Auditing Course Material

Part 3 of 61 (Chapters 201-300)

14. Stock Exchange

A stock exchange is a regulated marketplace where financial instruments such as stocks, bonds, commodities, and derivatives are bought and sold. It serves as a platform that facilitates the trading of securities between buyers and sellers. The primary function of a stock exchange is to provide liquidity and a transparent pricing mechanism for these financial instruments.

The **On-line Trading System** is buying and selling assets, through a brokerage, internet based proprietary trading platform. BSE's BOLT (Bombay OnLine Trading) and NSE's NEAT (National Exchange for Automated Trading) are the examples of on-line trading system. It is also known as e-trading or self-directed investing.

The stock exchanges are managed by the Board of Directors (BOD) or Council of Management consisting of elected brokers and representatives of Government and Public, appointed by the SEBI. **Bombay Stock Exchange (BSE)**, set up in 1875 and **National Stock Exchange (NSE)**, set up in 1992, are the prominent stock exchanges of India.

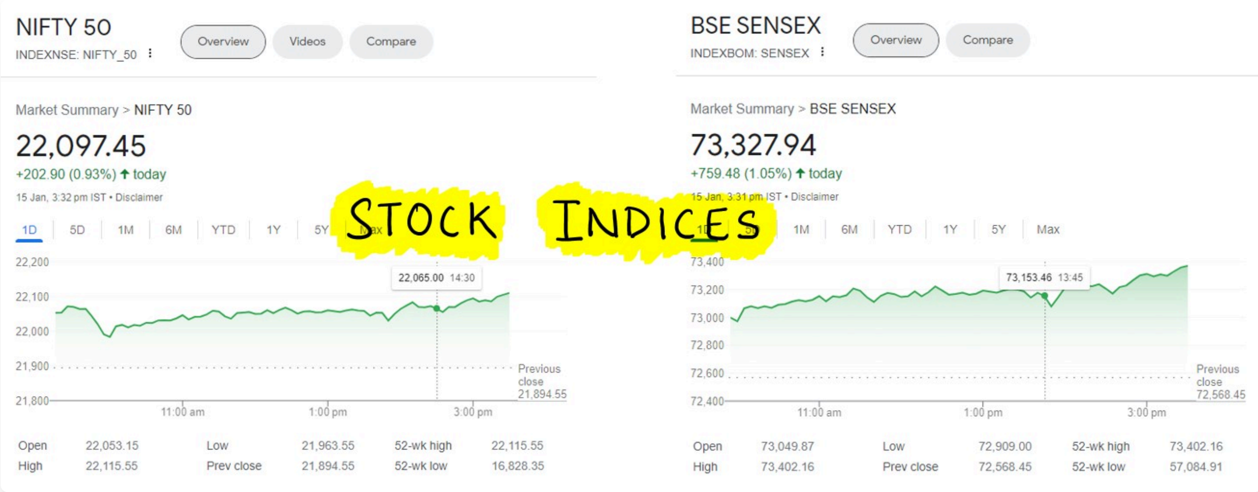
The **Metropolitan Stock Exchange**, MSE (formerly known as MCX Stock Exchange Limited) was recognized by SEBI in 2008. The NSE IFSC Limited (NSE International Exchange) started in 2017, is a fully owned subsidiary company of NSE. It is located at the International Financial Services Centre (IFSC), Gujarat International Finance Tec-City (GIFT), near Gandhinagar, Gujarat. The **India International Exchange Limited** (India INX) was also set up in 2017 at IFSC, GIFT City in Gujarat. It is a subsidiary of BSE. Operating on an advanced technology platform of EUREX T7, the Exchange is fastest in the world with a turn-around time of 4 micro seconds.

The **Inter-Connected Stock Exchange (ISE)** was a national level stock exchange that started its operations in the year 1998. The ISE was promoted by around 15 regional stock exchanges with a main objective of increasing the liquidity of the shares listed on them. It was de-recognised in 2014.

The **Over The Counter Exchange Of India (OTCEI)** was India's first stock exchange for small companies, founded in 1990. It was de-recognised by SEBI in 2015.

In July 2019, the Government proposed a **Social Stock Exchange** for social enterprises and voluntary organisations, working for social welfare, to help them raise capital through debt, equity and mutual fund. In Sep 2019, the SEBI constituted a working group on Social Stock Exchanges (SSE) under the chairmanship of Ishaat Hussain, Director, SBI Foundation.

14. Stock Exchange



It is a statistical measure, which shows changes taking place in the stock market. To create an index, a few similar kinds of stocks are chosen, amongst the securities already listed on exchange, and are grouped together. These indices act as barometers of stock market and reflect the movement in the same.

The popular indices in India are:

- BSE Sensex (30 companies)
- BSE 200 (200 companies)
- NSE S&P CNX Nifty (50 companies)- renamed as Nifty 50 since 2015.
- NSE CNX 100 (100 Companies)

These are broad based indices comprising of stocks of companies from across sectors. There are also sector specific indices (Nifty Bank, Nifty Auto, etc.) and special indices (based on Midcap, Small-cap companies). The indices are based on free float market capitalization of constituent stocks.

NASDAQ (USA), Dow Jones (USA), S&P 500 (USA), FTSE (London), HKSE (Hongkong), NIKKEI (Japan), DAX (Frankfurt Stock Exchange) are some examples of international stock indices.

14. Stock Exchange

Depositories such as NSDL (National Securities Depository Limited) and CDSL (Central Depository Services Limited) are institutions that hold investors' securities—like shares, debentures, government securities, ETFs, and mutual fund units—in electronic or "demat" form, replacing the old system of physical share certificates.

They function very similar to banks, but instead of handling money, they handle securities. Depositories ensure safe storage, quick transfer, and smooth settlement of trades carried out on stock exchanges.

NSDL, established in 1996, is India's first and largest depository and is closely associated with NSE, while CDSL, established in 1999, is the second depository and primarily linked with BSE. Both operate nationwide through Depository Participants (DPs) like banks, brokers, and financial institutions, who act as intermediaries between the investor and the depository.

By digitizing securities, they eliminate risks like theft, loss, forgery, and delays, and make India's trading and settlement system efficient, transparent, and secure.

14. Stock Exchange

Demat Account is the account that should be started by an investor to buy or sell shares in the stock market. One of the most impactful reform measures in the stock market was the introduction of dematerialization. Simply put, **Dematerialization** is the practice of keeping and delivering share certificates to investors in electronic form rather than in physical form, like a documented printed paper.

For the introduction of dematerialization, there should be an institution or organization, who should keep the share certificates in electronic form. That institution is called Depository. A **Depository** is an organisation which holds securities (like shares, debentures, bonds, government securities, mutual fund units etc.) of investors in electronic form at the request of the investors through a registered Depository Participant. It also provides services related to transactions in securities. At present, there are two depositories, viz. **National Securities Depository Limited (NSDL)** and **Central Depository Services Limited (CDSL)** are registered with SEBI.

The depositories don't directly interact with the customers who purchase and sell the shares. Rather, they provide their services, like keeping of share certificates in electronic forms through another set of institutions called **Depository Participants (DP)**. A DP is an agent of the depository. It is through this agent that the depository interfaces with the investor and provides depository services. Depository participant functions are provided by diverse institutions recognised by the SEBI. Public financial institutions, scheduled commercial banks, foreign banks operating in India with the approval of the Reserve Bank of India, state financial corporations, custodians, stock-brokers, clearing corporations /clearing houses, NBFCs and Registrar to an Issue or Share Transfer Agent, complying with the requirements prescribed by SEBI, can be registered as DP.

14. Stock Exchange

Stock brokers are individuals or entities registered with stock exchanges and securities regulatory authorities. They act as intermediaries between buyers and sellers in financial markets. Stock brokers facilitate the buying and selling of stocks, bonds, commodities, and other financial instruments on behalf of their clients. They can be individuals, firms, or online platforms that execute trades on behalf of investors. Stock brokers earn commissions or fees for their services and play a crucial role in providing liquidity and efficiency to financial markets.

Sub-Brokers

Sub-brokers are individuals or entities who are registered with a stockbroker to act on their behalf. They operate as intermediaries but work under the authorization and supervision of a registered stock broker. Sub-brokers cannot directly interact with stock exchanges; instead, they execute trades through their affiliated stock broker. They assist clients in trading securities and provide advisory services. Sub-brokers may have a client base of their own and often operate in specific geographic areas. Their compensation is generally a share of the commission earned by the main stock broker for whom they work.

14. Stock Exchange

A **Corporate Action** is any decision or event initiated by a company that brings a change in its **capital structure**, **operations**, or **financial position**, and directly affects its shareholders. These actions are approved by the company's board of directors and often require shareholder approval as well. Corporate actions can influence the company's share price, number of shares, or the value received by shareholders.

Types of Corporate Actions

Corporate actions are generally classified into **three categories**:

1. **Mandatory Corporate Actions**
2. **Mandatory-with-Choice Corporate Actions**
3. **Voluntary Corporate Actions**

Below are all major types of corporate actions explained in simple language:

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1. Dividend

A portion of the company's profit distributed to shareholders.
It can be in the form of:

- **Cash Dividend** (paid in money)
- **Stock Dividend** (paid as additional shares)

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2. Bonus Issue

Free shares given to existing shareholders by converting reserves into share capital.
Increases the number of shares held but not the total investment value initially.

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3. Rights Issue

Company offers new shares to existing shareholders at a discount in proportion to their existing shareholding.
Shareholders can subscribe, ignore, or sell their rights.

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4. Stock Split

The face value of each share is reduced and the number of shares increases (e.g., 1 share of ₹100 → 5 shares of ₹20).
Makes the share more affordable and increases liquidity.

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5. Reverse Stock Split (Consolidation)

Face value increases and number of shares decreases (e.g., 10 shares of ₹10 → 1 share of ₹100).
Used to boost the market price or meet listing norms.

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6. Buyback of Shares

Company repurchases its own shares from the market or shareholders.
Reduces number of shares and increases EPS, often boosting share price.

7. Mergers and Acquisitions

- **Merger:** Two companies combine to form one entity
- **Acquisition:** One company takes over another
  Affects ownership, valuation, and shareholding pattern.

8. Spin-off / Demerger

A company separates one of its divisions into a new independent company.
Shareholders receive shares of both companies.

9. Bonus Debentures

Free debentures issued instead of dividends, typically interest-bearing and redeemable.

