9,995 lakh and corresponding previous period : ₹ 10,088 lakh) which is based on a valuation report and Real Estate Investment Trust units at fair value of ₹ 20,987 lakh (previous year: ₹ 20,966 lakh and corresponding previous period : ₹ 12,793 lakh).
7. Short term other approved securities includes Certificate of Deposits amounting to ₹ 33,713 lakhs, Fixed deposits amounting to ₹ NIL, Commercial Paper amounting to ₹ 20,637 lakh and TREPS amounting to ₹ 24,007 lakh (previous year: Certificate of Deposits amounting to ₹ 11,181 lakhs, Fixed deposits amounting to ₹ 3,844 lakhs, Commercial Paper amounting to ₹ 22,510 lakh and TREPS amounting to ₹ 29,146 lakh and corresponding previous period : Certificate of Deposits amounting to ₹ 1,939 lakh, Fixed deposits amounting to ₹ 11,639 lakh, Commercial Paper amounting to ₹ 15,151 lakh and TREPS amounting to ₹ 22,907 lakh).
8. Investment assets have been allocated in the ratio of policyholders and shareholders funds.

Source: *https://www.iciciprulife.com/content/dam/icicipru/about-us/FinancialInformation/AnnualReports/FY2022-AnnualReport.pdf*

III. T, Cyber Security & Data Protection Compliances

All insurers regardless of size, complexity, or lines of business, collect, store, and share with various third-parties (e.g., service providers, reinsurers etc.), substantial amounts of personal and confidential policyholder information, including in some instances sensitive health-related information. Insurance repositories, call centers, Common Service Centers etc. also have access to policyholders' data.

While Information sharing is essential for conducting the business operations, it is essential to ensure that adequate systems and procedures are in place for ensuing that there is no leakage of information and information is shared only on need-to-know basis.

Further, due to rapid development Information Technology, there are many challenges in maintaining confidentiality of information. The technology even though has many advantages, brings in risks associated with it like any other technology. With the fast growth of web based applications, cyber threat landscape has been growing and there is concern across all sectors. Cyber risks have grown and cyber criminals have become increasingly sophisticated.

For insurers, cyber security incidents can harm the ability to conduct business, compromise the protection of personal and proprietary data, and undermine confidence in the sector. It is observed that the level of awareness of cyber threats and cyber security within the insurance sector, as well as supervisory approaches to combat the risks, appear to vary across organizations. Information obtained from regulated entities through cyber-crime may be used for financial gain through extortion, identity theft, misappropriation of intellectual property, or other criminal activities.

Exposure of personal data can potentially result in severe harm for the affected policyholders, as well as reputational damage to insurance sector participants. Similarly, malicious cyber-attacks against an insurer's and Insurance Intermediaries' critical systems may impede its ability to conduct business.

Therefore, guidelines on Information and Cyber Security for Insurers has been drafted by the Regulator, Insurance Regulatory and Development Authority of India (IRDAI). Such security related issues have the potential to undermine public confidence and may lead to reputation risks to insurers. Hence, it is essential to ensure that a uniform framework for information and cyber security is implemented for insurers and an in-built governance mechanism is in place within the regulated entities in order to make sure that all such security related issues are addressed time to time.

The vision and objective of these guidelines are

- To ensure that a Board approved Information and Cyber Security policy is in place with all insurers.
- To ensure that necessary implementation procedures are laid down by insurers for Information and Cyber Security related issues.
- To ensure that insurers are adequately prepared to mitigate Information and cyber security related risks.
- To ensure that an in-built governance mechanism is in place for effective implementation of Information and cyber security frame work.

These guidelines are applicable to all insurers regulated by Insurance Regulatory and Development Authority of India (IRDAI). These guidelines are applicable to all data created, received or maintained by insurers wherever these data records are and whatever form they are in, in the course of carrying out their designated duties and functions.

LESSON ROUND-UP
• The board of the insurer, to comply with the provisions of Section 27A (2) (ii) of the Act, may delegate to Investment Committee, for investments already made and the continuance of such investments from controlled fund / assets, in otherwise than in an approved investments, and in All India Financial Institutions recognized as such by RBI for investments carrying a rating of less than AA and being part of Approved Investment.

- Pattern of Investment not applicable for Shareholders' funds held in business beyond required solvency margin, and not taken in calculation of solvency margin.
- Every insurer shall constitute an Investment Committee which shall consist of a minimum of two non-executive directors of the Insurer, the Chief Executive Officer, Chief of Finance, Chief Risk Officer, Chief of Investment division, and the Appointed Actuary.
- The funds of the insurer shall be invested and continued to be invested in equity shares, equity related instruments and debt instruments rated as per Note below Regulations 4 to 8 by a credit rating agency, registered under SEBI (Credit Rating Agencies) Regulations, 1999.
- Every Insurer shall constitute an Audit Committee of the Board, headed by an individual, as per the IRDAI Corporate Governance Guidelines and such person, shall not be the Chairman of Investment Committee.
- The Investment in Units of REIT / InvITs shall be valued at Market Value (last Quoted price should not be later than 30 days). Where Market Quote is not available for the last 30 days, the Units shall be valued as per the latest NAV (not more than 6 months old) of the Units published by the trust.
- The IRDAI permits Debt ETFs with underlying Debt Securities of Central Public Sector Enterprises (CPSEs) proposed to be launched in India, as eligible class of Investment, and as a part of "Mutual Fund" exposure.
- Insurance companies are significant institutional investors in listed companies and the investments are held by them as custodians of policyholders' funds.
- All the insurers need to review and update their existing stewardship policy based on the Revised Guidelines on Stewardship Code for Insurers in India within 3 months from the date of issue of the same and the updated stewardship policy needs to be approved by the Board of Directors.
- The Board shall ensure that there is effective oversight on the insurer's stewardship activities and the Audit Committee of the Board shall exercise the same.
- All insurers regardless of size, complexity, or lines of business, collect, store, and share with various third-parties (e.g., service providers, reinsurers etc.), substantial amounts of personal and confidential policyholder information, including in some instances sensitive health-related information. Insurance repositories, call centers, Common Service Centers etc. also have access to policyholders' data.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation).

1. Differentiate between approved assets and deemed assets.
2. Discuss the provisions of IRDAI with respect to investments of Life Insurance Company.
3. Discuss the limitations imposed by IRDAI in case of investments of General Insurer.
4. Can the insurance company invest in shares of Public company?
5. Discuss the role and functions of Audit Committee and Investment Committee in monitoring the investments of Insurance Company.

LIST OF FURTHER READINGS

- 09 Feb 2023 IRDAI-F&I-CIR-INV-42 Formation of Consultative Committee on Investments.pdf
- Annexure - D Guidelines For Investment In Debt Etfs With Cpse Bonds As Underlying.pdf
- Annexure - A Amendments to Investments-Master Circular.pdf
- Preparation of Financial statements for FY 2019-20 and Onwards.pdf
- Revised Guidelines on Stewardship Code for Insurers in India.pdf
- https://www.aicofindia.com/AICEng/General_Documents/Notices%20And%20Tenders/IRDAI-GUIDELINES.pdf

Functions in Insurance & Compliance Related Thereto: (Part – IV)

Lesson 21

KEY CONCEPTS

■ Risk ■ Risk Management ■ Risk Management Committee ■ Reinsurance ■ Coinsurance ■ Insurance Broker ■ Reinsurance Broker

Learning Objectives

To understand:

- Types of risks in Insurance Companies
- Management of risks faced by Insurance companies
- Reinsurance as a risk management process for insurance companies
- Coinsurance as a process for sharing risks

Lesson Outline

- Introduction
- Risk Management
  - Various types of risks in Insurance Companies
  - Managing risks - market risk, product risk, investment risk, liquidity risk
  - Role of Risk Management Committee
  - Business Continuity Procedures
  - Risk Governance
- Reinsurance
  - Reinsurance Concepts
  - Reinsurance Markets
  - Types of Re-insurance Arrangements: obligatory, quota share, treaty and facultative, Proportional and non-proportional
  - Designing and framing of Reinsurance programme
  - Placements of reinsurance covers – treaty and facultative
- Coinsurance
  - Meaning of Coinsurance
  - Principle of Contribution
  - Coinsurance and Double insurance
- Lesson Round-Up
- Test Yourself
- List of Other References

INTRODUCTION

Risk is inherent in nature. Risk is usually not perceived or sometimes consciously ignored. Some risks can be managed or retained while some risks need to be assessed, measured and carefully managed by using various techniques and tools or risk management.

In this lesson the various risks to which insurance companies are exposed, the risk management process adopted by the insurance companies are discussed. The concept, process and types of reinsurance contracts and co-insurance are also covered.

There is no generally or universally accepted definition of risk. Often the terms "risk" and "uncertainty" are used interchangeably. Risk is often thought of in terms of chance (or probability) of loss.

The Characteristics of risks are:

- The likelihood of an unfortunate occurrence
- Possibility of adverse deviation from expected outcomes
- An outcome that is not favorable

Uncertainty falls into two broad categories. There are those for which the probability of occurrence is calculable either on a priority grounds or through the statistical analysis of a series of similar events that have occurred in the past. While risk is a state of nature, uncertainty is a state of human mind. It is therefore possible to consider a situation risky if a number of outcomes are possible and the actual outcome that materializes is not known in advance. Thus, risk is defined as the relative variation of the actual outcome from the anticipated or expected outcome. For instance, for a manufacturing firm, the development of a new product is risky as the profits from the sale of the product in the market are uncertain before the actual sale. Likewise, the development of a new drug by a pharmaceutical company is characterized by risk because of the range of possible outcomes with regard to the market reception for the drug. It can be concluded that if uncertainty is measured, that can be called as 'risk'.

The concept of risk is to be distinguished from the term 'peril'. 'Peril' is defined as the cause of loss. Perils that cause damage to property include theft, burglary, fire, hailstorm, windstorm, lightning and earthquakes. Thus theft, burglary, fire, collision, cyclone, earthquake, floods are all perils as these have the potential to cause losses. Valuables may be lost as a result of theft and burglary, houses and factories may be burnt down by fire, or accidents may occur while travelling by air, sea or land. We all know about the terrible losses caused by earthquake and floods in the country from time to time. All these economic losses and loss of life were caused by different perils. An example of peril is, if Rama's car is damaged in a collision with Ramesh's car, collision is the peril or cause of loss.

RISK MANAGEMENT

Risk is a condition where there is a possibility of an adverse deviation from a desired outcome that is expected or hoped for. There is no requirement that the possibility should be measurable but only that it must exist. Risk is not necessarily a bad thing. In fact, risk-taking is an essential component of a competitive economy. At the same time, an important characteristic of risk is that some losses will actually occur. There is a financial loss when a wage earner dies, or money is stolen or a building is destroyed by fire. Such losses are examples of primary burden of risk and the main factor prompting individuals and businesses to try to avoid risk or mitigate its impact.

Once an individual or organization or society is exposed to risk, there is a need to manage the risk by suitable techniques. The management of risk is a process with the objective of identifying risk exposures faced by an individual/organization with a view to selecting the best available technique for treating such exposures. According to Bernstein "the essence of risk management lies in maximizing the areas where we have some control over the outcome while minimizing the areas where we have absolutely no control over the outcome".

The subject of risk management does not have a long history. The focus on risk management, particularly by corporates, has undergone remarkable change over time. There has been a change in regard to concern with gravity of risk. The corporates have become far less concerned with traditional "high frequency, low severity" risks but have started devoting greater attention to risks that could lead to corporate collapse and corporate bankruptcy.

Risk management is about insurance and hedging and biases the use of both insurance and financial instruments to control the costs of corporate risk. For a long time, corporates have used insurance to manage property, liability and other insurable risks. Insurable risks expose the firm to volatility that is only on the downside – chance of loss, not of gain. However, it was slowly recognized that insurance is not the only possible strategy. To pay for losses, insurance provides the needed funds. With no insurance, the firm could pay for losses by contracting a debt or raise fresh equity capital. It is increasingly accepted that the source of risk is of no great importance. Furthermore, the contribution of each source of risk cannot easily be isolated. There is therefore a need to adopt a comprehensive approach for managing risk. This comprehensive strategy for treating risk is referred to as "Integrated Risk Management" (IRM) or "Enterprise Risk Management" (ERM).

The objectives of Risk Management:

The objectives of risk management for individuals and businesses can be categorized in to pre loss objectives and post loss objectives. The pre loss objectives include preparedness for potential loss in the most economical way before a loss occurs, which reduces anxiety and ready to meet legal obligations. For example workmen's compensation act, installation of safety devices to protect workers from harm etc.

The important post loss objectives that is after a loss occurs include:

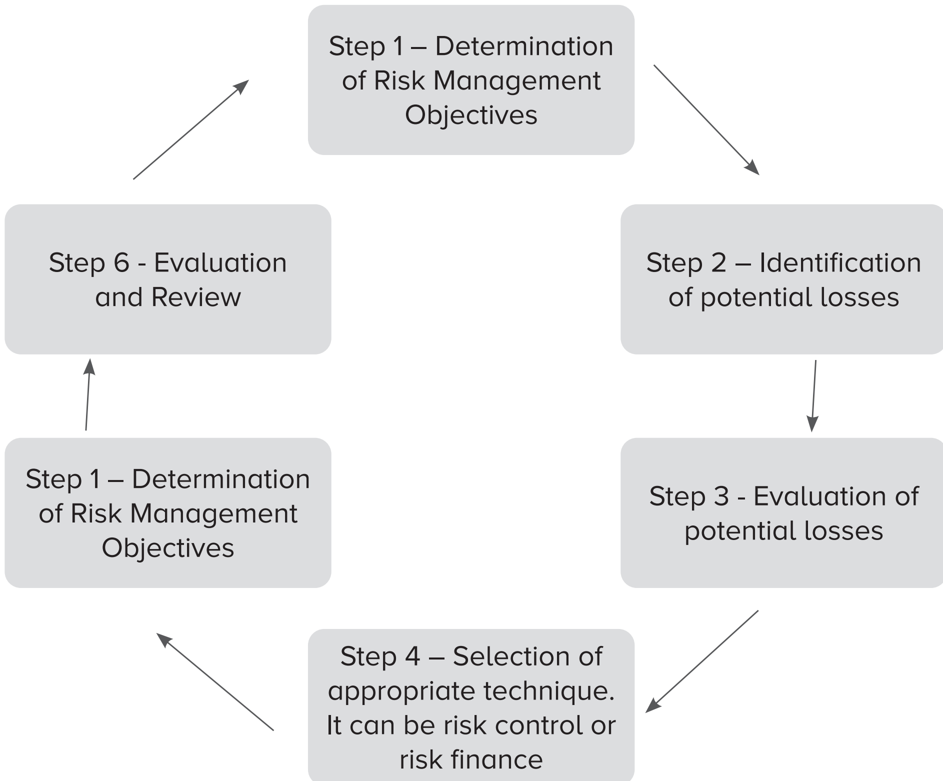
- Survival – after a loss occurs the firm can resume at least partial operations within some reasonable time period.
- Continue operating – competitive firms must continue to operate after a loss. Otherwise business will be lost to competitors.
- Stability of earnings – additional expenses to operate in another location.
- Continued growth of the firm – the effect of loss on future growth through new products and markets.
- Social responsibility – minimize the effect of loss on employees, suppliers, creditors and the community in general.

Ultimately, the purpose of risk management *is to maximize the economic value of an individual or organization where value is defined as the discounted value of expected future cash flows.* Risk management contributes to economic value by reducing economic harm. Economic harm can arise in four ways:

- A reduction in the value of existing wealth.
- An increase in future expenditure.
- A reduction in future income.
- An increase in the discount rate.

Process of Risk Management:

We may discuss here the process of management of pure risks. Whether the risk exposures is by an individual or business concern, the steps generally taken for management of such risks are the same. The scientific approach to risk management of pure risks involves a logical sequence of the following six steps:



After determination of the objectives of management of risks, the most important element of and the second step in the risk management process is the identification of risks and exposures to loss. This involves a systematic and careful analysis of all major and minor potential loss exposures. An essential prerequisite for a conscious choice of appropriate and efficient methods for dealing with losses if they occur is the recognition of all sources of possible losses. A loss exposure is a potential loss that may be connected with a particular category of risk. As such, the classification of loss exposures is the same as the one adopted for pure risks; that is, losses associated with life, health, property and liability risks.

The approaches used for risk identification include use of loss exposure checklists, flow charts, statistical analysis of historical loss data, analysis of financial statements and on-site inspection.

The next step in the process of risk management lies in selecting the appropriate techniques for managing the loss exposures. The techniques are broadly classified as follows:

(i) **Risk Control**: The methods of risk control include risk avoidance and various approaches to reducing risk through prevention of loss and efforts of risk control. Risk reduction involves techniques that are aimed at reducing the likelihood of loss or the potential severity of losses that do occur.

a. **Avoidance:**

This is the most drastic way of handling the risk. This happens when the activity that causes the risk is avoided. For example, the potential consequences of an escape of a highly toxic gas may be so catastrophic that a chemical company may decide to avoid the risk by ceasing to produce or use it. Another example is when a risk of damage by flooding may be avoided by moving to another site well above recorded flood levels.

b. **Loss control:** Those efforts that are aimed at minimizing the severity of loss if it should actually occur are referred to as techniques of loss control. For example, installation of a sprinkler system.

(ii) Risk financing: This covers all methods employed to fund either the probability of loss – producing events occurring or the potential size of losses that do occur. For example installation of fire extinguishers to minimize loss in case of fire. The methods are:

- **Risk Retention**: Retention refers to financing of losses internally either fully retained or partially retained. Losses that do occur when prior planning for their financing has been done are also retained. Retention is resorted to when no other risk management treatment is available like when insurance coverage is not available or very expensive. Further, non-insurance transfer may be unavailable. Thus, retention may in fact be a residual method. Retention can be effectively used when the potential losses are highly predictable. It is also said that "the more risk averse the less the retention". Hence, Risk retention can be planned or unplanned retention and funded or unfunded retention programmes.

- **Planned and Unplanned retention:** In planned retention, certain risks are retained, as there may be no satisfactory alternative to doing so. Again a few risks may be retained because retention is the most cost effective and appropriate technique in the given circumstances. In unplanned retention, the company does not recognize the risk that exists in a particular situation and therefore does nothing about it. This could sometimes have disastrous consequences.

- **Funded and Non-funded retention:** In a funded retention programme, an emergency fund is created to pay for such losses. Funded retention programmes can be in the form of obtaining credit from financial institutions, maintaining reserve funds, self-insurance and captive insurers. In non-funded retention programme, the company meets losses arising out of retained risks from the company's current revenues.

(iii) Risk transfer: Risk transfer is the process of shifting the risk burden on others. There are different ways of transferring risks which include hedging, sub-contracting, asking for sureties, diversification, indemnity agreements, incorporation, insurance. It can be classified as insurance and non – insurance transfers

- **Non-Insurance Transfers**: They are techniques (other than insurance) by which a risk exposure and its potential financial losses are transferred to another party who is in a better position to exercise loss control. A number of instances of non-insurance transfers can be cited. A computer lease agreement by a firm may contain a clause to the effect that maintenance, repairs etc., of the computer are the responsibility of the computer firm. A publishing firm may specify that the author and not the publisher is legally liable for plagiarism, if any.

- **Insurance Transfers**: This is a transaction, which involves payment by one party (the one transferring the risk) to the other party the one to whom the risk is transferred who agrees to bear the risk (transferee). For the insurer the degree of risk gets reduced through the transfer process because he is in a better position to use the law of large numbers to estimate possibility of loss. Commercial insurance is a technique of transferring risk from one party (individual or business) for whom the risk is costly to another party who is willing and is able to bear the risk. Insurance is thus one of a number of available instruments for hedging risk. It is an instrument for post loss financing. Purchase of medical insurance is an appropriate strategy for controlling loss exposures that have a high severity of loss coupled with a low probability of loss.

a. **Combination:** This method takes advantage of the law of large numbers. One can combine a large number of independent exposure units in one portfolio. By doing this, an insurance company is able to reduce the risk of its aggregate losses. The best example would be in the case of a large group which by centrally pooling the risk of breakage of its shop windows could contain annual losses within narrow limits.

b. **Hedging:** Firms that enter into contracts to supply goods at a fixed price in the future face the risk that a rise in prices between entering into the contract and the delivery date may involve them in a loss. Hedging gives protection, say, to the Indian importers by allowing them to forward purchase specific foreign currencies. Thus, regardless of the exchange rate the importer's liability will be limited to the cost of purchasing the currency.

c. **Research:** This is done to improve the information on which decisions are taken that can help reduce risk. For example when marketing a new product, a firm may go for market research to reduce uncertainty against its reception in the market. For the purpose of determining the appropriate technique(s) for tackling losses, there may be a need for a combination of more than one type of risk management techniques referred to as a matrix. The matrix classifies the various loss exposures on the basis of frequency and severity.

RISK MANAGEMENT MATRIX

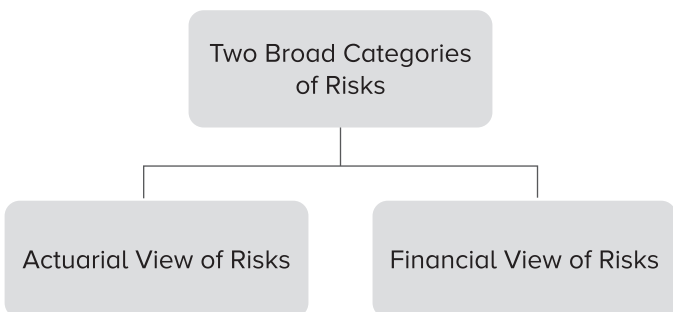
Types of Loss	Frequency of Loss	Severity of Loss	Appropriate Risk Management Techniques
1	Low	Low	Retention
2	High	Low	Loss Control and Retention
3	Low	High	Insurance
4	High	High	Avoidance

As can be noticed, for the purpose of selection of the method for handling losses, both severity and frequency of loss have to be considered. When the frequency and severity of loss are low, (that is, where the loss is small and occurs infrequently such as loss of a cheap transistor radio in the house or loss of the typist's dictionary in the office) retention is the most appropriate risk management technique. When the loss frequency is low and severity is high (third type of loss exposure in the table), the most appropriate technique to choose is insurance. Examples of this type of loss exposure include natural disasters, explosions, fires, law suits and premature deaths.

The next step in the process of risk management by individuals and businesses is implementation and monitoring of the programme to achieve the objectives. To achieve the goal and to make the programme effective, a periodic review of the programme is called in order to determine whether or not the objectives of the risk programme are being realized. This step will be helpful in modifying the programme, if found necessary, in the light of the record of experience.

RISKS IN PROVIDING INSURANCE SERVICES

Insurers are in the business of risk. They assume various types of actuarial and other risks in providing their services to the public. Insurers, by and large, identify and manage these risks according to a classification of risks developed by actuarial profession. FIs utilize a more general and more developed risk classification scheme. With increasing financial services convergence, we can anticipate a parallel convergence of the actuarial and financial views of risks.



Under the actuarial view, the sources of risk to companies are grouped into four categories:

1. Asset Risk (C1)
2. Pricing Risk (C2)
3. Interest Rate Risk (C3)
4. Miscellaneous Risks (C4)

1. **Asset Risk (C1) or Asset Depreciation Risk:** It is the risk that assets lose value because of the possibility that borrowers of insurer funds may default on their obligations to the company, or Market value of an insurer's investment assets may decline, except if caused by interest rate movements. Careful financial management through credit and investment analysis is the best risk management tool against asset risk. Investment staff concerned with this risk.

2. **Pricing Risk (C2) or Pricing Inadequacy Risk:** It is the risk that liabilities will increase in value because future operating results are worse than those implicit in product pricing. Negative deviations can occur because of higher than anticipated:

   - mortality experience
   - morbidity experience
   - lapse experience
   - expense experience.

   Likewise, the possibility of lower than expected investment income or sales gives rise to pricing risk. Pricing risk primary province of product development and pricing actuaries. Management of the risk is more challenging.

3. **Interest Rate (C3) Risk:** Risk that Asset and / or Liability values will be negatively affected by interest rate movements. The effect of these risks may be very complex. If not managed properly, it can result in insolvency. Precise linkage between interest rate movements and asset or liability values will depend on whether interest rates are rising or falling. In a rising interest rate regime, both assets and liability values ordinarily decrease. The risk is immense if asset value decrease exceeds liability decrease, thus reducing capital. The policyholder in fear may exercise surrender and loan options, necessitating forced asset sale at depressed prices, leading to a liquidity crisis. On the other hand, in a falling interest rates environment, both asset or liability values ordinarily will increase. It may so happen that although total book value of assets may exceed liabilities, current or cash assets may be insufficient to meet current or cash liabilities.

4. **Miscellaneous (C4) Risks:** These risks are associated with social, legal, political, technological and other changes. Ex: product obsolescence, tax and regulatory changes, loss of confidence in the insurer by policy owners, liability arising from misconduct of employees or agents. These risks lend themselves neither to prediction nor quantitative analysis. Quality of insurer management determines extent of control of these risks. The rating agencies place great weight on management quality.

FINANCIAL VIEWS OF RISK

Financial risk definitions are used by non-insurer Financial Intermediaries. The risks are classified as follows:

- Actuarial Risk
- Systematic Risk
- Credit Risk
- Liquidity Risk
- Operational Risk
- Legal Risk

Actuarial Risk: Risk that arises from an insurer collecting funds through sale of insurance policies and other liabilities. In financial terms, it is the risk that the insurer charged **too little** for the options embedded in the insurance policies if the insurer cannot expect to achieve satisfactory cash flow in the long run. The finance profession's definition of actuarial risk – would be valued from an options pricing point of view than the traditional actuarial pricing point of view.

Example of Actuarial Risk:

When mortality or morbidity experience deviates negatively from that implicit in the insurer's pricing consequence of :

(1) Projections based on inadequate knowledge of the loss distribution, or

(2) Losses exceed projections. The degree to which they deviate from the mean-depends on the precise nature of the risks insured. In actual practice, this risk may be less important than that which arises from other policy options, particularly policy surrender and loan options.

Systematic Risk: This is also called market risk. This includes risk of changes in value of Assets and Liabilities. This risk cannot be eliminated by diversification. Ex: come in numerous forms. Foreign exchange risk, Interest rate risk, Inflation risk, Management of these risks important. For most Financial Intermediaries, especially life insurers, the interest rate risk is crucial. For life insurers, interest rate risk follows from their transforming liquidity and maturity risks. They sell insurance contracts (secondary securities), and invest proceeds in bonds, shares, mortgages (primary securities). This mismatch is source of interest rate risk and other systematic risks. This financial risk classification conforms most closely to C3 risk (actuarial risk) but also subsumes a portion of C1 risk. (Decline in asset values, other than caused by interest rate changes)

Credit Risk: The Risk is that promised cash flows on primary securities held by insurers may not be paid in full. Actuarial C1 (asset) risk includes credit risk. Firm-specific credit risk is diversifiable, while systematic credit risk is non-diversifiable. Credit risk also includes country (sovereign) risk – when governments interfere with nationals paying foreign creditors.

Liquidity Risk: This is usually called as a funding risk. This risk subsumes under C3 (interest rate) risk and, also in part of the C1 (asset) risk. Ordinarily, insurers cash outflows are predictable, while Cash inflows usually larger than cash outflows. No real need for insurers to hold excessive amounts of cash.

Operational Risk: This risk includes system failures or human errors which will substantially disrupt operations. This risk includes fraud, negligence, accidents, and acts of god, failure of supply or marketing channels. This also falls in C4 classification.

Legal Risk: Risk that new government laws, regulations, or court opinions may decrease the value of the firm. This risk Falls within C4.

ROLE OF RISK MANAGEMENT COMMITTEE

The IRDAI guidelines on Corporate Governance, 2016, has recommended the constitution of a risk management committee in every insurance company. The sound management of an insurance company, as in the case of other financial sector entities, is dependent on how well the various risks are managed across the organization.

In pursuit of development of a strong risk management system and mitigation strategies, insurers should set up a separate Risk Management Committee to implement the company's Risk Management Strategy. The risk management function should be under the overall guidance and supervision of the Chief Risk Officer (CRO) with a clearly defined role. It shall be organized in such a way that it is able to monitor all the risks across the various lines of business of the company and the operating head has direct access to the Board. It should not focus solely on compliance; it should focus on adding value to rest of the business. Risk management function should work in close co-ordination with the finance function, but independently assess and evaluate the capital, finance and other operating decisions.

