DIRECTORATE OF DISTANCE EDUCATION

M.Com.,

IV SEMESTER

33544 - BANKING AND INSURANCE
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UNIT – I BANKER AND CUSTOMER

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1.1 INTRODUCTION
Today banks have become a part and parcel of our life. There was a time when the dwellers of city alone could enjoy their services. Now banks offer access to even a common man and their activities extend to areas hitherto untouched. Apart from their traditional business oriented functions, they have now come out to fulfil national responsibilities. Banks cater to the needs of agriculturists, industrialists, traders and to all the other sections of the society. Thus, they accelerate the economic growth of a country and steer the wheels of the economy towards its goal of “self-reliance in all fields.” It naturally arouses our interest in knowing more about the ‘bank’ and the various men and activities connected with it.

1.2 ORIGIN OF BANKING
Since the banking activities were started in different periods in different countries, there is no unanimous view regarding the origin of the word ‘bank’. The word, ‘Bank’ is said to have derived from the French word ‘Banco’ or ‘Bancus’ or ‘Banque’ which means, a ‘bench’. In fact the early Jews in Lombardy transacted their banking business by sitting on benches. When their business failed, the benches were broken and hence the word ‘bankrupt’ came into vogue. But, Macleod in his book, ‘Theory and Practice of Banking’ has expressed a different view. According to him, the money changers were never called ‘Benchieri’ in the Middle ages. So, this derivation may be a mere conjecture.

Another common-held view is that the word ‘bank’ might be originated from the German word ‘Back’ which means a joint stock fund.
Of course, a bank essentially deals with funds. In due course, it was Italianised into “banco”, Frenchised into ‘bank’ and finally Anglicised into ‘bank’. This view is most prevalent even today.

1.3 BANKER

A person who is doing the banking business is called a banker. But, it is not at all easy to define the term ‘banker’ precisely because a banker performs multifarious functions. First, a banker must be a man of wisdom. He deals with others’ money but with his own mental faculties. Secondly, a banker is not only acting as a depository, agent, but also as a repository of financial advices. The scope of activities of a banker is ever expanding. Thus, a banker is dealing with the field of banking which is highly dynamic, complex and sophisticated and which must cater to the ever growing requirements of millions of people belonging to different strata of society. the banks have diversified their activities on an accelerated pace to cater to the sophisticated needs of corporate clients and other segments of trade and industry. Hence, the banking terminology seems to be the most incomprehensible one.

Still, some attempts have been made to define the term ‘banker’ This can be studied under the following heads:

Earlier Views

The early definitions were not positive in the sense, they did not point out any of the functions performed by a banker. For instance, The Bill of Exchange Act of 1882 defines the banker thus “ Banker includes a body of persons whether incorporated or not who carry on the business of banking” So also Sec. 3 of the Negotiable Instruments Act States that “ the term banker includes a person or a corporation or a company acting as a banker. “ These definitions are vague. They amount to saying that a person who acts as a banker is a banker.

Experts’views

Later on, some attempts were made by experts to define the term ‘banker’ Among them the most important ones are the following

Macleod’s view According to Macleod “ The essential business of a banker is to buy money and depts by creating other debts. A banker is essentially a dealer in debts or credit
Dr. Hart’s view Dr. L. Hart states in his book ‘Law of Banking’ that a banker is one who in the ordinary course of his business honours Cheques drawn upon him by persons from and for whom he receives money on current accounts.

Sir John Paget’s view Sir John Paget in his book ‘Law of Banking’ defines the term banker as follows “That no person or body corporate or otherwise can be a banker who does not (i) take deposit accounts (ii) take current accounts (iii) issue and pay cheques and (iv) Collect cheques crossed and uncrossed for his customers. He embellishes his definition by adding that one claiming to be a banker must profess himself to be a full time banker and the public must accept his as such and his main business must be that of banking from which, generally, he should be able to earn his living.

All these experts have pointed out some aspects of a banker. They are the following receiving deposits of various kinds, lending money or creating credit, issuing cheques, honouring cheques and collecting cheques. These are the essential functions of a bank. However, these definitions do not include any agency and general utility services rendered by modern bankers.

Indian view

The definition given in India in the banking Regulation Act appears to be more precise and acceptable. Thus Sec. S(B) of the above mentioned act defines the term ‘Banking company’ as “a company which transacts the business of banking, and the term ‘Banking’ has been defined as “Accepting for the purpose of lending and investment, of deposits of money from the public, repayable on demand, order or otherwise and withdrawable by cheque, draft order or otherwise.” This definition also pinpoints the principal functions of a banker, namely receiving deposits, lending or investing these deposits and repaying these deposits on demand by cheque or otherwise. Even this definition does not indicate the subsidiary services rendered by the bankers. By now, it is quite evident that no definition of the term ‘banker’ will be a complete one.

1.4 BANKING AND OTHER BUSINESS

In this connection an interesting question may arise as to whether to call a moneylender a banker or not. Traditionally money lenders and
indigenous bankers have been advancing loans. But they don’t receive deposits from the public. They rely upon their own resources. In Samyukta samajan Vs. GoliKalyani, it was held that the firm lending money out of its own capital was not a bank. moreover their main business in not banking. They used to combine banking with trading business. In Stafford Vs. Henry it was held that carrying on banking business as a part of any business would not entitle a man to be called a banker. Similarly these money lenders do not issue cheques which is one of the essential functions of the bankers. Hence, moneylenders and indigenous bankers are not regarded as bankers in the strict sense of the term.

Some financial institutions like I.F.C., S.F.C., I.D.B.I. Co-operative Land Development Banks etc., are providing loans to industries and agriculturists. They are not regarded as banks since they do not accept deposits from the public regularly. Of late, many business houses and industries have begun to invite fixed deposits from the public by offering attractive rates of interest. They can not be strictly called banks because they don’t lend and they don’t issue any cheques.

**1.5 CUSTOMER**

It is equally difficult to define the term ‘customer’. Different views have been expressed at different times. Even under the law, the term ‘customer’ is not defined. But this term ‘customer’ is of much significance to a collecting banker because he can get protection under Sec.131 of the Negotiable Instruments Act only if he collects a crossed cheque for his customer in good faith and without negligence. Thus to solve many of the disputes that may arise in banking transctions, a clear – cut definition of the term customer is essential. Who is then a customer?

To have a proper understanding of this subject, a study of the term ‘customer’ as they obtained at different stages can be made.

**Early Stage – Some Sort of an Account**

In early periods a man who held some sort of an account was considered to be a customer. In Great Western Railway Co., Vs. London and county Bank it was held that “there must be some sort of Account – either customer of a bank. “ The opening of an account is the only qualification needed by a man to become a customer. This argument appears to be logical. However, in those days other different opinions were
also prevalent. For instance Lord Brampton was of the view, “It is not necessary to say that the keeping of an ordinary banking account is essential to constitute a person customer of bank.” It is not prudent to call a person having no account a customer and so it is totally unacceptable. Thus, we can say that some sort of an account is necessary for a person to be called a customer.

Second Stage — Frequency of Transactions

At this stage, some refinements were made to the early definitions. Since the word customer itself implies a custom, Sir John Paget puts forth a different view. According to him, “to constitute a customer there must be some recognisable course or habit of dealing in the nature of regular banking business.” Hence, a person can not become a customer on mere opening of an account and so there must be frequent transactions so as to establish a recognisable course between a banker and his customer. Thus, Sir John Paget gives importance to the time element and therefore his theory is popularly known as the ‘duration theory’. The same view was expressed in the case of Mathews Vs. Williams Brown & Co. His view regarding the dealing of banking nature has been universally accepted. But his view about duration’ is subject to several criticisms. It is very difficult to say how many transactions will make a person a customer or how much time should elapse between two successive transactions to qualify a person as a customer.

Modern view- Single Transaction

The eminent jurists in recent times have completely exploded the view expressed by Sir John Paget. According to them even a single transaction can constitute a person a customer. They have gone to the extent of saying that the moment a banker has agreed to collect a cheque for a person, the latter becomes a customer. It means that a person becomes a customer the moment his banker agrees to admit him as a customer. Thus, in Ladbroke Vs. Todd Justice Bailhache rightly observed: “the relation of banker and customer begins as soon as the first cheque is paid in and accepted for collection not merely when it is paid.” Commenting upon the case Lord Chorely observed: “By accepting a request to open an account, the banker enters into a contract with the offeror in which it is considered that such a continuous relationship is implicit.” Again, the same
view was expressed in Commissioner of taxation Vs. English Scottish and Australian Bank wherein it was confirmed by Lord Dunedin that “the word customer signifies a relationship in which duration is not of the essence.” It is now beyond doubt that neither the number of transactions nor the period is material in deciding whether or not a person is a customer. In Savory &CoVs. Lloyds Bank Ltd. Mr. Smith had instructed the Lloyds Banker to collect the cheques stolen by him and credit them to his wife’s account at the Red Hill Branch. His wife didn’t have any account at all. But, it was held that Mrs. Smith became a customer from the moment the banker had accepted those cheques for collection.

Moreover a person does not become a customer by virtue of the bank performing a casual service like accepting valuables for safe custody or giving change for a hundred rupee currency note for him. Hence the dealing must be of a banking nature.

To sum up, the following are the prerequisites to constitute a person as a customer:

(a) He must have some sort of an account.
(b) Even a single transaction may constitute him as a customer.
(c) Frequency of transactions is anticipated but not insisted upon.
(d) The dealings must be of a banking nature.

1.6 RELATIONSHIP BETWEEN BANKER AND CUSTOMER

Any dispute between two parties can be settled only on the basis of the nature of the existing relationship between the two. Hence, it is imperative that one should know the exact relationship between the banker and the customer. This relationships falls under two broad categories namely (i) general relationship and (ii) special relationship.

1.7 GENERAL RELATIONSHIP

1.7.1 Is there a Depository Relationship? When a person opens an account with a banker there arises a contractual relationship by implication. Once, the banker was thought of a depository. This was the case during the period of Goldsmiths of London. A depository is one who receives some valuables and returns the same on demand: But at present, a banker is not bound to return the same coins and currency notes deposited by a
customer. Instead, he is required to give the same amount. So, he is not a depository. If a customer insists upon the return of the same coins and currency notes, then a banker can not run his main business namely lending. Moreover, if a banker is acting as a depository, he can not make use of the money to his best advantage. A banker has to make use of the money in deposit with him for earning the maximum profit and the whole income is not returned to the customer. Only a part of it is returned to the customer. That is why Lord Cottenham rightly observed in Foley Vs. Hill “the money paid into a bank ceases altogether to be the money of the principal; it is then the money of the banker. He is known to deal with it as his own …… He is bound to return an equivalent by paying a similar sum that deposited with him when he is asked for it."

**A banker as a bailee:** A banker becomes a bailee when he receives gold ornaments and important documents for safe custody. In that case he can not make use of them to his best advantage because he is bound to return the identical articles on demand. Moreover, a banker can not acquire any title in respect of stolen articles. A banker does not allow any interest on these articles. It is only the customer who has to pay rent for the lockers. So, a banker acts as a bailee only when he receives articles for safe custody and not when he receives money on deposit account.

1.7.2 **Is there a Trustee Relationship?** Prof. Keeton defines a trust as ‘a relationship which arises wherever a person called trustee is compelled in equity to hold property, whether real or personal by legal or equitable title for the benefit of some person.’ If a banker is regarded as a trustee, he can not make use of the money deposited by a customer to his best advantage. He will be bound by the trust deed and he will have to render an account for everything he does with the money. For this reason he is not a trustee when he opens an account for a customer.

**A banker as a trustee:** A banker becomes a trustee only under certain circumstances. For instance, when money is deposited for a specific purpose, till that purpose is fulfilled the banker is regarded as a trustee for that money. In Official Assignee of Madras Vs. J.W. Irwin a certain sum of money was deposited with the bank with the specific instruction to buy shares. When that bank failed, it was held that the banker was a trustee for
that part of the amount which was earmarked for the specific purpose. So also, when a cheque is given for collection, till the proceeds are collected, he holds the cheque as a trustee. But the proceeds are not to be held in trust. That is why Lord Justice Atkin has rightly observed in Joachinson Vs. Swiss Banking Corporation, “The bank undertakes to receive money and to collect bills for its customer’s account. The proceeds so received are not to be held in trust for the customers’ but the bank borrows the proceeds and undertakes to repay them.”

1.7.3 Is there an Agent Relationship? Section 182 of the Indian Contract Act defines an agent as one employed to do any act for another or to represent another in dealing with third person.

When a banker receives deposits from the customers, he is not regarded as an agent of his customers. If he acts as an agent, he should use the deposit money according to the instructions of his principal (customer) in return for a remuneration for this agency service. But this is not the case. The agent is also accountable to the principal and as such the banker should give a detailed list of how he used the deposit money, the income earned thereon and so on. The whole income should go to the customer.

A banker as an agent: The agent - principal relationship is said to exist between a banker and his customer, when the banker buys and sells shares, collects cheques, bills, dividend warrants, coupons and pays insurance premia, subscriptions etc., on behalf of his customer. The banker is acting as an agent of his customer under such circumstances. So also when he executes the will of a customer, he is acting as an Executor; when he administers the estate of a customer he is regarded as an Administrator. This kind of relationship doesn’t exist when he receives deposits from a customer.

1.7.4 What then is the Relationship? At this stage we are curious to know the exact nature of the relationship that exists between a banker and his customer. When a banker receives deposits from a customer, he is technically said to borrow money from the customer. So, he is acting as a debtor who is bound to return the money on demand to his creditor namely his customer.
**Debtor-creditor relationship:** According to Sir John Paget “The relation of a banker and a customer is primarily that of a debtor and a creditor, the respective position being determined by the existing state of the account. Instead of the money being set apart in a saferoom it is replaced by a debt due from the banker. The money deposited by a customer with the banker becomes the latter’s property and is absolutely at his disposal.” Hence, there exists a relationship of debtor and creditor; the banker, being the debtor, is bound to repay the deposit as and when the customer asks for it.

**The banker as a privileged debtor:** A banker, as a debtor is not the same as an ordinary commercial debtor. An ordinary commercial debtor’s duty is to seek out the creditor and pay the money. But a banker as a debtor enjoys many privileges and hence he is called a privileged debtor. The privileges enjoyed by a banker have been listed below: (1) The creditor i.e. the customer must come to the banker and make an express demand in writing for repayment of the money. According to the decision given in Joachinson Vs. Swiss Banking Corporation an express demand by a customer in writing is essential to get back the deposit money. But for this privilege, the banker will have to go to the very doors of thousands of his customers and find out whether or not they are in need of money. This will be detrimental to the very business of banking. (2) In the case of an ordinary commercial debt the debtor can pay the money to the creditor at any place. But, in the case of a banking debt, the demand by the creditor must be made only at the particular branch where the account is kept. It was held in Clare & Co. Vs. Dresdner Bank, that locality is an essential element in a banking debt and the banker should pay the money only when the demand is made at the branch where the account is kept. (3) Time is not an essential element in the case of an ordinary commercial debt whereas the demand for repayment of a banking debt should be made only during the specified banking hours of business which are statutorily laid down. In Arab Banks Vs. Barclays Bank it was held that a banker is liable to honour a cheque provided it is presented during the banking hours. (4) The banker is able to get the deposit money without giving any security to the customer while it is not possible in the case of an ordinary debtor. Thus the customer is acting only as an unsecured creditor. It is really an enviable
privilege given to the banker. (5) The Law of Limitation which is applicable to all debts lays down that a debt will become a bad one after the expiry of three years from the date of the loan. But this Law is not applicable to a banking debt. According to Article 22 of the Law of Limitation Act, the period of 3 years will be calculated from the date of demand for repayment of the banking debt and not from the date of the deposit. Practically, when the demand is made, the banker will return the money immediately and so this Law does not apply to a banking debt. Otherwise, the customers will be deprived of their deposits on the ground that they have become bad debts by being not withdrawn within 3 years from the date of the deposit. This will not be conducive to the smooth running of the banking business. Thus, a banker is a highly privileged debtor who is not bound to repay the debt unless an express demand by the customer in writing is made at the branch where the account is kept and during the banking hours. (6) A banker as a debtor has the right to combine the accounts of a customer provided he has two or more accounts in his name and in the same capacity. This is another of his privilege. In early days, a banker was allowed to combine the accounts of a customer even without obtaining the permission of the customer as was decided in the case of Garnett Vs. Mckervan. However, prudence demands the banker getting the consent beforehand for exercising his right to combine the accounts. Now it has been clearly established in Greenhalgh Vs. Union Bank of Manchester that a banker can combine the accounts of a customer only after getting the consent of his customer. It is advisable on the part of a banker to get a letter of set-off duly signed by a customer at the time of his opening two or more accounts. This will avert many complications. This letter of set-off permits the banker to exercise the right to set-off even without giving any prior notice to his customer. (7) Similarly, an ordinary debtor can close the account of his creditor at any time. But a banker cannot close the account of his creditor at any time without getting his prior approval.

A banker as a creditor: The debtor-creditor relationship holds good in the case of a deposit account. But in the cases of loan, cash credit and overdraft, the banker becomes a creditor and the customer assumes the role of a debtor. Here again, the banker is a privileged person because he is
acting as a secured creditor. He insists upon the submission of adequate securities by the customer to avail of the loan or cash credit facilities. Moreover, the Law of Limitation will operate in such cases from the date of the loan unless it is renewed.

1.8 SPECIAL RELATIONSHIP
Apart from these general features of the relationship, there exists some special features which are discussed hereunder:

Statutory Obligation to Honour Cheques
When a customer opens an account there arises a contractual relationship between the banker and the customer by virtue of which the banker undertakes an obligation to honour his customer’s cheques. This obligation is a statutory obligation since Sec. 31 of the Negotiable Instruments Act compels a banker to do so. Sec. 31 runs as follows:

“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.”

Limited Obligation
Eventhough law compels a banker to honour all cheques, he can not blindly honour all cheques. Thus this obligation is not an absolute but only a qualified one. The statutory obligation to honour cheque is limited in the following ways:

(a) The availability of money in the account of the Customer: A banker’s obligation to pay a cheque is subject to the amount available in the deposit account. If there is no sufficient, balance, the banker is justified in overriding his obligation. At times, this obligation may be extended to the extent of the overdraft or cash credit sanctioned by the banker. If there is a prior arrangement for O.D., the banker is bound to honour the cheque as was decided in the case of Rayner & Co. Vs. Hambros Bank.fi a banker, by mistake, honours a cheque in the absence of sufficient balances, it will be taken as a precedent and he will be expected to pay cheques in future also in the absence of sufficient balance.

(b) The correctness of the cheque: The obligation to pay a cheque
depends upon the correctness of the cheque. All the required particulars like the date, name of the payee, amount in words and figures and the signature of the drawer ought to have been correctly filled in.

(c) Proper drawing of the cheque: The cheque will be honoured only when it is drawn according to the requirements of law. It must be drawn on an printed form supplied by the banker and it should not contain any ‘request’ to pay the amount.

(d) Proper application of the Funds: The banker will honour a cheque only when the funds are meant for its payment. For instance, if trust funds are withdrawn by a cheque for private use, the banker will not honour it.

(e) Proper presentation: The banker will undertake to honour cheques provided they are presented at the branch where the account is kept and during the banking hours. If the cheques are presented after six months from the ostensible date of issue, they will be regarded as Stale cheques and they will not be honoured. So this obligation of the banker to honour cheques is conditioned by the proper presentation of cheques.

(f) Reasonable time for collection: A customer can not impose on the banker a condition that the latter should pay his cheques blindly even when they are drawn against cheques sent for collection before they are collected. In Underwood Vs. Barclays Bank, it was held that in the absence of an express or implied agreement giving the customer a right to draw cheques against uncleared items, a banker is entitled to return such cheques with the remarks “Effects not Cleared.”

(g) Existence of legal bar: A banker is relieved from his statutory duty of honouring his customers’ cheques if there is any legal bar like Garnishee Order attaching the customer’s account.

**Overriding the Obligation**

When a banker overrides his statutory obligation and dishonours a cheque on reasonable grounds discussed above, the banker is justified in doing so. However, if he dishonours a cheque by mistake, it amounts to a
wrongful dishonour. In such a case, the banker is violating the provisions of law and hence he should be penalised for his offence. Thus a banker may fail to honour a cheque by over-sight. It amounts to saying that the banker is negligent in his duty of paying cheques and there is a breach of contract between the banker and the customer. To err is human and so inspite of all his careful observation of the procedures laid down, a banker may, by chance, dishonour a cheque even though it is good for payment. When a banker does so, he brings injury to his customer’s credit for which he is liable to compensate the customer for any loss or damage caused to him.

In Marzetti Vs. Williams,

Lord Teterden rightly observed “It is discredit to a person and therefore injurious, fact, to have payment refused of a cheque!draft ................. it is an act particularly injurious to a person in trade.”

**Liability to the Customer Only**

When a cheque is wrongfully dishonoured, a banker is liable only to his customer who happens to be the drawer of the cheque in question and he is not at all liable to any other parties.

In Jagjivan Manji Vs. Ranchhod das Meghji, it was held that the liability of the banker for wrongful dishonour is only towards the drawer or the customer and not towards the payee or the holder of the cheque.

**Assessment of Damages**

As per Sec. 31 of the Negotiable Instruments Act, if a banker wrongfully dishonours a cheque, he has to compensate for any loss or damage suffered by the customer. The word ‘loss’ or ‘damage’ as mentioned in Sec. 31 of the N. I, Act does not depend upon the actual amount of the cheque but upon the loss to one’s credit or reputation. That is why “the smaller the amount of the cheque, the greater the damage” principle is adopted. In fact, the customer suffers more loss of credit when a cheque for a small amount is dishonoured.

**Ordinary Damage Vs. Special Damage**

A banker is always liable to pay damages for wrongful dishonour of cheques. The damage may be of two kinds: (i) ordinary damage or nominal damage and (ii) special damage or substantial damage. As a general rule, a
customer must always prove and plead for his loss. He will get only nominal damages. But there are two exceptions to this. Under the following two circumstances, a special damage can be claimed:

(i) an action brought forth for breach of marriage.

(ii) an action brought forth by a businessman having sufficient funds for the wrongful dishonouring of his cheque.

A banker is primarily concerned with the second case and he has nothing to do with the first one. In assessing damages, the loss to one’s credit or reputation is mainly taken into account. A trader-customer is supposed to suffer more in credit if his cheque is dishonoured. Non-traders are generally allowed only ordinary damages for wrongful dishonour, because, it will not affect their credit much. If the dishonour of the cheque is wilful, the banker is liable to pay vindictive damages. Thus, a customer can proceed against the banker for wrongful dishonour on the following grounds:

(i) Breach of contract, (ii) Negligence and (iii) Libel.

Hence, the words ‘loss or damage’ as appearing in Sec. 31 imply the following:

a) damage for the breach of the contract to pay cheques,

b) damage to the drawer’s general business,

c) damage to his general reputation and credit, and

d) damage for the negligence of the banker.

Case Law Illustration

In New Central Hall Vs. United Commercial Bank Ltd., it was held that a trader could get special damage as the dishonour of a cheque would affect his major asset namely his credit and a non-trader could claim only nominal damages. In Gibbons Vs. Westminster Bank, Mrs. Gibbons, a non-trader, had issued a cheque for a sum of £9 16sh in favour of her landlord towards the rent. Owing to a mistake, it was dishonoured. The court awarded only a nominal damage of sh 40 since, she happened to be a non-trader. In Sterling Vs. Barclays Bank Ltd., the banker had wrongfully dishonoured Mrs. Sterling’s cheque. Though Mrs. Sterling was a trader, the court awarded only nominal damages since she had two cheques dishonoured previously and also people of that trade did not worry about
their cheques being dishonoured as they led a hand-to-mouth existence. In Davidson Vs. Barclays Bank Ltd., the banker of a bookmaker had dishonoured a cheque for a small sum of £ 2-15sh by mistake. Taking into account his business and the amount of the cheque, he was awarded a special damage of £ 250. Hence, in assessing damages, the courts of law give due weight to factors like the financial position, business reputation and the custom of trade.

In Canara Bank Vs. I. V. Rajagopal, the banker had dishonoured by mistake a cheque for Rs. 294.40 drawn by a non-trader customer Mr. I. V. Rajagopal. It was proved in the court that this erroneous dishonour led to the termination of his employment. The court found that the customer had suffered much damage and so a special damage of Rs. 14,000/- was awarded to the customer.

Thus, generally a non-trader customer is not entitled to recover substantial damages. However, the damages which he has suffered is alleged and proved, he can claim special damages.

It is evident from the above case law illustrations that the damage will be assessed on the basis of the loss to one’s credit or reputation, irrespective of the fact whether he is a trader or non-trader, though non-traders are not generally entitled to claim special damages.

**Is there any obligation to pay bills?** Even though there is no statutory obligation on the part of a banker to honour the bill of a customer, modern bankers undertake the duty of paying the bills on behalf of their customers. When a customer accepts a bill and makes it payable at his bank, it is called domiciliation of a bill. If a bill is so domiciled, the banker should pay it on the due date.

**Prior Arrangement**

Bankers generally do not render this service unless they are appointed to do so by their customers. A customer should have made prior arrangements with his banker to honour such domiciled bills. Otherwise, it will be taken as a precedent and he will be expected to do so in future also.

**Indemnity Bonds**

In the absence of any compulsion from outside, a banker voluntarily...
takes up the duty of honouring a bill just to please his customer and thus to render him some service. But he should keep in mind that the statutory protection extended to cheques under Sec. 85 of the Negotiable Instruments Act is not extended to the payment of bills. So, in his own interest, he should demand an indemnity bond from his customer for whom he renders this service. This bond safeguards the banker against possible losses that may arise on account of the payment of a bill.

**Precautions**

Inspite of the above mentioned safeguards, a banker should observe the following additional precautions. He must see:

a) whether all the particulars in the bill are correctly filled in.

b) whether it is adequately stamped.

c) whether it is due for payment.

d) whether the signature of his customer on the bill is genuine.

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**1.9 BANKER’S LIEN**

Another special feature of the relationship existing between a banker and his customer is that a banker can exercise the right of lien on all goods and securities entrusted to him as a banker.

**Right to Retain the Goods**

A lien is the right of a person to retain the goods in his possession until the debt due to him has been settled. For instance, a creditor who has in his possession, goods of his debtor, may have a lien over the goods in respect of the money due by the debtor. This right to retain goods as security is known as lien. According to Sec.71 of the Indian Contract Act “Bankers …… may in the absence of a contract to the contrary, retain as security for a general balance of account, any goods bailed to them ……”

**Kinds of Lien**

Lien is of two kinds - particular lien and general lien. A particular lien is so called because it confers a right to retain the goods in connection with which a particular debt arose. In other words, a particular lien applies to one transaction or certain transactions only. For example, a watchmaker has a lien over the watch till the repair charges due from the owner of the watch are paid to him. General lien, on the other hand, gives a right to a banker to retain the goods not only in respect of a particular debt but also
in respect of the general balance due from the owner of the goods to the person exercising the right of lien. It extends to all transactions and din's it is more extensive than that of a particular lien.

**A Banker's Lien**

A Banker’s lien is always a general lien. A banker has a right to exercise both kinds of lien. His general lien confers upon him the right to retain the securities in respect of the general balance due from the customer. In Brandao Vs. Barnett it was held, “Bankers most undoubtedly have a general lien on all securities deposited with them as bankers by a customer unless there is an express contract or circumstances that show an implied contract inconsistent with lien.”

**Circumstances for Exercising Lien**

If the following conditions are fulfilled, a banker can exercise his right of lien:

a) There must not be any agreement inconsistent with the right of lien.

b) The property must come into the hands of a banker in his capacity as a banker (qua banker).

c) The possession should be lawfully obtained in his capacity as a banker.

d) The property should not be entrusted to the banker for a specific purpose.

These are the four vital factors of a banker’s lien.

**Lien can not go beyond the agreement**

In C. R. Narasimha Setty Vs. Conor a Bank (1990) the plaintiff Mr. C. R. Narasimha Setty had purchased a vehicle under a hire purchase finance by executing a hypothecation deed. Subsequently, the banker exercised a lien on the vehicle by seizing it for the amount still due Rs. 3594.90 (ground rent charges, seizure charges etc.) and also for the open cash credit limit of Rs. 50,000/- sanctioned to a firm in which he was a partner and for which the vehicle was offered as a collateral security only. The plaintiff contended that no right of lien was available to the banker in respect of the debt due by the firm.
Decision

It was held that the banker could not exercise his lien on the vehicle in respect of the cash credit dues of the firm since the hypothecation deed did not give any right to the bank to seize the vehicle for the dues of the firm. The bank was directed to return the vehicle subject to the recovery of It Rs.1694.90 only. Thus, it is evident that a lien can not go beyond the terms M I b r loan agreement.

Agiun. in K Jagdishwar Reddy Vs. Andhra Bank,(1988) it was held that the banker has no right of lien on the gold ornaments deposited for a loan in respect of another debt due by him as a guarantor, since, there is no contract by the customer offering the gold ornaments as a pledge for the debt due by him as a guarantor. In another case, Vysya Bank Ltd., Vs. Akkem Mallikarjuna Reddy, the customer had obtained two gold loans and one crop loan. When the gold loans were repaid, the banker refused to give the jewels, exercising lien on them for the amount due under the crop loom. But, the customer pleaded that the banker couldn’t exercise his general lien on the jewels, since, the crop loan, loan had been already waived under the waiver scheme of the Government. Moreover, the jewels were deposited specifically for the gold loans only. It was held that the bank can exercise his general lien on the jewels because:

(i) the waiver scheme is not applicable to private banks, and (ii) there is an agreement "to retain the gold ornaments for all the monies now owing, or which shall, at any time thereafter he owing, to the bank is any capacity whatsoever."

Again, In Syndicate Bank Vs. Vijayakumar (1992), it was held that the bank has a general lien on the FDRs which were given along with a special agreement giving power to the bank the liberty of adjusting the proceeds to any loan or O.D.

A Banker’s Lien as an Implied Pledge

It must be noted that a banker’s lien is generally described as an implied pledge. It means that a lien not only gives a right to retain the goods but also gives a right to sell the securities and goods of the customer after giving a reasonable notice to him, when the customer does not take any steps to clear his arrears. In Deverges Vs. Sandeman, a month’s notice
was considered as a reasonable one. That is why Sir John Paget rightly says in his book ‘Law of Banking’ that “It has been generally understood that the banker’s lien conferred rights more extensive than ordinary liens ……”

This right of sale is normally available only in the case of pledge. That is why lien is regarded as an implied pledge. This right of sale is available only in exceptional circumstances in the case of lien.

Lien on Negotiable and Quasi Negotiable Securities

A banker has a lien on all securities entrusted to him in the capacity of a banker. In Miia Vs. Currie, it was ruled that a banker’s general lien applies to bills, cheques and money paid to bankers in the capacity of bankers. A banker’s lien over negotiable securities applies even to instruments which are not the property of the customer. It is so because the banker becomes a holder in due course provided he has acted in good faith. Hence, his title will be superior to that of his customer. The lien also extends to quasi negotiable securities like a policy of insurance, share certificate, documents of title to goods, deposit receipt etc.

No General Lien on Safe Custody Deposits

Bankers have no general lien on safe custody deposits. The bankers receive valuables such as sealed boxes, parcels, documents and jewellery for safe custody. Such articles are left with the bankers for a specific purpose. In Pollock Vs. Mulla, it was held that the general lien of a banker does not extend to securities deposited for safe custody or for special purpose. Moreover, the banker becomes a bailee in such cases and as such he cannot acquire a better title than that of his customer from whom he got them. Hence, a banker’s lien does not cover safe custody deposits. To quote Sir John Paget again “a banker's lien only attaches to such securities as a banker ordinarily deals with for his customer otherwise than for safe custody, when there is no question or contemplation of indebtedness on the part of the customer.” But, Heber Harot in the Gilbert Lectures has expressed a different view which does not hold good. However, the banker can exercise his particular lien on them for the locker charges due.

No Lien on Documents Entrusted for a Specific Purpose

In Greenhalgh Vs. Union Bank of Manchester it has been clearly
established that if a bill of exchange or any other document or money is entrusted for a special purpose, a banker’s lien cannot be extended to them. It is so because when they are entrusted for a specific purpose, the banker becomes a trustee till that purpose is fulfilled. Hence, he cannot avail of his right of lien. In K. Jagadeshwar Reddy Vs. Andhra Bank, Nizamabad (1988) it was held that in the absence of any agreement to the contrary, the bank has no general lien in respect of those securities which were given specifically for a particular loan.

**No Lien on Articles Left by Mistake**

A banker cannot exercise any lien in respect of the property which comes into his hands by mistake. It amounts to unlawful possession. In Lucas Vs. Dorrien, the banker had refused to grant an advance against certain securities. The customer by mistake forgot to take back the securities while leaving the bank premises. It was held that the banker could not exercise his right of lien over those securities because they came into his possession in an unlawful manner.

**Lien on Securities Not Taken Back After the Repayment of the Loan**

The banker can exercise the right of lien on securities which are allowed to remain with him even after the repayment of the loan. This is so because the securities are supposed to be redeposited with him. This view was held in Re-London and Globe Finance Corporation.

**Lien on Bonds and Coupons**

Lien applies to bonds and coupons that are deposited for the purpose of collection. The reason is that the banker is acting merely as a collecting agent. But Lord Chorley has questioned the validity of this view. However, if the coupons and bonds are left in safe custody, a banker’s lien cannot cover them. The court will therefore apply “Collection/Safe Custody Test”. If bonds are deposited with the condition that the banker can cut off the interest coupons for collection, then lien would attach both to coupons and bonds. On the other hand, if the customer himself cuts off the coupons, then, lien does not apply to coupons since the customer’s intention is to provide for the ‘safety’ of the coupons. In the case of bonds, however, lien applies.
No Lien Until the Due Date of a Loan

When a specific amount is given as loan for a definite period, no lien arises until the due date. The reason is that no debt arises till that date. In the same way, a banker cannot retain any money belonging to the customer against the discounted bills which have not yet matured. The reason is that no liability arises till the date of maturity. Moreover, even on the date of maturity, this liability may or may not arise.

No Lien on Deposits

Generally speaking a banker has no lien upon the deposit account of a customer in respect of a loan account due from the same customer. However, he has a right to set off one account against the other. Set off is an accounting situation which is always available to the banker and it should not be confused with lien. Sec. 171 gives a right of lien only in respect of goods bailed as security. Under bailment, the same goods should be returned to the borrower. But, in the case of a deposit, the money deposited into any account ceases to be the property of the customer and it need not be repaid in identical coins and currency notes. Hence, a deposit does not come within the meaning of bailment and hence a banker’s general lien is not available in respect of a deposit account. In Official Liquidator, Hanuman Bank Ltd., Vs. K.P.T. Nadar A others, it was held that when moneys are deposited into a bank, the ownership of the money passes on to the bank. So, the right of the bank over the money deposited with it cannot be a lien at all. In the same way, a banker cannot exercise the right of lien on the deposit account of a partner in respect of a debt due from the partnership firm. Also, no lien arises on trust account in respect of the debt due from the person operating that trust account.

A banker has no lien on a stolen bond given for sale if the true owner claims it before the sale is effected.

A Banker’s lien is not barred by the Law of Limitation Act.

A banker has no lien on the security of fixed deposit receipt which has not been endorsed and discharged on maturity. In Union Bank of India Vs. Venugopalan, it was held that the banker cannot exercise his lien on the fixed deposit account of the defendant’s brother (Venugopalan’s brother) unless the F.D.R. is duly discharged and given to the bank as a collateral.
cover to I In- loan given to the defendant.

When a Bill of Exchange is handed over to the banker for the purpose of safety till maturity and thereafter for collection, then the banker’s lien does not extend to that bill till maturity since that bill has been entrusted to him for a specific purpose. On the date of maturity there is no objection to the exercising of the right of lien on that bill since it is given for collection which is a routine business of a banker.

**Negative Lien:** It is otherwise called non-possessory lien. In the case of a negative lien, the securities are not in the possession of the creditor. But, the debtor gives an undertaking that he will not create any charge on those securities in question without the prior written permission of the creditor. Such a letter of undertaking must be duly stamped. Thus, in the case of a negative lien, the possession of the security is with the debtor himself, who promises not to create any charge over them until the loan is repaid.

### 1.10 BANKER’S DUTY TO MAINTAIN SECRECY OF CUSTOMER’S ACCOUNTS

A banker is expected to maintain secrecy of his customer’s account. The word ‘Secrecy’ is like a Damocle’s Sword hanging on the head of the banker and every employee of a bank has to take an oath of secrecy regarding the customer’s accounts. The banker should not disclose his customer’s financial position and the nature and the details of his account. Even though this practice came into vogue as early as in 1868 in Hardy Vs. Veasey, it was firmly rooted only in 1924 in a leading, case, popularly known as Tournier’s case. (Tournier Vs. National Provincial and Union Bank of England Ltd.). In the above case the banker had disclosed to a third party the customer’s connection with book-makers. It resulted in the loss of employment to the customer. It was held by Justice Bankes that there is a qualified contractual duty which has been acquired by the bank in the character of banker not to disclose information concerning the depositor. In this case, it was not done and hence, the bank was held liable to compensate for the loss suffered by the customer.

Of course, the duty of secrecy is not a statutory one. Only the nationalised banks in India are compelled, under Sec. 13 of the Banking Companies (Acquisition and transfer of undertakings) Act, 1970, to main-
tain secrecy of their customers’ accounts’. However, professional etiquette demands that a banker should not reveal the nature of his customer’s account to third persons.

Sir John Paget goes to the extent of saying that this secrecy should be maintained even after the account is closed and even after the death of the customer. It is immaterial whether the account is in debit or credit. This duty of secrecy goes beyond the state of the account. It extends to all transactions that go through the account.

The disclosure of the financial position of a customer may affect his reputation and bring considerable loss. If a customer suffers any loss on account of the unwanted disclosure of his account, the banker will be compelled to compensate for the loss suffered by his customer.

At the same time, a banker must remember that he cannot maintain cent per cent secrecy at all times. There may be certain reasonable grounds under which he can justifiably disclose his customer’s account. In the words of Judge Banks “... the duty is an legal one arising out of contract, and the duty is not absolute but qualified... on principle. I think that the qualifications can be classified under four heads: (a) Where disclosure is under compulsion by law: (b) Where there is a duty to the public to disclose: (c) Where the interests of the bank require disclosure: (d) Where the disclosure is made by the express or implied consent of the customer.”

(A) Disclosure Under the Compulsion of Law

When law requires the disclosure of the state of a customer's account, lie cannot override it. His duty to his customer is subject to his duty to the law of the country. The following are the examples of this category:

i. Under Sec. 4 of the Bankers Book Evidence Act, 1891, a banker may be asked to produce a certified copy of his customer’s account in his ledger.

ii. Under Sec. 285 of the Indian Income Tax Act. 1961, a banker is asked to advise the Income Tax Officer the names of those who have earned Rs. 10,000 or over as interest on deposits during any financial year. Moreover, the officials have free access-to the books of accounts kept by bankers.

In Sankarlal Agarwalla V.s. Stare Bank of India and Another, it was
held that the bankercannot be made liable for having disclosed the
deposit of high denomination Notes as per law to the Income Tax
Department.

iii. Under Sec. 45 B of the Reserve Bank of India Act. the Reserve
Bank is empowered to collect credit information from banking
companies relating to their customers.

iv. Under Sec. 26 of the Banking Regulation Act. 1949,every bank is
compelled to submit an annual return of deposits which remain
unclaimed for 10 years.

v. Under Sec. 36 of the Gift Tax Act, the Gift Tax Officer can
examine a banker on oath and compel him to produce the books of
account.

vi. Under the Exchange Control Act, 1947, the government has the
power to gather information about the financial position of a
customer who is suspected of violating the provisions of the above-
mentioned Act.

vii. When a Garnishee order nisi is received, the banker must disclose
the nature of the account of a customer to the court.

In Kattabomman Transport Corporation Ltd. Vs. State Bank of
Travancore (1992) it was held that banks are justified in disclosing the
account of a customer without his consent under the compulsion of law.

(B) Disclosure in the Interest of the Public

As between individual interest and public interest, public interest is
more important and so the individual interest should be sacrificed for the
sake of public interest. Hence, a banker is justified in disclosing the state of
his customer’s account in the interest of the public. It is not easy to give an
example of this type. The following grounds generally fall under this
category:

i. Disclosure of the account where money is kept for extreme political
purposes.

ii. Disclosure of the account of an unlawful association.

iii. Disclosure of the account of a revolutionary body to avert danger to
the state.

iv. Disclosure of the account of an enemy in times of war.
(C) Disclosure in the Interest of the Bank

When his own position is at stake, a banker may be compelled to ignore his oath of secrecy. Any prudent banker will safeguard his position before fulfilling his obligations. The following are the instances of this kind:

i. Disclosure of the account of the customer who has failed to repay the loan to the guarantor.

ii. Disclosure to a fellow banker. Bankers amongst themselves have the practice of exchanging information about customers for the sake of common courtesy. When an enquiry of this type comes to a banker, he should in his own interest answer the enquiry because later on he may also be in need of such information for which he has to approach his fellow banker. Usually, when a piece of information about a customer who happens to be an acceptor of a bill under discount is required, the banker will make a courtesy call on his fellow banker. This is called common courtesy.

iii. As a defence of past action disclosure can be made. In Sunderland Vs. Barclays Bank the banker had dishonoured the cheque of Mrs. Sunderland drawn in favour of a tailor. In fact, she had asked the banker to give proper reasons for the dishonour of that cheque to her husband. To defend his past action (i.e., dishonour) the banker had to reveal the fact of her having drawn cheques in favour of bookmakers without the knowledge of her husband. After having honoured the last cheque drawn in favour of a bookmaker, the banker had to dishonour the cheque in question for want of funds. Mrs. Sunderland could not tolerate this disclosure to her husband and so she sued the banker for unwarranted disclosure. It was held that the banker was not liable because the banker had to disclose the fact in his own interest. Besides, there were supposed to be no secrets between a husband and a wife. Moreover, she had permitted the banker to give proper reason for the dishonour of her cheque to her husband.

(D) Disclosure Under the Express or Implied Consent of Customer

It is implied in the contract between a banker and his customer that the
banker would not reveal anything about the state of the bank balance without the customer’s express or implied consent.

i. If a customer has given the name of his banker for trade reference, then the banker would be justified in answering the same.

ii. So also when a proposed guarantor puts questions to the banker regarding the account of the customer, the banker is expected to reveal the exact position. This is so because any guarantor who has assumed great responsibility would be anxious to know about the monetary position of the person whose position is being guaranteed. In all cases, it would be advisable to get the consent of the customer in writing.

**General Precautions**

In disclosing the state of the account to a customer, great care should be exercised. If the banker is careless, he is liable to pay damages:

i. to his customer who suffers damage because of unreasonable disclosure,

ii. to a third party who incurs loss relying upon the information which is untrue and misleading.

Hence a banker should have certain norms about disclosing the state of his customer’s account. They are:

i. The banker should not be negligent in giving information.

ii. He should strictly give bare facts. That is, only a general information must be given. He should not disclose the actual state of the account.

iii. Information should be given only after getting the express consent of his customer.

iv. He should not speak too favourably or too unfavourably of a customer. Such misleading informations may put the parties in difficulties and the banker will have to compensate for the consequent loss.

v. The information should be given in such a way that he may avoid any liability in future. That is why, while supplying credit information, bankers add a clause stating, “This information has been given
in strict confidence and without any liability on our part”. In Banbury Vs. Bank of Montreal it was established that the bank was not liable for the statement made by the manager and the manager himself was not liable if he did not sign the letter. Further it was expressly stated that the information was given “without prejudice” and in “strict confidence.”

vi. As far as possible the banker should supply the information only to a fellow banker.

vii. On no account should he disclose to the holder of a cheque the exact balance in a customer’s account.

**Right to claim incidental charges**

Another special feature of the relationship that exists between a banker and a customer is that the banker may claim incidental charges on unremunerative accounts. This practice is much more in vogue in England. In India, in order to encourage people to open more accounts, such charges are not levied. However, of late, banks in India resort to this practice of claiming incidental charges on an increasing scale. Perhaps, it is due to the fact that their profitability has been very much affected in recent times.

These incidental charges take the form of ‘service charges’, ‘processing charges,’ ledger folio charges,’ ‘appraisal charges,’ ‘penal charges,’ ‘handling/collection charges’ and so on.

The charges which have come into effect from 1st April, 2002 onwards in public sector banks have been listed below:*  

i. Ledger folio charges of Rs. 500/- p.a. in computerised branches  
   Other branches Rs. 200 p.a.  

ii. Collection charges for cheques:

<table>
<thead>
<tr>
<th>Above</th>
<th>Rs. 1,001 – 10,000</th>
<th>Rs. 4 per thousand of part there of 1,00,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto</td>
<td>Rs. 1,000</td>
<td>Rs. 30</td>
</tr>
<tr>
<td>Above</td>
<td>Rs. 10,001 – 10,000</td>
<td>Rs. 40</td>
</tr>
<tr>
<td>Rs. 10,001</td>
<td>–</td>
<td>Rs. 3.50 per thousand subject to a minimum of Rs.450.</td>
</tr>
<tr>
<td>Above</td>
<td>Rs. 10,00,000</td>
<td></td>
</tr>
</tbody>
</table>

*
iii. Remittance charges for drafts, M.T. and T.T. are as follows:

- Upto Rs. 1,000: Rs. 20
- 1,001 to 10,000: Rs. 25
- 10,001 to 1,00,000: Rs. 3 per thousand or part thereof
- 1,00,001 to 10,00,000: Rs. 2 per 1,000 subject to a minimum of Rs. 300

Issue of duplicate DD: Rs. 30 per instrument

iv. Handling charges for cheques dishonoured of 50% the collection charges subject to a minimum of Rs. 20/- per cheque for outstation cheques and Rs. 50/- for each bill.

v. Processing charges for all types of loans above Rs. 2 lakhs at the rate of Rs. 75 per lakh subject to a maximum of Rs. 7,500/-. 

vi. Standing instructions charges of Rs. 20/- per instruction involving credit to other than customers’ own accounts within the branch and if it involves an upcountry centre, Rs. 3 plus postal charges.

vii. A charge of Rs. 2/- per cheque leaf to be levied at the time of issue of cheque books in the four metropolitan cities where MICR cheques are processed.

viii. A penal charge of Rs. 50/- if that operation has the effect of bringing down the balance in the current account below the minimum balance.

ix. Stop payment instructions charge Rs. 25 per cheque.

However, in practice, the above service charge regulations are not literally followed by all banks. They have a tendency to manipulate the service charge regulations so as to attract more and more customers. Customers do not hesitate to shift from one bank to another depending upon the personalised services available in a particular bank and also at the cost at which they are available. Thus, there is a shift from ‘relationship banking’ (opening an account in a bank and patronising it for ever) to ‘transaction banking.’ It is not a healthy trend.
Right to charge compound interest

As per general law, levying of compound interest is strictly prohibited. But a banker is given a special privilege of charging compound interest. Usually bankers charge interest on the money lent at the end of every quarter. The same practice of crediting the customer’s account with interest at the end of every half year is followed.

In National Bank of Greece Vs. Pinios Shipping Co., (1990) the house of Lords has categorically established the banker’s right to capitalise interest, if unpaid, by the borrower on yearly or half-yearly basis, irrespective of the fact, whether it is a secured or unsecured loan. This judgement is very useful in Indian context where the existence of this right has been doubted in D.S. Gowda Vv. Corporation Bank. However, in Syndicate Bank Vs. M/s West Bengal Cement Ltd., (1989), the method of dealing with loan accounts in bank transactions by adding interest unpaid when due, to the amount advanced and treating the merged amount as the principal loan has been recognised. In re: Bank of India case, the Supreme Court has very recently ruled that banks cannot charge compound, interest with periodic rests, for agricultural loans. It is so because, agriculturists do not have any regular sources of income other than the sale of crops, which narbrnally takes place only once in a year.

Again, in M/s. Kharvela Industries Private Ltd. Vs. Orissa State financial Corporation & Others, it was held that the payments made by a debtor is in the first instance to be applied towards interest and thereafter towards the principal unless there is an agreement to the contrary.

Exemption from the law of limitation act

Another distinguishing feature is that the banker is exempted from the law of Limitation Act. As per the provisions of this law, a debt will become a bad one after the expiry of 3 years from the date of the debt. But, according to Article 22 of the Law of Limitation Act, 1963, for a banking debt, the period of 3 years will be calculated from the date on which an express demand is made for the repayment of the debt. It follows that a banker’s debt is not to be made time barred. However, in practice, a reasonable period has been fixed for the banker’s debt also. Sec. 26 of the Banking Regulation Act prescribes a period of 10 years to consider a banking debt as a bad one. In the case of fixed deposit, this period of 3
years/10 years will be calculated from the date on which the F.D.R. is surrendered. In the case of a safe custody deposit, this period commences from the date of demand. In the case of an overdraft, the period of these years will be counted from the date on which it is not used.

In the actual banking practice no banker would wait for the expiry of 10 years. If there is no operation in an account for one year, it will be marked as a 'dormant account.' After two years of marking, it will be transferred to an account called ‘Inoperative account’ and it will be thereafter transferred to the Central Office after 5 years.
**RELATIONSHIP IN A NUTSHELL**

Chart showing the Relationship Between a Banker and a Customer

<table>
<thead>
<tr>
<th>Banker and Customer</th>
<th>Banker and Customer</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>NOTES</strong></td>
<td><strong>NOTES</strong></td>
</tr>
<tr>
<td><strong>Banker and Customer</strong></td>
<td></td>
</tr>
<tr>
<td><strong>NOTES</strong></td>
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<tr>
<td><strong>Banker and Customer</strong></td>
<td></td>
</tr>
<tr>
<td><strong>NOTES</strong></td>
<td></td>
</tr>
</tbody>
</table>

### General Relationship
- **Banker**
  - Not a Depositor
  - Not an Agent
  - Not a Trustee
  - Obligation to honour cheque
  - Duty to maintain secrecy of customer's account
- **Customer**
  - Right to claim incidental charges
  - Right to charge compounded interest
  - Exemption from the Law of Limitation Act

### Special Relationship
- **Privileged Debtor**
  - (1) Express demand by the creditor necessary.
  - (2) Demand only at a particular branch.
  - (3) Only during banking hours.
  - (4) Get money from customers without security.
  - (5) Law of Limitation does not apply.
  - (6) Can combine accounts with the consent of the customer.
- **Privileged Creditor**
  - When the customer acts as a creditor he acts as an unsecured creditor.
  - But the banker acts as a secured creditor.

---

*Self-Instructional Material*
**How long the relationship would continue?**

As long as there is some sort of an account either a deposit or a loan account, the relationship would continue. The relationship would be terminated on the happening of events like death, insolvency or insanity of a customer or closing of the account either on the initiative of the customer or the banker. This relationship would not come to an end just because the banker has demanded the repayment of the loan outstanding as was decided in the case of National Bank of Greece Vs. Pinios Shipping Co., (1990).

Since banking is a service industry, it is all the more essential that good relationship is not only created but also maintained by means of offering excellent personalised services.

**1.11 TERMINOLOGIES**

1) Banker 2) Customer 3) Banking 4) Business 5) Interest 6) Public

**1.12 MODEL QUESTIONS**

1) Define the terms ‘banker’ and ‘customer’ and bring out the relationship that exists between them.

2) What is Banker’s lien? When can he exercise such a lien?

3) Is a banker obliged to maintain the secrecy of his customer’s account? Under what circumstances can he disclose the account and what precautions should he take in such cases?

4) State and explain the banker’s obligation to honour cheques. What risks he has to face in the case of wrongful dishonour of a cheque?

5) How will you assess damages in the case of a wrongful dishonour of a cheque?

**1.13 REFERENCE BOOKS**


UNIT – II DEPOSITS

2.1 Introduction
2.2 General Precautions for opening Account
2.3 Current Deposit Account
2.4 Fixed Deposit Account
2.5 Savings Deposit Account
2.6 Recurring Deposit
2.7 Other Deposit
2.8 New Deposit Scheme for NRI’s (1992)
2.9 Terminologies
2.10 Model Questions
2.11 Reference Books

2.1 INTRODUCTION

This is an era of keen competition among banks. Most of the commercial banks vie with one another in tapping the savings of the public by means of different kinds of deposits. It is not an exaggeration to say that almost every day a new kind of deposit is being introduced. At the same time, a bunker should be very careful in opening deposit accounts. Some of the deposit accounts are operated very often. He should safeguard his position in such a way that he may not be victimised by unscrupulous persons. When a banker accepts deposits, technically speaking, he is said to borrow money. As a borrower, he should safeguard his position so as to avoid untoward happenings. As such, before opening a deposit account, the banker should take certain general precautions.

2.2 GENERAL PRECAUTIONS FOR OPENING ACCOUNT

(1) Application Form

The prospective customer is first of all asked to sign an application form prescribed for that purpose after furnishing all particulars. Different bankers have different printed application forms. They also vary with classes of customers and for kinds of deposits. These application forms contain the rules and regulations of the bank along with the terms and conditions of the deposit.

SPECIMEN OF AN APPLICATION FORM FOR OPENING AN ACCOUNT

To

The Manager,
Modern Bank Of India
Madurai

.....2002
Dear Sir,

Please open Savings Deposit Account in my/our name(s)

____________________________________________________________
____________________________________________________________
____________________________________________________________

(Name and Address in Block Letters)

I/we agree to comply with and to be bound by the bank’s rules for the
time being for the conduct of such accounts.
The account be operated upon*

**Date of birth                                                                                  19

Yours faithfully,

___________________

Introduced by

If in joint names, State [1] either or survivor,
[2] both of survivor,
[3] any one of us or any one of the
survivors of us or
the last survivors

In the case of minors.