10. Amalgamation

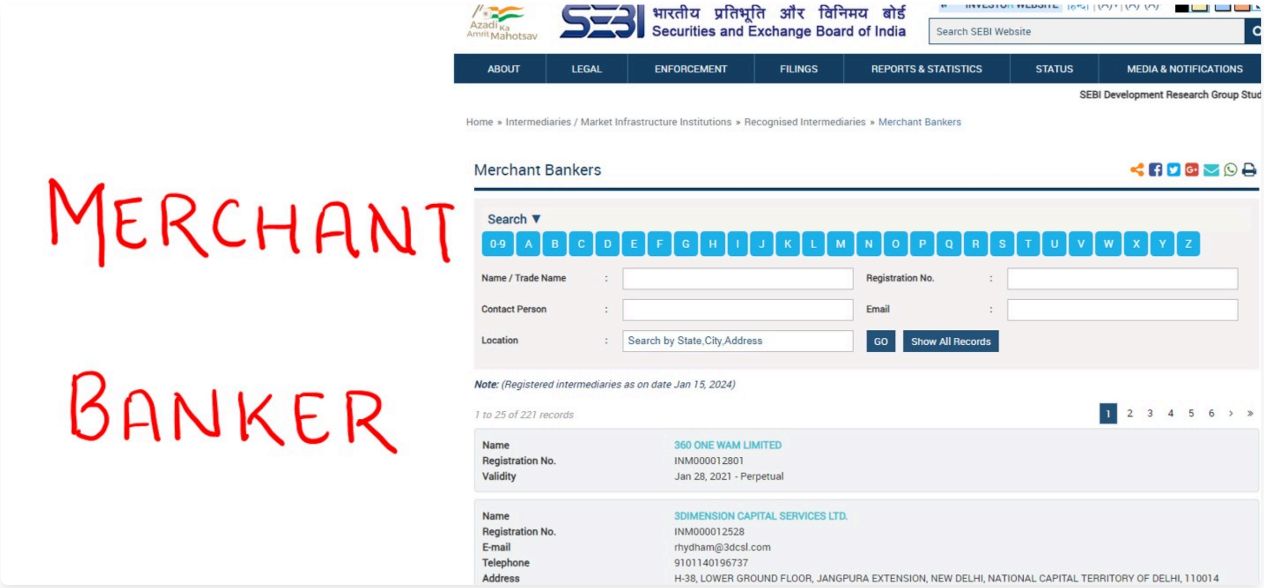
Combination of multiple companies into one, often for efficiency or expansion.

15. Financial Intermediaries

Intermediaries, within the context of the financial system, play a crucial role as service providers, forming an integral component of the overall framework. These entities facilitate the smooth functioning of financial transactions and services. In both the primary and secondary markets, the Securities and Exchange Board of India (SEBI) holds the responsibility of regulating these intermediaries. Through its comprehensive regulations, SEBI ensures that intermediaries operating within these markets adhere to established guidelines, promoting transparency, accountability, and the overall integrity of the financial ecosystem.

Various parties involved are discussed next.

15. Financial Intermediaries



A merchant banker is a financial institution or individual specializing in capital market activities and corporate finance. They assist businesses in raising capital through services such as underwriting, advisory, and project financing.

Merchant bankers also play a crucial role in managing the issuance of securities, ensuring compliance with regulatory requirements, and conducting market research.

They provide expertise in risk management, advising on financial risks associated with operations.

Additionally, merchant bankers may offer post-issuance services, including investor relations and compliance assistance.

These professionals contribute significantly to shaping financial strategies, facilitating transactions, and supporting clients in navigating complex financial markets.

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15. Financial Intermediaries

A Banker to an Issue refers to a scheduled bank engaged in specific activities related to the issuance of securities. These activities include:

Acceptance of Application and Application Monies: The banker facilitates the process of receiving applications from investors interested in subscribing to the securities being issued. It also collects the application monies accompanying the applications.

Acceptance of Allotment or Call Monies: Upon the allotment of securities, the banker is involved in accepting allotment or call monies from investors. This step is crucial in completing the transaction and ensuring that investors fulfill their financial commitments.

Refund of Application Monies: In cases where the application is not fully or conditionally accepted, the banker is responsible for refunding the application monies to the investors. This process is conducted in accordance with regulatory requirements.

Payment of Dividend or Interest Warrants: The banker plays a role in the distribution of dividend or interest warrants to the investors. This involves the timely and accurate payment of dividends or interest earned on the securities issued.

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15. Financial Intermediaries

Registrars to an Issue and Share Transfer Agents are pivotal intermediaries in the primary market, specializing in services crucial for new capital mobilization.

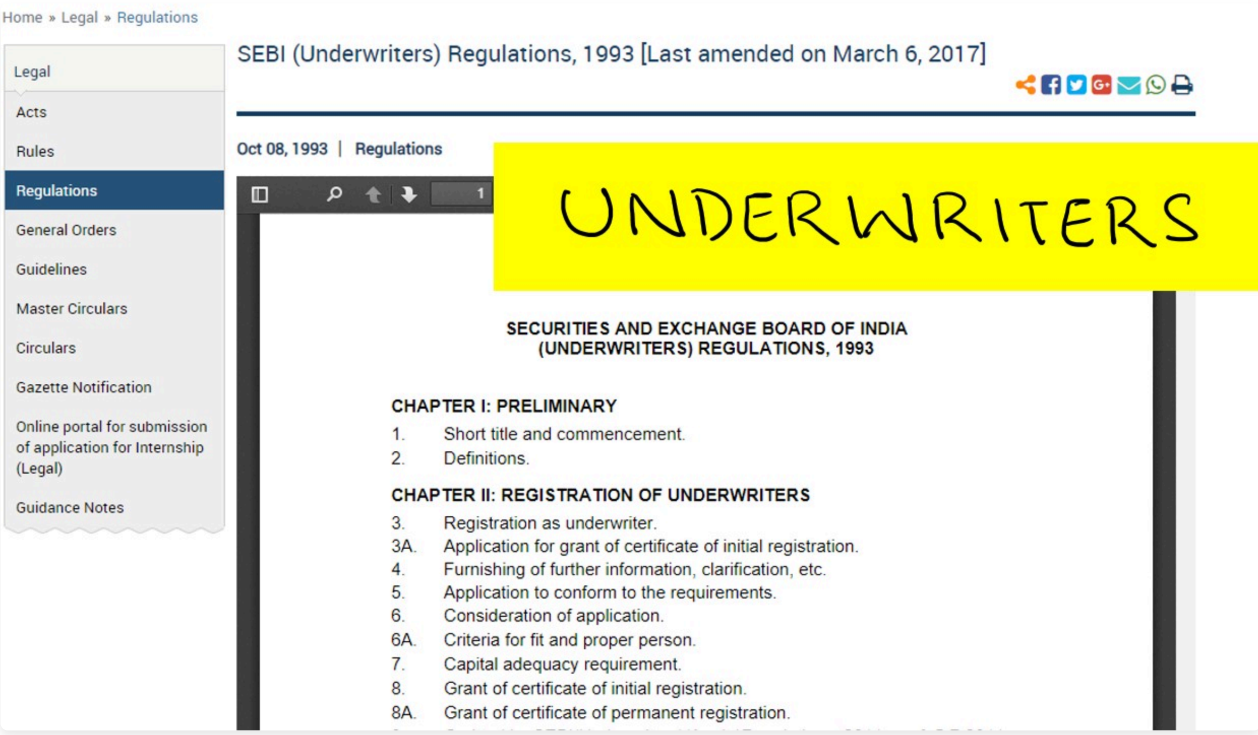
Their responsibilities encompass maintaining precise records of investor details during securities issuances, such as IPOs and rights issues. Registrars play a key role in determining the basis for allotment, ensuring a fair and transparent process in accordance with SEBI regulations.

They facilitate the allotment of securities, ensuring adherence to predefined criteria. Additionally, in collaboration with Share Transfer Agents, they manage the smooth transfer of shares between investors, updating the company's share register.

Registrars also handle dividend distribution and communicate essential information to investors, contributing to transparency and investor confidence.

Their paramount role lies in ensuring compliance with regulatory standards, safeguarding the interests of both issuers and investors.

15. Financial Intermediaries



Underwriters play a crucial role in the capital-raising process by providing assurance to subscribe to the unsubscribed portion of securities up to a specified limit. In the context of underwriting, certain parties commit to taking up shares, debentures, or other securities to a predetermined extent if public subscription falls short of anticipated levels.

This arrangement involves a formal agreement between the issuing company and the underwriting party, which can be a financial institution, bank, merchant banker, broker, or any other entity.

The underwriter's commitment helps mitigate the risk for the issuing company, ensuring a successful issuance by guaranteeing the absorption of any remaining securities in the market.

16. Key Terms on Valuation

⭐ 1. Face Value (FV)

Face Value is the nominal or original value of a share as decided by the company at the time of issuance.
It remains constant and is used for calculating dividends, interest on bonds, and stock splits.
It does **not** affect the market price, but it is important for accounting and regulatory purposes.

⭐ 2. Market Price (MP)

Market Price is the current trading price of a share in the stock market.
It constantly changes based on demand–supply forces, news, results, and investor sentiment.
This is the price at which investors buy or sell shares in the secondary market.

⭐ 3. Book Value (BV)

Book Value represents the net worth of a company as recorded in its financial statements.
It is the value of total assets minus total liabilities, divided by the number of shares.
If a stock trades far above its book value, the market expects strong future performance.

⭐ 4. Intrinsic Value

Intrinsic Value is the “true value” of a stock based on fundamentals rather than market fluctuations.
It is calculated using future earnings, cash flows, and growth potential.
Value investors buy stocks when market price is below intrinsic value.

⭐ 5. P/E Ratio (Price-to-Earnings Ratio)

P/E Ratio measures how much investors are willing to pay for ₹1 of company earnings.
A high P/E means the stock is expensive or expected to grow fast.
A low P/E indicates undervaluation or weak growth expectations.

⭐ 6. EPS (Earnings Per Share)

EPS shows how much profit the company earns for each outstanding share.
It is a key indicator of financial performance and helps evaluate profitability.
Higher EPS usually leads to stronger investor confidence and higher share prices.

⭐ 7. Dividend

A dividend is a portion of profits distributed to shareholders as a reward for investing.
It may be issued in cash or shares, depending on the company’s policy.
Companies with stable earnings, especially in mature industries, pay regular dividends.

⭐ 8. Dividend Yield

Dividend Yield shows how much return an investor earns from dividends relative to the market price.
High dividend yield stocks are preferred by conservative, income-focused investors.

Yield changes when the stock price moves up or down.

⭐ 9. Dividend Payout Ratio

This ratio measures what percentage of profits is distributed as dividends.
A high payout means the company is rewarding shareholders generously but reinvesting less.
Low payout companies retain earnings for expansion and growth.

⭐ 10. Market Capitalization

Market Cap is the total market value of a company, calculated as market price × total shares.
It categorizes companies into large-cap, mid-cap, and small-cap segments.
It reflects the company's size, stability, and investor confidence.

⭐ 11. Enterprise Value (EV)

EV is a comprehensive measure of a company's total value, including debt and excluding cash.
EV = Market Cap + Debt – Cash.
It is used in valuation because it shows how much it would cost to acquire the entire company.

⭐ 12. Price-to-Book Ratio (P/B Ratio)

P/B shows how much investors are paying relative to the company's book value.
A P/B less than 1 may indicate undervaluation, especially for banks and financial firms.
It is useful when assets form a key part of the business.