The Role of the Risk Management Committee includes the following:

- Establish effective Risk Management framework and recommend to the Board the Risk Management policy and processes for the organization.
- Set the risk tolerance limits and assess the cost and benefits associated with risk exposure.
- Review the Company's risk- -reward performance to align with overall policy objectives.

- Discuss and consider best practices in risk management in the market and advise the respective functions.
- Assist the Board in effective operation of the risk management system by performing specialized analyses and quality reviews.
- Maintain an aggregated view on the risk profile of the Company for all categories of risk including insurance risk, market risk, credit risk, liquidity risk, operational risk, compliance risk, legal risk, reputation risk, etc.
- Advise the Board with regard to risk management decisions in relation to strategic and operational matters such as corporate strategy, mergers and acquisitions and related matters.
- Report to the Board, details on the risk exposures and the actions taken to manage the exposures; review, monitor and challenge where necessary, risks undertaken by the Company.
- Review the solvency position of the Company on a regular basis.
- Monitor and review regular updates on business continuity.
- Formulation of a Fraud monitoring policy and framework for approval by the Board.
- Monitor implementation of Anti-fraud policy for effective deterrence, prevention, detection and mitigation of frauds.

BUSINESS CONTINUITY PROCEDURES (BCP)

Business continuity Procedures/ planning is a proactive business process that lets a company understand potential threats, vulnerabilities and weaknesses to its organization in times of crisis. The creation of a business continuity program ensures company leaders can react quickly and efficiently to business interruption.

The Organization's Business Continuity Management (BCM) framework shall consist of documented business continuity and disaster recovery plans. A single framework shall be maintained to ensure all plans, across businesses and processes are consistent, to consistently address information security requirements, and to identify priorities for testing and maintenance.

The BCP plans shall address at a minimum:

- Enterprise-wide business continuation
- Continuation of critical applications
- Organization's Data Center Disaster Recovery Plans
- Network connection / link
- Roles and responsibilities of all individuals in the Business Continuity and Disaster Recovery Plans.

I. Business Impact Analysis

- Recovery Time Objective (RTO) which can be understood as the amount of time after a disaster in which business operation is retaken, or resources are again available for use and Recovery Point Objective (RPO) can be understood for a given operation, as to how much data loss can one could afford in terms of time or in terms of amount of information, shall be defined for all applications based on the business requirements.
- All dependencies on IT systems by the business functions shall be clearly documented.

II. Risk Management and Evaluation

- Organization shall ensure that adequate coverage is provided in the identification of threat that may cause disruption to the availability of the assets supporting the business operations.

- A defined and documented Risk Assessment Methodology shall be used to conduct the Risk Assessment Exercise.
- Risk Analysis shall be performed at least on an annual basis.
- The acceptable levels of risk shall be defined, documented and approved by the management.
- Existing controls shall be assessed for their strength and effectiveness. The mitigation of a risk due to the presence of existing controls shall factor in the control strength and control effectiveness values.
- Control assessment may be undertaken on a sampling basis as required. In such cases, the sampling frequency shall be clearly documented.
- All risks having a risk rating above the acceptable level of risk shall have risk mitigation plans. These plans shall be approved by the management.
- Risk Mitigation plans shall have clearly defined ownership for the action points.
- The Risk Mitigation plan shall be reviewed and tracked to closure on a quarterly basis.
  1. A managed process shall be developed and maintained for business continuity throughout the organization that addresses the information security requirements needed for the organization's business continuity.
  2. A comprehensive Business Continuity Plan (BCP) shall be developed and implemented in order to maintain or restore business operations in the required time scales following interruption to, or failure of, critical business processes. The BCP shall include effective Disaster Recovery (DR) procedures for quickly recovering from an emergency with minimum impact to the company's operations.
  3. Business Continuity Plan shall be developed based on critical business processes and the likely disruptive events along with their probability, impact and consequences for information security identified through Business Impact Analysis.
  4. It shall be ensured that any new application introduced in the IT environment of Organization shall have a documented ITDR processes based on its criticality and shall integrate with the existing recovery processes. It shall also have a business defined RTO and RPO.
  5. Any changes made that may have an impact on the developed recovery procedures shall be duly identified as a part of the change control process and shall be approved by the ITDR Manager before implementation.

Testing of BCP

1. The business continuity and DR plans shall be tested at least once annually or when significantly changed to identify incorrect assumptions, oversights, or changes in equipment or personnel.
2. Test results shall be reported to the ISRMC and shall be used to revise the BCP / DRP.
3. IT DR testing framework shall include DR drills that represent not only plan shutdown but also real disaster scenarios.
4. All IT DR tests shall be conducted after careful planning to ensure no disruption to the business operations. All risk factors shall be documented and communicated to all affected persons prior to test.

Review of BCP

BCP shall be reviewed as per periodicity defined in the BCP itself and after each test and updated to ensure that the BCP considers the effectiveness of the current nature of business processes, infrastructure, personnel, etc.

RACI Matrix

Responsible	Accountable	Consulted	Informed
IT	IS	Risk	Business Users

RISK GOVERNANCE

Risk Governance in a company aims to focus on the common well-being of its target audience. The target audience for the Organization's policy is the employees of Organizations, contractors, and third-party service providers who have access to or use Organization's Information systems and Information in any form.

The implementation of this policy shall be the responsibility of various departments named in specific sections of the Governance policy such as IT, Administration, Human Resources and the respective Business departments. However, irrespective of specific roles being assigned, all departments must be aware of and comply with this policy.

Governing Board

The Risk Management Policy of Organization shall be governed by the Risk Management Committee comprising of the Chief Risk Officer (CRO), Chief Information Security Officer (CISO), Chief IT Security Officer (CITSO), Chief Security Officer (CSO), Chief Human Resource Officer (CHRO), Chief Technology Officer (CTO), Function heads of Operations, Finance, Legal, and Compliance.

The RMC shall be responsible for changes to the policy and approvals thereof. It shall also be responsible to ensure that the policy remains updated at all times. The RMC meeting shall require CRO and at least two members to participate with all members meeting at least twice in a year.

REINSURANCE

An Insurer, like any other business firm, obtains insurance for those loss exposures that are too great for the insurer to retain. This practice of transfer of loss exposures is known as Reinsurance. In life insurance, this practice is referred to as Reassurance. Reinsurance can be defined as a *contractual agreement* under which one insurer, known as the *Primary Insurer* transfers to another insurer, known as the *Reinsurer,* some or all of the loss exposures accepted by the primary insurer under insurance contracts it has issued or will issue in the future.

The *Primary Insurer* may be also referred to as the:

- *Ceding Insurer*
- *Ceding Company*
- *Cedent*
- *Reinsured*

Salient Features of Reinsurance Contract

In almost all reinsurance agreements, the *Reinsurer* does not assure *all* of the exposure of the primary insurer. The reinsurance agreement usually requires the *Primary insurer* to keep a portion of the exposure. This is known as insurer's *retention.*

Retention can be expressed as a dollar amount, or a percentage of the original amount of insurance, or a combination of the two. The reinsurance agreement usually contains an *upper limit* above which loss exposures are the responsibility of the Primary Insurer. *Reinsurers* like the Primary insurers may also reinsure loss exposures with other Reinsurers under reinsurance contracts. In this way loss exposures are shared *globally* in the *Reinsurance community*.

These transactions are known as *retro cessions,* whereby the loss exposures are transferred from the *retrocedent* to the *retro cessionaire.*

Functions of Reinsurance

There are several practical *business constraints* that are specific to the nature of the insurance business, and the *regulatory environment* in which it operates. Reinsurance functions to alleviate these constraints. Reinsurance can provide the following to primary insurers: -

- Stabilization of loss exposures
- Large-line capacity
- Financing (surplus relief)
- Catastrophic protection
- Underwriting assistance
- Withdrawal from a territory or class of business

I. **Stabilization of loss exposure:** Like any other business, insurance business must also have a steady flow of profits in order to retain *capital* and increase its capital and surplus to support growth. Insurance *losses* fluctuate widely because of:

- Demographic differences
- Economic conditions
- Social and natural forces
- By simple chance

Smoothening these *peaks* and *valleys* of the loss exposure curve is a major function of reinsurance. The PI obtains stability in its underwriting results through the reinsurance transaction.

II. **Large Line Capacity:** This refers to an insurer's ability to provide a high limit of insurance on a single loss exposure.

Examples: coverage of Rs. 150 million on a commercial office building,

Rs. 160 million of physical damage (hull) coverage.

Rs. 100 million coverage on a passenger airplane.

Very few insurers have the capacity to write such large amounts of insurance on a single loss exposure without reinsurance. Some regulators prohibit an insurer from writing an amount of insurance in excess of 10% of its policyholder's surplus on any one exposure. An insurer can write a *large line* by keeping its retention within a reasonable relationship to its capital and surplus and reinsuring the balance of risk. Reinsurers on the other hand operating through *pools* or individually, take shares of the exposure.

III. ***Financing (surplus relief):*** The limit of premiums an insurer can write is a function of policyholder's surplus. For practical purpose, an insurer is likely to be considered as over extended it its *net written premiums*, after deducting premium on reinsurance ceded, exceed its policyholder's surplus by a ratio of more than 3: 1 The ratio of 3-to-1 is favourable. But a growing insurer might find it difficult to maintain this ratio – because the *premium-to-surplus* ratio of a rapidly growing insurer is like a candle burning at both ends. As the premium grows, it causes the surplus to shrink.

The shrinkage results from the prepaid expense portion of the unearned premiums reserve, such as agents' commission and policy issuance being charged against surplus. Accounting practices necessitate a mismatch of income & expense. The insurer must establish an *initial unearned premium reserve equal to total premium* for the policy and then to recognize the income over the life of the policy. On the other hand the insurer pays most of its exposures at the inception of the policy and is required to charge these expenses against income immediately. To meet these expenses, the insurer takes money from *surplus*. This is referred to as *surplus drain*. This illustrates the financing functions of *reinsurance* – the reduction of *surplus* drain for a growing insurer that results from having to recognize all expenses where they are incurred. This function is called as *surplus relief*.

IV. ***Catastrophic protection:*** There are special form of reinsurances that protect against the adverse effects of catastophes such as Earthquakes, hurricanes, tornadoes, Explosives, plane crashes, resulting large property liability claims to a single insurance.

V. ***Underwriting assistance:*** With their contracts with wide variety of insurer, the RI have great deal of information regarding

- Experiences,
- Coverage,
- Methods of rating,
- Underwriting various coverages.

All this information can be helpful to Primary Insurers who are planning to enter into a new line.

VI. ***Withdrawal from a territory or class of business:*** Occasionally an insurer or a reinsurer decides to go out of business or withdraw from a territory or a class of business. There are two ways of achieving this end.

- Either the insurer could cancel, or non-renew the unwanted policies and refund the unearned premiums (but this is unwieldy, expensive, create ill will).
- Or to reinsure the unwanted business with another insurer or Reinsurer.

This process of reinsuring all losses for an entire class, territory, or book of business is known as *Portfolio Reinsurance*.

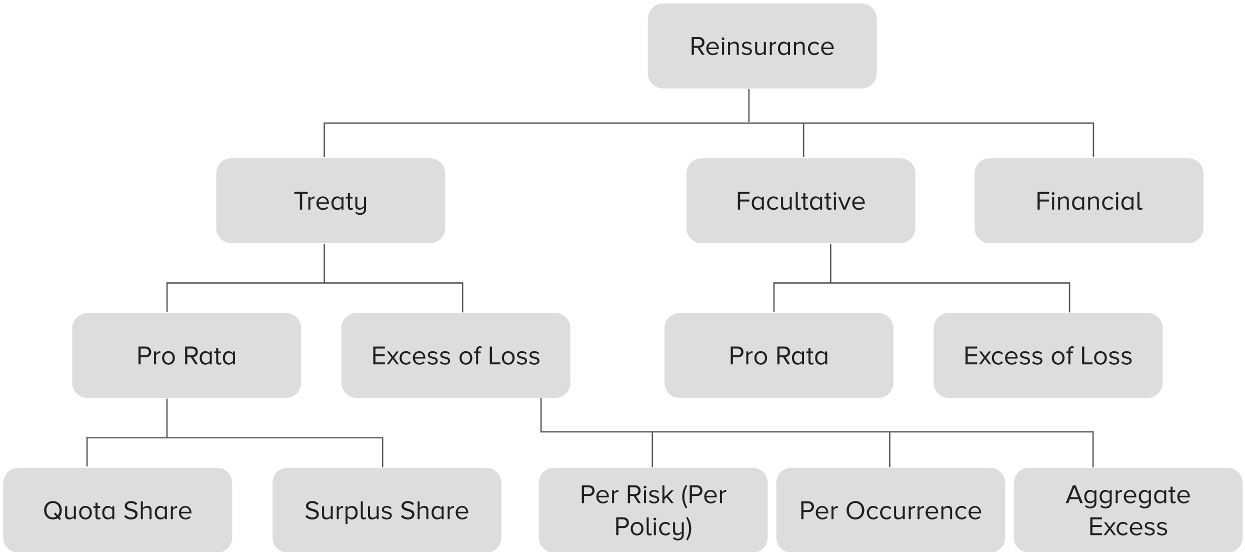
Benefits of Reinsurance: Policyholders as well as Primary Insurers benefit from reinsurance as follows:

- It enables them to obtain all of their insurance from one insurer instead of buying it in bits and pieces.
- It avoids the potential problem of gaps and loss collections when dealing with several Primary insurers.
- It helps to maintain the Solvency of Primary Insurer.
- The rating of Primary Insurer is affected by the strength of their Reinsurer.
- Reinsurance helps all small insurers to compete effectively against larger ones thus increasing the options available to the insurance buyers.

TYPES OF REINSURANCE

Several types of RI have developed to serve the various needs of Primary insurers. Each reinsurance contract is tailor made to the specific needs of the primary insurer and the primary insurer.

Categories of Reinsurance



I. ***Facultative Reinsurance***

- The Primary insurer negotiates a *separate agreement* for each risk it wishes to reinsure.
- There is no obligation on the part of the Primary insurer to purchase reinsurance on a policy it does not wish to reinsure and similarly there is no obligation on the part of the Reinsurer to accept all policies submitted to it.

II. ***Treaty Reinsurance***

- Primary insurer agrees in advance to reinsure certain lines of business in accordance to the terms and conditions of the treaty.
- The Reinsurer agrees to accept the business that falls within the treaty.
- No prior consultation of the reinsurer is required.

III. ***Facultative Treaty***

This is a hybrid variety where in the Reinsurance contract under which the ceding company has the option to cede and the Reinsurer has the option to accept or decline classified risks of a specific line. This is also called as *Facultative Obligatory, Automatic Facultative Treaty.*

IV. ***Pro-rata Reinsurance***

Another system wherein the manner in which losses under the contract are divided between the primary insurer and the Reinsurer are as follows: Amount of insurance, premiums and losses are divided between the primary insurer and the Reinsurer in the same agreed proportions.

E.g.

If a RI gets

- 35% of the coverage under a given policy.
- it also gets 35% of the premium.
- Pays 35% of each loss under the policy regardless of the size of the loss.

The Reinsurer pays the ceding commission to the primary insurer to cover expenses.

IV. ***Excess of Loss Reinsurance – (Non/proportional)***

In this type of Reinsurance, no amount of insurance is ceded. Excess of loss reinsurance does not become involved until the PI has sustained a *loss* that exceeds its *Retention* under the contract and is covered by the excess of loss agreement.

Subdivision of Treaty Reinsurance

Whether the Primary Insurer chooses pro-rata or excess of loss treaty is determined by the following factors:

- Kind of exposures.
- Financial needs of the Primary Insurer.
- Other factors.

PRORATA/PROPORTIONAL TREATY

The Pro-rata is further divided into

i. **Quota Share**

ii. **Surplus Share**

The difference between this division is the way in which the Primary insurer's retention is stated:

(i) *Quota Share:*

Retention stated as a percentage. The PI cedes a fixed, predetermined % of every risk it insures within the class / subject to the treaty. Even the smallest risks are reinsured. The PI's retention is stated as a Percentage of the amount of insurance. The RI assumes the amount of insurance less the PI's retention upto the RI limit. The RI receives the same % of premium (less the commission) generally used in property &liability coverage. Simple to rate and administer

Disadvantages:

- Quota share treaty results in ceding a large share of presumably profitable business.
- Used by small insurer who need surplus relief.

(ii) *Surplus Share:*

In this type of reinsurance the retention is RETENTION stated as a DOLLAR Amount. Like quota share, the Primary insurer and the reinsurer share amount of insurance, premium and losses in the same percentage. The retention is stated as a minimum Dollar amount. If amount of insurance is less than retention limit, no insurance is ceded. If amount of insurance exceeds the retention limit, the amount of insurance above the retention is ceded to the RI, subject to the RI limit. The RI receives the Premium, and is responsible for all losses regardless of size in the same proportion that the amount ceded bears to the amount retained. Even though individual loss may be less than the retention of the ceding company, it will be shared between the ceding company & surplus share RI, if the amount of insurance exceeds the retention amount.

Note: The difference between Quota share and Surplus is that – although the same % of RI applies to all eligible policies under Quota share, the % varies from policy to policy in a surplus share.

Disadvantages:

In this type of reinsurance, there is increased administration expenses. The PI should submit records of all Reinsured loss exposure information regarding premium and loss information called Bordereau. It provides large-line capacity.

Excess of loss/Non- Proportional Treaties:

The Primary Insurer and the Reinsurer do not share the amount of insurance, premium and losses in the same proportion. No insurance is ceded, only losses and premiums are shared. Reinsurer pays no ceding commission to Primary insurer. The Reinsurance premium is usually stated as a percentage of the Primary insurer's income for covered lines of business. The excess Reinsurance is responsible for losses that Exceed the retention and fall within the coverage provided by the RI contract.

Classification of general classes of Excess of Loss.

Per risk/per policy excess	Per Occurrence Excess (per loss excess)	Aggregate excess
- Applies to property insurance. - Retention and limit apply to each risk separately. - Per Policy/ applies to Liability insurance with retention and limit applying separately to each policy. - Retention amount stated as Dollar amount of loss. - RI agrees to pay only a stated amount of loss 90/95% of loss in excess of retention. - Premiums are low. - Helps in providing large-line capacity. - No relation with premium/amount of Insurance. - Only concerned with Loss sharing - Helpful in Catastrophes.	- Provides indemnity against loss in excess of retention of Primary insurer. - Number of risks are not regarded. - Both either property or liability losses covered. - All sorts of claims can be combined into one. - Helps in smoothening the loss experience. - No significant Surplus relief. - No ceding commissions are paid because premiums are very low.	- Also called as excess of loss or stop loss treaties. - Used in crop insurance. - The Reinsurance begins to pay when all the PI claims for a given period exceed the limit. - Most effective in stabilization of loss ratio or experience. - No ceding commission.

Facultative Reinsurance

Under the Facultative Reinsurance each type of coverage is negotiated separately. It can be almost in any form. It can be at almost at any rate agreeable to both parties. Factors to be taken into consideration in Facultative reinsurance contracts are as follows:

- Management of the Primary insurer
- Classes reinsured
- Geographical spread
- Primary insurer's loss experience for the lines
- No individual loss exposures covered.

After acceptance, the Reinsurer formalizes the agreement with a *Certificate of Reinsurance.*

Why is Facultative Reinsurance preferred?

I. Treaty contracts exclude "Target Risks" like large art museums, major bridges, etc.

II. The primary insurer's use facultative coverage to protect its treaties, for a favorable commission.

III. Facultative reinsurance covers loss exposures that exceed the limits under applicable treaties.

Pro-rata Facultative Reinsurance

This functions similarly to a surplus share treaty except, that each agreement relates to a *Single* subject of insurance.

Excess of Loss Facultative Reinsurance

This functions exactly like the per risk/ per policy excess treaty. The Reinsurer pays only if the loss exceeds the Primary Insurer's retention and it pays only the amount in excess of the retention.

Financial Reinsurance

All reinsurance contracts are financial contracts. The traditional reinsurance contracts are designed to transfer underwriting risk- the risk that the losses and expenses will exceed premium. Financial Reinsurance contracts transfer very little underwriting risk. They may transfer some Investment risk, some timing risk, or both. *Investment risk* is a chance that a reinsurer's investment portfolio will yield a lower return than expected. *Timing risk* is the risk that losses will be paid more quickly than expected, thus producing less investment income than expected.

The principal categories of financial reinsurance are:

- Time and distance contracts
- Loss portfolio transfers
- Retrospective aggregate contracts
- Prospective aggregate contracts
- Financial quota share treaties

Under a time and distance contract, the primary insurer pays an agreed premium to the reinsurer at the inception of the contract. In return, the reinsurer promises to pay to the primary insurer one or more future payments, with the date and amount of each payment specified in the contract.

Loss portfolios transfers deal with losses incurred by the primary insurer before the inception of the reinsurance contract.

Retrospective aggregate reinsurance cover the reserves for both reported losses and incurred- but-not-reported (IBNR) losses.

Prospective aggregate contracts deal with future losses.

The Reinsurer agrees to make specified payments in the future to assist the primary insurer in paying future losses.

Financial Quota share treaties, also called as surplus relief treaties shield the reinsurer from the underwriting risks.

REINSURANCE PRACTICE

The primary insurers benefit from a well-planned and well-executed reinsurance program in more than one ways. A good reinsurance program can only be executed with assistance from:

- Reinsurers,
- Brokers, and
- Consultants.

A reinsurance plan must take into account the primary insurer's needs and be based on a thorough understanding of the reinsurance market. There are two considerations:

- The primary insurers must continue to be solvent and
- Insurers must be able to pursue the future growth plans.

The factors determining the reinsurance needs of a primary insurer are many. But the more important of them are the following:

- Kinds of Insurance written
- Exposures subject to catastrophic loss
- Volume of Insurance written
- Available Financial Resources
- Stability and Liquidity of Investment Portfolio and
- Growth Plans.

Reinsurance Negotiations:

Negotiations depend on several factors but, chiefly the nature of the primary insurer and Reinsurer, the kind of reinsurance transacted. Before signing a reinsurance treaty, the reinsurer must be satisfied about the integrity of the primary insurer, Management characteristics, Underwriting policies, Underwriting results, Financial condition, Classes of business the primary insurer is writing and Geographic area of operations. Since reinsurance negotiations are two-sided, even the primary insurer must collect enough information concerning the solvency of the Reinsurers, satisfactory claims practices, competitiveness of rates and Licensing in the territory where the primary insurer operates.

REINSURANCE COMMISSIONS

There are two kinds of commission involved in reinsurance transactions, namely:

1. Ceding commissions paid by the reinsurer to the primary insurer; and
2. Brokerage commissions paid by the reinsurer to the reinsurance broker.

Ceding commissions compensate to some extent the initial costs of acquisition of the primary insurer as well as the cost of servicing the business. The negotiation of the ceding commission depends on the

- Administrative expenses of the primary insurer ;
- the Reinsurer's estimate of the premium volume;
- The loss experience expected under the treaty being negotiated; and
- The market situation of demand for and supply of reinsurance.

Brokerage commission is varying between 2% and 5% of the reinsurance premium for pro rata treaties and 5% and 10% for EOL treaties.

CLAIM SETTLEMENT AND THE PART PLAYED BY REINSURERS

The procedure differs from treaty to treaty based on individual agreements. If it is a pro rata treaty, the primary insurer sends a monthly bordereau to the reinsurer, detailing the premiums due to the reinsurer and claims due from the reinsurer. The primary insurer will remit the difference to the reinsurer when the premiums exceed the losses and if the losses exceed the premiums, the reinsurer remits the difference to the primary insurer. In the case of excess treaties, as soon as losses exceed the retention, intimation is given and the reinsurer pays on being given proof of settlement, which is simply a statement of losses paid by the primary insurer, together with estimates of current reserves. In the case of aggregate excess treaties, the reinsurers are known to make initial payments say sixty days after the end of the accounting year. If it is clear that the losses will exceed the retention, then payments may be made before the end of the year.

REINSURANCE REGULATIONS

The reasons that went into regulating insurers chiefly were to protect insureds from unfair trade practices of some insurers and also possible insolvency of insurers, apart from unreasonable premium rates. Another important regulation relates to a contingency when a primary insurer goes bankrupt. The *insolvency clause* provides that the insolvency of the primary insurer will not affect the liability of the reinsurer for losses under the reinsurance contract. The reinsurer will make payment to the liquidator or the receiver of the insolvent primary insurer for the benefit of their creditors, namely the insured. The *intermediary clause* whereby the risk of insolvency of the reinsurance broker is passed on to the reinsurer so any default by the reinsurance broker either to transmit the reinsurance premium to the reinsurer or pass on reinsurance claims payments to the primary insurer will be made good by the reinsurer since the reinsurance broker is an agent of the reinsurer and not the primary insurer.

REINSURANCE REGULATIONS IN INDIA

In India, the Insurance Regulatory and Development Authority has prescribed regulations for the reinsurance sector for general as well as life insurance and we give below these regulations. The IRDAI (General Insurance-Reinsurance) Regulations, 2000, states the objectives of a reinsurance program as:

- To maximize retention within the country;
- Develop adequate capacity;
- Secure the best possible protection for the reinsurance costs incurred;
- Simplify the administration of business.

Every insurer shall cede such percentage of the sum insured on each policy for different classes of insurance written in India to the Indian reinsurer as may be specified by the Authority in accordance with the Insurance Act, 1938 in this regard. Insurers shall place their reinsurance business outside India with only those reinsurers who have over a period of the past five years counting from the year preceding for which the business has to be placed, enjoyed a rating of at least BBB (with Standard & Poor) or equivalent rating of any other international rating agency. Placements with other reinsurers shall require the approval of the Authority. Insurers may also place reinsurances with Lloyd's syndicates taking care to limit placements with individual syndicates to such shares as are commensurate with the capacity of the syndicate.

In addition, every insurer shall make an appropriate provision for incurred but not reported (IBNR) claims on its reinsurance-accepted portfolio on actuarial estimation basis.

REINSURANCE MARKETS

The Reinsurance market: It is difficult to define the boundaries of reinsurance market in a geographical sense but the reinsurance is spread over the different parts of the world.

The following table shows the world's 20 largest reinsurers:

Company	Country of Domicile
Munich Re	Germany
Swiss Re	Switzerland
Employers Re	United States
General re/Cologne Re Group	United States
Assicurazioni Generali S.p.A.	Italy
Hanover Re Group	Germany
Lincoln National Re	United States

Company	Country of Domicile
Gerling Global Re Group	Germany
SCOR Group	France
Tokio Marine & Fire Ins. Group	Japan
Mercantile & General Re	England
American Re	United States
AXA Re	France
Toa Fire & Marine	Japan
Transatlantic Re	United States
Everest Re	United States
Winterthur	Switzerland
Yasuda Fire and Marine Ins.Co	Japan
Berkshire Hathaway	United States
Centre Re	Bermuda

Reinsurance Pool: A reinsurance pool (or syndicate or association) is an association of reinsurers banded together to underwrite reinsurance jointly. Some pools write reinsurance for only members.

Some others write for non-members as well. Industrial insurers may form a pool to write specific risks that require large capacity. Specialized pools are also formed for energy insurance.

REINSURANCE BROKERS

Just as there may be brokers for primary insurers who act as intermediaries between the insured and the insurer, there are reinsurance brokers who are go-betweens to primary and reinsurers.

The percentage commission paid by the reinsurers to the reinsurance brokers is relatively small, compared to the commission paid to the insurance brokers and is sometimes as low as one percent of the reinsurance premium.

INWARD REINSURANCE

Inward reinsurance is adding a reinsurance wing to direct insurer. The essence of inward reinsurance is to augment the premium income by taking reinsurance cessions either as a direct reinsurance acceptance or as retrocessions from what is ceded to a reinsurer. There may be a drain of premium when reinsurance is ceded but with inward reinsurance, this drain may be reversed to some extent. At the same time, since it is reinsurance in every sense, all the concepts and procedures that are essential to make a reinsurance program effective and successful must be followed meticulously.

- Designing and arranging of a reinsurance program.
- Sources of business.
- Classes of insurance with different frequencies and severities of risks.
- Geographical distribution of business.
- Identification of exposures.
- Exclusions and reinsurance limits are determined based on individual exposures.