On the back of the application form itself there is a provision for giving
specimen signatures.

**BACK PORTION OF THE APPLICATION FORM**

<table>
<thead>
<tr>
<th>Specimen Signature Card for Savings Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>Name of Account __________________________</td>
</tr>
<tr>
<td>A/c No. ___________________________</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>NAME (IN BLOCK LETTERS)</th>
<th>SIGNATURE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. _______________________</td>
<td></td>
</tr>
<tr>
<td>2. _______________________</td>
<td></td>
</tr>
<tr>
<td>3. _______________________</td>
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<tr>
<td>4. _______________________</td>
<td></td>
</tr>
<tr>
<td>5. _______________________</td>
<td></td>
</tr>
</tbody>
</table>

VERIFIED BY
However, the application form for opening a current account contains many conditions which are not normally found in other cases.

(2) Specimen Signature

Every new customer is expected to give three or more specimen signatures. Usually they are obtained on cards which are filed alphabetically for ready reference. Each bank maintains a Signature Book for this purpose. Now-a-days, banks obtain specimen signatures right on the application forms.

(3) Letter of Introduction

It is always advisable on the part of the banker to allow the prospective customer to open an account only with a proper introduction. The usual practice for the banker is to demand a letter of introduction from a responsible person known to both the parties. Failure to get a letter of introduction may land him in trouble and affect his credit. For instance, as soon as a new party opens a current account, he should be supplied with a cheque book which may be misused to his best advantage, if he happens to be an unscrupulous person. The responsible person who issues the letter must also be cautious because if he supplies any false information about a party, he would be held liable to compensate for the loss, if any, suffered by the banker: (Bloodnok & Sons Vs. United Kingdom Bank). If the introduction turns out to be a forged one, the account is treated as having not been introduced at all.

A letter of introduction or a letter of reference always protects a banker in the following ways:

(a) Protection against fraud. A letter of introduction serves as a precaution against fraud. It protects a banker against issuing a cheque book to an undesirable and dishonest person. But for such a letter, he could have given a cheque book to an undesirable person who might have made use of his cheque leaves to his best advantage even in the absence of sufficient funds. In such a case, the goodwill of the bank would suffer. If the customer is a man of good character, he will not do such things. The banker can find out the character of a new party only through this letter. Thus, the purpose of introduction is to identify the depositor and to find out whether he is a genuine party or an impersonator or a fraudulent person as
was decided in the case of Union of India Vs. National Overseas & Grindlays Bank Ltd. (1978).

(b) Protection against inadvertant overdraft. It may so happen that a bank clerk may misread the balance of a customer and pay a cheque. The result will be the emergence of an overdraft. The banker can recover the money only if the customer is a man of good character.

(c) Protection against an undischarged bankrupt: If a new party happens to be an undischarged bankrupt, the fact of which is not known to the banker and if the properties deposited by him are not acquired by him, the banker is answerable to the Official Assignee for the transactions. A letter of introduction prevents the occurence of such events. Moreover, it is the duty of a banker to inform the existence of an account in the name of an undischarged bankrupt and get his consent for the operation of such an account.

(d) Protection against negligence under Sec. 131 of the Negotiable Instrument Act: If a banker fails to obtain a letter of introduction at the time of opening a new account, it constitutes a negligence on the part of the collecting banker under Sec. 131 of the Negotiable Instruments Act and so he will lose the statutory protection (Ladbroke Vs. Todd, Commissioner of Taxation Vs. English Scottish and Australian Bank).

(e) Protection against giving incorrect information to fellow bankers. It is a courtesy among bankers to give reference about the financial position of their customers to fellow bankers. In the absence of a reference letter, a bankers may not be able to supply correct informations

(4) Interview

At the time of opening of new accounts, it is always advisable to have an interview invariably with the prospective customer so as to abviate the chances of perpetration of any fraud at a later stage.

(5) Account in cash

It is a common practice among bankers to allow a new party to open an account only in cash. In the absence of an express notice, a banker need to worry about neither the source of money, nor the customer’s title over the money. On the other hand, if the account is opened by depositing a cheque, the risks are greater, For instance, if the customer’s title to the
cheque is defective, the banker is answerable for it (Ladbroke Vs.Todd)

(6) Mandate in Writing

If a new party wants its account to be operated by somebody else, the banker should demand a mandate from his customer in writing. The mandate contains the agreement between the two regarding the operation of the account, the specimen signatures of the authorized person and the powers delegated to the authorized person.

(7) Verification of Documents

If the new party happens to be a corporate body, it is essential that the banker should verify some of the important documents like Memorandum of Association, Articles of Association, Bye-law copy etc. In other cases, the verification of certain other documents like Trust Deed, Probate, Letter of Administration etc., may be necessary.

In Lumsden & Co., London Trusty Saving Bank, one of the grounds for banker’s negligence was the failure to verify the passport of the customer who had recently arrived from Australia.

(8) Conversant with the Provisions of Special Acts

Since a banker has to deal with different classes of customers, he has to be thoroughly conversant with certain laws like Indian Companies Act, Indian Partnership Act, Insolvency Act, the various Trust Acts, the Co-operative Societies Act etc.

(9) Pay-in-Slip Book, Cheque Book and Pass Book

Then, the Customer is supplied with a pay-in-slip book. The pay-in-slip is a document which is used for depositing cash or cheque or bill into the account. It has a counterfoil which is returned to the customer for making necessary entries in his books.

<table>
<thead>
<tr>
<th>SPECIMEN COPY OF A PAY-IN-SLIP</th>
</tr>
</thead>
<tbody>
<tr>
<td>C.O.S. 14 X</td>
</tr>
<tr>
<td>CASH</td>
</tr>
<tr>
<td>Modern Bank of India</td>
</tr>
<tr>
<td>Current Account Pay-in-Slip</td>
</tr>
<tr>
<td>For Notes and Coins Only</td>
</tr>
<tr>
<td>Ledger Folio.....</td>
</tr>
<tr>
<td>......2002</td>
</tr>
<tr>
<td>Particulars</td>
</tr>
</tbody>
</table>
Deposits

<table>
<thead>
<tr>
<th>Notes</th>
<th>Rs.</th>
<th>P.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rupees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Smaller Coin</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Copper</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rupees</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Teller

Head Cashier by

Scroll Cash No... Entd. by

The customer is also supplied with a cheque book which normally contains 10 to 20 blank forms. A cheque leaf is used for the purpose of withdrawing money. If the customer does not like to have a cheque book, he can make use of the withdrawal form for withdrawing money. The first cheque book is usually branded with the rubber stamp ‘N’

**SPECIMEN COPY OF A WITHDRAWAL ORDER FORM**

Care: This Savings Bank Withdrawal Order is NOT a cheque.
The pass Book must accompany this Order Form
Otherwise Payment will be refused.

To,

Modern Bank of India
Savings Bank
Madurai

Pay Self or bearer
Rupees .................

and debit the amount to my/our Savings Bank Account No. .........

Depositor
A withdrawal form should be accompanied by the pass book. Every cheque book contains a ‘Requisition slip’ attached to it at the end. When the cheque book is nearing completion, he can fill up the Requisition Slip and obtain a fresh cheque book.

In addition to the above, a customer is also given a pass book which reflects the customer’s account in the banker’s ledger. It usually contains the rules and regulations of the bank and the terms and conditions of the deposit. Every customer is supposed to have read and understood the conditions. He should comply with them under all circumstances.

10. Passport Size Photograph

Now-a-days banks insist upon the prospective customers to affix their passport size photographs on the application forms at the time of opening accounts. This is to prevent impersonation and for easy identification.

Other Important Points

(1) Every deposit becomes the property of the bank
(2) Generally the bank is responsible for the safety of the deposit.
(3) If the deposit of a customer is the property of another, say a trust, then that deposit does not become the property of the bank
(4) A banker may use his discretion in allowing or not allowing a person to deposit money and it cannot be questioned..(Faselli Vs. Liggs National Bank)
(5) If money or cheque is entrusted to an employee of the bank for being credited to the customer’s account and if that money/cheque is misappropriated and false entries are made in the pass book, the bank is not liable to make good the loss caused to the customer unless the fraud was committed by the employee in the course of his employment as was decided in the case of State Bank of India Vs. Shyama Devi (1978)

2.3 CURRENT DEPOSIT ACCOUNT (CURRENT OR RUNNING ACCOUNT)

A current account is an account which is generally opened by business people for their convenience. Money can be deposited and
withdrawn at any time. Money can be withdrawn only by means of
cheques. Usually, a banker does not allow any interest on this account.
Even then, people come forward to deposit money on current account,
namely

(1) Overdraft facility, and

(2) Other facilities like collection of cheques, transfer of money and
rendering agency and general
utility services.

That is why current accountholders do not mind a banker charging
some commission for services rendered and incidental charges for
maintaining the account – whether it is in debit or in credit. Even though a
banker does not allow any internet, he charges interest on overdraft on a
day-to-day basis. In Bank of Maharashtra Vs. United Construction Co. &
Others, it was held that when a customer overdraws the account with or
without express consent, it amounts to a loan and the customer is around to
make good the payment with a reasonable interest. Current accountholders
should keep a minimum balance Rs. 500/- to keep the account running. In a
mechanised branch, a minimum balance of Rs 5,000 has to be maintained.
If this minimum is not kept, a minimum charge of Rs 1/-per operation will
be debited to the account. The bank sends a ‘Statement of Account’ to the
customers every month. As these deposits are repayable on demand, the
banker should keep a large cash reserve. This may be one of the reasons
why a banker does not pay any interest on current deposit. In addition to
the above, a banker should observe all the general precautions in opening
the account as listed earlier in this chapter.

2.4 FIXED DEPOSIT ACCOUNT

A fixed deposit is one which is repayable after the expiry of a
predetermined period fixed by the customer himself. The period varies
from 15 days to 3 years. A deposit account can be opened for a period of
more than 3 years and in that case the rate of interest remains the same
level. In England, these deposits are not repayable on demand but they are
withdrawable subject to a period of notice. Hence, it is popularly known as
‘Time Deposit’ or ‘Time Liabilities’ In India also, the banks have begun to
call it ‘Term Deposit’ Normally the money on a fixed deposit is not
repayable before the expiry of a fixed period.
Opening the Account

As usual, the prospective fixed depositholder is expected to fill up an application form prescribed for the purpose, stating the amount and the period of deposit. The application itself contains the rules and regulations of the deposit in addition to the space for specimen signature. Unlike as in opening a current account, a banker does not insist upon a letter of introduction or reference for opening a fixed deposit account because of the absence of frequent transactions of this account. After all, this account will never show any debit balance and put the banker in trouble.

Interest

The interest rate offered on the fixed deposit is so attractive that it has resulted in a change in the composition of bank deposits. Till recently, most of the deposit of commercial banks had been demand-deposits and now fixed deposit occupies more than 70% of the bank deposits. The rate of Interest varies according to the period of deposit. In Indian banking history, the first ever highest interest rate of 15% was offered on term deposits from 1.2.97 on wards.

However, in recent times, the R.B.I has deregulated the interest rates on fixed deposit. The banks are given the freedom to fix their own rates for different periods.

Consequent upon the reduction of bank rate to the lowest level in the history of Indian Banking, most of the banks have reduced the interest rates on fixed deposit considerably. However, special rates have been fixed for deposits of senior citizens of 60 years of age or above giving them some incentives.

The present rates applicable to fixed deposits in most of the nationalized banks with effect from 05.05.2003 are as follows

<table>
<thead>
<tr>
<th>Serial No.</th>
<th>Term of the Deposit</th>
<th>Interest Per Annum</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>7 days to 14 days</td>
<td>4.00</td>
</tr>
<tr>
<td>2.</td>
<td>15 days and upto 45 days</td>
<td>4.25</td>
</tr>
<tr>
<td>3.</td>
<td>46 days and upto 179 days</td>
<td>5.00</td>
</tr>
<tr>
<td>4.</td>
<td>180 days to less than 1 year</td>
<td>5.25</td>
</tr>
<tr>
<td>5.</td>
<td>1 year to less than 2 years</td>
<td>5.50</td>
</tr>
</tbody>
</table>
For deposits of senior Citizens

<table>
<thead>
<tr>
<th>Serial No.</th>
<th>Term of the Deposit</th>
<th>Interest Per Annum</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>1 year to less than 2 years</td>
<td>6.00</td>
</tr>
<tr>
<td>2.</td>
<td>2 year to less than 3 years</td>
<td>6.25</td>
</tr>
<tr>
<td>3.</td>
<td>3 year and above</td>
<td>6.50</td>
</tr>
</tbody>
</table>

Tax Deduction Scheme (T.D.S) Extended to fixed Deposit

Though the interest rates on fixed deposit are attractive, the system of tax deduction at source was extended in 1991-92 to cover interest payment made by banks on fixed deposits, where the interest payment exceeds Rs. 2,000/- per financial year. Since it acted as a deterrent factor in the welfare and development of a sound and healthy banking system, it was completely withdrawn by the Governor subsequently. However, it has been re-introduced from the financial year 1995-96. This T.D.S is applicable to interest payments exceeding Rs. 10,000 per financial year.

Period of the deposit

The minimum period has been fixed as low as 7 days. As per the guidelines of the Indian Banks Association, banks should not accept deposits for a period longer than 10 years. If the maturity date of a fixed deposit falls on a holiday, it should be paid only on the succeeding working day, since, a fixed deposit cannot be claimed before the maturity date as per the terms of the original contract.

Fixed Deposit Receipt

At the time of opening the deposit account, the banker issues a receipt acknowledging the receipt of money on deposit account. It is popularly known as F.D.R (Fixed Deposit Receipt). It contains the amount of deposit, the name of the holder of the deposit, the rate of interest, due date etc., On the reverse side of the F.D.R separate columns are provided for making entries regarding interest.
### PARTICULARS OF A F.D.R.

<table>
<thead>
<tr>
<th>No</th>
<th>Name of the bank and place</th>
<th>Due Date</th>
<th>Date</th>
<th>Name of the Depositor</th>
<th>Amount</th>
<th>Period</th>
<th>Interest Rate</th>
<th>Signature of the Manager</th>
</tr>
</thead>
</table>

**FIXED DEPOSIT RECEIPT**

*(FACE VIEW)*

**Royal Bank Ltd**

No : 145678

Due on Nazareth Branch

Date .......2002

Received from..............................

Rupees .................. as a fixed deposit repayable

In......... months after date with interest at at the rate

% Per annum.

Rs. Accountant

Manager

### BACK VIEW OF F.D.R

**MEMORANDUM**

**PAYMENT OF INTEREST**

<table>
<thead>
<tr>
<th>1. This F.D.R duly discharged should be surrendered at the time of payment or renewal of deposit. To prevent loss of interest, the receipt intended for renewal should be sent on due date</th>
<th>Date</th>
<th>Half year ended</th>
<th>Amount</th>
<th>Signature of authorised person</th>
</tr>
</thead>
</table>

Self-Instructional Material
date.

2. The F.D.R. is not transferable by endorsement. In the absence of special instruction, the amount of F.D.R. can be paid only to the depositor in person.

3. Rate of interest overleaf is subject to Reserve Bank’s directive issued from time-to-time. Received payment/Please renew… month/years

SIGNATURE OF THE DEPOSITOR

Debtor and Creditor Relationship

The Legal position of a banker in respect of a fixed deposit is that of a debtor who is bound to repay the money only after the expiry of a fixed period. The banker continues to be a debtor even after the period is over, though he does not pay any interest after the date of maturity. In the case Hindustan Commercial Bank Ltd., Vs. Jagtar Singh, it was held that the fixed deposit, after the expiry of the said period, becomes a “demand deposit” payable without interest and it does not become a loan and such Article 60 of the Limitation Act relating to deposit is applicable.

Cheques not permitted

The customer has no right to draw cheques on this deposit account. Hence, the amount can not be withdrawn by means of cheques after the period is over. Alternatively, the customer can request the banker to transfer the amount with interest either to a current or savings account and thereafter he can withdraw the amount by means of a cheque.

Surrender of F.D.R.

Every bank makes it obligatory on the part of the depositor to surrender of F.D.R. before claiming the money on maturity. Therefore, it is essential to get the receipt duly discharged at the time of maturity. When such a receipt is so surrendered by the owner, the banker can not put forth any excuse and refuse to repay the amount. (United Commercial Bank Ltd.
Loss of F.D.R

Where a deposit receipt is lost, generally a banker demands the customer to sign an indemnity bond with a guarantee. It will protect the banker against losses in future. In extraordinary cases, the customer may be asked to go to the court and seek its authorization. Hence, to avoid troubles the customer is well advised to preserve the receipt very carefully till be gets the payment.

Exemption from stamp Duty

A fixed deposit receipt, though an important document, is exempted from stamp duty under the Indian Stamp Act. This is just to popularize the deposit account, Otherwise and receipt exceeding Rs.20/- requires to be stamped.

F.D.R--- Not a Negotiable Instrument

A deposit receipt is not a Negotiable Instrument. The transferee, therefore, can not get better title than of the transferor himself. That is why the receipt has been specifically marked ‘Not transferable’. How ever, money in deposit account becomes a debt from the bank and like any other debit this can be assigned, To be effective, prior notice of assisgnment should have been served on the banker. The assignee should also give a notice to the banker informing him of his right to the deposit.

In Abdul Rehiman Vs. Central Bank of India. it was held that the F.D.R was not a negotiable instucment and therefore it could not be transferred by a were endorsement in blank. Hence to be on the safer side, the banker should pay it only to the original depositor.

Fixed deposit – subject to Garnishee Order

A Garnishee Order is one of a court order attaching a customer’s account in the hands of the banker. This order can attach only a present debt and not a future debt. Since the fixed deposit is a present debt payable, as a future debt, it can very well attach this account. A Garnishee Order issued in joint names cannot attach an individual account.

Fixed Deposit – Subject to Income Tax Act

The Officers of the Income Tax have been vested with wide powers to attach the account (Current or Savings or Fixed) of a customer in the hands of a banker for non-payment of income tax under Sec. 226 of the
Income Tax Act 1961. In recent times the income tax officers have been increasingly using this right to collect income tax arrears from the assesses. In such cases a banker is bound to comply with their orders. Again the I.T.O may call for information regarding fixed deposits of Rs. 50,000/- or above.

**F.D.R. — Subject to Donatio Mortis Causa**

A fixed deposit receipt may contain a clause namely Donatio Mortis Causa Clause. It means a gift made in contemplation of death. Hence, a holder of a Fixed Deposit Receipt can give it as a gift to any person in anticipation of his death. This gift will be valid and the donee will get a good title only when the donor dies. The donee’s title is subject to the title of the donor.

**F.D.R. — Subject to Conversion**

Conversion means dealing with the goods of another inconsistent with his right. For instance, if a banker collects an uncrossed cheque for a person who is not a real owner of the cheque, then the banker will be held liable for conversion. So also, the collection of a Fixed Deposit Receipt amounts to conversion because it acknowledges only the receipt of money and it is not an order to pay money to somebody. In Pearce Vs. Creswick, the banker was held liable for having paid the money to another banker as usual against Fixed Deposit Receipt.

**Fixed Deposit Claimed before Maturity**

Normally a customer is not allowed to withdraw money before the expiry of the fixed period. But banks in England allow their customers to withdraw the fixed deposit amount at any time after giving a short notice. This is not considered to be a good practice because the very purpose of this deposit will be defeated. Moreover, bankers will find themselves in a tight corner during depression when the money market will be tight.

In India, many banks allow their customers to borrow money by offering F.D.R. as security. The F.D.R. should be returned after having it duly discharged. Generally a banker allows upto 90% of the deposit as loan. The interest charged on this loan is 2% higher than the interest allowed on the deposit. Besides, it is subject to a tax on interest which works out to approximately ½ % (i.e., Interest allowed + 2% x 0.3% tax).
In recent times, a provision has been made for a pre-mature withdrawal of fixed deposit. If a customer wants to withdraw a fixed deposit before maturity, he should forego 1% less than the rate applicable to the period for which the deposit has remained in the bank. Example: A person opens a fixed deposit for 3 years. The rate of interest allowable is 6%. But at the end of the first year he wants to withdraw money. The rate applicable for one year is 5.5%. Now the banker will allow 4.5% interest (5.5% - 1 %) and not (6% -1 %) on the deposit and allow the customer to withdraw money.

Simultaneous O.D. Facility to Fixed Depositholders

A new scheme has been introduced by the State Bank of India called CASHKEY' scheme. As per this scheme, simultaneous O.D. facility in a current account equal to 75% of the amount of deposit made under the 'CASHKEY' scheme are automatically available to term deposit holders who have a minimum initial deposit of Rs. 5000/. This scheme is available at all branches of the State Bank of India.

Lien on Fixed Deposit Receipt

As stated earlier, no lien is available on the fixed deposit account. The banker has only a right of set-off. However, a banker can exercise his lien on the fixed deposit receipt which can be offered as security provided it is duly stamped and signed by the customer. In Union Bank of India Vs. Venugopalan (1990) it was clearly established that the banker could exercise lien on the F.D.R. only when it is duly discharged and given to the banker as a collateral security.

Payment of Interest

Interest on fixed deposit is payable only for the fixed period of deposit. Interest will be payable by the bankers on the deposit for the overdue period only when the deposit is renewed. Interest is paid for each calendar half year. Of late, some banks have begun to make even monthly payment of interest on the standing instruction of their customers. But it has been banned. However, quarterly payment of interest on fixed deposit is permitted.

Nomination Facility

The nomination facility has been extended to deposits of all kinds and safety lockers with effect from 29.03.1985 on the recommendations of the Talwar Committee. The said nomination can be made in favour of only one individual. Where the nominee happens to be a minor, another individual can be appointed to receive the amount on behalf of the minor. This nomination can be cancelled or varied at any time during which the deposit is held by the bank in the name of the depositor. Separate nomination forms are available for nomination, cancellation and variation of nomination.
Fixed Deposit in Joint Names

A fixed account may be opened in the names of two or more individuals. While opening such a joint account, a banker should get clear instruction as to whom the amount should be paid on the due date. In the absence of such clear instruction, a banker should pay only when the Fixed Deposit Receipt is duly discharged by all of them. Difficulties may arise in the event of the death of one of the parties. There was a time when a banker was justified in paying the amount to any one of joint deposit holders as was decided in the case of Wallace Vs. Kelsall. It does not hold good any more. A banker cannot presume that the survivor is entitled to claim the amount especially when there is a dispute between the survivor and the legal representative of the deceased depositor. In McEvoy Vs. Belfast Banking Company, it was held that the rule of survivorship was not applicable in the absence of clear instructions. To avoid difficulties, it is advisable that the joint account holders, at the time of opening the account, declare in writing that it is “with benefit to the survivor.” The usual clause in such cases is "Either or Survivor," "Former or Survivor" which invariably finds its place in the Account Opening Form itself.

Fixed Deposit and the Law of Limitation Act

The Law of Limitation does not cover a fixed deposit. The F.D.R. invariably contains a condition for its return to claim the fixed deposit amount. Hence, the period of three years will be calculated from the date on which the F.D.R. is surrendered. Otherwise, the period of three years will have to be calculated from the date of expiry of the fixed deposit account.

2.5 SAVINGS DEPOSIT ACCOUNT

This deposit is intended primarily for small-scale savers. The main object of this account is promotion of thrift. Hence, there is restriction on withdrawals in a month. Heavy withdrawals are permitted only against prior notice. Generally, the number of withdrawals permitted is 50 per half year.

This account can be opened with a minimum amount which differs from bank to bank. The smallest amount that can be deposited or withdrawn is Rs. 1/-. A minimum balance of should be maintained and if cheque book facility is allowed, the minimum balance should be Rs. 250/-. In the case of a mechanized branch, this minimum balance has been fixed at Rs. 1,000/-. If the minimum balance is not maintained, incidental charges is levied by the bank.

In carries an interest rate of 4% from April 2000 per annum. Interest is allowed on minimum monthly balances in steps of Rs. 10/- and multiples there of between the 10th and the last day of each calendar month.

Generally, overdraft facility is not available in the Savings Bank Account. However, instant credit facility upto Rs. 2,500/ only is available
to Savings Bank customers for their outslalion cheques provided such cheques do not arise out of trade transactions. It is indeed a privilege given to savings bank accountholders who are non-traders. Again, occasional overdrawings upto Rs. 2,500/- are permitted only to those who have satisfactory dealings.

The depositor is supplied with a pass book. Generally, no withdrawals are allowed without the presentation of the pass book along with the withdrawal slip. Now-a-days savings accountholders are given cheque facilities and money can be withdrawn by means of cheques also. Cheques are also collected on this account. The nomination facility is also available in Savings Bank Accounts.

Now, bankers demand a letter of introduction for opening a savings deposit account also because cheque book facility has been extended to this account. In India, Post Offices also offer savings bank facility. Since they combine two conveniences namely postal and savings bank, they have registered a phenomenal growth.

A savings bank account can be closed after one year. If closed earlier, a nominal service charge of Rs. 10/- would be levied.

**Insurance-Linked Savings Bank Deposit**

In recent times, some of the banks have been offering the additional benefit of life insurance protection along with the usual benefits of a savings deposit account. This insurance benefit is a free service and entails no formalities like medical examination. The depositor has to maintain a balance of Rs. 500/- if the branch is in a rural area or Rs 1,000/- if it is situated in other centres. In case the depositholder dies, he is entitled to get an insurance benefit of double the average balance in the account if he is between 18 and 40 years. It is subject to a maximum of Rs. 10,000/-. If he is between 41 and 49 years, the amount of insurance benefit is the same as the average balance subject to a maximum of Rs. 5,000/-. Therefore the insurance benefit ceases. This type of deposit is a real boon to a person who dies prematurely.

**2.6 RECURRING DEPOSIT**

It is one form of savings deposits. Depositors save and deposit regularly every month a fixed instalment so that they are assured of the sizeable amount at a later period. This will enable the depositors to meet contingent expenses. Banks have found these deposits popular. Many people would not have saved if these deposits had not been introduced. This deposit works on the maxim ‘little drops of water make a big ocean.’ Any person can open this deposit account. He can even have more than one account at a time. This account can be opened in joint names also.

It may be opened for monthly instalments in sums of Rs. 5/- or in multiples of Rs. 5/- with a maximum of Rs. 1,000/-. The number of monthly instalments may vary from 12 months to 72. The total amount is repayable 30 days after the last instalment has been paid.

For deposits of higher instalments, the maturity amounts can be calculated as multiples of the maturity amount for an instalment of Rs. 5.

Every depositor should pay the monthly instalment within 30 days
from the due date. If he fails to do so, interest will be charged on the instalments in arrears at the rate of 4 paise for every Rs. 5/- per month.

A recurring deposit holder can get a loan on the security of a recurring deposit. The banker may grant 75% of the total amount paid as loan and the interest of 2% over the recurring deposit rate is charged. These accounts are transferable from one branch to another. A recurring deposit holder is given the recurring deposit pass book for his verification. The rate of interest is similar to the rate offered on fixed deposit but it is compounded.

2.7 OTHER DEPOSITS

In addition to the above, a mushroom growth of deposits has come into practice. In fact, for most of the above deposits, Recurring Deposit Scheme forms the basis. By identifying a package of scheme suitable to different target group of customers, the banks have come forward to really cater to the requirements of different customers. To be successful in the ever increasing competitive market, all efforts should be taken to increase the number of ‘satisfied’ customers by offering them attractive and innovative deposit schemes so as to meet their requirements.

2.8 NEW DEPOSIT SCHEME FOR NRI’S (1992)

With a view to mobilise substantial deposits and attract foreign exchange on a non-repatriable basis, a new Non-Resident (Ordinary Non-Repatriable) Rupee Deposit Scheme has been recently introduced by the Government of India. The transfer of foreign exchange, from non-residents and overseas corporate bodies, to this account would be converted into rupees at the prevailing exchange rate. Deposits with a maturity of 6 months to 3 years can be accepted and they are free from any reserve requirements and net bank credit regulations. Above all, the banks are free to determine the deposit and lending rates under this scheme.

2.9 TERMINOLOGIES

1) Current account
2) Savings account
3) Fixed deposit account
4) Recurring deposit
5) Joint deposit

2.10 MODEL QUESTIONS

1) Explain the legal position of a banker with regard to a fixed deposit.
2) Draw a fixed deposit and discuss its main features.
3) Distinguish between a Current Account and Savings Bank Account
4) Discuss the formalities which a banker has to observe before opening a new account.
5) What is a letter of introduction? Why is it required at the time of opening a new account?

2.11 REFERENCE BOOKS

Practice”, Himalaya Publishing House, Mumbai.


UNIT – III PASS BOOK

3.1 Introduction
3.2 Maintenance of a Pass Book
3.3 Is PassBook an authentic Record
3.4 Situation in America
3.5 Position in India
3.6 Correct Entry
3.7 Entries Favourable to the Customer
3.8 Wrong entry Favourable to a Customer Constitutes a Settlement of account only when.
3.9 Entries Favourable to the Banker
3.10 Terminologies
3.11 Model Questions
3.12 Reference Books

3.1 INTRODUCTION

All kinds of deposit accounts are in the nature of running accounts. So it becomes imperative for a banker to inform his customers of the real position of their accounts from time to time. For this purpose, a banker makes use of a small booklet called pass book. A pass book is a booklet where in a banker records his customer’s account as it appears in his ledger. It is called a pass book because it passes between the hands of a banker and his customer very often. It reflects the customer’s account in the banker’s ledger. All the amounts deposited by a customer are credited and the cheques paid by banks against his account are debited. The balance is shown from time to time. In the place of a passbook, statements of account may also be sent to customers.

3.2 MAINTENANCE OF A PASS BOOK

A pass book may be maintained in the form of a ledger account with debit entries on the left hand side and credit entries on the right hand side. This method is not popular amongst bankers. Most of the banks follow a tabular form for maintaining the pass book. There is economy of stationary in this method. The specimen given is the next page illustrates it well.

A pass book may also be maintained in the form of a ‘loose-leaf ledger card system.’ In such a case, entries would have to be made by means of book keeping machines. It can be adopted only by big banks. When such a system is followed, it becomes necessary for the banker to send periodical statements regarding the accuracy of the entries made there
in to the customers for their approval and return. These statements serve the purpose of a pass book.

Some Western banks, having a large number of customers of their rolls and a large number of transactions, take Photostat copies of their customer’s account and forward them for their approval. It saves the labour of writing cut statements.

Specimen of a pass Book with Specimen Entries

<table>
<thead>
<tr>
<th>Date</th>
<th>Particulars</th>
<th>Dr. Rs. P.</th>
<th>Cr. Rs. P.</th>
<th>Balance Rs.P.</th>
<th>Initials</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>By Cash</td>
<td>50</td>
<td>450</td>
<td></td>
<td></td>
</tr>
<tr>
<td>June 5</td>
<td>By Cheque</td>
<td>160.50</td>
<td>760.50</td>
<td>1,210.50</td>
<td>1,050</td>
</tr>
<tr>
<td>June 9</td>
<td>To Cheque</td>
<td>100</td>
<td>950</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td>June 15</td>
<td>04468</td>
<td></td>
<td>800</td>
<td>820</td>
<td></td>
</tr>
<tr>
<td>June 17</td>
<td>To Self 04469</td>
<td>200</td>
<td>20</td>
<td>820</td>
<td></td>
</tr>
<tr>
<td>June 23</td>
<td>By Interest</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>June 27</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>June 30</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3.3 IS PASS BOOK AN AUTHENTIC RECORD?

A pass book is nothing but a statement of account rendered by a banker to his customer. Does it bind both the parties? What is its proper function? The answer to these questions are very difficult because law is not yet definite on these points. In the absence of sufficient provisions in Law, the bankers have to fall back upon custom and past experience.

According to Sir John Paget “the proper function of a pass book is
to constitute a conclusive and unquestionable record of transactions between the banker and customer and it should be recognized as such.” Thus, the entries in the pass book are prima facie evidence against the banker and the customer is bound by it. To support Sir John Paget’s View, in Devaynes Vs. Noble it was pointed out in judgement that on delivery of the pass book to the customer “….. he examines it and if there arises an error of omission, he brings it or sends it back to be rectified and if not, his silence is regarded as an admission that the entries are correct.” A pass book has been accorded so much significance. As against this, there are some opposite views which deny any authoritative position given to a pass book. In Keptigalla Rubber Estate Company Ltd. Vs. National Bank of India Ltd, Justice Bray said “he knew of no authority in England for the proposition, when a pass book is taken out of the bank by a customer or by some clerk of his, and is returned without objection, there is a settled account between the banker and customer by which both are bound. It would be absurd to hold that the taking of a pass book and its return constitutes a settled account.” In Canara Bank Vs. Canara Sales Corporation and others, it was held “an implied contract as to the settlement of accounts, does not arise between an customer and his banker merely by reason of the banker sending a pass book to a customer and the customer failing to point out any irregularities therein.” One is really confused in one’s attempt to find out an answer to the question “What then is the proper function of a pass book?”

3.4 SITUATION IN AMERICA

The significance of an entry in a pass book is not well defined in India. So, we have to find out the position as obtaining in other countries. In America, the situation is favourable to a banker. There, a pass book is recognised as an authentic record. It is because there is a duty on the part of a customer to examine his pass book. Therefore, whenever, the pass book sent to him, it is his duty to examine it very carefully. If he keeps silent, means he has admitted the entries as correct and the pass book in such a case constitutes a settled account. Thus, in Morgan Vs. United States Mortgage and Trust Company, it was laid down that “a depositor who sends his pass book to be written-up and receives it back with his paid cheques as vouchers, is bound to examine the pass book and vouchers and
to report to the bank without unreasonable delay, any error which may be
discovered.”

3.5 POSITION IN INDIA

The position in India is not well defined. This difficulty arises because
a customer is not bound to examine his pass book. So, if a customer does
not examine the pass book, we cannot claim that he has accepted it as a
settlement of account. To find an answer to what the real effects of entries in
a pass book are, we have to carefully analyse the type of entries. The
entries in a pass book may be of two kinds viz., (i) a correct entry, and ii) a
wrong entry.

3.6 CORRECT ENTRY

A dispute does not arise in respect of a correct entry and therefore we
can boldly say that a correct entry constitutes a settlement of account as
between a banker and a customer.

Wrong Entry

To err is human and therefore a banker may commit an error in a pass
book. What is the result of this wrong entry? To find out an answer to this
question, we have to decide the nature of the wrong entry. The wrong entry
may again be either (i) favourable to a customer, or (ii) favourable to a
banker.

3.7 ENTRIES FAVOURABLE TO THE CUSTOMER

Can a customer rely upon a wrong entry favourable to him? The
answer is “yes” It is so because all the entries in a pass book are made by
the banker or his agent. Therefore a pass book record can be used as an
evidence against a banker. If the customer acts upon them as bonafide so as
to alter his legal position, the banker is stopped from rectifying the same
Thus, in Pakley Bowden and Co. Vs. The Indian Bank Ltd, it was observed
that “ if a bank makes a wrong entry of credits without knowing the fact, at
the time the entries were made and intimated to its customer the credit
entries and the customer acting upon he intimation of credit entries alters
his positions to his prejudice, the banker, there after, will be stopped from
contending the credit entries were wrongly made….. “This in skyrings Vs.
Greenwood an army officer was paid a particular sum by mistake and he
spent away the amount thinking that it was his own. It was held that the
officer had altered his position and the money could not be recovered.

However if the customer has not altered his position by relying upon a wrong entry, then the banker will not be held liable. In United Overseas Bank Vs. Jiwani (1977) the banker had credited Mr. Jiwani’s A/c twice by mistake with a sum of $11,000 which facilitated him to buy a hotel without the necessity to borrow any money from elsewhere. It was held that, though the banker had supplied him an inaccurate information, Mr. Jiwani had not acted differently. In other words, he would still have purchased the hotel by borrowing extra money even if the mistaken credit had not been available to him. So the banker was not held liable.

In Canara Bank Vs. Canara Sales Corporation and Others, the Chief Account Officer of the Corporation forged the signature of the Managing Director of 42 Cheques between 1957 and 1961, for a total amount of Rs.3,26,047/42. This was discovered by the corporation only during March.’61, and the banker was sued for having paid cheques with forged signatures. But the bank pleaded that the corporation was negligent, for it did not raise any objection at the appropriate time even though it was supplied with the monthly statements of accounts and half yearly accounts. It was held that the bank was liable because there was no binding on the part of the customer to examine his pass book and to report the discrepancies to the bank.

Thus, if a customer draws a cheque relying upon the larger credit balance, his banker will have no right to dishonor it. If the banker dishonours the cheque, he will be held liable to pay damages for wrongful dishonor of cheque, as was decided in the case of Holland Vs. Manchester Liver Pool District Banking company. In the above case, the pass book was showing a credit balance of £ 70 instead of £ 60. The banker later found out the mistake and dishonoured the customer’s cheque for £ 65 which was drawn in complete reliance on the larger credit balance. It was held that the banker was liable to pay damages. Thus,

3.8 **WRONG ENTRY FAVOURABLE TO A CUSTOMER CONSTITUTES A SETTLEMENT OF ACCOUNT ONLY WHEN**

(i) the customer believes that it is true.

(ii) the customer draws a cheque in good faith and in complete reliance on the larger
credit balance,

(iii) the wrong entry is communicated to the customer (Smith Vs. Cox and Co).

(iv) in any case a customer can not rely upon any fictitious entry made in the pass book by a bank employee. (British and North European Bank Vs. Zalzstien).

A banker can have this mistake rectified, Provided (i) the customer has not been adversely affected. and (ii) the sum has not been withdrawn. Hence, if a banker wants to rectify the mistake, he must immediately inform the customer. Until the matter is settled, the banker should go on honouring the cheques drawn in reliance on the larger credit balance. The principle is longer the duration, lesser the chances of a banker to rectify the mistake. To conclude, we can say that a pass book belongs to a customer and the entries made in it are statements on which the customer is entitled to depend and act.

3.9 ENTRIES FAVOURABLE TO THE BANKER

The wrong entry in a pass book may sometimes be favourable to a banker. Does it constitute a settlement of account? The answer is ‘no’ It is so because, the mistake is committed by the banker and the customer is not bound by the mistake. However, there is one exception to the above rule. That is, where a customer has so acted as to render the entries as correct by his conduct, then those entries would constitute a settled account. In other words, if the customer, by his conduct, accepts the entries as correct, later on he can not question the accuracy of those entries. Whether the customer has rendered the entries as settled one or not depends only upon the circumstances. For instance in Chatterton Vs London and Country Bank the customer returned the pass book to the banker after ticking all the items as correct ones. Even then it was held that there was no admission of the correctness of entries.

There have also been certain judgements favourable to bankers. In Vagliano Brothers Vs. Bank of England, the plaintiff received his pass book from time to time and used to check each item with the paid bills as vouchers. Only then the pass book was returned. It was held that the Vagliano brothers had rendered the account as a settled one by their
conduct and so they had been guilty of negligence with respect to the examination of the false vouchers. So the banker was not held responsible for the mistake. In Balakrishna Pramanink Vs. Bhowanipore Banking Corporation Ltd., the customer used to scrutinize entries in the pass book and call for explanations when needed. It was held that the customer, by his conduct, had rendered the entries as settled ones and so later on the could not complain about the compound interest being debited to this account.

From the above cases it is quite evident that where a customer has voluntarily taken up the duty of examining his pass book and if he is negligent of verifying those entries, then, the liability falls only on the customer. Those entries constitute a settled account.

A customer’s duty to examine his pass book can arise, from an express agreement. In special circumstances, if the attention of the customer is drawn to the accounts, he is under an obligation to examine the pass book and to report any inaccuracies in them. In such a case, if the customer keeps silent, it may be presumed that he has accepted the entries as correct. If a banker succeeds in establishing this custom, the court may give legal recognition to the practice. That is why some bankers send periodical statements to their customers and ask them to certify them as correct. If they do so, they are bound by them.

This concept of settled account is based upon one main principle namely “one will not be permitted to profit from a mistake of which one has been a ware.”

The place of pass book in the Indian Banking System is not well defined. To be on the safe side, a banker should see that the pass book is made up, signed and returned to the customer as often as possible. When a pass book is sent, the date should be noted in the ledger together with the initials of the clerk who is in charge of it. He is responsible for its accuracy. Whenever an error is discovered, the customer should be informed of it immediately and asked to return the pass book for correction. When a pass book is lost, a duplicate can be given against a payment of Rs. 3/- with opening entries and with additional charge of Rs. 2/- per ledger folio and it should be marked ‘DUPLICATE.’ If a pass book is prepared carefully it will eliminate many complications.
3.10 TERMINOLOGIES

3.11 MODEL QUESTIONS
1) Under what circumstances does a wrong entry in a pass book in favour of a banker bind the customer?
2) What is the effect of sending confirmation slips along with a pass book?
3) When will a wrong entry favourable to a customer constitute a settlement of account?
4) What is the proper function of a pass book according to Sir John Paget?
5) Explain the entries favourable to the banker.

3.12 REFERENCE BOOKS
UNIT – IV CROSSING

4.1 Introduction

A cheque without crossing is called an open cheque. It is open to many risks. In order to protect it from risks, crossing has been introduced. Crossing originated almost by accident. It was Irwin, one of the bank employees, who mooted the idea of Clearing House. It was there, the practice of crossing cheques originated. So, he can better be called, the father of crossing. In those days, bankers used to stamp their names on cheques while passing them through Clearing Houses. It enables the clearing house clerks to make up the accounts. Moreover, such stamping (crossing) of a cheque ensured safely, because, there was the danger of bank employees being mishandled and robbed, while carrying cheques to the clearing house. Seeing the advantage of such crossing, people began to cross cheques. They began to insert the words “& Co”, when the name of the payee’s banker was not known. But, crossing was not recognized outside the clearance.

In the year 1856, crossing of cheques became a matter of legislation. It was laid down by the 1956 Act:

(i) that, when a cheque is crossed with or without the words ‘& Co’ in between, it should be presented through some banker, and

(ii) that, when a cheque is crossed in favour of a particular banker, its payment should be made only to that banker or another banker.
acting as his agent.

But in Simmons Vs. Taylor, it was laid down that crossing was not an integral part of a cheque and that its erasure did not amount to forgery. In Bellamy Vs. Morjori Banks, it was also said that “........ crossing is a mere memorandum on the face of the cheque and forms no part of the instrument itself and in no way alters its effects ….”

The above decision was nullified by the Act of 1858. It was laid down in that Act that, crossing was a material part of a cheque and its obliteration or alteration amounted to forgery and that, the person committing this fraud was liable to transportation for life. This Act led to the foundation of the law of special crossing. Later on, in 1876, the Act of 1858 was repealed. This is the story behind the present form of crossing.

4.2 KIND – OF CROSSING

Crossing is of two types namely General Crossing and Special Crossing.

General Crossing

Sec. 123 of the Negotiable Instruments Act 1881 defines general crossing as follows:

“Where a cheque bears across its face, an addition of the words ‘And company’ or any abbreviation there of, 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 to be a ‘crossing, and the cheque shall be deemed to be crossed generally.”

4.3 ESSENTIALS OF GENERAL CROSSING

(i) Two lines are of paramount importance in crossing.

(ii) The lines must be drawn parallel and transverse. Transverse means, that, they should be arranged in a crosswise direction. They should not be straight lines. Mathematical signs for plus and multiplication do not constitute crossing, because, they are not constitute a crossing within the meaning of Sec.123:

<table>
<thead>
<tr>
<th>(a)</th>
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<th>(c)</th>
<th>(d)</th>
<th>(e)</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>X</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(iii) The lines are generally drawn on the left hand side so as not to
obliterates or alter the printed number of the cheque. Preferably, the line should cut across some of the writings. The following picture will make the position clear.

(iv) The words ‘And Company’ or its abbreviation may be written in between the lines. They themselves are not essential and so, they do not constitute crossing, without two parallel transverse lines. But, it has been the practice to write them when the drawer does not know the name of the payee’s banker.

(v) So also, the words ‘Not Negotiable’ may be added to a crossing. But, they themselves do not constitute a crossing.

4.4 FORMS OF GENERAL CROSSING

Note: Two parallel transverse lines themselves constitute a crossing. So, inbetween these lines, any word can be written.

4.5 SIGNIFICANCE OF GENERAL CROSSING

(i) The effect of general crossing is that it gives a direction to the paying banker.

(ii) The direction is that, the paying banker should not pay the cheque at the counter. It should be paid only to a fellow banker. In other words, payment is made through an account and not at the counter. Sec. 126 of the Act clearly lays down that, “where a cheque is crossed generally, the banker on whom it is drawn, shall not pay it otherwise than to a banker.”

(iii) If a crossed cheque is paid at the counter in contravention of the crossing:
(a) the payment does not amount to payment in due course. So, the paying banker will lose his statutory protection,

(b) he has no right to debit his customer’s account, since, it will constitute a breach of his customer’s mandate,

(c) he will be liable to the drawer for any loss, which he may suffer,

(d) he will be liable to the true owner of the cheque who may be a third party, irrespective of the fact, that, there is no contract between the banker and the third party. As a general rule, a banker is answerable only to his customer and this liability to a third party her is an exception.

(iv) The main intention of crossing a cheque is to give protection to it. When a cheque is crossed generally, a person who is not entitled to receive its payment, is prevented from getting that cheque cashed at the counter of the paying banker. But, it gives only a limited protection, in the sense, that if the thief is not the customer of the paying banker, he can encash that cheque through his banker, by forging the signature of the payee. However, it can be detected. To avoid this danger, special crossing was introduced.

4.6 SPECIAL CROSSING

Sec. 124 of the Negotiable Instruments Act of 1881 defines a special crossing as follows: “where a cheque bears across its face, an addition of the name of a banker, 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.”

Essentials of Special Crossing

(i) Two parallel transverse lines are not at all essential for a special crossing.

(ii) The name of a banker must be necessarily specified across the face of the cheque. The name of the banker itself constitutes special crossing.

(iii) It must appear on the left hand side, preferably on the corner, so as
not to obliterate the printed number of the cheque.

(iv) The two parallel transverse lines and the words ‘Not Negotiable’ may be added to a special crossing.

**Forms of Special Crossing**

![Forms of Special Crossing Diagram]

**Significance of Special Crossing**

(i) It is also a direction to the paying banker. The direction, is that, the paying banker should pay the cheque only to the banker, whose name appears in the crossing or to his agent. Sec 126 of the Act clearly lays down that “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.”

(ii) If a cheque specially crossed to a bank is presented by another bank, not in the capacity of its agent, the paying banker is justified in returning the cheque.

(iii) A special crossing gives more protection to the cheque than a general crossing. It makes a cheque still safer because, a person, who does not have a real claim for it, would find it difficult to obtain payment. In special crossing, the cheque is specially crossed to the payee’s banker. Hence, the banker, in whose favour the cheque has been crossed, knows the payee and his specimen signature well. So, he will not collect it for any person other than the payee. If there is any forgery, it can be easily detected by the banker. But, we can not say that, it gives full protection in the sense, that, an unscrupulous person, who has an account in the same bank but at a different branch, can encash it by forging the signature of the payee. It can also be detected. However, there is some danger in special crossing also. To overcome this danger,
`Not Negotiable' and `A/c payee' crossings have been introduced.

4.7 NOT NEGOTIABLE CROSSING

As stated earlier, Secs. 123 and 124 of the Act permit the use of the words `Not Negotiable' in the crossing. This type of crossing is termed as `Not Negotiable' crossing.

Forms of Not Negotiable Crossing

Forms of Not Negotiable Crossing

Significance of Not Negotiable Crossing

`Not Negotiable' does not mean not transferable. Not negotiable crossing does not affect the transferability, but, it kills only the `negotiability.' Negotiability is something different from transferability. Negotiability is a broader term which includes transferability. As per law, negotiability means transferability by mere delivery or endorsement and delivery plus transferability free from defect. But, transferability does not possess the second quality namely transfer free from defect. So, one part of the negotiability is the transferability. In other words, if a document is a negotiable one, a bonafide transferee who receives it in good faith and for value paid, can obtain a good title, despite the fact that, the documents, has prior defects. But, in case a document is a not negotiable instrument, the transferee cannot obtain a good title, when there is prior bad title. Hence, no one can be a holder in due course in the case of a not negotiable instruments. In Hibernian Bank ltd. Vs. Gysin and Hansan, It was held that the words `Not Negotiable' when they appear on a bill must be assigned their ordinary meaning in law i.e., the instrument is deprived of one of the most important characters of negotiable instruments namely, transferability free from defects.

Thus, a Cheque Crossed `Not Negotiable' can be transferred like any other cheque. But, the transferee can not obtain a better title than that of the transferor. It has been provided in sec. 130 of the Negotiable Instruments Act that "A person taking a cheque crossed generally or
specially, in either case bearing the words “not negotiable”, shall not have and shall not be capable of giving a better title to the cheque than that, which the person from whom he took it had.”

The words ‘Not Negotiable’ do not impose any additional duty on either the collecting banker or the paying banker. But, it is a warning to the person, who takes this document, that, he should be very careful in receiving it. In commissioners of state savings Bank of Victoria Vs. Permewan Wright and Co., learned Judge Griffith said “In my opinion, the words ‘Not Negotiable’ on a crossed cheque are a danger signal held out before every person invited to deal with it and are equivalent to saying “take care, this cheque may be stolen.” Thus, a cheque crossed ‘not negotiable’ is just like a stolen property, where good title can not be passed on to others. If that cheque is offered, the transferee should know the previous endorsers and their good title to the cheque. Otherwise, he will be compelled to give it back to the true owner, if that cheque happens to be a forged one. That is why sir John paget rightly says that the words. ‘Not Negotiable’ have no special meaning as far as a banker is concerned, and so, he can justifiably ignore it.

The object of this type of crossing is to give protection to the true owner of the cheque by protection to the true owner of the cheque by preserving his right against any subsequent holder. so, this type of crossed cheques can safely be sent through post.

To put it in a nutshell, if a cheque is crossed ‘not negotiable’ it is taken out of the category of negotiable instruments. But, it can be transferred subject to the title of the transferor.

4.8 A/C PAYEE CROSSING

There is no provision in law regarding this type of crossing. But it has been developed in practice. If the words, ‘A/c Payee’ are added to a crossing, it becomes and A/c payee crossing.

Significance of A/c Payee Crossing

‘A/c payee’ crossing does not restrict the transferability of cheques. In British Bank of Middle East Vs. Abmal Brothers, the drawer of a cheque (Abmal Brothers) pleaded that, since, the cheque had been marked A/c payee only, the negotiation on it was null and void. But it was held that ‘A/c payee’ crossed cheque can be negotiated. But, if the words “or order”
which appear immediately after the payee’s name, are struck through and if the cheque is crossed ‘A/c payee’, that cheque will be considered to be not transferable.

Forms of A/c Payee Crossing

This type of crossing gives a further protection to a cheque. This crossing gives a direction to the collecting banker. The direction is that, the collecting banker should not collect it for any person other than the payee. In other words, a collecting banker should ensure that, the cheque is credited only to the account of the payee. Hence, practically speaking, such cheques can not be negotiated further.

If a collecting banker collects such a crossed cheque for any person other than the payee, it will constitute negligence on the part of the collecting banker, and so, he will lose the statutory protection given under Sec.131 of the Act.

In India, the A/c payee directions were abused during the multi-crore securities scam period. The A/c payee cheques issued to banks on RBI, instead of being credited to the payee banks, were directly credited to the broker’s accounts. Hence, the RBI has issued the following strict orders with regard to an A/c payee crossing. “Crediting the proceeds of A/c payee cheques to parties other than that clearly delineated in the instructions of the issues of the cheques is unauthorised and should not be done under any
Thus, in actual practice, A/c payee crossed cheques cannot be collected to the account of any person other than the payee himself. The paying banker is not concerned with this type of crossing. However, if such a cheque bears any endorsement other than that of the payee, the safest method will be to return it. It is so because, if the words ‘A/c Payee’ were put on by the drawer, and if the banker honours it, it would amount to disobeying his customer’s mandate.

The safest form of crossing will be a combination of ‘Not Negotiable’ and ‘A/c payee’ crossings, which give the fullest protection to a cheque.

**4.9 DOUBLE CROSSING**

Sec. 125 of the Act provides that “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”.

**Form of Double Crossing**

This form is not followed in practice. The present practice is to indicate the agent by specifying the fact on the back of the cheque as follows:

```
Pay to Canara Bank as agent for collection for Indian Bank (sd) Manager
```

Sec. 127 of the Act lays down that, “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 there of “ Thus, if a cheque is crossed to two or more banks, the paying banker is put in confused position as to whom he should pay. Such ambiguity renders the cheque invalid. But, a banker in whose favour a cheque is crossed, can cross it again in favour of another banker for the purpose of collection. It does not render the cheque invalid.

**Who Can Cross a Cheque**

(i) The drawer of a cheque can cross it at the time of issuing it.
(ii) Any holder can cross an uncrossed cheque. He can convert general crossing into special crossing, and, he can even add the words “Not Negotiable” or “A/c payee” to a crossing.

(iii) The banker in whose favour a cheque has been crossed, can again cross it in favour of another banker, for the purpose of collection, as an agent.

4.10 OPENING OF CROSSING

The cancellation of crossing is usually termed as ‘opening of crossing’. Law does not make any provision for the cancellation of a crossing. But, it has been risen out of custom. When a drawer wants to cancel the crossing, he writes the words ‘Pay cash’ upon the cheque, followed by his full signature. The drawer alone has a right to cancel the crossing. But, once a crossed cheque has been issued, even the drawer’s right ceases. In the words of Sir John Paget “When the drawer has once parted with the cheque, he can not retract or neutralize his mandate to the prejudice of any one who has taken the cheque on the faith of it…”

4.11 TERMINOLOGIES

1) Crossing 2) Special 3) Double 4) Cheque 5) Opening 6) Payee

4.12 MODEL QUESTIONS

1) What is ‘marking’ of a cheque? What is its significance?