⭐ 13. Price-to-Sales Ratio (P/S Ratio)

P/S Ratio compares the market price with the company's revenue per share.
It is useful when earnings are negative or unstable.
A lower P/S suggests that the stock is cheaper relative to sales.

⭐ 14. PEG Ratio (Price/Earnings to Growth)

PEG adjusts the P/E ratio by considering the earnings growth rate.
PEG < 1 usually means the stock is undervalued relative to growth.
It helps compare growth companies more effectively.

⭐ 15. Beta

Beta measures the volatility of a stock relative to the overall market.
Beta > 1 means the stock is more volatile; Beta < 1 indicates stability.
It helps assess risk and is widely used in portfolio decisions.

⭐ 16. Yield (Current Yield)

Current Yield measures the annual interest or dividend return compared to the current market price.
It helps investors evaluate return relative to price.
Higher yield often comes with higher risk.

⭐ 17. Discounted Cash Flow (DCF)

DCF is a valuation method that estimates a company's worth by calculating the present value of its future cash flows.
It requires assumptions about growth rates, discount rates, and future earnings.
DCF helps determine whether a stock is undervalued or overvalued.

⭐ 18. Free Cash Flow (FCF)

FCF is the cash available after paying operating expenses and capital investments.
It shows the company's ability to grow, pay dividends, or reduce debt.
Higher FCF means stronger financial health and flexibility.

⭐ 19. Return on Equity (ROE)

ROE measures how effectively the company generates profit from shareholders' investment.
Higher ROE indicates efficient use of equity capital.
It is especially important for comparing companies in the same industry.

⭐ 20. Return on Assets (ROA)

ROA indicates how efficiently the company uses its total assets to generate profit.
Higher ROA means better utilization of assets like machinery, buildings, and inventory.
Useful for asset-heavy industries like manufacturing.

⭐ 21. Earnings Yield

Earnings Yield is the inverse of the P/E ratio (Earnings ÷ Price).
It shows how much earnings the company generates for each rupee invested.
Useful for comparing stocks with fixed-income instruments like bonds.

⭐ 22. Fair Value

Fair Value is the estimated worth of a stock according to valuation models like DCF, P/E, or P/B.
If market price < fair value → stock is undervalued (a buying opportunity).
It guides long-term investment decisions.

⭐ 23. Margin of Safety

This concept refers to buying a stock at a significant discount to its intrinsic value.
It protects investors from mistakes, market volatility, or wrong assumptions.
Benjamin Graham and Warren Buffett strongly advocate this principle.

⭐ 24. Overvalued/Undervalued

A stock is **overvalued** when its market price is higher than its intrinsic value.
A stock is **undervalued** when its market price is lower than intrinsic value.
Helps investors decide buying or selling strategies.

⭐ 25. Price Band

Price Band is the range within which investors can bid during book-built IPOs and FPOs.
The lowest price is the **floor price**, and the highest is the **cap price**.
It helps discover the final issue price based on investor demand.

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17. Key Terms in Stock Market

Key terms in Stock market are listed below:

Jobber

A jobber is an individual or a firm on a stock exchange who specializes in buying and selling securities for their own account. Jobbers facilitate market liquidity by dealing with brokers, other jobbers, and traders. They play a crucial role in maintaining an orderly market by providing continuous buy and sell quotes.

Broker

A broker is an intermediary or an agent who facilitates the buying and selling of financial securities on behalf of clients. Brokers may work with individuals (retail clients) or institutions, executing trades in the financial markets. They earn a commission or fee for their services.

Bull

A bull is an investor or a market participant who is optimistic about the prospects of the market or a specific asset. A bullish stance is characterized by an expectation that prices will rise, and bulls often take actions such as buying securities with the anticipation of future gains.

Bear

In contrast to bulls, bears are investors or market participants who adopt a pessimistic view on the market or a specific asset. A bearish stance involves an expectation that prices will decline. Bears may take actions such as selling securities or adopting strategies to profit from falling prices.

Lame Duck

A lame duck typically refers to a company or an investment that is not performing well or is facing financial difficulties. It can also be used to describe a person or entity with diminished influence or power. In the context of investments, a lame duck may refer to an underperforming stock or a company facing challenges.

Stag

A stag is an investor who applies for and receives shares in a new issue (IPO) with the intention of selling them quickly for a profit when they start trading on the secondary market. Stags aim to take advantage of the expected initial price increase when the securities become publicly available for trading.

Speculation

Speculation refers to the act of taking on financial risk in the hope of achieving significant returns. Speculators make financial decisions based on their expectations of future market movements, aiming to profit from price fluctuations. It involves a degree of risk and uncertainty, and speculators often use various strategies to capitalize on market opportunities.

Arbitrage

Arbitrage is the practice of taking advantage of price differences of the same asset in different markets or forms. Arbitrageurs seek to profit from inefficiencies in pricing by buying low in one market and selling high in another.

Blue Chip

Blue chip refers to large, well-established companies with a history of stable earnings, strong financials, and a reliable reputation. Blue-chip stocks are considered safer investments compared to smaller or riskier stocks.

Market Capitalization (Large Cap, Mid Cap, Small Cap)

Market capitalization categorizes stocks based on their total market value. Large-cap stocks have a high market value, mid-cap stocks fall in the middle range, and small-cap stocks have a lower market value.

Basis Point (BPS)

A basis point is a unit of measure used to describe the percentage change in a financial instrument. One basis point is equal to 0.01%, or one-hundredth of a percentage point.

Circuit Breaker

A circuit breaker is a regulatory mechanism designed to temporarily halt trading in financial markets during extreme price fluctuations. It is implemented to prevent panic selling or buying and provide time for investors to reassess the situation.

Market Order

A market order is an instruction to buy or sell a security immediately at the best available current market price. Market orders guarantee execution but do not specify the price.

Penny Stock

Penny stocks are low-priced stocks with a small market capitalization, often traded over-the-counter. They are considered highly speculative and can be more volatile than stocks of larger companies.

Dividend Yield

Dividend yield is the annual dividend income expressed as a percentage of the current market price of a stock. It helps investors assess the income potential of a dividend-paying stock.

Rollover

Rollover refers to extending the maturity or expiration date of a financial instrument, such as a futures contract or an option.

Market Maker

A market maker is a financial institution or individual that facilitates trading by providing buy and sell quotes for securities. Market makers help maintain liquidity in the market.

Day Trading

Day trading is a trading strategy where individuals buy and sell financial instruments within the same trading day, aiming to profit from short-term price movements.

Margin Trading

Margin trading involves borrowing funds to increase the size of a trading position. It amplifies both potential gains and losses and requires maintaining a margin account.

Float

The float refers to the number of a company's shares available for trading on the open market, excluding those held by insiders, institutional investors, or locked-in shares.

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1. Introduction

Ministry of Science & Technology

Technology Development Board and Small Industries Development Bank of India forge strategic alliance to boost MSMEs through Technology-Focused Financing

Posted On: 17 NOV 2023 3:06PM by PIB Delhi

In a significant move to bolster the Micro, Small, and Medium Enterprise (MSME) sector in India, the Technology Development Board (TDB) and the Small Industries Development Bank of India (SIDBI) have formalized a Memorandum of Understanding (MoU) to facilitate easier access to credit for enterprises engaged in the development and commercial application of indigenous or imported technology.

Through this MoU, TDB and SIDBI have entered into a credit alliance, wherein TDB and SIDBI shall refer additional funding needs of companies they have previously funded to each other. With dedicated key contacts, both organizations will streamline coordination for seamless referral exchange. TDB and SIDBI will also provide financial support to eligible MSMEs, following their respective policy guidelines.

Finance for micro, small, and medium-sized enterprises (MSMEs) has been a concern for all stakeholders including entrepreneurs, financial institutions, and government organizations.

The predominant sources of finance used by MSMEs are bank loans; loans from non-banking institutions (e.g., NBFCs); venture capital; microfinance institutions; loans from family, relatives, and friends; equity finance; and own funds.

2. Development Finance Institutions (DFIs)

Development Finance Institutions (DFIs) are specialized institutions aimed at fulfilling certain policy objectives of providing finance to those market segments that are unlikely to be funded by commercial financial sector.

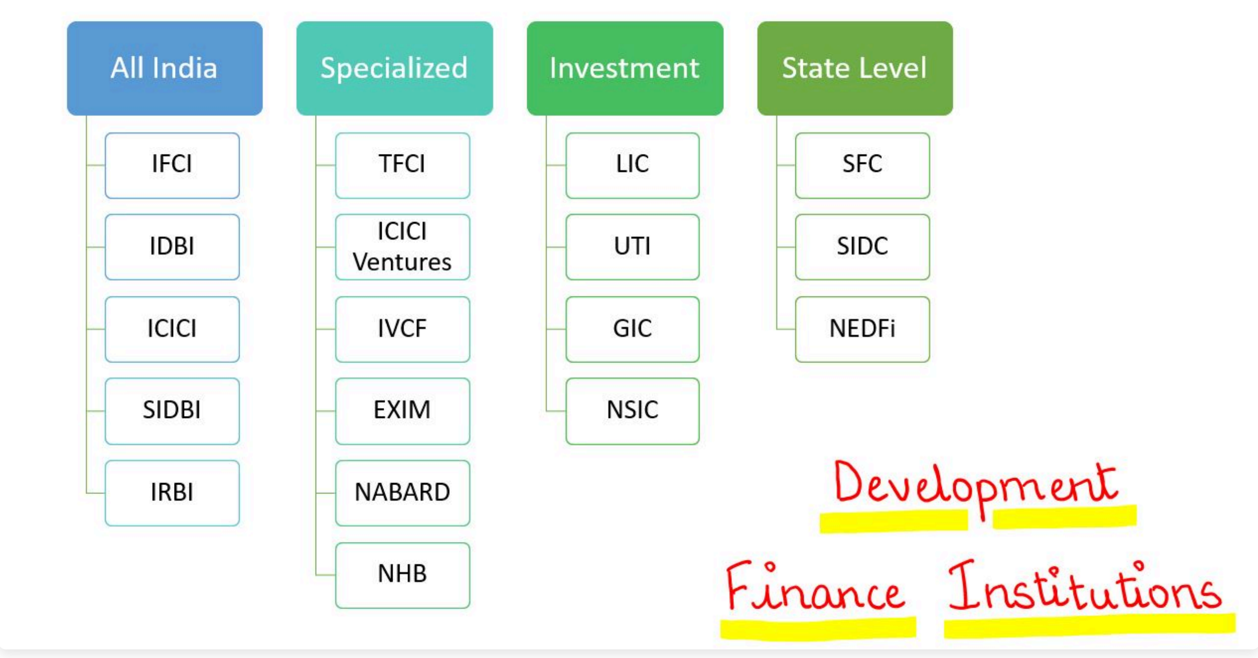
The importance of these DFIs has come to the fore due to the economic disruptions caused by COVID-19. During economic disruptions caused by COVID-19, DFIs – on a national, regional and multilateral level – have played an important role in enabling economic recovery. DFIs have emerged as a source of finance and preferred vehicles to deliver financial stimulus support provided by the governments to support struggling industries, invest in necessary infrastructure and lead the way out of a recession.