Thus, the essence of a Reinsurance treaty should be to fix retention and reinsurance limits by considering all the factors as above and choosing a bouquet of treaties, which will maximize profits and minimize loss exposures and expected losses.

Coinsurance

In insurance practice, co-insurance is the splitting or spreading of risk among multiple parties. Coinsurance is a clause used in insurance contracts by insurance companies on property insurance policies such as buildings. This clause ensures policyholders insure their property to an appropriate value and that the insurer receives a fair premium for the risk. Coinsurance is usually expressed as a percentage.

Co-insurance has different meanings for different types of insurance policies. For property related policies the insured bears a portion of the risk only when it is underinsured. The main reason behind this is to ensure that the insured willingly protects the property insured.

Different meanings of coinsurance

1. Co-insurance is a method by which more than one insurer share a risk in agreed proportion.

   Example: An industry that is insured for Rs. 1000 crores with a premium of Rs. 50 crores is shared by three insurers.

Insurer	Share	Sum Insured	Premium
A	40%	400 crore	20 crore
B	30%	300 crore	15 crore
C	30%	300 crore	15 crore

   If and when a claim arises it is paid in the same proportion. Insurer A who is having a larger share is the leader and he will issue policy and service the account.

2. Co-insurance also means sharing the loss by the insured. When a claim arises under the policy the insured bears an agreed portion of loss. This may be expressed as a percent or certain specified amount.

   Example: Under a Mediclaim policy it may be agreed that in every claim the insured bears 10% and the balance is paid by the insurer. This is also known as deductible or excess. In some policies there will be compulsory deductible. Along with compulsory deductible there can be provision for voluntary deductible, which will result in reduction in premium depending upon the size of deductible. Higher the deductible more will be the discount in the premium.

Operational aspects

The losses are calculated and divided between the insurer and the insured on a pro-rata basis. This depends on the ratio between the actual insurance carried and the amount of insurance required. The amount to be collected from the insurer is thus calculated using the following formula: -

$$\textbf{Recovery} = \frac{\textbf{Insurance Carried} \times \textbf{Loss}}{\textbf{Insurance Required}}$$

Principle of Contribution and Coinsurance

The Federation of the Insurance Institute of Bombay has defined the principle of contribution as the right of an insurer who has paid for a loss under a policy to recover a proportionate amount from the other insures who are liable for the loss. Thus, Contribution is the right of an insurer to call upon others similarly, but not necessarily equally liable to the same insured to share the cost of an indemnity payment. This principle of contribution enables the total claim to be shared in a fair way.

The doctrine of contribution operates as a corollary of the doctrine of Indemnity and hence is applicable to general insurance. The principle of contribution should be property worded in the contract. The general wording is: *If at the time of any loss, damage or liability arising under this policy there shall be any other insurance, whether effected by the insured or any other person covering the same property or liability or any part thereof, the company* *shall not be liable for more than its rateable portion of such loss or damage.* Thus, as per the doctrine of contribution, the indemnity provided for the loss occurring on the asset, which is insured with several insurers has to be proportionately shared among them according to the rateable proportion of the loss. The amount of total compensation or indemnity provided to the insured by all the insurers should not exceed the amount of loss.

Sometimes the value of the asset may be very high and the amount of risk involved will be higher and that particular asset if insured by the company would form a significant portion of the total risk. This in turn increases the business (operation) risk of the insurance company. Usually insurance companies try to concentrate on a higher number of policies of lower value for diversification benefits. Diversification serves to reduce the overall risk level of an insurance company. Rather than avoiding business arising from high value assets insurers follow the practice of underwriting high value assets partially. Thus a single insurer takes up a part of the total value of the asset and the asset is insured by a group of two or more insurance companies.

This practice has further implications particularly in case of settlement of claims relating to such contracts. The question as to how much of the compensation is to be borne by each Insurer has to be addressed. It is here that the doctrine of Contribution is applied to resolve such complications. The insured has the choice to recover from any insurer on a priority basis. After recovering the share of loss from the first insurer the insured can approach other insurers as per the doctrine of contribution. In case one insurer indemnifies the insured in full the concerned insurance company can claim the share of compensation from other insurance companies.

Examples:

a. Where there are two insurers covering the asset equally, in case of loss each has to contribute half of the compensation.

b. 'A' insured his house against fire with X for Rs.50000 and with 'Y' for Rs. 75000. Fire broke out in the building and a loss of Rs.40000 occurs. 'A' may file a suit against both the insurers or against one only. The liability of each insurer is determined by applying the following formula:

$$\frac{\textbf{The sum insured with an insurer} \times \textbf{Loss}}{\textbf{The total sum insured with all insurers}}$$

$$\frac{\textbf{Liability of } \times = \textbf{50,000} \times \textbf{40000}}{\textbf{The total sum insured with all insurers}} = \textbf{Rs. 16,000}$$

$$\frac{\textbf{Liability of } \times = \textbf{50,000} \times \textbf{40000}}{\textbf{1,25,000}} = \textbf{Rs. 16,000}$$

$$\frac{\textbf{Liability of Y = 75,000 x 40000}}{\textbf{1,25,000}} = \textbf{Rs. 24,000}$$

It has to be noted that a life insurance is a contingent contract, and as such the principle of contribution will not apply to life policies. If the same life has been insured more than once, all the amounts will become payable in full.

The following conditions must be satisfied for the applicability of the principle of Coinsurance or contribution:

1. The same subject matter is insured with more than one insurer.
2. The policies must cover the same peril.
3. The assured must be the same person in all the polices.
4. All the policies must be in force at the time of loss.
5. Each insurer has to pay to the insured his share of loss only.

LESSON ROUND-UP

- The concept of risk is to be distinguished from the term 'peril'. 'Peril' is defined as the cause of loss. Perils that cause damage to property include theft, burglary, fire, hailstorm, windstorm, lightning and earthquakes.
- Once an individual or organization or society is exposed to risk, there is a need to manage the risk by suitable techniques. The management of risk is a process with the objective of identifying risk exposures faced by an individual/organization with a view to selecting the best available technique for treating such exposures.
- Financial risk definitions are used by non-insurer Financial Intermediaries. The risks are classified as Actuarial Risk; Systematic Risk; Credit Risk; Liquidity Risk; Operational Risk; Legal Risk.
- The IRDAI guidelines on Corporate Governance, 2016, has recommended the constitution of a risk management committee in every insurance company.
- The risk management function should be under the overall guidance and supervision of the Chief Risk Officer (CRO)
- Business continuity planning is a proactive business process that lets a company understand potential threats, vulnerabilities and weaknesses to its organization in times of crisis.
- This practice of transfer of loss exposures is known as Reinsurance. In life insurance, this practice is referred to as Reassurance.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Distinguish between risk and uncertainty.
2. Outline the difference between pure risk and speculative risk. Discuss the importance of the distinction.
3. Write a brief note on each:
   a) Personal Risk
   b) Property Risk
   c) Liability Risk
   d) Strategic Risk
4. Explain the important objectives of Risk Management by Individuals/Organizations.
5. How is potential loss evaluated?
6. Distinguish between subjective and objective risks.
7. Distinguish between Fundamental and Particular risks.
8. Discuss various Risk Control techniques.
9. Discuss different risk-financing techniques.
10. What is a risk management matrix. Give an illustrative matrix.

LIST OF OTHER REFERENCES

- https://irdai.gov.in/hi/document-detail?documentId=382140
- https://irdai.gov.in/c/portal/layout?p_l_id=459&_com_irdai_document_media_IRDAIDocumentMediaPortlet_filterDepartment
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Functions in Insurance & Compliance Related Thereto: (Part – V)

Lesson 22

KEY CONCEPTS

■ Corporate Governance ■ Compliance Management ■ Regulatory Filings ■ Reporting Disclosures ■ AML ■ PMLA ■ Outsourcing

Learning Objectives

To understand:

- IRDAI regulations on Corporate Governance
- Role and responsibilities of the Board of Directors, Independent Directors
- Delegation of functions to various Committees of Board
- Roles and responsibilities of KMPs
- Compliance management processes and procedures

Lesson Outline

- Introduction
- Corporate Governance
- IRDAI regulations on Corporate Governance
- Role and responsibilities of the Board of Directors, Independent Directors
- Delegation of functions to various Committees of Board
- Audit Committee
- Nomination & Remuneration Committee
- Investment Committee
- Risk Management Committee
- Policyholders Protection Committee
- CSR Committee
- Other Non-Mandatory Committees
- KMPs & their roles & responsibilities
- Audit & Auditors
- Whistle Blower Policy
- Compliance Management, Regulatory Filings
- Compliance Management Framework
- Role of Compliance Officer
- Regulatory Filings
- Reporting & Disclosures
- BAP Reporting
- GIC/ LC and IIB Reporting
- Other Compliances
- AML/ PMLA Compliance
- Place of Business
- Outsourcing Regulations
- Lesson Round-Up
- Test Yourself
- List of Other References

REGULATORY FRAMEWORK

- Insurance Act, 1938.

INTRODUCTION

Corporate Governance is a system of financial and other controls in a corporate entity and broadly defines the relationship between the shareholders, Board of Directors and Management. In case of the financial sector, where the entities accept public liabilities for fulfillment of certain contracts, the relationship is fiduciary with enhanced responsibility to protect the interests of all stakeholders.

The Corporate Governance framework clearly defines the roles and responsibilities and accountability within an organization with built-in checks and balances. The importance of Corporate Governance has received emphasis in recent times, since poor governance and weak internal controls have been associated with major corporate failures.

As regards the insurance sector, the regulatory responsibility to protect the interests of the policyholder demands that, the insurers have in place, good governance practices for maintenance of solvency, sound long term investment policy and assumption of underwriting risks on a prudential basis. The emergence of insurance companies as a part of financial conglomerates has added a further dimension to sound Corporate Governance in the insurance sector with emphasis on overall risk management across the structure and to prevent any contagion to ensure financial stability.

Consequently, the IRDAI in 2016 came up with the comprehensive Guideline on Corporate Governance for Insurers ("Guideline") specifically, with the intent to incorporate such changes considering inter-alia other changes in the insurance sector in last one decade.

The Guidelines provides for having various controls/systems in place and set out norms for appointment of key managerial persons, statutory auditors, the constitution and functions of the Board of Directors, delegation of the functions of the Board, disclosure requirements and provisions with respect to whistle blower policy.

Objective

The objective of these Corporate Governance guidelines is to ensure that the structure, responsibilities and functions of Board of Directors and the management of the company recognize the expectations of all stakeholders as well as those of the regulator. The structure company is required to adopt sound and prudent principles and practices for the governance of the company and should have the ability to quickly address issues of non-compliance or weak oversight and controls. These guidelines emphasize certain issues which are covered in the Insurance Act, 1938 and the regulations framed thereunder and include measures which are additionally considered essential by IRDAI for adoption by insurers.

Some of the highlights of the Guideline include:

- Mandatory appointment of independent directors and a woman director on Board as required under Section 149 of the Companies Act, 2013.
- Prevention of conflict of interest and compliance with the provisions as to related party transactions under Section 188 of the Companies Act, 2003.
- Constitution of Nomination Remuneration Committee, Risk Management Committee & Audit Committee.
- Have a Board approved Outsourcing policy.
- Annual review of performance of agencies to whom operations have been outsourced.
- Filing of compliance certificate, compliance report etc.

- The guidelines accordingly address the various requirements broadly covering the following major structural elements of Corporate Governance in insurance companies:-
- Governance Structure.
- Board of Directors.
- CEO.
- Key Management functions.
- Role of Appointed Actuaries.
- External audit – Appointment of Statutory Auditors.
- Disclosures.
- Relationship with Stakeholders.
- Interaction with the Supervisor.
- Whistle Blower Policy.

SIGNIFICANT OWNERS, CONTROLLING SHAREHOLDERS – ROLE OF BOARD

The IRDAI prescribes a minimum lock-in period of 5 years from the date of certificate of commencement of business of an insurer (R3) for the promoters of the insurance company and no transfer of shares of the promoters is permitted within this period without the specific approval of the Authority. Section 2 (7A) of the Insurance Act, 1938 has prescribed the ceiling of Foreign Investment in Indian Insurance Companies at 26% in 2000, which increased to 49% in 2010, and further increased to 74% subject to the Indian Insurance Company being Indian owned and controlled. The manner of computation of Foreign Investment to satisfy this requirement is specified in the Rules and Regulations issued by the Government and IRDAI from time to time. Therefore, it has to be demonstrated through express provisions in the agreements between the promoters/ shareholders and/ or the Articles of Association of the Insurance companies that the ownership as well as control does not lie with foreign entities but ultimately rests with resident Indian citizens at all times.

The Insurance Act, 1938 also stipulates prior approval of the IRDAI for registration/transfer of shares, exceeding one per cent and/or which involve holding of share capital, after such transfer, in excess of 5 per cent of the paid-up capital of the company. The Board of Directors of the company shall ensure that the registration of shares is in compliance with the above provisions of the Act, Regulations and circulars issued by IRDAI from time to time.

ROLE AND RESPONSIBILITIES OF THE BOARD OF DIRECTORS

The following are the guidelines with regards to the role and responsibilities of the BOD:

1) The Board should ensure that the Governance principles set for the insurer comply with all relevant laws, regulations and other applicable codes of conduct.

2) The Board should set the following policies in consultation with the Management of the Company.

   (a) Define and periodically review the business strategy.

   (b) Define the underwriting policy of the insurer.

   (c) Determine the retention and reinsurance policy and in particular, the levels of retentions of risk by the insurer and the nature and extent of reinsurance protection to be maintained by the insurer.

   (d) Define the policy of the insurer as regards investment of its assets consistent with an appropriate asset liability management structure.

(e) Define the insurer's policy on appointments and qualification requirements for human resources and ensure that the incentive structure does not encourage imprudent behaviour.

3) The Board should define and set the following standards:-

(a) Define the standards of business conduct and ethical behaviour for directors and senior management.

(b) Define the standards to be maintained in policyholder servicing and in redressal of grievances of policyholders.

4) The Board would be responsible to provide guidance for implementation of business strategy and review the same periodically.

5) As an integral part of proper implementation of the business strategy, the Board should take action as under:-

(a) Establish appropriate systems to regulate the risk appetite and risk profile of the Company. It will also enable identification and measurement of significant risks to which the company is exposed in order to develop an effective risk management system.

(b) Ensure that all directions of IRDAI are submitted to the Board and the recommendations are implemented as per the Board philosophy.

(c) Ensure that the IT systems in the company are appropriate and have built-in checks and balances to produce data with integrity and put in place a business continuity and disaster recovery plan.

(d) Ensure that the company has put in place a robust compliance system for all applicable laws and regulations.

(e) Prescribe requirements and frequency of reporting in respect of each of the above areas of responsibility as may be decided by the Board.

6) In discharge of the above and other Governance functions, the Board may delegate the responsibilities to mandated/ other recommended Empowered Committees of Directors while retaining its primary accountability.

ROLE OF BOARD ON CONFLICT OF INTEREST

The Board has important role to play where a company proposes to enter into a contract or arrangement with Related Parties as defined in Companies Act 2013. The disclosures by Directors and necessary approvals as required under Sections 184, 177(4)(iv) and 188 of Companies Act 2013, should be obtained. Adequate systems, policies and procedures to address potential conflicts of interest and compliance with the provisions of Companies Act, 2013 need to be established by the insurers. These include:

- Board level review of key transactions;
- Disclosure of any conflicts of interest to manage and control such issues.

Where the transactions with related parties are in the nature of transactions such as reinsurance arrangements or investment transactions or outsourcing to related parties, for which specific regulations or guidelines have been notified, compliance with the respective regulations or guidelines shall also be ensured.

1. The Board of Directors of an insurer should formulate a Policy on Related Party Transactions laying down the following:

(a) Definition of Transactions in the ordinary course of the insurance business giving examples specific to the insurance company.

(b) Method of determination of arm's length pricing.

(c) List of items requiring approvals from various authorities, Audit Committee, Board, Shareholders etc.

(d) Any other matter relevant to the Related party transactions.

The Policy shall be reviewed by the Board on yearly basis. In the case of insurance cover given by the insurance company to the group companies, price/ premium quoted by the companies under F&U guidelines should be considered as arm's length. The disclosures about payments made to group entities of the insurer out of the policyholders funds, shall be made as a part of the related party disclosures in terms of para 9 of these guidelines; and all such transactions may be grouped together under the related party transactions.

2. Auditors, Actuaries, Directors and Key Management Persons shall not simultaneously hold two positions in the insurance company that could lead to conflict or potential conflicts of interest.

3. The Board should ensure ongoing compliance with the statutory requirements on capital structure while planning or examining options for capital augmentation of the Company.

Governance Structure

Insurers in India have recently became public and have got their shares listed on the stock exchanges. The composition of the Boards of the Public Sector Undertakings in the insurance sector is also laid down by the Government of India. It is relevant to observe that the Corporate Governance requirements of companies listed in the Stock Exchanges have evolved over time and are outlined in SEBI (Listing Obligations and Disclosure Requirements) Regulations 2015. As the listing requirements are available in public domain they are not being repeated. The Authority advises all Indian Insurance Companies to familiarize themselves with Corporate Governance structures and requirements appropriate to listed entities. The companies, even if unlisted, are also well advised to initiate necessary steps to address the extant "gaps" that are so identified to facilitate smooth transition at the time of their eventual listing in course of time.

Chairman of the Board

The insurance companies presently could have different structures with the Board of Directors headed by an Executive or Non-Executive Chairman with distinct oversight responsibilities over the other Directors and Key Management Persons.

Groups and Conglomerates

The governance structure of the insurer could also be influenced by its association with an insurance group or a larger financial/ non-financial conglomerate. Insurers who are a part of a financial group could also be subject to the regulatory requirements on governance policies and practices established for the group level and implemented uniformly across the group. However, these practices should be reoriented at the level of the insurer taking into account its specific business and risk profile and sectoral regulatory requirements. Such insurers should nevertheless strive to maintain consistency in policies and practices in order to reinforce controls across the group.

Board of Directors

Composition : The Insurance Act stipulates that the insurance companies in India would be public companies and hence, would require a properly constituted Board. Insurance companies should ensure that the Board comprises of competent and qualified Directors to drive the strategies in a manner that would sustain growth and protect the interests of the stakeholders in general and policyholders in particular. The size of the Board in addition to being compliant with legal requirements (where applicable), should be consistent with scale, nature and complexity of business. The size and composition should ensure that they collectively provide knowledge, skills, experience and commitment. Further, the Board Members should be in a position to dedicate sufficient time and commitment to fulfill their responsibilities. It is expected that the shareholders of the companies elect or nominate Directors from various areas of financial and management expertise such as accountancy, law, insurance, pension, banking, securities, economics, etc., with qualifications and experience that is appropriate to the company. It is essential that the Directors possess the knowledge of group structure, organizational structure, process and products of the insurer and the Board generally complies with the following requirements: -

- The Board of Directors and Key Management Persons (KMP) should understand the operational structure of the insurer and have a general understanding of the lines of business and products of the insurer, more particularly as the insurer grows in size and complexity.
- The Board of Directors of an insurer belonging to a larger group structure/ conglomerate should understand the material risks and issues that could affect the group entities, with attendant implication on the insurer.
- The Board of Directors is required to have a minimum of three "Independent Directors". However, this requirement is relaxed to 'two' independent directors, for the initial five years from grant of Certificate of Registration to insurers. The optimum composition of Independent and Non-Executive Directors enhances the quality of business judgment and benefits the shareholders and policyholders. This is especially important in respect of insurance companies under conglomerate structure and where there is potential scope for transfer of risks and conflicts of interests that affect the group entities.
- Insurers which have less than three independent directors shall ensure that they comply with this requirement within one year of the date of effect of these guidelines.
- An independent Director shall fulfill all the conditions specified under Section 149 of the Companies Act, 2013. An appointment letter shall be issued to the Independent director laying down the terms and conditions, including his duties, responsibilities, sitting fees, etc. In case the number of independent directors falls below the required minimum laid down, such vacancy shall be filled up before the immediately following Board meeting or 3 months from the date of such vacancy, whichever is later, under intimation to the Authority.
- Similarly, where the Chairman of the Board is non-executive, the Chief Executive Officer should be a whole time director of the Board.
- As required under Section 149 of the Companies Act, 2013, there shall be at least one Woman Director on the Board of every Insurance company.

ROLE AND RESPONSIBILITY OF THE BOARD

The Board would primarily concentrate on the direction, control and governance of the insurer and in particular should articulate and commit to a corporate philosophy and governance that will shape the level of risk adoption, standards of business conduct and ethical behaviour of the company at the macro level. The Board should also set clear and transparent policy framework for translation of the corporate objectives. The Board can delegate its authority to the Board Committees in the discharge of this responsibility but such delegation does not absolve the Board from its primary responsibilities. In this regard, the Board should seek detailed and transparent information flow from the senior management (CEO and other KMPs) through well documented agenda notes and also devise appropriate systems to serve as effective monitoring arrangements. As the Boards generally do not meet at frequent intervals, it is imperative that the senior management is clearly made accountable for the two way information flow. The structure of the Board of Directors should be oriented to setting-up of objectives to meet the expectations of various stakeholders, strategies for their fulfillment and for monitoring the achievements. The Boards of insurance companies need to consider interests of all stakeholders, and especially their policy holders as a specific group. Further, since there could arise a conflict of interest amongst the various stakeholders, a key board function would be to establish strategies and policies that define ethical individual and corporate behaviour and ongoing, effective processes that ensure adherence to these strategies and policies.

Thus, with a view to being effective, the Board in active consultation with the Key Management Persons, should establish and evaluate strategies and policies to address, at the minimum, a broad range of areas, as indicated below:

- There should concurrently be arrangements to review the policies from time to time to ensure that they are dynamic.
- Overall direction of the business of the insurance company, including policies, strategies and risk management across all the functions.
- Projections on the capital requirements, revenue streams, expenses and the profitability. While laying down the projections, the Board must address the expectations of the shareholders and the policyholders.
- Obligation to fully comply with the Insurance Act and the regulations framed thereunder, and other statutory requirements applicable to it.
- Addressing conflicts of interest.
- Ensuring fair treatment of policyholders and employees.
- Ensuring information sharing with and disclosures to stakeholders, including investors, policyholders, employees, the regulators, consumers, financial analysts and/or rating agencies.
- Establishing channels for encouraging and facilitating employees raising concerns or reporting a possible breach of law or regulations, with appropriate measures to protect whistle blowers.
- Developing a corporate culture that recognizes and rewards adherence to ethical standards.

DELEGATION OF FUNCTIONS- COMMITTEES OF THE BOARD

With a view to providing adequate Board time for discharge of the significant corporate responsibilities, the Board can consider setting up of various Committees of Directors by delegating the overall monitoring responsibilities after laying down the roles and responsibilities of these Committees to the Board.

In particular, the following aspects need to be defined in respect of the role and functions of the Committees:

- Constitution
- Objectives
- Responsibilities
- Frequency of meeting/ quorum requirements
- Appointment and removal of members
- Reporting to the Board

Insurers may establish several Committees to undertake specific functions depending on the size and level of the complexity of the operations. Typically, the Committees that assist the Board are:

- Audit Committee
- Risk Management Committee
- Nomination and Remuneration Committee
- Investment Committee
- Ethics Committee and
- Asset-Liability Management Committee

However, the Authority advises all insurers that it is mandatory to establish Committees for Audit, Investment, Risk Management, Policyholder Protection, Nomination and Remuneration, Corporate Social Responsibility (only for insurers earning profits). In addition, Regulation 45d of the IRDA (Non-linked Insurance Products) Regulations, 2013 requires constitution of a 'With Profits' Committee by Life Insurance Companies comprising of one Independent Director of the Board, the Chief Executive Officer, the Appointed Actuary of the Company and an Independent Actuary. Establishment of the other Committees is left to the option of the insurer. The role and responsibilities of the Committees would generally be as detailed below:-

I. Audit Committee (Mandatory)

- Every Insurer shall constitute an Audit Committee as per Section 177 of the Companies Act, 2013.
- The Audit Committee shall oversee the financial statements, financial reporting, statement of cash flow and disclosure processes both on an annual and quarterly basis. It shall set-up procedures and processes to address all concerns relating to adequacy of checks and control mechanisms.
- The Chairperson of the Audit Committee should be an Independent Director of the Board with an accounting/finance/audit experience and may be a Chartered Accountant or a person with a strong financial analysis background. The association of the CEO in the Audit Committee should be limited to occasions where the Audit Committee requires eliciting any specific information concerning audit findings. As required under Section 177 of the Companies Act, 2013, the Audit Committee shall comprise of a minimum of three directors, majority of whom shall be Independent Directors.
- The Audit Committee will oversee the efficient functioning of the internal audit department and review its reports. The Committee will additionally monitor the progress made in rectification of irregularities and changes in processes wherever deficiencies have come to notice.
- The Audit Committee shall be directly responsible for the recommendation of the appointment, remuneration, performance and oversight of the work of the auditors (internal/statutory/Concurrent).
- In case of statutory audit, the independence of the external auditors shall be ensured (although the approval of appointment, remuneration and removal of the statutory auditors shall be done by the shareholders at the general body meeting).
- The Audit Committee shall have the oversight on the procedures and processes established to attend to issues relating to maintenance of books of account, administration procedures, transactions and other matters having a bearing on the financial position of the insurer, whether raised by the auditors or by any other person.
- The Audit Committee shall discuss with the statutory auditors before the audit commences, about the nature and scope of audit as well as have post-audit discussions to address areas of concern.
- Act as a Compliance Committee to discuss the level of compliance in the Company and any associated risks and to monitor and report to the Board on any significant compliance breaches.
- Any additional work other than statutory/internal audit that is entrusted to the auditor or any of its associated persons or companies shall be specifically approved by the Board keeping in mind the necessity to maintain the independence and integrity of the audit relationship. All such other work entrusted to the auditor or its associates shall be specifically disclosed in the Notes to Accounts forming part of the annual accounts of the insurance companies. However, it may be ensured that insurance companies comply with Section 144 of the Companies Act, 2013 before deciding to provide any additional work to the Statutory Auditors.

II. Investment Committee (Mandatory)

- The Board of every Insurer shall set up an Investment Committee comprising of at least two Non-Executive Directors, the Chief Executive Officer, Chief of Finance, Chief of Investment, Chief Risk Officer and, the Appointed Actuary.

- The Committee shall be responsible to recommend investment policy and lay down the operational framework for the investment operations of the insurer. The policy should focus on a prudential Asset Liability Management (ALM) supported by robust internal control systems. The investment policy and operational framework should, inter alia, encompass aspects concerning liquidity for smooth operations, compliance with prudential regulatory norms on investments, risk management/ mitigation strategies to ensure commensurate yield on investments and above all protection of policyholders' funds.
- The Investment Committee shall be responsible for implementing the Investment Policy duly approved by the Board.
- Members of the Committee should familiarize themselves and be conversant with the various Acts, Rules, Regulations, Guidelines, Circulars, etc., issued by the Authority as amended from-time-to-time.
- For assessment of credit risk and market risk, the members of the Committee should not be influenced only by the credit rating. The committee should independently review their investment decisions and ensure that support by the internal due diligence process is an input in making appropriate investment decisions.
- The Committee shall formulate an effective reporting system to ensure compliance with the policy set out by it apart from Internal/Concurrent Audit mechanisms for a sustained and on-going monitoring of Investment Operations.
- The Committee shall meet at least once in a quarter to review investment operations and submit a report to the Board on the performance of the investment portfolio with regard to its safety and soundness.

III. Risk Management Committee (Mandatory)

It is now well recognized that the sound management of an insurance company, as in the case of other financial sector entities, is dependent on how well the various risks are managed across the organization. In pursuit of development of a strong risk management system and mitigation strategies, insurers shall set up a separate Risk Management Committee to implement the company's Risk Management Strategy. The risk management function should be under the overall guidance and supervision of the Chief Risk Officer (CRO) with a clearly defined role. It shall be organized in such a way that it is able to monitor all the risks across the various lines of business of the company and the operating head has direct access to the Board. It should not focus solely on compliance; it should focus on adding value to rest of the business. Risk management function should work in close co-ordination with the finance function, but independently assess and evaluate the capital, finance and other operating decisions. Broadly, the Risk Management Committee shall:

- Establish effective Risk Management framework and recommend to the Board the Risk Management policy and processes for the organization.
- Set the risk tolerance limits and assess the cost and benefits associated with risk exposure.
- Review the Company's risk- reward performance to align with overall policy objectives.
- Discuss and consider best practices in risk management in the market and advise the respective functions.
- Assist the Board in effective operation of the risk management system by performing specialized analyses and quality reviews.
- Maintain an aggregated view on the risk profile of the Company for all categories of risk including insurance risk, market risk, credit risk, liquidity risk, operational risk, compliance risk, legal risk, reputation risk, etc.