2) Is it obligatory to mark a cheque? Is it similar to acceptance of a bill?

3) Bring out the significance of marking at the request of a drawer.

4) Can a banker present a cheque to another to be marked as good for payment? If so, what is its significance?

5) Discuss the legal implications of marking of a post-dated cheque with a relevant case law on this subject.

4.13 REFERENCE BOOKS


5.1 Introduction

A banker on whom a cheque is drawn should pay the cheque when it is presented for payment. This cheque-paying function is a distinguished one of a banker. This obligation has been imposed on him by Sec. 31 of the N.I.Act. A banker is bound to honour his customer’s cheques, to the extent of the funds available and the existence of no legal bar to payment. Further, the cheque must be in order and it must be duly presented for payment at the branch where the account is kept. The paying banker should use reasonable care and diligence in paying a cheque, so as to, abstain from any action likely to damage his customer’s credit. If the paying banker wrongfully dishonours a cheque, he will be asked to pay heavy damages. At the same time, if he makes payment in a hurry, even when there is no sufficient balance, the banker will not be allowed to debit the customer’s account. If he does so, it will amount to sanctioning of overdraft without prior arrangement, and, later on, the customer can claim it as a precedent and compel the banker to pay cheques in the absence of sufficient balance. His position is very precarious and is in between the devil and the deep sea.

5.2 Precautions before honouring a Cheque

In order to safeguard his position, the paying banker has to observe the following precautions before honouring a cheque.

1. Presentation of the Cheque

First of all, a paying banker should note whether the presentation of the cheque is correct, It can be found out by paying attention to the following factors.

(a) Type of the cheque: Before honouring a cheque, he must find out the type to which it belongs. Cheques may generally be of two types—
open or crossed. If it is an open one, the payment may be made at the counter. If it is crossed, the payment must be made only to a fellow banker. If it is specially crossed, the payment must be specifically made to that banker, in whose favour it has been crossed. If there are ‘A/c Payee’ and ‘Not Negotiable’ crossings, the paying banker need not worry, as they are the directions only to the collection banker. If the paying banker pays a cheque contrary to the crossing, he is liable to the drawer and to the true owner and this payment cannot be regarded as a payment in due course. Therefore, he must pay special attention to the type of a cheque.

(b) Branch: Then the paying banker should see whether the cheque is drawn on the branch where the account is kept. If it is drawn on another branch, without any prior arrangement, the banker can safely return the cheque.

(c) Account: Even in the same branch, a customer might have opened two or more accounts. For each account, a separate cheque book would have been issued. Hence, the paying banker should see that the cheque of one account is not used for withdrawing money from another account. In State Bank of India Vs. Vathi Sambamurthy (1988) it was held that, for the withdrawal of money from an account, only the cheque relating to the account from which money has to be withdrawn must be used.

(d) Banking hours The paying banker should also note whether the cheque is presented during the banking hours on a business day. Payment outside the banking hours does not amount to payment in due course. In Joachimson Vs. Swiss Banking Corporation it was held that “the promise to repay is to repay at the branch of the bank where the account is kept, and during banking hours. “However, a banker is justified in extending the time, during peak days, for those, who are still waiting for encashing a cheque, The banker may allow a slight margin as was decided in the case of Baines Vs. National Provincial Bank. In the aforesaid case, a cheque was presented and paid at 3.05 p.m. instead of paying it before 3 p.m. It was held that the bank did not act out of the way in making payment.

The hours of banking business are statutorily laid down. Even public holidays are notified under the Negotiable Instruments Act. It is so, because, Sec. 25 of the N.I. Act specifies that “when the day, on which a
promissory note or bill of exchange is at maturity is public holiday, the instrument shall be deemed to be due on the next proceeding business day." Thus, the object of declaring a public holiday is to enable the determination of due dates of instruments. Hence, cheques should not be paid on a bank holiday or during non-banking hours on a working day.

(e) Mutilation: If the cheque is torn into pieces or cancelled or mutilated, then, the paying banker should not honour it. He should return the cheque for the drawer’s confirmation. In case a cheque is torn accidentally, the drawer must confirm it by writing such words as “Accidentally torn by me” and affixing his full signature. A cheque torn into two or more pieces is generally returned with a remark “Mutilated.”

II. Form of the Cheque

Before honouring a cheque, a banker should see the form of the cheque and find out whether it is regular or not.

(a) Printed form: The cheque must be in the proper form. It must satisfy all the requirements of law. The customer should draw cheques only on the printed leaves supplied by the bankers, failing which, the banker may refuse to honour it.

(b) Unconditional order: The cheque should not contain any condition. If it is a conditional one, the paying banker’s position will become critical and he may not honour it.

(c) Date: Before honouring a cheque, the bank must see whether there is a date on the instrument. If it is undated, it can not be regarded as a valid instrument. If a cheque is ante dated, it may be paid if it has not become stale by that time. A cheque which is presented after six months, from the date of its issue is a stale one. If a cheque is post-dated, he should honour it only on its due date. Sir John Paget rightly observes “a banker who pays a post-dated cheque has disobeyed his customer’s mandate and authourity.”

(d) Amount: The next important precaution is that the banker should see whether the amount stated in the cheque, both in words and figures, agree with each other. If the amount is stated only in figures, the banker should return it with a remark “Amount required to be stated in words.” However, if the amount is stated only in words, the banker may honour it. Supposing, there is a difference in the amount stated in words
and figures, then, the banker can take any one of the following courses available to him:

(i) he can dishonor the cheque with a memorandum “words and figures differ,” or

(ii) he can honour the amount stated in words, or

(iii) he can honour the smaller amount.

According to Sec. 18 of the N.I. Act, “If the amount undertaken or ordered to be paid is stated differently in figures and words, the amount stated in words shall be the amount undertaken or ordered to be paid.” However, in practice, if the difference is insignificant, payment is sometimes made. But, usually the paying banker returns the cheque under such circumstances, since, there is an audit objection to the practice of honouring such cheques.

(e) Material alteration: A paying banker should be very cautious in finding out the alterations that may appear on a cheque. If there is any material alteration, the banker should return it with a memorandum “Alteration requires drawer’s confirmation.” If the alteration is confirmed by the drawer by means of his full signature, then the banker can have no objection to honour it. If the alteration is not apparent, and, if it is paid in due course, then, the banker will not be liable.

III. Sufficient Balance

There must be sufficient balance to meet the cheque. If the funds available are not sufficient to honour a cheque, the paying banker is justified in returning it. So, before honouring a cheque, he must check up the present state of his customer’s account. For this purpose, he must compute the balance in the account of his customer. In computing the balance, the previous agreement, if any, for O.D. should be taken into account. He should not disclose the state of affairs of his customer’s account to anybody. He must not offer a part of the amount of the cheque, if the balance is insufficient to meet the full amount of the cheque. For computing the balance, a banker may combine the accounts of the same customer, if he has more than two, after giving due notice to the customer. Under certain circumstances, a banker, in order to protect the customer, may combine the accounts and pay a cheque. In computing the balance, he must not earmark any money for meeting contingent liabilities.
IV. Signature of the Drawer

The next important duty of a paying banker is to compare the signature of his customer found on the cheque with that of his specimen signature. If he fails to do so and if he pays a cheque, which contains a forged signature of the drawer, then, the payment will not amount to payment in due course. Hence, he can not claim protection under Sec. 85 of the N.I. Act. If the signature has been too skillfully forged for the banker to find it out, even then the banker is liable. However, if the customer facilitates the forgery of his signature by his conduct, then, the banker will be relieved from his liability.

V. Endorsement

Before honouring a cheque, the banker must verify the regularity of endorsement, if any, that appears on the instrument. It is more so in the case of an order cheque, which requires an endorsement before its delivery. For instance, if there is per pro endorsement, the banker must find out the existence of authority. Failure to do so constitutes negligence on the part of the paying banker.

VI. Legal Bar

The existence of legal bar like Garnishee Order limits the duty of the banker to pay a cheque.

VII. Minor Precautions

A paying banker should look into the following minor details also, before honouring a cheque.

(a) He must see whether there is any order of the customer not to pay a cheque.

(b) He must see whether there is any evidence of misappropriation of money. If so, the cheque should be returned e.g., breach of trust.

(c) He must see whether he has got any information about the death or insolvency or insanity of his customer. Failure to note those instructions will land him in trouble.

5.3 CIRCUMSTANCES UNDER WHICH A CHEQUE CAN BE DISHONOURED

A paying banker is under a legal obligation to honour his customer’s mandate. He is bound to do so under his contractual
relationship with his customer. A wrongful dishonor will have the worst
effect on the banker. However, under the following circumstances, the
payment of a cheque must be refused:

(a) Countermanding: Countermanding is the instruction given by
the customer of a back requesting the bank not to honour a particular
cheque issued by him. When such an order is received, the banker must
refuse to pay the cheque.

Countermanding, in order to be really effective, must be in writing.
The written mandate should contain all the details of the cheque, viz., date,
number of the cheque, name of the payee and the amount. Without these
details, the banker would find it difficult to oblige the customer. The
mandate must be signed by the customer. In the case of a company, any
director can stop payment of cheque. So also, any partner or any one of the
joint account holders can stop the payment of a cheque.

If the countermanding instructions are not clear, then the banker will
not be liable. In Westminster Bank Vs. Hilton, the customer had
instructed his banker not to pay his cheque No. 117283 instead of 117285.
The cheque No.117285, therefore, was paid. It was held that the banker
was not liable. In Mitchel Vs. Security Bank, the cheque in question was
for 196.75 and was dated Dec.23. But a stop payment order was given for
196.75 and the date was given as Dec. 21. The banker was not held liable
for having paid the cheque,. It was said that “where the drawer notifies a
bank to stop payment on a cheque, his notification must be explicit, and
describe the cheque with reasonable accuracy.” Where a customer is
maintaining two accounts and the account number is not specified, it is
advisable to register the stop order on both the accounts. (Reade Vs. Royal
Bank of Ireland). The countermanding instructions should be served to the
officer of the bank in the banking house and during banking hours.

If a customer informs by telephone or telegram regarding the
stopping payment of a cheque, the banker should diplomatically delay the
payment, till written instructions are received. If the situation is very
critical, he can return the cheque by giving a suitable answer like ‘payment
countermanded by telegram and postponed pending confirmation. ‘In
curttice Vs. London city and Midland Bank Ltd. a telegram sent to stop
payment of a cheque, was put into the bank’s letter box. When the box
was opened, the telegram was overlooked. It was held that the countermanding was not effective until the telegram came into the hands of the manager. Even a stop order given over the telephone is valid but it is advisable to act upon written instructions. In Shude Vs. American State Bank, a stop order was given over the telephone and the customer identified himself as “Mr. Shude from Anchor Steel.” But, the banker returned the cheque drawn by the Anchor Steel Company. It was held that the banker was liable. However, it would not be advisable to act upon the oral orders because, if the banker returns the cheque, the customer, if he happens to be an unscrupulous person, may claim damages for wrongful dishonour of the cheque by saying that he never informed the banker to stop payment of his cheque.

The drawer alone has the right to countermand the payment of a cheque. In case a cheque is lost by a holder, he should stop payment of that cheque only through its drawer. It is so because, a banker is always answerable only to the drawer, in the case of dishonour of a cheque. In the case of a draft, its purchaser has no right to countermand its payment.

Any countermanding instruction given to one branch is not effective, as a notice given to another branch, as was decided in the case of Burnett Vs. Westminster Bank.

Again, if a cheque is covered by a ‘cheque card,’ then, that cheque can not be countermanded. A cheque card is a document issued by a bank which enables the holder to encash cheques, upto a stated maximum, at any branch of the issuing bank. Since it contains an undertaking by the issuing bank to pay it, it is readily acceptable to all parties particularly to third parties. Hence, it can not be countermanded.

If a banker, by mistake, honours a countermanded cheque:
(a) the payment does not amount to payment in due course,
(b) he will have to answer for having disobeyed his customer’s mandate,
(c) he has no right to debit his customer’s account with the amount of the countermanded cheque,
(d) he may have to dishonour the customer’s subsequent cheques for want of funds in the account,
Therefore, countermanding instructions, once received, must be kept as constant record. A ‘stopped payment’ register may be maintained for ready reference. It is advisable that a slip, giving the details of the cheque to be countermanded, is pasted on the customer’s account. Alternatively, a red ink mark may be made against the customer’s account, so that, the clerk concerned with posting of cheques may be careful.

When a banker dishonours a countermanded cheque, it would be advisable to give answers like “ordrs not to play” rather than “Payment stopped” because the latter can be interpreted in any way.

(b) Upon the receipt of notice of death of a customer. Death puts an automatic end to the contractual relationship between a banker and his customer. When a banker receives written information from an authoritative source, (preferably from the nearest relatives) regarding the death of a particular customer, he should not honour any cheque drawn by that deceased customer. If the banker is unaware of the death of a customer, he may honour the cheque drawn by him. It would be held valid notwithstanding the fact the payment has been actually made after his death.

(c) Upon the receipt of notice of insolvency: Once a banker has knowledge of the insolvency of a customer, he must refuse to pay cheques drawn by him. Usually, the banker will be served with a notice of the presentation of petition upon which he can take necessary action.

(d) Upon the receipt of notice of insolvency: Where a banker receives notice of a customer’s insanity, he is justified in refusing payment of the cheque drawn by him. The banker should make a careful note, when the lunacy order is received. It is advisable that the banker should act upon a definite proof of the customer’s insanity like a doctor’s certificate, a court order etc.

(e) Upon the receipt of notice of Garnishee Order: Garnishee Order refers to the order issued by a court attaching the funds of the judgement debtor (i.e., the customer) in the hands of third party (i.e., the banker.) The term ‘Garnishee’ refers to the person who has been served with the order.

This Garishee proceedings comprise of two steps. As a first step ‘Garnishee Order Nisi’ will be issued. ‘Nisi’ means ‘unless’. In other words, this order gives an opportunity to the banker to prove that this order
could not be enforced. If the banker does not make any counterclaim, this order becomes an absolute one, This ‘Garnishee order absolute’ actually attaches the account of the customer. If it attaches the whole amount of a customer’s account, then, the banker must dishonour the cheque drawn by that customer. He can honour his cheques to the extent of the amount that is not garnished. Hence, the banker should go through the terms of the order very carefully.

If the order is vague or if it gives a wrong description of the party, it is not effective, (Koch Vs. Mineral Ore Syndicate). A Garnishee Order issued against a husband’s account can not attach a joint account in the name of the husband and wife (Hirschorn Vs.Evans). If the order is so worded as to attach two accounts in different capacities, then, it attaches both the accounts. (Plunkett Vs. Barclays Bank Ltd). A Garnishee Order in the name of a firm, attaches both firm’s account and the private account of the partners. A cheque in favour of a judgement debtor can not be attached by the order, because, the cheque is not property of the payee until the money is paid to him. The proceeds of sale of shares, stock etc., are not attached, if they are not received by the bankers on the date of the order. this order cannot attach cheques paid into the account of the judgement debtor but not yet collected. however, in case where a cheque is sent for collection by one bank(principal bank) to another(agent bank), the moment the cheque has been realized by the agent bank,that realization is deemed to be a realisation made by the principal bank itself, and as such it could be attached as was decided in the case of geraldC.S.lobo vs.canar a bank (1991). the fact that the realisation slip was recived by the principal bank at a later date was considered immaterial in the above case. foreign balances are not attachable. if this order is sent to the head office,then,a reasonable time should be given for communicating this order to the concerned branch.in India this provision is contained in order 121,Rule 46 of the code of civil procedure 1908.

(f) Upon the receipt of notice of assignment: the bank balance of a customer constitutes an asset and it can be assigned to any person by giving a letter of assignment to the banker. once on assignment has been made, the assignor has no legal rights over the bank balance and therefore, if any cheque is drawn by him, the banker should refuse to honour it.
(g) when a breach of trust intended: in the case of a trust account mere knowledge of the costomer’s intention to use the trust funds for his personal use, is a sufficient reason to dishonor his cheque.

(h) Defective title: if the person who brings a cheque for payment has no title or his title is defective, the banker should refuse to honour the cheque presented by him. for instance, a person who brings a cheque, which has been countermanded or which has been forget, has no title to it.

(i) Other grounds: A banker is justified in dishonouring a cheque under the following circumstances also.

- If a cheque is:
  - i. A conditional one,  
  - ii. Drawn on an ordinary piece of paper,  
  - iii. A stale one,  
  - iv. A post-dated one,  
  - v. multilated,  
  - vi. Drawn on another branch where the account is not kept,  
  - vii. presented during non-banking hours,  
  - viii. if the words and figures differ,  
  - ix. if there is no sufficient funts,  
  - x. if the signature of the costomer is irregular, and  
  - xi. if the endorsement is irregular, and  
  - xii. if a crossed cheque is presented at the counter.

5.4 ANSWERS TO A DISHONOURED CHEQUE

Eventhough it is not obligatory on the part of a paying banker to give reasons, while dishonouring a cheque, in practice, he gives such reasons to satisfy the rules of the clearing house. in giving the reasons, he must be very cautious and must see that his answer neither damages the customer’s credit nor misleads the party presenting the cheque. that is why, usually information is sparingly given in such cases. most of the banks have a slip containing the reasons printed on it and they put a tick mark against the appropriate reason.

TAMILNADU BANK LTD,  
Regd.office: Madurai  

MEMORANDUM OF CHEQUE RETURNED
cheque No.______________ is returned for
the Reason Marked X Below

<table>
<thead>
<tr>
<th>Reason</th>
</tr>
</thead>
<tbody>
<tr>
<td>PAYEE’S ENDORSEMENT REQUIRED</td>
</tr>
<tr>
<td>PAYEE’S ENDORSEMENT IRREGULAR</td>
</tr>
<tr>
<td>PAYEE’S ENDORSEMENT REQUIRES BANK’S CONFIRMATION</td>
</tr>
<tr>
<td>CHEQUE IS POST-DATED</td>
</tr>
<tr>
<td>CHEQUE IS OUT OF DATE</td>
</tr>
<tr>
<td>REFER TO DRAWER</td>
</tr>
<tr>
<td>PAYMENT STOPPED BY DRAWER</td>
</tr>
<tr>
<td>AMOUNT IN WORDS AND FIGURES DIFFERS</td>
</tr>
<tr>
<td>EFFECTS NOT CLEARED PLEASE PRESENT AGAIN</td>
</tr>
<tr>
<td>CROSSED CHEQUE SHOULD BE PRESENTED THROUGH A BANK</td>
</tr>
<tr>
<td>NO ADVICE</td>
</tr>
<tr>
<td>ALTERATION REQUIRES DRAWER’S FULL SIGNATURE</td>
</tr>
<tr>
<td>NOT SUFFICIENT FUNDS</td>
</tr>
</tbody>
</table>

To

____________
____________
Manager.

In this connection, one must note that, the return of a dishonoured cheque itself amounts to, giving a notice of dishonour.

Usual Answers

(a) N.S., N.F., N.S.F.: These abbreviations denote the absence of sufficient money in the account of the customer. N.S. means Not Sufficient, N.F. means No Funds, N.S.F. means Not Sufficient Funds.

(b) E.I. It means ‘Endorsement Irregular.’
(c) E.N.C. It refers to ‘Effects Not Cleared.’ This answer is used when cheques are drawn against cheques paid in but not yet collected.

(d) D.D. It denotes ‘Drawer Deceased.’

(e) W.F.D. It means ‘Words and Figures Differ.’

(f) ‘Exceeds Arrangement’: It is used when the cash credit or O.D. is completely exhausted.

(g) D.R. It is an abbreviation of ‘Discharge Required.’ It is used when the instrument is not discharged with proper endorsement.

(h) N.P.F. It means ‘Not Provided For.’ It is used when no arrangements are made to meet a cheque in the absence of any balance.

(i) R.D: It means ‘Refer to Drawer’. For the first time it was held in Sterling Vs. Barclays Bank Ltd. that the words ‘Refer to Drawer’ has defamatory meaning and the banker is liable for an action of libel. In Jayson Vs. Midland Bank Ltd., it was held that R.D. had the effect of lowering the prestige of the customer. In Pyke Vs. Hibernia Bank, the banker was liable to pay £400 of libel for having used the term R.D. However, in Plunket Vs. Barclays Bank Ltd. the banker was justified in using the term R.D. Again, in Baker Vs. Australia and New Zealand Bank Ltd., the court held that the reason present again is defamatory.

Now R.D is most commonly used by bankers. It is a milder form of refusal. It is generally meant to convey to the holder the idea that the cheque has been dishonoured and he should find out the reason for it from the drawer.

Banking Practice in India

As per the banking practice in India, R.D. refers to the dishonour of a cheque for want of funds in the account of the drawer, as was decided in a recent case Voltas Ltd., and others Vs. Agarwalla and others (1991). Again in V.S Krishnan Vs. V.S Narayanan, (1991) it was held that the use of the term R.D. would not render the complaint non-maintenable under Sec.138 of the N.I.Act.

According to the New Sect. 138, if a cheque is returned with the words. (a) amount insufficient to honour the cheque. and/or (b) exceeds the amount arranged to be paid from the account, it constitutes an offence and
is punishable under the Act. Since the expression R.D. does not disclose a definite reason, it is advisable on the part of the bankers in India to give a more positive and definite reason (Specifically the twin reasons mentioned under sec. 138 if applicable) for the dishonour of a cheque, so that, the scheme of the new Section would be more effective and meaningful.

5.5 STATUTORY PROTECTION TO A PAYING BANKER

Supposing, a paying banker pays a cheque which bears a forged signature of the payee or endorsee, he is liable to the true owner of the cheque. But, it is quite unjustifiable to make the banker responsible for such errors. It is so because, he is not expected to know the signature of the payee or endorsee. Therefore, law relieves the paying banker from his liability to the true owner in such cases. This relief is known as ‘Statutory protection,’ The origin of the statutory protection can be traced to the passing of the Stamp Act of 1853 in England. Sec.60 of the Bill of Exchange Act, 1882 gives protection to the paying banker in England.

Statutory Protection Under Indian Law

Sec. 85 of the N.I.Act, 1881 offers protection to the paying banker in India. It reads as follows.

“Where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course.” To Claim protection under sec.85, the banker should have fulfilled the following conditions.

(i) He should have paid an order cheque.
(ii) Such a cheque should have been endorsed by the payee or his order.
(iii) It should have been paid in due course.

Order Cheque

The Statutory protection has been extended to an order cheque.

Example of an order cheque is “Pay to X or order.” When such a cheque is paid by the banker, he is entitled to get protection. Endorsement is a must for an order cheque and so protection is mainly extended to an order cheque endorsed by payee or his order.
such a cheque requires an endorsement by its payee. so, it must be properly endorsed by him to any person authorized by him to abrain payment. protection can not be claimed if such a cheque is not endorsed by a payee or any third party.

5.6 PAYMENT IN DUE COURSE
The cheque should have been paid in due cours. sec.10 of the N.I.Act defines payment in due course as follows:
“payment in due course means payment in accordance with the apparent tenor of the instrument, in good faith and without negligence, to any person in possession thereof unter circumstances which do not afford a reasonable ground for believing, that,he is not entitled to receive payment of the amount of the amount therein mentioned.”
This concept of payment in due course has three essential features”

(i) Apparent tenor of the instrument: To avail of the statutory protection, the payment should have been made according to the apparent tenor of the instrument. the apparent tenor refers to the intention of the parties as it is evident from the face of the instrument. example: if a drawer draws a cheque with a post-date, his intention is to make payment only after a certain date. if it is paid before the due date, this payment does not amount to payment in due course. so also, the payment of a countermanded cheque does not amount to payment in due course.

(ii) payment in good faith and without negligence: Good faith forms the basic for all banking transactions, and so, it is taken for granted. as regards negligence, the banker may sometimes be careless in his duties which constitutes an act of negligence is proved, the banker will lose the statutory protection given under sec.85.

example:
(a) payment of a crossed cheque over the counter.
(b) payment of a post – dated cheque before maturity.
(c) failure to verify the regularity of an endorsement.
(d) In madras provincial co-operative bank Ltd., Vs, south Indiar Match factory Ltd.,(in liquidation) one Mr. Ramachandra Rao,a former employee, was appointed as a liquidator, the fact of which was known to the banker. Once, a cheque drawn in favour
of Rao, in his official capacity, was paid into his private account. It was held that the paying banker was negligent.

(iii) Payment to a person who is entitled to receive payment: the banker should have made the payment to the 'holder' of the instrument. In other words, the banker must see that the person who presents the cheque, is in possession of the instrument and he is entitled to receive the amount. It was the cheque.

Sec. 8 of the N.I. Act defines a holder as “the holder of a promissory note, bill of exchange or cheque, means any person entitled in his own name, to the possession thereof and to receive the or recover amount due thereon from the parties thereto.”

The more possession of a document does not make one a holder. He must have a genuine title to it. For instance, if a person brings in a cheque which has been countermanded, or forged, though he is in possession of the instrument, he has no title to it. Thereof, if a banker suspects the title of the paying banker person, he should not make payment. If a banker makes payment in such cases, he can not get statutory production under sec. 85.

**Protection to a Bearer Cheque**

Now, this protection has been extended to bearer cheques also under sec.85(2). (Refer to Endorsement chapter for sec.85(2)). If a bearer cheque is paid in due course, the banker is entitled to get protection.

**Protection to a Crossed Cheque**

Originally, this protection was extended only to open cheques. Now, this has been extended to crossed cheques also. Sec. 128 of the N.I. Act gives protection in respect of crossed cheques also. Sec.128 of the N.I. Act gives protection in respect of crossed cheque to the drawer as well, provided, it comes into the possession of the payee.

Sec.128 of the act runs as follows: “where a 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 rights 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.

Protection to a Materially Altered cheque:

Protection has also been extended to a materially altered cheque. (Refer to Material Alteration chapter.)

Protection to a Draft: protection has been extended to drafts drawn by one office of a bank on another office of the same bank. This was made possible by the amendment of sec. 84 in 1930.

Forgery of a customer's signature: sec. 85 of the N.I. Act/gives protection only when the payee or endorsee’s signature is forged and the banker makes payment in due course. If a banker pays a cheque which carries a forged signature of his customer, it does not amount to payment in due course. It is so because every banker is expected to know the signature of his own customers. Hence, he can not even think of claiming protection in the case of forged endorsement of the drawer.

In Bihta co-operative development and cane Marketing Union Ltd. Vs. Bank of Bihar, the supreme court pointed out that “if the signatures on the cheque are not genuine, there is no mandate on the bank to pay and the cheque is a mere nullity.” When this is the case, a paying banker cannot claim any protection in respect of a cheque where the customer's signature has been forged.

In Canara Bank Vs. Canara sales corporation Others, the supreme court has categorically said that “a cheque carrier a mandate, to the bank to pay. If the cheque is forged there is no such, mandate, and the banker therefore, cannot debit the customers’ account. Inaction on the part of the customer for a long period cannot by itself afford a satisfactory ground for the bank to escape from he liability.”

In National Westminster Bank Ltd. Vs. Barclays Bank International Ltd. and another, it was held that “the mere fact that a banker honoured a did not carry with it an implied representation of the banker to the payee that the drawer’s signature was genuine and that the paying bank can recover the money”. However, if the customer by his conduct enabled the forgery of his signature, then, the paying banker is relieved from his liability. Whether the customer has enabled the forgery or not depends upon the circumstance of the case.
For instance, it was held in Bansi Lal Vs. Sadasheo Bhopati that the rule, requiring customers to keep cheque books under lock and key, was not valid. Even leaving a signed blank cheque form in an unlocked table doesn’t form a good ground for the customer’s negligence (Baxendale Vs. Bennett).

In Lewes Laundry Co. Vs. Barclay and Co., the secretary who was previously convicted for forgery, was allowed to keep the company’s pass book and cheque book. He forged the signature of the directors and obtained payment for many cheques. It was held that the banker was liable and the customer did not enable the forgery.

In Greenwood Vs. Martins Bank, Mr. Greenwood, the customer, did not inform the banker of the forgery of his signature by his wife. He was silent even though he knew about the forgery. It was held that the customer was liable. It was pointed out in the aforesaid case that “mere silence would not amount to representation but when there was a duty to disclose, deliberate silence might become significant and amount to a representation.” So also, if the customer comes to know of any suspicious activities of any officer of a bank connected with banking, he must report the matter to the director immediately. Thus, the fundamental rule which is applicable here is “a banker must recognise his customer’s signature.” Therefore, if he pays a cheque which contains a forged signature of his customer, he can not claim statutory protection under Sec. 85 of the Act (Canara Bank Vs. Canara Sales Corporation and others).

Again in Babulal Agarwala Vs. State Bank of Bikaner and Jaipur (1989), the banker had claimed statutory protection for a bearer cheque which contained a forgery of his customer’s signature. The banker had paid it without knowing the forgery. It was held that the banker could not claim any protection at all since, it was a question of forgery of a customer’s signature and a forged cheque is ‘no cheque’ at all.

**When a Banker Acts Both as Paying and Collecting Banker**

When a banker acts both as a collecting banker and a paying banker, it would be as a collecting banker that a decision would be taken. In Worshipful Carpenter’s Company Vs. British Mutual Banking Company Ltd., it was held that the statutory protection is available only when a bank acts as a paying banker and not as both paying and collecting banker.
5.7 HOLDER IN DUE COURSE

One should not confuse the term holder in due course with the concept of payment in due course. Sec. 9 of the N.I.Act lays down that ‘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 endorsee 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.” Thus, a holder in due course is the person (i) who receives an instrument innocently (i.e., in good faith and without negligence), and (ii) who has paid value for the same, (iii) who has received the instrument before its maturity, (iv) who is in possession of the instrument as a bearer or payee or endorsee. That is why it is said, “every holder in due course is a holder, but, every holder is not a holder in due course.” For all legal purposes, the title of the holder in due course is superior to that of the true owner. But, if the instrument contains a forgery, than, his title is lost. True owner’s title will become superior.

One of the important conditions to be fulfilled to become a holder in due course is that one must receive the instrument in good faith and without negligence. If person receives a cheque for valuable consideration, knowing fully well that it had been dishonoured previously, he cannot be regarded as a holder in due course as was decided in the case of sukanraj Khimraj, Bombay Vs. N.Rajagopalan & Others (1989)

However, in M/s Ponnappa Moothan & Sons Vs. Catholic Syrian Bank Ltd, & Others (1991) it was held mere failure to prove bonafide or absence of negligence by the holder would not negative his claim of being a ‘holder in due course,’

5.8 RIGHTS AND PRIVILEGES OF A HOLDER IN DUE COURSE

The following are some of the important rights and privileges of a holder in due course.

(1) He obtains a better title to the instrument than that of a true owner.

(2) The defective title of the previous endorsers (if any) will not adversely affect his rights.

(3) He can pass on a better title to others, since, once the instrument
passes through his hands,

it is purged of all defects,

(4) Until the instrument is finally discharged, every party to that instrument is liable to him.

(5) Even that drawer of a negotiable instrument cannot claim invalidity of the instrument against him.

(6) His claim cannot be denied on the ground that the payee has no capacity to endorse.

(7) The principle of estoppel is applicable against the endorser to deny the capacity of previous parties.

Thus, the title of a holder in due course is supreme.

5.9 RECOVERY OF MONEY PAID BY MISTAKE

Since, in a bank thousands of transactions take place every day, it is quite natural that mistakes do occur. By mistake, a banker may pay money to a wrong person. Can a banker recover money paid by mistake? The law on this subject is not yet clear. As a general rule, a person who has committed a mistake, has every right to rectify the same. But, in rectifying the mistake, he should not bring and disadvantage to a party. In the same way, a banker can recover the money paid by mistake without adversely affecting the other party.

**Money can be Recovered**

Under the following circumstances, money wrongly paid can be recovered.

(i) Money received mala fide is recoverable: When a person receives money by mistake in bad faith, knowing that he is not entitled to receive that money, then, the banker is entitled to recover the same.

(ii) Money paid under a mistake of fact is recoverable: If the mistake is a mistake, of fact, then, the money wrongly paid is recoverable. For instance, a banker pays money to X, thinking that he is Y. This is a mistake of fact regarding the identity of the parties. Y is under a legal duty to pay the money back to the banker.

(iii) Mistake between the party paying and the party receiving: If the mistake is between the party paying and the party receiving, then, the
money is recoverable. For instance, a banker by mistake, pays a cheque to X, the payee, in the absence of sufficient balance in the account of the drawer. In such circumstances, the banker can not recover the money paid by mistake because the mistake is not between the party paying (banker) and the party receiving (X), but it is between the banker and the drawer.

However, now the position has been entirely changed. When a person is under a statutory obligation to pay, the mistake committed by him is deemed to be between the party paying and the party receiving. (Well Blundell Vs. Synott).

Money can not be Recovered

(i) Money paid under a mistake of law is not recoverable: Ignorance of law is no excuse. When a banker pays money mistaking law, he can not recover it. In Holt & Co. Vs. Markhan, Markhan was overpaid a sum of £310 by Holt & Co. on behalf of the Government in ignorance of the provisions of law. He was on the emergency list of officers, who were entitled to get gratuity at a lesser rate. It was held that the money, thus overpaid, could not be recovered, since, he had already spent the amount believing that it was his own. The same view was held in Skyring Vs. Greenwood.

(ii) Money paid on a negotiable instrument to an innocent holder is not recoverable: When money is paid by mistake on a negotiable instrument to a holder in due course, it can not be reclaimed after a lapse of time. Example: A banker who pays a bill to an innocent holder by mistake cannot recover the money because, after a lapse of time, he can not trace his previous parties to make them liable (London & Riverplate Bank Vs. Bank of Liverpool).

(iii) When a person, who receives money in good faith by mistake, alters his position relying upon it, need not return the same.

In Deutsche Bank Vs. Beiro & Co., a person deposited a bill with Beiro & Co., for collection who in turn left the same with Deutsche Bank for collection. Deutsche Bank paid the amount to Beiro & Co. stating that the bill had been collected. Relying upon this information, Beiro & Co. paid the amount to the holder. In fact, the bill was not honoured. It was
held that Deutsche Bank could not recover the money from Beiro & Co., because, they had altered their position adversely relying upon the wrong statement supplied by the banker, who was not bound to make such wrong statements.

(iv) Money paid to an agent by mistake: Where a banker pays money by mistake to an agent, who in turn has paid the same to the principal or used it before the mistake is found out, the money can not be recovered.

5.10 TERMINOLOGIES
1) Paying Banker 2)Circumstances 3) Dishonoured 4)Payment 5) Recovery 6)Due Course

5.11 MODEL QUESTIONS
1) Enumerate the points which a current account ledger keeper must scrutinize before passing a cheque for payment.
2) Discuss in detail the statutory protection granted to a paying banker under Sec.85 of the N.I. Act.
3) Under what circumstances, is a banker justified in refusing payment of cheques drawn upon him? Discuss his liability in the case of wrongful dishonour of a cheque.
4) Discuss the position of a paying banker with regd to the following:
   (i) a cheque containing the forgery of endorsement of the payee.
   (ii) a cheque containing the forgery of the drawer's signature.
5) Explain the duties and liabilities of a paying banker.

5.12 REFERENCE BOOKS
UNIT – VI COLLECTING BANKER

6.1 Introduction
6.2 Banker as a holder for value
6.3 Banker as an Agent
6.4 Conversion
6.5 Statutory protection
6.6 Protection extended to Dividend, Warrants, Drafts etc.,
6.7 Basis of negligence
6.8 Duties of a collecting Banker
6.9 Terminologies
6.10 Model Questions
6.11 Reference Books

6.1 INTRODUCTION

A collecting banker is one who undertakes to collect the amount of a cheque for his customer from the paying banker. A banker is under no legal obligation to collect cheques drawn upon other banks for a customer. But, every modern banker performs this duty, because, no customer will be satisfied merely with the function of payment of cheques alone. Moreover, in the case of crossed cheques, there is no other alternative to collect the cheques except through some banker. In rendering such services, a banker should be careful, because, he is answerable to a number of persons with whom he has no contractual relationship and any negligence or carelessness on his part may land him in difficulties.

6.2 BANKER AS A HOLDER FOR VALUE

In collecting a cheque, the banker can act in two capacities namely

(a) as a holder for value, and (2) as an agent for collection. The banker would be regarded as a holder for value:

(1) If he allows his customers to withdraw money before cheques paid in for collection are actually collected and credited (Underwood Vs. Barclays Bank),

(2) If any open cheque is accepted and the value is paid before collection, and/or

(3) If there is a reduction in the overdraft account of the customer before the cheque is collected and credited in the respective account.

In all these cases, the banker acquires a personal interest.

Rights of a Banker as a Holder for Value

If the banker acts as holder for value, his rights will be the same as those of a holder in due course. Thus, according to Sir. John Paget “Apart from the
question of forged endorsement, if the customer has either no title to the
cheque or his title is defective, the banker is the holder in due course with a
good independent title against all the prior parties on the cheque.” The title
of the holder in due course is superior to that of the true owner. If the
instrument (cheque) contains a forgery, then the title of the true owner will
be superior. So, if there is forgery, the collecting banker will have to refund
the amount to the true owner. But, he can recover the money from the last
endorser, i.e., his own customer for whom he collected the cheque. If the
customer is unable to meet the liability, then, the banker will have to bear
the burden. If the cheque is paid in due course, all the parties will get
discharged.

6.3 BANKER AS AN AGENT

In practice, no banker credits a customer’s account even before a
cheque is collected. He collects a cheque on behalf of a customer. So, he
can not acquire any of the rights of a holder for value. He has to act only as
an agent of the customer. This is so because, he can not have a title better
than that of the customer himself. So, a collecting banker can not choose
the capacity in which he wants to act at his discretion. He will be regarded
only as an agent. So, during collection, if a banker, in his capacity as an
agent, collects a cheque which belongs to some other person, to the account
of his customer, he will be held liable for “conversion” of money received.

6.4 CONVERSION

‘Conversion’ is a wrongful interference or meddling with the goods
of another. Eg: taking or using or destroying the goods or exercising some
control over them in a way that is inconsistent with the owner’s right of
ownership. The term ‘goods’ includes bill of exchange, cheque or promis-
sory note. Conversion may be committed innocently. Conversion is a
wrong that renders the person committing it personally liable. This liability
exists even when a person acts merely as an agent.

A Banker’s Liability

Hence, if a collecting banker, however innocent he may be, has con-
verted the goods of another, he will be held personally liable. This liability
exists because the banker is acting as an agent and not as a holder of value.
If it is so, no banker will be in a position to collect cheques for his
customers. In those days, the position of a collecting banker was far from satisfactory. Therefore, the statutory protection was granted by Sec.131 of the N.I. Act against conversion. Sec.131 of the N.I. Act, 1881 corresponds to Sec. 82 of the B/E Act 1882.

6.5 STATUTORY PROTECTION

According to Sec. 131 of the N.I. Act, “A banker who has in good faith and without negligence, received payment for a customer of a cheque, crossed generally or specially to himself, shall not, in case the title to the cheque proves defective, incur any liability to the true owner of the cheque, by reason only of having received such payment.” Thus, Sec.131 protects the collecting banker against an action of conversion. Of course, this is a very high privilege given to the collecting banker. Here, the banker is protected to a certain extent even against the equity principles of law i.e., the object of law is always to protect the rights of the true owner.

The above statutory protection is available to the collecting banker only if he fulfills the following conditions:

1. The cheque he collects must be a crossed cheque.
2. He must collect such crossed cheques only for his customer as an agent and not as a holder for value.
3. He must collect such crossed cheques in good faith and without negligence.

(1) Crossed cheques only: Statutory protection can be claimed by a collecting banker only for crossed cheques. It is because, in the case of an open cheque, it is not absolutely necessary for a person to seek the service of a bank. So, a banker, when collecting an open cheque, in which his customer has no title, becomes liable for conversion.

Protection can be claimed only for those cheques which are crossed before they reach the hands of a banker. If a cheque is crossed only after it has reached the hands of a banker, protection under Sec.131 can not be claimed because it can not be called a crossed cheque within the meaning of the Sec.131.

(2) Collections on behalf of customers as an agent: The above protection can be claimed by a banker only for those cheques collected by
him as agent of his customers. If he acts as a holder for value, he will acquire a personal interest in them, and so, he can not claim protection under Sec. 131. So also, if he collects a cheque for a person other than a customer, he will not be protected. That is, if the stranger (other than the customer) for whom he collects a cheque has no title, then the banker will be liable for conversion.

(For the term customer refer to the Chapter—Banker and Customer).

3) In good faith and without negligence: In order to get the protection under this Section, a collecting banker must act in good faith and without negligence. This applies to the whole transaction from the receipt of the cheque from the customer to the receipt of the proceeds from the paying banker. The question of good faith is not very material because, joint stock banks do not act otherwise than in good faith. But, the matter of negligence is of great importance. Hence, the term negligence has been discussed under a separate heading later in this chapter.

6.6 PROTECTION EXTENDED TO DIVIDEND WARRANTS, DRAFTS ETC.

In England, Sec. 95 of the B/E Act offers statutory protection to a collecting banker against the true owner, in the case of dividend warrants, which can be crossed. The B/E Amendment Act of 1932 extends protection to a banker’s draft also. This rule applies to India as well. In India, the N.I. Acts products a banker when he collects dividends warrants, bank drafts and similar papers. this protection is extended to cheques bearing not negotiable crossing also.

N.I. Act Amended in 1922

In England, the banker used to credit the accounts of their customers with the cheque even before the receipt of their proceeds. In capital and county bank Ltd. Vs. Gordon, Lord Lindly said “it must never be forgotten that, the moment the banker places money to his customer’s credit, the customer is entitled to draw upon it, unless, something occurs to deprive him of that.” This ruling proved to be prejudicial to the bankers, as they were not able to claim protection under sec.82 of the B/E Act. so, it led to the passing of the B/E (crossed cheque) Act of 1906. similarly, the N.I. Act was amended in 1972. the following explanation was added to
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sec.131.

“a banker receives payment of a crossed cheque, for a customer, within the meaning of this section, not withstanding that he credits his customer’s account with the cheque before receiving payment thereof”

6.7 BASIS OF NEGLIGENCE

The word ‘negligence’ has no definite meaning in banking law. It has been very widely interpreted by courts of law frequently to the detriment of bankers. It is flexible and is ever expanding in its scope as new circumstances arise.

The liability for negligence imposes on the banker a statutory duty to the true owner. But, as a general rule, a banker owes no duty to third parties. According to Sir John Paget “The assumption of this duty to a stranger must be regarded as a part of the price paid by bankers for protection...”

Moreover, when a collecting banker wants to claim protection under I Sec. 131, he has the burden of proving that he has acted without negligence. It is so because, the true owner’s case is complete, as soon as, conversion is proved prima facie against the banker.

There has been considerable difference of opinion, as to, what constitutes negligence for the purpose of Sec.131. It should be noted that negligence in this Section is more or less artificial, as there is no contractual relationship between the collecting banker and the true owner of the cheque.

In Lloyds Bank Vs. Chartered Bank of India, Australia and China Ltd, it was stated “there is no duty at common law on the collecting banker to exercise care: the duty is entirely created by the Act.”

The following definition of the term negligence was given in W. Walbank & Co. Ltd. Vs. Westminster Ltd. “Negligence is the doing of that which a reasonable man under all the circumstances of the particular case in which he is acting, would not do, or the failure to do something, which a reasonable man under those circumstances would do.” The doctrine of negligence is so shifting in its implication, that, it can not be said with certainty as to what constitutes negligence.

For a proper understanding, negligence can be studied under the
following heads:

(i) Gross negligence.

(ii) Negligence connected with the immediate collection of cheque.

(iii) Negligence under remote grounds.

(iv) Contributory negligence.

(i) Gross Negligence: If a banker is completely careless in collecting a cheque, then, he will be held liable under the ground of ‘Gross Negligence’.

(i) Collecting a cheque crossed ‘A/c payee’ for other than the payee’s account: Account payee crossing is a direction to the collecting banker. If he collects a cheque crossed ‘A/c payee’ for any person other than the payee, then, this fact will be proved as an evidence of gross negligence. (Akrokerri Atlantic Mines Ltd. Vs. Economic Bank).

(ii) Failure to verify the correctness of endorsement: If a banker omits to verify the correctness of endorsement on cheques payable to order, he will be deprived of the statutory protection. (Babins Junior & Sons Vs. London & South Western Banks).

(iii) Failure to verify the existence of authority in the case of per pro signatures: If a collecting banker fails to verify the existence of authority in the case of per pro signatures, if any, it will be proved as an evidence of gross negligence.

(ii) Negligence Connected with the Immediate Collection: If, on the face of a cheque, there is a warning that there is misappropriation of money, the collecting banker should not disregard such warnings. He should make some reasonable enquiry and only after getting some satisfactory explanations, he can proceed to collect cheques.

Examples:

(i) Collecting a cheque drawn against the Principal’s A/c, to the Private A/c of the agent without enquiry: In Midland Bank Vs. Reckitt, a solicitor named Lord Terrington, with a special power of attorney, drew cheques on Reckitt’s account and paid them into his private account with Midland bank, who collected
them for him. It was held that the banker was negligent in not making proper enquiry, and so, he could not get protection under Sec.131. Similarly, collecting a cheque payable to the Principal’s A/c, to the Private A/c of the agent without enquiry, constitutes negligence, which, deprives the banker of the protection guaranteed under Sec.131.

(ii) Collecting a cheque payable to the firm to the Private A/c of a partner without enquiry: In Bevan Vs. The National Bank Ltd., the banker had collected a cheque payable to the firm to the private account of the partner, who was authorised to operate be account. In was held that the banker was liable for conversion.

(iii) Collecting a cheque payable to the company to the private account of a direction or any other officer without enquiry: In Underwood Vs. The Bank of Liverpool and Maretins, since the banker had collected a number of cheques payable to the one man company, to the private account of a sole director, he was held to be negligent and answerable to debentureholders.

(iv) Collecting a cheque payable to the employer to the private account of the employee would constitute negligence under Sec. 131 of the N.I. Act.

(v) Collecting a cheque payable to the trustee, to the private account of the person operating the trust account is another instance of negligence of a banker.

(iii) Negligence Under Remote Grounds: Normally, we can not expect a banker to be liable under certain circumstances. But, the bankers have been held negligent under those situations which are branded as ‘remote grounds.’

Examples:

(i) Motors Trader’s Guarantee Corporation Ltd. Vs. Midland Bank Ltd.

Facts: Turner, a dealer in motor car had an account with the defendant Bank at Birstol. Once, he fraudulently induced the plaintiff – a motor car hire purchase finance corporation – to make out a crossed cheque for £ 189.5sh. in favour of ‘Wells and Co.’ a wellknown firm of motor
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dealers. Turner had represented the plaintiff that he was interested in buying a motor car and subsequently, he would enter into a hire purchase agreement. Then, Turner short circuited the entire thing i.e., he made the cheque payable to himself by forging the signature of the payee. He paid it into his bank for collection. Of course, the cashier had made reasonable enquiries and was satisfied.

Decision: It was held that the banker was negligent, because, he failed to make adequate enquiry in collecting a cheque, payable to a third person, for a customer whose past transactions had not been satisfactory and where his cheques had been dishonoured from time to time. In the above case, the banker had previously dishonoured 35 cheques of Turner. Commenting upon the aforesaid case, Sir John Paget rightly observes “lack of enquiry into the behaviour and habit of the customer seems somewhat remote from the actual transaction.

(ii) Failure to ascertain the name of the employer of a new customer constitutes negligence under Sec. 131. (Savory & Co. Vs. Lloyds Bank). In the case of a married women, failure to verify the name of the employer of her husband constitutes negligence.

(iii) Omission to obtain a letter of introduction from a new customer causes negligence ((a) Ladbroke Vs. Todd, (b) Commissioner of Taxation Vs. English, Scottish and Australian Bank).

In Guardians of St. John’s Hampstead Vs. Barclays Bank, it was held that “the bank will be negligent if it opens the account on the basis of a reference from a person unknown to the bank.”

However, in Indian Overseas Bank Vs. Industrial Chain Concerns (1989), the banker opened an account in the name of the above concern for which one Mr. ‘S’ was the proprietor. Mr. ‘S’ was wellknown to the bank manager and so he himself had given the letter of introduction. Then, a number of cheques belonging to the company were collected and later on, it was found that Mr. ‘S’ was only an employee of the firm. Hence, the banker was sued for negligence.

In the Supreme Court, it was held that the banker was not negligent, since, there was no violation of any rules of the bank. ‘S’ having been believed to have been the proprietor, left little scope of suspicion for the
bank in regard to cheques payable to industrial chain concerns. Thus, except when suspicion arises, in making enquiries, the bank’s attitude may be solicitous and not detective. (Marfani & Co. Vs. Midland Bank).

(iv) Failure to enquire into the source of supply of large funds into an account which has been kept in a poor condition for a long time constitutes negligence. In Lloyds Bank Vs. Chartered Bank, it was held that, a sudden payment of valuable cheques into the account, which was kept in a poor condition for a longer period, should make the collecting banker enquire into it before accepting that cheque for collection. In this case, the Chartered Bank failed to do so and it was held liable.

(v) Contributory Negligence: In fact, this is a guise under which a collecting banker escapes from his negligence. It is possible that a collecting banker, even after accepting negligence on his part, can plead for contributory negligence. That is, if the customer’s negligence is the proximate cause for the loss, then, the customer will be liable. In Morison & Co. Vs. London & County Bank Ltd. one Mr. Abbot was allowed to draw cheques on behalf of the firm Morison & Co. For a period of two years, he drew nearly 50 cheques against the firm’s account and paid them into his bank with the instruction to collect and credit them to his private account. When things came to light, the banker approved negligence on his part, and in turn, proceeded against the employer for contributory negligence. The bank pleaded that, since the auditor had already pointed out in his report about the irregularities of drawing cheques by Abbot, the employer should have pointed out this fact to the banker. But, the firm failed to do so. It was held that the banker was not liable, since, Morison’s Contribution was the proximate cause of the loss.

The statutory protection under Sec. 131 will not be available to a collecting banker, who collects cheques, where amounts have been altered. (Kulatilleke Vs. Bank of Ceyton).

If a banker takes a cheque as an independent holder by way of negotiation, he cannot get protection because he receives payment for himself and not for a customer.

6.8 DUTIES OF A COLLECTING BANKER

(i) Exercise reasonable care and diligence in collection work: when a banker collects a cheque for his customer, he acts only as an agent of the
As an agent, he should exercise reasonable care, diligence and skill in collection work. He should observe utmost care when presenting a cheque or a bill for payment. Reasonable care and diligence depend upon the circumstance of each case.

(ii) Present the cheque for collection without any delay: The banker must present the cheque for payment without any delay. If there is delay in presentment, the customer may suffer loss due to the insolvency of the drawer or insufficiency of funds in the account of the drawer or insolvency of the banker himself. In all such cases, the banker should bear the loss.

In Forman Vs. Bank of England, the bank had passed on a cheque through country clearing instead of town clearing and so the presentment was delayed. This resulted in the dishonour of customer’s another cheque. So, Forman sued the banker for damages. It was held that the banker was negligent in collecting the cheque in question, and so, the customer was awarded compensation.

Recently, the Coimbatore District Consumer Disputes Redressed Forum awarded a damage of Rs. 2,000/- for the negligence of Dr. Nanjappa, Road Branch of the Vijaya Bank for having sent a cheque for collection after a delay of 20 days.

To ensure quick collection of cheques, the RBI has very recently issued clear – cut instructions specifying the number of days within which a cheque has to be collected. Generally, 10 to 14 days are allowed depending upon the location of the branch. If a banker fails to collect a cheque within this stipulated period, he is liable to pay interest at 2% above the savings Bank. Interest rate, subject to a minimum of Rs.5. This amount should be automatically credited to the customer’s account, irrespective of the fact, whether he claims it or not.

(iii) Notice to customer in the case of dishonour of a cheque: If the cheque, he collects, has been dishonoured, he should inform his customer without any delay. The N.I. Act has prescribed a reasonable time for giving the notice of dishonour. If the fails to do so, and consequently, any loss arises to the customer, the banker has to bear the loss.

(iv) Present the bill for acceptance at an early date: As per Sec. 61
of the N.I. Act, a bill of exchange must be accepted. Acceptance gives an additional currency to the bill, because, the drawee becomes liable thereon from the date of acceptance. Moreover, in the case of a bill of exchange payable after sight, acceptance is absolutely essential to fix the date of maturity. If a banker undertakes to collect bills, it is his duty to present them for acceptance at any early date. Sooner a bill is presented and got accepted, earlier is its maturity.

However, presentment for acceptance is excused in the following cases: (a) where a bill payable on demand, (b) where the drawee is either a fictitious person, dead, insane or bankrupt or person having no capacity to enter into a contract, (c) where, inspite of a reasonable diligence on the part of the banker, the presentment cannot be effected, (d) where, although the presentment is not quite regular, the drawee has refused to accept it on some other ground.

Usually, the bill will be presented for acceptance on the same day on which it is received or on the next working day. If the drawee is not within the banker’s call, he may present it through his agent or through registered post.

(v) Present the bill for payment: The banker should present the bills for payment in proper time and at proper place. If he fails to do so and if any loss occurs to the customer, then, the banker will be liable. According to Sec.66 of the N.I. Act a bill must be presented for payment on maturity. As per Sec.21, sight bills are payable on demand. Sec.22 lays down that the maturity of the bill is the date on which it is due for payment, to which, 3 days of grace are added. Thus, the rules for calculating the maturity dates are given in Sec.23,24 and 26 of the N.I. Act. For instance, when the period is stated in months, the last day of the concerned month is the due date of which 3 days of grace are added. When the period is stated in days, the first day may be excluded in calculating the due date. When the due date falls on a public holiday, it is deemed to be due on the next working day.