Categories of DFIs

A wide variety of Development financial institutions have been set up at the national and state levels. These institutions cater to the diverse financial requirements of small industries.

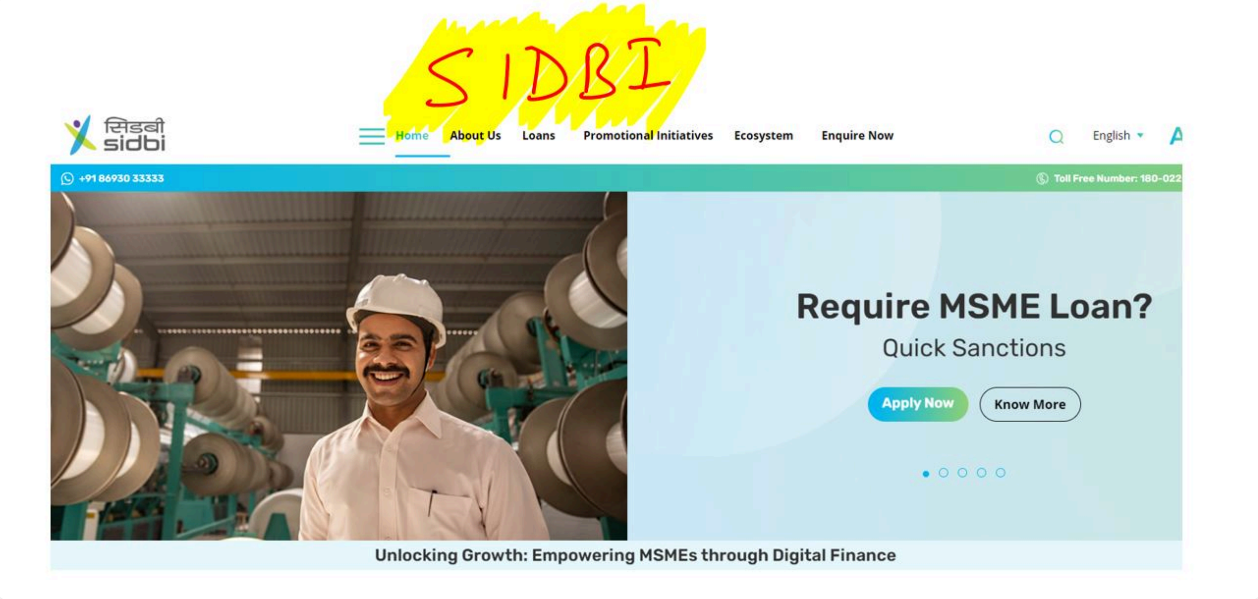
Development Finance Institutions can be categorized as follows.

- National Development Banks such as IDBI, SIDBI, ICICI, IFCI, IRBI etc.
- Sector-specific financial institutions such as TFCI, EXIM Bank, NABARD, IVCF, NHB etc.
- Investment Institutions such as LIC, GIC, UTI etc.
- State-level institutions such as State Finance Corporations, SIDC etc.



The role of some of the prominent Development Finance Institutions is discussed next.

3. Small Industries Development Bank of India



The Small Industries Development Bank of India (SIDBI) was set up by the Government of India in April 1990, as a wholly owned subsidiary of IDBI. Head office of SIDBI is in Lucknow. It is the principal financial institution for promotion, financing and development of Micro, Small and Medium Enterprises (MSME) sector. SIDBI has also floated several other entities for related activities.

Credit Guarantee Fund Trust for Micro and Small Enterprises provides guarantees to banks for collateral-free loans extended to SMEs.

The various initiatives of SIDBI concerning strengthening of MSMEs are discussed next.

3. Small Industries Development Bank of India

The various initiatives of SIDBI concerning strengthening of MSMEs are discussed below.

SIDBI Venture Capital Limited

SIDBI Venture Capital Limited (SVCL) is a venture capital company focused at SMEs. SVCL incorporated in 1999, is an investment management company and a wholly owned subsidiary of SIDBI. SVCL has managed funds focussed on different themes including Startups/ early stage technology businesses, manufacturing SMEs, service entities, agri businesses, financial inclusion companies, etc.

Technology Development & Modernisation Fund

SIDBI has set up Technology Development & Modernisation Fund (TDMF) scheme for direct assistance of small scale industries to encourage existing industrial units in the sector, to modernise their production facilities and adopt improved and updated technology so as to strengthen their export capabilities.

National Equity Fund

National Equity Fund (NEF) under SIDBI provides equity type assistance to SSI units, tiny units at 5% service charges.

Small Industries Development Fund

SIDBI also administers Small Industries Development Fund (SIDF), which provides refinance assistance for development, expansion, modernisation, rehabilitation of SSIs.

Mahila Udyam Nidhi

Another SIDBI initiative is Mahila Udyam Nidhi (MUN) Scheme that provides equity support to women entrepreneurs for setting up projects in Tiny Sector.

Pradhan Mantri MUDRA Yojana

The Pradhan Mantri MUDRA Yojana (PMMY) was launched in 2015 for providing loans upto Rs 10 lakh to the non-corporate, non-farm small/micro enterprises. These loans are classified as MUDRA loans under PMMY. These loans are given by Commercial Banks, RRBs, Small Finance Banks, Cooperative Banks, MFIs and NBFCs. The borrower can approach any of the lending institutions mentioned above or can apply online through Udyami Mitra Portal. Under the aegis of PMMY, MUDRA has created three products namely:

- **Shishu:** covering loans up to Rs 50,000
- **Kishor:** covering loans above Rs 50,000 and up to Rs. 5 lakh
- **Tarun:** covering loans above Rs 5 lakh and up to Rs. 10 lakh

Micro Units Development & Refinance Agency Limited (MUDRA) has been set up as a wholly owned subsidiary of SIDBI for “funding the unfunded” micro enterprises in the country.

Receivables Exchange of India Limited

The Receivables Exchange of India Limited (RXIL) was set up in 2016 as a joint venture of SIDBI and National Stock Exchange of India Limited (NSE), with an objective to operate India’s First Trade Receivables Discounting System (TReDS) - an online platform for financing of receivables of Micro, Small & Medium Enterprises. RXIL commenced operations on January 09, 2017.

India SME Asset Reconstruction Company Limited

The India SME Asset Reconstruction Company Limited (ISARC) was incorporated in 2008 by SIDBI, in association with leading Public Sector Banks as the country’s first Asset Reconstruction Company. It commenced business operations in 2009, with the principal objective to acquire non-performing assets (NPAs), primarily from MSMEs, and accelerate the restructuring of potentially viable units and liquidation of unviable units, so that productive use of the assets is maximized.

India SME Technology Services Limited

The India SME Technology Services Limited (ISTSL) was set up in November 2005 by SIDBI along with Indian Bank, Oriental Bank of Commerce, Indian Overseas Bank and State Bank of India with the primary objective to strengthen and accelerate the process of technological modernization in the MSME sector.

ISTSL is channel partner for Ministry of New and Renewable Energy (MNRE) prestigious solar roof top project "gird connected rooftop and small power plants programme" providing project management consultancy services for implementation of renewable energy (especially solar rooftop PV system projects).

Fund of Funds for Start-ups

In line with the Start-up India Action Plan, the Government established Fund of Funds for Start-ups (FFS) at SIDBI for contribution to various Alternative Investment Funds (AIFs) with a corpus of Rs 10,000 crore. Introduced with a focused objective of supporting development and growth of innovation driven enterprises, the Fund of Funds (FFS) facilitates funding needs for Start-ups through participation in capital of SEBI registered Venture Funds. Another similar initiative is India Aspiration Fund (IAF).

SIDBI Start-Up Mitra

The SIDBI Start-Up Mitra is a digital initiative that address gaps in the start-up ecosystem. The portal was launched in 2016. It acts as a virtual platform to bring together all stakeholders, start-up entrepreneurs, incubators, investors (Angel networks / Venture Capital Funds), industry bodies, mentors /advisors and banks to meet the financing and developmental needs of the early stage start-ups and enterprises.

SRIJAN Scheme

The TIFAC (Technology Information, Forecasting and Assessment Council) created a Revolving Fund in 2010 for facilitating development, demonstration and commercialization of technology innovation projects and placed it with SIDBI to provide assistance to MSMEs for development, up-scaling, demonstration and commercialization of innovative technology based projects. The scheme has been named SRIJAN. The programme supports MSMEs towards development, up-scaling, demonstration and commercialization of innovative technology based projects by providing developmental loans at flexible terms & interest rate to encourage / promote development / innovation of new technology / process / product and its commercialization. Currently, the scheme supports upto 80% of project cost, upto a maximum of Rs 100 lakhs, while offering selective assistance in case of costs above Rs 100 lakhs.

SIDBI Make in India Soft Loan Fund

The SIDBI Make in India Soft Loan Fund for Micro Small & Medium Enterprises (SMILE) was launched during the FY 2015-16 as Rs 10,000 crore fund by SIDBI, in line with the Government's ambitious 'Make in India' initiative. The target sectors under SMILE include all the identified 25 Make in India sectors as indicated by the GoI for the Make in India Programme. The objective of the scheme is to offer soft loans in the nature of quasi-equity so as to meet the required debt-equity ratio to facilitate the term loan on relatively soft terms for MSME's. Loans extended under the scheme cannot be used for repayment of earlier loans.

MSME Receivable Finance Scheme (MSME RFS)

With a strong understanding of the significance of speedy receivables for the Financial Health of a Micro Small and Medium Enterprises, SIDBI offers solutions that help mitigate the problem of delayed payments to MSME's with respect to their credit sales to large purchaser companies by offering them finance against bills of exchange/Invoices arising out of such sales. The objective is to facilitate speedy recovery of payments for MSME's through a series of thoughtful schemes that help improve their cash flow / liquidity.

SME Rating Agency

SME Rating Agency (SMERA) of India Limited provides composite ratings to SMEs. SMERA is a joint initiative of SIDBI and Credit Analysis and Research Limited (CARE).

CriSidEx

Launched in February 2018, CriSidEx, is India's first Sentiment Index for Micro and Small Enterprises (MSEs), developed jointly by CRISIL & SIDBI. It is a composite index based on a diffusion index of 8 parameters and measures MSE business sentiment on a scale of 0 (extremely negative) to 200 (extremely positive).

Other Schemes of SIDBI

Other Schemes of SIDBI are as follows.

- Working Capital Assistance to MSMEs Objective
- Secured Business Loans for MSMEs (SBL)
- Inland Letter of Credit (INLC)
- Guarantee Schemes for MSEs
- General Purpose Term Loan.