- Advise the Board with regard to risk management decisions in relation to strategic and operational matters such as corporate strategy, mergers and acquisitions and related matters.
- Report to the Board, details on the risk exposures and the actions taken to manage the exposures; review, monitor and challenge where necessary, risks undertaken by the Company.
- Review the solvency position of the Company on a regular basis.
- Monitor and review regular updates on business continuity.
- Formulation of a Fraud monitoring policy and framework for approval by the Board.
- Monitor implementation of Anti-fraud policy for effective deterrence, prevention, detection and mitigation of frauds.
- Review compliance with the guidelines on Insurance Fraud Monitoring Framework dt. 21st January, 2013, issued by the Authority.

IV. Policyholder Protection Committee (Mandatory)

The Authority is mandated by statute to protect poliycholders' interests and therefore adoption of sound and healthy market practices in terms of sales, marketing, advertisements, promotion, publicity, redressal of customer grievances, consumer awareness and education is essential.

The Authority has, therefore, notified the following Regulations/Guidelines:

(a) Protection of Policyholders' Interests Regulations, 2002;

(b) Insurance Advertisements and Disclosure Regulations, 2002;

(c) Master Circular on Insurance Advertisements in August, 2015;

(d) Guidelines on Public Disclosure for insurance companies;

(e) Guidelines on Advertisements, Promotion & Publicity of Insurance Companies and Insurance Intermediaries in May 2007;

(f) Various Circulars on Handling and Disclosure of the Unclaimed Amounts pertaining to the Policyholders;

(g) Guidelines on Grievance Redressal by Insurance Companies in July 2010 and Handling of Complaints/ Grievances from Policyholders in April 2015;

(h) Guidelines on Electronic Mode of Payments for Claims.

Indian Insurance companies are also required to report on the number and nature of complaints to the IRDAI at monthly intervals to enable IRDAI to assess the governance and market conduct issues with respect to each insurance company. With a view to addressing the various compliance issues relating to protection of the interests of policyholders, as also relating to keeping the policyholders well informed of and educated about insurance products and complaint-handling procedures, each insurer shall set up a Policyholder Protection Committee.

Such Committee shall be headed by a Non-Executive Director and shall include an expert/representative of customers as an invitee to enable insurers to formulate policies and assess compliance thereof. The Committee shall recommend a policy on customer education for approval of the Board and ensure proper implementation of the same. The Committee should put in place systems to ensure that policyholders have access to redressal mechanisms and shall establish policies and procedures, for the creation of a dedicated unit to deal with customer complaints and resolve disputes expeditiously.

The functions and responsibilities of the Policyholders' Protection Committee shall include:-

- Adopt standard operating procedures to treat the customer fairly including time-frames for policy and claims servicing parameters and monitoring implementation thereof.

- Establish effective mechanism to address complaints and grievances of policyholders including mis-selling by intermediaries.
- Put in place a framework for review of awards given by Insurance Ombudsman/Consumer Forums. Analyze the root cause of customer complaints, identify market conduct issues and advise the management appropriately about rectifying systemic issues, if any.
- Review all the awards given by Insurance Ombudsman/Consumer Forums remaining unimplemented for more than three (3) months with reasons therefor and report the same to the Board for initiating remedial action, where necessary.
- Review the measures and take steps to reduce customer complaints at periodic intervals.
- Ensure compliance with the statutory requirements as laid down in the regulatory framework.
- Ensure adequacy of disclosure of "material information" to the policyholders. These disclosures shall comply with the requirements laid down by the Authority both at the point of sale and at periodic intervals.
- Provide details of grievances at periodic intervals in such formats as may be prescribed by the Authority.
- Ensure that details of insurance ombudsmen are provided to the policyholders.
- Review of Claims Report, including status of Outstanding Claims with ageing of outstanding claims.
- Reviewing Repudiated claims with analysis of reasons.
- Status of settlement of other customer benefit payouts like Surrenders, Loan, Partial withdrawal requests etc.
- Review of unclaimed amounts of Policyholders, as required under the Circulars and guidelines issued by the Authority.

The Board shall review the status report on policyholders' protection issues, submitted by the Committee, in each of its meeting.

V. Nomination And Remuneration Committee (Mandatory)

The Nomination and Remuneration Committee shall be constituted in line with the provisions of Section 178 of the Companies Act, 2013. Indian Insurance Companies which have constituted two independent committees for Nomination and Remuneration separately may merge these two Committees after seeking the Board approval, under intimation to the Authority, within a period of 180 days from the date of issue of these guidelines.

The Nomination and Remuneration Committee shall scrutinize the declarations of intending applicants before the appointment/reappointment/election of directors by the shareholders at the General Meetings. The Committee shall also scrutinize the applications and details submitted by the aspirants for appointment as the Key Management Persons. The Nomination and Remuneration Committee could also make independent/discreet references, where necessary, well in time to verify the accuracy of the information furnished by the applicant.

The insurance companies are further advised that they should obtain an annual declaration from the Directors/ KMPs that the information provided in the declaration at the time of appointment/ reappointment has not undergone any change subsequently and the changes, if any, are apprised by the concerned Director to the Board. The Directors are also required to enter into a Deed of Covenant, with the insurance company, duly approved by the Board, pursuant to their terms of appointment to ensure that there is a clear understanding of the mutual role of the company, the Directors and the Board in Corporate Governance.

It is pertinent to draw attention to the provisions of Section 34 (A) (1) of the Insurance Act, 1938 which stipulates that the remuneration of CEOs/Whole-time Directors of Indian insurance companies is subject to statutory approval of the IRDAI. Further, the overall management costs of the insurer are also additionally governed by the limits prescribed statutorily in the Insurance Act and Regulations framed there under in order to protect the interests of the policyholders. The setting up of a Nomination and Remuneration Committee should keep the above requirements in view.

The role of the Committee includes the following aspects:-

- The Nomination and Remuneration Committee is required to determine on behalf of the Board and on behalf of the shareholders with agreed terms of reference, the insurance company's policy on remuneration packages and any compensation payment, for the CEO, the Executive Directors, Key management Persons of the company.
- The remuneration package shall be aligned appropriately with the performance objectives laid down for the Key Management Persons.
- In order to avoid conflict of interest, the Nomination and Remuneration Committee, may comprise of at least three non-executive directors, with the Chairman of the Committee being an independent director. At least one-half of the Committee shall comprise of Independent Directors.
- The Nomination and Remuneration Committee shall ensure that the remuneration packages of the Key Management Persons of the company are as per the Remuneration Policy approved by the Board.
- The Committee shall also ensure that the proposed appointments/ re-appointments of Key Management Persons or Directors are in conformity with the Board approved policy on retirement/ superannuation.

VI. Corporate Social Responsibility Committee ('CSR Committee') (Mandatory)

Section 135 of the Companies Act, 2013 requires constitution of a CSR Committee if certain conditions as mentioned in the said Section are fulfilled. For Indian Insurance Companies, a CSR Committee is required to be set up if the insurance company earns a Net Profit of Rs. 5 Crores or more during the preceding financial year.

Further the 'Net Profit' for this purpose shall be as under:-

"Net profit" means the "profit/(loss) before tax" as per its financial statements prepared in accordance with the applicable provisions of the Insurance Act, 1938 and the Regulations framed thereunder, but shall not include the following, namely

(i) Any profit arising from any overseas branch or branches of the company, whether operated as a separate company or otherwise; and

(ii) any dividend received from other companies in India, which are covered under and complying with the provisions of section 135 of the Companies Act.

Provided that net profit in respect of a financial year for which the relevant financial statements were prepared in accordance with the provisions of the Insurance Act, 1938, shall not be required to be re-calculated in accordance with the provisions of the Companies Act. In line with Section 135(5) of Companies Act, 2013, the Board of Directors of the Company shall ensure that the Company spends not less than 2% of the three years' average Net Profits as defined above towards the CSR activities.

(a) CSR will be based only on the average of the three years' profit as per the Statement of Profit and Loss Account as stated above.

(b) The CSR Committee shall formulate a CSR policy and get it approved by the Board. Constitution of CSR Committee will be as per Companies Act, 2013.

(c) The expense incurred on CSR shall not be included for the purpose of calculation of ceilings on Expenses of Management under Section 40B or Section 40C, as the case may be.

(d) The expenses incurred on CSR activities should not be charged to the Policyholders' Account.

VII. With Profits Committee

The Authority has issued IRDA (Non-Linked Insurance Products) Regulations 2013, which lay down the framework about the With Profit Fund Management and Asset sharing, among other things. In terms of these Regulations, every Insurer transacting life insurance business shall constitute a With Profits Committee comprising of an Independent Director, the CEO, The Appointed Actuary and an independent Actuary.

The Committee shall meet as often as is required to transact the business and carry out the functions of determining the following:

- the share of assets attributable to the policyholders
- the investment income attributable to the participating fund of policyholders
- the expenses allocated to the policyholders.

The report of the With Profits Committee in respect of the above matters should be attached to the Actuarial Report and Abstract furnished by the insurers to the Authority. The Board of an insurer shall ensure that any other stipulations regarding the constitution and/ or functioning of the With Profits Committee as indicated in the Regulations made by the Authority from time to time shall be complied with at all times.

VIII. Other Committees

The other Committees which can be set up by the Board, include the Ethics Committee and ALM Committee (other than life insurers). In cases where Board decides not to constitute such Committees, their functions and responsibilities can be addressed in such manner as the Board may deem fit. However, once these Optional Committees are in place, the insurer is required to comply with the requirements on the "Role and Responsibilities" of such Committees as laid down under these Guidelines.

Wherever the functions of the mandatory committees are capable of being merged without affecting the independence and objectivity envisaged in the corporate governance structure, insurance companies may do so under specific approval of their Boards and intimation to the Authority. However, the Audit Committee and the Investment Committee shall not be merged with any other Committee of the Board under any circumstances.

IX. Ethics Committee (Not Mandatory)

Functions and Responsibilities of the Ethics Committee shall include:

- Monitoring the compliance function and the insurance company's risk profile in respect of compliance with external laws and regulations and internal policies, including its code of ethics or conduct.
- Receiving reports on the above and on proactive compliance activities aimed at increasing the insurance company's ability to meet its legal and ethical obligations, on identified weaknesses, lapses, breaches or violations and the controls and other measures in place to help detect and address the same.
- Supervising and monitoring matters reported using the insurer's whistle blowing or other confidential mechanisms for employees and others to report ethical and compliance concerns or potential breaches or violations.
- Advising the board on the effect of the above on the insurer's conduct of business and helping the board set the correct "tone at the top" by communicating, or supporting the communication, at all levels of the insurer of the importance of ethics and compliance.
- Approving compliance programmes, reviewing their effectiveness on a regular basis and signing off on any material compliance issues or matters.

X. Asset Liability Management (Alm) Committee

ALM is an ongoing process of formulating, implementing, monitoring and revising strategies related to assets and liabilities to achieve an organization's financial objectives, given the organization's risk appetite, risk tolerances and business profile. The need for ALM cannot be over-emphasized as it lays down the framework to ensure that the insurer invests in a manner which would enable it to meet its cash flow needs and capital requirements at a future date to mitigate liquidity risk and solvency stipulations.

The functions of the ALM Committee (wherever constituted) shall include:

- Setting the insurer's risk/reward objectives and assessing policyholder expectations.
- Quantifying the level of risk exposure (eg. market, credit and liquidity) and assessing the expected rewards and costs associated with the risk exposure.
- Formulating and implementing optimal ALM strategies and meeting risk-reward objectives at both product and enterprise level.
- Ensuring that liabilities are backed by appropriate assets and manage mismatches between assets and liabilities to ensure they remain within acceptable monitored tolerances for liquidity, solvency and the risk profile of the entity.
- Monitoring risk exposures at periodic intervals and revising ALM strategies where required. Reviewing, approving and monitoring systems, controls and reporting used to manage balance sheet risks including any mitigation strategies.
- Regular review and monitoring of mismatch between assets and liabilities and the acceptable tolerance limits for mismatch, if any.
- Ensuring that management and valuation of all assets and liabilities comply with standards, prevailing legislation and internal and external reporting requirements.
- Submitting the ALM information before the Board at periodic intervals. Annual review of strategic asset allocation.
- Reviewing key methodologies and assumptions including actuarial assumptions, used to value assets and liabilities.
- Managing capital requirements at the company level using the regulatory solvency requirements.
- Reviewing, approving and monitoring capital plans and related decisions over capital transactions (e.g. dividend payments, acquisitions, disposals, etc.).

Where an insurer does not constitute the Asset Liability Management (ALM) Committee, the functions of ALM shall form part of the Risk Management Committee.

The mandatory committees, except Nomination and Remuneration Committee, the Corporate Social Responsibility Committee and the With Profits Committee shall meet at least four times in a year and not more than four months shall elapse between two successive meetings of such Committees. The quorum shall be two members or one-third of the members of the Committee, whichever is greater, however in case independent director(s) is/ are mandated to be in any of the Committees, at least one such independent director or his alternate director, should necessarily be present to form the quorum.

As specified in the proviso to Section 161(2) of the Companies Act, 2013, no person shall be appointed as an alternate director for an independent director unless he/she is qualified to be appointed as an independent director under the provisions of this Act. This condition shall be applicable even while appointing an alternate director to an Independent director in any of the Committees. It is emphasized that the overall responsibility for directing the affairs of the insurers shall be with the Board and it shall continue to exercise its oversight directly on matters that are not specifically delegated to any of its Committees.

KEY MANAGEMENT PERSONS

Definition – Key Management Person (KMP):

"Key Management Person" means members of the core management team of an insurer including all whole-time directors/ Managing Directors/ CEO and the functional heads one level below the MD/CEO, including the CFO, Appointed Actuary, Chief Investment Officer, Chief Risk Officer, Chief Compliance Officer and the Company Secretary.

Explanation: The nomenclature or designations used in the above definition are only illustrative and shall be appropriately mapped to the respective functions of the Insurers while reporting information under these guidelines, wherever, necessary.

CEO/ Managing Director/ Whole-Time Director: The Chief Executive Officer/Whole Time Director/ Managing Director of the company and other key functionaries are responsible for the operations and day to day management of the company in line with the directions of the Board and the Committees set up by the Board. Section 34A of the Insurance Act, 1938 requires prior approval of the Authority for appointment, re-appointment or termination of the Chief Executive Officer and the Whole Time Directors. The Authority expects the CEO to be responsible for the conduct of the company's affairs in a manner which is not detrimental to the interests of the policyholders and which is consistent with the policies and directions of the Board.

The Board should, therefore, carry out effective due diligence to establish that the new incumbent is 'fit and proper' before recommending the name for Authority's approval. In case the CEO resigns, the Authority should be kept informed of such resignation and the reasons therefor. The Insurance Act also prohibits the Managing Director or other Officer of a life insurance company from being a Managing Director or Other Officer of any other Life insurance company or of a Banking company or an Investment Company. As the appointment of the CEO is made with the prior approval of the IRDAI the Board should take proactive steps to decide on the continuance of CEO well in time before the expiry of his tenure or to identify the new incumbent.

AUDIT & AUDITORS

Appointment of Statutory Auditors by Insurers

Section 12 of Insurance Act, 1938 prescribes that all insurers must be audited annually by the Auditors.

The Authority has reviewed the existing guidelines as regards appointment of auditors by insurers. In light of the amendments to the Insurance Act, 1938 and the Companies Act, 2013, Authority issues the revised guidelines as under:

Insurers shall comply with the provisions relating to appointment of Auditors as contained in the Companies Act, 2013. Additionally, insurers shall also comply with the provisions contained in these guidelines.

On recommendation of the Audit Committee, the Board shall appoint the statutory auditors, subject to the shareholders' approval at the general meeting of an Indian insurance company. The remuneration of the auditors shall also be approved by the shareholders in the general meeting.

I. The eligibility, qualifications and other requirements of the auditors are detailed below:

1. The Auditor of an insurer shall be a firm, including a Limited Liability Firm, constituted under the LLP Act, 2008.
2. The Firm should have been established and in continuous practice for at least 15 years.
3. The auditor should have:
   - (a) a minimum of 5 full-time partners, of whom,
     - (i) at least 2 should have been in full-time practice as partners exclusively associated with the firm for a continuous period of minimum of 10 years, and
     - (ii) at least 2 other partners should have been in continuous association with the audit firm either as partner or as employee for a minimum period of 5 years, and
     - (iii) one partner in full-time practice with the firm as a partner for a minimum period of 1 year, and

(iv) out of the total partners of the firm, at least two should be FCA and be in practice for a minimum period of 5 years as FCA.

OR (Alternatively),

(a) a minimum of 7 Chartered Accountants,

(i) of which not less than 2 are partners in full-time practice exclusively associated with the firm for a continuous period of a minimum of 10 years, and

(ii) at least 3 other Chartered Accountants in continuous association with the audit firm as partner or employee for a minimum period of 5 years, and

(iii) at least 2 Chartered Accountants should be FCA and be in practice for a minimum period of 5 years as FCA.

4. At least one partner or employee of the audit firm should possess the DISA/ CISA or equivalent qualification as may be recognized by the IRDAI from time to time and such partner or employee must be involved in the audit of the insurer.

5. The Audit firm should have a minimum experience of 5 years in audit assignments of entities in the financial sector. At least one of the joint statutory auditors of an insurer must have experience in insurance company audits of at least two years.

6. For the above purposes, a full-time partner shall not include a person who is –

(a) a partner in other CA firm(s) or

(b) employed full time/ part time elsewhere, practicing in own name, or engaged in practice otherwise or engaged in other activity which would be deemed to be in practice under section 2(2) of the Chartered Accountants Act, 1949.

7. Insurers should verify to their satisfaction that the proposed auditors meet the eligibility criteria before considering/ approving their appointment. A declaration in the prescribed format (Form A1) shall be obtained by insurers at the time of appointment of auditors.

8. Any change in the constitution of the Audit firm/information submitted/certifications submitted which affects the eligibility criteria indicated in these guidelines, should be duly informed by the Audit firm to the Insurers within 7 working days of such change. In such cases, the insurer must ensure compliance with the guidelines within six months from date of such intimation.

9. The Authority must be informed about appointment of auditors within 7 working days thereof with a certification to the effect that the above eligibility stipulations have been met, as per the format Form A2.

10. Insurers are also advised to file a Return on an annual basis in Format A3 giving details of Chartered Accountant firms engaged in various capacities like Statutory Auditors, Internal Auditors, Concurrent Auditors, Tax Auditors etc.

If it comes to the notice of the Authority that the appointment of auditors by insurers is not in line with these guidelines, the appointment is liable for cancellation and it shall be open for the Authority to consider such further action as may be deemed necessary in this regard.

An insurer shall not remove its statutory auditor without the prior approval of the Authority.

II. Maximum Number of Statutory Audits of Insurers that can be accepted by an audit firm at a time :

(1) An Audit firm shall be entitled to carry out Statutory Audits of not more than three Insurers (Life/ Nonlife/Health/Reinsurer) at a time.

Provided that an audit firm shall not have the audit assignments of more than 2 insurers in one line of business (i.e. life insurance, general insurance, health insurance and reinsurance) at a time.

Explanation: An audit firm shall include its associate/ affiliate firms which are under the same network or other firm(s) whose name or trade mark or brand is used by the audit firm or any of its partners.

External Audit - Appointment of Statutory Auditors

The IRDAI (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002 empower the Authority to issue directions/guidelines on appointment, continuance or removal of auditors of an insurer. These guidelines/directions include prescriptions on qualifications and experience of auditors, their rotation, period of appointment, etc. as may be deemed necessary by the Authority.

> The Board should therefore ensure that the statutory auditors are compliant with the regulatory requirements and there are no conflicts of interest in their appointment. The auditors should possess the competence and integrity to alert the appropriate authorities promptly of any event that could seriously affect the insurance company's financial position or the organization structure of its administration or accounting and of any criminal violations or material irregularities that come to his notice.

Access to Board and Audit Committee

The Audit Committee should have discussions with the statutory auditors periodically about internal control systems, the scope of audit including the observations of the auditors (where applicable) and review the quarterly/half yearly and annual financial statements as the case may be before submission to the Board of Directors and also ensure compliance with the internal control systems. The statutory auditors should also have access to the Board of Directors through the Audit Committee.

WHISTLE BLOWER POLICY

Insurers are well advised to put in place a "whistle blower" policy, where-by mechanisms exist for employees to raise concerns internally about possible irregularities, governance weaknesses, financial reporting issues or other such matters. These could include employee reporting in confidence directly to the Chairman of the Board or of a Committee of the Board or to the Statutory Auditor.

The Policy illustratively covers the following aspects:

- Awareness of the employees that such channels are available, how to use them and how their report will be handled.
- Handling of the reports received confidentially, for independent assessment, investigation and where necessary for taking appropriate follow-up actions.
- A robust anti-retaliation policy to protect employees who make reports in good faith.
- Briefing of the board of directors.

The appointed actuary and the statutory/internal auditors have the duty to 'whistle blow', i.e., to report in a timely manner to the IRDAI if they are aware that the insurance company has failed to take appropriate steps to rectify a matter which has a material adverse effect on its financial condition. This would enable the IRDAI to take prompt action before policyholders' interests are undermined.

COMPLIANCE MANAGEMENT FRAMEWORK

Compliance in simple term means following rules and orders applicable to the entity. Every entity is governed under law and order and that entity needs to follow the rule and regulations prescribed by it. Businesses set up in India require following several compliances under different laws. Apart from compliance, companies have to file annual returns and filings which are prescribed by the government. Businesses have to be registered with several authorities to follow several compliances.

An insurance business is established initially as a company. The business has to be registered with the Registrar of Companies (ROC). Apart from this, once the insurance business begins operations, there would be various compliances under different laws and regulations. The law related to insurance is present under the Insurance Act, 1938 and the Insurance Regulatory and Development Authority Act 1999. Primarily, the IRDAI compliance for Insurance companies is required so that the company can follow the rules and bye-laws which are laid down by the authority for the following reasons:

- To ensure that the insurance company is registered as per the requirements of the authority.
- To settle claims and grievances related to policyholders.
- To ensure that the insurance companies act in the best interests of policyholders.
- To ensure that there is a proper system of monitoring insurance companies.
- Foreign exchange is allowed in insurance. Compliance with the rules related to FEMA would ensure that the company is following procedures.

Apart from this, there are different regulatory authorities and laws that insurance companies have to be compliant with. IRDAI Compliance for insurance companies comes under the following authorities:

- For setting up a company, the compliance would be under the Companies Act 2013 and previous company law. The insurance company would have to deal with the ministry of corporate affairs (MCA) and the Registrar of Companies (ROC) for setting up a company. The company has to be compliant with Insurance Laws and Insurance Act for being registered with the IRDAI and has the minimum capital requirements such as:
  (i) Minimum Capital Requirements for an Insurance Company- 100 Crores.
  (ii) Minimum Capital Requirements for Reinsurance Company- 200 Crores.
- Foreign Exchange Management Compliance- The insurance company would have to comply with the laws related to Foreign Exchange Management Act 1999 (FEMA). Foreign exchange management regulations are developed by the Reserve Bank of India (RBI). Reporting amount of inward inflow and outward inflow that occurs in an Insurance company having a specific amount of foreign investment.
- E-commerce compliance for insurance companies are regulated by the Insurance E-Commerce Business/ Internet Guidelines (IRDA/ INT/ GDL/ ECM/ 055/03/ 2017)- Guidelines as per section 34 of the Insurance Act, 1938 and Section 14 of the IRDA Act 1999. These include:
  (i) The insurance business must register as an e-Commerce company when dealing with internet insurance.
  (ii) The company must ensure that the website is according to the guidelines as per issued by the IRDAI.
  (iii) The company must ensure that the price of the products complies with the IRDAI.
  (iv) The Company must ensure that all policyholders are provided with information on the website.

THE COMPLIANCE FRAMEWORK UNDER VARIOUS AUTHORITIES IS SUMMARIZED AS FOLLOWS:

Setting up of an Insurance Company and Corporate Governance Norms

- The company must incorporate as a public company under the CA 2013 or previous company law.
- Insurance Company needs to be registered as a public company under the Companies Act or Previous company law.

- Filing of resolutions to the Ministry of Corporate Affairs, the declaration from directors, appointment of directors and auditors, annual filings are required to be followed by companies.
- Insurance companies registered under this Act are required to file numerous board resolutions related to topics such as resignation or appointment of directors, appointment of auditors, problems related to shares, etc. with the ROC.
- The filing of the balance sheet in XBRL is exempted from the insurance company. Also, the annual return they file in AOC-4, and MGT-7 needs to be filed within 60 days of the AGM (Annual General Meeting).
- Corporate Governance Guidelines is another provision that is issued by the IRDAI for the insurance companies. The company is required to strictly follow the regulations and also should strictly abide by the rules prescribed in these guidelines while forming the committees.

E-Commerce – Internet Compliance for Insurance Company

- The applicant has to set up an independent ISNP (Insurance Self Network Platform).
- Prior permission is required from the authority to set up such a platform.
- Application must be made in Form-ISNP-1 to set up an internet e-commerce platform in India to conduct e-Commerce activities.
- The applicant has to pay a non-refundable fee of Rs 10,000.
- The application form has to fill with details as per the requirements, and the authority will return within 15 days.
- The authority would give the permission to secure the license.

Conditions taken by the authority before granting permission

The interests of the policyholders will be taken into consideration.

- Before granting permission, the authority will see the prospects of internet-based insurance activities.
- The company must not have breached guidelines issued by the authority.
- The applicant does not violate the provisions of the Insurance Act, 1938, IRDA Act, 1999, insurance Rules, Regulations Guidelines, circulars, orders, notices, etc. issued by the authority.

Compliance under Insurance Regulatory and Development Authority/ Audit

Insurance companies have to file the following reports:

- Quarterly Reports;
- Monthly reports;
- Annual Reports;
- Monthly informational reports of policy grievances, business information. This would also apply to quarterly reports; and
- The insurance company are required to put forth their overall performance and which involves the risks related topics and how they deal with particular risks along with the details of the policyholder and management details.

Insurance companies have to maintain a solvency margin ratio regularly and must prepare their accounts according to the prescribed authority. An essential requirement of the company is that the annual return must be filed in four copies within six months to the authorities from the end of the financial year. In case if the business is carried outside India, this period is slightly extended by three months. It is a must that this annual report contains the signatures of the principal officer, two directors, and the chairman.

Reports of Businesses outside India

For those insurers who have their business established outside India need to file four certified copies to the authority in the English language for each of the balance sheet, account, statement, abstract and report.

In addition to this, the statement that an auditor or a qualified person audited under the law of insurer's country should be supplied, which indicates the information of all the assets possessed by the insurer in India itself as per the date stated in any of the balance sheets.

They have to supply a separate abstract of the valuation report to the authority before the due date is prescribed.

Compliance Requirements under FEMA

These provisions are specially designed and imposed for those insurance companies that possess foreign investments or have foreign promoters. They must abide by the guidelines as prescribed by the FEMA.

It is mandatory for the insurance companies coming under FEMA to produce an annual report that is filed following the provisions prescribed and within the specified period to the RBI. Thus, as per the laws formulated for various insurance companies, these companies must abide by the provisions of these guidelines for smoother working of the organization.

Insurance companies have specific requirements related to foreign equity holding. Foreign investors are allowed to invest in insurance companies. Foreign Direct Investment is allowed in the insurance sectors. There is a specific compliance for outward investment and inward investment related to an insurance company.

Internet/E-commerce Insurance Business- IRDA Compliance for Insurance Companies

- Form - ISNP – 1.
- KYC documents.
- Fee.
- Application form.

Company Law Documentation- IRDA Compliance for Insurance Companies

- Identity Proof such as Aadhaar card, PAN card, Driving License, Voter Id of all the designated directors, and shareholders.
- Address Proof of all the proposed directors and shareholders of the company.
- PAN card details of all the directors and shareholders.
- Utility bills such as telephone, gas, water, or electricity bill of the registered office are residential proof of the business place. It should not be older than two months.
- A NOC or No Objection Certificate from the landlord of the business place.
- DIN or Directors Identification Number of all the designated directors.
- DSC or Digital Signature Certificate of the designated directors.
- Memorandum of Association (MOA) and Article of Association (AOA).