(vi) Protest and note a foreign bill for non – acceptance: In case of dishonour of a bill by non – acceptance or non – payment, it is the duty of the collecting banker to inform the customer immediately. Generally, he returns the bill to the customer. In the absence of specific instructions,
collecting bankers do not get the inland bills noted and protested for dishonour. If the bill in questions happens to be a foreign bill, the banker should have it protested and noted by a Notary public and then forwarded it to the customer.

6.9 TERMINOLOGIES
1) Collection 2) Value 3) Agent 4) Conversion 5) Statutory 6) Negligence

6.10 MODEL QUESTIONS
1) Give two instances under which a banker can act as a holder for value.
2) Give two examples for negligence under remote grounds.
3) Discuss in detail the statutory protection granted to a collecting banker in India.
4) Explain with reference to the relevant provisions, the duties and liabilities of a collecting banker and the legal protection he enjoys.
5) What constitutes negligence under Sec. 131 of the N.I. Act?

6.11 REFERENCE BOOKS
UNIT – VII SUBSIDIARY SERVICES

7.1 Introduction
7.2 Agency Services
7.3 Payment and Collection
7.4 Purchase and sale of Securities
7.5 Banker as Executor, Administrator and Trustee Executor
7.6 Administrator
7.7 Trustee
7.8 Attorney
7.9 Miscellaneous or General utility services
7.10 Terminologies
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7.1 INTRODUCTION

Modern commercial banks, besides performing the main functions viz., accepting deposits and lending money, cover a wide range of financial and nonfinancial services to customers and general public. The bank services are steadily increasing to meet the growing needs of the community.

The services and facilities provided by a modern banker may be classified into two as,

(i) Agency services.

(ii) Miscellaneous services or general utility services.

7.2 AGENCY SERVICES

The banker acts as the agent of his customer in performing the following functions.

(I) Payment and collection of subscriptions, dividends, salaries, pension etc.

(II) Purchase and sale of securities.

(III) Acting as executor, administrator and trustee.

(IV) Acting as attorney.

7.3 PAYMENT AND COLLECTION

Bankers make payments and receive money on behalf of their customers in the following ways.

(a) Payment of insurance premia.

(b) Payment of membership subscription to clubs, libraries and professional associations.

(c) Payment of rent and salaries.

(d) Collection of dividends on behalf of customers.
(e) Collection of pension, rent etc.

(f) Transfer of funds from one account to another.

The banks charge only a nominal amount for this service. Tannan considers this service as an indirect asset that promotes the business of the bank.

For doing this service, the banker should get a clear instruction in writing from the customer. The instructions of the customer should be clear and unambiguous. It should not be in uncertain terms which give rise to controversial meaning. If the banker goes wrong due to equivocal instruction, he cannot be held liable on the ground of negligence, if he acted in good faith.

The banker may not accept instructions which are difficult to comply with, but once accepted, it is the duty of the banker to carry out instructions carefully and promptly. Once, the instructions are accepted, the customer should ensure that necessary funds are in his credit on the specified date. The banker is under no obligation to make payment unless the account is in credit or operating with an agreed overdraft.

Having accepted standing instructions, a banker would be deemed to be negligent if he fails to carry them out, unless it can be proved that non-compliance has resulted from circumstances beyond his control. In order to ensure timely compliance, the standing instructions must be recorded in a register designated as “Standing Instruction Register” and noted in the ledger folio of the account holder concerned.

7.4 PURCHASE AND SALE OF SECURITIES

Banks undertake to purchase and sell shares and debentures of joint stock company on behalf of its customers only. Whenever the customers delegate the work, the bankers should get clear and precise instruction in a special form used for this purpose. The form should contain the following particulars.

(a) Particulars of securities to be sold or purchased.

(b) The minimum and maximum price at which the securities are to be sold or purchased.

(c) The period within they are to be sold or purchased.

(d) The names, address of the persons in whose name they are to be registered.
In executing the sale or purchase order, the banker acts as an agent of the customer. Only members of the stock exchange can be the function of purchase and sale of securities. As the banks are not the members of the stock exchange, they appoint brokers who act as sub-agents of the banks to carry out the bank’s instructions. The recent amendment in the Stock Exchange Regulation Act, permits the bank to become members in the local stock exchange. The banker should strictly follow the customer’s instructions and use skill and care in execution of sale and purchase order.

In case of an order from the customer for purchase of securities, the bankers should ensure that sufficient funds are available in the account of the customer. The banker should ensure that this position continues till the order is executed. While delivering the shares to the customer, he should be advised to have them transferred to his name as early as possible.

No action for execution of sale order should be taken until the securities come into possession of the bank and they are found good for immediate delivery in the market. Relative transfer deeds duly signed by the seller and witnessed must accompany the shares. On receipt of the sale proceeds, the amount has to be credited to the customer’s account under advice to him.

The banks today undertake to purchase and sell government securities, bonds of public undertakings, National Saving Certificates and units of Units Trust of India.

7.5 BANKER AS EXECUTOR, ADMINISTRATOR AND TRUSTEE

A person may make a will expressing his intention regarding disposal of his properties after his death. A will has to be in writing signed by the person making the will who is called testator and attested by two witnesses. A will becomes effective only after it is approved by a court of competent jurisdiction by the issuance of a probate. A probate is a copy of the will duly certified under the seal of the court together with a grant of administration to the estate of the testator. The probate is conclusive as to the appointment of executor and the validity and content of the will. The person appointed by the will to administer the estate of the deceased is known as the executor.

7.6 ADMINISTRATOR
In case a person dies without making a valid will, the property of the person will devolve according to the law which he is subject to. The person claiming the property of the deceased may apply to the court for the administration of the estate. The person in whose favour the court grants letter of administration is known as the administrator.

The administrator and the executor perform similar functions except that the administrator administer the property of the deceased according to the law and that the executor follows the instructions contained in the will of the deceased.

### 7.7 TRUSTEE

A person may desire that after his death, a part or whole of his estate be held in a trust for the benefit of certain beneficiaries named in the will. In such a case he may create a trust under his will directing certain person to hold the property on a trust and hand over the income from the property to such person after a specified time or upon the happening of a specified event. The person who holds the property for the beneficiaries is known as trustee. In some cases, the owner of the property may divest himself of the property in part or whole, in favour of person or persons known as trustees who have to administer the property.

**Banker as Executor, Administrator and Trustee**

Commercial banks undertake the function of executors, administrators and trustees. Many banks have set up their respective head offices. Executor and Trustee Department which administers the trust and will of the customers. Banks are better fitted to do the service because:

1. The bank, being a corporate body has a continuous existence. An individual may not be able to act due to his incapacity or death.
2. Banks have staff having specialized knowledge and rich experience and so the management of the trust/property will be efficient.
3. The management of the trust/property is economical as the overhead charges are spread over a number of trusts.
4. Banks act honestly and promptly which may not be expected from an individual trustee.
5. The affairs relating to the estate are kept confidential as in case of other business of customers.
The banks also act as trustees for debenture holders as companies finance their projects through the issue of debentures. Banks are in a better position to act as such trustees as they have knowledge of the working of the industry and can safeguard the interest of the debenture holders.

7.8 ATTORNEY

Power of attorney may be given by a customer to his banker. Legal effect of acting under a power of attorney is as valid as if customer had done it himself. By granting power of attorney, the customer authorizes the banker to receive dividend and interest on securities belonging to him and give a valid discharge thereof. The banker may also be empowered to sign transfer forms in respect of purchase and sale of stock exchange securities and government securities.

7.9 MISCELLANEOUS OR GENERAL UTILITY SERVICES

The banker provides the following general utility services to customers.

1) Safe custody of valuables,
2) Letters of credit,
3) Traveller’s cheques,
4) Remittance of funds,
5) Merchant banking,
6) Dealing in foreign exchange business,
7) Lease financing,
8) Factoring,
9) Housing finance,
10) Underwriting of securities
11) Tax consultancy,
12) Credit cards,
13) Gift cheques,
14) Consultancy service,
15) Teller system.

1. Safe custody of valuables

Banks accept shares, debentures, bonds, fixed deposit receipts, deeds of property, life insurance polices and sealed boxes and packets containing will or valuables such as jewellery from their customers for safe custody. Banks are equipped with strong, fire proof and their proof rooms
for safe maintenance of the articles. There are two ways through which a banker ensures safety of its customer’s valuables.

(i) By accepting valuable for safe custody.

(ii) By hiring out safe deposit vaults or lockers to the customers.

(i) Safe Custody: Safe custody accounts are normally opened only for those customers who maintain satisfactory accounts or who are properly introduced to the bank.

The articles for safe custody may be handed over to the banker either openly or in a sealed box or envelope. While accepting sealed boxes, the banker should see that they are sealed properly. The words ‘contents unknown’ should be prominently written on such boxes to indicate that the bank has no knowledge of the content of the package.

The bank issues a safe custody receipt which contains the name and address of the customer and the particulars about the articles lodged for safe custody. The customer is asked to preserve the safe custody receipt and surrender the same while taking delivery of the articles. In case the receipt is lost by the customer, the articles may be delivered against a letter of indemnity signed by the account holder.

A customer may take delivery of all securities lodged for safe custody or only a part of them. In the former case, he has to surrender the safe custody receipt duly discharged. Where the customer desires a part delivery, he has to write a delivery order and hand it over to the bank along with the relative safe custody deposit receipt.

Ordinarily, the securities are returned to the customer himself and not to a third party. In case, the articles are to be delivered to a third party, the banker should ensure that:

(a) the safe custody receipt is duly discharged by the customer,
(b) delivery of securities is permitted to a third party by a separate letter of authority signed by the customer.

Safe custody accounts can be opened in single or joint names, partnership firms, companies, trust etc.

**Liability of the banker**

The liability of the banker in respect of safe custody is the same as that of a bailee under the contract of bailment.
The banker should take as much care of the articles accepted for safe custody as a man of ordinary prudence would take in case of his own goods. If he does so and thereafter there is loss or destruction of valuables, he shall not be liable for the loss in the absence of any contract to the contrary.

However, the customer may hold the banker liable in the following cases:

1. **For negligence:** The banker shall be held liable for negligence e.g., the safe deposit vaults are not strong and thus thefts are possible, the banker leaves the vault unlocked and entry to the safe vault is not restricted that enables anyone to remove the articles.

   **Chandra Trikha Vs. Punjab National Bank**
   It was decided in the case that where a bailee bank failed to deliver the box in the same condition as it was entrusted and items of ornaments found missing, the bank has failed in its duty as bailee to take care of goods and hence liable to compensate the bailor for the loss suffered.

2. **For conversion:** If the property held for safe custody is delivered to a wrong person, the banker will be held for conversion.

3. **For fraud by his own employees:** The bank shall be held liable for any fraud committed by any of its employees dealing with the articles given for safe custody.

   (ii) **Safe Deposit Vault:** Banks provide safe deposit locker facility to its customers in metropolitan cities and large towns to keep articles and valuables. Lockers which are convenient repositories for personal jewellery, official documents and securities are hired out to customers. Locker cabinets are usually installed in strong rooms which have security arrangements like grill doors and a fire resistant strong door. The doors can be opened by the use of separate keys held by the bank officers for dual control. The customer is allowed access to the vault during the prescribed business hours. Some private banks have cameras monitoring those using lockers. Further accessed guards are employed in the premises.

   Each locker has only one key for use by the renter and there is no duplicate of it. For opening the locker, two keys are to be used i.e., the renters’ key and another key which is common for all lockers in the cabinet.
known as the ‘custodian key’ or ‘master key’. Usually one master key is kept in the safe custody of another branch of the same bank or another bank. Once a locker is opened with the help of the master key and renter’s key, it can be locked by the renter’s key alone. The banker has neither knowledge nor takes cognizance of the locker.

**Opening of Locker Account:** As a general rule, the renter should be introduced. They are required to open a savings or current account and file an authority to the bank to debit rental charges to the respective account.

**Lease Agreement:** The hirer is required to execute a lease agreement which contains all the terms and conditions under which the locker is hired out.

**Rent:** The rent for the locker depends on its size and is collected in advance from the renter. In case a locker is surrendered before the expiry of the term, no refund of rent for the unexpired period is usually allowed. Lockers are usually let out for one year although they may also be let out for two or three years.

**Nomination:** The hirer of a locker is allowed to nominate a person to whom, in case of death of the hirer, the bank may give access to the locker and liberty to remove the contents of the locker.

**Rama Chakravarthy Vs. Punjab National Bank**

In the above case, the wife of a deceased customer claimed the content of the safety locker as the nominee of the deceased customer. But the banker demanded a successions certificate from her.

It was held that the banker has no business to ask the nominee to produce a succession certificate where there is an nominee.

**Loss of Key:** If the key of the locker is lost, note should be made of the loss on the declaration card, specimen signature book and the safe custody register. The bank should call upon the renter in writing to deposit an amount sufficient to cover the cost of breaking open the locker and fitting a new one. The drilling open should be done in the presence of renter/renters. If the renter is unable to be present, he must sign a letter authorizing the bank to break open the door in the presence of a specified person and to deliver the contents to him after the locker is opened.
Surrender of Locker: A locker may be surrendered at any time. While surrendering the locker, the renter should open the locker, remove all contents and handover the key to the custodian of the vault. The banker should obtain the signature of the renter to a declaration on the relative card that the renter has removed the contents of the locker and the banker is relieved from liability.

Death of Renter: In case of death of a renter, the contents of the locker shall be delivered to the legal representative of the deceased only after getting a valid succession certificate from the court.

Prohibitory orders: a banker may receive an order from a court or a government department asking him to seal a particular locker and stop operations. The locker should be promptly sealed with bank’s seal under intimation to the renter.

Joint Names: a locker may be hired in the joint names of two or more persons. In such a case, the banker must get clear instructions in regard to operation of the locker account. The instructions can not be varied by any one of the joint renters. Subsequent modifications can be made by the consent of the them.

2. Letters of Credit

Letters of credit assume great importance in international trade. The problem in the foreign trade is that the exporters and importers are separated by distance and are unfamiliar with each other. The exporter will send the goods only if he is satisfied with the credit worthiness of the importer. Moreover, if the exporter is to be paid immediately after shipment of the goods, the importer will have to make payment before he actually receives them. On the other hand, if payment is to be made by the importer after receipt of the goods, the exporter will have to wait for a long time to get payment for the goods. The problem of payment in foreign trade is overcome by banks which issues what is known as a letter of credit. The letter of credit assures payment to exporters soon after he parts with the goods and enables the importer to make payment only after he
receives the goods or the document of title to goods. Thus letters of credit facilitate foreign trade.

Definition: “A letter of credit is defined as, “letter issued by the importer’s bank in favour of the exporter authorizing him to draw bills up to an amount specified in it and assuring him of payment against the delivery of the prescribed documents in his own country.”

The letter of credit is a sort of a guarantee to the exporter that his draft will be honoured by a specified bank upto a certain amount as per the specified terms.

The importer who wishes to import goods approaches his banker and requests him to open a letter of credit in favour of the overseas supplier. The letter of credit is a sort of a guarantee to the exporter that his draft will be honoured by a specified bank upto a certain amount as per the specified terms.

The importer who wishes to import goods approaches his banker and requests him to open a letter of credit in favour of the overseas supplier. The importer is called the opener of Accountee and his bank is known as opening bank. The letter of credit is sent to the foreign branch of the bank or to its correspondent bank, which is called the negotiating bank. After satisfying itself about the authenticity of the credit, the bank forwards it to the exporter who is called the beneficiary.

The exporter ships the goods, prepares the documents and draws a bill on his importer. The negotiating bank receives the bill and pays the amount if it is in accordance with the letter of credit. The opening bank receives the bill and documents and presents them for acceptance if they are D/A bills and for payment if D/P bills. Documents are delivered on payment or acceptance, as the case may be, to the importer who takes delivery of the goods from the ship.

A letter of credit has four principle parties:

1. Applicant (Opener): Normally applicant is the buyer of goods on whose behalf the LC is opened on the basis of his instructions.

2. Issuing Bank (opening Bank): The bank which issues the LC and undertakes to make payment to the beneficiary on surrender of documents as per terms of the LC.
3. Beneficiary: Beneficiary is normally the seller of goods who has to get payment from buyer, in whose favour the LC is opened.

4. Advising Bank: The bank through whom the LC is advised to the beneficiary thereby assuring genuineness of the credit. Advising bank is normally situated in the country/place of beneficiary.

The other parties involved in a letter of credit are:

1. Confirming Bank: This is a bank normally in the exporter’s country which adds its confirmation to the LC, thereby undertaking the responsibility of payment/negotiation/acceptance/under credit, in addition to that of the issuing bank.

2. Negotiating Bank: The bank which negotiates the documents received under the LC.

3. Paying Bank or Nominated Bank: The bank nominated and authorized by the issuing bank to make payment under credit.

4. Reimbursing Bank: The bank authorized to honour the reimbursement claim of settlement to negotiation/acceptance/payment. It is normally the bank with which the issuing bank maintains an account, from where payment will be made.

**Types of Letters of Credit**

The various types of letters of credit are as follows:

(i) Documentary and clean letter of credit: A documentary or secured letter of credit is one which the issuing bank undertakes to honour the bills drawn under it only when it receives with it certain documents such as bill of lading, insurance policy, invoice, certificate of origin etc. The documents are held by the issuing bank as security for advance made by it.

A clean or open letter of credit is one where no documents are involved. The issuing bank undertakes to honour the bills without production of any documents. Such a letter of credit is issued for customers of high financial standing.

(ii) Revocable and irrevocable letter of credit: A revocable letter of credit is one where the issuing bank reserves the right to cancel or modify the credit at any time without giving notice of cancellation to the beneficiary. A revocable letter of credit, therefore, does not constitute a
legally binding undertaking between the banker and the exporter. It is mere intimation or advice to the beneficiary to draw bills under the credit. Such credit provides no real security to the exporter. But, if there is a specific provision in the letter of credit that notice of cancellation should be given, the banker must abide by it.

An irrevocable letter of credit is one which can not be cancelled or modified without the consent of the beneficiary. Banks in India, generally, open only irrevocable credits.

(iii) Fixed and Revolving Letter of Credit: A fixed letter of credit is opened for a specific amount or for a specific period. The exporter may draw one or more bills up to the amount specified. The credit would exhaust as soon as the total amount has been withdrawn. If the period is fixed, it expires after the lapse of the prescribed time.

In case of revolving letter of credit, the amount of credit remains constant during the period of validity. When a bill is drawn, the amount gets reduced and when the bill is duly honoured, the credit amount is automatically renewed. For example, a revolving letter of credit is opened for a sum of Rs. 70,000. The exporter draws a bill for Rs. 20,000. Now the credit amount will get reduced to Rs. 50,000. When the bill for Rs. 20,000 is paid by the importer the original sum Rs. 70,000 will be available to the beneficiary. The revolving credit obviates the need to establish a fresh credit each time.

(iv) Confirmed and unconfirmed letter of credit: The purpose of letter of credit to the exporter is that he can undertake shipment of goods without ascertaining the credit worthiness of the importer. However, to what extent can the exporter rely on the undertaking given by a bank in a foreign country? To overcome this, the exporter may ask the importer to open a confirmed letter of credit.

In such a case, the importer has to request his bank to open a confirmed letter of credit. The opening bank then would request the negotiating bank to add confirmation to the credit and the latter does so, it is called confirmed letter of credit. The negotiating banker here becomes the confirming bank.

The confirming bank becomes independently liable to make payments to the beneficiary. A confirmed letter of credit can neither be
modified nor cancelled without the consent of all parites. So it is essentially an irrevocable letter of credit.

An unconfirmed letter of credit is one which does not carry the confirmation of the negotiating bank.

(v) With or without recourse letter of credit: In case of a letter of credit with recourse; the beneficiary of the letter of credit holds himself liable to the holder of the bill, in the event of dishonour. Where the beneficiary does not hold himself liable, such a letter of credit is known as without recourse letter of credit.

(vi) Transferable and non-transferable letter of credit: Under an ordinary letter of credit, the beneficiary alone has the right to draw bills of exchange and get them negotiated. He can not transfer his right to another person. In case, a transferable credit is issued, the beneficiary has the right to transfer the credit in whole or in part to one or more third parties. Such letters of credit are issued in cases where beneficiary may be an intermediary in the trade transaction and not a supplier himself.

(vii) Back-to-back letter of credit: If an intermediary in a trade transaction has received a non-transferable letter of credit he can not transfer it to the supplier. In such a case, he can request the banker to open a new credit in favour of the supplier on the security of the letter of credit issued in his in favour of the supplier on the security of the letter of credit issued in his favour. Such a letter of credit is called back-to-back letter of credit.

(viii) Red clause letter of credit: A red clause letter of credit is one which contains a clause which gives to the negotiating bank to grant advance for short period to the beneficiary upto a specified amount at the responsibility of the issuing bank. The particular clause in the letter of credit used to be generally printed in red ink and so is known as red clause and the credit is known as red clause letter of credit.

(ix) Green clause letter of credit: In addition to the credit facilities available under Red clause for purchase, processing and packing, the exporter get finance for warehousing and insurance charges at the port where the goods are stored pending availability of the ship.

Traveller’s Letter of Credit:
Traveller’s letters of credit are issued for the convenience of travelling public. A traveler who intends to go abroad incurs great risk if he keeps cash with him. Traveller’s letter of credit issued by banks avoids the risk of loss or inconvenience in carrying large amount of cash.

A traveler’s letter of credit takes the form of a request by the issuing bank to its foreign agents or correspondents to honour the drafts issued by it in favour of the traveler who is called the beneficiary. If the letter is addressed to more than one bank it is called a circular letter of credit.

The traveler’s letter of credit consists of two parts (i) letter of credit and (ii) letter of identification or letter of indication. It is essential to produce before the banker the letter of identification along with the letter of credit to receive payment. To avoid theft and impersonation, the customer should keep the letter of credit and letter of identification separate.

Every withdrawal with full details viz., date, name of the payee, place of payment, the amount in words and figures, the name of the paying bankers are recorded in the proforma printed on the back of the letter of credit. The paying bank collects the drafts issued by the issuing bank at the time of making payments from the beneficiary and presents them to the issuing bank to get reimbursement.

The applicant for a letter of credit is asked to deposit full amount for which the letter of credit is required. In some cases the account of the customer is debited with the amount.

A letter of credit is also issued against the guarantee of the customers to pay the amount with interest at a latter date. Such a letter of credit is called guarantee letter of credit.

Circular Note:

A Circular Note resembles a circular letter of credit, but with one difference. Circular notes are in the form of cheques issued for a round sum, generally in the currency of the country of the issuing bank. The name of the holder and the number of letter of letter of identification supplied and instruction to the correspondent bank are entered on the reverse side of the circular note.

3. Travellers’ Cheques
The Travellers’ Cheque can be useful to persons who frequently travel within the country or abroad. The features of the a travellers’cheque are the following:

1. A travellers’ cheque can be purchased by anyone. He need not be a customer of the bank.
2. Travellers’ cheque are issued in different denominations printed thereon, e.g. Rs. 50, Rs. 100 or Rs. 500. A person can buy any number of cheques. No commission is charged on sale of travelers cheques negotiable in India.
3. The purchaser has to deposit money with the issuing bank equivalent to the amount of travelers cheque he intends to buy.
4. At the time of purchase, the purchaser shall have to sign at the place marked ‘when countersigned below with this signature’.
5. At the time of encashment, the purchaser is required to sign on the travelers cheque at the specified place and to fill in the date and place of encashment.
6. The travelers cheques are usually encashable only at the branches of the issuing bank or at the branches of the other banks with which the issuing bank may have arrangement. Nowadays, banks enter into arrangements with the establishments such as hotels, restaurants, shops etc. Who accept the travelers cheques from their customers. Such establishments display the following sign board for this purpose.
‘WE ACCEPT STATE BANK’S TRAVELLERS CHEQUES’
7. There is no expiry period for the traveller’s cheques. Unused cheques can be returned back to the issuing bank and payment can be obtained for them.
8. The travellers’ cheques are issued in single name only i.e. not in joint names / clubs, societies and companies.

4. Remittance of Funds

Banks remit funds from one place to another through the network of their branches. The main instruments for transfer of funds are bank drafts, mail transfer, telegraphic transfers and travelers cheques.

Bank Drafts
A bank draft is an order from one branch to another branch of the same bank to pay a specified sum of money to the person named therein or to his order.

A person who wants to send money can buy a draft by paying the required amount from a bank and send to another who can encash it in his place. Banks issue drafts for a nominal commission. The commission depends upon the amount to be remitted. This service is extended to public in general. The purchaser of the draft need not be a customer or account holder or the bank.

**Legal Status of a Draft**

According to Section 13 of the Negotiable Instruments Act, bank draft is not a negotiable instrument. But a draft has all the attributes of a bill of exchange, such as an instrument in writing, containing an unconditional order, signed by the banker etc. Hence a bank draft is treated on par with a bill of exchange. Sections 85-A and 131 of the Negotiable Instruments Act specifically treat a bank draft as a bill of exchange or a cheque. Section 85-A provides protection to bank against forged or unauthorized endorsement on drafts and Section 131 gives protection to collecting banker in respect of crossed draft.

The Calcutta High Court in Shukla Vs. The Punjab National Bank Ltd., (1960) has observed that “a bank draft, which is an order by branch of a bank to its another branch, fulfils all the attributes of a bill of exchange.” The above view was upheld by the Calcutta High Court in a subsequent case, State Bank of India and another Vs. Jyothi Ranjan Mazumdar. Hence a bank draft can be treated as a negotiable instrument.

**Stopping payment of Bank Draft**

A bank draft is a commitment on the part of the issuing bank to pay a certain amount of money to a third party. The purchaser of the bank draft is not deemed to be a party to the instrument. Therefore, the banker should not comply with ‘stop payment order’ of the purchaser of a draft. If the draft is passed on to the payee, he acquires a right in the instrument which can not be set aside by the ‘Stop payment order’ of the purchaser. If the draft has been negotiated by the payee to a holder in due course, the latter would have enforceable right against the banker.
Cancellation of Draft

Sometimes the purchaser of the bank draft may return it to the issuing bank with a request to cancel it and refund the amount to him. In such a case, the banker is justified in complying with such request of the purchaser provided the draft has not been delivered to the payee. The contract entered into between the bank and the payee of the draft is incomplete and revocable until and unless it is delivered to the payee. The purchaser is, therefore, competent to get the draft cancelled so long as it is not delivered to the payee. The moment the draft is sent to the payee the purchaser loses this right.

Loss of Draft

In case the draft is lost and it is reported to the issuing bank, it should promptly advice the loss to the drawee branch which will make note of the loss in the record to guard itself against the fraudulent use of the lost draft. If the purchaser reports that the draft has been lost without any endorsement thereon, the issuing bank may safely refuse payment of the same because any endorsement thereon would be deemed to be a forged endorsement and the holder of the draft can not get good title.

Where the draft is lost by the purchaser he is entitled to get a duplicate one from the issuing bank. The banker, before issuing a duplicate draft, should take the following steps:

1. The banker should be satisfied with the genuineness of the request by the purchaser for the issue of a duplicate.
2. A confirmation as regards non-payment of the draft should be obtained from the drawee bank.
3. An indemnity bond must be obtained from the purchaser. If the draft has reached the hands of the payee, he should also sign the indemnity bond.
4. When a duplicate draft is issued, the drawee bank must be advised of it.

The period of validity of the draft is six months from the date of issue.

Mail Transfer

The facility of transforming money by mail is available to customers having some sort of an account with the bank. The remitter
deposits the amount to be transferred with a small commission with the remitting branch. After receiving the money, the bank sends instructions by mail to its drawee branch to credit the account of the payee with the specified amount and informs the payee about it. Remittance of money by mail transfer is relatively cheaper, safer and more convenient. Mail transfers are effected not only for remittance within the country but also for international remittances.

**Telegraphic Transfer**

Telegraphic transfers are effected by telegram, telephone or telex as desired by the remitter. Transfer of funds by telegraphic transfer is the most rapid and convenient but expensive method.

**Electronic Remittances**

Now-a-days almost all banks have computerised their operation. Besides, all banks in different countries are inter-linked with each other through internet. This mechanization has facilitated easy remittance of money not only within the country but also to any part of the world through the press of a button. Money can be transferred from one account in one branch to another account in another branch of the same bank or a different bank.

After the introduction of computers, M.T. and T.T. have lost their significance. It is so because computers have facilitated speedy remittance of funds from one end to another in a moments notice. Thus, it minimises the loss of interest since money is transferred instantly from one end to another. Moreover, it facilitates transfer of money from one branch of a bank to another branch of a different bank also which is not possible in the case of M.T. or T.T.

Recently arrangements have been made to pass on messages either general or specific through satellite facility. For instance banks all over the world are inter-linked with a satellite maintained by SWIFT (Society for Worldwide Inter – bank Financial Telecommunications) in Europe. In India, Gateway, Bombay, maintained by the Computer Maintenance Corporation of India is its agent. Those banks which want to enjoy this satellite facility in India can open SWIFT centres with Gateway, and thus, all the banks in the world are inter-linked with each other. Any general information like foreign exchange rate movements or specific information
like remittance of money. Or opening of Letter of Credit or making forfeiting arrangements can be passed on to the banks concerned or to all the banks as a whole as the case may be in a moment’s notice through this satellite arrangement.

**Foreign Inward Remittance Payment Scheme (FIRPS)**

This new scheme is mainly intended for facilitating easy remittance of money from foreign countries. It is meant purely for foreign inward remittance. Any NRI or foreign notional can remit money in foreign currency to any beneficiary in India through his bank in abroad. Generally, it is done by means of an order to its branch or correspondent in India to pay the stated sum to the person named in the document. This remittance is in foreign currency. This document can be encashable only at the specified branch or the specified bank which is acting as a correspondent.

Now, under this new scheme, the branch concerned or the correspondent bank in India will convert the foreign currency into Indian rupee at the then prevailing market rates and issue another document in favour of the beneficiary. This document is called FIRP instrument. Since the bankers in India are authorised dealers in foreign exchange, they can covert the foreign currency into Indian rupee easily.

For all practical purposes, this FIRP instrument is treated as a Negotiable instrument and hence it can be endorsed to anybody in settlement of claims. Moreover, it is encashable at any branch of any commercial bank which is a member of the Foreign Exchange Dealers Association of India (FEDAI).

**5. Merchant Banking**

Merchant banking is a British concept brough into India by Grindlays Bank in 1969. State Bank of India, Bank of Baroda, Bank of India, Canara Bank, Indian Bank, Indian Overseas Bank and Syndicate Bank have organized merchant banking divisions.

Merchant banking divisions offer under one roof a wide range of services financial, technical, managerial etc., which are ordinarily available through a widely spread non-banking agencies and professionals.

The main services of a merchant banking division of a commercial bank are the following:
1. All aspects of project counseling such as, preinvestment and feasibility studies to identify a project.

2. Liaison work to help the entrepreneurs obtain various government consent including letter of intent and industrial licences and other permissions from government and semi – government bodies.

3. Preparation of project reports after examining means and sources of finance.

4. Assisting in formulation of financial plan and preparation and filing of application for of loans.

5. Management of public issue including preparation and issue of prospectus, finalization of issue agencies and completion of the issue.

6. Assisting companies in matters relating to corporate restructuring, amalgamations, mergers and take over etc.,

7. Assistance to widen and strengthen the capital base of small scale industries which are planning to enter medium scale sector by undertaking expansion/diversification of their activities and involving change in the type of organization.

8. Help to locate and evaluate new market in foreign countries and assist in finding out foreign collaboration.

The amount of fee charged for the service by the bank depends upon the type and nature of service as well as time required for completing the assignment.

6. **Dealing in Foreign Exchange Business:**

   Banks offer varied services in respect of foreign exchange business.

   (1) Deferred payments: Banks execute deferred payment guarantee on behalf of their constituents to enable them to acquire plant and machinery from overseas suppliers on deferred payment terms. In suitable cases even foreign currency loans are arranged for this purpose.

   (2) Import packing facility: Import packing facilities are extended to first class customers whereby the imported goods are released against trust receipts. Outstandings under such facility are to be liquidated within a stipulated period.

   (3) Export Finance: Banks grant export finance both at pre-and post-shipment at concessional rates of interest. Under post-shipment credit,
facilities like discounting of bills etc., are made available. Preshipment advances are granted for a maximum period of 90 days

(4) Forward Contracts: Some banks enter into forward contracts with importers or exporters for sale or purchase of foreign exchange at fixed rate to safeguard them against fluctuations in the rates of foreign exchange.

(5) Issue of solvency certificates, freight certificates, introduction letter for various purposes relating to foreign exchange business is another significant service.

(6) Banks get trade information and disseminate it and pass on the enquiries to the importers and exporters. They also initiate trade enquiries on behalf of customers to locate suitable buyers for their products abroad.

7. **Leasing Finance**

Lease is a method of financing equipment and machinery. It is a mechanism by which a person acquires the use of an asset by paying a pre-determined amount called ‘rental’ periodically over a period of time. In countries like USA, UK and Japan approximately 25 per cent of plant and equipment is being financed by leasing companies.

The Banking Regulation Act, 1949, did not permit banks to directly transact leasing business. The Banking Laws (Amendment) Act, 1983, enables commercial banks to carry on equipment leasing business and set up subsidiaries for carrying on such business. A subsidiary company promoted by a bank may undertake equipment leasing business and such other activities incidental thereto.

8. **Factoring**

Factoring is a “continuing arrangement between a financial institution (the ‘factor’) and a business concern (the ‘client’) selling goods or services to trade customers (the ‘customers’) whereby the factor purchases the client’s book debts (accounts receivables) either with or without recourse to the client and in relation thereto controls the credit extended to the customers and administers the sales ledger.”

The purchase of book debts or receivables is central to the function of factoring, permitting, the factor to provide basic services such as: (i)
administration of the seller’s sales ledger, (ii) Provision of pre – payment against the debts purchased, (iii) collection of the debts purchased and (iv) covering the credit risk involved. Besides the above four basic services, factors could also provide certain advisory services by virtue of their experience in credit and financial dealings and access to extensive credit information. Thus, as a financial system combining all the related services, factoring offers a district solution to the problems posed by working capital tied up in trade debts.

To ease the working capital problems arising from delays in payment of bills, introduction of factoring service was recommended by Vaghul Committee. Later, Kalyanasundaram committee was specifically appointed to examine the feasibility of introduction of factoring service in India. The committee’s recommendation that there is need and scope for factoring was accepted by the Reserve Bank of India. Banking Regulation Act was amended in July 1990 for the purpose and RBI directed that factoring activities could be undertaken by banks through the medium of separate subsidiaries. Following this, the State Bank of India has set up Factors and commercial Service Private Limited for providing factoring service to industries.

9. Housing Finance

Banks played insignificant role in providing housing finance till the early seventies. The Reserve Bank of India appointed a ‘Working Group’ to examine the role of banking system in providing finance to housing schemes. The recommendations of the Group were examined by the Reserve Bank which issued guidelines to banks in 1979. Accordingly, the banks could advance housing loans directly to the parties concerned or indirectly to State Housing Boards or Housing and Urban Development Corporations in the form of subscription to their bonds or debentures.

State Bank of India, Canara Bank and Punjab National Bank have formed housing subsidiaries to provide housing finance. In tune with the new housing policy of the government, the Reserve Bank of India has liberalised credit for housing finance. According to the new guidelines the maximum period of repayment is 15 years, the maximum margin is 35 per cent and the rate of interest is 12.5%, 13.5%, 14% and 14.5% to 16% per
annum according to the size of the loan. The rate of interest for scheduled caste and tribes on housing loan upto Rs. 5,000 will remain at 4% per annum.

10. Underwriting of Securities

Commercial banks underwrite a portion of the public issue of shares, bonds and debentures of joint stock companies. Such underwriting provides an indirect form of insurance to the companies on the event of public subscriptions falling short of expectations. Nowadays banks act as bankers to a particular issue of shares or debentures. They receive applications for share and application money from the public. They also undertake to receive subsequent instalments from those who are allotted shares.

11. Tax Consultancy

Tax consultancy service is of recent origin. This service is intended to help tax payers who may not be able to afford a consultant of their own. The bank’s income tax department offers complete tax service which consist of advice on income tax and other personal taxes, preparing customer’s annual statement, claiming allowances, file appeals etc., The consultancy service is also provided to non-resident Indians. A survey reveals that quite a few people utilise this service.

12. Credit Cards

Banks have recently introduced the credit card system. Credit cards are issued to good customers having current or saving accounts, free of charge. The credit card enables a customer to purchase goods or services from certain retail and service establishments upto a certain limit without making immediate payment. The establishments get paid by the bank operating the plan. The bank assumes the risk and responsibility of collecting the dues from the customers.

Each credit card bears the specimen signature of the holder and is embossed by the issuing banker with the holders’ name and address. The establishments, on presentation of the card, delivers the goods or provides the services. The supplier places the credit card in a special imprinter
machine to record the holder's name and number on a sales voucher to which are added the particulars of the transaction. The holder signs the voucher and the signature is compared by the supplier with that on the card. The voucher is then sent to the bank which pays it after deducting its service charges. Once in a month, the bank sends a statement of all the credit purchase in the previous month to the credit card holder and the latter has to remit the amount either by cash or by cheque.

The facilities provided to credit card holders are fast expanding. Central Bank and Canara Bank permit their credit card holders to withdraw cash from any branch of the bank upto a certain limit. Central Bank got tied up with Mastercard of USA, the largest card – issuing organization in the world. More than three million establishments spread over 140 countries honour Mastercard. As on June 30, 1998 twelve banks, SBI and its associates were engaged in credit card business further 20 Indian banks have entered into business by having tie up arrangements with other banks.

13. Gift Cheques

Banks in India sell gift cheques against payment in cash or by debit to an account. Gift cheques are issued in fixed denominations. As the name indicates, these cheques are intended to be given as gifts on occasions such as wedding, birthdays etc. The purchaser of the cheque need not be an account holder with that bank. The payee can encash them at any time. The gift cheque is payable on par at all branches of the issuing bank. It has no negotiability and its payment is made only to the payee.

14. Consultancy Service

State Bank of India and Indian Bank have set up consultancy cell to provide consultancy service to small scale industries. The consultancy service covers technical, financial, managerial and economic aspects. This service is offered not only at the project stage but also at every stage of implementation of the project.

15. Teller System
The object of the teller system is to expedite payment of cheques for small amounts. Under this system, the teller is authorised to receive cash and make payments up to limited amounts without reference to the ledger balance or the specimen signatures. He is expected to be conversant with the type of accounts allotted to him and the specimen signatures of relative customers. Only in case of doubt, the teller gets the balance or signature verified. This system is adopted at certain selected centres and not all the branches of a bank.

7.10 TERMINOLOGIES


7.11 MODEL QUESTIONS

1. Describe the mechanism and effect of different commercial letters of credit.

2. What is a letter of credit? What is its significance in financing foreign trade?

3. Describe the procedure to be followed in regard to safe deposit vault.

4. Explain the agency service performed by a banker.

5. Describe the subsidiary services of a modern commercial bank.

7.12 REFERENCE BOOKS


UNIT – VIII INSURANCE AND RISK

Structure
8.1 Introduction
8.2 Methods of Risk Management
8.3 Lack of Insurance
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8.1 INTRODUCTION

Insurance Risk Management is the assessment and quantification of the likelihood and financial impact of events that may occur in the customer's world that require settlement by the insurer; and the ability to spread the risk of these events occurring across other insurance underwriter's in the market. Risk Management work typically involves the application of mathematical and statistical modelling to determine appropriate premium cover and the value of insurance risk to 'hold' vs 'distribute'.

Insurance Risk Management: Value

Alignment of the pricing market strategy and reinsurance arrangements to the organisation's risk appetite as well as optimising the goals of the organisation

Assist clients to recognise risk events and changes to claim rates earlier, so as to move towards a more market responsive, risk-based pricing approach which ensures the efficient deployment of capital and a reduction in extreme risk event losses.

Enhance the feedback mechanism from claims function to underwriting and product development processes to improve the performance and profitability of these processes.

8.2 Methods of Risk Management

As people begin to age, they usually encounter more health risks. Managing pure risk entails the process of identifying, evaluating and subjugating these risks – a defensive strategy to prepare for the unexpected. The basic methods for risk management – avoidance, retention, sharing, transferring, and loss prevention and reduction – can apply to all facets of an individual's life and can pay off in the long run. Here's a look at these five methods and how they can apply to managing health risks.

1) Avoidance

Avoidance is a method for mitigating risk by not participating in activities that may incur injury, sickness or death. Smoking cigarettes is an example of
one such activity because avoiding it may lessen both health and financial risks.

According to the American Lung Association, smoking is the leading cause of preventable death in the U.S. and claims more than 438,000 lives per year. Additionally, the U.S. Center for Disease Control and Prevention notes that smoking is the No. 1 risk factor for getting lung cancer, and the risk only increases the longer that people smoke.

Life insurance companies mitigate this risk on their end by raising premiums for smokers than nonsmokers. Under the Affordable Health Care Act, also known as Obamacare, health insurers are able to increase premiums based on age, geography, family size and smoking status. The law allows for up to a 50% surcharge on premiums for smokers.

2) Retention
   Retention is the acknowledgment and acceptance of a risk as a given. Usually, this accepted risk is a cost to help offset larger risks down the road, such as opting to select a lower premium health insurance plan that carries a higher deductible rate. The initial risk is the cost of having to pay more out-of-pocket medical expenses if health issues arise. If the issue becomes more serious or life-threatening, then the health insurance benefits are available to cover most of the costs beyond the deductible. If the individual has no serious health issues warranting any additional medical expenses for the year, then they avoid the out-of-pocket payments, mitigating the larger risk altogether.

3) Sharing
   Sharing risk is often implemented through employer-based benefits that allow for the company to pay a portion of insurance premiums with the employee. In essence, this shares the risk with the company and all employees participating in the insurance benefits. The understanding is that with more participants sharing the risks, the costs of premiums should shrink proportionately. Individuals may find it in their best interest to participate in sharing the risk by choosing employer health care and life insurance plans when possible.

4) Transferring
   The use of health insurance is an example of transferring risk because the financial risks associated with health care are transferred from the individual to the insurer. Insurance companies assume the financial risk in exchange for a fee known as a premium and a documented contract between the insurer and individual. The contract states all the stipulations and conditions that must be met and maintained for the insurer to take on the financial responsibility of covering the risk.

By accepting the terms and conditions and paying the premiums, an individual has managed to transfer most, if not all, risk to the insurer. The insurer carefully applies many statistics and algorithms to accurately determine the
proper premium payments commensurate to the requested coverage. When claims are made, the insurer confirms whether the conditions are met to provide the contractual payout for the risk outcome.

5) Loss Prevention and Reduction
   This method of risk management attempts to minimize the loss, rather than completely eliminate it. While accepting the risk, it stays focused on keeping the loss contained and preventing it from spreading. An example of this in health insurance is preventative care.

Health insurers encourage preventative care visits, often free of co-pays, where members can receive annual checkups and physical examinations. Insurers understand that spotting potential health issues early on and administering preventative care can help minimize medical costs in the long run. Many health plans also provide discounts to gyms and health clubs as another means of prevention and reduction in order to keep members active and healthy.

8.3 Lack of Insurance
   Although it’s easy to perceive insurance as a cost, in reality, it’s probably one of the biggest value adds to any business. Devastating events such as natural disasters can single-handedly bring a business to its end, quickly and without any prior warning. Insurance can effectively minimize the damage cause by these unforeseen events, which in some instances can mean saving a company from having to close its doors – that’s a tremendous amount of value.
   However, many small businesses and young companies are often underinsured. As NBC News notes, this is for two reasons: First, they may not have the capital to acquire all the insurance they need to cover their bases. Second, they are unaware of what they need to insure and don’t take stock of their insurance needs regularly, so their companies outgrow their coverage.

“One of the biggest lapses is in the area of business interruption insurance,” Clair Wilkinson, vice president at the Insurance Information Institute, explained to the news source. “This kind of coverage, which you might need to buy separately from a standard business insurance package, can be critical after a natural disaster, fire or power failure that shuts your business down. Business interruption insurance covers lost profits and operating expenses, such as salaries, that must still be paid even when a company can’t operate.”

8.4 PERKS( BENEFITS) OF INSURANCE TO RISK MANAGEMENT
   For young businesses, insurance should be a crucial cornerstone in risk management programs because it brings so much to the table. Risk Management Monitor recently discussed some of the core benefits of risk management:
1) **Protection from financial loss** – For young businesses, a multitude of things can go wrong, from natural disasters to theft and burglary. Insurance can be a key tool in preventing financial losses in the early stages of the game. When companies have small budgets, even having to buy a new laptop because a thief stole one from the office can be devastating.

2) **Better reputation** – New businesses are always looking for financial support, whether it’s from angel investors or banks. Having insurance reflects well on the company and makes the owner look responsible, which can help secure that necessary loan or investment.

3) **Improve liability** – General liability insurance protects entrepreneurs against unforeseen everyday threats, whether it’s someone slipping on their floors or getting their fingers jammed in the door on the way out. There are only so many things businesses can prepare for, liability insurance helps entrepreneurs prepare for the rest.

If you wish to learn more about risk management programs, [leave your contact info](#) and one of our representatives will contact you shortly.

### 8.5 General Structure of the Insurance Market

The insurance market has evolved from the establishment of the first automobile insurance policy to the various types of life insurance products that are available today. The insurance market has a structure that involves property and casualty insurers, life insurers as well as health insurers. Each of these types of insurers have regulations that apply to the policies that they provide. Insurers are regulated by a combination of state and federal laws, depending on the type of insurance they offer.

1) **Property and Casualty**

Property and casualty insurers offer various types of insurance for individuals to purchase, such as automobile and homeowners insurance. A property and casualty insurer can also offer types of commercial insurance, such as a small business package, general business liability, umbrella policies and workers compensation. Property and casualty insurers are regulated by laws in each state where they sell policies.

2) **Mutual Insurance Companies**

A mutual insurance company is a company owned by policyholders. This means that each policyholder is given a vote to decide who will sit on the board of directors. A mutual insurance company can sell types of insurance or only provide one type of product or service to their customers. The earnings from a mutual insurance company are distributed to policyholders in the form of dividends.
3) Stock Insurance Companies

A stock insurance company is a company owned by stockholders. Unlike a mutual insurance company, a stock insurer not only needs to protect its policyholders but also maximize profits for the company's policyholders. A stock insurance company can pay dividends to stockholders but generally do not pay dividends to their policyholders.

4) Life Insurance

Property and casualty insurers can also provide types of life insurance. A life insurance company can be a mutual insurance company or part of a stock insurance company. Companies that provide life insurance usually offer financial products to their policyholders, such as annuities and certain types of mutual funds.

5) Health Insurance

The insurance market also contains companies that provide health insurance policies to individuals as well as employers in the form of a group health insurance policy. Companies that provide a group health insurance policy to an employer are regulated by a combination of federal and state laws. States can also provide health insurance to residents if it is unavailable from a private insurer because of cost or ineligibility.

6) Common Ownership

Many insurance companies are under a common ownership in which one corporation has one or more insurance business that act as independent companies. The most common type of common ownership for an insurance company is when it is established as a captive insurer. A captive insurer can be formed to provide coverage for various types of business risks. The most common type of captive insurer provides reinsurance coverage. This is a type of insurance where multiple insurance companies share the same loss.

8.6 Significant Aspects of an Industry

Evaluating a company’s future performance

Understanding a subject entity's industry is a hallmark of any good valuation report. Conducting a very detailed and intense industry analysis can provide valuation analysts with specific knowledge needed to determine an appropriate conclusion of value. As a general rule, a company’s performance is commensurate with the industry to which it belongs. Understanding the different aspects of an industry is a key component to evaluating future performance and the overall value of a company. This is an aspect of business valuation that warrants greater attention from valuation professionals.
“Oftentimes, the industry outlook section of a business valuation report is overlooked and not given the proper attention it deserves.”

Oftentimes, the industry outlook section of a business valuation report is overlooked and not given the proper attention it deserves. Appropriately analyzing a company’s industry has many useful applications. First and foremost, a valuation analyst should understand a subject entity’s industry to determine whether he or she can reasonably expect to perform the valuation engagement with professional competence. A poor understanding of a company’s industry is a legitimate reason to decline an engagement.

Industry research and analysis is applicable when reviewing both nonfinancial and financial information during the course of a valuation engagement. Nonfinancial industry data that needs to be considered include industry performance, industry outlook, environmental concerns, supply chains, products and/or services offered, competitive landscape, and capital intensity, to name a few. These considerations assist in determining (and defending, if necessary) projected growth rates, capital requirements, discount rates, and the discount for lack of marketability.

There are a number of items to consider when researching industry performance. They include external competition, current performance, industry restructuring, trends, and regulations. The industry outlook is important because it gives the reader of a valuation report an idea of where a company may be going in the next three to five years. This information is not only useful in forecasting, but it allows for analyzing a company with respect to economic indicators such as a recession, rising employment, consumer expenditures, etc. Environmental concerns can be a material factor if there is a major concern in a particular industry. This may impact future capital investment and cash flow. A valuation analyst should, if possible, evaluate a subject entity’s supply chain and understand the interplay between a company
and both their key buying (e.g. vendors) and selling (e.g. customers) industry participants. Perhaps the most important consideration is a company’s product/service segmentation and understanding how it relates to their industry. This gives the valuation analyst knowledge about a company’s main source of revenue, opportunities for growth, and concentration level. All factors described in this paragraph are key drivers in determining revenue volatility.

An industry’s competitive landscape offers important information regarding cost structure benchmarking, competition, and barriers to entry. Understanding cost structure benchmarks of an industry helps a valuation analyst to compare a subject entity’s profit margin against industry norms. Competition can be broken down by geographic location to further analyze the number of companies competing and whether internal and/or external competition exists. Internal competition may include price, location, quality of service, and extra services offered. External competition mainly includes any sort of cheaper alternative available to a consumer. A valuation analyst should consider and make a checklist of the following factors when determining an industry’s barriers to entry: competition, concentration, life cycle stage, capital intensity, technology change, regulation, and industry assistance.

Most valuation reports of operating entities include analytical procedures as part of the financial analysis. This includes analyzing liquidity, profits and profit margins, sales, debt, and assets. In addition to performing a financial analysis of a subject entity, a valuation analyst should obtain financial information specific to the subject entity’s industry (if available). This includes comparative common size industry financial information for the relevant time period. It is important to compare and benchmark the performance of a subject entity with competitors and industry trends and norms. This comparison between a subject entity’s financial performance and the financial performance of the subject entity’s industry as a whole is a good indication of the overall health of a company.

Analyzing a subject entity’s industry also assists with determining an appropriate discount rate. There are three main types of industry risk to consider. Those three industry risks are: structural risk, growth risk, and sensitivity risk. Structural risks include such components as barriers to entry, competition, supply/demand, revenue volatility, and life cycle stage. Growth risk evaluates forecasted industry growth against past performance of a subject entity. Sensitivity risk evaluates the most significant external factors affecting an industry’s performance. For example, components of sensitivity risk may include per capita disposable income and the national unemployment rate. These items are very general, but there may be components of sensitivity risk applicable to a certain industry which should be considered.

Understanding a subject entity’s industry is a hallmark of any good valuation report. Conducting a very detailed and intense industry analysis can provide valuation analysts with specific knowledge needed to determine an appropriate
As a general rule, a company’s performance is commensurate with the industry to which it belongs. Understanding the different aspects of an industry is a key component to evaluating future performance and the overall value of a company. This is an aspect of business valuation that warrants greater attention from valuation professionals.

### 8.7 Reforms in Insurance Sector in India:

The winter session of the India parliament concluded on December 20, 2013. Against the backdrop of the slowing growth rate and demands from the investment community for economic reforms, one critical piece of legislation that was expected to be considered by the parliament was the Insurance Laws (Amendment) Bill, 2008 (the "Bill"). The government’s approval to increase the foreign direct investment limit for the insurance sector from 26 per cent. to 49 per cent. had also given rise to the expectation that the Bill would be passed at the winter session of the parliament.

In 2004, the Law Commission recommended a comprehensive reform of the Insurance Act, 1938 (the “Insurance Act”). In 2005, the Narasimhan Committee made further recommendations for changes to the Insurance Act. The Bill, which amends the Insurance Act, 1938, the General Insurance Business (Nationalisation) Act, 1972 and the Insurance Regulatory and Development Authority ("IRDA") Act, 1999 and incorporates the recommendations of the Law Commission and the Narasimhan Committee has been up for consideration by the parliament since 2008.

Lack of political consensus has led to yet another hiatus in the passage of the Bill into law. Had the Bill been passed at the recently concluded session of parliament, it may perhaps have reinforced the message to the global investment community that economic reforms are underway.

**Key features of the bill**

- **Increased foreign investment**: The bill proposes an increase in the foreign investment ceiling from 26 per cent to 49 per cent.

- **Capital raising**: The Bill provides for general insurance companies to raise funds from the capital markets with the permission of the government. Under the current laws, insurance companies may raise only equity share capital.

- Lloyd's, the society of underwriters based in London is to be allowed to do business in India through joint ventures through Indian partners and to act as reinsurers through their branches in India. Since Lloyds is not a company but an insurance market, further clarity is needed as to whether the intention is to allow individual members to operate in the country.
• Special Economic Zone ("SEZ"): The Bill proposes to allow foreign insurers to operate in SEZs without regulatory control but allows the government in its discretion to allow any of the provisions of the Insurance Act to be applicable to such insurers.

proposals other
The Bill also proposes, amongst others, to provide greater protection to the insured by imposing penalties to those insurers who fail to meet their obligations with respect to underwriting third party motor insurance or other insurance policies in rural sectors and allows for the partial assignment of insurance policies. The Bill also does away with the existing requirement for Indian promoters of an insurance company to reduce their stake to 26 per cent over a period of ten years.