4. Other Development Finance Institutions

The Development Finance Institutions (DFIs) other than SIDBI are discussed next one by one.

4. Other Development Finance Institutions

The Industrial Finance Corporation of India Ltd (IFCI Ltd) was the first development finance institution set up in 1948 under the IFCI Act in order to pioneer long-term institutional credit to medium and large industries. It is public sector NBFC. It aims to provide financial assistance to industry by way of rupee and foreign currency loans, underwrites/subscribes the issue of stocks, shares, bonds and debentures of industrial concerns, etc.

The IFCI Group has the following subsidiaries:

- Stock Holding Corporation of India Ltd.
- IFCI Venture Capital Fund Ltd.
- IFCI Factors Ltd.
- IFCI Infrastructure Development Ltd.
- IFCI Financial Services Ltd.
- MPCON Ltd.
- Management Development Institute and Institute of Leadership Development.

4. Other Development Finance Institutions

The Industrial Development Bank of India (IDBI) was established in 1964 as an apex financial institution for industrial development in the country. It caters to the diversified needs of medium and large scale industries in the form of financial assistance, both direct and indirect. Direct assistance is provided by way of project loans, underwriting of and direct subscription to industrial securities, soft loans, technical refund loans, etc. While, indirect assistance is in the form of refinance facilities to industrial concerns.

Subsequently, in September 2004, the RBI incorporated IDBI as a Scheduled Bank.

4. Other Development Finance Institutions

The Industrial Credit and Investment Corporation of India was formed in 1955 at the initiative of the World Bank, the Government of India and representatives of Indian industry. The principal objective was to create a Development Financial Institution (DFI) for providing medium-term and long-term project financing to Indian businesses. In 2002, ICICI was merged with the ICICI Bank, thus converting it from DFI to a Universal Bank.

4. Other Development Finance Institutions

The Industrial Reconstruction Corporation of India Ltd., set up in 1971 for rehabilitation of sick industrial companies, was reconstituted as Industrial Reconstruction Bank of India (IRBI) in 1985 under the IRBI Act, 1984. With a view to converting the institution into a full-fledged development financial institution, IRBI was incorporated under the Companies Act 1956, as Industrial Investment Bank of India Ltd. (IIBI) in March 1997. The IIBI was closed down in 2012.

4. Other Development Finance Institutions

Shipping credit and Investment Company of India Ltd. (SCICI) was incorporated as a public limited company in 1986 under the Companies Act, was notified as a public financial institution. It was the nodal agency for assisting shipping, fishing and related industries. The SCICI was merged with ICICI in 2013.

These are also some specialized institutions which have been set up to serve the increasing financial needs of commerce and trade in the area of venture capital, credit rating and leasing, etc.

4. Other Development Finance Institutions

Tourism Finance Corporation of India Ltd. (TFCI) has been set-up as an All India Financial Institution, pursuant to the recommendations of “National Committee on Tourism” set-up under the aegis of Planning Commission in 1988. The main object of setting-up the specialised financial institution was to expedite the growth of tourism infrastructure in the country by providing dedicated line of credit on long term basis to tourism related projects in the country.

4. Other Development Finance Institutions

Formerly known as Technology Development & Information Company of India Limited (TDICI), it was founded in 1988 as a joint venture with the Unit Trust of India. Subsequently, it became a fully owned subsidiary of ICICI. It is a technology venture finance company, set up to sanction project finance for new technology ventures.

4. Other Development Finance Institutions

IVCF formerly known as Risk Capital & Technology Finance Corporation Ltd. (RCTC), is a subsidiary of IFCI Ltd. It was promoted with the objective of broadening entrepreneurial base in the country by facilitating funding to ventures involving innovative product/process/technology. The RCTC was set up in 1988 and was converted into IVCF in 1998. It was first venture capital fund of India. The Head office is in New Delhi.

4. Other Development Finance Institutions

The Export Import Bank of India was established in 1982. The Head office is in Mumbai. It is designed and developed as an apex institution in India for financing promotion and development of exports in the country. The EXIM Bank is a wholly-owned subsidiary of the Indian Government.

The key functions of EXIM bank are given below.

1. **Buyer's credit** – it is a credit facility programme that encourages Indian exporters to explore new regions across the globe. It also facilitates exports for SMEs by offering credit to overseas buyers to import goods from India.

2. **Corporate banking** – it offers a variety of financing programmes to augment the export-competitiveness of Indian companies.

3. **Lines of credit** – it offers extended a line of credit to Indian exporters to help them expand to new geographies and uses line of credit as an effective market-entry tool.

4. **Overseas investment finance** – it offers term loans to Indian companies for equity investments in their overseas joint ventures or wholly-owned subsidiaries.

5. **Project exports** – encourages project exports from India and helps Indian companies secure contracts abroad.

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4. Other Development Finance Institutions

National Bank for Agriculture and Rural Development (NABARD) was established on 12 July 1982 by an Act of the Parliament. NABARD, as a Development Bank, is mandated for providing and regulating credit and other facilities for the promotion and development of agriculture, small scale industries, cottage and village industries, handicrafts and other rural crafts and other allied economic activities. The Head office is in Mumbai. In April 2019, the control of NABARD has been handed over from the RBI to the Government.

The major functions of NABARD include promotion and development, refinancing, financing, planning and monitoring and supervision. They can be grouped into credit and non-credit functions.

Non-credit related functions

The non-credit related functions of NABARD are as follows.

- Credit Planning and Monitoring, Coordination with various agencies and institutions.
- Assist in policy formulation of Centre Government, RBI and State Governments.
- Institutional development and capacity building of Cooperatives and Regional Rural Banks (RRBs) to strengthen the rural credit delivery system.
- Statutory inspection of Regional Rural Banks (RRBs) and State Cooperative Banks (StCBs) and District Central Cooperative Banks (DCCBs) and voluntary inspection of State Cooperative Agriculture and Rural Development Banks (SCARDBs).
- Promotional and developmental initiatives.
- Supporting the financial inclusion efforts of Regional Rural Banks and Cooperative Banks
- Thrust on promotion of livelihood opportunities and Micro Enterprises

Credit related functions

The credit related functions of NABARD are as follows.

- Refinance to Rural Financial Institutions for investment credit (long term loan) and production and marketing credit (short term loan) purposes for farm and off-farm activities in rural areas.
- Loans to State Governments for developing rural infrastructure warehousing and strengthening of the Cooperative Credit Structure.

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4. Other Development Finance Institutions

The National Housing Policy, 1988 envisaged the setting up of National Housing Bank (NHB) as the apex level institution for housing. In pursuance of the above, the NHB was set up on July 9, 1988 under the National Housing Bank Act, 1987. The RBI contributed the entire paid-up capital. In May 2019, the RBI exited the NHB, thus making it a fully government-owned entity. The Head Office of NHB is at New Delhi.

The basic functions of the NHB are to operate as a principal agency to promote housing finance institutions both at local and regional levels.

Other Specialized financial institutions include Power Finance Corporation, Indian Railway Finance Corporation (1986), Indian Renewable Energy Development Agency (1987), etc.

These are the most popular form of financial intermediaries, which particularly cater to the needs of small savers and investors. They deploy their assets largely in marketable securities.

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4. Other Development Finance Institutions

Life Insurance Corporation of India (LIC) was established in 1956 as a wholly-owned corporation of the Government of India. It was formed by the Life Insurance Corporation Act, 1956, with the objective of spreading life insurance much more widely and in particular rural area.

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4. Other Development Finance Institutions

Unit Trust of India (UTI) was set up as a body corporate under the UTI Act, 1963, with a view to encourage savings and investment. It mobilises savings of small investors through sale of units and channelises them into corporate investments mainly by way of secondary capital market operations.

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4. Other Development Finance Institutions

General Insurance Corporation of India (GIC) was formed in pursuance of the General Insurance Business (Nationalisation) Act, 1972 (GIBNA), for the purpose of superintending, controlling and carrying on the business of general insurance or non-life insurance. Initially, GIC had 4 subsidiary, namely:

- National Insurance Company Ltd.
- New India Assurance Company Ltd.
- Oriental Insurance Company Ltd.
- United India Insurance Company Ltd.

But these branches were delinked from GIC in 2000.

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4. Other Development Finance Institutions

The National Small Industries Corporation Ltd (NSIC) was established in 1955 by the Government of India as per the recommendations of the International Planning Team of Ford Foundation, its objectives are to aid, assist, counsel, finance, protect and promote the industries in the country. The NSIC assists small scale industries through its various schemes such as hire purchase, equipment leasing, marketing, export, raw material assistance and single point registration scheme.

Several financial institutions have been set up at the State level which supplement the financial assistance provided by the All India Institutions. They act as a catalyst for promotion of investment and industrial development in the respective States.

The Government is the single largest buyer of a variety of goods. With a view to increase the share of purchases from the small-scale sector, the Government Stores Purchase Programme was launched in 1955-56. NSIC registers Micro & small Enterprises (MSEs) under Single Point Registration scheme (SPRS) for participation in Government Purchases. The units registered under **Single Point Registration Scheme** of NSIC are eligible to get the benefits under Public Procurement Policy for Micro & Small Enterprises (MSEs) Order 2012 as notified by the Government of India, Ministry of Micro Small & Medium Enterprises, New Delhi

To meet the credit requirements of MSME units, NSIC has entered into a Memorandum of Understanding with various Nationalized and Private Sector Banks. Through syndication with these banks, NSIC facilitates MSME in accessing credit support (fund based or non-fund based limits) from the banks. NSIC assists MSMEs in completion of the documentation for submitting the proposals to the banks and also does the follow up with the banks. These handholding supports are provided by NSIC without any cost to the MSMEs

The **Raw Material Assistance Scheme** aims at helping MSMEs by way of financing the purchase of Raw Material (both indigenous & imported). This gives an opportunity to MSMEs to focus better on manufacturing quality products.

Promotion of the product of Micro and Small Entrepreneurs is one of the major needs. In the present competitive scenario a need has been felt to facilitate Micro and Small Enterprises to market their goods/ services individually or collectively through 'Consortium'. Accordingly, the scheme for promoting the products of the MSEs has been reviewed in 2011 & named as **Consortia and Tender Marketing Scheme**.

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4. Other Development Finance Institutions

State Financial Corporations Act, 1951 was enacted by the Parliament to provide institutional framework for financing medium and small-scale industries, which fell outside the operational scope of the IFCI (Industrial Finance Corporation of India). After enactment of the Act, SFCs were set up in the various States over a period of time. The Act provides special role for the State Governments in the promotion and management of the affairs of the SFCs.

At present, there are 18 SFCs of which 17 were set up under the SFC Act, 1951 while the Tamil Nadu Industrial Investment Corporation Ltd. was incorporated under the Companies Act, 1956 but still functions as SFC.