IRDAI Documentation- IRDA Compliance for Insurance Companies

- Evidence of Capital for an Insurance Business- that is equity capital of 100 crores.
- Evidence of Capital for a Reinsurance Business- that is the equity capital of 200 crores.

- Name and address of the directors.
- Qualifications of the directors.
- Certified Copy of the Prospectus.
- A statement indicating the distinctive numbers of shares issued to each promoter and shareholder with respect to the applicant's share capital.
- Any other additional information.

Thus, IRDAI Compliance for Insurance Companies is required to be followed by all insurance companies. An insurance company that specializes in life insurance or general insurance would have different compliances based on the regulatory norms related to insurance. IRDA compliance for insurance companies is required for a company to operate in the field of insurance.

Financial Statements Disclosure and Reporting

The IRDAI (Preparation of Financial Statements and Auditors' Report of Insurance Companies) Regulations, 2002, have prescribed certain disclosures in the financial statements. The Board should ensure that the information on the following, including the basis, methods and assumptions on which the information is prepared and the impact of any changes therein are also disclosed in the annual accounts:-

- Quantitative and qualitative information on the insurance company's financial and operating ratios, viz. incurred claim, commission and expenses ratios.
- Actual solvency margin details vis-à-vis the required margin.
- Insurers engaged in life insurance business shall disclose persistency ratio of policies sold by them.
- Financial performance including growth rate and current financial position of the insurance company.
- Description of the risk management architecture.
- Details of number of claims intimated, disposed off and pending with details of duration.
- All pecuniary relationships or transactions of the Non-Executive Directors vis-à-vis the insurance company shall be disclosed in the Annual Report.
- Elements of remuneration package(including incentives) of MD & CEO and all other directors and Key Management Persons.
- Payments made to group entities from the Policyholders Funds.
- Any other matters, which have material impact on the insurer's financial position.

Where finalization of annual accounts extends beyond 90 days from the end of the Financial Year, the status on disclosure in the financial statements required under this clause may be made within 15 days of adoption of annual accounts by the Board of Directors of the Insurers.

Interaction with the Regulator

Effective corporate governance practices in the office of the insurance company will enable IRDAI to have greater confidence in the work and judgment of its board, Key Management Persons and control functions.

In assessing the governance practices in place, the IRDAI would:

- Seek confirmation that the insurance company has adopted and effectively implemented sound corporate governance policies and practices;
- Assess the fitness and propriety of board members;
- Monitor the performance of boards;

- Assess the quality of insurance company's internal reporting, risk management, audit and control functions;
- Evaluate the effects of the insurance company's group structure on the governance strategies;
- Assess the adequacy of governance processes in the area of crisis management and business continuity.

REGULATORY FILINGS

Insurers should examine to what extent they are currently complying with these guidelines and initiate immediate action to achieve compliance (where not already in compliance) within a period of three months from the date of notification of these guidelines. It is expected that all the arrangements should be in place to ensure full compliance with the guidelines from the financial year 2016-2017. Where such compliance is not possible for any specific reason, the insurance companies should write to the IRDAI for further guidance.

The regulatory filings generally include the following:

- Monthly Returns.
- Quarterly, Half-Yearly and Yearly Returns.
- Cyber Security Audit.

However, during the pandemic, the IRDAI further relaxed and extended time for submission of filings as under:

Additional Time allowed for filing Regulatory Returns as at 31.03.2020

(a) Monthly Returns : 15 days

(b) Quarterly, Half-Yearly and Yearly Returns : 30 days

(c) Cyber Security Audit : 30 days

It may be noted that this time is granted in addition to the time normally available for filing the above returns.

ROLE OF COMPLIANCE OFFICER

Each insurer should designate Company Secretary as the Compliance officer whose duty will be to monitor continuing compliance with these guidelines. Annual Report of insurers shall have a separate certification from the Compliance Officer.

Evaluation of Board of Directors including Independent Directors

As required under Schedule IV of the Companies Act, 2013, the independent directors shall meet at least once in a year to evaluate the performance of other than independent Directors. Similarly, there shall be an evaluation of the Independent Directors by the other members of the Board of Directors as required in the Schedule.

These guidelines shall be applicable to all insurers granted registration by the Authority except that:

(i) reinsurance companies may not be required to have the Policyholders' Protection Committee; and

(ii) branches of foreign reinsurers in India may not be required to constitute the Board and its mandatory committees as indicated herein.

BUSINESS ANALYTICS PROJECT (BAP) REPORTING

The IRDAI has taken an initiative of automation for facilitation of various activities that need to be undertaken by Insurance companies, surveyors, brokers and Third Party Administrators (TPAs) for regulatory compliance. This program is called the 'Business Analytics Project' or BAP as referred to henceforth.

The following are the guidelines for Submission of Returns for Life through Business Analytics Project (BAP):

The IRDAI has been constantly endeavoring to initiate processes of online filing and submission of returns to the insurer and other regulatory entities, for different functions, in a phased manner. The insurers are required to access the website http://www.irdabap.org.in for submission of returns.

From the period 1.7.2015 all the insurers are required to comply with the following timelines for the various periodical returns to be filed online:

1.	All monthly returns	Before 15th day of the following month
2.	All quarterly returns	Within 45 days from the end of the quarter
3.	All Half yearly returns	Within 45 days from the end of the half year
4.	All annual returns	Within 45 days from the end of the period
5.	12th Monthly, 4th Quarterly and the Annual returns (Audited figures)	On or before 30th June of the Following Financial Year

Note to Insurers:

i. The instructions for filing and furnishing the data templates are placed in the login area of Life Module of the BAP.

ii. The Authority may revise the same based on requirements and suggestions, and the updated version, if any, shall be made available to the users.

iii. Insurers have already furnished the returns from FY 2013-14 onwards in physical/ excel form and the same may be cross checked with the returns, wherever applicable, that would be submitted through BAP module.

iv. The helpline system is made available in the BAP module and the queries will be attended by the team on priority basis.

v. Queries have to be routed through Helpline in the Module. If not resolved within reasonable time, escalations can be made.

vi. Class 2 and Class 3 digital signatures of the Authorized signatories shall be accepted by the Module.

vii. Insurers are required to obtain Digital Signatures from Authorized Vendors (i.e. E-Mudra, Sify, etc.).

viii. Insurers are advised to take suitable steps to generate input files as per prescribed templates, from their accounting and MIS systems, to be directly uploaded in the BAP module without manual interventions. The insurer shall apprise their respective Boards about the progress in complying with the submissions as advised in the circular. Insurers are also advised to ensure that there are adequate manual controls and validation in order to ensure that the data is submitted through the system in factually correct and matches.

ix. The Data Submission Guideline document is placed along with the input templates in the portal and will be updated on a regular basis.

x All life insurers are advised to take a note of the above for compliance.

GIC Reporting

The General Insurance Council (GI Council) is a representative body of general insurers including Stand-alone Health Insurers, Specialized Insurers, Reinsurers, Foreign Reinsurer Branches (FRBs) and Lloyd's India, registered with IRDAI. As per Section 64C of the Insurance Act, 1938 (and amended in January 2015) all general insurers, health insurers and reinsurers granted registration and licence by IRDAI to carry out business in India are members of the General Insurance Council.

After the passage of the Insurance Laws (Amendment) Act in April 2015, GI Council is a Self-Regulatory Organization for the non-life insurance industry's market conduct and practices.

As per Section 64L (1) of the Insurance Act, 1938 the GI Council has the following functions:

- to aid and advise insurers, carrying on general insurance business, in the matter of setting up standards of conduct and sound practice and in the matter of rendering efficient service to holders of policies of general insurance.
- to render advise to IRDAI in the matter of controlling the expenses of such insurers carrying on business in India in the matter of commission and other expenses.
- to bring to the notice of IRDAI the case of any such insurer acting in a manner prejudicial to the interests of holders of general insurance policies.

Advisory Committee on Loss Prevention and Loss Minimization

The IRDAI has constituted an Advisory Committee on Loss Prevention and Loss Minimization in General Insurance Industry in 2019 vide its order ref. IRDAI/NL/ORD/MISC/223/12/2019 dated 12th December 2019. The Working Group in its report had recommended setting up an exclusive organisation having objective as promotion of safety and loss prevention.

There will be two sub-committees within the Advisory Committee, one on Property Insurance, and other on Motor Insurance, to take forward the idea of Loss Prevention and Minimisation at the industry level in the areas specified.

The Authority may review and modify the activities as and when felt necessary.

The Advisory Committee shall submit work progress report to the Authority on monthly basis.

The Advisory Committee shall have a term of two years. The activities to be performed by the committee include the following:

Activities to be Performed by Advisory Committee:

A. On Property Insurance:

i. Creating repository of past risk inspection reports and developing standard survey/inspection report formats.

ii. Setting and reviewing codes and benchmarks in collaboration with various industry participants.

iii. Creation and analysis of database of industrial property risks in the country where total value at risk is above Rs. 50 Crores, using geo code/unique property ID as the location-wise, occupancy-wise property identifier in collaboration with IIBI.

iv. Collect and build segment-wise/ occupancy-wise loss data with geo code, analyse and publish pattern of losses including severity, root cause analysis and suggestions on loss prevention and minimisation techniques in collaboration with IIBI.

v. Issue advisories on packaging and transportation of cargo.

vi. Publish technical literature on fire hazards, fire safety.

B. On Motor Insurance:

i. Develop guidelines on inspection of vehicles and standard operating processes to be followed by vehicle owners in the event of loss.

ii. Mapping high exposure accident spots across the country.

iii. Develop standard matrix (score) to incorporate safety features for each make and model of vehicles.

iv. Lay down guidelines on repair charges for parts for each model of vehicle to bring standardization across the industry. Creation of garage network master for providing average repair cost in terms of repair of each part, average painting cost and turnaround times for different types of repair.

v. Develop guidelines on adoption of technology such as Block Chain, Telematics for loss prevention and minimisation and highlight best practices in the world in this regard.

C. Activities common for both segments

i. Creating awareness about Loss Prevention and Minimization and circulate best practices adopted internationally.

ii. Co-ordinating with various government agencies/authorities, institutions, insurers and international organizations/bodies etc. on the matters of loss prevention and minimization.

iii. Any other activity deemed fit by the Chairperson of the Authority and in the absence of Chairperson, senior most Member of the Authority.

Apart from the above mentioned Advisory Committee on Loss Prevention and Loss Minimization, the IRDAI set up committees and panels through GIC to suggest industry overhaul. These panels have been formed to look into areas of regulation, products, distribution, finance, health, finance, taxation, ease of doing business, among others. The main objective behind this initiative is to overhaul the insurance sector, suggest reforms in several areas of general, reinsurance and life insurance.

These panels include heads of private and public sector insurance companies, members of IRDAI, and representatives from the GIC. GIC was formed by IRDAI to act as a link between the insurance regulator and the non-life insurance industry, and has representation from the industry.

Under this initiative, about five committees each have been formed to suggest changes in the general insurance business, non-life insurance space, and two panels will look into the reinsurance segment. IRDAI aim to create an enabling framework for entry of more global players in the industry, among some of the other reforms for the industry.

Letter of Credit (LC)- Trade Credit Reporting Guidelines

Trade credit insurance protects businesses against the risk of non-payment for goods and services by buyers. It usually covers a portfolio of buyers and indemnifies an agreed percentage of an invoice or invoices that remain unpaid as a result of protracted default, insolvency/ bankruptcy. It contributes to the economic growth of a country by facilitating trade and helps in improving economic stability by addressing the trade losses due to payment risks.

These guidelines set out the regulatory framework:

a. to promote sustainable and healthy development of trade credit insurance business.

b. to facilitate general insurance companies to offer trade credit insurance covers to suppliers as well as licensed banks and other financial institutions to help businesses manage country risk, open up access to new markets and to manage non-payment risk associated with trade financing portfolio.

c. to enable general insurance companies to offer trade credit insurance with customised covers to improve businesses for the SMEs and MSMEs, considering the evolving insurance risk needs of these sectors.

The Regulator mandates that every insurer underwriting trade credit insurance business shall have Board approved Underwriting and Risk Management Policy in addition to or forming part of the underwriting policy prescribed under Guidelines on Product Filing Procedures for General Insurance Products which shall be filed with the Authority.

The Underwriting policy relevant to trade credit insurance products, at the minimum, shall cover the following:

a. Risk appetite for underwriting e.g. exposure to specific industry/sector etc.

b. Underwriting criteria and tools for credit assessment

c. Mechanism for carefully assessing the credit insurance business risk and develop risk early warning system for major risk types

d. System to carry out stress tests periodically for trade credit insurance business;

e. Impact on reserving and solvency requirements

f. Proposed risk monitoring and control of key product risks identified

g. Proposed reinsurance arrangement

h. Plans to enhance skills for internal underwriting, risk management, claims, reinsurance expertise; training to improve risk identification capabilities

i. Distribution channel/s and target market

j. Business development plan

k. Internal Control Management i.e., the insurance company carrying out trade credit insurance business should be centrally managed by the head/corporate office, branches to carry out trade credit insurance business under the control of head/corporate office.

Maintenance of Data/ Furnishing of Information

Every Insurer should maintain, at the minimum, the following information.

a. Policy-holder wise earned and gross written premium

b. Loss ratio for the trade credit insurance product

c. Policy-holder wise -Buyer wise claims reserves

d. Policy-holder wise -Buyer wise claims paid

e. Policy-holder wise -Buyer wise claims recovery

f. Country wise data.

The Insurer shall provide the above data/information as and when required by the Authority. The additional information/forms may be prescribed by the Authority from time to time. However, the information on every loss known to the insurer, which is in excess of one percent of the net worth of the insurer, as and when intimation is received by the insurer, shall be reported in writing to the Authority.

IIB Reporting

The IRDAI under clauses (e) and (f) of sub section (2) of section 14 and section 26 of Insurance Regulatory and Development Authority of India Act, 1999, has framed the Information Bureau of India (IIB) Regulations, 2021. The aim of Insurance Information Bureau of India is to facilitate collection of Data from the regulated entities on behalf of the Authority. The Insurance Regulatory and Development Authority of India (Insurance Information Bureau of India) Regulations, 2021 also provide the Standards of Compliance for Regulated Entities towards Submission of Data to IIB. The IIB seeks valuable inputs from all the stakeholders.

"Regulated Entities" refers to all Entities regulated by the Authority and which are mandated by the Authority to submit data to IIB.

"Stakeholders" include Regulated Entities, Government and its Bodies and Agencies, Insurance Councils, Institute of Actuaries of India (IAI) and other entities specified in IIB's Formation of IIB.

The Authority has constituted the IIB as an Advisory Body comprising experts from IT, Domain and Data, under the Chairmanship of Chairman of the Authority. IIB had been registered as a Not-for-Profit Society under AP Societies Registration Act, 2001 in November, 2012. IIB is responsible for providing information support to its Stakeholders, who will be provided with only specific levels of permissions to use the Data.

Objectives of IIB

The Objectives of IIB enable it to carry out all activities including Collaborations towards giving Services and Analytical Insights to its Stakeholders. Authority shall be the sole and exclusive owner of all Data Collected/ Received from the Insurance Industry.

The important objectives of IIB is to:

i. Collect, Analyse and Report Data/Information pertaining to Insurance and related domains for the benefit of the Stakeholders of IIB and to undertake Projects of Insurance and other related sectors regulated by the Authority in order to further its effective use to Market Players, Regulator, Government, and General Public.

ii. Promote, Innovate, Develop, Create appropriate Software, Applications in Insurance and Related Domain.

iii. Undertake, Execute, Deal, Embark, Accomplish, Effect, Achieve, Complete, fulfil any Project, Work, Mission, Venture, Assignment, Job, Task etc., of the Insurance and other related Sectors regulated by the Authority in order to further its effective use to Market Players, Researchers, Policy Holders, Regulators, Government/ Semi Government/ Quasi Government Agencies, Authorities, Departments, Entities and General Public.

iv. Act as a Platform to, Enhance, Educate, Influence, Promote and Influence issues relating to the Stakeholders of Insurance and related domain and to provide a platform to review business practices besides Initiating, Exploring and Identifying Business Opportunities.

v. Act as a Repository for the Data of Life, General, Standalone Health Insurers, Reinsurers and other Regulated Entities for performance of Analytics, Generation of Reports and other outputs for the benefit of the Sector.

vi. Act as a Central Repository/Platform for the Insurance Industry aimed at accessing and exchanging information among Insurers and other Stakeholders with the Aim of Preventing/ Mitigating/Detecting Frauds in all Lines of Insurance Business.

vii. Constitute and Operate Fraud Repositories/Registry in accordance with the Fraud Monitoring Framework Guidelines issued by the Authority.

viii. Generate benchmark rates for different Lines of Insurance Business including Life, Motor, Health, Marine, Fire and others on periodic basis for promoting reasonableness and sustainability of Premiums in Insurance Business.

ix. Act as an Exchange/Hub for Electronic Insurance Accounts and Policies and to Promote Issuance of Paperless and instant/real-time Policies.

x. To act as a KYC Repository for Storage and Exchange of KYC information and for upload and download of KYC documents by Insurers

xi. Provide Sectoral Information and share Data with Government Bodies/Ministries and to llaborate with other bodies for mutual exchange of information for the benefit of the Industry.

xii. Act as a Platform to enhance, promote issues relating to Stakeholders of Insurance and related domains. To initiate and participate in collaborative activities with entities at National or International level besides serving as a centre for promoting co-operation among various entities in Insurance and related domains.

xiii. Act as a Consultant, Analyst, Expert in Insurance and related domains for the benefit of the Stakeholders.

Governance of IIB

a. Composition of the Governing Council of IIB

   i. Chairman of Governing Council of the IIB: The Chairman of the Authority shall be the Chairman of the Governing Council of IIB in his Ex-Officio capacity.

   ii. Ex-officio Members of IIB: The Member (Life), Member (Non-Life) and Member (Actuary) of the Authority and one of the Executive Directors of the Authority to be nominated by the Chairman of the IIB shall be the other Ex-Officio Members of the Governing Council. Further, the Chairman of Life Insurance Corporation of India, the Chairman of General Insurance Public Sector Association, Secretaries of the Life and General Insurance Councils and the President of the Institute of Actuaries of India shall also constitute the Ex-Officio Members of the Governing Council.

   iii. Non-Ex-Officio Members of IIB: The Non-Ex-Officio Members shall be appointed by the Chairman of the IIB and their tenure shall be in accordance with the provisions of the AoA.

b. The Governing Council shall conduct its affairs in accordance with the MoA and AoA.

Functions of IIB

a. Data Repositories: Collection, Validation and Maintenance of Policy, Claims and other Data from the regulated entities at a frequency and in the formats and manner to be specified by the Authority from time to time and creation of the following Repositories:

   i. Life

   ii. Motor

   iii. Health

   iv. Fire, Marine, Engineering and Other Lines of Business

   v. Insurance Intermediaries

   vi. Any other Repository as directed by the Authority

b. Central Fraud Registry/Fraud Repository/Caution Repository: IIB shall constitute a Central Fraud Repository towards which it shall collect and maintain information pertaining to fraudulent/ black-listed/ suspicious persons, entities and records within all Lines of Insurance Business, in accordance with the Fraud Monitoring Framework Guidelines issued by the Authority. All Regulated Entities as directed by the Authority shall submit Data and comply with Regulatory directions in this regard.

c. Industry Platform for exchange of Policy and other Information to prevent Underwriting, Claims and other Frauds.

d. Analysis of Data

   i. Mortality & Morbidity Studies in Life Insurance: Generation of Benchmark Mortality & Morbidity Rates in Life Insurance, Annuity and Health/Critical Illness Portfolios on the strength of the Data created at IIB.

   ii. Benchmark Rates for General Insurers: Motor Third Party, Fire-SFSP Burn Costs, Health Burn Costs and other benchmark rates as advised by the Authority from time to time.

   iii. Predictive Models: Develop Statistical Models to assess the risk propensity, probable persistency and others on the basis of the Industry Data compiled at IIB.

iv. Periodic/Thematic/Bespoke Reports: Generate Industry Reports and Updates on matters of interest and importance at a regular frequency for the information and consumption of Insurers and other Stakeholders.

Obligations of Regulated Entities:

All Regulated Entities shall submit Data to IIB in accordance with the directives to be issued by the Authority from time to time, and comply with the following principles in the course of capture of Data, Storage and Submission thereof to IIB:

(1) Data Management: Regulated Entities are advised to ensure that Data is maintained in accordance with the norms laid down by these Regulations as listed below to support seamless transmission.

a. Data Capture:

Regulated Entities shall ensure collection of Data from their Clients at the time of Proposal, Claims or any other stage in a manner that would cover the Data Submission requirements as specified to ensure and enable smooth Transmission of Data to IIB. They shall also capture the mandated Data in their Database to enable smooth transmission of the same to IIB.

b. Data Classification:

Regulated Entities shall maintain Data in their Databases in a manner that supports seamless transmission of the same to IIB.

- The regulated entities shall, endeavor to store Data in their Databases conforming Formats and Definitions prescribed in IIB's Data Circulars and devise Data Dictionaries/Data Manuals to align with the data submission requirements.
- The Data Capture shall cover and be in alignment with the Masters/drop-downs/options provided against each Data Field.
- The regulated entities shall put in place proper validations while capturing Data Points and ensure consistency between Data Points in course of its submission to IIB.

c. Data Standardization:

To overcome the issue of Data Heterogeneity, Data Inadequacy and Anomalies, IIB in coordination with the Authority, the Insurance Councils and Industry shall lay down Standard Nomenclature, taxonomy Classification, Masters and Data Type. The Manner, Procedure and Transition Time for implementation of the same would be stipulated by the Authority.

(2) Industry Participation: All Regulated Entities shall take part in the initiatives taken up at IIB for the benefit of the sector under the directives of the Authority.

(3) Compliances:

Regulated Entities shall submit Data and Information as per the Frequency and Formats required by the Authority from time to time. The regulated entities shall ensure Accuracy, Completeness and Timeliness in course of their Data Submission. The regulated entities shall align their Systems and Databases in a manner that would enable submission of complete Data without Anomalies and Distortions.

Obligations of IIB

i. Infrastructure: IIB shall put in place suitable IT and other Infrastructure to support the Databases and the Projects managed by it.

ii. Industry Databases: Creation and Updation of the Databases as laid down by the Authority Mandates and Guidelines from time to time.

iii. Analytics & Services: Performance of Analytics, Generation of Reports and Provision of Services for the benefit of the Stakeholders and compliance with the directives of the Authority in this regard.

iv. Data Security, Confidentiality and Privacy: IIB shall comply with the statutory mandates for Data Protection and shall take due measures and precautions to ensure that the Security, Privacy and Confidentiality of the Data shared by the Regulated Entities to it is maintained adequately in proportion to the sensitivity of the Data in its custody. IIB shall share the Data only in accordance with the Data Sharing Policy approved by its Governing Council.

v. Collaborations: Enter into collaborations and working relationships with various Government Departments/Bodies and other entities for exchange of Data/Information and partnering with them in other ways in the interest of promotion of Insurance Industry's interests.

OTHER COMPLIANCES

AML & PMLA Compliance Guidelines

Money Laundering is a process or activity of moving illegally acquired money through financial systems so that it appears to be legally acquired. Section 3 of PMLA specifies the Offence of Money Laundering. As per the IRDAI guidelines, the Insurers should take steps to implement provisions of PML Act and the PML Rules, as amended from time to time, including operational instructions issued in pursuance of such amendment(s).

Important Definitions:

"Aadhaar number", shall have the meaning assigned to it under clause(a) of section 2 of the Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Act, 2016, hereinafter referred to as The Aadhaar Act.

"Authentication", means the process as defined under clause (c) of section 2 of the Aadhaar Act as amended from time to time.

"Beneficial owner" shall have the meaning assigned to it under sub clause (fa) of clause (1) of Section 2 of the PML Act.

"Central KYC Records Registry" (CKYCR) means an entity defined under clause (ac) of sub rule (1) of Rule 2 of the PML Rules, to receive, store, safeguard and retrieve the KYC records in digital form of a customer.

"Client" shall have the meaning assigned to it under sub clause (ha) of clause (1) of Section 2 of the PML Act.

Explanation: For the purpose of this guideline, the term client includes a customer/ person (Natural or Juridical) who may be a proposer or policyholder or master policyholder or life assured or beneficiaries or assignees, as the case may be.

"Client Due Diligence" (CDD) shall have the meaning assigned to it under sub clause (b) of clause (1) of Rule 2 of the PML Rules.

"Designated Director" shall have the meaning assigned to it under sub clause (ba) of clause (1) of Rule 2 of the PML Rules.

"Digital KYC" shall have the meaning assigned to it under sub clause (bba) of clause (1) of Rule 2 of the PML Rules.

"KYC Templates" means templates prepared to facilitate collating and reporting the KYC data to the CKYCR, for individuals and legal entities.

"Offline verification" shall have the same meaning as assigned to it in clause (pa) of section 2 of the Aadhaar Act.

"On-going Due Diligence" means regular monitoring of transactions to ensure that they are consistent with the customers profile and source of funds.

"Officially valid document" shall have the meaning assigned to it under sub clause (d) of clause (1) of Rule 2 of the PML Rules.

"Politically Exposed Persons (PEPs)" shall have the meaning assigned to it under sub clause (xii) of 3(b) of Chapter I of Master Direction – Know Your Customer (KYC) Direction, 2016 issued by Reserve Bank of India (RBI), as amended from time to time.

"Principal Officer" shall have the meaning assigned to it under sub clause (f) of clause (1) of Rule 2 of the PML Rules.

"Suspicious Transaction" shall have the meaning assigned to it under sub clause (g) of clause (1) of Rule 2 of the PML Rules.

"Video Based Identification Process (VBIP)" means an alternative (optional)electronic process of Identification/ KYC in paperless form, carried out by the insurer/authorised person (person authorised by the insurer and specifically trained for face-to-face VBIP) by undertaking seamless, secure, realtime, consent based audio-visual interaction with the customer/beneficiary to obtain identification information including the necessary KYC documents required for the purpose of client due diligence and to ascertain the veracity of the information furnished by the customer/ beneficiary.

Internal policies, procedures, controls and compliance arrangement

Every Insurer has to establish and implement policies, procedures, and internal controls that effectively serve to prevent and impede Money Laundering (ML) and Terrorist Financing (TF). The insurers shall:

- Develop an AML/CFT program comprising of policies and procedures, for dealing with ML and TF reflecting the current statutory and regulatory requirements.
- Ensure that the content of these guidelines are understood by all staff members/agents. Develop staff members/agents awareness and vigilance to guard against ML and TF.
- The AML/CFT program should have the approval of the insurer's board. The program should be reviewed periodically on the basis of risk exposure and suitable changes (if any) be effected based on experience and to comply with the extant Act/ Rules/ Regulations and other applicable norms.
- Adopt client acceptance policies and procedures which are sensitive to the risk of ML and TF.
- Undertake CDD measures to an extent that is sensitive to the risk of ML and TF depending on the type of client, business relationship or transaction.
- Have in place a system for identifying, monitoring and reporting suspected ML or TF transactions to FIU-IND and the law enforcement authorities (if so required).

Policies and procedures set under AML/CFT program shall cover

- Communication of policies relating to prevention of ML and TF to all level of management and relevant staff that handle policyholder's information (whether in branches or departments) in all the offices of the insurer.
- The Client Due Diligence Program including policies, controls and procedures, approved by the senior management, to enable the insurers to manage and mitigate the risk that have been identified either by the insurers or through national risk assessment.
- Maintenance of records.
- Compliance with relevant statutory and regulatory requirements.
- Co-operation with the relevant law enforcement authorities, including the timely disclosure of information.
- Role of internal audit or compliance function to ensure compliance with the policies, procedures and controls relating to the prevention of ML and TF, including the testing of the system for detecting suspected money laundering transactions, evaluating and checking the adequacy of exception reports generated on large and/or irregular transactions, the quality of reporting of suspicious transactions

and the level of awareness of front line staff, of their responsibilities in this regard. The internal audit function shall be independent, adequately resourced and commensurate with the size of the business and operations, organization structure, number of clients and other such factors.