The insurance sector:
Currently, there are 52 insurance companies operating in India. Out of these 52 companies, 1 is in the reinsurance business, 24 are in the life insurance business and 27 are in the non-life insurance business. The General Insurance Corporation is the sole national reinsurer in the country. Insurance penetration (measured as a ratio of the premium to the GDP) and insurance density (measured as a ratio of the premium to the total population) in India has been at significantly low levels in India compared to its peers in Asia. As of 2011, insurance penetration in the life insurance sector was 3.40 percent, whereas the penetration in the non-life insurance sector was in the range of 0.55 per cent. to 0.75 per cent. Insurance density as of 2011 was USD 49.0 for the life insurance sector and USD 10.0 in the non-life sector. The measure of insurance penetration and insurance density reflects the level of development of the insurance sector in a country. These low penetration levels suggest that the insurance sector in India has a promising potential for growth. Additionally, a rising population, a growing economy, increased domestic savings and greater awareness of insurance products are positive indicators for growth for the insurance industry.

The insurance industry in India does appear to be at a crossroad. A regulatory environment which is perceived to be discouraging to innovation and competitiveness has stifled the ability of insurance companies to remain profitable and seek ways to increase their product offerings. It is prescient that the IRDA in its annual report stated that "Since the opening up of the Indian insurance sector for private participation in 1999, India has reported an increase in insurance density for every subsequent year and for the first time reported a fall in the year 2011."

What the passage of the bill into law would mean
Indication that the government is focused on reforms:

The passing of the Bill in parliament would be an important reinforcement to the foreign investment community of India's commitment to financial and economic reforms. It is important for the global business community to
perceive India as a safe harbor for their capital.

**Address capital requirements:**

The insurance business is a capital intensive business. The IRDA estimates that if insurance companies are to improve insurance penetration and introduce new products and improve distribution networks while maintaining and increasing their customer base, they will need approximately 612 billion rupees. With a raise in the investment ceiling to 49 per cent., the insurance sector would be able to raise much needed capital to grow and improve the value proposition to end customers and operational performance. Increasing the ceiling for investment in the insurance sector is the best way to meet additional capital requirements. Also, like water seeking its own level, any delay in the passage and implementation of the Bill may also result in capital moving to other competitive markets.

**Prospects for growth:**

India is expected to have a working population of 795.5 million by the year 2026. Additionally, increasing incomes would also lead to greater disposable incomes which are often the target of financial service providers like insurance companies. Also, as the population becomes more financially literate, their appreciation of the benefits of insurance would be enhanced. With the wider participation of foreign insurers in the Indian insurance industry, the potential for growth in the insurance sector be realized to a greater degree.

**Infrastructure investment:**

Another persuasive argument for the Bill to be passed is the need for investment in the infrastructure sector. Infrastructure or its lack thereof is frequently cited as one of the biggest hurdles to doing business in India. India's planning commission has projected a doubling of infrastructure investment to $1,025 billion in the 12th Five Year Plan (2012-2017). The government has set of target of $500 billion in infrastructure spending from the private sector. It is widely anticipated that the reforms to the insurance sector once implemented would result in more capital flow into the country which would lead to more investments by insurance companies in the infrastructure sector. The Bill also complements the relaxations which the IRDA had effected to allow insurers to invest in the infrastructure sector.

**The past of insurance sector in India**

In the history of the Indian insurance sector, a decade back LIC was the only life insurance provider. Other public sector companies like the National Insurance, United India Insurance, Oriental Insurance and New India Assurance provided non-life insurance or say general insurance in India.

However, with the introduction of new private sector companies, the insurance sector in India gained a momentum in the year 2000. Currently, 24 life
insurance companies and 30 non-life insurance companies have been aggressive enough to rule the insurance sector in India.

But, there are yet many more insurers who are awaiting for IRDAI approvals to start both life insurance and non-life insurance sectors in India.

**The present of insurance sector in India**

So far as the industry goes, LIC, New India, National Insurance, United insurance and Oriental are the only government ruled entity that stands high both in the market share as well as their contribution to the Insurance sector in India. There are two specialized insurers – Agriculture Insurance Company Ltd catering to Crop Insurance and Export Credit Guarantee of India catering to Credit Insurance. Whereas, others are the private insurers (both life and general) who have done a joint venture with foreign insurance companies to start their insurance businesses in India.

This collaboration with the foreign markets has made the Insurance Sector in India only grow tremendously with a high current market share. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014. IRDAI states – Insurance Laws (Amendment) Act, 2015 provides for enhancement of the Foreign Investment Cap in an Indian Insurance Company from 26% to an Explicitly Composite Limit of 49% with the safeguard of Indian Ownership and Control.

Private insurers like HDFC, ICICI and SBI have been some tough competitors for providing life as well as non-life products to the insurance sector in India.

**8.8 The Future of Insurance Sector In India**

Though LIC continues to dominate the Insurance sector in India, the introduction of the new private insurers will see a vibrant expansion and growth of both life and non-life sectors in 2017. The demands for new insurance policies with pocket-friendly premiums are sky high. Since the domestic economy cannot grow drastically, the insurance sector in India is controlled for a strong growth.

With the increase in income and exponential growth of purchasing power as well as household savings, the insurance sector in India would introduce emerging trends like product innovation, multi-distribution, better claims management and regulatory trends in the Indian market.

The government also strives hard to provide insurance to individuals in a below poverty line by introducing schemes like the

- Pradhan Mantri Suraksha Bima Yojana (PMSBY),
- Rashtriya Swasthya Bima Yojana (RSBY) and
- Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY).
Introduction of these schemes would help the lower and lower-middle income categories to utilize the new policies with lower premiums in India.

With several regulatory changes in the insurance sector in India, the future looks pretty awesome and promising for the life insurance industry. This would further lead to a change in the way insurers take care of the business and engage proactively with its genuine buyers.

Some demographic factors like the growing insurance awareness of the insurance, retirement planning, growing middle class and young insurable crowd will substantially increase the growth of the Insurance sector in India.

8.9 Importance of the Privatization of Insurance Industry

Public Enterprises in any country cannot perform all the economic and business activities efficiently. Even in a socialist country, public enterprises in all the fields cannot discharge their full responsibilities. Complete governmentalisation or nationalisation will lead towards serfdom or anarchism. In absence of free will personal interests; the economic activities will not provide adequate and qualitative production.

This is the reason that some troubles have started in some parts of the USSR and China. In Indian conditions where we have adopted mixed economy, expecting too much from public enterprises will distort the economy and ultimately will lead towards wastage of precious resources.

Supporting and subsidizing by the Government indirectly punish the tax-payers and the country-men. Therefore, it is the high time to recast our Industrial Policy and should consider the productivity and efficiency as criteria to continue a particular unit whether public enterprises or private enterprises.

The public enterprises cannot be sustained as sacred cow without milk. Similarly, the unscrupulous private enterprises declaring themselves sick cannot be put on ambulance for a longer time. It is a matter of satisfaction that the Government has started taking pragmatic approaches to revive the productivity and efficiency base criteria for the development of an enterprise.

The restrictions on utilisation of full capacity by private enterprises are being removed gradually to increase production and productivity of the economy. The public enterprises will have to come at the combative of the private enterprises.

If the formers are losing in the efficiency and productivity criteria, they should be closed down and the private enterprises having more efficiency and productivity should be encouraged to increase production of the economy.

The industrial policy that public enterprises provide more employment opportunities although production is nominal should be changed to bring them under productivity criterion. Providing employment for the sake of employment is adding fuel to the fire of inflation any trend in the economy because the productivity is very low.
The Government decision to denationalise certain production undertaking is welcome step because they remain idle without production or very small production. Other political parties should realise the gravity of productivity and discard the public enterprises for the sake of political system.

The Government cannot perform all the functions with equal efficiency. The regulatory role, promotional role, entrepreneurial role and planning role have not been fully discharged by Government.

Barring few enterprises as envisaged in the Industrial Policy 1956, rest of the public enterprises should be returned back to the private institutions if their productivities are not improved to the level of a private enterprise.

The government should concentrate more on regulatory and planning roles. The entrepreneurial role should be confined only to those areas where the private entrepreneurs are hesitant and cannot discharge their functions satisfactorily at national level.

Non-profitable business activities, defense, transport, education, communication and such types of public activities should be undertaken by the Government. W. A. Levis observed: “The nationalisation of industry is not essential to planning; a government can do nearly anything it wants to do by way of controlling industry without resorting to nationalisation”.

Neither state monopoly nor private monopoly is desirable in the economy. The competition, being the backbone of the productivity should be encouraged to promote the economy.

The competition may be between and amongst the public and private enterprises. The productivity and efficiency are the important criteria to permit the continuation of an enterprise.

The public enterprises in some areas performed better than the private enterprises and, therefore, should be permitted to continue to accelerate the growth of the economy. On the other hand, many public enterprises are wasting public money because of continuous loss and less production.

Such enterprises should be handed over to the competent private companies. On the reverse, some private enterprises are at loss and declaring themselves sick. They should be taken over by the Government companies of the area or by the private houses as the circumstances and nature of the business may be prevailing at that time.

The privatisation may be done after analysing the efficiency of the organisation and their role in the economy. The problem of public enterprises, inefficiency of public enterprises and efficiency of private enterprises, are considered under privatisation and efficiency.
8.10 PROBLEMS FACED BY PUBLIC ENTERPRISES

The following are the problems faced by government (Public) enterprises:

1. Bureaucratic management: The organizations are run by bureaucrats who may not have knowledge of running an enterprise or knowledge of the industry trends and practices.

2. Lack of autonomy: These enterprises lack freedom and flexibility. They are subject to the control of the politicians and bureaucrats. Due to this, their performance is affected.

3. Delayed decisions: Decisions are delayed due to red-tapism and bureaucratic procedures. A file may have to pass through many officials for approval before a decision can be taken. By the time a decision is taken, the business environment might have undergone considerable changes.

4. Unplanned production: Many of the public sector enterprises produce products which are not in tune with the market demand. The needs of consumers are not taken into account while planning production. The result is poor sales and the organization is left with huge unsold stocks which are then disposed off at a discount.

5. No clear-cut price policy: There is no clear cut price policy. Certain organization follow a cost plus price policy, some administered pricing, a few dual pricing followed by those adopting association pricing. There is no clarity with regard to the price policy.

6. Delays and cost overruns: Due to poor planning, lack of funds, mismanagement etc. many projects face delays and the consequent cost overruns. It is common to find new projects being announced without earlier projects being completed.

7. High overheads: Many of these organizations incur high overheads. There is very little focus on cost control and cost reduction. Wastage of resources are rampant. Many organizations even maintain entire townships and incur high costs.

8. Over-staffing: The salary costs and pension costs of many of these organizations are high. It is because government considers these organizations as generators of employment and many of them are overstaffed.

9. Poor productivity: Due to reliance on outdated technology, lack of upgradation and inefficiencies, low levels of employee motivation and poor work culture, the productivity of many of these enterprises is quite low.

10. Lack of proper planning: Planning is poor and in some cases even absent. Projects are commenced without detailed analysis and planning. This results in losses and delays.

11. Low capacity utilization: Capacity utilization is very low because of inefficiencies in management, inefficiencies in processes and procedures and low employee efficiency.
12. Poor profitability: The profitability of the enterprises is quite low due to several inefficiencies in the way in which they are managed. Many enterprises incur heavy losses and the government regularly infuses capital to run them.

13. Poor labour management relations: The industrial climate in many of the enterprises is strained. This results in poor employee productivity. Unions are strong and strikes, go-slow tactics and agitations are common. This results in low morale and motivation levels and as a consequence, low output, poor quality of products and services are common.

14. High employee turnover: There is no incentive for improved performance, very little freedom to implement innovative ideas and practices, promotions are based on seniority and not on performance, chance of work in new technologies is very less with salary levels very low when compared to the private sector. Therefore many talented employees leave the organization and the rate of employee turnover is high.

15. Nepotism and Corruption: Many of these enterprises function according to the dictates of politicians. There are many instances of corruption and undue favors being extended to select group of people who enjoy political patronage.

16. Poor work ethic: Employees of the public sector enterprises, enjoy job security. In many enterprises there are strong labor unions with political affiliations to protect employee interests. Due to these factors, employees do not feel the need to work in a dedicated manner and contribute to the growth of the organization. Low productivity, poor quality of work, absenteeism etc are common in these enterprises.

17. Low quality of output: The output of public enterprises, whether it is a product or a service, is not of high quality. This is due to lack of investment in technology, low employee morale, inferior quality of raw materials, poor work culture and lack of quality focus. Therefore they are not able to compete with the superior quality products and services offered by the private sector.

18. Uncertain financial allocation: These units are dependent on the government for funding and the quantum of funds allocation is uncertain. Therefore they are not in a position to plan for long term investment needs in an efficient manner.

8.11 Relation Between Insurance and Economic Growth

The following point shows the role and importance of insurance:

Insurance has evolved as a process of safeguarding the interest of people from loss and uncertainty. It may be described as a social device to reduce or eliminate risk of loss to life and property.

Insurance contributes a lot to the general economic growth of the society by provides stability to the functioning of process. The insurance industries develop financial institutions and reduce uncertainties by improving financial resources.
1. **Provide safety and security:**
Insurance provide financial support and reduce uncertainties in business and human life. It provides safety and security against particular event. There is always a fear of sudden loss. Insurance provides a cover against any sudden loss. For example, in case of life insurance financial assistance is provided to the family of the insured on his death. In case of other insurance security is provided against the loss due to fire, marine, accidents etc.

2. **Generates financial resources:**
Insurance generate funds by collecting premium. These funds are invested in government securities and stock. These funds are gainfully employed in industrial development of a country for generating more funds and utilised for the economic development of the country. Employment opportunities are increased by big investments leading to capital formation.

3. **Life insurance encourages savings:**
Insurance does not only protect against risks and uncertainties, but also provides an investment channel too. Life insurance enables systematic savings due to payment of regular premium. Life insurance provides a mode of investment. It develops a habit of saving money by paying premium. The insured get the lump sum amount at the maturity of the contract. Thus life insurance encourages savings.

4. **Promotes economic growth:**
Insurance generates significant impact on the economy by mobilizing domestic savings. Insurance turn accumulated capital into productive investments. Insurance enables to mitigate loss, financial stability and promotes trade and commerce activities those results into economic growth and development. Thus, insurance plays a crucial role in sustainable growth of an economy.

5. **Medical support:**
A medical insurance considered essential in managing risk in health. Anyone can be a victim of critical illness unexpectedly. And rising medical expense is of great concern. Medical Insurance is one of the insurance policies that cater for different type of health risks. The insured gets a medical support in case of medical insurance policy.

6. **Spreading of risk:**
Insurance facilitates spreading of risk from the insured to the insurer. The basic principle of insurance is to spread risk among a large number of people. A large number of persons get insurance policies and pay premium to the insurer. Whenever a loss occurs, it is compensated out of funds of the insurer.

7. **Source of collecting funds:**
Large funds are collected by the way of premium. These funds are utilised in the industrial development of a country, which accelerates the economic
growth. Employment opportunities are increased by such big investments. Thus, insurance has become an important source of capital formation

8.12 Terminologies

8.13 Model Questions
1. What are the benefits of Insurance to Risk Management?
2. Explain the General Structure of the insurance market?
3. What are the significant aspects of an Industry?
4. State the future of insurance sector in India?
5. Explain the problems faced by public enterprises?

8.14 Reference Books
UNIT - IX
REGULATIONS RELATING TO INSURANCE ACCOUNTING AND MANAGEMENT

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9.1  INTRODUCTION

This module assumes that the reader has an understanding of basic accounting concepts, along the lines normally included in an introductory accounting course at the university level. Rather than provide a basic primer on the subject of accounting, the module describes aspects of accounting that are specific to the field of insurance and, more particularly, are critical to the supervisor in understanding and assessing the business and operations of an insurer. Notwithstanding this general objective, in order to facilitate understanding, the module also summarizes basic accounting principles (generally accepted accounting principles, known as GAAP), relates these to so-called statutory accounting principles (SAP), and summarizes some advantages and disadvantages of various systems of supervisory reporting. Deriving from the underlying nature of the insurance business, insurance accounting exhibits a number of interesting attributes. For example, because claims are incurred after the insurance contracts have been sold, insurers must price their product before they know what it will cost them to provide the service they are selling—an unusual situation for any business. Can you imagine an automobile manufacturer having to price its new line of cars when the input costs of labor and material are not only unknown, but are subject to great and unpredictable variation from period to period? In the life insurance field, companies routinely issue contracts where a claim may not be made for 40 or 50 years in the future, and yet it is clear, since the company has undertaken an obligation, that some sort of liability should be reported when the contract is issued. In the field of general insurance (also known as non-life insurance), the time period until Insurance Supervision Core Curriculum the claim occurs may be shorter, but the company does not know how many claims will be made, when they will be paid, or the ultimate amount that will be paid. Insurance accounting has to reflect the unique characteristics of the insurance business, which is why specialized accounting techniques are required. ICP A: An Introduction to Insurance Accounting
9.2 Systems of Accounting

Insurance supervisors worldwide use two main systems of accounting in various combinations: GAAP reporting and statutory reporting. GAAP constitutes the normal basis of public accounting for most types of business entities. Statutory reporting is specialized and is designed to highlight the particular interests and concerns of supervisors. Not every jurisdiction has separate GAAP and statutory accounting rules; often they are the same in most respects. Generally accepted accounting principles Not all regions of the world adhere to exactly the same GAAP rules, but the basic principles included in most, if not all, GAAP regimes are listed below. In each case, additional comments are provided to place the principle in the context of insurance supervision. The business entity concept The accounts of a company are kept separate and distinct from the accounts of the owners of the company and from any other legal entities except to the extent that accounts of several entities may be consolidated subject to certain conditions. When parties that are related to the insurance company borrow money from the insurer or engage in other types of transactions with a related insurance company, the business entity concept is called into question, placing the insurance company potentially at risk. Related party transactions have been the root cause of many serious financial problems among insurers. The going concern concept .

This is the underlying assumption that a business will continue to operate indefinitely into the future, unless there is specific evidence that this may not be the case. By contrast, in many countries insurance supervisors maintain their own accounting rules for supervisory purposes. A very conservative approach is often adopted under statutory accounting rules, which negates the going concern concept. In other words, statutory accounting rules are often built on an underlying assumption that the insurer may have to be liquidated in the near future (the liquidation concept) and that values and transactions should be accounted for on that basis. Insurance Supervision Core Curriculum.

Accounting estimates should be fair and reasonable, and while there may sometimes be a range of options when accounting for a particular transaction, a conservative approach is favored over an aggressive approach. A common problem for insurance supervisors is that some insurers adopt aggressive accounting practices that tend to overstate their income and understate their liabilities, thus overstating their financial strength and maximizing the possibility for paying dividends to shareholders and performance bonuses to management. In recent years, the principle of conservatism may have been less practiced than in the past—witness current scandals involving financial reporting of some of the large dot-com companies. The objectivity principle Accounting entries should be made on the basis of objective evidence. Objective evidence is evidence that will lead different observers to arrive at consistent conclusions when they review the transaction independently. For example, in countries that do not have developed capital markets, real estate often becomes a major area of investment for insurers. A frequent problem for supervisors in these jurisdictions is to obtain appropriate valuations of buildings and properties that are owned by insurance companies. Valuation approaches that rely on estimates of future cash flows may or may not be
objective and have to be analyzed carefully by the supervisor. In contrast, valuation methods that emphasize the sale of similar properties to independent third-party buyers potentially have greater objectivity because they do not involve estimates by persons who may have an incentive to maximize the appraisal value. A preferred alternative could involve the use of both methods to validate each other.

The revenue recognition concept Normally revenue should be recognized in a way that corresponds to provision of the service or product to the customer. Thus when an automobile dealer receives a check and transfers ownership of a new car to its customer, it immediately recognizes the revenue in its accounts. In contrast, a company in the business of providing landscaping services where customers pay in advance should only recognize revenue as the services are provided over time. Insurance contracts present a similar situation. The normal convention is for customers to pay their premium at the beginning of the insurance term (or periodically during that term for policies with more than one premium expected). However, at this point in time the insurer has not yet provided any insurance coverage since the term is just commencing. It would therefore give a misleading picture of an insurer’s earnings if premiums were recognized as revenue at the time the customers ICP A:

An Introduction to Insurance Accounting pay their premiums. Instead, premiums are “earned” over the term of the policy (or period for which premiums have been paid). See the detailed discussion on accounting for premiums in section C. The matching principle Expenses related to the generation of revenue should be expensed in the periods that relate to the corresponding revenue. When a particular expense is incurred, it is usually in the expectation that it will help the company to earn income in the future. If there is good evidence that a particular expense will help to generate revenue over the next three accounting periods, then the expense would normally be spread over those three periods, matching expenses and revenue. A classic example of this is the commission paid to an agent or broker on the sale of an insurance contract. If the contract is for 12 months, then according to the revenue recognition concept the revenue will be earned over the period of the contract rather than at the time of selling the contract. Similarly, under the matching principle, the commission will likewise be spread over the term of the contract because the expense (the commission) will generate revenue for 12 months into the future (subject to some other considerations such as recoverability). To be conservative, some statutory accounting regimes do not follow the matching principle for commissions and other acquisition expenses but require instead that the entire expense be written off (that is, be fully expensed) at the time the premium on which it was based is received or the expense is incurred. The cost principle Assets should be recorded at their actual cost. This is in keeping with the objectivity concept because cost is a known and documented amount. If the purchase is from an independent third party, the cost should be a good estimate of the worth of the asset to the purchasing company at the time of the purchase: if the value is higher, the independent seller generally would not be willing to sell it for a lesser amount;
if the asset is worth less to the purchaser than is indicated by its actual cost price, then the purchaser presumably would have no reason to make the expenditure. This is also in keeping with the objectivity principle. The recorded cost of an asset in the company’s accounts is often referred to as the book value of the asset (although in some situations book value could be different than cost). If there is strong, objective evidence that the value of an asset has permanently changed, then most GAAP regimes permit (subject to various conditions and safeguards) the company to write up or down the asset value on its books. Some GAAP regimes require that the current market value of a security be held. Statutory insurance accounting rules, where they exist, are usually even more emphatic than GAAP regimes in insisting that assets be recorded at cost (also in keeping with the principles of conservatism and objectivity) or sometimes even at the lower of cost or market value (to be even more conservative). The consistency principle Businesses should use the same accounting procedures to record similar transactions in different periods. If a different treatment is used from one period to another, the change should be disclosed to the reader of the financial statements and the impact of the changed procedure should be indicated. If this principle were not followed, companies would be free to pick and choose their accounting practices from year to year in ways designed to maximize their reported earnings. This principle affects insurance companies in the same way as other businesses. The materiality principle All financial information deemed to be material (or important) to the users of the information must be included. Reporting on very minor matters would cause the accounting reports to become too voluminous, which, in turn, could cause truly important information to be overlooked. An issue can arise here for insurers (and supervisors) when the insurers change their assumptions in several areas at the same time and the effect of any one change would not be material, but, when taken together, there may be a material impact on earnings. Guidance is emerging from actuarial organizations and supervisors on the need to report the source of earnings to deal with concerns in this area (in keeping with the full disclosure principle). The full disclosure principle all important matters should be disclosed to the readers of financial statements, even if they do not affect the ledger accounts directly. In these cases, the disclosure should be by way of notes to the financial statements. Typical examples are outstanding law suits, tax disputes with the government, and company takeover attempts. Insurance companies may be involved with so-called off-balance-sheet items, such as some derivative instruments, where the insurer contracts to make certain purchases or sales, depending on specified future conditions. Where the impact of these off-balance-sheet items are, or conceivably may be, material, they should be disclosed in the notes to the financial statements. For greater certainty, many supervisory filings include specific exhibits where insurers must disclose the nature and potential financial impacts of these off-balance-sheet items. ICP A: An Introduction to Insurance Accounting

The balance sheet and income statement format required for a general insurer under Canadian GAAP is shown in appendix II. The entire financial filing for both life and general insurers can be downloaded from
Many countries have an accounting and auditing institute or association that is responsible for establishing specific GAAP standards within the jurisdiction. In some countries, GAAP standards are established by a standard-setting body that is independent of the accounting profession.

While in most cases the specific rules will be based on the general principles set out above, accounting standards worldwide are in a state of transition. For example, over the past few years, the cost principle and the matching principle have come under particular pressure, to the point where the United States and some other countries have adopted what is known as a fair value basis for recording certain asset and liability values for financial instruments. For more discussion of current trends in this area, see section D on international financial reporting standards. A country’s institute of accountants and auditors is generally also responsible for putting in place the standards of professional practice that apply to its members as they carry out their responsibilities. Sometimes there are separate associations for the development of accounting standards and the development of auditing standards. (Accounting institutes in some smaller countries simply adopt the professional accounting and auditing standards of a larger country in order to save time and money.)

As is well known, over the last few years there have been some major corporate scandals as the GAAP framework has been stretched by aggressive accounting and auditing practices. The resulting corporate collapses have shaken up the accounting world, and in many developed countries there has been a move to tighten up accounting principles, auditing standards, and corporate governance in general.

Statutory accounting principles One can make the case that insurance companies and other types of financial institutions are fundamentally different from other types of businesses. For one thing, in addition to having equity financing, insurers are significantly financed by their customers (policyholders) by means of cash premiums paid in advance and by claim liabilities that have not yet been discharged. Thus an unscrupulous insurer or other type of financial institution has easy access to public funds, which could be misappropriated.

### 9.3 Framework for IRDAI Rules

**A. Organizational Structure of IRDAI:**

**Composition of IRDAI:**

As per Sec. 4 of IRDAI Act, 1999, the composition of the Authority is:

a) Chairman;
b) Five whole-time members;
c) Four part-time members,
(appointed by the Government of India)

**IRDAI’s Head Office is at Hyderabad**

All the major activities of IRDAI including ensuring financial stability of insurers and monitoring market conduct of various regulated entities is carried out from the Head Office.

**IRDAI’s Regional Offices are at New Delhi & Mumbai**
The Regional Office, New Delhi focuses on spreading consumer awareness and handling of Insurance grievances besides providing required support for inspection of Insurance companies and other regulated entities located in the Northern Region. This office is functionally responsible for licensing of Surveyors and Loss Assessors. Regional Office at Mumbai handles similar activities, as in Regional Office Delhi, pertaining to Western Region.

B. Insurance Regulatory Framework:

1. Insurance Regulatory and Development Authority of India (IRDAI), is a statutory body formed under an Act of Parliament, i.e., Insurance Regulatory and Development Authority Act, 1999 (IRDAI Act 1999) for overall supervision and development of the Insurance sector in India.

2. The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938. The key objectives of the IRDAI include promotion of competition so as to enhance customer satisfaction through increased consumer choice and fair premiums, while ensuring the financial security of the Insurance market.

3. The Insurance Act, 1938 is the principal Act governing the Insurance sector in India. It provides the powers to IRDAI to frame regulations which lay down the regulatory framework for supervision of the entities operating in the sector. Further, there are certain other Acts which govern specific lines of Insurance business and functions such as Marine Insurance Act, 1963 and Public Liability Insurance Act, 1991.

4. IRDAI adopted a Mission for itself which is as follows:
   - To protect the interest of and secure fair treatment to policyholders;
   - To bring about speedy and orderly growth of the Insurance industry (including annuity and superannuation payments), for the benefit of the common man, and to provide long term funds for accelerating growth of the economy;
   - To set, promote, monitor and enforce high standards of integrity, financial soundness, fair dealing and competence of those it regulates;
   - To ensure speedy settlement of genuine claims, to prevent Insurance frauds and other malpractices and put in place effective grievance redressal machinery;
   - To promote fairness, transparency and orderly conduct in financial markets dealing with Insurance and build a reliable management information system to enforce high standards of financial soundness amongst market players;
   - To take action where such standards are inadequate or ineffectively enforced;
   - To bring about optimum amount of self-regulation in day-to-day working of the industry consistent with the requirements of prudential regulation.

5. Entities regulated by IRDAI:
   a. Life Insurance Companies - Both public and private sector Companies
   b. General Insurance Companies - Both public and private sector Companies. Among them, there are some standalone Health Insurance Companies which offer health Insurance policies.
   c. Re-Insurance Companies
   d. Agency Channel
e. Intermediaries which include the following:
- Corporate Agents
- Brokers
- Third Party Administrators
- Surveyors and Loss Assessors.

6. Regulation making process:
- Section 26 (1) of IRDAI Act, 1999 and 114A of Insurance Act, 1938 vests power in the Authority to frame regulations, by notification.
- Section 25 of IRDAI Act, 1999 lays down for establishment of Insurance Advisory Committee consisting of not more than twenty five members excluding the ex-officio members. The Chairperson and the members of the Authority shall be the ex-officio members of the Insurance Advisory Committee.
- The objects of the Insurance Advisory Committee shall be to advise the Authority on matters relating to making of regulations under Section 26.
- Accordingly the draft regulations are first placed in the meeting of Insurance Advisory Committee and after obtaining the comments/recommendations of IAC, the draft regulations are placed before the Authority for its approval.
- Every Regulation approved by the Authority is notified in the Gazette of India.
- Every Regulation so made is submitted to the Ministry for placing the same before the Parliament.

7. The Authority has issued regulations and circulars on various aspects of operations of the Insurance companies and other entities covering:
- Protection of policyholders’ interest
- Procedures for registration of insurers or licensing of intermediaries, agents, surveyors and Third Party Administrators;
- Fit and proper assessment of the promoters and the management
- Clearance /filing of products before being introduced in the market
- Preparation of accounts and submission of accounts returns to the Authority.
- Actuarial valuation of the liabilities of life Insurance business and forms for filing of the actuarial report;
- Provisioning for liabilities in case of non-life Insurance companies
- Manner of investment of funds and periodic reports on investments
- Maintenance of solvency
- Market conduct issues

C. Supervisory Role:

1. The objective of supervision as stated in the preamble to the IRDAI Act is “to protect the interests of holders of Insurance policies, to regulate, promote and ensure orderly growth of the Insurance industry”, both Insurance and Reinsurance business. The powers and functions of the Authority are laid down in the IRDAI Act, 1999 and Insurance Act, 1938 to enable the Authority to achieve its objectives.
2. Section 25 of IRDAI Act 1999 provides for establishment of Insurance Advisory Committee which has Representatives from commerce, industry, transport, agriculture, consume for a, surveyors agents, intermediaries,
organizations engaged in safety and loss prevention, research bodies and employees’ association in the Insurance sector are represented. All the rules, regulations, guidelines that are applicable to the industry are hosted on the website of the supervisor and are available in the public domain.

3. Section 14 of the IRDAI Act, 1999 specifies the Duties, Powers and functions of the Authority. These include the following:

- To grant licenses to (re) Insurance companies and Insurance intermediaries
- To protect interests of policyholders,
- To regulate investment of funds by Insurance companies, professional organisations connected with the (re)Insurance business; maintenance of margin of solvency;
- To call for information from, undertaking inspection of, conducting enquiries and investigations of the entities connected with the Insurance business;
- To specify requisite qualifications, code of conduct and practical training for intermediary or Insurance intermediaries, agents and surveyors and loss assessors
- To prescribe form and manner in which books of account shall be maintained and statement of accounts shall be rendered by insurers and other Insurance intermediaries;

D. Prudential approach: Reporting, Risk monitoring and intervention:

1. Reporting Requirements:
   Insurers are required to submit various returns like financial statements on an annual basis duly accompanied by the Auditors’ opinion statement on the annual accounts; reports of valuation of assets, valuation of liabilities and solvency margin; actuarial report and abstract and annual valuation returns giving information about the financial condition for life Insurance business; Incurred But Not Reported claims in case of general Insurance business; Reinsurance plans on an annual basis; and monthly statement on underwriting of large risks in case of general Insurance companies; details of capital market exposure on a monthly basis; Investment policy, Quarterly and annual returns on investments.

2. Solvency of Insurers:
   In order to monitor and control solvency requirements, it has been made mandatory to the insurers to submit solvency report on quarterly basis. In case of any deviation, the Supervisor initiates necessary and suitable steps so as to ensure that the Insurer takes immediate corrective action to restore the solvency position at the minimum statutory level.
   Computation of solvency margin takes into account the inherent risk that respective line of business poses to the insurer. Higher requirements are placed for risky lines of business compared to others posing less risk to the insurers. Even though the insurers are required to maintain a minimum solvency ratio of 150% at all times, the actual solvency margin maintained by insurers are well
above the required solvency margin leading to the solvency margin ratio significantly higher than 150% on average.
Quarterly solvency ratio reports have to be submitted to the Supervisor, maintaining minimum solvency ratio of 150%. This provides the regular mechanism to monitor the solvency position periodically over the financial year in order to ensure compliance with the requirements and hence to initiate suitable action in the event of any early warning signal on the Insurer’s financial condition.

3. Asset-Liability Management:
Under Asset-Liability Management reporting, Insurer must provide the year wise projected cash flows, in respect of both assets and liabilities. Insurers must maintain mismatching reserves in case of any mismatch between assets and liabilities as a part of the global reserves. Further, Life insurers are required to submit a report on sensitivity and scenario testing exercise in the prescribed format. Non-life insurers must submit a report on ‘Financial Condition’ covering the sensitivity analysis of the financial soundness in meeting the policyholders’ liabilities.

The supervisor requires management of investments to be within the insurer’s own organization. In order to ensure a minimum level of security of investments in line with Insurance Act Provisions, the regulations prescribe certain percentages of the funds to be invested in government securities and in approved securities. The regulatory framework lays down the norms for the mix and diversification of investments in terms of Types of Investment, Limits on exposure to Group Company, Insurer’s Promoter Group Company. Investment Regulations lay down the framework for the management of investments. The exposure limits are also prescribed in the Regulations. The Investment Regulations require a proper methodology to be adopted by the insurer for matching of assets and liabilities.

4. Reinsurance:
Transfer of risk through Reinsurance is recognized only to the extent specified in the regulations. Due safeguards are built in to ensure that adjustments are made to provide for quality of assets held. No other risk transfer mechanism exists in the current system. In order to minimize the counterparty risk, the reinsurers with whom business is placed must have the minimum prescribed rating by an independent credit rating agency as specified in the regulations. Legislation has specified the minimum capital requirements for an Insurance company. It further, prescribes that Insurance companies can capitalize their operations only through ordinary shares which have a single face value.

Reinsurer
General Insurance Corporation of India (GIC of India) is the sole National Reinsurer, providing Reinsurance to the Insurance companies in India. The Corporation’s Reinsurance programme has been designed to meet the objectives of optimising the retention within the country, ensuring adequate coverage for exposure and developing adequate capacities within the domestic market. It is also administering the Indian Motor Third Party Declined Risk Insurance Pool – a multilateral Reinsurance arrangement in respect of specified commercial vehicles where the policy issuing member insurers cede
Insurance premium to the Declined Risk pool based on the underwriting policy approved by IRDAI.

5. Corporate Governance:
In order to protect long-term interests of policyholders, the IRDAI has outlined appropriate governance practices applicable to Insurance companies for maintenance of solvency, sound long-term investment policy and assumption of underwriting risks on a prudential basis from time to time. The IRDAI has issued comprehensive guidelines for adoption by Insurance companies on the governance responsibilities of the Board in the management of the Insurance functions. These guidelines are in addition to provisions of the Companies Act, 1956, Insurance Act, 1938 and other applicable laws.

Corporate Governance Guidelines issued by IRDAI, requires insurers to have in place requisite control functions. The oversight of the control functions is vested with the Boards of the respective insurer. It lays down the structure, responsibilities and functions of Board of Directors and the senior management of the companies. Insurers are required to adopt sound 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.

The Guidelines mandated the insurers to constitute various committees viz., Audit Committee, Investment Committee, Risk Management Committee, Policyholder Protection Committee and Asset-Liability Management Committee. These committees play a critical role in strengthening the control environment in the company.

6. On and off site Supervision:

Onsite Inspections:
The Authority has the power to call for any information from entities related to insurance business – Insurance companies and the intermediaries, as may be required from time to time.

On site inspection is normally carried out on an annual basis which includes inspection of corporate offices and branch offices of the companies. These inspections are conducted with view to check compliance with the provisions of Insurance Act, Rules and regulations framed thereunder.

The inspection may be comprehensive to cover all areas, or may be targeted on one, or a combination of, key areas. When a market-wide event having an impact on the insurers occurs, the Supervisor obtains relevant information from the insurers, monitors developments and issues directions as it may consider necessary. Though there is no specific requirement, events of importance trigger such action. The supervisor reviews the “internal controls and checks” at the offices of Insurance companies, as part of on-site inspection.

Off-site Inspection:
The primary objective of off-site surveillance is to monitor the financial health of Insurance companies, identifying companies which show financial deterioration and would be a source for supervisory concerns. This acts as a trigger for timely remedial action.
The off-site inspection conducted by analyzing periodic statements, returns, reports, policies and compliance certificates mandated under the directions issued by the Authority from time to time. The periodicity of these filings is generally annual, half-yearly, quarterly and monthly and are related to business performance, investment of funds, remuneration details, expenses of management, business statistics, auditor certificates related to various compliance requirements.

The statutory and the internal auditors are required to audit all the areas of functioning of the Insurance companies. The particular area of focus is the preparation of accounts of the company to reflect the true and fair position of the company as at the Balance Sheet date. The auditors also examine compliance or otherwise with all statutory and regulatory requirements, and in particular whether the Insurance company has been compliant with the various directions issued by the supervisor. In addition, the Authority relies upon the certifications which form part of the Management Report. The Board is required to certify that the management has put in place an internal audit system commensurate with the size and nature of its business and that it is operating effectively.

All Insurance companies are required to publish financial results and other information in the prescribed formats in newspapers and on their websites at periodic intervals.

7. Micro Insurance and Rural & Social Sector Obligations

The IRDAI had issued micro Insurance regulations for the protection of low income people with affordable Insurance products to help cope with and recover from common risks with standardised popular Insurance products adhering to certain levels of cover, premium and benefit standards. These regulations have allowed Non Governmental Organisations (NGOs), Self Help Groups (SHGs) and other permitted entities to act as agents to Insurance companies in marketing the micro Insurance products and have also allowed both life and non-life insurers to promote combi-micro Insurance products. The Regulations framed by the Authority on the obligations of the insurers towards rural and social sector stipulate targets to be fulfilled by insurers on an annual basis. In terms of these regulations, insurers are required to cover year wise prescribed targets (i) in terms of number of lives under social obligations; and (ii) in terms of percentage of policies to be underwritten and percentage of total gross premium income written direct by the life and non-life insurers respectively under rural obligations.

9.4 Regulations Regarding General Insurance Investment in the Country(List of Countries by FDI Abroad)

This is the list of countries by stock of Foreign direct investment (FDI) abroad, that is the cumulative US dollar value of all investments in foreign countries made directly by residents - primarily companies - of the home country, as of the end of the time period indicated. Direct investment excludes investment through purchase of shares.

The list is based on the CIA World Factbook data.[1]
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<th>Country</th>
<th>Stock of FDI abroad</th>
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<td>Germany</td>
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<td>United Kingdom</td>
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<td>Switzerland</td>
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<td>Japan</td>
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## NOTES

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9.5 Role of Financial Reporting in Managing Insurance Operations

Chief Manager- Financial Reporting - Life Insurance (8-13 yrs)

Our Clients are a well established Life Insurance Company. They are a joint venture between a diversified financial services conglomerate in India, and one of the oldest life insurance companies in the world. Headquartered at Mumbai, it has Pan India presence through its various branches and currently has an employee strength of 1500+ employees. The following general role

General Accounting:
a. A full understanding of accruals accounting and the impact of entries on profit and loss account, the balance sheet and the cash flow statement.
b. Niche around various analytical connections between various accounting line items and complete accounting framework
c. Interpret and apply existing, new, or revised accounting principles and concepts to make accounting more accurate and more closely comply with reporting requirements
d. IGAAP and IFRS/IndAS experience and knowledge

Specialised Insurance Accounting:
Advance understanding to comprehend and translate various features of the product and funds into Insurance accounting language meeting the accounting standards, policies and regulatory guidelines.

Accounting Operations:
a. Ability to institutionalise Operational controls (both manual and system based) along with SLA management on all kind of accounting operations
b. Niche in quick understanding of possible gaps from time to time due to various dynamics
   impacting operational procedures.
c. Ability to bring overall efficiency, productivity and accuracy in all the accounting operational
   procedures / interconnected process.
d. Able to collaborate with various department and stakeholders to streamline overall accounting
   operations

e. Able to build various monitoring control dashboards for management review
f. Good expertise in analysing the data and information from accounting system and expertise in filtering the same as per need of various stakeholders such as auditors, management, regulator etc.
g. Very good in managing various external auditors such as Stat Auditors, IRDAI and other regulators.

**Risk Management:**
a. Identifies and manages the risks of failing to detect a misstatement, caused by inadvertent error or fraud that is material to financial statements.
b. Able to develop RCSA for all kind of processes and procedures being followed in the domain being managed.
c. Structured documentation (SOPs) to be developed, implemented and timely updated for bringing in more clarity among all team members and stakeholders.
d. Manages all actionables (which are arising out of various audit and risk assessment) to be implemented as per set out timelines and expectations.

**Reporting and Analytical Proficiency:**
b. Able to put clarity around Expense Management Framework with proper data and vectors.
c. Understanding and application of applicable Accounting standards/Ind AS. Can design and set up accounting policies. Analysis of all new pronouncements and proactive impact assessment on ETLI Financials/Reporting.
d. Good understanding of the reporting requirement and links with various report and systems, and file all IRDA and regulatory reporting with Zero non Compliance and with in stipulated time lines.
e. Able to draw conclusions and assess impact from analysis and interpretation of financial data.

### 9.6 Significance of Determining Solvency Margins

**What Is the Solvency Ratio?**

The solvency ratio is a key metric used to measure an enterprise’s ability to meet its debt obligations and is used often by prospective business lenders. The solvency ratio indicates whether a company’s cash flow is sufficient to meet its short-and long-term liabilities. The lower a company's solvency ratio, the greater the probability that it will default on its debt obligations.

The Formula for the Solvency Ratio Is

Liquidity Vs. Solvency

### How to Calculate the Solvency Ratio
The solvency ratio is calculated by dividing a company's after-tax net operating income by its total debt obligations. The net after-tax income is derived by adding non-cash expenses, such as depreciation and amortization, back to net income. These figures come from the company's income statement. Short-term and long-term liabilities are found on the company's balance sheet.

**What Does the Solvency Ratio Tell You?**

The solvency ratio is one of many metrics used to determine whether a company can stay solvent. Other solvency ratios include debt-to-equity, total-debt-to-total-assets, and interest coverage ratios.

The solvency ratio is a comprehensive measure of solvency, as it measures a firm's actual cash flow—rather than net income—by adding back depreciation and other non-cash expenses to assess the company’s capacity to stay afloat. It measures this cash flow capacity in relation to all liabilities, rather than only short-term debt. This way, the solvency ratio assesses a company's long-term health by evaluating its repayment ability for its long-term debt and the interest on that debt.

As a general rule of thumb, a solvency ratio higher than 20% is considered to be financially sound; however, solvency ratios vary from industry to industry. A company’s solvency ratio should, therefore, be compared with its competitors in the same industry rather than viewed in isolation.

The solvency ratio terminology is also used in regard to insurance companies, comparing the size of its capital relative to the premiums written, and measures the risk an insurer faces of claims it cannot cover.

### 9.7 Understanding of Solvency Ratios

As the owner of a small business, you are the one responsible for ensuring the company can meet its financial obligations now and into the future. One tool that can help you do that is known as a solvency ratio.

A key part of a financial analysis, a company’s solvency ratio determines whether it has sufficient cash flow to manage its debts as they come due. The following formula is used to track a business’ solvency ratio, which is usually expressed as a percentage:

For the purpose of calculating solvency, net income includes all cash and holdings that can be easily liquidated. Overall, companies with higher solvency ratios are viewed as more likely to meet their financial obligations, whereas those with lower scores are seen as posing a greater risk to banks and creditors. Although a good solvency ratio varies based on the industry in question, a company with a ratio at or above 20% is generally considered healthy. Solvency ratios are sometimes referred to as “leverage ratios.”
It’s important to realize that solvency ratios aren’t the same as liquidity ratios. Whereas liquidity ratios refer to the capacity of a company to handle short-term liabilities, solvency measures the ability to pay long-term debts.

In the long run, keeping an eye on your solvency ratio can help prevent the company from going bankrupt because of rising debt levels. In other words, knowing your ratio should help you determine when you can and can’t handle additional debt.

### 9.8 Importance of Calculating Solvency

Periodically checking your business’ solvency ratios can help ensure your company’s fiscal health. In addition to helping businesses evaluate their capital structures, solvency ratios may assist owners in determining whether internal and external equities must be redistributed. Furthermore, solvency ratios may affect your decision to take on more debt down the line. Businesses with excessive debt may struggle to manage cash flow or deal with rising interest levels. Not only does calculating solvency help companies make important financial decisions and ensure future profitability, but it also reassures creditors and shareholders that your business can pay its debts.

Lenders want to know that your company can pay back the loan principle as well as the interest that accumulates. A poor solvency ratio may suggest that your company will be unable to meet its obligations in the long term. A good solvency ratio varies by industry, so it’s important to compare your numbers with those of your competitors. Because businesses in some industries are able to survive with solvency ratios that would be considered unhealthy in others, companies should refrain from scrutinizing these numbers in a vacuum. Historically, technology companies tend to boast higher solvency ratios than those in debt-heavy industries, such as utilities.

Fortunately, most companies can take steps to improve their solvency ratios and boost profitability in the long term. Along with selling assets to reduce overall debt, a company may opt to reorganize its business structure, increase owner equity or reinvest money and assets in the business. And of course, struggling businesses should try to avoid taking on new debts until their solvency ratios improve. Finally, companies should also strive to improve sales, as this will ultimately boost both profitability and solvency.

### 9.9 Types of Solvency Ratios

There are different types of solvency ratios that you can use to track different elements of your finances. Here are some of the most common types of solvency ratios that companies track on a regular basis:

**Debt-to-Equity**

This ratio is a measure of total debt as compared to shareholder equity. As an equation, you take your business’ total liabilities and divide them by your shareholders’ equity.
Whereas a general high solvency ratio tends to indicate that a company is fiscally sound, a high debt-to-equity ratio suggests that the company over-utilized debt to bankroll its growth. As interest levels continue to climb, companies may suffer from volatile earnings. To prevent insolvency, business owners must focus on deferring costs, reducing debt and boosting overall profits.

**Total-Debt-to-Total-Assets**

This refers to the ratio of long-term and short-term liabilities compared to total holdings. As an equation, it is expressed as your business’ short- and long-term liabilities divided by its total assets. As a company’s total-debt-to-total-assets ratio increases, it poses a greater financial risk to banks and creditors.

When calculating total-debt-to-total-assets, it’s important to take into account the degree of leverage. While some liabilities, such as supplier costs and employee bonuses, may be negotiable, companies with high total-debt-to-total-assets have higher leverages and, as a result, lower flexibility. Because of this, businesses should strive to raise the value of current assets or reduce their debt levels moving forward.

**Interest-Coverage Ratios**

These ratios measure a company’s ability to keep up with interest payments, which rise along with outstanding debt. As a business owner, you can calculate interest-coverage ratio by dividing earnings before interest and tax (EBIT) by interest expenses.

Typically, a company with an interest-coverage ratio of 1.5 or less is viewed as financially unstable and may struggle to secure loans from banks and other lenders. To boost your interest-coverage ratio, strive to reduce debt and boost overall profits. Solvency ratios don’t just affect your ability to get loans from banks and creditors, but they also forecast your company’s health in the coming years. By calculating your business’ ratios often, you can ensure that you have the most accurate and thorough understanding of your finances, which will keep you from becoming insolvent.

9.10 Terminologies


9.11 Model Questions

1. Explain the System of Accounting
2. What are the role of financial reporting in managing insurance operations?
3. Discuss the significance of determining solvency margins?
4. What are the importance of Calculting solvency?
5. Explain the types of solvency ratios?
9.12 Reference Books


UNIT – X LIFE INSURANCE

Structure
10. 1 Introduction
10.2 Types of Life Insurance In India (Role of Riders in Insurance Policies)
10.3 Indian Life Insurance Industry Overview
10.4 General Insurance
10.5 Features of Fire Insurance Contract
10.6 Functions of Insurance Organizations Insurable Interest
10.7 Non-Life Insurance
10.8 Elements of Fire Insurance
10.9 Marine Insurance: Nature, Subject Matter and Principles
10.10 Rural Insurance: Coverage, Claim & Exclusions
10.11 Terminologies
10.12 Model Questions
10.13 Reference Books

10.1 Introduction

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

The insurance sector has gone through a number of phases by allowing private companies to solicit insurance and also allowing foreign direct investment. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014.[1] Since the privatization in 2001, the largest life-insurance company in India, Life Insurance Corporation of India has seen its market share slowly slipping to private giants like HDFC Life, Exide Life Insurance, ICICI Prudential Life Insurance and SBI Life Insurance Company.

History

Insurance in this current form has its history dating back to 1818, when Oriental Life Insurance Company[2] was started by Anita Bhavsar in Kolkata to cater to the needs of European community. The pre-independence era in India saw discrimination between the lives of foreigners (English) and Indians with higher premiums being charged for the latter. In 1870, Bombay Mutual Life Assurance Society became the first Indian insurer. At the dawn of the twentieth century, many insurance companies were founded. In the year 1912, the Life Insurance Companies Act and the Provident Fund Act were passed to regulate the insurance business. The Life Insurance Companies Act, 1912 made it necessary that the premium-rate tables and periodical valuations of companies should be certified by an actuary. However, the disparity still existed as discrimination between Indian and foreign companies. The oldest existing insurance company in India is the National Insurance Company, which was founded in 1906, and is still in business.
The Government of India issued an Ordinance on 19 January 1956 nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The Life Insurance Corporation (LIC)吸收ed 154 Indian, 16 non-Indian insurers and also 75 provident societies—245 Indian and foreign insurers in all. In 1972 with the General Insurance Business (Nationalisation) Act was passed by the Indian Parliament, and consequently, General Insurance business was nationalized with effect from 1 January 1973. 107 insurers were amalgamated and grouped into four companies, namely National Insurance Company Ltd., the New India Assurance Company Ltd., the Oriental Insurance Company Ltd and the United India Insurance Company Ltd. The General Insurance Corporation of India was incorporated as a company in 1971 and it commenced business on 1 January 1973.

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

**Industry structure**

By 2012 Indian Insurance is a US$72 billion industry. However, only two million people (0.2% of the total population of 1 billion) are covered under Mediclaim. With more and more private companies in the sector, this situation is expected to change. ECGC, ESIC and AIC provide insurance services for niche markets. So, their scope is limited by legislation but enjoy some special powers. The majority of Western Countries have state run medical systems so have less need for medical insurance. In the UK, for example, the corporate cover of employees, when added to the individual purchase of coverage gives approximately 11–12% of the population on cover due largely to usage of the state financed National Health Service (NHS), whereas in developed nations with a more limited state system, like USA, about 75% of the total population are covered under some insurance scheme.

**Insurance repository**

On 16 September 2013, IRDA launched “insurance repository” services in India. It is a unique concept and first to be introduced in India. This system enables policy holders to buy and keep insurance policies in dematerialised or electronic form. Policyholders can hold all their insurance policies in an electronic format in a single account called electronic insurance account (eIA). Insurance Regulatory and Development Authority of India has issued licences to five entities to act as Insurance Repository:

- CDSL Insurance Repository Limited (CDSL IR),
Legal structure

The insurance sector went through a full circle of phases from being unregulated to completely regulated and then currently being partly deregulated. It is governed by a number of acts.

The Insurance Act of 1938[4] was the first legislation governing all forms of insurance to provide strict state control over insurance business. Life insurance in India was completely nationalised on 19 January 1956, through the Life Insurance Corporation Act. All 245 insurance companies operating then in the country were merged into one entity, the Life Insurance Corporation of India.

The General Insurance Business Act of 1972 was enacted to nationalise about 107 general insurance companies then and subsequently merging them into four companies. All the companies were amalgamated into National Insurance, New India Assurance, Oriental Insurance and United India Insurance, which were headquartered in each of the four metropolitan cities. Until 1999, there were no private insurance companies in India. The government then introduced the Insurance Regulatory and Development Authority Act in 1999, thereby de-regulating the insurance sector and allowing private companies. Furthermore, foreign investment was also allowed and capped at 26% holding in the Indian insurance companies.

In 2006, the Actuaries Act was passed by parliament to give the profession statutory status on par with Chartered Accountants, Notaries, Cost & Works Accountants, Advocates, Architects and Company Secretaries. A minimum capital of US$80 million (Rs. 4 billion) is required by legislation to set up an insurance business.

Authorities

The primary regulator for insurance in India is the Insurance Regulatory and Development Authority of India (IRDAI) which was established in 1999 under the government legislation called the Insurance Regulatory and Development Authority Act, 1999.