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4. Other Development Finance Institutions

The State Industrial Development Corporations (SIDCs) have been established under the erstwhile Companies Act 1956, as wholly-owned undertakings of State Governments. They have been set up with the aim of promoting industrial development and providing financial assistance to small entrepreneurs.

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4. Other Development Finance Institutions

The North Eastern Development Finance Corporation Ltd (NEDFi) is a Public Limited Company registered under the Companies Act 1956. It was formed in 1995. It is notified as a Public Financial Institution under Section 4A of the said Act and was registered as an NBFC in 2002 with RBI. The shareholders of the Corporation are IDBI, SBI, LICI, SIDBI, ICICI, IFCI, SUUTI, GIC and its subsidiaries. NEDFi provides financial assistance to micro, small, medium and large enterprises for setting up industrial, infrastructure and agri-allied projects in the North Eastern Region of India and also provides microfinance through MFI/NGOs.

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4. Other Development Finance Institutions

The Entrepreneurship Development Institute of India (EDII), an autonomous body and not-for-profit institution, set up in 1983, is sponsored by apex financial institutions, namely the IDBI Bank Ltd, IFCI Ltd. ICICI Ltd and State Bank of India (SBI). EDII is located in Gandhinagar, Gujrat.

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4. Other Development Finance Institutions

The Federation of Associations of Small Industries of India (FASII) is a consequence of the visit of the Ford Foundation Team to India in 1953 which emphasised the need for a national apex body for Micro, Small, Village, Cottage and Rural Enterprises. FASII was ushered into existence in the year 1959 under the sponsorship of the Government of India. Padamshree A.R. Bhat, a Gandhian, was instrumental in the edifice of FASII. FASII's Headquarter in New Delhi was inaugurated by the then President of India Dr. S. Radhakrishnan in the year 1963.

Since 1963, FASII has played an instrumental role by its own accord and with the help of Government of India to make contributions for advancement of the MSME Sector in India and pave the roadmap for helping India to be a Global Economic Power through following attempts:

- Reservation of products for exclusive manufacture in the Micro and Small enterprises sector.
- Reservation of products for exclusive purchase from the micro and small enterprises sector.
- Establishment of Small Industries Development Bank of India.
- Equal disbursement of scarce raw materials, term loans and working capital to Micro and Small enterprises
- Leading the Government of India to take notice of the potential of the Micro, Small and Medium Enterprises sector to form a new Ministry with the purpose of looking after the same.
- Playing a major role in helping to make the Micro, Small and Medium Enterprises Act of 2006.
- Establishment of Credit Guarantee Fund Trust for Micro and Small Enterprises.
- Making available concession for Micro and Small enterprises on the Excise and other taxation fronts.
- Helping the Government to formulate schemes on Credit, Marketing, Pollution Control, Technology Upgradation, Exports, Women Entrepreneurs, Ancillaries, Industrial Estates, Quality & Standards.

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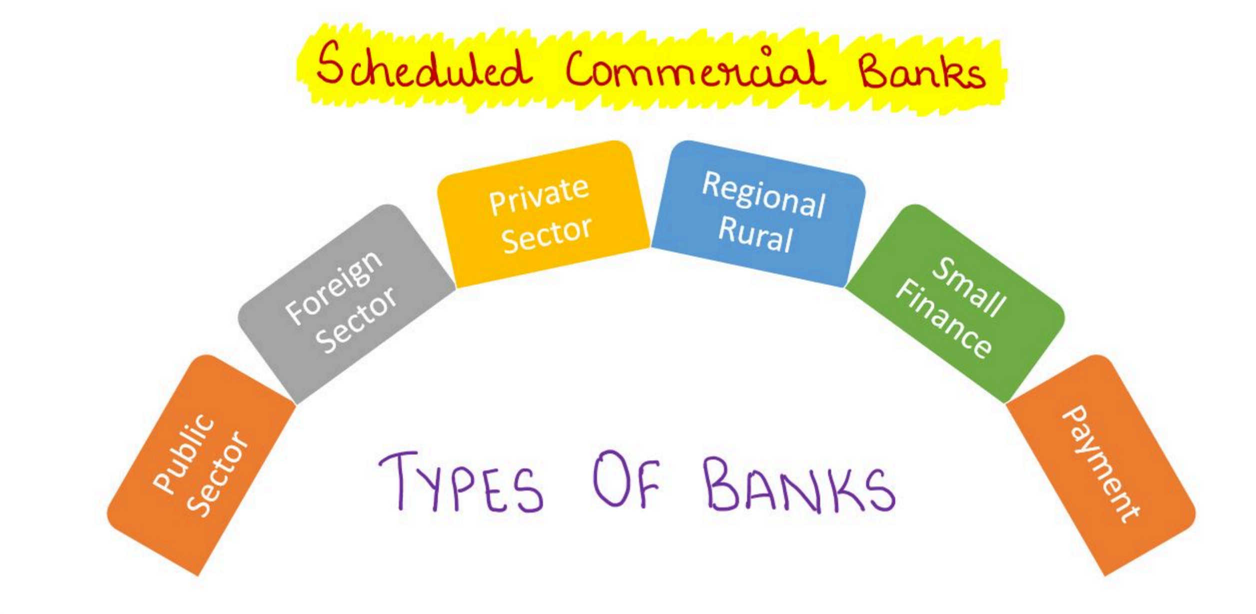
5. Scheduled Commercial Banks

Banks that are included in the Second Schedule of the Reserve Bank of India Act, 1934 are considered to be scheduled commercial banks.



Scheduled Commercial banks includes public sector, private sector, foreign banks, Regional Rural Banks (RRB), Small Finance Banks and Payment Banks.

1. **Public Sector Banks** - Public Sector Banks are constituted under the State Bank of India Act, 1955 and Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

2. **Foreign Banks** - Foreign Banks is a bank that has its headquarters outside India but runs its offices as a private entity at any other locations in India. Such banks are under an obligation to operate under the regulations provided by the Reserve Bank of India as well as the rule prescribed by the parent organization located outside India.

3. **Private Sector Banks** - Private Sector Banks are banking companies licensed to operate under Banking Regulation Act, 1949.

4. **Regional Rural Banks** - Regional Rural Banks (RRB) are the banks established under the Regional Rural Banks Act, 1976 with the aim of ensuring sufficient institutional credit for agriculture and other rural sectors. The area of operation of RRBs is limited to the area notified by the Central Government. RRBs are owned jointly by the Government of India, the State Government and Sponsor Banks.

5. **Small Finance Banks** - Small Finance Banks (SFB) licensed under Banking Regulation Act, 1949 and created with an objective of furthering financial inclusion by primarily undertaking basic banking activities to un-served and underserved sections including small business units, small and marginal farmers, micro and small enterprises and other underserved sections.

6. **Payment Banks** - Payment Banks are public limited companies licensed under Banking Regulation Act, 1949, with specific licensing conditions restricting its activities mainly to acceptance of demand deposits and provision of payments and remittance services.

6. Priority sector lending

To ensure that adequate institutional credit reaches some of the vulnerable sectors of the economy, which otherwise may not be attractive for banks from the profitability point of view, the RBI mandates banks to lend a certain portion of their funds to specified sectors called priority sectors.

As per RBI guidelines, Priority sector lending include only those sectors as part of the priority sector, that impact large sections of the population, the weaker sections and the sectors which are employment-intensive such as agriculture, and Micro and Small enterprises.

As updated by RBI in a circular published in December 2018, the Priority Sector includes the following categories:

- Agriculture,
- **Micro, Small and Medium Enterprises,**
- Export Credit,
- Education,
- Housing,
- Social Infrastructure,
- Renewable Energy, and
- Others.

The activities covered under Agriculture are classified under 3 sub-categories viz.: Farm credit, Agriculture infrastructure, and Ancillary activities.

6. Priority sector lending

The RBI has increased the mandatory Priority Sector Lending (PSL) target for all scheduled commercial banks from 40% to 40% of adjusted net bank credit (ANBC), a broader measure of bank credit. It includes loans, investments, and other advances.

The Target for Domestic commercial banks (excluding RRBs & SFBs) & foreign banks with 20 branches and above for “Total Priority Sector” is 40% of ANBC (Adjusted Net Bank Credit) or CEOBE (Credit Equivalent Amount of Off-Balance Sheet Exposure), whichever is higher. For Regional Rural Banks (RRBs) and Small Finance Banks (SFBs), this number is 75%.

Target for MSMEs is 7.5% of ANBC or CEOBE, whichever is higher.

This data is as per last update by RBI in July 2023.

Bank’s lending to the Micro, Small and Medium enterprises as under is eligible to be reckoned for priority sector advances:

- Loans up to Rs 50 crore to Startups, as per definition of MSME.
- Loans to entities involved in assisting the decentralized sector in the supply of inputs and marketing of output of artisans, village and cottage industries.
- Loans to co-operatives of producers in the decentralized sector viz. artisans, village and cottage industries.
- Loans sanctioned by banks to NBFC-MFIs and other MFIs (Societies, Trusts etc.) which are members of RBI recognized SRO for the sector for on-lending to MSME sector.
- Loans to registered NBFCs (other than MFIs) for on-lending to Micro & Small Enterprises.
- Credit outstanding under General Credit Cards (including Artisan Credit Card, Laghu Udyami Card, Swarojgar Credit Card and Weaver’s Card etc. in existence and catering to the non-farm entrepreneurial credit needs of individuals).
- Overdraft to Pradhan Mantri Jan-Dhan Yojana (PMJDY) account holders as per limits and conditions prescribed by Department of Financial Services, Ministry of Finance from time to time, will qualify as achievement of the target for lending to Micro Enterprises.
- Outstanding deposits with SIDBI and MUDRA Ltd. on account of priority sector shortfall.

The overdrafts under the Pradhan Mantri Jan-Dhan Yojana (PMJDY) will also qualify as achievement of the target for lending to Micro Enterprises. It may be noted that in September 2018, Overdraft limit to PMJDY account holder has been raised to Rs 10,000 from Rs 5,000. The age limit of 18-60 years has also been revised to 18-65 years. There are no conditions attached for overdraft up to Rs. 2,000.

7. Co-operative Banks

The co-operative credit structure in India can be broadly divided into 2 types, viz., *Urban Co-operatives* that cater to the financial needs of the customers in urban and semi-urban areas and *Rural Co-operatives* that is primarily mandated to ensure flow of credit to agriculture sector in rural areas.

Cooperative banks primarily support the agricultural activities, some small-scale industries and self-employed workers.

Key Characteristics

The key Characteristics of Co-operative Institutions are as follows.

- They have restricted area of operation.
- The Board of Directors is elected by shareholders in a democratic manner.
- The borrowing from these institutions is restricted only to its members.
- There is share linking to borrowing, viz., a part of the amount borrowed will be contributed to the share capital of the institution.
- Members can caste only one vote irrespective of the number of shares held.
- The shares of these institutions cannot be listed and traded.