Responsibility of Insurers:

The guidelines place the responsibility of a robust AML/CFT program on the insurers. Nonetheless, it is necessary that the following steps are taken to strengthen the level of control on the intermediaries/representative of insurer engaged by the insurers:

- The list of rules and regulations covering performance of intermediaries/representative of insurer must be put in place. A clause should be added making KYC norms mandatory and specific process document can be included as part of the contracts.
- Insurers shall initiate appropriate actions against defaulting intermediaries/representative of insurer who expose the insurers to AML/CFT related risks on multiple occasions.
- As most part of the insurance business is through intermediaries/representative of insurers, the selection process of intermediaries/representative of insurer should be monitored scrupulously in view of set AML/CFT measures.

Compliance Certificate:

Insurers shall submit annual compliance certificate within 45 days of end of Financial Year.

Appointment of a Designated Director and a Principal Officer

A Designated Director", who has to ensure overall compliance with the obligations imposed under chapter IV of the PML Act and the PML Rules, shall be appointed or designated by the insurers.

A Principal Officer (PO) at a senior level shall be appointed to ensure compliance with the obligations imposed under chapter IV of the Act and the Rules.

In terms of Section 13 of the PMLA, the Director, FIU-IND can take appropriate action, including imposing a monetary penalty on insurers or its Designated Director or any of its employees for failure to comply with any of its AML/CFT obligations.

PLACE OF BUSINESS

The guidelines issued by IRDAI for opening up of place of business is aimed primarily to expedite the opening of branch offices to provide better reach to the customers. Therefore, the IRDAI has mandated that from 1st January 01, 2006, new places of business should be opened within a period of one year from the date of approval letter from the Authority and after the expiry of the time limit, insurers have to apply afresh.

Further, the Regulator has further advised Insurers to review the existing position in respect of the branches/ offices where in-principle approval of IRDA has been granted but the offices have not been opened for more than one year thereafter and furnish us the full details. The Insurers shall also intimate to IRDA henceforth, the date of opening of the approved branch office, within 15 days of its opening.

OUTSOURCING ARRANGEMENTS

All outsourcing arrangements of an Insurer shall have the approval of a Committee of Key Management Persons and should meet the terms of the Board approved outsourcing policy. The Board or the Risk Management Committee should be periodically apprised about the outsourcing arrangements entered into by the insurer and also confirmation to the effect that they comply with the stipulations of the Authority as well as the internal policy be placed before them. An insurer shall not outsource any of the company's core functions other than those that have been specifically permitted by the Authority. Every outsourcing contract shall contain explicit safeguards regarding confidentiality of data and all outputs from the data, continuing ownership of the data with the insurer and orderly handing over of the data and all related software programs on termination of the outsourcing arrangement. The management of the insurance company shall monitor and review the performance of agencies to whom operations have been outsourced at least annually and report findings to the Board. The Authority reserves the right to access the operations of the outsourced entity to the extent these are relevant to the insurance company and for the protection of policyholder.

LESSON ROUND-UP

- This lesson covers crucial aspects of corporate governance, compliance management, regulations with respect to filing and reporting of insurance operations. Besides the rules and regulations relating to AML and PMLA are also covered in detail to give a detail picture of the governance philosophy as propounded by the regulator.
- Corporate Governance is a system of financial and other controls in a corporate entity and broadly defines the relationship between the shareholders, Board of Directors and Management. The Corporate Governance framework clearly defines the roles and responsibilities and accountability within an organization with built-in checks and balances.
- The importance of Corporate Governance has received emphasis in recent times, since poor governance and weak internal controls have been associated with major corporate failures.
- Insurers in India have recently became public and have got their shares listed on the stock exchanges. The composition of the Boards of the Public Sector Undertakings in the insurance sector is also laid down by the Government of India.
- Compliance is a very important function that the insurance companies. The IRDAI compliance for Insurance companies is required so that the company can follow the rules and bye-laws which are laid down by the authority. Besides, there are innumerable filing compliance that the companies should adhere to.
- In addition to compliance, the insurers also have to comply with regulating reporting formalities, including Monthly Returns, Quarterly, Half-Yearly, Yearly Returns and Cyber Security Audit.
- The IRDAI has initiated automation of various activities that need to be undertaken by Insurance companies, surveyors, brokers and Third Party Administrators (TPAs) for regulatory compliance. This program is called the 'Business Analytics Project' or BAP.
- Further, IRDAI has also laid down guidelines for reporting to GIC, LC or Trade Credit Reporting, and IIB Reporting. The Authority has also laid Anti-Money Laundering guidelines for insurance companies to comply with. As the insurance operations are becoming more demanding and specialized, the IRDAI has also allowed companies to outsource operations provided all arrangements have the approval of a Committee of Key Management Persons. Every outsourcing contract shall contain explicit safeguards regarding confidentiality of data and all outputs from the data, continuing ownership of the data with the insurer and orderly handing over of the data and all related software programs on termination of the outsourcing arrangement.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Briefly explain the following terms:
   a. AML
   b. Whistle Blower Policy
   c. e-KYC
   d. KMP
   e. e-Governance.
2. What are the mandated committees that insurance companies should constitute in compliance?

3. Discuss the role and responsibilities of BoD and Key Management Persons.
4. Explain with suitable examples the functions of the ALM Committee.
5. List out the compliance requirements under FEMA for insurance companies.
6. Explain the Underwriting policy features for trade credit insurance products.
7. "Ideally insurance operations cannot be outsourced". Justify.
8. What is Anti- money laundering and what are the requirements as mandated by IRDAI for AML?
9. What are the guidelines for opening up of new places of business for insurers?
10. Outsourcing has to leveraged. Do you agree? Give examples.

LIST OF OTHER REFERENCES

- https://irdai.gov.in/hi/document-detail?documentId=382140
- https://irdai.gov.in/hi/document-detail?documentId=367112
- Life Input Filing Guidelines-final.pdf

Inspection, Investigation, Penalty & Appellate Procedure

Lesson 23

KEY CONCEPTS

■ Inspection ■ Investigation ■ Regulatory Authority ■ Compliance ■ Penalties and Disciplinary Actions ■ Appellate Procedure ■ Due Process ■ Market Stability ■ Consumer Protection ■ Industry Best Practices

Learning Objectives

To understand:

- The purpose and importance of inspection, investigation, penalties, and appellate procedures in the insurance industry
- The methods and techniques used in conducting thorough inspections of insurance companies' books, records, and operations
- About the types of penalties that can be imposed for violations or non-compliance with insurance regulations and understand their impact
- The principles of fairness, due process, and transparency involved in the imposition of penalties and disciplinary actions
- The impact of effective inspections, investigations, and penalties in maintaining market stability, protecting policyholders, and fostering a culture of compliance within the insurance sector

Lesson Outline

- Power of Investigation and Inspection by IRDAI
- Penalty for Default in complying with or act in contravention of the Insurance Act
- Power of Court to Grant Relief
- Cognizance of Offence
- Appellate Provisions – Appeal to Securities Appellate Tribunal
- Lesson Round-Up
- Test Yourself
- List of Other References

INTRODUCTION

In the insurance industry, various mechanisms and procedures are in place to ensure compliance, transparency, and accountability. These include inspection, investigation, penalties, and appellate procedures.

Inspection involves the thorough examination of insurance companies' books, records, and operations by regulatory authorities such as the Insurance Regulatory and Development Authority of India (IRDAI). The purpose of inspection is to assess the financial soundness, compliance with regulations, and overall functioning of insurance entities.

Investigation, on the other hand, delves into specific incidents or allegations of misconduct, fraud, or irregularities within the insurance sector. Regulatory bodies, like the IRDAI, possess the authority to conduct investigations to gather evidence, analyze facts, and uncover any wrongdoing. Investigations help maintain integrity within the industry and protect the interests of policyholders.

In cases where violations or non-compliance are established through inspection or investigation, penalties can be imposed. These penalties act as deterrents and serve as disciplinary measures to ensure adherence to regulatory guidelines. The severity of penalties may vary depending on the nature and gravity of the offense committed.

Furthermore, if an entity or individual disagrees with the decisions or actions taken by the regulatory authority, an appellate procedure allows them to challenge or appeal the decision before an independent body. For example, in India, the Securities Appellate Tribunal (SAT) handles appeals related to securities laws and regulations, including those pertaining to the insurance sector.

Overall, inspection, investigation, penalties, and appellate procedures form crucial components of the regulatory framework in the insurance industry. They help maintain market stability, protect policyholders' rights, and ensure compliance with established rules and regulations.

POWER OF INVESTIGATION AND INSPECTION BY IRDAI

Functions and Responsibilities of Supervision Department: The Authority derives the following powers from Section 14(2)(h) of the IRDAI Act, 1999:

- Calling for information;
- Undertaking inspection;
- Conducting enquiries and investigations including audit of the insurers, intermediaries, insurance intermediaries and other organizations connected with the insurance business.

Section 33 of the Insurance Act, 1938 empowers the Authority to appoint ‘Investigating Officer’ to investigate the affairs of any insurer or intermediary or insurance intermediary. The Investigating Officer may employ any auditor or actuary or both for the purpose of assisting him in any investigation under Section 33.

The Supervision Department undertakes onsite inspection/investigation of insurers, intermediaries, insurance intermediaries and other organizations connected with insurance business to verify compliance to various regulations and other directions issued by the Authority and other applicable legal provisions.

The functions of the Supervision Department broadly include the following:

- Formulation of annual inspection plan and its execution;
- Formation of teams for onsite inspections;
- Calling for required information from the entity to be inspected;
- Undertaking onsite inspection;
- Preparation and submission of detailed inspection reports;
- Forwarding the inspection reports to the inspected entities for their response.

Forwarding the inspection reports and response received from the inspected entities along with analysis of the Inspection Department to the 'Enforcement Department' of the Authority for necessary action.

Apart from the above, the functions of the Supervision Department also include the following:

- Providing inputs to Authority's Annual Reports
- Providing inputs to other departments where required
- Providing information to applications received under the RTI Act 2005
- Inputs to Authority's meetings, other meetings.
- Other related functions.

Section 33 of the Insurance Act, 1938 has conferred the power of investigation and inspection to IRDA. The Authority (IRDA) may, at any time, by order in writing, direct any person (hereafter in this section referred to as Investigating Authority) specified in the order to investigate the affairs of any insurer and to report to the Authority on any investigation made by such Investigating Authority. Provided that the Investigating Authority may, wherever necessary, employ any auditor or actuary or both for the purpose of assisting him in any investigation and also on being directed so to do by the Authority, cause an inspection to be made by one or more of his officers of any insurer and his books and account; and the Investigating Authority shall supply to the insurer a copy of this report on such inspection.

It shall be the duty of every manager, managing director or other officer of the insurer to produce before the Investigating Authority directed to make the investigation or inspection, all such books of account, registers and other documents in his custody or power and to furnish him with any statement and information relating to the affairs of the insurer as the said Investigating Authority may require of him within such time as the said Investigating Authority may specify.

Any Investigating Authority, directed to make an investigation or inspection, may examine on oath, any manager, managing director or other officer of the insurer in relation to his business and may administer oaths accordingly.

The Investigating Authority shall, if he has been directed by the Authority to cause an inspection to be made, and may, in any other case, report to the Authority on any inspection made therein.

On receipt of any report, the Authority may, after giving such opportunity to the insurer to make a representation in connection with the report as, in the opinion of the Authority, seems reasonable, by order in writing:

(a) require the insurer, to take such action in respect of any matter arising out of the report as the Authority may think fit; or

(b) cancel the registration of the insurer; or

(c) direct any person to apply to the court for the winding up of the insurer, if a company, whether the registration of the insurer has been cancelled under clause (b) or not.

The Authority may, after giving reasonable notice to the insurer, publish the report submitted by the Investigating Authority or such portion thereof as may appear to it to be necessary.

The Authority may by the regulations made by it specify the minimum information to be maintained by insurers in their books, the manner in which such information shall be maintained, the checks and other verifications to be adopted by insurers in that connection and all other matters incidental thereto as are, in its opinion, necessary to enable the Investigating Authority to discharge satisfactorily his functions under this section. The expression insurer shall include in the case of an insurer incorporated in India, all its subsidiaries formed for the purpose of carrying on the business of insurance exclusively outside India; andall its branches whether situated in India or outside India.

All expenses of, and incidental to, any investigation shall be defrayed by the insurer, shall have priority over that debts due from the insurer and shall be recoverable as an arrear of land revenue.

PENALTY FOR DEFAULT IN COMPLYING WITH OR ACT IN CONTRAVENTION OF ACT

Section 102 in The Insurance Act, 1938 specifies the Penalty for Default in complying with or act in contravention of the Insurance Act.

Section 102 states that "If any person, who is required under this Act, or rules or regulations made there under,-

(a) to furnish any document, statement, account, return or report to the Authority fails to furnish the same; or

(b) to comply with the directions, fails to comply with such directions;

(c) to maintain solvency margin, fails to maintain such solvency margin;

(d) to comply with the directions on the insurance treaties, fails to comply with such directions on the insurance treaties, he shall be liable to a penalty not exceeding five lakh rupees for each such failure and punishable with fine."

APPELLATE PROVISIONS – APPEAL TO SECURITIES APPELLATE TRIBUNAL

Securities Appellate Tribunal (SAT) is a statutory body established under the provisions of Section 15K of the Securities and Exchange Board of India Act, 1992 to hear and dispose of appeals against orders passed by the Securities and Exchange Board of India or by an adjudicating officer under the Act; and to exercise jurisdiction, powers and authority conferred on the Tribunal by or under this Act or any other law for the time being in force. Consequent to Government Notification No.DL-33004/99 dated 27th May, 2014, SAT hears and disposes of appeals against orders passed by the Pension Fund Regulatory and Development Authority (PFRDA) under the PFRDA Act, 2013. Further, in terms of Government Notification No.DL-(N)/04/0007/2003-15 dated 23rd March, 2015, SAT hears and disposes of appeals against orders passed by the Insurance Regulatory Development Authority of India (IRDAI) under the Insurance Act, 1938, the General Insurance Business (Nationalization) Act, 1972 and the Insurance Regulatory and Development Authority Act, 1999 and the Rules and Regulations framed thereunder.The Securities Appellate Tribunal has only one bench which sits at Mumbai.

QUALIFICATION & TENURE FOR APPOINTMENT AS PRESIDING OFFICER OR MEMBER

- **Presiding Officer :** The person so appointed as the presiding Officer should meet with the following requirements:

  The retired or sitting judge of the Supreme Court.

  Chief Justice of the High Court.

  Judge of the High Court, who has completed at least seven years of service as a judge in a High Court.

- Members

  Judicial Member: Judge of High Court for at least five years of service.

  Technical Member:

  Secretary or an Additional Secretary in the Ministry or Department of the Central Government or any equivalent post in the Central Government or a State Government; or

  Person of proven ability, integrity and standing having special knowledge and professional experience, of not less than 15 years, in financial sector including securities market or pension funds or commodity derivatives or insurance.

The Presiding Officer and Judicial Members shall be appointed by the Central Government in consultation with the Chief Justice of India or its nominee.

Tenure: The tenure for Presiding Officer or the Judicial or Technical Member will be five years from the date of appointment and shall be eligible for re-appointment for another term of maximum five years.

However, no presiding officer or the Judicial or Technical Member shall hold office after he has attained the age of 70 years.

Powers of SAT: The Securities Appellate Tribunal shall have the same powers as vested in a civil court under the code of civil procedure while trying a suit, with respect of the following matters namely:

- Enforce and summon the attendance of any person;
- Require the discovery and production of documents;
- Receive evidence on affidavits;
- Issue commissions for the examination of the documents or witnesses;
- Dismiss an application for default or deciding it ex-parte;
- Set aside any order or dismissal of any application for default or any other order passed by it ex-parte;
- Any other matter as and when prescribed.

Appeal to SAT: Any person aggrieved by an order of SEBI made, under this act, or by an order made by an adjudicating officer under this act, may prefer an appeal to a SAT having jurisdiction in the matter.

Time Limit: Every appeal shall be filed within 45 days from the date on which a copy of the order made by SEBI or the adjudicating officer is received by him and accompanied by such form and fees as may be prescribed.

The SAT may entertain an appeal after the expiry of the said period of 45 days if it is satisfied that there was sufficient cause for not filing it within that period. The appeal shall be made in 3 copies, with additional copies for each additional Appeal shall be signed by the authorized person.

On receipt of the appeal, the SAT may, after giving the parties to the appeal an opportunity of being heard, pass such order thereon as it thinks fit, confirming, modifying or setting aside the order appealed against.

SAT shall dispose of the appeal within 6 months from the date of receipt of the appeal.

Jurisdiction of Civil Court: No civil court has jurisdiction to entertain any suit or proceeding in respect of any matter which an adjudicating officer appointed under this Act or Securities Appellate Tribunal under this Act is empowered by or under this Act to determine and no injunction shall be granted by any Court or other authority in respect of any action taken or to be taken in pursuance of any power conferred by or under this Act.

Appeal against the order of SAT: Any person aggrieved by any decision or order of the SAT can file an appeal to the Supreme Court. The appeal can be filed only on a question of law. The appeal shall be filed within 60 days from the date of receiving a copy of the decision or order of SAT.

The Supreme Court may allow a further period of 60 days for making an appeal, if it is satisfied that the applicant was prevented by sufficient cause from filing the appeal within the first 60 days.

Scheduled Fee: Every appeal should be made along with an application fee remitted in the form of Demand Draft drawn on any nationalised bank and such fee is payable at the place where the registry is located. The amount of fee payable for appeal against adjudication orders made are as follows:

S. No.	Amount of Penalty Imposed	Amount of Fees Payable
1.	Less than Rs. 10,000	Rs. 500
2.	Rs. 10,000 or more	Rs. 1,200

S. No.	Amount of Penalty Imposed	Amount of Fees Payable
3.	Rs. 1 lakh or more	Rs. 1,200 inclusive of Rs. 500 for every one lakh of penalty.

Note: The fee payable for any other appeal against an order of the Board under the Securities and Exchange Board of India Act should be of Rs. 5000.

Procedure for Appeal: An appeal should be presented in the prescribed form by any aggrieved person in the registry of the appellate tribunal within whose jurisdiction falls or can be sent by registered post addressed to the Registrar. The appeal sent by post should be presented in the registry on the same date on which it was received in the registry.

Form and procedure of Appeal: Any aggrieved person in the registry of the Appellate Tribunal can present a memorandum of appeal which shall be presented in the Form. This memorandum of appeal has to be presented in the Appellate Tribunal within whose jurisdiction the concerned case falls or shall be sent by registered post addressed to the Registrar. In case, the memorandum of appeal is sent through the post by the aggrieved, then it shall be deemed to have been presented in the registry on the day it was received in the registry.

Sittings of Appellate Tribunal: The Appellate Tribunal will sit either at a place where its office is situated or at any other place where the jurisdiction of the Appellate Tribunal falls (whichever place the Appellate Tribunal finds suitable).

When the Presiding Officer is temporarily absent, Government of India can authorize either of the two other members to preside over the sitting of the Tribunal either at a place where its office is situated or at such other place where the jurisdiction of the Appellate Tribunal falls.

Language of Appellate Tribunal: All the proceedings in the Appellate Tribunal are to be conducted in either English or Hindi. Any appeal, application, representation, document or other matters contained in any language other than English or Hindi, will not be accepted by the Appellate Tribunal unless the same is accompanied by a true copy of the translation of the following matter, which will be in English or Hindi.

Appeal to be in writing: Every appeal, application, reply, representation or any document filed before the Appellate Tribunal should be typewritten, cyclostyled or printed neatly and legibly.

It should be typewritten on the side of a good quality paper of foolscap size in double space and separate sheets should be stitched together. Also, every page should be consecutively numbered and filed in the manner provided in sub-rule (2).

The appeal under sub-rule (1) shall be presented in 5 sets in a paper book along with an empty file size envelope. This envelope should bear the full address of the particular respondent whereas the full address of each respondent, in case the respondents are more than one. It should be provided along with a sufficient number of extra paper books together with an empty file size envelope.

Presentation and scrutiny of the memorandum of appeal: The Registrar will endorse the date on every appeal and will sign the endorsement. The date mentioned will be the one on which the appeal was presented under rule 4 or deemed to have been presented under that rule.

The appeal will be duly registered and a serial number will be given provided that on scrutiny, the appeal is found to be in order.

The Registrar may allow the appellant to rectify the defect in his presence if on scrutiny, the appeal is found to be defective and the concerned defect is formal in nature, but if the said defect is not formal in nature, the Registrar may give the appellant some time to rectify the defect as he may deem fit.

If the appeal has been sent by post and found to be defective, the Registrar may communicate the defects to the appellant and give the appellant some time to rectify the defect as he may deem suitable.

If the appellant fails to rectify the defect within the time allotted by the Registrar (in sub-rule (3)), the Registrar will pass an order which will provide for reasons to be recorded in writing and may decline to register such memorandum of appeal and communicate the order to the appellant within seven days from declining.

An appeal against the order of the Registrar under sub-rule (4) can be made within 15 days of receiving such order which declined the appeal. The appeal will be made to the Presiding Officer or in his temporary absence, to the Member authorized under sub-rule (2) of rule 5, whose decision will be considered as final.

Contents of the memorandum of appeal: Each memorandum of appeal filed under Rule 4 will be put down concisely under distinct heads. The grounds of such appeal will be passed without any argument or narrative.

The concerned ground shall be numbered consecutively and shall be in the manner provided in sub-rule (1) of rule 7.

It will not be required to present a separate memorandum of appeal to get an interim order or direction if the above-mentioned ground is prayed for in the memorandum of appeal.

Documents to accompany memorandum of appeal: The memorandum of appeal will be provided along with five copies and will be accompanied by copies of the order. Out of those copies, at least one of it will be a certified copy, against which the appeal is filed.

If the party is represented by an authorized representative, then the following should be added to the end of the appeal:

- a copy of the authorization to act as the authorized representative and,
- a written consent thereto by such authorized representative.

Plural remedies: A memorandum of appeal shall not seek relief or reliefs against more than one order unless the reliefs which are prayed for are consequential.

Notice of appeal to the respondent: A copy of the memorandum of appeal and the paper book should be given by the Registrar to the respondent after they are registered in the registry. The copy can be served by hand delivery, or by Registered Post or Speed Post.

Filing of reply to the appeal and other documents by the respondent: The reply to the appeal has to be filed by the respondent in five complete sets. The reply to appeal has to be accompanied by documents in a paper book form. This has to be filed with the registry within one month of the providing of the notice on him regarding the filing of the memorandum of appeal.

Every reply, application or written representation filed before the Appellate Tribunal has to be verified in the manner provided for, in the Form.

A copy of all the applications, replies, documents and other written materials filed by the respondent before the Appellate Tribunal shall be right away served on the appellant, by the respondent.

The Appellate Tribunal can allow the filing of reply referred to in sub-rule (1) after the expiry of the period mentioned in that. This may be done after an application by the respondent is received. It will be done at the complete discretion of the Appellate Tribunal.

Date of hearing to be notified: The Appellate Tribunal will send a notification to the parties regarding the date when the appeal will be heard. It will be done in a particular manner which will be provided by the Presiding Officer. The Presiding Officer will direct the manner by passing a general or special order.

Hearing of appeal: The appellant will be heard in support of the appeal filed, on the day fixed or on any other day to which the hearing may be adjourned.

After this, the Securities Appellate Tribunal will, then, if it thinks necessary, hear the Board or representative authorized by the Board, against the appeal.

During, hearing the Board or its authorized representative presenting arguments against the appeal, the appellant will be entitled to reply.

The written arguments could be supplemented by time-bound oral arguments, during the proceedings of the hearing of the appeal.

Provided that in the case when the Presiding Officer or of the Member authorized by the Government under sub-rule (2) of Rule 5 is temporarily absent, then the Presiding Officer can authorize the other Member present on that day to hear Board or authorized representative by the appellant, against the appeal.

In case the appellant is not present in person or through an authorized representative when the appeal is set for hearing, the Securities Appellate Tribunal may dispose of the appeal on the merits.

Provided that where an appeal has been disposed of as provided above and the appellant presents himself afterwards and is able to satisfy the Securities Appellate Tribunal that there were sufficient and justified reasons for his nonappearance when the appeal was called for hearing, the Securities Appellate Tribunal can pass an order setting aside the ex parte order and restore the appeal.

Order to be signed and dated: The Presiding Officer and the two other members will sign and date each and every order of the Appellate Tribunal. The Presiding Officer will possess the authority and power to pass interim orders or injunctions.

The interim orders or injunctions will be subject to reasons, to be recorded in writing, which it considers necessary in the interest of justice.

The interim orders or injunctions will be pronounced during the sitting of the Appellate Tribunal, presided by the Presiding Officer or by the Member authorized under sub-rule (2) of rule 5 (in the case of the temporary absence of the Presiding Officer).

Publication of orders: The orders of the Appellate Tribunal will be released for publication if the Appellate Tribunal thinks that it is fit for publication in any authoritative report or the press.

It will be released for such publication on some terms and conditions which the Presiding Officer will lay down.

Communication of orders: A certified copy of each and every order passed by the Appellate Tribunal shall be communicated to the following members (according to what the case is):

- to the Board,
- to the Adjudicating Officer, and
- to the parties.

Orders and directions in certain cases: The Appellate Tribunal may make such orders or give such directions which it thinks are necessary or expedient to give effect to the orders passed by it previously or to prevent exploitation of its process, or to make it certain that justice is provided.

Fee for inspection of records and obtaining copies:

- A fee for every hour or every part of that inspection will be charged;
- It will amount to rupees twenty;
- It will be subjected to a minimum of rupees one hundred charged for inspecting the records of a pending appeal by a party;
- A fee of rupees five will be charged, for a folio or part of that which do not involve typing;
- A fee of rupees ten will be charged for a folio or part of that which do not involve typing of statement;
- Figures shall be charged for providing copies of the records of an appeal, to a party in the concerned case.

POWER OF COURT TO GRANT RELIEF

Section 108 in The Insurance Act, 1938 has given powers of court to grand relief.

Section 108 states that *"If any proceedings, civil or criminal, it appears to the court hearing the case that a person is or may be liable in respect of negligence, default, breach of duty or breach of trust but that he has acted honestly and reasonably and that having regard to all the circumstances of the case he ought fairly to be excused for the negligence, default, breach of duty or breach of trust, the court may relieve him either wholly or partly from his liability on such terms as it may think fit."*

Thus, if any person is charged with respect of negligence, default, breach of duty or breach of trust but that he has acted honestly and reasonably, the court may relieve him either wholly or partly from his liability on such terms as it may think fit.

COGNIZANCE OF OFFENCE

Section 109 in The Insurance Act, 1938 deals with cognizance of offences.

Section 109 states that *"No court inferior to that of a Presidency Magistrate or Magistrate of the first class shall try any offence under this Act. No court shall take cognizance of any offence punishable under sub-section (4) of section 34B or subsection (1A) of section 102 except upon complaint in writing made by an officer of the Central Government generally or specially authorised in writing, in this behalf by the Authority and no Court inferior to that of a Presidency Magistrate or a Magistrate of the first class shall try any such offence."*

LESSON ROUND-UP

- Compliance with regulatory guidelines is essential for insurance companies to maintain their license to operate and ensure the protection of policyholders' interests.
- Inspection and investigation activities are conducted by regulatory authorities to monitor the financial stability and compliance of insurance entities.
- Inspections involve a comprehensive examination of an insurance company's financial records, operational procedures, and risk management practices.
- Investigations are carried out to address specific incidents of misconduct, fraud, or irregularities within the insurance industry.
- Penalties imposed for violations or non-compliance serve as deterrents and disciplinary measures to encourage adherence to regulations.
- The severity of penalties depends on the nature and seriousness of the offense committed by insurance companies.
- Appellate procedures provide an avenue for entities or individuals to challenge or appeal decisions made by regulatory authorities.
- The Securities Appellate Tribunal (SAT) is an independent body that handles appeals related to insurance sector regulations in India.
- SAT has the power to hear and dispose of appeals against orders passed by the Insurance Regulatory and Development Authority of India (IRDAI).
- The SAT consists of a Presiding Officer and Judicial and Technical Members who are appointed based on specific qualifications and tenure requirements.
- SAT has powers similar to a civil court, including summoning witnesses, receiving evidence, and issuing commissions for the examination of documents or witnesses.
- Appeals to SAT must be filed within a specified time limit, usually 45 days from the date of receiving the order, accompanied by the prescribed form and fees.
- SAT is empowered to confirm, modify, or set aside the order appealed against after giving all parties an opportunity to be heard.