The industry recognises examinations conducted by the IAI (for 280 actuaries), III (for 2.2 million retail agents, 361 brokers, 175 bancassurers, 125 corporate agents and 29 third-party administrators) and IIISLA (for 8,200 surveyors and loss assessors). There are 9 licensed web aggregators. TAC is the sole data repository for the non-life industry. IBAI gives voice to brokers while GI Council and LI Council are platforms for insurers. AIGIEA, AIIEA, AIIEF, AILICEF, AILIEA, FLICOA, GIEAIA, GIEU and NFIFWI cater to the employees of the insurers. In addition, there are a dozen Ombudsman offices to address client grievances.
Insurance education

A number of institutions provide specialist education for the insurance industry, these include;

- National Insurance Academy, Pune, specialized in teaching, conducting research and providing consulting services in the insurance sector. NIA offers a two-year PGDM programme in insurance. NIA was founded as Ministry of Finance initiative with capital support from the then public insurance companies, both Life (LIC) and Non-Life (GIC, National, Oriental, United & New India).

- Institute of Insurance and Risk Management, Hyderabad, was established by the regulator IRDA. The institute offers Postgraduate diploma in Life, General Insurance, Risk Management and Actuarial Sciences. The institute is a global learning and research centre in insurance, risk management, actuarial sciences. They provide consulting services for the financial industry.

- Amity School of Insurance Banking and Actuarial science (ASIBAS) of Amity University, Noida and established in 2000, offers MBA programmes in Insurance, Insurance and Banking, and MSc/BSc actuarial sciences to a Post Graduate Diploma in Actuarial Sciences.

- Pondicherry University offers an MBA in insurance management. Pondicherry University is the only central university which offers insurance management in India.

- Birla Institute of Management Technology is a graduate business school located in Greater Noida, established in 1988, offers a PGDM-IBM programme in insurance business management. This programme was launched in 2000 by the Centre for Insurance and Risk Management and is accredited by the Insurance Regulatory and Development Authority. Life Office Management Association (LOMA), USA is BIMTECH’s educational partner and BIMTECH is an approved centre for LOMA examination. The Chartered Insurance Institute (CII), UK has accorded recognition (by way of credits) to the BIMTECH PGDM-IBM programme. Their two-year PGDM programme in insurance business has been recognised as equivalent to the Associate level of the Insurance Institute of India, Mumbai.

- National Law University, Jodhpur offers a two-year MBA and one year MS (for engineering graduates) programme in insurance.

To become an insurance advisor in India, Insurance Act, 1938 mandates that the individual has to be “a Major with sound mind”. After the advent of IRDA as insurance regulator, it has framed various regulations, viz. training hours, examination and fees which are amended from time to time. Since November 2011 IRDA has introduced a syllabus (IC-33) conceived and developed by CII, London. The syllabus mainly aims to make an Insurance Agent a financial professional.
10.2 Types of Life Insurance In India (Role of Riders in Insurance Policies)

Life insurance products come in a variety of offerings catering to the investment needs and objectives of different kinds of investors. Following is the list of broad categories of life insurance products:

**Term insurance policies**

The basic premise of a term insurance policy is to secure the immediate needs of nominees or beneficiaries in the event of the sudden or unfortunate demise of the policy holder. The policyholder does not get any monetary benefit at the end of the policy term except for the tax benefits he or she can choose to avail of throughout the tenure of the policy. In the event of the death of the policyholder, the sum assured is paid to his or her beneficiaries. Term insurance policies are also relatively cheaper to acquire as compared to other insurance products.

**Money-back policies**

Money back policies are basically an extension of endowment plans wherein the policyholder receives a fixed amount at specific intervals throughout the duration of the policy. In the event of the death of the policyholder, the full sum assured is paid to the beneficiaries. The terms again might slightly vary from one insurance company to another.

**Whole life policies**

A whole life insurance plan covers the insured over his life. The primary feature of this product is that the validity of the policy is not defined so the policyholder enjoys the life cover throughout his life.

**Unit-linked investment policies (ULIP)**

Unit-linked insurance policies again belong to the insurance-cum-investment category where one gets to enjoy the benefits of both insurance and investment. While a part of the monthly premium pay-out goes towards the insurance cover, the remaining money is invested in various types of funds that invest in debt and equity instruments. ULIP plans are more or less similar in comparison to mutual funds except for the difference that ULIPs offer the additional benefit of insurance.

**Pension policies**

Pension policies let individuals determine a fixed stream of income post retirement. This basically is a retirement planning investment scheme where the sum assured or the monthly pay-out after retirement entirely depends on the capital invested, the investment timeframe, and the age at which one wishes to retire. There are again several types of pension plans that cater to different investment needs. Now it is recognized as an insurance product and is regulated by IRDA.
10.3 Indian Life Insurance Industry Overview

All life insurance companies in India have to comply with the regulations laid out by the Insurance Regulatory and Development Authority of India (IRDAI).

Life Insurance Corporation of India (LIC), the state-owned behemoth, remains by far the largest player in the market. The private companies like Exide Life Insurance have come out with products called ULIPs (Unit Linked Investment Plans) which offer both life cover as well as scope for savings or investment options as the customer desires. These type of plans are subject to a minimum lock-in period of five years to prevent misuse of the significant tax benefits offered to such plans under the Income Tax Act. Comparison of such products with mutual funds would be erroneous.

Commission / intermediation fees
The maximum commission limits as per statutory provisions are:

Agency commission for retail life insurance business:

- 7-25% for 1st year premium if the premium paying term is more than 20 years
- 7-10% for 1st year premium if the premium paying term is more than 15 years
- 7-10% for 1st year premium if the premium paying term is less than 10 years
- 7% - yr 2 and 3rd year and 3.5% - thereafter for all premium paying terms.

Tax Benefits

- Life insurance not only ensures the well-being of your family, it also brings tax benefits.
- The amount you pay as premium can be deducted from your total taxable income.
- However, this is subject to a maximum of Rs 1.5 lakh, under Section 80C of the Income Tax Act.
- The premium amount used for tax deduction should not exceed 10% of the sum assured.

10.4 General Insurance

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

<table>
<thead>
<tr>
<th>Situation 1</th>
<th>Situation 2</th>
<th>Situation 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>You plan to propose to your girlfriend on the Eiffel Tower.</td>
<td>You cannot stop celebrating your new car. You hit the roads with your latest possession. Everything goes well until a car suddenly tries to overtake you. It leaves huge dents and dislocates your left mirror.</td>
<td>Your daughter wants to become a pilot. You save all your disposable income to fund her dreams. Unfortunately, you fall severely ill.</td>
</tr>
<tr>
<td>You already finalised the deal with a jeweller in Paris.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>But, things don’t go as planned and you meet with an accident there.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| Your treatment requires Rs. 50,000. But, still paid for that dainty piece of jewellery. | Your new baby on the block needs repairs worth Rs. 30,000. Yet, you have a smile on your face. | You need Rs. 2 lakh for your treatment immediately. Yet, you also easily pay your daughter’s course fees. |

**HOW?**

| Your Travel insurance made you ready for emergencies. It paid for the expenses related to your accident. You could, thus, go ahead and surprise your partner with a diamond ring without worrying about the treatment costs. | The dent in your car didn’t cause a dent in your pocket. Your motor insurance’ own damage cover paid for your car’s damages caused by the accident. In fact, the insurer settled the bill directly at the garage. | You didn’t face a dilemma of choosing one over the other and compromise your daughter’s future. Your health insurance took care of your treatment costs. Your savings, thus, remained unaffected by your sudden illness. |
As you can see, General Insurance can be the answer to life’s various problems. But, for that, you need to select the right insurances from the myriad ones available.

**Types of General Insurance / What all can be insured?**

You can get almost anything and everything insured. But there are five key types available:

1. Health Insurance
2. Motor Insurance
3. Travel Insurance
4. Home Insurance
5. Fire Insurance

**Health Insurance**

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

It usually covers:

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

You can also opt for add-on benefits like:

- Maternity cover: Your health insurance covers you for the costs related to childbirth. This includes pre-delivery check-ups, hospitalisation during delivery, and post-natal care.
- Pre-existing diseases cover: Your health insurance takes care of the treatment of diseases you may have before buying the health insurance policy.
- Accident cover: Your health insurance can pay for the medical treatment of injuries caused due to accidents and mishaps.

Your health insurance can also help you save tax. Your premium payment can reduce your taxable income.

<table>
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<tr>
<th>For</th>
<th>Tax deduction on the premium amount</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Self</td>
<td>Rs. 25,000 (Rs. 30,000 if you are a senior citizen)</td>
<td>Rs. 25,000 (or Rs. 30,000)</td>
</tr>
</tbody>
</table>
Motor Insurance

Motor insurance is for your car or bike what health insurance is for your health.

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

You can also get motor insurance for your commercial vehicles.

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

Let’s look at the two key types:

1. Car Insurance

It’s precious—your car. You paid lakhs of rupees to buy that beauty. Even a single scratch can be painful, forget about bigger damages.

Car insurance can reduce this pain for a few thousand rupees.

How it works:

Pay annual premium → Get car insurance cover → Insurer pays for damages during the whole year

What the insurer will pay for depends on the type of car insurance plan you purchase.

2. Two-wheeler Insurance

This is your bike’s guardian angel. It’s similar to Car insurance.
You cannot ride a bike or scooter in India without insurance.

**How it works:**

As with car insurance, what the insurer will pay depends on the type of insurance and what it covers.

**Fire Insurance**

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

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

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

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

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**10.5 Features of Fire Insurance Contract**

As Fire insurance is a contract, it should satisfy all the features of general contract.

(a) **Proposal** :- The fire insurance proposal can be made either verbally or in writing. A printed proposal form is used for this purpose, in which the proposer furnishes the necessary information of the property to be insured. The description of the subject matter of insurance is the bases of contract for assessing the risk and fixing the premium.

(b) **Acceptance** :- The insurer will assess the risk after receiving the proposal form. When the contents and the subject matters are not very high amount, the insurer may accept the proposal. When the subject matters are of larger amount and where the involvement of hazard is variable or unknown in nature, the insurer may send his Surveyor to survey the property. Based on the Surveyor's report the proposal will be accepted. The unknown proposers are required to submit an evidence of respectability.

(c) **Commencement of Risk** :- As soon as the proposal is accepted, risk will commence irrespective of the fact that no policy was issued and no premium
was paid. Where risks are unknown and tremendous, the payment of premium will be the basis of the completion of the contract. The risk will commence only when the premium has been paid and not before that.

(i) Cover Note: - The insurer issues a 'Cover Note' or 'Interim Protection Note' when the risk was accepted provisionally or subject to the condition of payment of premium. This note will cover the property so far the final policy has not been issued. If loss occurs before issue of policy the cover note will be sufficient to prove insurance. The cover note, however, is not taken at part to the policy.

Policy

The insurer issues a duty stamped policy which will bear all the terms and conditions of the contract. Any contract of fire insurance comes within the meaning of the word 'policy'. It is a statutory and formal document of insurance contract.

Though there are different forms of policies for different types of policies, a standard form is also used. The policy contains the name and address of the insured, the subject-matter of insurance, the sum insured the term and the premium etc.

10.6 Functions of Insurance Organizations

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

Finally, risk must not be confused with loss itself which is the unintentional decline in or disappearance of value arising from a contingency. Wherever there is uncertainty with respect to a probable loss there is risk.

Every risk involves the loss of one or other kind. The function of insurance is to spread the loss over a large number of persons who are agreed to co-operate each other at the time of loss. The risk cannot be averted but loss occurring due to a certain risk can be distributed amongst the agreed persons. They are agreed to share the loss because the chances of loss, i.e., the time, amount, to a person are not known.
Anybody of them may suffer loss to a given risk, so, the rest of the persons who are agreed will share the loss. The larger the number of such persons the easier the process of distribution of loss. In fact; the loss is shared by them by payment of premium which is calculated on the probability of loss.

In olden time, the contribution by the persons was made at the time of loss. The insurance is also defined as a social device to accumulate funds to meet the uncertain losses arising through a certain risk to a person insured against the risk.

The functions of insurance can be studied into two parts (i) Primary Functions, and (ii) Secondary Functions.

**Primary Functions:**

(i) **Insurance provides certainty:**
Insurance provides certainty of payment at the uncertainty of loss. The uncertainty of loss can be reduced by better planning and administration. But, the insurance relieves the person from such difficult task. Moreover, if the subject matters are not adequate, the self-provision may prove costlier.

There are different types of uncertainty in a risk. The risk will occur or not, when will occur, how much loss will be there? In other words, there are uncertainty of happening of time and amount of loss. Insurance removes all these uncertainty and the assured is given certainty of payment of loss. The insurer charges premium for providing the said certainty.

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

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

**Secondary functions:**
Besides the above primary functions, the insurance works for the following functions:

(i) **Prevention of Los**
The insurance joins hands with those institutions which are engaged in preventing the losses of the society because the reduction in loss causes lesser payment to the assured and so more saving is possible which will assist in reducing the premium. Lesser premium invites more business and more business cause lesser share to the assured.

So again premium is reduced to, which will stimulate more business and more protection to the masses. Therefore, the insurance assist financially to the health organisation, fire brigade, educational institutions and other organisations which are engaged in preventing the losses of the masses from death or damage.

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

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

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

10.7 Non–Life Insurance

Your valuable possessions in life - your home, business, and vehicle are exposed to various hazards. Emergency medical expenses can also put you under serious financial stress. Traveling too involves risks such as accident, loss of baggage / passport and medical expenses.

LIST OF NON INSURANCE COMPANIES

Sl.No. Insurer & Address

1 IFFCO TOKIO General Insurance Co. Ltd.
<table>
<thead>
<tr>
<th>No.</th>
<th>Company Name</th>
<th>Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Liberty General Insurance Co. Ltd.</td>
<td>10th Floor, Tower A, Peninsula Business Park, G.K. Marg, Lower Parel, Mumbai-400013</td>
</tr>
<tr>
<td>3</td>
<td>Shriram General Insurance Co. Ltd.</td>
<td>E-8, EPIP, RIICO Industrial Area, Sitapura, Jaipur-302022(Raj.)</td>
</tr>
<tr>
<td>4</td>
<td>Reliance General Insurance Co. Ltd.</td>
<td>H Block, 1st Floor, Dhirubhai Ambani Knowledge City, Navi Mumbai - 400 710</td>
</tr>
<tr>
<td>5</td>
<td>DHFL General Insurance Co. Ltd</td>
<td>2nd Floor, DHFL House, 19 Sahar Road, Off Western Express Highway, Vile Parle (East), Mumbai - 400099</td>
</tr>
<tr>
<td>6</td>
<td>Bajaj Allianz Allianz General Insurance Co. Ltd</td>
<td>Bajaj Allianz House, Airport Road, Yerawada, Pune – 411006</td>
</tr>
<tr>
<td>7</td>
<td>Edelweiss General Insurance Co. Ltd</td>
<td>Edelweiss House, Off CST Road, Kalina, Mumbai 400098</td>
</tr>
<tr>
<td>8</td>
<td>Kotak Mahindra General Insurance Co. Ltd</td>
<td>27 BKC, C-27, Bandra Kurla Complex, Bandra (East), Mumbai - 400 051</td>
</tr>
<tr>
<td>9</td>
<td>Go Digit General Insurance Co. Ltd</td>
<td>Smartworks Business Center, 1st Floor, Nyati Unitree, West Wing, Samrat Ashok Road, Yerawada, PUNE - 411006</td>
</tr>
<tr>
<td>10</td>
<td>Royal Sundaram General Insurance Co. Ltd</td>
<td>&quot;Vishranthi Melaram Towers&quot; No.2/319 , Rajiv Gandhi Salai (OMR) Karapakkam, Chennai - 600 097</td>
</tr>
<tr>
<td>11</td>
<td>Exports Credit Guarantee of India Co. Ltd</td>
<td>Express Tower, 10th Floor, Nariman Point,Mumbai-400021</td>
</tr>
<tr>
<td></td>
<td>Company Name</td>
<td>Address</td>
</tr>
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</tr>
<tr>
<td>12</td>
<td>The New India Assurance Co. Ltd</td>
<td>87, M.G Road, Fort, Mumbai, Maharashtra – 400 001</td>
</tr>
<tr>
<td>14</td>
<td>National Insurance Co. Ltd.</td>
<td>3, Middleton Street, Prafulla Chandra Sen Sarani, Kolkata, West Bengal, 700071.</td>
</tr>
<tr>
<td>15</td>
<td>Universal Sompo General Insurance Co. Ltd.</td>
<td>Unit No. 401, 4th floor, Sangam Complex, 127, Andheri Kurla Road, Andheri (E), Mumbai – 400059, Maharashtra</td>
</tr>
<tr>
<td>16</td>
<td>Agriculture Insurance Company of India Ltd.</td>
<td>13th floor, Ambadeep Building, 14, K.G. Marg, New Delhi-110001</td>
</tr>
<tr>
<td>17</td>
<td>Acko General Insurance Co. Ltd.</td>
<td>Unit No. 301 &amp; 302, 3rd Floor, F Wing, Lotus Corporate Park, Off Western Express Highway, Goregaon East, Mumbai 400 063.</td>
</tr>
<tr>
<td>18</td>
<td>SBI General Insurance Co. Ltd.</td>
<td>‘Natraj’, 101, 201 &amp; 301, Junction of Western Express Highway &amp; Andheri-Kurla Road, Andheri (East), Mumbai - 400069</td>
</tr>
<tr>
<td>19</td>
<td>Bharti AXA General Insurance Co. Ltd.</td>
<td>First Floor, Fers Icon, Survey No. 28, Doddanekundi, Bangalore-560037</td>
</tr>
<tr>
<td>20</td>
<td>ICICI LOMBARD General Insurance Co. Ltd.</td>
<td>ICICI Lombard House, 414, Veer Savarkar Marg Near Siddhivinayak Temple, Prabhadevi Mumbai 400025, India</td>
</tr>
<tr>
<td>21</td>
<td>Magma HDI General Insurance Co. Ltd.</td>
<td>401, 4th Floor, Rustomjee Aspiree, Off. Eastern Express Highway, Imax Dome Theatre Road, Sion (East), Mumbai–400022</td>
</tr>
<tr>
<td>No.</td>
<td>Company Name</td>
<td>Address</td>
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</tr>
<tr>
<td>22</td>
<td>HDFC ERGO General Insurance Co.Ltd.</td>
<td>HDFC House, 1st Floor, 165-166, Backbay Reclamation, H.T. Parekh Marg, Churchgate, Mumbai - 400020</td>
</tr>
<tr>
<td>23</td>
<td>United India Insurance Co. Ltd.</td>
<td>24, Whites Road, Chennai-600 014</td>
</tr>
<tr>
<td>25</td>
<td>Future Generali India Insurance Co. Ltd.</td>
<td>Indiabulls Finance Centre, 6th Floor, Tower 3, Senapati Bapat Marg, Elphinstone Road (W), Mumbai - 400 013</td>
</tr>
<tr>
<td>26</td>
<td>Cholamandalam MS General Insurance Co. Ltd.</td>
<td>Dare House, 2nd floor, No 2, NSC Bose Road, Chennai 600001</td>
</tr>
<tr>
<td>27</td>
<td>Raheja QBE General Insurance Co. Ltd.</td>
<td>Raheja QBE General Insurance Co. Ltd. “Windsor House”, 5th Floor CST Road Kalina, Santa Cruz (East) MUMBAI 400 098</td>
</tr>
<tr>
<td>28</td>
<td>Star Health &amp; Allied Insurance Co.Ltd.</td>
<td>Star Health &amp; Allied Insurance Co.Ltd. 1, New Tank Street Valluvar Kottam High Road Nungambakkam CHENNAI 600 034</td>
</tr>
<tr>
<td>29</td>
<td>Apollo Munich Health Insurance Co. Ltd.</td>
<td>Apollo Munich Health Ins. Co. Ltd. 2nd &amp; 3rd Floor, iLabs Centre Plot no. 404 &amp; 405, Udyog Vihar, Phase – III Gurgaon – 122 016, Haryana</td>
</tr>
<tr>
<td>30</td>
<td>Religare Health Insurance Co. Ltd</td>
<td>Religare Health Insurance Co. Ltd. Vipul Tech Square, Tower C, 3rd Floor, Sector – 43, Golf Course Road, Gurgaon – 122009</td>
</tr>
<tr>
<td>31</td>
<td>Max Bupa Health Insurance Co. Ltd</td>
<td>Max Bupa Health Insurance Co. Ltd. Block B1/1-2, Mohan Cooperative Industrial Estate, Mathura Road, NEW DELHI – 110 044.</td>
</tr>
</tbody>
</table>
Regulations Relating to Insurance
Accounting and Management

NOTES

32 CIGNA TTK Health Insurance Co. Ltd.
CIGNA TTK Health Insurance Co. Ltd. CIGNA TTK Health Insurance Company Limited 401/402 Raheja Titanium, Westren Express Highway, Goregaon (East), Mumbai – 400063

33 Aditya Birla Health Insurance Co. Ltd.
9th Floor, One Indiabulls Centre, Tower-1,Jupiter Mill Compound, 841,S.B Marg, Elphinstone Road MUMBAI - 400013.

34 Reliance Health Insurance Limited
Reliance Centre, 6th Floor, North Wing, Off Western Express Highway, Santa Cruz (East) Mumbai – 400055

NON-LIFE INSURANCE COMPANIES

As of October 2018, IRDAI has recognized 34 non-life insurance companies. [2]

<table>
<thead>
<tr>
<th>Company</th>
<th>Sector</th>
<th>Headquarters</th>
<th>Founded</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Acko General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2016</td>
</tr>
<tr>
<td>2 Aditya Birla Health Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2015</td>
</tr>
<tr>
<td>3 Agriculture Insurance Company of India</td>
<td>Public</td>
<td>New Delhi</td>
<td>2002</td>
</tr>
<tr>
<td>4 Apollo Munich Health Insurance</td>
<td>Private</td>
<td>Gurgaon</td>
<td>2007</td>
</tr>
<tr>
<td>5 Bajaj Allianz General Insurance</td>
<td>Private</td>
<td>Pune</td>
<td>2001</td>
</tr>
<tr>
<td>6 Bharti AXA General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2008</td>
</tr>
<tr>
<td>7 Cholamandalam MS General Insurance</td>
<td>Private</td>
<td>Chennai</td>
<td>2001</td>
</tr>
<tr>
<td>Company</td>
<td>Sector</td>
<td>Headquarters</td>
<td>Founded</td>
</tr>
<tr>
<td>---------------------------------------</td>
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</tr>
<tr>
<td>8 Cigna TTK</td>
<td>Private</td>
<td>Mumbai</td>
<td>1918</td>
</tr>
<tr>
<td>9 DHFL General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2016</td>
</tr>
<tr>
<td>10 Digit Insurance</td>
<td>Private</td>
<td>Pune</td>
<td>2017</td>
</tr>
<tr>
<td>11 Edelweiss General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2017</td>
</tr>
<tr>
<td>12 Export Credit Guarantee Corporation of India</td>
<td>Private</td>
<td>Mumbai</td>
<td>1957</td>
</tr>
<tr>
<td>13 Future Generali India Insurance</td>
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<td>Mumbai</td>
<td>2007</td>
</tr>
<tr>
<td>14 HDFC ERGO General Insurance Company</td>
<td>Private</td>
<td>Mumbai</td>
<td>2002</td>
</tr>
<tr>
<td>15 ICICI Lombard</td>
<td>Private</td>
<td>Mumbai</td>
<td>2001</td>
</tr>
<tr>
<td>16 IFFCO TOKIO General Insurance</td>
<td>Private</td>
<td>New Delhi</td>
<td>2000</td>
</tr>
<tr>
<td>17 Kotak Mahindra General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2015</td>
</tr>
<tr>
<td>18 Liberty General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2013</td>
</tr>
<tr>
<td>19 Magma HDI General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2009</td>
</tr>
<tr>
<td>20 Max Bupa Health Insurance</td>
<td>Private</td>
<td>New Delhi</td>
<td>2008</td>
</tr>
<tr>
<td>Company</td>
<td>Sector</td>
<td>Headquarters</td>
<td>Founded</td>
</tr>
<tr>
<td>--------------------------------</td>
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</tr>
<tr>
<td>National Insurance Company</td>
<td>Public</td>
<td>Kolkata</td>
<td>1906</td>
</tr>
<tr>
<td>New India Assurance</td>
<td>Public</td>
<td>Mumbai</td>
<td>1919</td>
</tr>
<tr>
<td>Raheja QBE General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2007</td>
</tr>
<tr>
<td>Reliance General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2000</td>
</tr>
<tr>
<td>Reliance Health Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2017</td>
</tr>
<tr>
<td>Religare Health Insurance</td>
<td>Private</td>
<td>Gurgaon</td>
<td>2012</td>
</tr>
<tr>
<td>Royal Sundaram General Insurance</td>
<td>Private</td>
<td>Chennai</td>
<td>2000</td>
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<tr>
<td>SBI General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2010</td>
</tr>
<tr>
<td>Shriram General Insurance</td>
<td>Private</td>
<td>Jaipur</td>
<td>2008</td>
</tr>
<tr>
<td>Star Health and Allied Insurance</td>
<td>Private</td>
<td>Chennai</td>
<td>2006</td>
</tr>
<tr>
<td>Tata AIG General Insurance</td>
<td>Private</td>
<td>Mumbai</td>
<td>2001</td>
</tr>
<tr>
<td>The Oriental Insurance Company</td>
<td>Public</td>
<td>New Delhi</td>
<td>1947</td>
</tr>
<tr>
<td>United India Insurance Company</td>
<td>Public</td>
<td>Chennai</td>
<td>1938</td>
</tr>
</tbody>
</table>
### 10.8 Elements of Fire Insurance

<table>
<thead>
<tr>
<th>Policy Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Valued policy</td>
<td>The insurer firsts value the property and then undertakes to pay compensation up to that value in the case of loss or damage.</td>
</tr>
<tr>
<td>Floating policy</td>
<td>It covers the damages to properties lying at different places.</td>
</tr>
<tr>
<td>Comprehensive policy</td>
<td>This is known as an all-in-one policy. It has a wide coverage and includes damages due to fire, theft, burglary, etc.</td>
</tr>
<tr>
<td>Specific policy</td>
<td>This covers you for a specific amount which is less than the real value of the property.</td>
</tr>
</tbody>
</table>

**What does insurance not cover?**

Your policy may not cover liabilities in certain situations. These are known as exclusions.

**How much does insurance cost?**

Your insurance costs depend on your premium amount. This premium amount depends on several factors that differ from insurance to insurance. Here’s a look:

**Life Insurance**

- Age
- Health (past and current)
- Your occupation
- The type of coverage/plan
- Your smoking and drinking habits
- The sum assured
Motor/Auto Insurance:
- Make-Model of the vehicle
- The type of coverage/plan
- The value, age of your vehicle
- Your claim history

Travel Insurance
- The sum assured
- The type of coverage/plan
- Age
- Your health
- The location of travel

Health Insurance
- Your family health history
- The sum assured
- The type of coverage/plan
- Your age and gender
- Your health history

Home Insurance
- The size of your home
- The type of coverage/plan
- The age of your home and the systems installed therein
- The location of your home
- The sum assured

You can also use online calculators to check the premium amount.

How to use the insurance money?
- You have to make a claim against your insurance policy.
- Give details about the loss you suffered. This differs from insurance to insurance.
- Submit the bills/proof of damage, loss, hospitalisation, etc.
- The insurance company would verify your claim.
- It will then pay the bill or reimburse you for your loss.

Read informative General Insurance Articles at Acko.

Having a vehicle insurance policy helps protect against damages to your vehicle under various circumstances. Stay up to date with the latest Car Insurance Articles and Two Wheeler Insurance Articles here.
10.9 Marine Insurance: Nature, Subject Matter and Principles

Nature:
Marine insurance is concerned with overseas trade. International trade involves transportation of goods from one country to another country by ships. There are many dangers during the transhipment. The persons who are importing the goods will like to ensure the safe arrival of their goods.

The shipping company wants the safety of the ship. So marine insurance insures the coverage of all types of risks which occur during the transit. Marine insurance may be called a contract whereby the insurer undertakes to indemnify the insured in a manner and to the extent thereby agreed upon against marine losses.

Marine insurance has two branches:
(i) Ocean Marine Insurance
(ii) Inland Marine Insurance.

Ocean marine insurance covers the perils of the sea whereas inland marine insurance is related to the inland risks on the land. Marine insurance is one of the oldest forms of insurance. It has developed with the expansion of trade. It was started during the middle ages in Italy and then in England. The sending of goods by sea involves many perils; so it was necessary to get the goods insured. In modern times marine insurance business is well organised and is carried on scientific lines.

Lloyd’s Association:
This association has played an important role in marine insurance in England. During the middle of seventeenth century some persons used to assemble in coffee houses of London and transact marine insurance business. They used to transact business in their own names. One of the coffee houses was owned by Edward Lloy.

For the facility of his customers he started publishing a paper called Lloyd’s News in 1696. This paper contained all types of information about the movement of ships. The persons who used to assemble in Lloyd’s Coffee House formed an association called Lloyd’s Association.

This association provided only the requisite information, but business was contracted by the underwriters in their own names. Anybody interested in entering marine insurance business could become the members of this association. The member’s reputation and financial position was scrutinised properly. The association earned a great name in marine insurance and is considered one of the best organisations in the world even today.

Subject Matter to be insured:
The marine insurance may cover three types of things:
(i) Cargo Insurance:
The person who is importing the goods and the person who is sending them are interested in the safety of goods during the sea journey. The goods to be insured are called ‘cargo’. Any loss of goods during journey is indemnified by the insurance company.

The goods are generally insured according to their value but some percentage of profit can also be included in the value. The cargo policies may be special, reporting and floating. The special policy is only for one shipment. Reporting or open cargo policy, on the other hand, covers all shipments made by an exporter over a long period of time.

The floating policy is just similar to open cargo policy but differs from it only in respect of the method of paying the premium. In floating policies the value of the future shipments is estimated and premium is deposited with the company. Later on, actual shipments are compared with the estimates and the premium is adjusted.

(ii) Hull Insurance:
When the ship is insured against any type of danger it is called Hull Insurance. The ship may be insured for a particular trip or for a particular period.

(iii) Freight Insurance:
The shipping company has an interest in freight. The freight may be paid in advance or on the arrival of goods. The shipping company will not get freight if the goods are lost during transit. The shipping company may insure the freight to be received which is known as freight insurance.

Principles of Marine Insurance
Some of the principles related to marine insurance are given as under:
1. Utmost Good Faith:
The marine contract is based on utmost good faith on the part of both the parties. The burden of this principle is more on the insured than on the underwriter (insurance company). The insured should give full information about the subject to the insured. He should not withhold any information. If a party does not act in good faith, the other party is at liberty to cancel the contract.

2. Insurable Interest:
Insurable interest means that the insured should have interest in the subject when it is to be insured. He should be benefited by the safe arrival of commodities and he should be prejudiced by loss or damage of goods. The insured may not have an insurable interest at the time of acquiring a marine insurable policy, but he should have a reasonable expectation of acquiring such interest. The insured must have insurable interest at the time of loss or damage otherwise he will not be able to claim compensation.
3. Indemnity:
This principle means that the insured will be compensated only to the extent of loss suffered. He will not be allowed to earn profit from marine insurance. The underwriter provides to compensate the insured in cash and not to replace the cargo or the ship. The money value of the subject matter is decided at the time of taking up the policy. Sometimes the value is calculated at the time of loss also.

There is one exception to the principle of indemnity in marine insurance. Some profit margin is also allowed to be included in the value of the goods. The assumption is that the insured will earn profit when goods reach at their destination.

4. Cause Proxima:
This is a Latin word which means the nearest or proximate cause. It helps in deciding the actual cause of loss when a number of causes have contributed to the loss. The immediate cause of loss should be determined to fix the responsibility of the insurer. The remote cause for a loss is not important in determining the liability. If the proximate cause is insured against, the insurer will indemnify the loss.

Different types of marine insurance can be elaborated as follows:

Hull Insurance: Hull insurance mainly caters to the torso and hull of the vessel along with all the articles and pieces of furniture on the ship. This type of marine insurance is mostly taken out by the owner of the ship to avoid any loss to the vessel in case of any mishaps occurring.

Machinery Insurance: All the essential machinery are covered under this insurance and in case of any operational damages, claims can be compensated (post-survey and approval by the surveyor).

The above two insurances also come as one under Hull & Machinery (H&M) Insurance. The H&M insurance can also be extended to cover war risk covers and strike cover (strike in port may lead to delay and increase in costs)

Protection & Indemnity (P&I) Insurance: This insurance is provided by the P&I club, which is ship owners mutual insurance covering the liabilities to the third party and risks which are not covered elsewhere in standard H & M and other policies.

Protection: Risks which are connected with ownership of the vessel. E.g. Crew related claims.

Indemnity: Risks which are related to the hiring of the ship. E.g. Cargo-related claims.
Liability Insurance: Liability insurance is that type of marine insurance where compensation is sought to be provided to any liability occurring on account of a ship crashing or colliding and on account of any other induced attacks.

Freight, Demurrage and Defense (FD&D) Insurance: Often referred to as “FD&D” or simply “Defense,” this insurance provides claims for handling assistance and legal costs for a wide range of disputes which are not covered under H&M or P&I insurance.

Freight Insurance: Freight insurance offers and provides protection to merchant vessels’ corporations which stand a chance of losing money in the form of freight in case the cargo is lost due to the ship meeting with an accident. This type of marine insurance solves the problem of companies losing money because of a few unprecedented events and accidents occurring.

Marine Cargo Insurance: Cargo insurance caters specifically to the marine cargo carried by ship and also pertains to the belongings of a ship’s voyages. It protects the cargo owner against damage or loss of cargo due to ship accident or due to delay in the voyage or unloading. Marine cargo insurance has third-party liability covering the damage to the port, ship or other transport forms (rail or truck) resulted from the dangerous cargo carried by them.

The time limit for claims that are right to compensation may vary depending upon the content of the policy, and action is to be brought within that period from the date when the damage occurred.

For Newly built ships, the shipowner is under contract with the shipyard to take out insurance cover for a period (usually one year) from the date of yard delivery.

In addition to these types of marine insurance, there are also various types of marine insurance policies which are offered to the clients by insurance companies so as to provide the clients with flexibility while choosing a marine insurance policy. The availability of a wide array of marine insurance policies gives a client a wide arena to choose from, thus enabling him to get the best deal for his ship and cargo.

Different types of marine insurance policies are detailed below:

- **Voyage Policy**: A voyage policy is that kind of marine insurance policy which is valid for a particular voyage.

- **Time Policy**: A marine insurance policy which is valid for a specified time period – generally valid for a year – is classified as a time policy.
- **Mixed Policy**: A marine insurance policy which offers a client the benefit of both time and voyage policy is recognized as a mixed policy.

- **Open (or) Unvalued Policy**: In this type of marine insurance policy, the value of the cargo and consignment is not put down in the policy beforehand. Therefore reimbursement is done only after the loss of the cargo and consignment is inspected and valued.

- **Valued Policy**: A valued marine insurance policy is the opposite of an open marine insurance policy. In this type of policy, the value of the cargo and consignment is ascertained and is mentioned in the policy document beforehand thus making clear about the value of the reimbursements in case of any loss to the cargo and consignment.

- **Port Risk Policy**: This kind of marine insurance policy is taken out in order to ensure the safety of the ship while it is stationed in a port.

- **Wager Policy**: A wager policy is one where there are no fixed terms for reimbursements mentioned. If the insurance company finds the damages worth the claim then the reimbursements are provided, else there is no compensation offered. Also, it has to be noted that a wager policy is not a written insurance policy and as such is not valid in a court of law.

- **Floating Policy**: A marine insurance policy where only the amount of claim is specified and all other details are omitted till the time the ship embarks on its journey, is known as a floating policy. For clients who undertake frequent trips of cargo transportation through waters, this is the most ideal and feasible marine insurance policy.

- **Single Vessel Policy**: This policy is suitable for small shipowner having only one ship or having one ship in different fleets. It covers the risk of one vessel of the insured.

- **Fleet Policy**: In this policy, several ships belonging to one owner are insured under the same policy.

- **Block Policy**: This policy also comes under maritime insurance to protects the cargo owner against damage or loss of cargo in all modes of transport through which his/her cargo is carried i.e. covering all the risks of rail, road, and sea transport.

Marine Insurance is an area which involves a lot of thought, straightforward and complex dealings in order to achieve the common ground of payment and receiving. But as much as complex the field is, it is nonetheless interesting and intriguing because it caters to a lot of people and offers a wide range of services and policies to facilitate easy and uncomplicated business transactions. Therefore, in the interest of the clients and the insurance providers, it is beneficial and relevant to have the right kind of marine insurance.
insurance. It resolves problems not just in the short run, but also in the long run as well.

10.10 Rural Insurance: Coverage, Claim & Exclusions

The fact that 70% of the population in India lives in rural areas and contribute to the development of the country in a big way makes it important for them to avail schemes meant for their welfare. It wouldn’t be wrong to say that farmers and their agriculture business play an important part in the growth of our country. Thus, it makes sense for this section to get coverage as per their needs in the form of rural insurance plans.

What Is Rural Insurance?

Rural insurance ensures that families living in rural areas have a safe and secure future so that they can lead a happy life. The insurance helps them to cover risks related to various aspects of their life. Rural Insurance policies come with the affordable premium rates and faster claim process.

Types Of Rural Insurance

Rural insurance includes a wide range of plans to cover various sections. Some of them are:

<table>
<thead>
<tr>
<th>Plans</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Motor Insurance</td>
<td>Comprehensive coverage for agricultural vehicles like tractors, cars, scooters, trailers and motorcycles</td>
</tr>
<tr>
<td>Property Insurance</td>
<td>Covers home, shops, retail outlets, schools and agricultural equipment</td>
</tr>
<tr>
<td>Accident Insurance</td>
<td>Covers accidental death, partial or total disability of the insured</td>
</tr>
<tr>
<td>Livestock Insurance</td>
<td>Insurance coverage for cattle against death or disability</td>
</tr>
<tr>
<td>Health Insurance</td>
<td>Personal accident insurance and Mediclaim for the insured</td>
</tr>
<tr>
<td>Poultry</td>
<td>Covers broilers and parent stock of chicken</td>
</tr>
</tbody>
</table>
What Rural Insurance Covers?

Rural insurance is associated with the lifestyle risks of people residing in villages. This insurance policy includes:

- Hut insurance
- Poultry insurance
- Cycle rickshaw policy
- Sericulture insurance
- Honey bee insurance
- Failed-well insurance
- Sheep and goat insurance
- Lift irrigation insurance
- Farmers’ package insurance
- Agricultural pump-set policy
- Animal-driven cart insurance
- Gramin personal accident insurance
- Aqua-culture (prawn/shrimp) insurance
- Horticulture/plantation insurance scheme
- Animals included in rural insurance are elephants, rabbits, pigs, birds, zoo and circus animals.

How Rural Insurance Functions?

In order to get the best deal, it is important to understand rural insurance well and also, know how it functions:

- Analyse your requirement and the loss associated with your assets so that you know which type of insurance to opt for
- The analysis will also help in deciding the premium amount
- Check and compare various insurance companies and plans to pick up the best one for you
- The insurer checks whether the applicant resides in the rural area
- The premium is mutually agreed between the insurer and the insured after going through the property/livestock details
- When a risk occurs, the insured immediately informs the bank/insurer company about the mishap
- Evidence of the event, duly filled claim form and FIR Report (if needed) are submitted by the insured
- The claim is verified by bank officials. If authentic, the claim is settled, else it is rejected

Eligibility Criteria
According to the Insurance Regulatory and Development Authority of India (IRDA), rural sector which is eligible for this insurance has to fulfil the following categories:

- Has a population less than 5,000 people
- Density of population is not more than 400 per square kilometre
- Minimum 75% of male population must be engaged in farming activities

**Claim Process**

In case of some eventuality, you can make claims by following a set procedure. It is important to be aware of the steps in order to avoid any rejection:

- After the eventuality, inform the insurance company as soon as possible
- Provide the duly filled in claim form along with the required documents
- Submit the proofs and certificates
- After an assessment, if the provider finds it fit, your claim will be accepted and you will receive your compensation, else it will be rejected
- If you are not satisfied with the decision, you can approach the court of law

Some of the documents required to be submitted to the insurance company for making claims are:

- Duly filled in claim form
- Photocopy of insurance policy
- FIR report in case of accidents/ vandalism
- Death certificate (in case of death of the insured)
- Evidence of equipment damage (in case of property insurance)
- Ear tags (in case of cattle insurance)
- Demand draft/cancelled cheque of the bank account where the claim amount has to be paid

**Time Taken to Settle Claims**

Rural insurance claim is processed and settled within 30 days of submitting the supporting documents. If further investigation is needed, the insurance company can take maximum of 3 months.

**Exclusions**

Though rural insurance has different sets of exclusions, which are:
<table>
<thead>
<tr>
<th>Plans</th>
<th>Exclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cattle Insurance</td>
<td>· Death/ disability caused by neglect, overloading or treatment by unskilled people</td>
</tr>
<tr>
<td></td>
<td>· Intentional slaughter without permission of government authorities</td>
</tr>
<tr>
<td></td>
<td>· Theft/clandestine sale</td>
</tr>
<tr>
<td>Poultry Insurance</td>
<td>· Death caused by overcrowding</td>
</tr>
<tr>
<td></td>
<td>· Transit by any transport</td>
</tr>
<tr>
<td></td>
<td>· Theft/clandestine sale</td>
</tr>
<tr>
<td></td>
<td>· Intentional slaughter without the permission of government authority</td>
</tr>
<tr>
<td>Motor Insurance</td>
<td>· Loss/damage from theft</td>
</tr>
<tr>
<td></td>
<td>· Vehicle confiscated/destroyed by government body</td>
</tr>
<tr>
<td>Property Insurance</td>
<td>· Cost of dismantling to and from transport to workshop</td>
</tr>
<tr>
<td></td>
<td>· Faults existing at the time of commencement of the policy</td>
</tr>
<tr>
<td></td>
<td>· Damage for which the supplier/ manufacturer is responsible</td>
</tr>
</tbody>
</table>

Moreover, the claim is not payable if the claim amount does not exceed 10% of the total insured sum per acre/ Rs 1000 per affected acre, whichever is lower.

**Companies Offering Rural Insurance in India**

Rural insurance is a specially designed insurance, keeping in mind various sections of rural India. Some of the companies providing rural insurance in India are:

- TATA AIG
- Aviva India
- Cholamandalam
- Oriental Insurance
- IFFCO Tokio

**Advantages of Buying Rural Insurance**
It is important to spread awareness about various types of rural insurance so that people residing in rural areas get to benefit from schemes meant for them. Some of the benefits of purchasing rural insurance are:

- Easy to understand plans
- People have to pay low premium which can be affordable
- The plan can compensate for monetary losses covered under the plan
- The plan can help people in rural areas become independent

### 10.11 Terminologies

1) Life Insurance 2) Influencing 3) Organizations 4) Policies 5) Fire 6) Rural

### 10.12 Model Questions

1) Explain the types of life insurance in India?
2) State the General Insurance?
3) What are the futures of fire insurance contract?
4) Explain the functions of insurance organization?
5) Explain the rural insurance?

### 10.13 Reference Books

UNIT – XI  NON-LIFE INSURANCE

Structure
11.1 Introduction
11.2 Types of Motor Insurance Policies In India
11.3 Indian Insurance Industry Overview (Market Development Analysis)
11.4 Significance of Liability Insurance In India
11.5 Types of Liability Insurance Plan:
11.6 Companies Providing Liability Insurance Policy
11.7 Components of The Distribution Channels(System) of Life Insurance Companies in the Country
11.8 Role of Agents In The Life Insurance Sector In India
11.9 Important Activities Carried Out In A Life Insurance Organization: Marketing, Underwriting, And Administration
11.11 Terminologies
11.12 Model Questions
11.13 Reference Books

11.1 Introduction
Non-Life Insurance is a policy that provides compensation for losses incurred from a specific financial event. This type of policy is also known as general insurance, or property and casualty insurance. Examples of non-life insurance policies include automobile policies, home-owners policies, damage cover from fire, marine accidents, travel, theft and any catastrophe etc. Since the probability of occurrence of these risks is very difficult to ascertain, it thereby is an extremely difficult task to measure the amount of damage they would do, on their incidence.

The Firm strives towards providing solutions for these risks so that you can have an appropriately measured risk quantum that could have an effect on your business. We understand that it is very important for every business to appropriately book their liabilities whilst meeting the regulatory requirements that are dictated upon them while simultaneously being able to make profits on their businesses and our team endeavours to provide support for the same.

The Firm has been instrumental in Initial Product Pricing and Certification of some of the big players in India.

11.2 Types of Motor Insurance Policies In India
The primary objective of a two wheeler insurance is to offer protection against damage to the vehicle and liability to third party. But when you start to consider the various types of auto insurance available in the country today, it can get quite overwhelming. How do you assess the amount of coverage you require? Are there ways to protect your vehicle with the necessary coverage in an economical manner? Below we detail the various types of two-wheeler insurances available for your two-wheeler.
based on the coverage

Motor insurance policies can be classified into the following types, based on the coverage they offer:

- **Third-party Liability Insurance** - This type of insurance policy is mandated by law for all vehicles plying on the roads. This insurance provides protection to third-party for damages to property or injuries to individual, where the policyholder is accountable for the accident. Third-party liability insurance only covers minimal risks, and it does not protect the policyholder for damage or theft of the insured vehicle, or injuries that he suffers.

- **Comprehensive Insurance** - This type of insurance policy covers third-party liability, and the expenses incurred by the policyholder in the event of damage or theft of the insured vehicle. The policyholder also benefits from a personal accident cover that offers compensation if he is injured or faces death in an accident. The comprehensive insurance policy can be enhanced through add-on covers that offer extended benefits.

- **Add-on Covers** - Some of the add-on insurance covers that supplement a comprehensive insurance plan are as follows:
  - **Zero Depreciation Cover** - This is one of the most popular add-on covers in motor insurance. This policy ensures that the policyholder receives the full claim amount on the value of replaced parts, following an accident. However, this cover is available only for vehicles that are less than three years old.
  - **Roadside Assistance Cover** - In the event of an emergency such as a flat tyre, battery issues, or an empty fuel tank, this cover provides you assistance even if you are stranded at a remote location. Policyholders can benefit from services like fuel assistance, battery recharge, taxi, or even accommodation assistance.
  - **Engine and Electronic Circuit Cover** - This insurance covers expenses incurred when there is a damage to the insured vehicle’s engine or electronic circuits.
  - **NCB Protection Cover** - The No Claim Bonus is a reward given to a policyholder for not making any claims during the policy term. The NCB can amount to a significant reduction in premium for the following year. However, when the policyholder makes a claim in the subsequent years, he stands to lose the accrued NCB. The NCB Protection cover, as the name suggests, does not nullify the NCB in the event of a claim; it just brings down the slab at which the NCB discount is given on premium.
  - **Key Replacement Cover** - In the case of a lost ignition key, this insurance cover offers reimbursement for a part of the cost of a substitute key.

based on purpose of use

Vehicles can be used for private or commercial purposes, and the type of insurance that the owner purchases depends on the intended use of the vehicle.

- **Private Motor Insurance** - This type of insurance policy is purchased by owners of two-wheelers who intend to use the vehicle for private purposes.
A comprehensive private insurance and its owner in the event of accidents, and also offers third-party liability protection.

- **Commercial Motor Insurance** - This is an insurance policy that prevents a business from suffering financial loss from damages to the commercial vehicle. It offers third-party liability protection, and accident cover for the driver of the vehicle.

It is possible to strengthen your two-wheeler insurance by opting for sufficient additional coverages. These days, insurance companies also provide you the convenience of purchasing and renewing insurance policies online. So it is advisable to compare policies and choose one that is appropriate for your needs.

### 11.3 Indian Insurance Industry Overview (Market Development Analysis)

The insurance industry of India consists of 57 insurance companies of which 24 are in life insurance business and 33 are non-life insurers. Among the life insurers, Life Insurance Corporation (LIC) is the sole public sector company. Apart from that, among the non-life insurers there are six public sector insurers. In addition to these, there is sole national re-insurer, namely, General Insurance Corporation of India (GIC Re). Other stakeholders in Indian Insurance market include agents (individual and corporate), brokers, surveyors and third party administrators servicing health insurance claims.

**Market Size**

Government's policy of insuring the uninsured has gradually pushed insurance penetration in the country and proliferation of insurance schemes. Gross premiums written in India reached Rs 5.53 trillion (US$ 94.48 billion) in FY18, with Rs 4.58 trillion (US$ 71.1 billion) from life insurance and Rs 1.51 trillion (US$ 23.38 billion) from non-life insurance. Overall insurance penetration (premiums as % of GDP) in India reached 3.69 per cent in 2017 from 2.71 per cent in 2001.

In FY19 (up to October 2018), premium from new life insurance business increased 3.66 per cent year-on-year to Rs 1.09 trillion (US$ 15.46 billion). In FY19 (up to October 2018), gross direct premiums of non-life insurers reached Rs 962.05 billion (US$ 13.71 billion), showing a year-on-year growth rate of 12.40 per cent.

**Investments and Recent Developments**

The following are some of the major investments and developments in the Indian insurance sector.

- As of November 2018, HDFC Ergo is in advanced talks to acquire Apollo Munich Health Insurance at a valuation of around Rs 2,600 crore (US$ 370.05 million).
- In October 2018, Indian e-commerce major Flipkart entered the insurance space in partnership with Bajaj Allianz to offer mobile insurance.
- In August 2018, a consortium of WestBridge Capital, billionaire investor Mr Rakesh Jhunjhunwala announced that it would acquire
India’s largest health insurer Star Health and Allied Insurance in a deal estimated at around US$ 1 billion.

- In September 2018, HDFC Ergo launched ‘E@Secure’ a cyber insurance policy for individuals.
- Insurance sector companies in India raised around Rs 434.3 billion (US$ 6.7 billion) through public issues in 2017.
- In 2017, insurance sector in India saw 10 merger and acquisition (M&A) deals worth US$ 903 million.
- India’s leading bourse Bombay Stock Exchange (BSE) will set up a joint venture with Ebix Inc to build a robust insurance distribution network in the country through a new distribution exchange platform.

**Government Initiatives**
The Government of India has taken a number of initiatives to boost the insurance industry. Some of them are as follows:

- In September 2018, National Health Protection Scheme was launched under Ayushman Bharat to provide coverage of up to Rs 500,000 (US$ 7,723) to more than 100 million vulnerable families. The scheme is expected to increase penetration of health insurance in India from 34 per cent to 50 per cent.
- Over 47.9 million famers were benefitted under Pradhan Mantri Fasal Bima Yojana (PMFBY) in 2017-18.
- The Insurance Regulatory and Development Authority of India (IRDAI) plans to issue redesigned initial public offering (IPO) guidelines for insurance companies in India, which are to looking to divest equity through the IPO route.
- IRDAI has allowed insurers to invest up to 10 per cent in additional tier 1 (AT1) bonds that are issued by banks to augment their tier 1 capital, in order to expand the pool of eligible investors for the banks.

**Road Ahead**
The future looks promising for the life insurance industry with several changes in regulatory framework which will lead to further change in the way the industry conducts its business and engages with its customers.

The overall insurance industry is expected to reach US$ 280 billion by 2020. Life insurance industry in the country is expected grow by 12-15 per cent annually for the next three to five years.

Demographic factors such as growing middle class, young insurable population and growing awareness of the need for protection and retirement planning will support the growth of Indian life insurance.

*Exchange Rate Used: INR 1 = US$ 0.0159 as on March 31, 2019*

**11.4 Significance of Liability Insurance In India**
The necessity for insurance today is paramount and this is due to the fact that we live in an economically uncertain world and one never knows when financial help is required. Insurance acts as a safety blanket and protects customers from various issues that may arise. Insurance plans are of various
types based on the requirement. The most commonly acquire policies are Life Insurance policies, Health Insurance Policies, among others.

However, there are other insurance policies that are quite specific in nature and correspond to certain unique requirements. These types of policies are procured by customers who require cover only for certain issues and not for generic ones life life and health. One of this is the Liability Insurance.

**Liability Insurance Overview:**

Liability insurance is a policy that offers protection to businesses and individuals from risk that they may be held legally or sued for negligence, malpractice or injury. This insurance policy protects the insured from legal payouts and costs for which the policyholder is deemed to be responsible. However, contractual liabilities and intentional damage are usually not covered as part of this policy.

This policy was originally created by companies or individuals who experienced common risks and hence created a fund to help pay for each other’s issues regarding this. These policies offer cover against their party claims as the payment will not be for the insured to the person who has been affected by the damage caused. In case a claim is made then the policy provider will have to defend the policyholder.

**Why is Liability Insurance Required?**

This type of an insurance policy is generally procured by companies or individuals who may be held liable, legally for injuries or other issues. This especially the case for hospitals, doctors or even business owners. An example would be, if a product manufacturer sells products that have been faulty or causes damage to other’s products, then he/she may be sued for the damages caused. Procuring a liability insurance will cover the manufacturer from ensuing legal costs.

Liability insurance is one part of the general insurance policy itself under the risk transference category. In many countries, liability insurance is mandatory especially for drivers of public transport vehicles. The scope of this form of insurance in India has been defined by the Public Liability Insurance Act of 1991.

**11.5 Types of Liability Insurance Plan:**

There are number of liability insurance policies available for customers based on their line of work and requirements. The most common forms of Liability insurance are Public, Product, Employers and Third-party liability.

- **Public Liability Insurance**
  Although only certain countries have made this type of an insurance mandatory, most industries, especially those that have an affect on third parties such as visitors, trespassers, etc. Regardless of whether it is mandatory or not, most companies procure it so as to avoid unnecessary risk.
Certain small industries do not procure liability insurance policies as the premium is quite high, however, in the event of any claims, the legal costs will usually outweigh the premium costs. Therefore, procuring this policy is usually more prudent. This risk increases exponentially when these locations are shopping centres, theatres, clubs etc and areas where sporting events are held and places that allow consumption of alcohol.

In cases where the risk is extremely high, policy providers either refuse to insure these liabilities or charge an exorbitant premium.