The **Co-operative societies** appear at Entry 32 in the State List under the 7th Schedule to the Constitution of India. Hence, Co-operative Societies in India are a State subject. The Co-operative Credit Societies which are licensed to carry out banking activities function as a **co-operative bank** and are eligible to accept deposits from the public.

Urban co-operative banks and Rural co-operative banks are discussed next.

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7. Co-operative Banks

Though the Banking Regulation Act (BR Act) came into force in 1949, the banking laws were made applicable to co-operative societies only in March 1966 through an amendment to the BR Act, 1949.

The BR Act, 1949 defines Urban Co-operative Banks as a cooperative society, other than a primary agricultural credit society and satisfying the following conditions:

- the primary object or principal business of which is the transaction of banking business;
- the paid-up share capital and reserves of which are not less than Rs 1 lakh;
- the bye-laws of which do not permit admission of any other co-operative society as a member.

Urban Co-operative Banks (UCBs) are primarily registered as co-operative societies under the provisions of either the State Co-operative Societies Act of the State concerned or the Multi State Co-operative Societies Act, 2002 if the area of operation of the bank extends beyond the boundaries of one State. These banks are licenced by RBI to carry on banking business. Till sometime back, they were under the dual control of RBI and the Registrar of Co-operative Societies. The **Uni-State UCBs** were regulated by the Registrar of Co-operative Societies (RCS) of the respective State, whereas **Multi-State UCBs** were regulated by the Central Registrar of Co-operative Societies (CRCS).

On 27 June 2020, the President promulgated the Banking Regulation (Amendment) Ordinance, 2020. The Ordinance amended the Banking Regulation Act, 1949. As per this amendment, now the Urban Co-operative Banks (UCBs) and multi-state cooperative banks, are brought under supervisory powers of Reserve Bank of India (RBI). Note that this "duality of jurisdiction" has been abolished only for Urban Co-operative Banks (UCBs) and multi-state cooperative banks. All other types of Co-operatives are still under dual control. It means, there is no change in regulator of Rural co-operatives.

The Punjab and Maharashtra Cooperative (PMC) Bank scam in 2019 was the trigger point for the Government to amend Banking Regulation Act 1949, to bring in more efficiency in the functioning of cooperative banks in the country.

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7. Co-operative Banks

Rural credit co-operatives came into existence essentially as an institutional mechanism to provide credit to farmers at affordable cost and address the twin issues of rural indebtedness and poverty.

The **long-term co-operative credit structure** has the State Co-operative Agriculture and Rural Development Banks (SCARDBs) at the apex level and the Primary Co-operative Agriculture and Rural Development Banks (PCARDBs) at the district or block level. These institutions were conceived with the objective of meeting long-term credit needs in agriculture and they are under the regulatory purview of National Bank for Agriculture and Rural Development (NABARD).

The **short term co-operative credit structure** (STCCS) of the country primarily meets the crop and working capital requirements of farmers and rural artisans. The pyramid of STCCS is primarily 3-tier and is federal in nature within a State. The apex level is the **State Co-operative Bank (StCB),** at the district level there are **District Central Co-operative banks (DCCBs)** and at the village level, there are **Primary Agricultural Credit Societies (PACS).** In some state, the structure is two-tiered.

The PACS are regulated and monitored by the respective State Registrar of Cooperative Societies. While regulation of State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) vests with Reserve Bank, their supervision is carried out by National Bank for Agriculture and Rural Development (NABARD). The regulation of StCBs and DCCBs by RBI are similar to those of UCBs.

At present, India's co-operative banking sector comprises of State Cooperative Banks (18 Scheduled and 14 Non-Scheduled State Cooperative Banks), Urban Cooperative Banks (54 Scheduled and 1528 Non-Scheduled Urban Cooperative Banks), and District Central Cooperative Banks (366).

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8. Micro Finance

The **Microfinance** refers to a banking or financial service that is offered by banks or other financial institutions to individuals who belong to the low-income or underprivileged sections of the society.

Microfinance can be in the form of loans, insurance, and savings deposits. It is very helpful to small-sized enterprise owners as well as entrepreneurs with low capital. They live in rural areas as well as in urban areas of India and do not have sufficient knowledge and access to take help from conventional sources of finance such as banks and investors.

In India, the microfinance operates through 2 channels:

1. Self Help Group – Bank Linkage Programme (SHG-BLP)
2. Micro Finance Institutions (MFI)

These are discussed next.

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8. Micro Finance

This is the bank-led microfinance channel which was initiated by NABARD in 1992. Under the Self Hlep Group (SHG) model, the members, usually women in villages are encouraged to form groups of around 10-15. The members contribute their savings in the group periodically and from these savings small loans are provided to the members. In the later period, these SHGs are provided with bank loans generally for income generation purpose.

The group's members meet periodically when the new savings come in, recovery of past loans are made from the members and also new loans are disbursed. This model has been very much successful in the past and with time it is becoming more popular. The SHGs are self-sustaining and once the group becomes stable it starts working on its own with some support from NGOs and institutions like NABARD and SIDBI.

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8. Micro Finance

Those institutions which have microfinance as their main operation are known as Micro Finance Institutions (MFIs). A number of organizations with varied size and legal forms offer microfinance service. These institutions lend through the concept of **Joint Liability Group (JLG)**.

A JLG is an informal group comprising of 5 to 10 individual members who come together for the purpose of availing bank loans either individually or through the group mechanism against a mutual guarantee.

The Indian microfinance sector witnessed tremendous growth over the last two decades, during which institutions were subject to little regulation. Some microfinance institutions were subject to prudential requirements; however no regulation addressed lending practices, pricing, or operations. The combination of minimal regulation and rapid sector growth led to an environment where customers were increasingly dissatisfied with microfinance services, culminating in the Andhra Pradesh crisis in the fall of 2010.

Due to low repayment rates, microfinance institutions, with exposure to Andhra Pradesh, suffered significant losses. Banks stopped lending to microfinance institutions all over India; for fear that a similar situation would occur elsewhere, resulting in a liquidity crunch for microfinance institutions, which are largely dependent on bank lending as a funding source. With the sector at a standstill, microfinance institutions, microfinance clients, banks, investors, and local governments were calling for new regulation to address the prominent issues of the sector.

The Reserve Bank of India (RBI) responded by appointing an RBI sub-committee know as the **Malegam Committee.** The Malegam Committee released their recommended regulations in January 2011.

The Reserve Bank of India issued guidelines for the lending operations of MFIs based on the Malegam Committee recommendations. A new class of financial organizations named as **NBFC–MFIs** was created subject to satisfying certain conditions regarding the capital to be employed, lending to members, cap on interest to be charged and margin to be retained, etc. As the loans extended to the MFIs by banks qualify for priority sector category subject to fulfillment of similar conditions, other MFIs also strived to follow these guidelines. RBI's upgraded regulations and guidelines on NBFC-MFIs and inclusion of loans to MFIs by banks under priority sector resulted in phenomenal growth of MFIs during the last few years.

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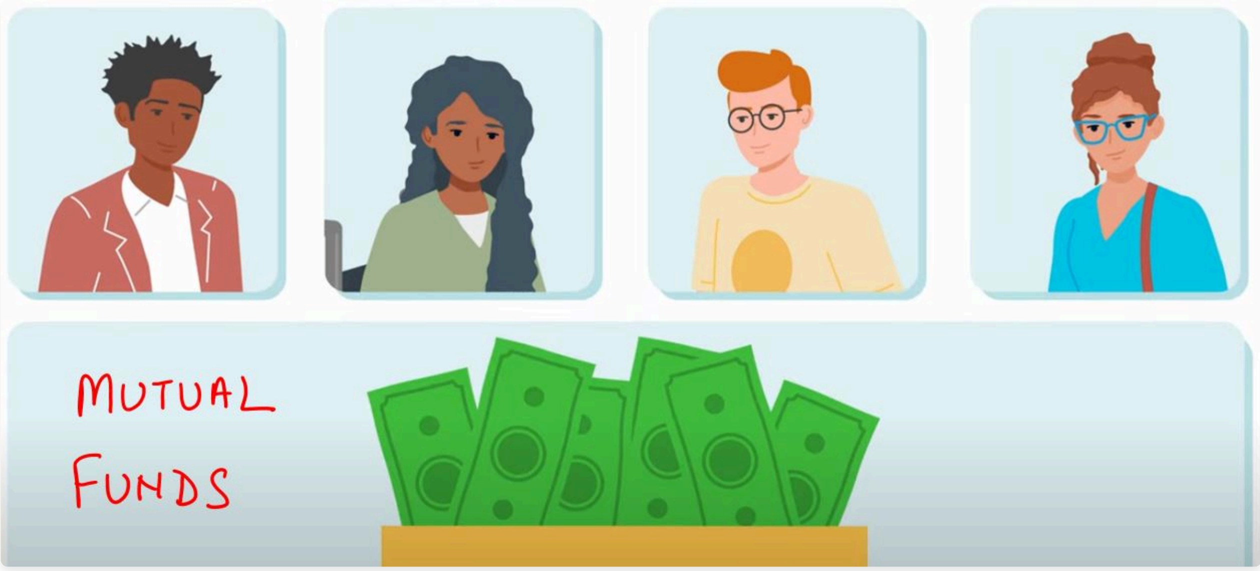
1. Introduction



A mutual fund is a financial vehicle that collects money from many investors and invests it in a professionally managed portfolio of securities such as shares, bonds, money market instruments, or a mix of these. Each investor owns units of the fund, which represent a proportional share of the overall portfolio. Mutual funds operate on the principle of pooling resources for collective investment, allowing investors to participate in markets with relatively small amounts.

Need and Importance of Mutual Funds

Mutual funds fulfil an essential need for investors who may not have the expertise, time, or resources to analyse financial markets on their own. They provide professional fund management, diversification, liquidity, and regulated investment options. For retail investors in India, mutual funds serve as a convenient avenue to participate in equity and debt markets, enabling long-term wealth creation and disciplined financial planning.