- If dissatisfied with the SAT's decision, an aggrieved party can file an appeal to the Supreme Court on a question of law within a specified time frame.
- The fee payable for filing an appeal with SAT depends on the amount of penalty imposed, with different fee structures for different penalty ranges.
- The SAT follows specific procedures for filing appeals, including the presentation of a memorandum of appeal in the prescribed form.
- The sittings of SAT can take place at its office or any other location falling within its jurisdiction.
- All proceedings in SAT are conducted in either English or Hindi, and documents in other languages must be accompanied by a translation.
- Appeals, applications, and other documents filed with SAT should be typewritten, legible, and consecutively numbered.
- The Registrar of SAT is responsible for the registration, scrutiny, and endorsement of appeals, ensuring they meet the necessary requirements before proceeding.
- Section 108 of the Insurance Act, 1938 grants the court the power to grant relief in cases where a person may be liable for negligence, default, breach of duty, or breach of trust but has acted honestly and reasonably.
- The court has the discretion to relieve the person partially or wholly from liability, based on the circumstances of the case.
- Section 109 of the Act establishes that offenses under the Act can only be tried by a Presidency Magistrate or a Magistrate of the first class, and no lower court has jurisdiction.
- For certain specific offenses, such as those punishable under sub-section (4) of section 34B or sub-section (1A) of section 102, a complaint in writing by an officer of the Central Government authorized by the Authority is required to initiate the proceedings.
- Section 102 deals with penalties for default or acts in contravention of the Insurance Act.
- If a person fails to furnish required documents, statements, accounts, returns, or reports to the Authority, they can be liable for a penalty not exceeding five lakh rupees for each failure and may face punishment by a fine.
- Similarly, failure to comply with directions or maintain solvency margin can also result in penalties under this section.
- The penalties mentioned in section 102 are applicable to individuals or entities who are required to fulfill certain obligations under the Act.
- The amount of penalty imposed may vary depending on the specific violation.
- The penalties serve as a means to enforce compliance with the Insurance Act and its associated rules and regulations.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. What is the scope and extent of the power of investigation and inspection held by the Insurance Regulatory and Development Authority of India (IRDAI)?
2. How does the IRDAI exercise its power of investigation and inspection in the insurance sector, and what are the objectives behind such activities?
3. What are the legal provisions and regulations governing the power of investigation and inspection vested in the IRDAI? How do these provisions ensure transparency, accountability, and fairness in the investigative and inspection processes?
4. What remedies or penalties does the IRDAI have at its disposal in cases where misconduct, non-compliance, or irregularities are identified through investigations or inspections?

5. Are there any procedural safeguards or rights provided to insurance companies or individuals being investigated or inspected by the IRDAI? How does the IRDAI ensure fairness and due process during these activities?
6. What is the process and procedure for filing an appeal to the Securities Appellate Tribunal (SAT) in India, and what are the prerequisites or conditions that need to be met for initiating such an appeal?
7. What is the jurisdiction of the Securities Appellate Tribunal (SAT) regarding appeals related to securities laws and regulations? Are there any limitations on the types of decisions or orders that can be appealed to the SAT?
8. What remedies or reliefs can be sought through an appeal to the Securities Appellate Tribunal (SAT), and what factors does the SAT consider in determining the appropriate course of action or outcome of the appeal?
9. How does Section 108 of The Insurance Act, 1938, enable the court to provide grand relief in insurance matters? Can you provide examples or scenarios where the court has exercised these powers to grant relief and their implications on the parties involved?
10. How does Section 109 of The Insurance Act, 1938, outline the process by which offences under the Act are brought to the attention of the appropriate authorities? What factors are considered when determining the cognizance of insurance-related offences?
11. What are the key provisions and penalties outlined in Section 102 of The Insurance Act, 1938, regarding non-compliance or contravention of the Act? How does this section ensure adherence to the regulatory framework within the insurance industry?

LIST OF OTHER REFERENCES

- www.irdai.gov.in
- Insurance Regulatory and Development Authority Act, 1999
- The Insurance Act, 1938

Professional Opportunities

Lesson 24

KEY CONCEPTS

■ Independent Directors ■ Corporate Governance ■ Arbitrators ■ Surveyors

Learning Objectives

To understand:

- Role of Company Secretary in different industries
- Recognitions to Company Secretary in Employment
- The Professional opportunities for Company Secretaries

Lesson Outline

- Company Secretaries
  - As Compliance Officers
  - As Independent Directors
  - As Governance Risk Professionals
  - As Corporate Governance professionals and advisors As Secretarial Auditors
  - As advisors for various compliances of Companies Act, Insurance laws, IRDAI Regulations, SEBI Regulations, Other legislations
  - As Arbitrators/ Surveyors/ Agents and Marketing Professionals /Valuation Experts/ Legal Advisors/ CSR Professional etc.
- Lesson Round-Up
- Test Yourself
- List of Further Reading

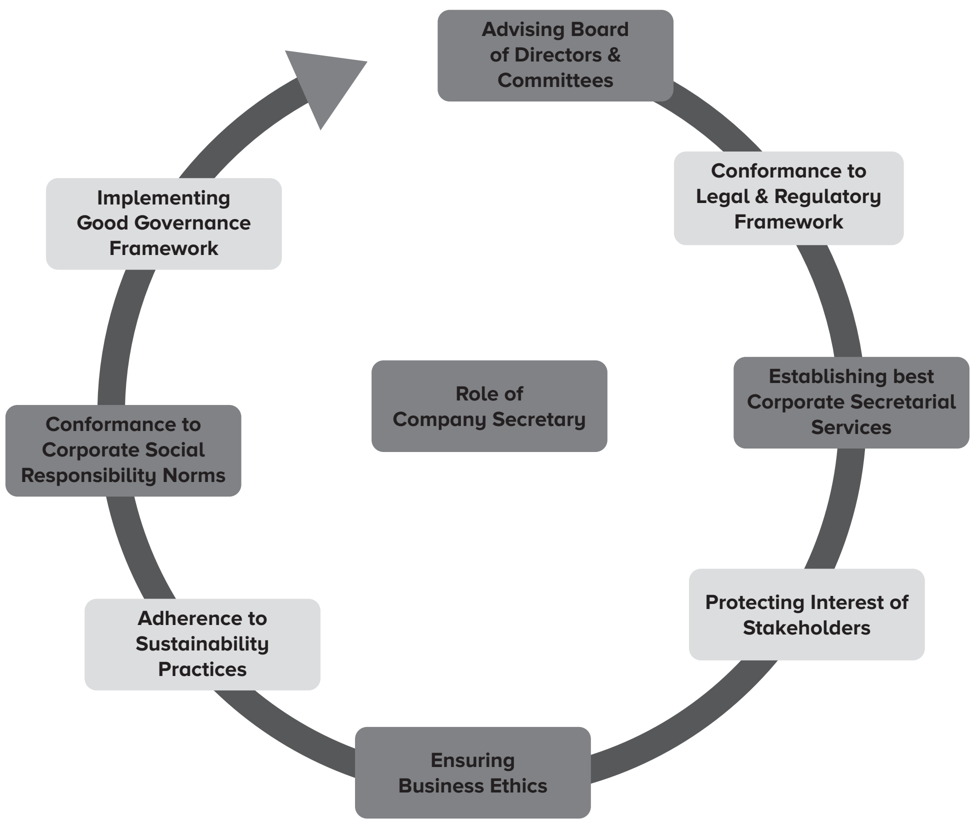
INTRODUCTION

A 'Company Secretary' is a senior, strategic-level corporate professional who plays a leading role of a Key Managerial Personnel (KMP) entrusted with the responsibility of the company's Corporate Governance. Corporate Governance is more than just complying with laws, regulations, standards and codes; it is also about creating a culture of good management practices. The position of a Company Secretary as the KMP comes close to that of the Chief Executive Officer or the Managing Director and underlines the importance of the role played by him in the company. He provides professional guidance to the board, individual directors, management, shareholders and other stakeholders on the governance aspects of strategic decisions for the growth of the company. As an advisor, he advises the Board on the best management practices and work ethics to be adhered to that will ensure wealth creation for the company. He also plays a critical role in organizing and implementing board's decisions, its committees and general body meetings while ensuring compliance with the existing legal structure to safeguard the interests of all stakeholders.

A company's reputation is one of its most prized possessions in pursuit of sustained growth. It is essential that this asset is not undermined by breach of law or failure to follow best practices. The Company Secretary as a compliance officer ensures that legislation is not infringed, that regulations are adhered to, and the areas of potential risks are identified and dealt with.

The Company Secretary, whose position is unique within a company, plays a major role in encouraging and monitoring best practices. The role of a Company Secretary requires him to keep up-to-date with changes and new developments to understand their implications across a wide range of business activities. To remain a distinct professional, he fulfills his role and duties assiduously.

The Companies Act, 2013 *(the Act)* piloted a new era of corporate governance and transparency in the Indian corporate sector by introducing significant changes in the provisions relating to governance, e-management, compliance, enforcement, disclosure norms, auditors, mergers and acquisitions, etc. The Act laid greater emphasis on good governance practices by enhancing the responsibility and accountability of Boards. While the law reposes enormous responsibilities on companies as regards compliances of various provisions in true letter and spirit, the list of laws falling under the ambit of a company's compliance umbrella is extensive. With each law and its compliance holding significance in its own accord, the need arises for an appropriate mechanism and utilization of expert services from the brigade of professionals highly attuned in their job of maintaining extensive compliance and all in all good governance i.e. the 'Company Secretaries.'



The Company Secretary plays a much broader role of acting as an 'Advisor' to the Board to shoulder the responsibility for the organisation's corporate governance. The responsibility for developing and implementing processes to promote and sustain good corporate governance largely falls within the ambit of the Company Secretary. Irrespective of the type of company, the role of Company Secretary has expanded beyond simply ensuring statutory compliance to becoming a pivotal one where the skills of the Company Secretary can have a direct impact on the effectiveness of the Board and organisation and ensuring corporate governance being followed in true letter and spirit.

A Company Secretary in employment is a robust professional aiding the efficient management of the corporate sector by playing the role of a Key Managerial Personnel (KMP) or Compliance Officer of a company. The Company Secretary has become to be accepted by all as an independent and indispensable professional. The role of Company Secretary in employment has transformed itself into a full-fledged Governance Professional occupying a critical place in the company's organizational hierarchy balancing the interests of the Management, Board, Shareholders and other stakeholders.

Alternatively, a Company Secretary may also practice independently as a professional after obtaining a Certificate of Practice (CoP) as provided in the Company Secretaries Act, 1980. Not merely concentrating on Corporate laws, Company Secretary in practice is the preferred professional who is finding depth in the areas of Intellectual Property, Business advisory, International laws, Commercial laws, Economic growth & Development projects, etc.

COMPANY SECRETARY IN EMPLOYMENT

Section 2(24) of the Companies Act, 2013 provides that ***"Company Secretary" or"secretary" means a Company Secretary as defined in clause (c) of sub-section*** *(1) of section 2 of the Company Secretaries Act, 1980 (56 of 1980) who is appointed by a company to perform the functions of a Company Secretary under this Act.*

(i) Provisions governing appointment as Key Managerial Personnel The Companies Act, 2013

Section 2(51) of the Companies Act, 2013 provides that Key Managerial Personnel (KMP), in relation to a company, means

(i) the Chief Executive Officer or the managing director or the manager;

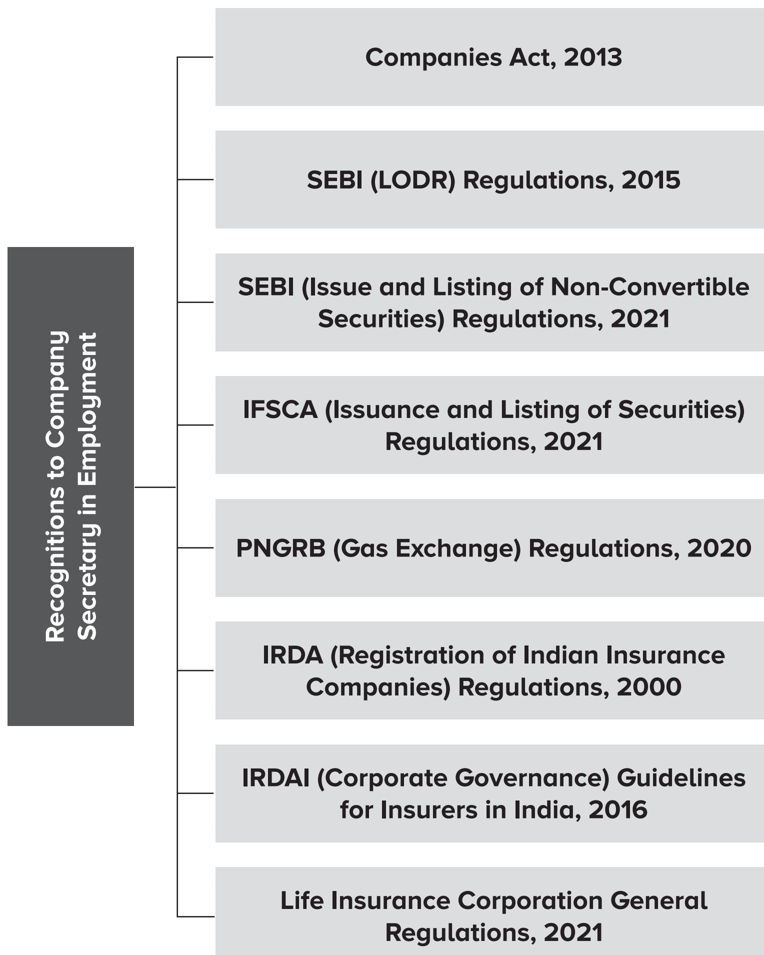
(ii) the Company Secretary;

(iii) the whole-time director;

(iv) the Chief Financial Officer;

(v) Such other officer, not more than one level below the directors who is in whole- time employment, designated as Key Managerial Personnel by the Board; and

(vi) Such other officer as may be prescribed.



Appointment of KMP

Section 203(1) of the Companies Act, 2013 provides that every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel:

(i) Managing Director, or Chief Executive Officer or Manager and in their absence, a Whole-Time Director;

(ii) Company Secretary; and

(iii) Chief Financial Officer.

Section 203 of the Companies Act, 2013 read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that the every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have whole-time key managerial personnel.

Sections 203 of the Companies Act, 2013 read with Rule 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides for appointment of Company Secretaries in Companies not covered under Rule 8 and reads as every private company which has a paid up share capital of ten crore rupees or more shall have a whole-time Company Secretary.

Further, Section 203 (2) provides that every whole-time key managerial personnel of a company shall be appointed by means of a resolution of the Board containing the terms and conditions of the appointment including the remuneration.

KMP in Whole-time Employment

Section 203(3) provides that a whole-time key managerial personnel shall not hold office in more than one company except in its subsidiary company at the same time:

Provided that nothing contained in this sub-section shall disentitle a key managerial personnel from being a director of any company with the permission of the Board:

Provided further that whole-time key managerial personnel holding office in more than one company at the same time on the date of commencement of this Act, shall, within a period of six months from such commencement, choose one company, in which he wishes to continue to hold the office of key managerial personnel.

The provisions mandatorily require engaging the Company Secretary as a KMP on a 'whole-time basis' in prescribed classes of companies. A KMP should hold office on whole time basis means that the KMP must contribute all his time in the efficient management of the company and as such the appointment as whole-time KMP shall not be in more than one Company except in its Subsidiary Company at the same time. It may be noted that the companies not covered under Section 203 of the Companies Act, 2013 read with Rule 8 and 8A of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, may also voluntarily appoint any or all Key Managerial Personnel for efficient management of their company.

(ii) The SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 Compliance Officer and his/her Obligations (Regulation 6)

(1) A listed entity shall appoint a qualified Company Secretary as the compliance officer.

(2) The compliance officer of the listed entity shall be responsible for-

(a) ensuring conformity with the regulatory provisions applicable to the listed entity in letter and spirit.

(b) co-ordination with and reporting to the Board, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities in manner as specified from time to time.

(c) ensuring that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under these regulations.

(d) monitoring email address of grievance redressal division as designated by the listed entity for the purpose of registering complaints by investors:

Provided that the requirements of this regulation shall not be applicable in the case of units issued by mutual funds which are listed on recognised stock exchange(s) but shall be governed by the provisions of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996.

A Company Secretary as the Compliance officer of a company is responsible for the efficient administration of a company particularly with regard to ensuring compliance with the statutory and regulatory requirements. He is entrusted to interact, coordinate, integrate and cooperate with various other functional heads in a company, keep the board members informed of their legal responsibilities and also represent before the statutory and regulatory authorities on behalf of the company for ensuring compliances required under various laws. Being a Compliance officer under the SEBI (LODR) Regulations, 2015, a Company Secretary is also required to ensure the compliances under the SEBI(Prohibition of Insider Trading) Regulations, 2015 ensuring that Unpublished Price Sensitive Information (UPSI) is handled with utmost diligence, people having access to UPSI do not trade in company shares or misuse the information as well as timely disclosures to Stock Exchanges.

Senior Management (Regulation 16 (d))

'Senior Management' shall mean officers/personnel of the listed entity who are members of its core management team excluding Board of Directors and normally this shall comprise all members of management one level below the chief executive officer/managing director/whole time director/manager (including chief executive officer/manager, in case they are not part of the board) and shall specifically include Company Secretary and chief financial officer.

(iii) SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 Filing of draft offer document (Regulation 27 (4))

The lead manager(s) shall ensure that the draft offer document clearly specifies the names and contact particulars including the postal and email address and telephone number of the compliance officer who shall be a Company Secretary of the issuer.

(iv) IFSCA (Issuance and Listing of Securities) Regulations, 2021 Compliance Officer and his Obligations (Regulation 130)

(1) A listed entity shall appoint a qualified Company Secretary as the compliance officer.

(2) The compliance officer of the listed entity shall be responsible for-

(a) ensuring conformity with the regulatory provisions applicable to the listed entity in true letter and spirit;

(b) co-ordination with and reporting to IFSCA, recognised stock exchange(s) and depositories with respect to compliance with rules, regulations and other directives of these authorities in the manner as specified from time to time; and

(c) ensuring that the correct procedures have been followed that would result in the correctness, authenticity and comprehensiveness of the information, statements and reports filed by the listed entity under these regulations.

(v) Petroleum and Natural Gas Regulatory Board (Gas Exchange) Regulations, 2020 Appointment of Compliance Officer (Regulation 30)

(1) Every Gas Exchange or Clearing Corporation shall appoint a compliance officer who shall be a Company Secretary as defined in paragraph (c) of sub-section of section 2 of the Company Secretaries Act, 1980 (56 of 1980) and be responsible for monitoring the compliance of the Act, Regulations, bye-laws and rules of the Gas Exchange or the Clearing Corporation as applicable and directions

issued thereunder and for redressal of grievances of the members, trading licensees and their respective clients.

(2) The compliance officer shall immediately and independently, report to the Board any noncompliance of any provision stated in sub-regulation (1) observed by him.

(vi) IRDA (Registration of Indian Insurance Companies) Regulations, 2000 Key Management Person (Regulation 2(1)(i))

"Key Management Person" will include members of the core management team of an insurer / applicant including all Whole-Time Directors/ Managing Directors/ Chief Executive Officer and the functional heads one level below the Managing Director / Chief Executive Officer, including the Chief Financial Officer, Appointed Actuary, Chief Investment Officer, Chief Risk/ Compliance Officer and the Company Secretary.

(vii) IRDAI (Corporate Governance) Guidelines, 2016 for Insurers in India Compliance Officer (Clause 11.4.2)

Each insurer should designate Company Secretary as the Compliance Officer whoseduty will be to monitor continuing compliance with these guidelines.

COMPANY SECRETARY IN PRACTICE

As per Section 2(25) of the Companies Act, 2013, "Company Secretary in practice" means a Company Secretary who is deemed to be in practice under sub-section (2) of section 2 of the Company Secretaries Act, 1980 (56 of 1980);

Section 2(2) of the Company Secretaries Act, 1980 defines a Company Secretary in Practice and reads as follows: Save as otherwise provided in this Act, a member of the Institute shall be deemed to be in practice when, individually or in partnership with one or more members of the Institute in practice or in partnership with members of such other recognised professions as may be prescribed, in consideration of remuneration received or to be received,

a. engages himself in the practice of the profession of Company Secretaries to, or in relation to, any company; or

b. offers to perform or performs services in relation to the promotion, forming, incorporation, amalgamation, reconstruction, reorganisation or winding-up of companies; or

c. offers to perform or performs such services as may be performed by -

   i. an authorised representative of a company with respect to filing, registering, presenting, attesting or verifying any documents (including forms, applications and returns) by or on behalf of the company,

   ii. a share transfer agent,

   iii. an issue house,

   iv. a share and stock broker,

   v. a secretarial auditor or consultant,

   vi. an adviser to a company on management, including any legal or procedural matter falling under the Industries (Development and Regulation) Act, 1951 (65 of 1951), the Companies Act, the Securities Contracts (Regulation) Act, 1956 (42 of 1956), any of the rules or bye-laws made by a recognised stock exchange, the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Foreign Exchange Management Act, 1999 (42 of 1999), the Competition Act, 2002 (12 of 2003)], or under any other law for the time being in force,

vii. issuing certificates on behalf of, or for the purposes of, a company; or

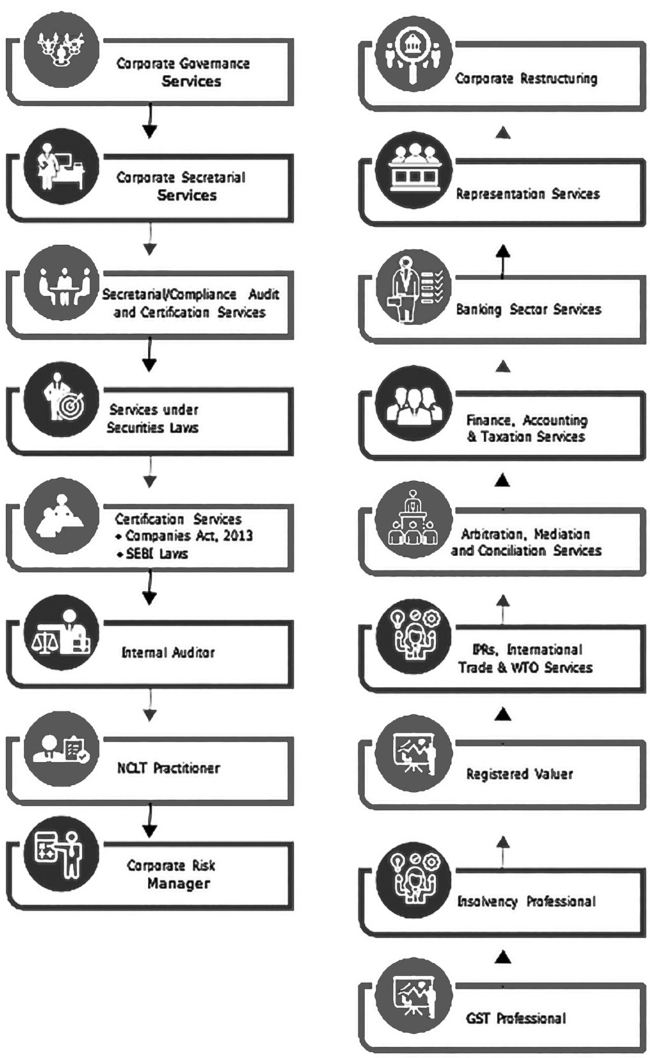
d. holds himself out to the public as a Company Secretary in practice; or

e. renders professional services or assistance with respect to matters of principle or detail relating to the practice of the profession of Company Secretaries; or

f. renders such other services as, in the opinion of the Council, are or may be rendered by a Company Secretary in practice;

and the words to be in practice, with their grammatical variations and cognate expressions, shall be construed accordingly.

Core areas for Company Secretary in Practice



Secretarial Audit (Section 204)

(1) Every listed company and a company belonging to other class of companies as may be prescribed shall annex with its Board's report made in terms of sub- section (3) of section 134, ***a secretarial audit report,*** given by a Company Secretary in practice, in such form as may be prescribed.

(2) It shall be the duty of the company to give all assistance and facilities to the Company Secretary in practice, for auditing the secretarial and related records of the company.

(3) The Board of Directors, in their report made in terms of sub-section (3) of section 134, shall explain in full any qualification or observation or other remarks made by the Company Secretary in practice in his report under sub-section (1).

(4) If a company or any officer of the company or the Company Secretary in practice, contravenes the provisions of this section, the company, every officer of the company or the Company Secretary in practice, who is in default, shall be liable to a penalty of two lakh rupees.

As per Rule 9 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the other class of companies shall be as under –

a) Every public company having a paid-up share capital of *fifty crore rupees or more*; or

b) Every public company having a turnover of *two hundred fifty crore rupees or more*; or

c) Every company having outstanding loans or borrowings from banks or public financial institutions of *one hundred crore rupees or more*.

Annual Return (Section 92)

The Annual Return is a comprehensive document and contains information about the company relating to its share capital, directors, shareholders, changes in directorships, etc. Much reliance is placed on the annual return by the regulators, shareholders, judicial and other regulatory authorities. Section 92 of the Act provides that annual returns of companies shall be required to be certified by a Company Secretary in Practice. The certification shall be to the effect that the company hascomplied with all the provisions of the Act.

SEBI (LODR) Regulations, 2015 - Secretarial Audit and Secretarial Compliance Report (Regulation 24A)

(1) Every listed entity and its material unlisted subsidiaries incorporated in India shall undertake secretarial audit and shall annex a secretarial audit report given by a Company Secretary in practice, in such form as specified, with the annual report of the listed entity.

(2) Every listed entity shall submit a secretarial compliance report in such form as specified, to stock exchanges, within sixty days from end of each financial year.

Corporate Secretarial Services

- Promotion, formation and incorporation of companies and matters related therewith.
- Filing, registering any document including forms, returns and applications by and on behalf of the company as an authorized representative.
- Co-ordinating Board/general meetings and follow-up actions thereof.
- All work relating to Securities and their transfer and transmission.
- Custodian of corporate records, statutory books and registers.

Secretarial/Compliance Audit and Certification Services

- Secretarial/Compliance Audit.
- Signing of Annual Return & other declarations, attestations and certifications under the Companies Act, 2013.

Certification Services (Indicative)

Companies Act, 2013

- Promotion, formation and incorporation of companies and related matters.
- Signing and Certification of Annual Return.
- Certification of various e-forms and other documents including annual filings (Including LLP's).

SEBI Laws

- Certification to the effect that all transfers have been completed within the stipulated time.
- Half-yearly certificate regarding maintenance of 100% security cover in respect of listed non-convertible debt securities.
- Certificate regarding compliance of conditions of corporate governance.
- Certificate that none of the directors on the board of the company have been debarred or disqualified from being appointed or continuing as Directors of Companies by the Board/Ministry of Corporate Affairs or any such Statutory Authority.

Appointment on the basis of Expert Knowledge

- **Expert** - Section 2(38) of the Companies Act, 2013 provides that 'expert' includes an engineer, a valuer, a Chartered Accountant, a Company Secretary, a Cost Accountant and any other person who has the power or authority to issue a certificate in pursuance of any law for the time being in force.
- **Scrutinizer** - Rule 20(ix) of the Companies (Management and Administration) Rules, 2014 provides that the Board of Directors shall appoint one scrutinizer, who may be Chartered Accountant in practice, Cost Accountant in practice, or Company Secretary in practice or an Advocate, who, in the opinion of the Board can scrutinize the e-voting process in a fair and transparent manner.
- **Technical Member** - Section 409 of the Companies Act, 2013 provides that Company Secretary who has been in practice for at least fifteen years may be appointed as a Technical Member of the NCLT.
- **Internal Auditor -** As per Section 138 of the Companies Act, 2013 the Board of Directors may appoint Company Secretaries as an internal auditor to perform internal audits of the company's internal controls.

SEBI has also prescribed Company Secretary in practice to undertake aninternal audit of various Capital Market Intermediaries:

- Internal Audit of Credit Rating Agencies;
- Internal Audit of Stock Brokers/Clearing Members/Trading Members;
- Internal Audit of Registrar and share transfer agents (RTAs);
- Internal audit & concurrent audit of depository participants;
- Annual compliance audit of research analyst;
- Reconciliation of share capital audit;
- Yearly audit of Investment Advisors.