- **Product Liability**
  This is again not a compulsory insurance requirement in many countries, but it is highly important. This is procured by companies whose products are widely used such as chemicals, tobacco, medical products, food, recreational products and others.

- **Employer Liability**
  This type offers cover to liabilities that an employer may incur if an employee is injured during his/her employment due to the job. Sometimes, companies do not deem this as important but if faced with a claim, they might be driven to bankruptcy.

- **Third-Party Liability**
  This policy covers damages caused by the insured to another. The insured is considered as the first party, the insurance company is the second and the third is the injured or the person/company making the claims.

- **How is the Premium Amount Decided?**
  The premium that is to be paid by the insured will be worked out using the base rate based on the insurance company’s needs and assessments. Another factor that is taken into consideration is the amount of risk that the company and its products come with. Higher the risk, higher is the premium to be paid.

Claim history, size of the risk and the company’s approach to the risk are additional factors.

While deciding the premium amount, insurance companies take into consideration the environment, number of claims made previously and their business record.

### 11.6 Companies Providing Liability Insurance Policy

There are a number of companies within India that provide different forms of liability insurance covers. Some of these are:

- **HDFC Ergo Commercial General Liability** - this insurance policy provides protection against claims of property damage or bodily injury for which the company is liable.

- **ICICI Lombard** offers numerous liabilities insurance covers to suit business requirements.

- **Bharti AXA Commercial General Liability Policy** offers cover for liabilities that are a result of business processes and operations.
TATA AIG offers a Commercial General Liability Insurance Policy that covers third party liabilities that are a result of business operations.

**Liability Insurance Claim Process:**

The claims process varies from one company to the other. There is generally a form to be filled for the same post which all necessary documents will have to be provided. However, when it comes to liabilities it is not as simple. There may be court cases or an out-of-court settlement. The claims process will be different based on what the claim is being made for.

**11.7 Components of The Distribution Channels(System) of Life Insurance Companies in the Country**

Insurers and underwriters need to decide on the way, or channel through which, their products are distributed. The aim of a distribution channel is to allow customers to access and purchase products in the most efficient way for the business.

A variety of distribution channels are available, and the business's choice will be determined by its structure, strategy and position in the market. Each channel requires different resources to be effective and will impact the pricing structure.

**Distribution channels can be divided into two categories:**

- **Direct channels** - these give the insurer direct contact with the customer. The business employs sales personnel with the skills to provide the product to the customer.
- **Indirect channels** - these contain a break in the link between the customer and the business. The break is filled by a skilled intermediary with a customer base that is the insurer's target audience.

**Direct channels**

**Call centres**

Call centres provide insurance companies with an efficient method of transacting insurance with customers. Their sales activities are focused on achieving specific targets, such as defined sales volumes, call queuing times and numbers’ of customers purchasing. The popularity of call centres has grown out of the competitive market as their efficiency reduces the transaction costs of policies.

Call centres can be located in any place where employees may be trained. This includes countries such as India where employee costs are much lower than in the UK. However, some customers now prefer call centres to be operated in their own country as a result of poor past experiences.

When a business is considering how much investment is necessary for the operation, it is important that it takes the design and cost of the technology
which will be used into account. To reduce the call centre's set-up costs, the business can operate a virtual call centre, where employees are home based and calls are routed to them from a central point. These can be set up quickly using secure networks.

Employees, who are often referred to as agents or operators, are guided by the software through a series of question prompts to ask customers. Telephone calls are held in a queue until one of the agents is ready to handle the call. The process is automated with the caller hearing an introductory message before the agent begins the conversation.

Call centres may collate data that can be used to improve the efficiency of their operations. For example, this could help the business to provide ways of ensuring that the centre has a sufficient number of employees available in peak times. Another way of increasing operational efficiency is to use computer-based, rather than paper-based, records when answering customer queries.

In addition to making new business sales, call centres are often used to support and develop the customer relationship. Outbound calls can promote the benefits of alternative products to existing customers; for example, motor insurance customers usually require home insurance as well. The more products that a customer buys from a certain organisation, the more likely they are to remain with it. Customers are also likely to become less price-sensitive as they associate themselves with a brand. Where insurers provide white label products (i.e. products provided by an insurer that are promoted using the branding of another organisation), call centres often divide themselves into different teams representing the different brands.

**Insurance agents**

An agent is an individual who acts on behalf of another person or group. For example, a call centre employee. Some insurers use external sales employees to act as agents and visit customers; they are paid a commission based on sales in addition to a basic salary. In Britain, insurance agents were a popular method for selling home and accident insurance, and life assurance. However, with the introduction of other channels, such as the internet, the administration costs of using agents were too high in the competitive market and customers began choosing other channels with lower priced offerings. This is partly because customers are now better educated in insurance products as a result of the discussions often had across various media, such as magazines, radio, TV and websites.

**Lloyd's agents**

These agents are appointed by Lloyd's as marine service providers to supply local shipping and casualty information. They also carry out pre- and post-loss marine cargo surveys, so are specialists in hull and machinery surveys. They perform a number of claims activities as well. There are approximately 300
agents worldwide in major ports and commercial centres, with a similar number of sub-agents, and they carry out around 100,000 surveys each year.

**Appointed representatives**

An agent can be appointed to provide advice and sell insurance products for a particular insurance company, but be independent of that company. These agents are referred to as appointed representatives, and may be an individual or a business which is representing another Financial Conduct Authority (FCA) regulated business. The appointed representative is only able to operate within the regulated activity of that insurer. If it carries out any other activities outside of its appointed representative status, it must be registered directly with the FCA. The insurer that grants appointed representative status is known as the 'principal' and is responsible for the activities of the appointed representative. The principal must monitor the appointed representative's activities to ensure that it acts in accordance with the regulations at all times.

**Mutual organisations**

In the past, tradesmen grouped together to form mutual organisations which provided protection for the risks that insurance companies were not willing to cover. For example, risks such as liability insurance or accident and injury benefits may be too high for an insurer's portfolio. Members own the mutual organisation and receive a variety of financial benefits, so it is in their best interests to support the organisation that represents them. Examples include the following:

- P&I clubs - offer marine liability cover
- National Farmers' Union - represents the agricultural and horticultural industries; provides a variety of financial services products
- DG Mutual - originally formed to provide injury and accident benefits to dentists, now represents most professional persons.

**Indirect channels**

**Insurance brokers**

Insurance brokers are independent of any insurance company and therefore able to provide advice and products to the customers from a variety of companies. Brokers select a panel of insurers they would like to represent and which meets the needs of their customers. The FCA requires brokers to have access to a sufficient number of insurers on their panel so that customers can make an informed choice. Some markets may be limited as a result of their specialist nature with few insurers offering cover. In these circumstances, the broker will advise the customer on why only these insurers may be approached.
Brokers may specialise in a segment of the market that they have knowledge and expertise in. This is attractive for customers, as they feel more confident that the broker will be able to identify their risks and source an insurer to provide cover. Brokers are responsible for collecting premiums from customers and have a credit agreement with insurers. As part of this agreement, brokers receive commission from insurers when placing risks with them. Some brokers charge customers a fee for their services in addition to or instead of the commission received from insurers. For example, when a customer, such as a manufacturing business, has several insurance policies arranged through a broker, the broker may charge a fee for placing the risk with a number of insurers instead of receiving a commission. Larger risks attract competition from other brokers and so the broker may charge customers a fee instead of receiving commission to keep the overall insurance cost at a competitive level.

Some brokers offer additional services to customers, such as business continuity planning or risk management advice. As no insurance product is provided with these services, the broker charges a fee for their use so that they create an additional revenue stream. Offering such services helps the broker to negotiate terms with the insurer, as the additional details supplied by customers can be used to help the underwriter understand their risks.

Large groups of people, such as a car club, are attractive to insurers because they offer a high premium volume and are more likely to be retained by a broker. The insurer benefits from the broker's knowledge, relationship with the group and processing of documents.

The insurer can reduce the cost of providing and administering the product further when it delegates an agreed authority to the broker. This is where an insurer gives the broker the authority to carry out certain actions; for example, relating to the types of risks that the broker can accept without referral to an underwriter, or to the premium rates and limits of cover that it can authorise. Whether the insurer chooses to delegate an agreed authority depends on the broker's expertise and the profitability of the scheme. The insurer will receive a monthly bordereau of the risks placed, premiums collected and details of any claims made. The broker benefits from having a stable and loyal customer base that it can cross-sell other products to, such as home insurance in the example of a car club. Some schemes may be available to another broker on a shared commission basis, creating a new link in the chain between the insurer and the customer.

Reinsurance brokers

An insurer may place a proportion of its risk with reinsurers in order to reduce the possibility of it suffering a major loss or catastrophe to its own account. Spreading the risk in this way allows the insurer to write higher limits of cover. Reinsurance brokers have specialist knowledge of which reinsurers an
insurer may share its account with or place one-off risks with under a facultative facility.

The amount that can be reinsured depends on the account and the risk, and the cover may be proportional or non-proportional. Proportional reinsurance can be provided on a quota share basis where the insurer and reinsurer share an agreed quota of the premium and claims. It can also be provided on a surplus basis where the insurer requires reinsurance above a set limit, known as a 'line'; the reinsurance is arranged on the basis of a number of these lines which add up to the overall limit required by the insurer.

Non-proportional risks can be covered on an excess of loss, stop loss or catastrophe excess of loss basis:

- Excess of loss basis - the reinsurer is responsible for any claim amount above an agreed limit
- Stop loss basis - applies across the account and stops account loss at an agreed level, so that the reinsurer is responsible for losses above that limit
- Catastrophe excess of loss basis - provides protection when a catastrophe occurs on the account as a result of an event which has caused an accumulation of losses, such as storm damage.

As well as having a risk management team, major corporations often appoint a captive insurer. Captive insurers offer a number of benefits; for example, they can provide wider cover than that given by the risk management team and retain premiums that would normally be passed to the insurance market. They are usually based in regions with lower tax rates, such as Bermuda. A reinsurance broker may then help to provide the captive insurer with reinsurance cover in order to protect it from catastrophic loss.

**Independent financial advisers (IFAs)**

Independent financial advisers (IFAs) provide advice to customers and businesses on life assurance, pensions and investments, and are regulated in the UK by the FCA. IFAs may also offer products that contain no investment element, such as personal accident insurance, permanent health insurance and medical insurance. They may belong to an insurance broking firm and use their specialist knowledge to provide non-life insurance products in addition to financial advice. Broking firms can also refer their customers to IFAs for financial advice.

**Financial organisations**

Financial organisations, such as banks and building societies, provide insurance to their customers in various ways. For example, a bank may have its own insurance broking firm. If a bank has provided a loan for premises or equipment, it will have an interest in making sure that adequate cover is
arranged to protect the item. The bank's broking team will be able to assist with arranging insurance to protect both the customer's and the bank's interests.

'Bancassurance' refers to when a bank owns an insurer or works directly with an insurer through an affinity group. When a bank incorporates an insurance company into part of its group, this creates a direct relationship between the customer and the insurer. Not all banks have their own insurance company or broker; some have an affinity group, discussed later in this fact file, which are operated by their employees or white label products provided by an insurer for the bank.

Managing general agents (MGAs)

According to the Managing General Agents' Association, a managing general agent (MGA) is 'an agency whose primary function and focus is the provision of underwriting services and whose primary fiduciary duty is to its insurer.' As an underwriting facility, MGAs focus on the small medium enterprise (SME) sector of the market. They provide either a package of cover or specific insurance such as property owners' liabilities and professional indemnity covers.

MGAs are operated by experienced underwriters with underwriting knowledge and expertise of risks, who have the authority to write risks. This underwriting capacity may have been given by one insurer or a panel of insurers, which wants to enter the market but does not have the resources to do so. For example, this could be appealing to an overseas insurer which would like to enter the SME market by using another organisation's brand and management, or to an underwriting team which has chosen to leave an insurer and start its own underwriting agency. MGAs also have claims authority, and act as a link in the chain between the insurer which is providing the capacity and the customer. They seek business from insurance brokers.

Retail organisations

When a customer acquires a retailer's loyalty card, the retailer gains information about the customer which enables it to target them with other branded products. Customers are more likely to buy products, such as insurance policies, from brands they trust. Retailers selling insurance policies offer white label products that are administered by an insurer through a call centre. The call centre may either have a team which is dedicated to that insurer or answer calls in the name of the retailer, having identified which is being used by the specific telephone number that callers have been given. Selling insurance in this way provides the retailer with an additional revenue stream in a short period of time, without the costs of setting up an insurance company.

Affinity groups
An affinity group is a group of people with similar or common interests. It may use its customer buying power to obtain insurance cover through a broker. For example, members of a car club are likely to support its promotions, as the commission that the club receives when they place insurance through the scheme will provide it with a revenue stream which supports members’ interests. In addition, sports organisations can use their membership volume to arrange cover for particular risks that may not be available to individuals. This cover is then received by members as part of their membership; it could include liability cover for injury to another member. An affinity group can use a broker to obtain specific wording in their cover which is underwritten by a specialist underwriter. The group handles the scheme’s administration, adding another link between the insurer and the customer.

**Peer-to-peer (P2P) groups**

Peer-to-peer (P2P) group insurance is a recent innovation which has created interest in the USA, UK and Germany. It aims to save money by removing inefficiencies and the conflicts of interest that arise between the insurer and customer at the time of a claim. A P2P group is made up of people who share similar characteristics; its premiums are calculated by assessing a number of factors that are common to all members. A motor insurer, for example, will consider a driver’s age, location, car and experience, and then add them to a group of similar motorists, or peers.

Half of the premium paid by the group’s members contributes to its management and the other half is injected into the premium pool. Claims made during the year are paid from the pool; if funds become depleted, they are topped up by the group’s fees. Any premium in the pool that is not used will be carried forward to the next year, when the group’s members will pay premiums to top up the pool again. The group’s members have an interest in keeping claims low so that they will benefit from lower premiums.

**Broker networks**

A broker network is made up of predominantly small, independent insurance brokers who join to form a club. The network uses its collective buying power to obtain terms of cover, premiums, facilities and commissions that are normally only available to larger broking organisations. The network requires its members to commit a level of premium to a panel of partner insurers. This enables members to demonstrate their support for the panel and network without compromising their customer relationships.

Additional services provided by broker networks include marketing advice and business planning support, which can help to increase brokers’ incomes, and regulatory support and advice, which helps brokers to remain compliant. Insurers may review their agency network with the aim of reducing their overall operating costs; however, broker networks are protected by their
collective relationships with insurers. Networks charge a fee to brokers for the support they provide, which may be based on either the volume of premium income arranged with the insurers or an agreed fixed charge for services.

**Aggregators**

Aggregators are online quotation services that can calculate premiums in minutes from a number of different insurers on to one website. Customers are prompted by selected questions to enter the details of their insurance requirements, and the aggregator website then calculates and displays a range of premiums and terms. Aggregators compete with each other, relying on their technology systems to provide fast quotations from a variety of providers. The premiums are displayed in ascending order, allowing the customer to select a quotation based on price. Quotation terms are also shown to help the customer in their comparison. If the customer selects a quotation, they will be transferred to the insurer's website for confirmation of the quotation and processing of documentation. To complete the purchase, the premium is paid online and the policy documents are sent electronically to the customer.

An advantage of aggregators is that they are available at all times, so the customer can make their choice at a time convenient to them. The aggregator is paid a fee for each customer purchase. Quotations are available on motor, home, personal accident, travel, van and tradesman liability insurance, but aggregators' systems are adaptable and other financial services, utilities and communication quotations are sometimes provided. However, not all insurers are quoted by aggregators; some choose to promote their products directly so that they can control the purchasing process without being compared to other insurers. These insurers encourage customers to make decisions based on the services provided and other benefits, rather than on price.

**11.8 Role of Agents In The Life Insurance Sector In India**

- Needs to have good relationship including good rapport with his/her existing and prospective clients
- General awareness about the markets
- Promotion of insurance brands needs to have a carefully drawn roadmap.
- Marketing strategies needs to be drawn and re-drawn from time to time, keeping in mind the customer preferences.
- Well-planned strategies and plans needs to be chalked out.
- Public-relation (PR) building exercise should be given significant importance
- Business Development tactics needs to be pursued aggressively.

A life insurance agent in addition to the life insurance policies, can sell general
insurance (non-life) policies viz. casualty insurance, health insurance, disability insurance, long-term care insurance, burglary insurance etc. In addition to the life insurance policies a life insurance agent can also be selling other financial packages like variable annuities, mutual funds and other securities. There are many avenues for opportunities as well as earning potential available for a life insurance agent and there are no limits or boundaries regarding this. The earning potential of an insurance agent may vary from one agent to another. Based on the outcome of the sales and targets achieved by an insurance agent, he or she can earn accordingly and there are no limitations or upper ceiling regarding the earning potential for an insurance agent. An insurance agent must be well aware about the market conditions to guide their customers accordingly.

If a client has asked for the best or economical insurance products and services, the insurance agent must strive hard to deliver the insurance products and services as desired by the customer, based on his/her requirements. Respecting the sentiments of the customer is an essential aspect and important, too. Using force to purchase insurance policies may not produce the desired results. Many times, it has been noticed that the customers may not be able to afford to pay the heavy premiums for certain insurance policies and may instead settle for a cheaper one that satisfies their requirements. The main goal of an insurance agent is to sell the insurance policy that is appropriate for a particular customer, based on his/her requirements. An insurance agent who is talented in marketing various insurance policies will not find it difficult to sell a term life insurance. Selling of term insurance policies is made relatively easy because of the low-term life insurance prices. But even the best or an experienced insurance agent may fumble or get tense when the clients ask regarding the investment in insurance products and services since there is no monetary value accumulated at the end of the period upon the expiry of a policy. In a tricky situation like this an insurance agent should be ready to offer a solution of miscellaneous saving schemes. An insurance agent should be taught the promotion and selling techniques regarding handling of customers who are apprehensive and are confused if they really want a policy or not, or have not yet arrived at a conclusion as to which policy should be purchased by him/her. The insurance agent should be taught the finer nuances about healthcare insurance business and the selling strategies and should be clever enough as to convert enquiries or objections into deals. The terms and conditions of these policies should be conveyed to the customer.

An insurance agent’s role is primarily that of a communicator, counselor and facilitator. The prospective customer can buy the best insurance products and services for his/her varied requirements viz. life, property, health, burglary insurance from the insurance agent. As a customer, when an insurance product is being purchased, let the insurance agent know beforehand regarding his/her budgetary allocation towards insurance coverage. The insurance agent in turn will help his/her clients to get the cheapest or the best insurance product prices. If the concerned individual has selected an independent insurance agent then, then he/she can expect to get best deals on insurance products and services from across different insurance companies. The customer can discuss
with his/her insurance agent insurance plan suited for him/her as per the requirements or customized based on the client’s needs. During the presentation process, the insurance agent will explain the client regarding the rates and what he/she will benefit from that particular insurance policy.

When the individual or the prospective client has decided to buy an insurance product or service from a particular insurance agent, the next step in the process is to check and make sure to have all the personal financial and investment data ready with him/her. While the agent asks for the financial data, the concerned individual should be able to furnish the details to his or her insurance agent so that the processing of the policy process can be carried out in a smooth manner. Nowadays, most insurance agents carry personal laptops that are directly connected to the insurance carriers or the insurance companies through the Internet. Because of this advancement, the prospective clients can get the instant quotes within 10 - 15 minutes.

Till recently, an insurance agent had many tasks to be carried out and completed in a prompt manner. When there was no internet facility, the insurance agents would have to fill out the application forms, submit the reports and make the payments. Thus, the insurance agents had a lot of manual work to be done and this included extensive paper-work. But now, with the internet connectivity, the tasks for insurance agents have become much easier wherein they have to switch on to their laptops and all the aforesaid mentioned tasks are completed within minutes. This not only helps the insurance agents to hasten the processing procedure, but also provide their prospective clients with the best insurance rates, as per the client’s requirements.

In return for their services, an insurance agent gets commission. The commission is taken out from insurance premiums that the customer pays to the insurance company. But always beware incase, if there is any insurance agent who is asking additional cash for the services rendered by him/her, the prospective customer should be vigilant and will have to negotiate well.

11.9 Important Activities Carried Out In A Life Insurance Organization: Marketing, Underwriting, And Administration

Marketing

We begin with marketing despite the fact that it is not the first step in starting a business. From a consumer’s point of view, it is the first glimpse into the operations of an insurer. Insurance may be bought through agents, brokers, or (in some cases) directly from the insurer (via personal contact or on the Internet). An agent legally represents the company, whereas a broker represents the buyer and, in half of the states, also represents the insurer because of state regulations. The compensation issue was brought to the limelight in 2004 when New York State Attorney General Eliot Spitzer opened an investigation of contingent commissions that brokers received from
insurers; these contingent commissions were regarded as bid rigging. Contingent commissions are paid to brokers for bringing in better business and can be regarded as profit sharing. As a result of this investigation, regulators look for more transparency in the compensation disclosure of agents and brokers, and major brokerage houses stopped the practice of accepting contingency commission in the belief that clients view the practice negatively. In many states, producer is another name for both agents and brokers. This new name has been given to create some uniformity among the types of distribution systems. Because life/health insurance and property/casualty insurance developed separately in the United States, somewhat different marketing systems evolved. Therefore, we will discuss these systems separately.

Life/Health Insurance Marketing

Most life/health insurance is sold through agents, brokers, or (the newest term) producers, who are compensated by commissions. These commissions are added to the price of the policy. Some insurance is sold directly to the public without sales commissions. Fee-only financial planners often recommend such no-load insurance to their clients. Instead of paying an agent’s commission, the client pays the planner a fee for advice and counseling and then buys directly from the no-load insurer. Unlike the agent, the planner has no incentive to recommend a high-commission product. Whether your total cost is lower depends on whether the savings on commissions offsets the planner’s fee.

Some companies insist that their agents represent them exclusively, or at least that agents not submit applications to another insurer unless they themselves have refused to issue insurance at standard premium rates. Others permit their agents to sell for other companies, though these agents usually have a primary affiliation with one company and devote most of their efforts to selling its policies.

The two dominant types of life/health marketing systems are the general agency and the managerial (branch office) system.

General Agency System

A general agent is an independent businessperson rather than an employee of the insurance company and is authorized by contract with the insurer to sell insurance in a specified territory. Another major responsibility is the recruitment and training of subagents. Subagents usually are given the title of agent or special agent. Typically, subagents are agents of the insurer rather than of the general agent. The insurer pays commissions (a percentage of premiums) to the agents on both new and renewal business. The general agent receives an override commission (a percentage of agents’ commissions) on all business generated or serviced by the agency, pays most of it to the subagents,
and keeps the balance for expenses and profit. Agent compensation agreements are normally determined by the insurer.

In most cases, the general agent has an exclusive franchise for his or her territory. The primary responsibilities of the general agent are to select, train, and supervise subagents. In addition, general agents provide office space and have administrative responsibilities for some customer service activities.

A large number of life/health insurers use personal producing general agents. A personal producing general agent sells for one or more insurers, often with a higher-than-normal agent’s commission and seldom hires other agents. The extra commission helps cover office expenses. The trend is toward an agent representing several different insurers. This is desirable for consumers because a single insurer cannot have the best products for all needs. To meet a client’s insurance needs more completely, the agent needs to have the flexibility to serve as a broker or a personal producing general agent for the insurer with the most desirable policy.

Managerial (Branch Office) System

A branch office is an extension of the home office headed by a branch manager. The branch manager is a company employee who is compensated by a combination of salary, bonus, and commissions related to the productivity of the office to which he or she is assigned. The manager also employs and trains agents for the company but cannot employ an agent without the consent of the company. Compensation plans for agents are determined by the company. All expenses of maintaining the office are paid by the company, which has complete control over the details of its operation.

Group and Supplemental Insurance Marketing

Group life, health, and retirement plans are sold to employers by agents in one of the systems described above or by brokers. An agent may be assisted in this specialized field by a group sales representative. Large volumes of group business are also placed through direct negotiations between employers and insurers. A brokerage firm or an employee benefits consulting firm may be hired on a fee-only basis by the employer who wishes to negotiate directly with insurers, thus avoiding commissions to the agent/broker. In these direct negotiations, the insurer typically is represented by a salaried group sales representative.

Supplemental insurance plans that provide life, health, and other benefits to employees through employer sponsorship and payroll deduction have become common. These plans are marketed by agents, brokers, and exclusive agents. The latter usually work on commissions; some receive salaries plus bonuses.
Property/Casualty Insurance Marketing

Like life/health insurance, most property/casualty insurance is sold through agents or brokers who are compensated on a commission basis, but some is sold by salaried representatives or by direct methods. The independent (American) agency system and the exclusive agency system account for the bulk of insurance sales.

Independent (American) Agency System

The distinguishing characteristics of the independent (American) agency system are the independence of the agent, the agent’s bargaining position with the insurers he or she represents, and the fact that those who purchase insurance through the agent are considered by both insurers and agents to be the agent’s customers rather than the insurer’s. The independent agent usually represents several companies, pays all agency expenses, is compensated on a commission plus bonus basis, and makes all decisions concerning how the agency operates. Using insurer forms, the agent binds an insurer, sends underwriting information to the insurer, and later delivers a policy to the insured. The agent may or may not have the responsibility of collecting premiums. Legally, these agents represent the insurer, but as a practical matter they also represent the customer.

An independent agent owns the x-date; that is, he or she has the right to contact the customer when a policy is due for renewal. This means that the insured goes with the agent if the agent no longer sells for the insurance company. This ownership right can be sold to another agent, and when the independent agent decides to retire or leave the agency, the right to contact large numbers of customers creates a substantial market value for the agency. This marketing system is also known as the American agency system. It is best recognized for the Big I advertisements sponsored by the Independent Insurance Agents & Brokers of America. These advertisements usually emphasize the independent agent’s ability to choose the best policy and insurer for you.

Direct Writers and Exclusive Agents

Several companies, called direct writers, The term direct writer is frequently used to refer to all property insurers that do not use the Independent Agency System of distribution, but some observers think there are differences among such companies. Market insurance through exclusive agents. Exclusive agents are permitted to represent only their company or a company in an affiliated group of insurance companies. A group is a number of separate companies operating under common ownership and management. This system is used by companies such as Allstate, Nationwide, and State Farm. These insurers compensate the agent through commissions that are lower than those paid to independent agents, partly because the insurer absorbs some expenses that are borne directly by independent agents. The insurer owns the x-date.
The customer is considered to be the insurer’s rather than the agent’s, and the agent does not have as much independence as do those who operate under the independent agency system. Average operating expenses and premiums for personal lines of insurance tend to be lower than those in the independent agency system.

Some direct writers place business through salaried representatives, who are employees of the company. Compensation for such employees may be a salary and/or a commission plus bonus related to the amount and quality of business they secure. Regardless of the compensation arrangement, they are employees rather than agents.

**Brokers**

A considerable amount of insurance and reinsurance is placed through brokers. A broker solicits business from the insured, as does an agent, but the broker acts as the insured’s legal agent when the business is placed with an insurer. In about half the states, brokers are required to be agents of the insurer. In the other states, brokers do not have ongoing contracts with insurers—their sole obligation is to the client. When it appears desirable, a broker may draft a specially worded policy for a client and then place the policy with an insurer. Some property/casualty brokers merely place insurance with an insurer and then rely on this company to provide whatever engineering and loss-prevention services are needed. Others have a staff of engineers to perform such services for clients. Modern brokerage firms provide a variety of related services, such as risk management surveys, information systems services related to risk management, complete administrative and claim services to self-insurers, and captive insurer management.

Brokers are a more significant part of the marketing mechanism in commercial property, liability, employee benefits, and marine insurance than in personal lines of insurance. Brokers are most active in metropolitan areas and among large insureds, where a broker’s knowledge of specialized coverages and the market for them is important. Some brokerage firms operate on a local or regional basis, whereas others are national or international in their operations.

With today’s proliferation of lines and services, it is extremely difficult for brokers to understand all the products completely. Brokers are always looking for unique product designs, but gaining access to innovative products and actually putting them into use are two different things. Generally, each broker selects about three favorite insurers. The broker’s concern is the underwriting standards of their insurers. For example, a broker would like to be able to place a client who takes Prozac with an insurer that covers such clients.

**Internet Marketing**

With today’s proliferation of Internet marketing, one can select an insurance product and compare price and coverage on the Internet. For example,
someone interested in purchasing a life insurance policy can click on Insweb.com. If she or he is looking for health insurance, ehealthinsurance or other such Web sites present information and a questionnaire to fill out. The site will respond with quotes from insurers and details about the plans. The customer can then send contact information to selected insurers, who will begin the underwriting process to determine insurability and appropriate rates. The sale is not finalized through the Internet, but the connection with the agent and underwriters is made. Any Internet search engine will lead to many such Web sites.

Most insurance companies, like other businesses, set up their own Web sites to promote their products’ features. They set up the sites to provide consumers with the tools to compare products and find the unique characteristics of the insurer.

Mass Merchandising

Mass merchandising is the selling of insurance by mail, telephone, television, or e-mail. Mass merchandising often involves a sponsoring organization such as an employer, trade association, university, or creditor; however, you are likely to be asked to respond directly to the insurer. Some mass merchandising mixes agents and direct response (mass mailing of information, for example, that includes a card the interested person can fill out and return); an agent handles the initial mailing and subsequently contacts the responding members of the sponsoring organization.

In some cases, you can save money buying insurance by mass merchandising methods. Direct response insurers, however, cannot provide the counseling you may receive from a good agent or financial planner.

Financial Planners

A financial planner facilitates some insurance sales by serving as a consultant on financial matters, primarily to high-income clients. An analysis of risk exposures and recommendations on appropriate risk management techniques, including insurance, are major parts of the financial planning process. A fee-only financial planner, knowledgeable in insurance, may direct you to good-quality, no-load insurance products when they are priced lower than comparable products sold through agents. You are already paying a fee for advice from the financial planner. Why also pay a commission to an insurance agent or broker?

In many instances, it is appropriate for the financial planner to send you to an insurance agent. Products available through agents may have a better value than the still limited supply of no-load products. Also, your financial planner is likely to be a generalist with respect to insurance, and you may need advice from a knowledgeable agent. In any event, financial planners are now part of the insurance distribution system.
Shopping for Insurance on the Internet

True to its name, Progressive was the first large insurer to begin selling insurance coverage via the Internet in the late 1990s. Other well-known names like Allstate and Hartford quickly followed suit. So-called aggregator sites like Insure.com, Quotesmith.com, Ehealthinsurance.com, and InsWeb.com joined in, offering one-stop shopping for a variety of products. To tap the potential of e-commerce, insurers have had to overcome one big challenge: how to sell complex products without confusing and driving away the customer. Therefore, the sale is not finalized on the Internet. The glimpse into the product is only the first step for comparative shopping.

An insurance application can be frustrating even when an agent is sitting across the desk explaining everything, but most people don’t walk out in the middle of filling out a form. On the Internet, however, about half of those filling out a quote request quit because it is too complicated or time-consuming. Most of those who do finish are “just looking,” comparing prices and services. Twenty-seven million shoppers priced insurance online in 2001, according to a recent study by the Independent Insurance Agents of America and twenty-six insurers, but less than 5 percent closed the deal electronically.

As shopping on the Internet becomes a boom business, each state department of insurance provides guidelines to consumers. For example, the Texas Department of Insurance issued tips for shopping smart on the Internet, as follows:

Insurance on the Internet—Shopping Tips and Dangers

- Be more cautious if the type of insurance you need recently became more expensive or harder to get and the policy costs far less than what other insurers charge.
- Don’t succumb to high-pressure sales, last-chance deals of a lifetime, or suggestions that you drop one coverage for another without the chance to check it out thoroughly.
- Check with an accountant, attorney, financial adviser, a trusted friend, or relative before putting savings or large sums of money into any annuity, other investment, or trust.
- Get rate quotes and key information in writing and keep records.
- If you buy coverage, keep a file of all paperwork you completed online or received in the mail and signed, as well as any other documents related to your insurance, including the policy, correspondence, copies of advertisements, premium payment receipts, notes of conversations, and any claims submitted.
- Make sure you receive your policy—not a photocopy—within thirty days.
Professionalism in Marketing

Ideally, an agent has several years of experience before giving advice on complicated insurance matters. You will be interested in the agent’s experience and educational qualifications, which should cover an extensive study of insurance, finance, and related subjects. A major route for life/health agents to gain this background is by meeting all requirements for the Chartered Life Underwriter (CLU) designation.

11.10 UNDERWRITING

Underwriting is the process of classifying the potential insureds into the appropriate risk classification in order to charge the appropriate rate. An underwriter decides whether or not to insure exposures on which applications for insurance are submitted. There are separate procedures for group underwriting and individual underwriting. For group underwriting, the group characteristics, demographics, and past losses are judged. Because individual insurability is not examined, even very sick people such as AIDS patients can obtain life insurance through a group policy. For individual underwriting, the insured has to provide evidence of insurability in areas of life and health insurance or specific details about the property and automobiles for property/casualty lines of business. An individual applicant for life insurance must be approved by the life insurance company underwriter, a process that is sometimes very lengthy. It is not uncommon for the application to include a questionnaire about lifestyle, smoking habits, medical status, and the medical status of close family members. For large amounts of life insurance, the applicant is usually required to undergo a medical examination.

Once the underwriter determines that insurance can be issued, the next decision is to apply the proper premium rate. Premium rates are determined for classes of insureds by the actuarial department. An underwriter’s role is to decide which class is appropriate for each insured. The business of insurance inherently involves discrimination; otherwise, adverse selection would make insurance unavailable.

Some people believe that any characteristic over which we have no control, such as gender, race, and age, should be excluded from insurance underwriting and rating practices (although in life and annuity contracts, consideration of age seems to be acceptable). Their argument is that if insurance is intended in part to encourage safety, then its operation ought to be based on behavior, not on qualities with which we are born. Others argue that some of these factors are the best predictors of losses and expenses, and without them, insurance can function only extremely inefficiently. Additionally, some argument could be made that almost no factor is truly voluntary or controllable. Over the years, insurers have used a variety of factors in their underwriting decisions. A number of these have become taboo from a public policy standpoint. Their use may be considered unfair discrimination. In automobile insurance, for
instance, factors such as marital status and living arrangements have played a significant underwriting role, with divorced applicants considered less stable than never-married applicants. In property insurance, concern over redlining receives public attention periodically. Redlining occurs when an insurer designates a geographical area in which it chooses not to provide insurance, or to provide it only at substantially higher prices. These decisions are made without considering individual insurance applicants. Most often, the redlining is in poor urban areas, placing low-income inner-city dwellers at great disadvantage. A new controversy in the underwriting field is the use of genetic testing. t’s medical history.

Keeping Score—Is It Fair to Use Credit Rating in Underwriting?

Body-mass index, cholesterol level, SAT score, IQ: Americans are accustomed to being judged by the numbers. One important number that you may not be as familiar with is your credit score. Determined by the financial firm Fair, Isaac, and Co., a credit score (also known as a FICO score) is calculated from an individual’s credit history, taking into account payment history, number of creditors, amounts currently owed, and similar factors.

Like your grade point average (GPA), your credit score is one simple number that sums up years of hard work (or years of goofing off). But while your GPA is unlikely to be important five years from now, your credit score will affect your major financial decisions for the rest of your life. This number determines whether you’re eligible for incentive (low-rate) financing on new cars, how many credit card offers get stuffed in your mailbox each month, and what your mortgage rate will be. The U.S. Federal Trade Commission (FTC) issued a directive to consumers about the handling of credit scores. If you are denied credit, the FTC offers the following:

- If you are denied credit, the Equal Credit Opportunity Act (ECOA) requires that the creditor give you a notice that tells you the specific reasons your application was rejected or the fact that you have the right to learn the reasons if you ask within sixty days. If a creditor says that you were denied credit because you are too near your credit limits on your charge cards or you have too many credit card accounts, you may want to reapply after paying down your balances or closing some accounts. Credit scoring systems consider updated information and change over time.

- Sometimes, you can be denied credit because of information from a credit report. If so, the Fair Credit Reporting Act (FCRA) requires the creditor to give you the name, address, and phone number of the consumer reporting company that supplied the information. This information is free if you request it within sixty days of being turned down for credit. The consumer reporting company can tell you what’s in your report, but only the creditor can tell you why your application was denied.
• If you’ve been denied credit, or didn’t get the rate or credit terms you want, ask the creditor if a credit scoring system was used. If so, ask what characteristics or factors were used in that system, and the best ways to improve your application. If you get credit, ask the creditor whether you are getting the best rate and terms available and if you are not, ask why. If you are not offered the best rate available because of inaccuracies in your credit report, be sure to dispute the inaccurate information in your credit report.

Your credit score may also affect how much you’ll pay for insurance. About half of the companies that write personal auto or homeowner’s insurance now use credit data in underwriting or in setting premiums, and the bad credit penalty can be 20 percent or more. But it’s not because they’re worried that poor credit risks won’t pay their insurance premiums. Rather, it’s the strong relationship between credit scores and the likelihood of filing a claim, as study after study has borne out. Someone who spends money recklessly is also likely to drive recklessly, insurers point out; someone who is lazy about making credit card payments is apt to be lazy about trimming a tree before it causes roof damage. Often, a credit record is the best available predictor of future losses. Insurers vary on how much they rely on credit scoring—most consider it as one factor of many in setting premiums, while a few flat out refuse to insure anyone whose credit score is below a certain number—but almost all see it as a valuable underwriting tool. It’s only fair, insurers say, for low-risk customers to pay lower premiums rather than subsidizing those more likely to file claims.

Consumer advocates disagree. Using credit scores in this manner is discriminatory and inflexible, they say, and some state insurance commissioners agree. Consumer advocate and former Texas insurance commissioner Robert Hunter finds credit scoring ludicrous. “If I have a poor credit score because I was laid off as a result of terrorism, what does that have to do with my ability to drive?” he asked at a meeting of the National Association of Insurance Commissioners in December 2001. Therefore, in 2004, twenty-four states have adopted credit scoring legislation and/or regulation that is based on a National Conference of Insurance Legislators (NCOIL) model law.

The debate over the use of credit scoring has spread across the country. More states are considering regulations or legislation to curb its use by insurers.

Administration

After insurance is sold and approved by the underwriter, records must be established, premiums collected, customer inquiries answered, and many other administrative jobs performed. Administration is defined broadly here to include accounting, information systems, office administration, customer service, and personnel management.
Service

Service is the ultimate indicator on which the quality of the product provided by insurance depends. An agent’s or broker’s advice and an insurer’s claim practices are the primary services that the typical individual or business needs. In addition, prompt, courteous responses to inquiries concerning changes in the policy, the availability of other types of insurance, changes of address, and other routine matters are necessary.

Another service of major significance that some insurers offer, primarily to commercial clients, is engineering and loss control. Engineering and loss control is concerned with methods of prevention and reduction of loss whenever the efforts required are economically feasible. Much of the engineering and loss-control activity may be carried on by the insurer or under its direction. The facilities the insurer has to devote to such efforts and the degree to which such efforts are successful is an important element to consider in selecting an insurer. Part of the risk manager’s success depends on this element. Engineering and loss-control services are particularly applicable to workers’ compensation and boiler and machinery exposures. With respect to the health insurance part of an employee benefits program, loss control is called cost containment and may be achieved primarily through managed care and wellness technique.

11.11 Terminologies


11.12 Model Questions

1. Explain the types of motor insurance policies in India?
2. Bring out the Indian insurance Industry.
3. State the significance of liability insurance in India.
4. Explain the role of Agents in the life insurance sector in India?
5. Explain the Underwriting

11.13 REFERENCE BOOKS

12.1 PRODUCT DEVELOPMENT IN THE LIFE

Today, companies providing life insurance coverage tend to have high-level services backed with a robust software system. Modern people don’t want to spare their time on emailing, calling, or visiting their agents. They need clear and user-friendly systems allowing them to get relevant services online. Thus, along with new policies, products, and pricing, companies modernize or build brand new insurtech platforms. In this article, you can learn more about life insurance product development process and its peculiarities.

Life Insurance Product

According to AccuQuote, there are two types of life insurance products: term and permanent. Both types come in different subtypes to satisfy different needs. Permanent type is aimed to provide coverage for as long as you need. There are many kinds of permanent life insurance but the key categories include whole life and universal life.

Term life insurance is temporary insurance which may last for 10-30 years, typically. It can provide coverage for the only limited period of time. The policies are quite clear and, usually, cheap.
companies, as a rule, guarantee that each year you will pay the same cost for your coverage. The rates may vary from $25 to $200 per month. Once your term comes to an end, you will get a notice about the increased costs for life insurance.

When comparing two types of insurance, we may admit that universal life and whole life cost more than temporary insurance. Unlike term, permanent insurance lasts forever. As long as you pay your premiums, your family members are guaranteed to get the death benefit, no matter when you die. Permanent insurance provides cash value which may be accessed at any time for any reason.

As insurance agencies strive to become more flexible to meet ever-changing market demand and conditions, they constantly look for innovation and ways to improve their products. In terms of better services and products, these companies, usually, choose two ways. Firstly, they can provide better services and products for their customers with the help of new software. Secondly, they can design new types of insurance products.

Before proceeding to software solutions, let’s talk about the traditional insurance life cycle. Usually, people may plan their life insurance according to definite periods of their lives. Thus, according to Lenox Advisors, there are the following stages of life insurance cycle.

**Life Insurance Cycle-Stages**

25-35 years old clients – starting a career and/or marriage – during this period of life people need the highest level of insurance which covers basic protection like life value and general family income

35-45 years old clients – growing income and/or family – on this stage, people usually need insurance for business planning purposes like buying/selling, deferred compensation, business succession, etc. It also comprises tax-advanced strategies, private placement life insurance, and access to an increase in policy cash value, etc.

45-55 years old clients – estate/retirement planning includes retirement planning strategies, whole life, supplemental retirement stream, asset, and creditor protection.

55-64 years old clients – highest earnings/taxes – charitable giving, planned giving, charitable lead trust.

65+ years old clients – estate planning – estate equalization, liquidity to offset, special needs children planning.

**12.2 Software do Insurance Companies Use- Types, Features, Benefits**

If you own an insurance agency or deal with CEOs, you probably know that there are two types of software – prepackaged and custom-designed. The former type is usually built for sale to any company to
serve a great number of users. The latter type is typically built specially for one single company that needs a completely customizable solution. Unlike custom software, prepackaged systems cannot be as customized individually as bespoke systems.

The privilege of bespoke software is in its unique set of features and functionalities that face users’ needs and requirements. When you create a system from scratch, you can get as many features as you need. And what is more important – you can get only those features your users need. Let’s take a closer look at the core features your life insurance software should have.

**Feature 1 – Life insurance product definition module**
This feature is aimed to provide a definition of new products, edit and modify the existing definition, store and transfer product’s data.

**Feature 2 – Policy management**
This feature is designed to manage the group or individual policies. It provides capabilities to register applications, assess risks, present information, modify insurance conditions, handle claims, etc.

**Feature 3 – Fund management**
This feature ensures automatic reports/orders generation. It also offers the following options: accounts management, operations, and orders handling, fund registries, etc.

**Feature 4 – Accounting and finance**
This feature is designed to categorize different events (taxable/non-taxable). It offers reminders of premium underpayment or nonpayment, cash flow management, and other important options.

To understand what other features you can get with custom development, let’s take a look at Insubiz company. Our company developed a fully customizable solution which offers a lot of options for its users:

- CRM
- Assets
- Claims
- Risks
- Insurance
- Reports
- Analysis

The solution is extra user-friendly as it provides all the initial wants and needs of all the stakeholders. Insubiz is easily implemented, provides fast support and regular updates. As you can see, bespoke platforms are able to ensure more functionalities and more options for their users as compared with the prepackaged ones.

Speaking about the benefits of implementing a comprehensive software system for managing life insurance policies, we should distinguish the following:
With a well-built system in place, you can enhance customer service and support, manage Big Data, and create large client databases. Custom-designed software is also able to automate data processing, sharing, and analyzing. Automation allows eliminating human errors and making insurance processes more efficient and streamlined. All the information is kept in one system and easily accessible. We can mention a lot of other advantages of insurtech solutions, however, you can read about an overall view of the insurance product development topic in our latest article.

### 12.3 Life Insurance Product Development Process

If you made up your mind to develop a custom system for managing your life insurance products, you should know how to build it from scratch. In our development best practices, we follow seven basic steps. Here is more information about software development phases.

**Step 1 – Brainstorming**

During the first stage of SDLC, a team must gather all the initial requirements and come up with innovative ideas. This analysis is performed by senior team members having extensive experience in creating similar products in a given industry. Once all the details are collected, the team can proceed to planning and feasibility analysis.

**Step 2 – Feasibility analysis**

During the second stage of SDLC, all the stakeholders should undertake a feasibility analysis. In-depth research can demonstrate how profitable a project could be. It also incorporates all the factors affecting development. These factors include technical and economic risks. As a result of the feasibility analysis, all the team members should present their estimations regarding time, costs, and resources needed to accomplish the project.

**Step 3 – Design**

Basing on initial requirements, the team writes a detailed SRS documentation (software requirements and specifications). It serves a basis for the product architecture and is usually tightly connected with design document specification (DDS). It is based on various parameters as risk assessment, product robustness, design modularity, budget and time constraints, the best design approach is selected for the product. A design approach clearly defines all the architectural modules of the product along with its communication and data flow representation with the external and third-party modules.

**Step 4 – Programming**

During this stage of SDLC, 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**
The objective of this phase is to perform system integration testing and get ensured that the developed systems meet all the requirements with the components and subsystems integrated. The system test may require any number of additional tests depending on the scope and complexity of the requirements; examples include security, conformance, accessibility, performance, stress, compatibility, and regression tests.

**Step 6 – Quality assurance and testing**
This stage is usually a subset of all the stages of SDLC. 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**
In the software development life cycle, a release is a final stage. It’s all about launching a new product for a target audience on a specific market. Sometimes, it can be a beta version of the product or an MVP. With the help of key features going live, developers can evaluate performance and get some valuable feedback from the first users of the product.

**12.4 Roles and Responsibilities In SDLC**
At first glance, it seems that a seven-step process is very simple. Keep in mind though that dedicated developers put a lot of efforts into the development process, especially if projects are long-term. Of course, you can buy an off-the-shelf product with a ready set of features. However, if you need a customizable solution, consider custom design. Besides, anybody in need of life insurance product can choose between in-house development and outsourcing. Let’s compare these alternatives.

**12.5 Launch a New Insurance Product**
Insurance companies include broad market leaders, niche leaders, low-cost leaders in the market, and moreover, there are those who have no clearly defined strategies. According to the Society of Actuaries, the most prolific companies were those which completed their product development efforts in 2014. The research also shows that the fastest companies were those having the shortest product development time, from generating the idea until launching the product. With regard to this data, we can admit that it’s important for insurance agencies to have a defined strategy and know definitely
how to market a new insurance product. Here are some steps to follow before launching a new product:
1. Analyze market.
2. Get a company license.
3. Develop a product and pricing.
4. Review compliance.
5. Perform state filing.

Surely, product development is one of the most time-consuming steps. This process includes idea generation, product feasibility, underwriting guidelines, product planning, and design, pricing, reinsurance, state filings, marketing campaign planning, etc. Once, you complete all these steps, you’ll be able to go live with your insurance product.

In this article, we offered responses to some of the most frequent questions about life and medical insurance product development process. You know what types of products are offered in the market, what types of software insurance agencies use, what features are crucial to have. Yet, if you need to get more detailed information about how to improve your existing systems, or modernize legacy software, we are here to help you. Moreover, our dedicated team has a strong background in creating sophisticated insurtech solutions from scratch.

12.6 Insurance Sector in India

Insurance industry in India has seen a major growth in the last decade along with an introduction of a huge number of advanced products. This has led to a tough competition with a positive and healthy outcome.

Insurance sector in India plays a dynamic role in the wellbeing of its economy. It substantially increases the opportunities for savings amongst the individuals, safeguards their future and helps the insurance sector form a massive pool of funds.

With the help of these funds, the insurance sector highly contributes to the capital markets, thereby increasing large infrastructure developments in India.

Indian Insurance Sector

The Indian Insurance Sector is basically divided into two categories – Life Insurance and Non-life Insurance. The Non-life Insurance sector is also termed as General Insurance. Both the Life Insurance and the Non-life Insurance is governed by the IRDAI (Insurance Regulatory and Development Authority of India).
The role of IRDA is to thoroughly monitor the entire insurance sector in India and also act like a custodian of all the insurance consumer rights. This is the reason all the insurers have to abide by the rules and regulations of the IRDAI.

The Insurance sector in India consists of total 57 insurance companies. Out of which 24 companies are the life insurance providers and the remaining 33 are non-life insurers. Out which there are seven public sector companies.

Life insurance companies offer coverage to the life of the individuals, whereas the non-life insurance companies offer coverage with our day-to-day living like travel, health, our car and bikes, and home insurance. Not only this, but the non-life insurance companies provide coverage for our industrial equipment’s as well. Crop insurance for our farmers, gadget insurance for mobiles, pet insurance etc. are some more insurance products being made available by the general insurance companies in India.

The life insurance companies have gained an investment prospectus in the recent times with an idea of providing insurance along with a growth of your savings. But, the general insurance companies remain reluctant to offer pure risk cover to the individuals.

Present of Insurance Sector In India

So far as the industry goes, LIC, New India, National Insurance, United insurance and Oriental are the only government ruled entity that stands high both in the market share as well as their contribution to the Insurance sector in India. There are two specialized insurers – Agriculture Insurance Company Ltd catering to Crop Insurance and Export Credit Guarantee of India catering to Credit Insurance. Whereas, others are the private insurers (both life and general) who have done a joint venture with foreign insurance companies to start their insurance businesses in India.

Life Insurance Companies:

Private Sector Companies

- Aegon Life Insurance Co. Ltd.
- Aviva Life Insurance Co. India Ltd.
- Bajaj Allianz Life Insurance Co. Ltd.
- Bharti AXA Life Insurance Co. Ltd.
- Birla Sun Life Insurance Co. Ltd.
- Canara HSBC Oriental Bank of Commerce Life Insurance Co. Ltd.
- DHFL Pramerica Life Insurance Co. Ltd.
- Edelweiss Tokio Life Insurance Co. Ltd
- Exide Life Insurance Co. Ltd.
- Future Generali India Life Insurance Co. Ltd.
- HDFC Standard Life Insurance Co. Ltd.
- ICICI Prudential Life Insurance Co. Ltd.
- IDBI Federal Life Insurance Co. Ltd.
Financial Management in Insurance companies and Insurance Ombudsman

NOTES

- IndiaFirst Life Insurance Co. Ltd
- Kotak Mahindra Old Mutual Life Insurance Ltd.
- Max Life Insurance Co. Ltd.
- PNB MetLife India Insurance Co. Ltd.
- Reliance Life Insurance Co. Ltd.
- Sahara India Life Insurance Co. Ltd.
- SBI Life Insurance Co. Ltd.
- Shriram Life Insurance Co. Ltd.
- Star Union Dai-Ichi Life Insurance Co. Ltd.
- Tata AIA Life Insurance Co. Ltd.

General Insurance Companies:

Private Sector Companies

- Aditya Birla Health Insurance Co. Ltd.
- Bajaj Allianz General Insurance Co. Ltd.
- Bharti AXA General Insurance Co.Ltd.
- Cholamandalam General Insurance Co. Ltd.
- Future Generali India Insurance Co.Ltd.
- HDFC ERGO General Insurance Co. Ltd.
- ICICI Lombard General Insurance Co. Ltd.
- IFFCO-Tokio General Insurance Co. Ltd.
- Kotak General Insurance Co. Ltd.
- L&T General Insurance Co. Ltd.
- Liberty Videocon General Insurance Co. Ltd.
- Magma HDI General Insurance Co. Ltd.
- Raheja QBE General Insurance Co. Ltd.
- Reliance General Insurance Co. Ltd.
- Royal Sundaram Alliance Insurance Co Ltd
- SBI General Insurance Co. Ltd.
- Shriram General Insurance Co. Ltd.
- TATA AIG General Insurance Co. Ltd.
- Universal Sompo General Insurance Co.Ltd.

Health Insurance Companies

- Apollo Munich Health Insurance Co.Ltd.
- Star Health Allied Insurance Co. Ltd.
- Max Bupa Health Insurance Co. Ltd.
- Religare Health Insurance Co. Ltd.
- Cigna TTK Health Insurance Co. Ltd.

This collaboration with the foreign markets has made the Insurance Sector in India only grow tremendously with a high current market share. India allowed private companies in insurance sector in 2000, setting a limit on FDI to 26%, which was increased to 49% in 2014. IRDAI states – Insurance Laws (Amendment) Act, 2015 provides for enhancement of the Foreign Investment
Cap in an Indian Insurance Company from 26% to an Explicitly Composite Limit of 49% with the safeguard of Indian Ownership and Control.

Private insurers like HDFC, ICICI and SBI have been some tough competitors for providing life as well as non-life products to the insurance sector in India.

**Future of Insurance Sector In India**

Though LIC continues to dominate the Insurance sector in India, the introduction of the new private insurers will see a vibrant expansion and growth of both life and non-life sectors in 2017. The demands for new insurance policies with pocket-friendly premiums are sky high. Since the domestic economy cannot grow drastically, the insurance sector in India is controlled for a strong growth.

With the increase in income and exponential growth of purchasing power as well as household savings, the insurance sector in India would introduce emerging trends like product innovation, multi-distribution, better claims management and regulatory trends in the Indian market.

The government also strives hard to provide insurance to individuals in a below poverty line by introducing schemes like the

- Pradhan Mantri Suraksha Bima Yojana (PMSBY),
- Rashtriya Swasthya Bima Yojana (RSBY) and
- Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY).