NCLT Practitioner

- Analysis and drafting in respect of matters which are required to be dealt with by NCLT or NCLAT.
- Appear before the Tribunal on behalf of the Company.
- Appeal to Supreme Court.
- Help the Company to execute the order of the Tribunal.
- Liquidator.

Issue of shares and other securities

- Advisor/consultant in issue of shares and other securities.
- Drafting of prospectus/offer for sale/letter of offer/ other documents related to issue of securities and obtaining various approvals.
- Listing/delisting of securities with recognized stock exchange.
- Private placement of shares and other securities.
- Buy-back of shares.
- Raising of funds from international markets ADR/ GDR/FCCBs/FCEBs/ ECB.
- Due diligence.

Corporate Restructuring

- Foreign Collaborations and Joint Ventures.
- Setting-up Joint Ventures/Wholly owned subsidiaries abroad.
- Ensuring compliance of Takeover Regulations and other applicable laws.
- Ensuring compliance with Prohibition of Insider Trading Regulations.

Representation Services

Company Secretaries have been authorized to represent before:

- Registrar of Companies and Regional Directors.
- National Company Law Tribunal and National Company Law Appellate Tribunal.
- Competition Commission of India.
- Securities Appellate Tribunal.
- Telecom Disputes Settlement and Appellate Tribunal.
- Authorities under Real Estate (Regulation &Development) Act, 2016.
- Authorities under the Pension Fund Regulatory & Development Authority Act, 2013.
- SEZ Authorities.
- Central Electricity Regulatory Commission.
- Tax Authorities.

Banking Sector Services

- Diligence Report and Certification in respect of Consortium/Multiple banking arrangement made by Scheduled Commercial Banks/Urban Co-operative Banks.
- Loan Syndication and Documentation, registration of charges, status and search reports.

Finance, Accounting & Taxation Services

- Determination of appropriate capital structure.
- Budgetary controls.
- Project Reports and Feasibility Studies.
- Tax management, tax planning, returns and reports under Income-Tax, GST and other taxation laws.

Arbitration, Mediation and Conciliation Services

- Advising in commercial disputes.
- Acting as Arbitrator/Conciliator in domestic and international commercial disputes.
- Drafting Arbitration/Conciliation Agreements.

IPRs, International Trade & WTO Services

Advising on matters related to:

- IPRs under TRIPs Agreement of WTO.

- Anti-dumping, subsidies & countervailing duties.
- Foreign Trade Policy and Procedures (also issuing certificates thereunder).
- Intellectual Property licensing and drafting of Agreements.
- IPR – Protection, Management, Valuation and Audit.
- Acting as registered Trade Marks Agent.

Registered Valuer

A Company Secretary in Practice with requisite experience and after passing the examination can become a Registered Valuer for conducting valuation required under the Companies Act, 2013. A Registered Valuer may conduct valuation of securities or financial assets as per Companies (Registered Valuers and Valuation) Rules, 2017, if required under any other law or by any other regulatory authority. The field of valuation, as an area of activity is still untapped, demanding the presence of experts possessing the right knowledge and capabilities which brings upon the realisation that Company Secretaries as professionals can tap this huge opportunity.

Insolvency Professional

Company Secretaries having passed necessary examination, possessing prescribed number of years of experience, enrolled with an Insolvency Professional Agency and registered with Insolvency and Bankruptcy Board of India (IBBI) as an Insolvency Professional, can take up matters relating to corporate insolvency resolution process as Interim Resolution/Resolution Professionals, as well as also take up voluntary liquidation cases. They can also act as authorized representatives for a class of creditors in a meeting of Committee of Creditors in a resolution process.

GST Professional

With their expertise in interpreting laws and skills to tackle and manage regulatory compliances under GST, Company Secretaries render value added services to the trade and industry while acting as extended arms of regulatory mechanism. A person having passed CS final examination is eligible for enrolment as GST Practitioner. Company Secretaries provide guidance and advisory services to business entities to interpret GST laws and assist in effectively discharging various compliances under GST while undertaking activities like tax planning, maintenance of GST records, drafting legal documents like replying to show cause notices, conducting impact analysis, etc.

Company Secretary as Other Services Provider

Appointments on the basis of expert knowledge:

- Scrutinizer for e-voting process in a fair and transparent manner.
- Company Liquidator/ Provisional Liquidator.
- Technical Member of National Company Law Tribunal.
- Part of Expert Panels of various Government, Judicial and Quasi-Judicial Bodies.

Under other laws:

Issue of shares and other securities:

- Advisor/consultant in issue of shares and other securities.
- Drafting of prospectus/offer for sale/letter of offer/ other documents related to issue of securities and obtaining various approvals.

- Listing/delisting of securities with recognized stock exchange.
- Private placement of shares and other securities.
- Buy-back of shares.
- Raising of funds from international markets ADR/ GDR/FCCBs/FCEBs/ ECB.
- Due diligence.

Banking Services:

- Diligence Report and Certification in respect of Consortium/Multiple banking arrangement made by Scheduled Commercial Banks/Urban Co-operative Banks.
- Loan Syndication and Documentation, registration of charges, status and search reports.

Corporate Restructuring and Compliances:

- Foreign Collaborations and Joint Ventures.
- Setting-up Joint Ventures/Wholly owned subsidiaries abroad.
- Ensuring compliance of the Takeover Regulations and other applicable laws.
- Acting as Compliance Officer and ensuring compliance with Prohibition of Insider Trading Regulations.

Finance, Accounting and Taxation Services:

- Determination of appropriate capital structure.
- Analysis of capital investment proposals.
- Budgetary controls.
- Preparation of Project Reports and Feasibility Studies.
- Advisory services on tax management and tax planning under Income-Tax, GST and other taxation laws.
- Preparing/reviewing various Returns and Reports required for compliance with the tax laws and regulations.

Arbitration and Conciliation Services:

- Advising in commercial disputes between parties.
- Acting as Arbitrator/Conciliator in domestic and international commercial disputes.
- Drafting Arbitration/Conciliation Agreement/Clauses.

Role, Responsibilities & Duties of Company Secretary

A Company Secretary in today's world is a Senior Corporate Officer with wide- ranging responsibilities, who serves as a focal point for communication with the Boardof Directors, Senior Management and the company's shareholders. He occupiesa key role in the administration of critical corporate matters. A key responsibility for the Company Secretary is to ensure that the Board has the proper adviceand resources for discharging its fiduciary duty under the law. Providing adviceon Corporate Governance issues is an increasingly important role for Company Secretaries. Many shareholders, particularly Institutional Investors, view sound Corporate Governance as essential to Board and Company's performance. They are quite vocal in encouraging Boards to perform frequent Corporate Governance reviews and to issue written statements of Corporate Governance principles. The Company Secretary is usually the Executive to assist directors in these efforts, providing information on the practices of other Companies and helping the Board to tailor Corporate Governance principles and practices to fit the board's needs and expectations of investors.

Duties of Company Secretary

Section 205 of the Companies Act, 2013 read with Rule 10 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 prescribes the functions of Company Secretary and reads as follows:

The functions of the Company Secretary shall include,—

(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;

(b) to ensure that the company complies with the applicable secretarial standards;

(c) to discharge such other duties as may be prescribed;

Explanation.—For the purpose of this section, the expression "secretarial standards" means secretarial standards issued by the Institute of Company Secretaries of India constituted under section 3 of the Company Secretaries Act, 1980 and approved by the Central Government;

Rule 10 of Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 prescribes further duties to be discharged by the Company Secretary, as under:-

(1) to provide to the directors of the company, collectively and individually, such guidance as they may require, with regard to their duties, responsibilities and powers;

(2) to facilitate the convening of meetings and attend Board, committee and general meetings and maintain the minutes of these meetings;

(3) to obtain approvals from the Board, general meeting, the government and such other authorities as required under the provisions of the Act;

(4) to represent before various regulators, and other authorities under the Act in connection with discharge of various duties under the Act;

(5) to assist the Board in the conduct of the affairs of the company;

(6) to assist and advise the Board in ensuring good corporate governance and in complying with the corporate governance requirements and best practices; and

(7) to discharge such other duties as have been specified under the Act or rules; and

(8) such other duties as may be assigned by the Board from time to time.

These provisions casts an onerous responsibility on the Company Secretaries in employment in the discharge of their duties and they are expected to exhibit a proactive and responsible role to meet the expectations of the respective companies and regulatory authorities.

Role of Company Secretaries in National and Global Governance

The speed and the tenor with which the changes are happening in India and abroad, make it imperative for professionals to keep pace with these changes in all their dimensions to surge ahead in promoting good governance and sustainability of the corporate and nation as a whole.

As professionals being exclusive custodian of governance expertise, they need to profess high ethical and moral values, and to redeem governance culture. As specialist in Corporate Governance, Company Secretaries continuously own the responsibility to ensure that the corporate sector creates a governance culture that is able to generate wealth in a sustainable, ethical and socially beneficial manner and fulfils their obligation to all the stakeholders.

The Company Secretaries are the guardians of Company's Governance and an independent adviser to the corporates. As Governance professionals, they are the guardians of not only huge funds invested in the corporate but also of the stakeholder trust, they need to ensure that such trust is not breached and funds are utilized towards sustainable growth. As Governance Professionals and the practitioners of corporate governance, they are in a leading role in making India a global leader in good governance practices. Foremost, it is important to adhere to values of honesty, integrity, truthfulness and adopt the best practices.

Governance Professionals have a significant impact on the level and quality of governance and development of a conducive governance culture within the organisation whether it is banking sector, insurance sector, non-governmental organisation (NGO), financial markets, etc. The governance professional assists an entity to adopt a vision and strategy enforcing the elements of good governance. Governance professional provides effective and efficient safeguard against corruption, fraud and mismanagement and ensures responsiveness towards its multiple stakeholder groups.

Emerging economic and regulatory scenario requires Board of Companies to be competent enough to handle the compliance requirements under various jurisdictions. The Company Secretary is the most coveted officer to ensure compliances across jurisdictions and this is the reason that today appointment of a Company Secretary is being made mandatory in various jurisdictions. The role of Company Secretary is transforming at the global platform into the Governance professional.

At the global frontier, the Institute is a founder member of Corporate Secretaries International Association (CSIA) and has linkages with various International bodies involved in promoting the cause of Corporate Governance. The Malaysian Association of Company Secretaries (MACS) has launched Secretarial Practice Guide on meetings of the Board of Directors by adopting Secretarial Standard-1 on Board Meetings issued by the ICSI. It is a testimony that other global organisations are adopting our governance frameworks.

Currently, the Institute has six overseas centres opened in United States of America, Australia, UAE, United Kingdom, Singapore and Canada. The leadership role of the Institute in Corporate Secretaries International Association (CSIA) and participation of the Institute in International Conferences is an indication of Institute's growing global presence.

The ICSI, as a premier organization of international repute with an apparition of serving professional excellence in compliance and governance, has been instrumental in going hand in hand with the governments' initiatives towards establishing and advancing the culture of methodical good governance in the nation.

The ICSI has not only aced in its role as the pioneer of pursuing good governance, rather it has spawned good governance in areas beyond corporate governance and has sprawled good corporate governance beyond the boundaries of this nation. The ICSI takes pride in its roots in ancient history and intends to take it along in its journey forward and expand extensively with its Vision to be a global leader in promoting good corporate governance and Mission to develop high calibre professionals facilitating good corporate governance.

Our Nation's unique wisdom emanating from our cultural heritage and the remarkable achievements during the last 75 years provide us with the intrinsic strength of offering something that the global community requires. India as a Vishwaguru in promoting Good Governance can provide the impetus, guidance and direction for strengthening the same. A Company Secretary is considered one of the core guidance providers for an organization due to the specialized skills and technical knowledge gained in the course of their dealing with many corporates. They are the natural conscience keepers for the corporate sector being specialists in the fields of corporate governance, regulation and processes. Professionalism entails possessing specialist knowledge and following a standard of conduct based on ethics that governs the use of this knowledge when providing services to the corporate. Company Secretaries, as governance professionals provide specialist knowledge to various corporates, are viewed as one carrying additional moral responsibility with honesty, objectivity, impartiality and high integrity.

Company Secretaries are well suited to play a significant role in national as well as global governance. In developing a global and sustainable corporate governance model, they identify corporate governance practices that promote a durable culture of sustainability within the organizations. Considering the evolving responsibility of navigating from national to global governance, the Company Secretaries play an integral role in driving awareness at Board level by advising the Board on adoption of best practices that facilitates the Board's understanding of compliance, Risk Management, ESG and Technology Governance.

The Corporate world looks upon the Company Secretaries to build a sustainable corporate governance model that can be benchmarked with international peers. To achieve this, they need to continually develop their skill sets to enhance their level of awareness required for the changing role through training and professional development programs. They also need to be responsive to changes to guide the organizations through more complex regulatory environment and closer stakeholder scrutiny in an integrated and holistic approach.

LESSON ROUND-UP

- The Company Secretary, whose position is unique within a company, plays a major role in encouraging and monitoring best practices. The role of a Company Secretary requires him to keep up-to-date with changes and new developments to understand their implications across a wide range of business activities. To remain a distinct professional, he fulfills his role and duties assiduously.
- The Company Secretary plays a much broader role of acting as an 'Advisor' to the Board to shoulder the responsibility for the organisation's corporate governance. The responsibility for developing and implementing processes to promote and sustain good corporate governance largely falls within the ambit of the Company Secretary. Irrespective of the type of company, the role of Company Secretary has expanded beyond simply ensuring statutory compliance to becoming a pivotal one where the skills of the Company Secretary can have a direct impact on the effectiveness of the Board and organisation and ensuring corporate governance being followed in true letter and spirit.
- As per Section 2(25) of the Companies Act, 2013, "Company Secretary in practice" means a Company Secretary who is deemed to be in practice under sub-section (2) of section 2 of the Company Secretaries Act, 1980.
- Section 203(1) of the Companies Act, 2013 provides that every company belonging to such class or classes of companies as may be prescribed shall have the following whole-time key managerial personnel Managing director, or Chief Executive Officer or manager and in their absence, a whole-time director; Company Secretary; and Chief Financial Officer.
- Section 203 of the Companies Act, 2013 read with Rule 8 of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014 provides that the every listed company and every other public company having a paid-up share capital of ten crore rupees or more shall have whole-time key managerial personnel.
- A Company Secretary as the Compliance officer of a company is responsible for the efficient administration of a company particularly with regard to ensuring compliance with the statutory and regulatory requirements. He is entrusted to interact, coordinate, integrate and cooperate with various other functional heads in a company, keep the board members informed of their legal responsibilities and also represent before the statutory and regulatory authorities on behalf of the company for ensuring compliances required under various laws.
- Every listed company and a company belonging to other class of companies as may be prescribed shall annex with its Board's report made in terms of sub- section (3) of section 134, a secretarial audit report, given by a Company Secretary in practice, in such form as may be prescribed. It shall be the duty of the company to give all assistance and facilities to the Company Secretary in practice, for auditing the secretarial and related records of the company.
- The Annual Return is a comprehensive document and contains information about the company relating to its share capital, directors, shareholders, changes in directorships, etc. Much reliance is placed on the annual return by the regulators, shareholders, judicial and other regulatory authorities. Section 92 of the Act provides that annual returns of companies shall be required to be certified by a Company Secretary in Practice. The certification shall be to the effect that the company has complied with all the provisions of the Act.

- A Company Secretary in Practice with requisite experience and after passing the examination can become a Registered Valuer for conducting valuation required under the Companies Act, 2013. A Registered Valuer may conduct valuation of securities or financial assets as per Companies (Registered Valuers and Valuation) Rules, 2017, if required under any other law or by any other regulatory authority. The field of valuation, as an area of activity is still untapped, demanding the presence of experts possessing the right knowledge and capabilities which brings upon the realisation that Company Secretaries as professionals can tap this huge opportunity.
- Company Secretaries having passed necessary examination, possessing prescribed number of years of experience, enrolled with an Insolvency Professional Agency and registered with Insolvency and Bankruptcy Board of India (IBBI) as an Insolvency Professional, can take up matters relating to corporate insolvency resolution process as Interim Resolution/Resolution Professionals, as well as also take up voluntary liquidation cases. They can also act as authorized representatives for a class of creditors in a meeting of Committee of Creditors in a resolution process.
- With their expertise in interpreting laws and skills to tackle and manage regulatory compliances under GST, Company Secretaries render value added services to the trade and industry while acting as extended arms of regulatory mechanism. A person having passed CS final examination is eligible for enrolment as GST Practitioner. Company Secretaries provide guidance and advisory services to business entities to interpret GST laws and assist in effectively discharging various compliances under GST while undertaking activities like tax planning, maintenance of GST records, drafting legal documents like replying to show cause notices, conducting impact analysis, etc.

TEST YOURSELF

(These are meant for recapitulation only. Answer to these questions are not to be submitted for evaluation.)

1. Company Secretary' plays a leading role of a Key Managerial Personnel (KMP) entrusted with the responsibility of the company's Corporate Governance. Critically Examine.
2. Discuss Advisory role of a Company Secretary.
3. "A whole-time key managerial personnel shall not hold office in more than one company". Examine the statement with the legal provisions of Companies Act, 2013.
4. When a member of the Institute shall be deemed to be in practice as per Company Secretaries Act, 1980?
5. Secretarial Audit Report and Secretarial Compliance Report are same. Analyse.

LIST OF FURTHER READING

- https://www.icsi.edu/media/webmodules/17112022_CSA_Preferred_Professional_Final.pdf

WARNING

Regulation 27 of the Company Secretaries Regulations, 1982

In the event of any misconduct by a registered student or a candidate enrolled for any examination conducted by the Institute, the Council or any Committee formed by the Council in this regard, may suo-moto or on receipt of a complaint, if it is satisfied that, the misconduct is proved after such investigation as it may deem necessary and after giving such student or candidate an opportunity of being heard, suspend or debar him from appearing in any one or more examinations, cancel his examination result, or registration as a student, or debar him from re-registration as a student, or take such action as may be deemed fit.

It may be noted that according to regulation 2(ia) of the Company Secretaries Regulations, 1982, 'misconduct' in relation to a registered student or a candidate enrolled for any examination conducted by the Institute means behaviour in disorderly manner in relation to the Institute or in or around an examination centre or premises, or breach of any provision of the Act, rule, regulation, notification, condition, guideline, direction, advisory, circular of the Institute, or adoption of malpractices with regard to postal or oral tuition or resorting to or attempting to resort to unfair means in connection with writing of any examination conducted by the Institute, or tampering with the Institute's record or database, writing or sharing information about the Institute on public forums, social networking or any print or electronic media which is defamatory or any other act which may harm, damage, hamper or challenge the secrecy, decorum or sanctity of examination or training or any policy of the Institute.

PROFESSIONAL PROGRAMME
BANKING & INSURANCE – LAWS & PRACTICE
GROUP 2 • ELECTIVE PAPER 7.4

(This test paper is for practice and self-study only and not to be sent to the Institute)

Time Allowed: 3 Hours *Maximum Marks: 100*

All questions are compulsory.

Marks for each question is indicated alongside of the question.

PART I : BANKING LAWS (50 MARKS)

Question No. 1

Every organization faces risks in their operations. Banking organizations too are prone to risks which need to be managed. Banks being financial sector organizations face risks - some originate within the organization and some outside the organization. If these risks are not properly managed, they have the potential to destabilize not only a particular bank, but can create system wide chaos. To manage these risks regulatory bodies have given directions and guidelines which need to be followed and implemented as applicable in the respective cases of each bank.

The Banking sector has a very important role in the development of the economy of any country. As one of the key drivers of economic growth of a country, banking sector plays a pivotal role in making use of idle funds for nation-building. The foundation of a strong economy depends on how strong the Banking sector is and vice versa. Banking is always considered to be a very risky business. In the context of Banking, Risk' can be defined as the potential loss from a banking transaction - in the form of a loan, or investment in securities or any other transaction that a bank undertakes for itself or for its customer.

Banks are exposed to both, financial (e.g. monetary loss) as well as non-financial (e.g.. reputation loss) risks. Basic function of any bank is to accept funds from public for the purpose of lending and investment. In case something goes wrong, banks can collapse and failure of one bank is sufficient to send shock waves right through the economy." It is imperative that bank managements must be very careful in identifying the types as well as the degrees of risk exposure and mitigate them positively. Therefore, banks must recognise risk management as an ongoing and unavoidable activity with the active participation of the Board of Directors.

In economic / financial / business activities risk is directly proportional to returns, higher the risk a bank takes, it can expect to gain more profits. However, greater risk also increases the danger that the bank may incur big losses and can be out of the business and perhaps out of existence. In fact, today, a bank must run its operations with twin objectives in mind - generate profit and stay in business. However, banks must ensure that their risk-taking decisions are measured, informed and prudent.

The Basel Committee has put forward a framework consisting of three options for calculating operational risk capital charges in a 'continuum' of increasing sophistication and risk sensitivity. These are, in the order of their increasing complexity, viz., (i) the Basic Indicator Approach (ii) the Standardised Approach and (iii) Advanced Measurement Approaches. Though the Reserve Bank proposes to initially allow banks to use the Basic Indicator Approach for computing regulatory capital for operational risk, some banks are expected to move along the range toward more sophisticated approaches as they develop more sophisticated operational risk management systems and practices which meet the prescribed qualifying criteria.

As a step towards enhancing and fine-tuning the risk management practices as also to serve as a benchmark for banks, the Reserve Bank of India had issued Guidelines from time to time for banking risk.

In view of the above, answer the following questions:

a) Banking sector is very uncertain and involves various types of risks. Which are the different types of risks involved in banking sector in India?

b) Reserve Bank of India (RBI) is the Central Bank of India. Explain various measures taken by RBI to avoid the risks in banking sector.

c) Banks are required to classify Non Performing Assets (NPAs) into three categories, based on the period for which the asset has remained Non Performing. Which are these categories and how a bank can reduce Non Performing Assets in Bank?

d) Discuss briefly the stages of Risk Management.

e) Basel III guidelines were released by Basel Committee on Banking Supervision (BCBS). Basel III framework is based on 3 components called 3 pillars. Explain the features of Basel III and which are those three pillars on which Basel III is based?

(5 Marks each)

Question No. 2

(i) ABS Bank is an American bank that want to open its Branches in India. The Concerned team approached you to open a branch or local office in India. Advise the ABS bank in this regard.

(ii) Mr. Bhwani is non-resident Indian and settled in Canada from last 15 years. He had one savings bank account in India which was not operated in last 15 years. He needs some money and wants to transfer his money to his account in Canada. He sent a mail for this to his branch in India, but the bank denied to transfer the money. As per the reply received from bank the amount deposited in his Savings bank account was transferred to an account under Depositor Education and Awareness Fund Scheme. What is Depositor Education and Awareness Fund Scheme and how Mr. Bhawani can transfer his money to his bank account in Canada?

(5 Marks each)

Question No. 3

(i) Mr. Jain is working as CFO in a private company in Delhi which deals in Solar panel. His company wants to avail credit facility from a private bank to complete one new big proposal in Saudi Arabia. Advise the company regarding credit facilities are available for a company?

(ii) Amrawati Private Limited is dealing in car batteries and export to different counties around the world. In year 2022 two counties had war due to which overseas payments were stuck. Society for Worldwide Inter-bank Financial Telecommunications (SWIFT) denied to accept payment for those two counties due to war. What is SWIFT and what are the other alternatives to make payment outside India?

(5 Marks each)

Question No. 4

(i) Mr. Bhuwan is 25 years old and working in a private sector company. He wanted to investments to secure his postretirement life and want to take Atal Pension Yoina. Explain the scheme Afal Pension Yoiana. What are the benefits and eligibility criteria of this scheme?

(5 Marks)

PART II : INSURANCE LAWS (50 MARKS)

Question No. 5

Ashwini, aged 30 years, was employed as a supervisor in a bank. On 4th June, 2018, he took two life endowment insurance policies on his life for 50,000 each from Prudent Life Insurance Co. Ltd. Each policy had a different maturity term and period. Both the policies had accident claim benefit of an equivalent amount, viz. in the case of death of the insured due to an accident, the amount payable by the insurer would be twice the amount of the sum assured. Ashwini made his wife Smt. Asha as his nominee under the policies and also the legal assignee, since the couple had no issues then.

On 31st May, 2020, Ashwini while going to his office on his two-wheeler was involved in a head-on collision with a motor car coming from the opposite direction and was severely injured. He was admitted to a hospital, but succumbed to the injuries and died in the hospital on the morning of 2nd June, 2020.

Smt. Asha filed a claim under the policies with the insurer for payment of the sum assured together with the accident benefits. The company, after processing the claim, informed her on 15th July, 2020 that they were rejecting the claim on the ground that Ashwini, while taking the policies, had suppressed material facts.

The insurer indicated that Ashwini did not mention in the proposal form, the fact of an earlier ailment of having suffered from para-typhoid in June - July, 2016 and having been away from his employer on medical leave between 6th June, 2016 and 5th July, 2016.

The nominee filed a complaint on 18th August, 2020 with the District Consumer Forum stating that the repudiation of the claim was not justified. The insurer reiterated its argument that the on-mention of the previous ailment to it was a suppression of material facts and affected the fundamental nature of the contract.

The District Consumer Forum on consideration of the arguments before it held in favour of the insurer agreeing with it that the deceased had suppressed material facts at the time of the proposal.

Smt. Asha, not accepting the decision of the District Consumer Forum, filed an appeal with the State Forum. Her counsel contended before the Forum that even if the deceased had suffered from para-typhoid less than two years prior to obtaining the policies and did not give the necessary information in the proposal form, it did not amount to a material suppression of facts. His main argument was that the cause of death was the accident with the motor vehicle and the cause had no nexus whatsoever with the alleged ailment. Thus, there was no suppression of facts.

The State Forum after hearing the arguments of both the parties, allowed Smt. Asha's appeal and held that the cause of death was accident and not illness. The non-mention of the fact of illness and hospitalisation did not amount to any non-disclosure of material facts. The Forum granted the relief asked for and directed the insurance company to pay Smt. Asha Rs. 2,00,000 under the policies. The decision taken on 6th January, 2021 also entitled the nominee with interest at 9% per annum from the date of filing the claim, viz. 18th August, 2020.

From the information given above, answer the following questions.

(a) Was the State Forum justified in its conclusion in terms of the conditions of life policies issued by Indian insurance companies? Give reasons for your answer.

(b) If Ashwini had died on account of an illness, and not in an accident, will the decision of the State Forum be different? Give reasons.

(c) What are the provisions of the Insurance Act, 1938 regarding the time-limit beyond which the terms of a life insurance policy cannot be questioned?

(d) What do you mean by 'guaranteed surrender value' in a life policy?

(e) Can a discontinued life insurance policy be revived by the insured and if so under what circumstances and on what terms?

(5 Marks each)

Question No. 6

(i) "Insurance plays an important role in financial planning as a tool for asset protection and also for tax efficient investment". Explain.

(ii) Mr. Bharat is running a provisional store. He lives in a joint family with his wife, two children and his parents. He wants to purchase a Mediclaim policy for his family. Briefly discuss the different categories of Health Insurances plans. Advise him on the suitable Insurance policy for joint family.

(5 Marks each)

Question No. 7

(i) Mr. A need some urgent money for his business but he does not have any property for security. The Branch manager suggested him to assign his life insurance policies in favour of bank as security. Explain the term assignment in relation with insurance policy.

(ii) Mr. Y Purchase a policy in 2015 and he paid the insurance premium till 2019. Due to some financial problems, he could not pay his premium in year 2020 and 2021. Now he wants to surrender his policy and approached the insurance company to return his premium paid from 2015 to 2019. The insurance company said that he can claim for surrender value of the policy. Explain the concept of surender value with respect to insurance policy. Can Mr. Y take paid up value of his policy?

(5 Marks each)

Question No. 8

Anil, an individual, has taken with Urban Insurance Co. Ltd, a fire policy against his residential property, for a sum assured of Rs. 3,00,000. The cover valid till the end of September, 2022. On 20th May, 2022, an accidental fire takes place and the entire building is gutted and damaged. Anil prefers a claim with the insurance company. The claim is rejected on the ground of negligence on Anil's part. Representations made by Anil to the insurer against such a rejection were not successful.

What options are left to Anil to proceed further in this regard? Discuss.

(5 Marks)

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