Introduction of these schemes would help the lower and lower-middle income categories to utilize the new policies with lower premiums in India.

With several regulatory changes in the insurance sector in India, the future looks pretty awesome and promising for the life insurance industry. This would further lead to a change in the way insurers take care of the business and engage proactively with its genuine buyers.

Some demographic factors like the growing insurance awareness of the insurance, retirement planning, growing middle class and young insurable crowd will substantially increase the growth of the Insurance sector in India.

Having a vehicle insurance policy helps protect against damages to your vehicle under various circumstances. Stay up to date with the latest Car Insurance Articles and Two Wheeler Insurance Articles here.

**12.7 Role of Risk Evaluation in the Process of Insurance Product Formation**

Risk insurance is at the heart of what Standard & Poor's Ratings Services does when analyzing insurers and reinsurers. Within each category of analysis used to evaluate insurers, Standard & Poor's implicitly and explicitly evaluates risk and how risks are managed. With the new risk-management evaluation process
described in this article, risk management will become a separate, major category of our analysis. In our published full analyses, the new category will be titled "Enterprise Risk Management." The companies that are seen to be the best performers in this category will be those that have robust risk-management processes that are carried across the entire enterprise and that form a basis for informing and directing the firm's fundamental decision making. Specifically, enterprise risk management (ERM): • Allows a more prospective view of an insurer's risk profile and capital needs. • Is a highly tailored analytic process that recognizes each insurer's unique structure, products, mix of business, potential earnings streams, cash flows, and investment strategy. • Is a process that recognizes the benefits and risks of a diversified base of products, investments, and geographic spread of risk that can quantify the benefits of uncorrelated or partially correlated risks. The ERM evaluation will provide a more disciplined tool to bring information about this major aspect of management and corporate strategy into the rating rationale. The quality of management in the area of risk and the strategic choices relating to risk and return will be emphasized. Unfavorable operating performance will be viewed in the light of risk choices and risk tolerances that are a part of the ERM evaluation. Favorable operating performance that is driven by higher risk taking will be distinguished from higher returns for the same levels of risk within the ERM evaluation process. Current levels of capitalization have always been compared with risks, but with the ERM evaluation, future comparisons of risk and capital will be emphasized as well as the reasoning for the choices that will determine the future positions.

12.8 Future Trends In The Domain Of Insurance Product Design And Development

Welcome to the future of insurance, as seen through the eyes of Scott, a customer in the year 2030. His digital personal assistant orders him an autonomous vehicle for a meeting across town. Upon hopping into the arriving car, Scott decides he wants to drive today and moves the car into “active” mode. Scott’s personal assistant maps out a potential route and shares it with his mobility insurer, which immediately responds with an alternate route that has a much lower likelihood of accidents and auto damage as well as the calculated adjustment to his monthly premium. Scott’s assistant notifies him that his mobility insurance premium will increase by 4 to 8 percent based on the route he selects and the volume and distribution of other cars on the road. It also alerts him that his life insurance policy, which is now priced on a “pay-as-you-live” basis, will increase by 2 percent for this quarter. The additional amounts are automatically debited from his bank account.

When Scott pulls into his destination’s parking lot, his car bumps into one of several parking signs. As soon as the car stops moving, its internal diagnostics determine the extent of the damage. His personal assistant instructs him to take three pictures of the front right bumper area and two of the surroundings. By the time Scott gets back to the driver’s seat, the screen on the dash informs him of the damage, confirms the claim has been approved, and that a mobile response drone has been dispatched to the lot for inspection. If the vehicle is drivable, it may be directed to the nearest in-network garage for repair after a replacement vehicle arrives.
While this scenario may seem beyond the horizon, such integrated user stories will emerge across all lines of insurance with increasing frequency over the next decade. In fact, all the technologies required above already exist, and many are available to consumers. With the new wave of deep learning techniques, such as convolutional neural networks, artificial intelligence (AI) has the potential to live up to its promise of mimicking the perception, reasoning, learning, and problem solving of the human mind (Exhibit 1). In this evolution, insurance will shift from its current state of “detect and repair” to “predict and prevent,” transforming every aspect of the industry in the process. The pace of change will also accelerate as brokers, consumers, financial intermediaries, insurers, and suppliers become more adept at using advanced technologies to enhance decision making and productivity, lower costs, and optimize the customer experience.

12.9 Insurance Underwriting

Insurance underwriters are professionals who evaluate and analyze the risks involved in insuring people and assets. Insurance underwriters establish pricing for accepted insurable risks. The term underwriting means receiving remuneration for the willingness to pay a potential risk. Underwriters use specialized software and actuarial data to determine the likelihood and magnitude of a risk.

Meaning

Insurance underwriters evaluate the risks involved in insuring people and assets and establish pricing for a risk. Underwriters in investment banking guarantee a minimum share price for a company planning an IPO (initial public offering). Commercial banking underwriters assess the risk of lending to individuals or lenders and charge interest to cover the cost of assuming that risk. Insurance underwriters assume the risk of a future event and charge premiums in return for a promise to reimburse the client an amount in the event damage or occurs.

Need for insurance underwriting

- 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 or 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 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.

A lot of underwriting is automated, so in cases where the situation doesn't have a special circumstance, the underwriting may be programmed into computer programs, similar to the kind of quoting systems you might see when you get an online insurance quote.

### 12.10 Factors That Affect The Activities Performed By The Underwriter

Using an insured’s loss history in combination with group data and models are the best ways to ensure profitable underwriting. Underwriting is an art, and the best underwriters know it’s best to filter out unrelated data that could result in an unprofitable decision.

Anyone who has looked incredulously at the latest fad, whether it’s buying $350 ripped jeans or frenzied Beanie Babies collecting, knows that long-term trends are better predictors of behavior.

An insured’s history of losses, in combination with modeling and group data, should be the primary factors in any analysis of risk from an underwriting perspective. History has shown that it’s nearly always useless to try to predict future behavior. Vague gut feelings are frequently wrong, and this is true for underwriters as well as for most individuals.

In fact, underwriting is a perfect example of collective intelligence being able to produce better results than any one individual, as most recently outlined in James Surowiecki’s *The Wisdom of Crowds*.

In that book’s opening anecdote, he writes of an experiment where the aggregate guesses of a crowd at a county fair, many of whom had no knowledge of the subject, more accurately guessed the weight of an ox than the individual estimates of experts who were asked.

What is underwriting other than a collection of the wisdom of crowds? The collected history of insureds is the best predictor of what the future will hold. Adding in unrelated data that purports to predict behavior creates a flawed calculation.

Even the attempt to add in that data can put carriers in a potentially risky situation. Such is the case when underwriting specific, individual risks butts up against the strict laws against the use of health-related data in workers’ compensation, for example,
In addition, the use of genetic testing results raises serious ethical, and potentially legal, questions if used to underwrite group life-insurance policies.

How can an insurance carrier really calculate the best price if the underwriting is flawed by using unrelated data? New underwriting factors, unrelated to the specific risk should be ignored, especially if the data invades the privacy of the insured.

Using past history of an insured in combination with modeling and group data is the prudent way to analyze risk and underwrite.

### 12.11 Steps Involved In The Process Of Insurance Underwriting

life insurance is easy. It takes only a few minutes to apply. Once you have life insurance, if you die during the policy’s term then your loved ones will receive a death benefit to help pay for the expenses you paid for while alive. But to determine how much your life insurance policy costs, an underwriter will issue you an insurance classification. The underwriter is someone who works on behalf or for the life insurance company figures out if you actually get the rate you were originally quoted by looking at your health information. He or she will determine how likely you are to die before the end of your policy’s term is up and offer you a premium based on that.

Going through this process is called underwriting. All insurance products involve some degree of underwriting, which is used to get a picture of who you are based on your characteristics and how they relate to the kind of insurance you’re purchasing. For life insurance, the underwriter looks at data like your health and medical history as well as lifestyle information like your hobbies and driving ability.

Some parts of the underwriting process require action on your part, while others require the input of someone else, such as your doctor. Although underwriting can take several weeks and potentially even longer, Policygenius can make the process easier by shopping around your underwriting results to different carriers to get you the best rate.

Read on to learn more about:
- The underwriting manual
- Step 1: application quality check
- Step 2: paramedical exam
- Step 3: attending 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

#### The underwriting manual

Every carrier has its own underwriting manual. This defines the guidelines that an individual carrier will use to determine your final premium rates.
An underwriting manual will state things like what service a carrier’s underwriters should use for ordering an attending physician statement online, when they require a prescription history report, how height and weight correlate to health classifications, and more.

Of course, since each carrier has their own guidelines, that means that the other steps of the underwriting process – which tests are ordered, what tools are used, and what all of this ultimately means for your final life insurance rates – varies, too. Everything that follows is a pretty standard set of tools and tasks for an underwriter, but the specifics of what’s used, when, and how won’t be the same across companies.

**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.

Depending on the carrier, you may need to do a phone interview as well. You’ll usually need to do this if you only gave the most basic information on your application, like your date of birth, address, and coverage needs, and the carrier needs to dig a little deeper into things like your hobbies.

After that, you’ll go into the official underwriting process. Each of the following checks can add some time to your application, but it’s important in getting you the premium price you’ll need to pay over the life of your policy.

**Step 2: paramedical exam**
One of the first steps of the 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. You’ll have to go to a lab where a medical technician will perform the exam. The tech can also come to 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 attending physician statement, or 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 down 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? They’ll find out.

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 he or she finds 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. You can request to see your MVR from your state. It’s also used when determining your auto insurance rates, so a copy of your MVR can be nice to have.

**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, tool, 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 you have results in a Standard (or worse) 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.

If that was a lot to digest, you could consider getting simplified-issue life insurance, which skips the paramedical exam and the attending physician statement. But simplified-issue offers lower coverage amounts and isn’t available to people with certain health profiles.

**12.12 Terminologies**
12.13 Model Questions

1. Explain the product development in the life?
2. Explain the Non-life insurance sectors in India?
3. State the future trends in the domain of insurance product design?
4. What are the need for insurance underwriting?
5. What are the factors affecting the activities performed by the Underwriter?

12.14 Reference Books

UNIT – XIII CLAIMS MANAGEMENT

13.1 Introduction
Claims management is a collective term for all work that Van Ameyde carries out for people or companies that suffer damage, as well as for the insurance provider. What does this work involve?

- Registering the claim notification (by telephone, e-mail, post or online), which automatically opens the client file.
- Checking the cover: is the damage insured and up to what amount? Asking for documents such as police reports of road accidents, medical reports in case of injury, invoices, etc.
- Determining which party is liable for the damage if another party is involved.
- Determining the amount of the claim and engaging a loss adjuster if necessary.
- Arranging for the damage to be repaired or for transport back home if the damage occurs abroad.
- Paying the claim to the insured party.
- Recovering losses from liable (responsible) third parties, if applicable.
- Reporting to our client (the insurance provider), including management information, showing e.g. the progress of all their claims files and the total amounts to be reserved and paid.
- Fraud prevention checks.

13.2 FACTORS AFFECTING THE INSURANCE CLAIM MANAGEMENT SYSTEM
1. NEW ENTRANTS
Insurance companies have remained relatively constant. Most of them have been in business for a good hundred years. Recently, however, there has been a rise in the number of new entrants marketing, selling or servicing insurance products or providing new capital. A range of new companies is coming in,
redefining how insurance is done, and reshaping the economics of the industry in the process. Many of these new entrants are interesting organizations with great capabilities. Google, which entered the UK market in 2011 as an insurance aggregator, is perhaps the most formidable new entrant, from the perspective of a traditional insurer. The technology giant joined the emerging insurance aggregation market, significantly disrupting competitive market conditions and, by some accounts, subsequently helping lower insurance premiums by roughly 30% over the last 5 years.

Introducing that sort of intense price competition into an industry which is not overly profitable to begin with, has changed the dynamics of the market substantially. To compound the issue, other companies are entering the fray as well, including retailers and their strong brand names, and telecommunications companies boasting telematics capabilities. Even car manufacturers are starting to embed telematics capabilities into vehicles and, in some cases, to sell insurance directly.

2. SOCIAL AND ECONOMIC DYNAMICS
We’ve moved into a very low interest rate period, and those low rates are putting a lot of pressure on the profitability of insurance companies. Insurance is an industry that, essentially, takes in money and invests that money before subsequently paying claims. So, with lower investment returns, there’s less profit being generated by the insurance sector.

And it’s a sector that doesn’t really generate a lot of profit to begin with. Over the last 30 years, many U.S.-based insurance companies have failed to return their cost of capital. On top of low interest conditions, there has also been a lot of volatility on those returns, especially since the financial crash of 2007 and 2008.

On the plus side, insurers have rebuilt their balance sheets. However, market volatility makes it much harder to run their business. It’s much more difficult to find stable, growing assets to match against long-term liabilities, for example.

The most obvious societal shift, and one that is certainly impacting developed countries, is the retirement of baby boomers. As they retire, they are taking money out of their accumulation products to provide an ongoing source of income; trillions of dollars are going to flow out of these products over the next 5 to 10 years.
On the other hand, this growing section of the retired population has more wealth than people who retired previously, and they’re also living longer. That means they’re generating new and different insurance needs, necessitating different types of insurance products — particularly around payouts and long-term care.

Of course, there’s also growth related to Generation Y, which is largely composed of consumers who are unlikely to buy insurance in the same way that their parents would have. They’re unlikely to walk down to the local broker and sit down to have a discussion over a cup of coffee to buy what is, in essence, a commodity product. Instead, they want everything now, everything mobile, everything available by text.

Meanwhile, it’s in developing countries that we clearly see most of the growth. There’s a move to urbanization, which is creating a much larger and more affluent middle class. And clearly, where there are assets, there is also income.

There are families emerging that have started to drive a lot of new insurance needs. As a result, in the developing world, we’re seeing a lot of demand for insurance products. This is driving growth for domestic companies, but it’s also acting as a magnet for some of the global insurers. Examples like AXA, MAPFRE and Prudential UK have all moved aggressively into the Asian and the Latin American markets.

3. THE DATA REVOLUTION
Insurance companies have always made use of substantial amounts of data, but how they leverage data is changing in significant ways. It used to be that, if an insurer had an efficient operation and a large volume of risk data, it could find success by comparing, pooling and underwriting similar risks. Now, data is everywhere. It’s pervasive, and it’s immediately available. The whole concept of pooling risks may end up disappearing because, in effect, the data revolution will actually enable insurers to underwrite down to the individual level.

Historically, insurance has been about pricing a risk. Going forward though, the industry might be moving into a new realm that places more value on managing a risk. For example, telematics can be leveraged to give people driving scores — getting them to drive more slowly, brake more effectively, corner less aggressively, leave more distance between the car in front of them. On the life side, wearable technology and analytics can combine to create compelling wellness programs for clients. These programs are, in effect, enabling insurers to manage the risks they are writing — by rewarding good behavior and penalizing bad behavior.
4. THE DIGITAL MANDATE
The convenience and efficiency of online and mobile channels, coupled with
the commoditization of the core insurance product, has led insurance
customers to seek a new experience.

The digital insurance trend, then, is really about the way consumers will
choose to interact with an insurance company, as opposed to the way today’s
insurance companies try to dictate interactions with consumers. Going
forward, insurers will need to focus far more on the consumer as an individual.
In this environment, an effective omnichannel strategy will be key, as will an
insurer’s capabilities around self-service.

THE CASE FOR TRANSFORMATION
Together, these four factors combine to create a compelling case for digital
insurance transformation. If traditional insurers expect to remain competitive,
they must become more:

• Agile, as they respond to new and increasing competitive threats
• Efficient, as they address profitability challenges
• Customer-centric, as they respond to social changes and increasing consumer
  expectations
• Even more advanced in terms of data and analytics, as the industry moves
  from just pricing and pooling risks to truly managing individual risks

Addressing these four business imperatives is a complex effort that will
require insurers to both transform their legacy operations and build out new
operations. As insurers consider their next move, they’ll need to ask
themselves: How do we reduce our “run and maintain” costs in order to build
the kinds of new capabilities necessary to stay competitive? How do we enable
or evolve our legacy systems to support today’s digital imperatives? How do
we accept new sources of data and analyze that data properly? And, perhaps
most importantly, how do we do it all simultaneously?

At DXC, we feel strongly that these challenges are best met through a
technology-agnostic approach supported by strong partnerships. A partner
with deep industry expertise and knowledge of back-office systems can help
guide the move to a service-enabled environment, which brings new
capabilities while significantly lowering costs. With these updates, insurers
can invest more heavily in building for the future, while paying special
attention to evolving cybersecurity and regulatory compliance requirements, as
well as big data and analytics opportunities, and capitalizing on new and
emerging channels.

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<tr>
<th>13.3 TYPES OF DOCUMENTS NEEDED IN VARIOUS TYPES OF CLAIMS</th>
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<tbody>
<tr>
<td>a) Insurance Policy: The insurance policy sets out all the terms and conditions of the contract between the insurer and insured.</td>
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<tr>
<td>(b) Certificate of Insurance: It is an evidence of insurance but does not set out the terms and conditions of insurance. It is also known as ‘Cover Note’.</td>
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<td>(c) Insurance Broker’s Note: It indicates insurance has been made pending issuance of policy or certificate. However, it is not considered to be evidence of contract of insurance.</td>
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<th>13.4 CAUSE PROXIMA</th>
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<td>Principle of Causa Proxima (a Latin phrase), or in simple english words, the Principle of Proximate (i.e Nearest) Cause, means when a loss is caused by more than one causes, the proximate or the nearest or the closest cause should be taken into consideration to decide the liability of the insurer.</td>
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**Cause proxima in insurance claim settlement**

proximate cause.

1. **Lord Bacon in his Maxims of Law has said,**
   “it was infinite for the law to consider the cause of causes, and their impulsions one of another; therefore it contenteth itself with the immediate cause, and judgeth of acts by that, without looking to any further degree”.

2. **In Leyland Shipping Co. V. Norwich Union Fire Insurance Society (1918), the maxim laid down was,**
   “To treat the proximate cause as if it was the cause which is proximate in time is out of the question. The cause which is truly proximate is that which is proximate inefficiency. That efficiency may have been preserved although other causes may meantime have sprung up, which have yet not destroyed it or truly impaired it, and it may culminate in a result of which it still remains the real efficient cause to which the event can be ascribed”.

3. **In YORKSHIRE DALE S.S. Co. V. MINISTER OF WAR TRANSPORT (1942), the statement made was,**
   “Choice of the real or efficient cause from out of the whole complex of the facts must be made by applying commonsense standards. Causation is to be understood as the man in the street, and not as either scientist or the metaphysician would understand it”.

Self-Instructional Material
**Proximate Cause Examples**

It is only by considering a number of propositions and examples that the doctrine of proximate cause can best be understood.

A man goes to a late night cinema and whilst returning home from the show he is attacked by a group of vandals, stabbed and killed.

The proximate cause of his death is stabbing and certainly not going to the cinema, although it may be wrongly argued that has he not had gone to cinema he would not have met the vandals and got killed in this way.

Here, going to cinema may be simply a remote cause without proximately causing his death.

To take another example, a man riding a horse in a lonely hilly place falls from the horseback, gets an injury and remains unconscious the whole night under exposure to severe cold. The following morning he is discovered by some persons.

In the meantime, due to the severe exposure, he contracts pneumonia and dies.

Here the proximate cause of his death is accident or falling from the horseback, the reason being that injury leading to unconsciousness, exposure to severe cold and then pneumonia are all natural events developing gradually one after another without really being intervened by a new or independent source (The example is based on a judgment given in Etherington v. Lancashire and Yorkshire Accident Insurance Co., 1909).

For finding out the proximate cause we shall have to watch closely the chain of events, leading ultimately to a result, and out of such events whether in broken or unbroken sequence, interrupted or uninterrupted, the cause proximate to the result must be established.

So long the first cause retains its identity and efficiency until the result we may say that it is the proximate cause.

If, however, the chain of causation is broken so that the first cause loses its identity, and a new cause develops bringing about the result actively and efficiently then we may tag the result to have been proximately caused by the new intervening cause.

To give an example, let us take 10 bricks arranged in a lined standing order one after another keeping a gap of say 6 inches in between. Somebody gives a kick on the first brick and gradually the last brick in the line also falls.
Here the proximate cause of falling off the last brick is certainly the kick because the strength of the kick was such that it could effectively make the last brick fall without the intervention of any new force started.

Let us, however, assume that as a result of the kick only 6 bricks fall but suddenly a man throws a stone on the 7th brick and gradually falls the 7th, 8th, 9th and 10th brick.

In this case, the proximate cause of falling the last brick is throwing the stone and not the kick because the kick was not efficient enough to cause the last brick to fall.

On the other hand, a new and intervening force developed (throwing of the stone) which was active, efficient and potent enough to cause the result, i.e., falling off the last brick. Let us take another example.

A policy covers accidental fire but specifically excludes earthquake fire. There is an earthquake fire somewhere near the insured building. Due to the prevailing wind, the fire spreads gradually to neighboring buildings one after another and ultimately sets the insured building into the fire.

The claim is not payable because the proximate cause of loss is earthquake fire and not ordinary fire even though the earthquake had nothing to do with the insured building.

This is so because throughout the spread and travel, with the help of natural wind, the fire retains its identity as earthquake fire. The situation would have been different had the spread of fire been interrupted by a new and independent cause.

If, in the same example, it so happens that from mid-journey of the fire somebody lights a candlestick, carries this fire and sets the property of somebody under fire then that resultant fire shall be accidental fire or malicious fire and certainly not earthquake fire as the chain of events has been broken by a new and independent force, which is active, efficient and potent enough to bring about the result. (This example is based on a Morgan Owen prize paper, C. 1.1, journal No. 42, 1939)

From all the examples explained hereinbefore the readers would possibly appreciate that it is indeed the Common Sense that is required most to find out the proximate cause of a result. We should not try to find out the cause of causes thereby getting mixed up and complicating the issue.

A learned judge, therefore, rightfully commented with confidence, “if you want to find out the proximate cause, do not ask a scientist or a lawyer, ask a man from the street. Probably his answer will be the correct one”.

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This comment certainly conveys the feeling of the learned judge as to how he feels the importance of common sense in finding out the proximate cause.

13.5 INSURANCE PRICING AND MARKETING

1. **There is increased price and value transparency.** A fast-growing collection of price and feature-comparison websites empowers consumers to compare and contrast hundreds of insurance products by price, value, and benefits. These sites are also educating consumers on how to more effectively match a product choice with their unique needs and willingness to pay, as are insurance brokers.

2. ** Consumers are more informed and sophisticated.** As prices have become more transparent, consumers are increasingly open to new propositions based on different variables—such as security, mobility, and different types of coverage—and these propositions require new, dynamic pricing structures.

3. **Regulations are putting pressure on profitability.** New regulations, including Solvency II, require insurers to maintain higher capital levels without decreasing overall returns, and to do that, insurers must either reduce costs or increase pricing.

4. **New entrants are bringing focused, superior propositions.** The insurance industry is diversifying, with e-commerce, automotive OEMs, retailers, and other nontraditional players offering new, innovative business models and products.

5. **New technology disruptors are enabling new pricing models.** Big data, the Internet of Things, and predictive data analysis tools are giving insurance companies an advanced and broad ability to design usage-based and other innovative pricing models; draw data from new, external sources and estimate risk or consumer willingness to pay, buy, or churn more accurately; and more accurately identify—during the underwriting phase—those applicants likely to commit fraud.

   Insurers that do not recognize these factors and fail to pursue and adopt new pricing models will end up playing a guessing game, which will further diminish their pricing capabilities. Those insurers will quickly lose competitive edge to rivals that better understand what is driving their clients’ needs and willingness to pay—and as such are able to design more attractive propositions at lower prices or at higher margin at the same prices.

   Further, those insurers who continue to rely solely on a traditional actuarial model with a cost-based perspective and a limited set of risk differentiators will eventually end up with a larger pool of relatively riskier and less profitable clients. This will negatively impact profitability and, ultimately, market share.
13.6 PRINCIPLES OF INSURANCE PRICING AND MARKETING

The two main trade bodies for UK insurance firms have adopted a set of guiding principles for the pricing of several types of personal insurance. It’s long overdue recognition that the market has a pricing problem. Yet do these pricing principles offer the necessary commitment to drive change on a well established practice across a diverse market?

There’s been a pricing problem in UK personal insurance for several years now. It started out with discounts for new customers being funded by increase prices for existing customers – so called dual pricing. That has since evolved into something much more sophisticated. Insurers have invested huge resources into price optimisation, whereby prices are set according to how much the consumer might be willing to pay. After all, the logic goes, why offer people an introductory discount when they would have given us their business on normal rates (more here and here)

Recognising the Problem

So the publication by the two trade bodies for insurers and brokers of a set of guiding principles and action points should be good news. And it is, to an extent. Yes – it is recognition that there is a problem that needs fixing. And yes, given their roles as trade bodies, the ABI and BIBA were only ever going to present principles that reflected the minimum their members would jointly commit to. Yet for all their well manicured narrative, these pricing principles are a disappointment.

The pricing principles signal a commitment to do better, but give little substance as to how much that better will be, what it will look like or how it will be achieved. And the pricing problem that needs fixing is portrayed more as down to customer inertia than to insurer and broker behaviour. It’s almost as if the sector is saying ‘it is not our fault; they made us do it.’ That lack of reflective honesty could point to a culture that would prefer to resist change.

The Focus Remains on Insurance Firms

So while they engage as a nice piece of public relations, these pricing principles are not where attention should be focused. The spotlight must remain on the insurers and brokers who make the real, tangible pricing decisions. Those firms now have to respond, on the one hand, to the commitments made on their behalf by their trade body, and on the other hand,
to the expectations of a regulator who has made clear that each firm’s pricing strategy needs to be based around a clear set of principles.

The worst thing those insurers and brokers could do would be to rehash the ABI/BIBA pricing principles into a localised version. That would be a mistake because the ABI/BIBA principles are amorphous and unclear; more like statements of broad intent. So where should insurers and brokers look for the template upon which they can start working out their own principles?

The FCA is looking for principles that link, in a specific pricing way, with their Principles for Businesses. Those principles talk about acting with integrity, about fair treatment of consumers and about addressing conflicts of interest. So an insurer should have a principle relating to the fairness of its pricing that resonates with key audiences like investors, regulators and business partners.

**Colossal Differences in Price**

And of course, insurers also need to show how their pricing principles are being implemented. Take the current position in the UK household market. A customer who stays with their existing insurer for 5 years will, on average, pay 70% more than a new customer (more here). That’s a colossal difference. Clearly, a pricing principle that addresses fairness needs to address that scale of premium differential. Yet by how much? What does a ‘marked improvement’ mean?

And will be the impact for that insurer, on rates, on competitiveness, on profitability? Confidence in the sector (think investors, regulators and consumers) will be threatened if an unravelling of price optimisation doesn’t go well. One scenario that is more than a little possible would involve an initially subdued response by insurers to these pricing problems, followed by a more significant response being forced on the sector by a regulator. The more the sector treats these pricing problems as a public relations exercise, the more likely that scenario becomes.

These pricing principles have emerged because the sector read the regulator’s warning signs that they needed to get their pricing strategies in order. Yet will these principles be enough for the sector to gain the initiative? I doubt it – it feels too little, too late. Before insurers can offer something substantive, the regulator will take control of this pricing debate. They will present evidence of
the detriment that price optimisation can cause and draw a line from it straight to an individual on the SMCR responsibility map.

**Banned**

Consider for a minute events in the US insurance market. There, in over 20 states, price optimisation has been labelled as unfairly discriminatory and banned where based upon any of the following mechanisms:

- price elasticity of demand;
- propensity to shop for insurance;
- retention adjustment at an individual level;
- a policyholder’s propensity to ask questions or file complaints.

What this tells us is that some quite significant regulators are prepared to tackle pricing practices head on. Will the FCA be prepared to do the same? Time will tell, but what I am sure of is that they have been assembling an evidence base that gives them that option, should they wish to do so.

### 13.7 INSURANCE PRICING METHODS

The premium rates set by insurance companies involve calculation methods that incorporate the costs of insuring a person or business while generating some sort of profit in the process. Insurance pricing methods can vary in terms of the types of variables considered when determining pricing rates. Methods used may consider risk factors, probability factors and individual claims histories depending on the type of insurance involved.

**Schedule Rating Method**

Insurance pricing methods—also known as rate making—provide baseline or standard rates that form the basis for pricing individual case scenarios. Different pricing methods may rely more heavily on baseline rates when other factors like risk and claims history are involved. The schedule rating method uses baseline rates as a starting point and then factors in other variables depending on the degree of risk they carry, according to ThisMatter, a financial planning resource site. Schedule rating methods are used within the commercial property insurance industry, where factors like location, size and business purpose provide baseline indicators for determining pricing rates. Baseline indicators rely on identified risk factors found within a group or class of policyholders that have similar
characteristics such as age, sex and line of work. These indicators provide the starting points, or baseline rates, used to calculate a premium rate for individual policyholders.

**Retrospective Rating Method**

Some types of insurance provide protection against risks that are less predictable than the risks covered by other types of insurance. An example of this would be burglary insurance where the odds of predicting how often a business would be burglarized are more difficult than predicting health risks, such as heart disease or diabetes with health insurance ratings. According to ThisMatter, the retrospective rating method relies more on a policyholder’s actual claims experience when setting pricing rates as opposed to baselines, or standard pricing rates. In order to do this, a company may require premium payments be made in increments, with a portion due at the start of a policy term and the remainder due at the end of a policy term. In the case of burglary insurance, the amount of the remaining premium payment is based on whether a burglary occurred since the start of the policy period.

**Experience Rating Method**

Experience rating pricing methods rely more heavily on a policyholder’s past claim experience when determining what premium rates to charge. The types of insurance that use this method include automobile, workers compensation and general liability insurance. Price rates are determined according to a credibility factor, which uses a person’s past claim history as an indication of the level of risk involved and the likelihood that future claims will be filed. Once a risk level is determined, the credibility factor is measured against a baseline pricing rate that represents to average rate charged to a class of policyholders that have similar characteristics. Adjustments are then made to the baseline pricing rate based on each policyholder’s credibility rating.
13.8 SEVEN WAYS TO IMPROVE CLAIMS OUTCOMES:

1. Make good use of your claims data. Claims generate a lot of data – and the right technology can tell you what it means. Artificial intelligence combined with big data can help you identify:

   - Complex claims that would benefit most from early involvement and an experienced adjuster
   - Claims with high fraud potential so those can be quickly referred to an investigator
   - Claims with high litigation potential so defense counsel can immediately start building a case
   - Claims that need additional medical resources to determine if the current treatment follows best practices

2. Institute a comprehensive task-management system. There are a lot of moving parts with a claim, so diligently record everything you can within the claim file – including adjuster notes, medical diagnosis, reserves, and settlement authority. That way, everyone involved knows exactly what was done and who did it. And if an action isn’t recorded, don’t consider it done.

3. Follow the 24-hour rule. Claims that drag on cost more – and that’s particularly true with workers’ compensation claims. Any lag in response time sends a message to the injured employee that you don’t care. To increase your odds of a good outcome, aim for making initial contact within 24 hours.

4. Have a strong return-to-work program. The longer an employee stays out, the more expensive it is. Establish clear return-to-work policies and guidelines – and apply them consistently across your organization.

5. Know when to bring in outside help. Analytics can help you determine when to bring in outside help to manage work levels, add expertise, or get someone geographically closer to the situation.

6. Make vendors an integral part of your team. Vendors – including attorneys, medical professionals, auto-repair shops, contractors, medical case managers, and TPAs – are an extension of your risk management team, whether you like it or not. Strengthening vitally important relationships can balance workloads, control costs, and drive efficiency. Get to know your vendors personally, establish clear performance expectations – and hold them accountable.

7. Use dashboards extensively. A well-executed dashboard shows you everything you need to assess the health of your claims operation at a glance.
Keep your dashboard focused on the six to eight metrics you need to do your job effectively. And if the C-suite calls, you’ll be ready.

### 13.9 HEALTH INSURANCE

Health is wealth. Never have truer words been spoken. If you are healthy, you find yourself in the right frame of mind to tackle any hurdles that are thrown your way. However, just like life that has its ups and downs, your health too is not always predictable. You may make healthy choices every day, follow a good diet and exercise regularly, but may still find yourself falling sick once in a while. Situations like accidents come as a surprise and can never be planned for. Even while you are in the best of health, it is important that you visit a medical professional for regular check-ups. In any given case, it is always advantageous for you to have a health insurance plan. You may be selecting a health insurance plan through an employer or independently. Whatever the case may be, most people require some guidance on how to choose the right health insurance plan. Here are three important things to consider before you pick a health insurance plan.

1. **Financial Stability**

   When it comes to healthcare, the costs are rising. A health insurance plan or a mediclaim policy offers you some degree of financial protection. One of the perks of a health insurance plan is that most plans offer a tax-savings incentive. However, do not make tax savings the sole objective when you purchase a health/medical insurance plan. A detailed health plan is the best route to achieving financial stability in the long run. A medical emergency can quickly escalate into a financial crisis if you do not have health insurance. If you or an earning member of your family falls ill, it becomes a double whammy. This is because the ill individual requires funds for healthcare while losing the ability to earn an income. Almost nobody can be productive while they are sick. Having a health insurance plan is like paying a small price for long-term fiscal benefits.

2. **An Employers Plan**

   Receiving a health insurance plan through your employer is a wavering situation. There might be instances where the medical insurance your employer offers is optimal. However if you are self-employed, then an employer’s health insurance plan is not even a consideration. Once you retire, an employer may not continue to provide you with health insurance. If you have a family, your employer’s plan may not cover the insurance expense for all your family members. You need to do some research here about what the best way forward is while considering a health insurance plan through an employer. Simply tagging along with your employer’s health insurance plan in
India may not be the best decision for you. Make an educated decision about whether to pursue a health insurance plan through your employer or not.

3. **Premium**

Often while considering health insurance plans, the tendency is to look at just the monthly premiums. However, a monthly premium could turn out to be the least of your costs. A co-payment could be a major expense. A co-payment is the amount that you will pay out of pocket before the insurance covers costs. Here is where you want to make a practical decision regarding how high or low a health insurance premium you can afford. Simply comparing premiums could be misleading. Based on your budget, you want to find a fine balance between out of pocket expenses and your health insurance plan premium.

When it comes to your health, the stakes are high. You want a holistic health insurance plan. Hence, you should pick a plan only after you carefully think over all aspects of the health insurance plan in question. Do not get befuddled by the unfamiliar terminologies or diversity of mediclaim policies available. The great news is that HDFC Life offers a set of health insurance plans that are tailored to your needs. Just think of the aforementioned simple considerations and you are on the correct path to picking the right health insurance plan for yourself and your family. Once you are insured, you can have a sense of security and lay any uncertainties to rest. Having a health insurance plan is a good boost to having peace of mind.

4. **Tax Benefits with health insurance plan**

Yes, you may be eligible for tax benefits under section 80D of the Income Tax Act 1961. Please note that the above mentioned benefits are as per the current tax laws. Your tax benefits may change if the tax laws are changed. It is advisable to re-confirm the same with your tax consultant.

5. **Can I Nominate or Assign**

As per Section 39 of the Insurance Act, 1938, you can nominate a person to receive the benefits under this health insurance policy. During your lifetime and while your policy is in force, you may at any time, by written notice to us, designate any person or persons as a nominee to whom we shall pay benefits under this health insurance policy upon your unfortunate death. In case the nominee so named is a minor, then the policyholder is required to name an appointee (other than himself) for the minor nominee. Assignment shall be subject to Section 38 of the Insurance Act 1938.

6. **How can I pay the Health Insurance Premium**

You can pay your health insurance/mediclaim policy premiums online via:

- Net banking
- Credit card/ Debit card
- Debit Card with PIN
- SI on card
13.10 Terminologies

13.11 Model Questions
1. Explain the Claim Management?
2. Bring out the types of documents needed in the claims?
3. Explain the Causa Proxima in insurance claim settlement?
4. Explain the Insurance pricing and marketing?
5. Explain the health Insurance?

13.12 Reference Books
UNIT -XIV FINANCIAL MANAGEMENT IN INSURANCE COMPANIES AND INSURANCE OMBUDSMAN

14.1 Introduction
14.2 Importance of financial management in Insurance companies
14.3 Tools managing expenses in the Insurance companies
14.4 Modes used by the Insurance companies in channelizing their funds
14.5 Reinsurance
14.6 Areas of the application of Reinsurance
14.7 Information Technology in Insurance
14.8 Application of information technology in the Insurance Sector
14.9 Role of Insurance companies in Insurance Security
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14.13 Reference Books

14.1 INTRODUCTION

If you are not satisfied with the grievance redressal mechanism of your insurer or bank, you can lodge a complaint with the relevant ombudsman. And for property related issues, you can approach the Real Estate Regulatory Authority that comes under the purview of the real estate Act.

ET Wealth lists the step by step process of how you can file a complaint with a banking ombudsman, insurance ombudsman, and the Real Estate Regulatory Authority.

1. Banking Ombudsman

Approach bank first and allow them a period of 30 days to respond

- If the bank does not respond or fails to meet your expectations, approach the banking ombudsman (BO) office under whose ambit your case falls. Now you can do so through cms.rbi.org.in.
- Do not delay escalation beyond a year of having received the bank's response or a year and a month of having filed the complaint.
- You can file a written complaint after downloading the form available on the Banking Ombudsman portal (https://bankingombudsman.rbi.org.in), along with relevant documents.
- You can also take the online route to register your grievance (https://secweb.rbi.org.in/BO/precompltindex.htm).
- The BO will either facilitate a settlement through conciliation or pass an award.
- If ombudsman fails to meet expectations, approach the appellate authority.

2. Insurance Ombudsman

Insurer should be first port of call; do not approach ombudsman offices directly. The complaint should be in writing with supporting documents.
• If insurer fails to respond or response is unsatisfactory, escalate the complaint through Irdai’s integrated grievance management system (igms.irda.gov.in)
• You can also approach ombudsman under whose jurisdiction your case falls
• If you feel let down by ombudsman too, approach consumer courts

3. Real Estate Regulatory Authority (RERA)
Log on to the RERA authority's website and register as a complainant

• You will need to provide details like email ID and mobile number
• Go to Accounts >> My Profile and enter the details asked for
• Click on 'Complaint Details' tab and choose 'Add New Complaints'
• Provide details asked for, including project's registration numbers, and the respondent's antecedents
• Upload the relevant project-related documents and share the facts of your case
• Specify the nature of relief you are seeking, explaining the grounds and the relevant legal provisions
• Make a declaration of having provided accurate information and pay the requisite fees online
• RERA adjudicating officer will hear the case and issue an order
• If you are dissatisfied, you can approach the appellate tribunal within 60 days from receipt of the order; next stop is the High Court.

14.2 IMPORTANCE OF FINANCIAL MANAGEMENT IN INSURANCE COMPANIES

• It's important to have business insurance because the financial consequences of a potential mishap could easily wipe out the assets of a small business. Insurance provides protection in case customers or passersby experience harm at the hands of your company, or if your company is harmed by an incident such as a fire.

• In addition to protecting yourself, it's also important to have business insurance so you can protect others. If you own a food business and a customer becomes ill after eating one of your products or if you own a delivery business and one of your vehicles hits a pedestrian, you need to be able to pay for the damage you've caused.

14.3 TOOLS OF MANAGING EXPENSES IN THE INSURANCE COMPANIES
The Insurance Regulatory and Development Authority of India (Irdai) has brought out a new set of norms on expenses of management for general
insurance and standalone health insurance companies, based on the line of business. These take effect from this financial year.

In the segments of motor, health retail and miscellaneous retail (like public liability), the expenses allowed are higher. There would be penalties if the expense limits are exceeded.

Expenses of management would include all those in the nature of operating expenses — commission, brokerage, remuneration to agents and to intermediaries, charged to the revenue account.

No general insurance or health insurance business can exceed the amount stipulated. In motor insurance, the allowable expense is 37.5 per cent of gross premium for the first Rs 500 crore. It is 32.5 per cent for the next Rs 250 crore and 30 per cent for the balance.

Any violation of the limits on an overall basis could even lead to restriction on performance incentives for the managing director, chief executive officer, wholetime directors and key management. Also, possible restrictions on opening of new places of business and removal of managerial personnel and/or appointment of administrator.

Irdai said it may also direct the insurer to not underwrite new business in one or more segments in case of persistent violation of these regulations. It has also asked insurers to ensure that at the segment level, the deviation between actual incurred claim ratio and that projected at the time of filing of a product be not more than 10 per cent.

If there be a deviation higher than this over a period of three years, an exception report and a plan of action, specifying the reasons, has to be sent to it.

14.4 MODES USED BY THE INSURANCE COMPANIES IN CHANNELIZING THEIR FUNDS

When you purchase life insurance, you agree to pay a specific sum of money, or premium, to the insurance provider at regular intervals. The frequency or period of your payments depends on your mode of premium. Most insurance providers offer several modes of premium, the most common of which come annually, semi-annually, quarterly or monthly.

Determining Mode of Premium

The mode of premium payment is not the same as your mode of payment. Your mode of premium payment determines the frequency with which
payments are made. It also determines the way in which you make payments, such as by cash, check, credit card or another option.

Policyholders select their mode of premium when they sign their policy. It is common practice to make your first premium payment to activate the coverage on your policy. The insurance agent should highlight the possible frequency of premium payments before you sign your policy.

Many insurers allow policyholders to change the mode of premium to a higher or lower frequency during the life of the policy. Dates of change normally coincide with pre-existing payment dates, meaning if you want to change from a semi-annual to a monthly premium, then you will likely make your first monthly payment on the date of your next scheduled semi-annual payment. The payment schedule would switch to monthly from that point forward.

Why Mode of Premium Matters

As a general rule, more frequent modes of premium payments tend to cost less per payment. However, more frequent payments also tend to cost more in total. For instance, an insurer might charge you $150 per month, $400 per quarter, $700 per semi-annual payment or $1,250 per year for your policy. The up-front costs of the annual payment are much higher than the others, but it is actually the cheapest mode for an entire year's worth of coverage. The monthly, quarterly and semi-annual modes would cost $1,800, $1,600 or $1,400 per year, respectively, versus the $1,250 annual payment.

The reason more frequent payment modes tend to cost more is that insurance companies need to offset the uncertainty and higher collection costs. Imagine you are the insurance provider. You are very likely to place added value on receiving a full year's worth of payments up front, because this means you have to worry about fewer late or missing payments in the future. Higher payments improve cash flow right away and make it easier to predict your future financial status. You can also use the extra money to make larger, earlier investments.

Think of modes of payments like the payments on a loan. In a loan scenario, borrowers who take a long time to pay back their principal usually end up paying more in interest. Similarly, the longer it takes a policyholder to pay the full cost of his annual life insurance coverage, the more it costs. Life insurance is not a debt and policyholders are not borrowers, but the relationships between time and cost of payment are comparable. Some insurance providers even offer an annual percentage rate (APR) calculator on their website to see how mode of premium payment influences the final cost.
Picking Your Mode of Premium
To secure the lowest overall cost for your life insurance, pick a less frequent mode of premium payment. Ignoring other considerations, the annual costs of less frequent payment modes are often substantially discounted, compared to more frequent modes.

Do not forget to consider two factors: opportunity costs and liquidity. Your liquidity is the amount of cash you have ready to make premium payments. If you only have $50 in the bank, it is probably unwise to choose a $1,250 annual premium payment option.

Even if you have the money for an annual payment, the opportunity cost of choosing a $1,250 annual payment over a $150 monthly payment is everything else you could have done with $1,100 in the short term. It may be possible to invest that money and earn more than the added cost of the monthly payment option.

Another consideration is that, if you terminate your policy early, many insurance providers do not refund portions of premiums already paid. Suppose you purchase life insurance and pay an annual premium on Jan. 10. Unfortunately, your insurable interests change midyear, and you decide to terminate your contract on July 10. Even though you only used 50% of your annual coverage, your insurance provider does not have to refund you the remaining 50%.

14.5 RE INSURANCE
Reinsurance is a form of insurance purchased by insurance companies in order to mitigate risk. Essentially, reinsurance can limit the amount of loss an insurer can potentially suffer. In other words, it protects insurance companies from financial ruin, thereby protecting the companies' customers from uncovered losses.

Reinsurance in the insurance sector
- Reinsurance occurs when multiple insurance companies share risk by purchasing insurance policies from other insurers to limit their own total loss in case of disaster.
- By spreading risk, an insurance company takes on clients whose coverage would be too great of a burden for the single insurance company to handle alone.
- Premiums paid by the insured is typically shared by all of the insurance companies involved.
- U.S. regulations require reinsurers to be financially solvent so they can meet their obligations to ceding insure.
14. 6 AREAS OF THE APPLICATION OF REINSURANCE

Reinsurance in Fire Insurance Business
The surplus treaty is most widely used. Quota share treaties are used by the newly established companies or with regard to the new business of established companies.
The service of facultative reinsurance is also occasionally utilized, particularly with regard to bigger risks, where

Excess of loss treaties is utilized for catastrophe risks or where there is a possibility of accumulation of risks leading to conflagration fire, or where fire policies provide additional covers such as cyclone, hurricane flood etc.

Reinsurance in Marine and Aviation Insurance Business
Quota share and surplus are quite common even though the facultative method is still very widely used.
Excess of loss and stop loss arrangements are also made in catastrophe hazards, such as general average, the total loss to hull etc.

Reinsurance in Accident Insurance Business
All types of treaties are commonly used.
In cases of hazardous elements or where accumulation and catastrophe are apprehended or in cases of liability insurances, an excess of loss or stop loss is most favored. Pools are considered in special types of risks, such as crop insurance.

The facultative method is not much used unless the business is beyond the absorption capacity of the treaty.

The facultative method is also used when the ceding company does not wish to interest the treaties for some obvious reasons.

Reinsurance in Life Insurance Business
The most commonly used type is the surplus treaty. The facultative cover is also still in use although in a very limited degree.
Pools are used for various types of impaired lives, such as lives suffering from heart disease, blood pressure, diabetes etc.

14.7 INFORMATION TECHNOLOGY IN INSURANCE
Information technology has impacted our lives and businesses. Insurance is no different. If we have to assess the scope of technology in this business, we need to understand its impact across the value chain.

Every business is dependent on customers. Satisfying their needs through products and services is their main objective. Insurers are better positioned today by using technology for lead generation, requirement gathering/analysis, specific targeting based on sagacity segmentation, and fulfilment through paperless, online purchase process. Customers are able to buy insurance
suiting to their requirements with tremendous ease and convenience using technology.

The purchase decision above is highly influenced by the knowledge customers are gathering from the internet. Online comparison engines are offering wide array of options and are enriching customers with requisite knowledge. Hence, taking a decision even for a complex product like insurance has become quiet easy.

Policy issuance and management has become very convenient with technology has enabled insurers to issue policies on a real-time basis. Claims management has also been impacted with technological advancements like e-filling, online upload of documents, approval controls internally with technology based work-flow models and transfer of claim proceeds online using internet banking. It is uncommon now to get your claim amount by any other means than a wire transfer.

Technology has helped insurers achieve operational efficiency in every aspect of the value chain.

Insurance business is highly data centric. It captures huge amount of data at various stages in the value chain. Technology is going to play a dominant role in data analytics to provide a competitive advantage for business. Please also refer my blog on “insurtech and broking” for more details.

14.8 APPLICATION OF INFORMATION TECHNOLOGY IN THE INSURANCE SECTOR

Life Insurance Applications

(a) Life Administration Module: Policy Servicing of existing policies: The existing policyholders may require various services after taking the insurance policy. For example: Change of Nominee, Change of address, of change in mode of payment, assignment of the policy, Claims payment etc. These changes or payment can be made very easily through computers.

New Business: As and when the new business is acquired the initial data of a policyholder is quite large and as stated above the data is to be maintained for a longer period therefore storage of data in computer is useful. Renewal notice/Billing: Renewal notices to be sent for the payment of the premium and with a no. of policyholders are very large and the renewal is on different dates. The computer generates the renewal notice at very high speed and does it automatically. The inter-mediatary bills are generated very fast and quickly.

Loans: The Policyholders do take loans and the insurer has to maintain the records as the insurer has to recover the loan from the policyholder along with the interest. The recovery of loan may be regular or recovery at the time of payment of claim.

(b) Statistics and MIS Claims: As the data in computer can be stored for longer period the data may be useful for the insurer to prepare the type of policies are
sold in the market and type of claim arisen in the particular region. These types of data will be useful for management to take any decision.

(c) Archiving of historical data and imaging Systems: As the past data is available with life insurer therefore they can design the new products and price them accordingly.

**General Insurance Applications**

a) **Front Office System**

Policy Management and underwriting system

Co-insurance  Reinsurance

Claims Management System

Financial’ Accounts and Audit

Statistics and MIS

b) **Reinsurance System**

Inward insurance

Outward Insurance

Reinsurance Account MIS.

c) **Risk Management System**

Other Applications

a) Investment

Term Loan ..

Money market .

Investment Accounts .

Market Operations

(b) Personnel System.

Payroll system

Performance Appraisals

Attendance and leave system
(C) Office Services

Purchases

Inventory

Tours and Travels etc

Corporate Accounting System

**General Insurance Applications.**
Let us discuss about Front Office System In the General Insurance Industry. These applications can be written in any language and they may differ from Office to Office of The different Insurance Companies. The software namely GENESIS~ is being used by General Insurance Companies. On-line Front Office System is the first step towards computerization of any insurance Company and a welldesigned system at the front offices has following advantages to the company.

To carry out business transactions efficiently.

Easy to handle growing volume of business and variety of business Efficient customer services.

Reduction in office expenses z MIS for the Branch Managers . A good Front Office System should allow Insurer, Underwriters, and agents to manage the day to day operations of the office. The system should be capable of administering all stages of policy development from questions to new business, through adjustments by way of endorsements and renewals of policies. Coinsurance, Claims re-insurance and all accounting functions. The main components of the Front office System are given below: ¾ Policy Management including Underwriting (Policy acceptance and printing and customer services) ¾ co-insurance ¾ Re-insurance ¾ Claims. ¾ Statistics & MIS ¾ Accounts

**14.9 ROLE OF INSURANCE COMPANIES IN INSURANCE SECURITY**

*Insurance companies* are a special type of financial institution that deals in the business of managing risk. A corporation periodically gives them money and, in return, they promise to pay for the losses the corporation incurs if some unfortunate event occurs, causing damage to the well-being of the organization.

Here are a few terms you need to know when considering insurance companies:
• **Deductible:** The amount that the insured must pay before the insurer will pay anything

• **Premium:** The periodic payments the insured makes to ensure coverage

• **Co-pay:** An expense that the insured pays when sharing the cost with the insurer

• **Indemnify:** A promise to compensate one for losses experienced

• **Claim:** The act of reporting an insurable incident to request that the insurer pay for coverage

• **Benefits:** The money the insured receives from the insurance company when something goes wrong

### 14.10 CONTOURS OF THE FUTURE OF INSURANCE IN RURAL AREAS

The rural market in India, constituting 742 million people, is by far the largest potential market in the world. The annual rural household income of Rs 56,630 (as per NCAER, IMDR 2002) coupled with changing rural aspirations in consumption patterns and lifestyles unfolds tremendous opportunities for rural marketing. However, some of the issues that seem to be hindering large-scale advent in the rural markets are lack of understanding of rural customer, inadequate data on rural markets, poor infrastructure, low levels of literacy and poor reach of mass media.

The insurance sector, per se, also did not make much headway in the rural sector. The insurance market in India, liberalised in 2000 with the advent of private insurance companies in November 2000 has not expanded in real terms beyond the urban domain. The penetration of insurance in India is pitifully low and if we aim for the modest target of insurance premium becoming 5% of GDP, insurance companies need to look at newer market segments rather than fight for a share in the same pie.

There exists a vast potential in the rural areas where more than 70% of our population lives. But it is common perception and belief amongst the insurance companies that it is expensive to do business in rural areas. Most
companies are focusing only on meeting regulatory requirements from rural areas and don't see them as commercially viable rural business opportunities, waiting to be exploited.

14.11 TERMINOLOGIES

1) Ombudsman 2) Financial management 3) Reinsurance
4) Information Technology 5) Security 6) Rural area

14.12 MODEL QUESTIONS

1. Explain the importance of financial management in insurance companies?
2. Explain the role of managing expenses in the insurance companies?
3. State the insurance companies in channelizing their funds?
4. Bring out the areas of the application of reinsurance?
5. Explain the contours of the future of insurance in rural areas?

14.13 REFERENCE BOOKS

1. Define Banking.
2. What is Recurring deposit?
3. Define Conversion.
4. What is Executor?
5. Define Insurance.
6. What is Non-Life Insurance?
7. What is Product Design?
8. Define Underwriter.
9. What is Claims Management?
10. Define Reinsurance

PART – B (5x5=25)
Answer All the Questions

11. a. Explain the Relationship between Banker and Customer?
   (or)
   b. State the Entries Favorable to the Customer.
12. a. Bring out the Payment in due course?
   (or)
   b. Explain the Basis of negligence?
13. a. Explain the Subsidiary Services?
   (or)
   b. What is Significance of insurance and risk.
14. a. Explain the importance of the Privatization of Insurance industry
   (or)
   b. Bring out the Framework for IRDA.
15. a. Explain the role of riders in insurance policies?
   (or)
   b. Explain the need for insurance underwriting.

PART – (3x10=30)
Answer any THREE Questions

16. Explain the Circumstances under which a cheque can be dishonored?
17. Discuss the role of financial reporting in managing insurance operations.
18. Explain the critical aspects of aviation industry in the country.
19. Explain the product development in the life and Non-life insurance sectors in India.
20. What is Ombudsman? Explain the importance of financial management in Insurance Companies.