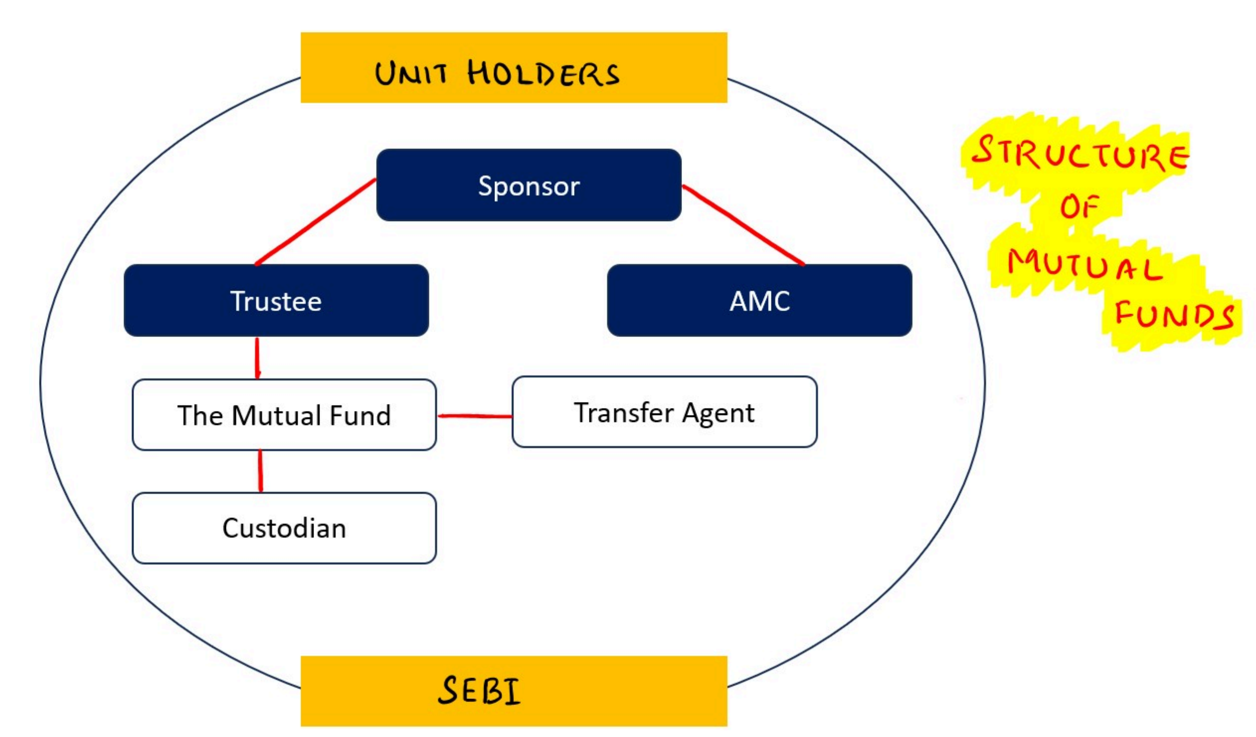
Advantages for Investors

Mutual funds offer several benefits, including portfolio diversification, professional management, lower transaction costs, regulatory oversight by SEBI, liquidity (especially in open-ended schemes), transparency through periodic disclosures, and the availability of different fund types suited to varying risk profiles. They also support systematic investment through SIPs, enabling long-term wealth creation.

Limitations for Investors

While beneficial, mutual funds also have limitations. Returns are not guaranteed and depend on market performance. Expense ratios reduce the overall returns. Fund performance varies across AMCs and fund managers, and some schemes may carry higher risks (e.g., sectoral themes, credit risk funds). Additionally, during extreme market volatility, even diversified portfolios may experience significant fluctuations.

2. Three-Tier Mutual Fund Structure



Mutual funds in India operate through a **three-tier structure** consisting of the **Sponsor**, the **Trustees**, and the **Asset Management Company (AMC)**. This structure ensures transparency, investor protection, and regulatory compliance. All mutual funds in India are created as **trusts** under the *Indian Trusts Act, 1882* and governed by *SEBI (Mutual Funds) Regulations, 1996*.

A mutual fund collects money from many investors and invests this pooled corpus in securities according to the scheme's stated objective. The returns earned are distributed to investors after deducting expenses payable to the AMC, custodians, RTAs, and other service providers.

1. Sponsor (First Tier)

The sponsor is similar to a promoter of a company. They take the initiative to start a mutual fund by creating a trust and appointing trustees and the AMC.

Key responsibilities of the Sponsor:

- Prepare and submit the trust deed to SEBI.
- Appoint the Board of Trustees and set up the AMC.
- File all required documents, including draft Memorandum and Articles of Association of the AMC.
- Undergo SEBI due-diligence regarding financial stability, compliance systems, grievance-redressal track record, and integrity.

SEBI Eligibility Criteria for Becoming a Sponsor (MF Regulations, 1996):

- Minimum **five years** of experience in the financial services business.
- Positive net worth for the last **five years**.
- Net worth in the previous year must exceed the AMC's capital contribution.
- Profitable business in **three of the last five years** (after depreciation, interest, and tax).
- Must be financially sound and fit and proper.
- Must contribute ≥ **40%** of the AMC's net worth.

If SEBI is satisfied with the sponsor, it grants approval for setting up the mutual fund trust.

2. Trust and Trustees (Second Tier)

Once SEBI approves the sponsor, a **trust** is created through a trust deed. The trust becomes the mutual fund itself, and it appoints trustees to safeguard investors' interests.

Characteristics and requirements:

- Trust is registered with SEBI as a mutual fund.
- Must have **a minimum of four trustees**.
- Trustees act as internal regulators of the mutual fund.
- Trustees oversee all activities of the AMC but do not directly manage investments.
- Two-thirds of AMC directors appointed must be independent.

Functions of Trustees:

- Ensure AMC systems — back office, accounting, dealing rooms — are compliant and effective.
- Ensure that AMC has not favored any related party against investors' interests.
- Oversee all AMC transactions for compliance with SEBI regulations.
- Take corrective action if any violations occur.
- Review AMC's net worth and operations at least quarterly.
- Monitor investor complaints and the grievance-handling system.
- Approve new schemes before launch and ensure proper disclosures.

Trustees act as custodians of investor interest, ensuring transparency and regulatory adherence.

3. Asset Management Company (AMC) (Third Tier)

The AMC is the investment manager of the mutual fund. It manages the pooled money, executes investment decisions, and undertakes all operational functions.

Key requirements for the AMC:

- Appointed by trustees with SEBI approval.
- Must have at least **four directors**, and **50% must be independent**.
- Can be terminated by trustees or by 75% of unit holders.
- Shall not undertake any business other than financial services.

Functions of the AMC:

- Launch mutual fund schemes with trustee approval.
- Process applications, issue units, handle redemptions, and maintain investor records.
- Manage investments through fund managers who decide what to buy/sell and when.
- Calculate and publish **daily NAVs**, maintain accounts, and file reports with AMFI/SEBI.
- Maintain ongoing compliance with SEBI and AMFI guidelines.
- Select and coordinate with auditors, legal advisors, custodians, brokers, and RTAs.
- Conduct marketing activities, appoint distributors, and liaise with collection centers.
- Maintain risk-management systems and portfolio disclosures.

AMCs may outsource activities such as fund accounting or investor servicing but remain fully accountable.

Other Key Participants in Mutual Fund Structure

1. Custodian

The custodian holds the securities purchased by the AMC in demat form.

Functions:

- Maintain custody of securities and ensure their safe transfer.
- Settle trades (delivery of securities and payment).
- Ensure receipt of dividends, interest, bonus, and rights benefits.
- Perform back-office accounting and record-keeping.
- Cannot participate in buy/sell decisions.

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2. Registrar and Transfer Agent (RTA)

RTAs act as the primary link between AMC and investors. The largest RTAs in India are **CAMS** and **KFin Technologies**.

Functions:

- Issue and redeem units; update investor folios.
- Maintain KYC, contact information, and unit-holding records.
- Provide account statements and transaction confirmations.
- Communicate dividend declarations and periodic reports.
- Maintain daily records of investors entering/exiting schemes.

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3. Fund Accountant

Responsible for:

- Calculating the daily NAV of mutual fund schemes.
- Recording assets, liabilities, accrued income, and expenses.

This may be handled internally or outsourced to specialized firms.

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4. Auditor

Auditors verify:

- Compliance with accounting standards and SEBI norms.
- Accuracy of NAV calculations.
- Proper verification of purchase and sale of securities.
- Prevention of fraud through sample transaction audits.

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5. Brokers

- Licensed by SEBI to execute trades for AMCs.
- Provide research reports and market insights.
- Act as intermediaries between AMCs and financial markets.

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6. Dealers

Dealers place buy/sell orders in markets on behalf of the AMC in coordination with brokers. They ensure proper documentation and execution.

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7. Intermediaries / Distributors

These include banks, financial advisors, agents, and distribution companies.

Functions:

- Market mutual fund schemes to investors.
- Provide investment guidance.
- Earn commissions from the AMC under SEBI-approved structures.

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3. Regulatory Framework

Mutual funds in India operate under a well-defined regulatory system designed to protect investors, ensure transparency, and maintain stability in the financial markets. The regulatory framework is primarily governed by SEBI, supported by industry bodies like AMFI, along with detailed disclosure and compliance requirements.

1. SEBI (Mutual Funds) Regulations, 1996

The **Securities and Exchange Board of India (SEBI)** introduced the SEBI Mutual Funds Regulations in 1996, which form the backbone of mutual fund governance in India.

Key provisions include:

- Mutual funds must be set up as **trusts** under the Indian Trusts Act, 1882.
- A mutual fund must have a **Sponsor, Trustees, and an AMC** (three-tier structure).
- Minimum **net-worth requirements** for AMCs.
- Detailed rules on launching schemes, disclosures, advertising, fees, and NAV calculation.
- Restrictions on investments to protect investors (limits on debt exposure, derivatives, etc.).
- Mandatory risk management practices and periodic reporting to SEBI.

These regulations ensure that every mutual fund operates with professional management, high transparency, and strong investor safeguards.

2. AMFI & Code of Conduct

The **Association of Mutual Funds in India (AMFI)** is the industry body representing all AMCs.

Roles of AMFI:

- Promote best practices across the industry.
- Provide training and certification for distributors (NISM exams).
- Maintain the consolidated mutual fund website for data and disclosures.
- Issue guidelines and disciplinary actions against members who violate norms.

AMFI Code of Ethics (ACE):

A mandatory code for AMCs and distributors covering:

- Fair treatment of investors
- Transparency in advertising & communication
- Avoidance of mis-selling
- Ethical conduct and compliance with regulations

Adherence to ACE helps maintain trust and professionalism in the industry.

3. Disclosure Norms

Mutual funds must maintain strong transparency. Key disclosure requirements include:

- **Daily NAV** publication on AMC, AMFI, and SEBI websites.
- **Monthly portfolio disclosure** of all holdings (equity, debt, cash).
- **Quarterly scheme factsheets** with key risks, performance, and expenses.
- **Scheme Information Document (SID)**: full details of objectives, strategy, benchmark, risk factors.
- **Key Information Memorandum (KIM)**: concise investor-friendly version.
- **Annual reports, half-yearly financial statements**, and auditor reports.

  Disclosure norms help investors make informed decisions and compare schemes easily.

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4. Net Asset Value (NAV) & Pricing

Net Asset Value (NAV) represents the per-unit market value of a mutual fund scheme. It reflects the fair value of all assets of the scheme minus all liabilities, divided by the total number of outstanding units. NAV is the most fundamental measure used to track the performance of any mutual fund scheme.

NAV changes daily based on the market value of the securities held in the portfolio and the expenses charged by the fund.

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2. Formula for NAV Calculation

The standard formula prescribed by SEBI is:

NAV per unit = (Total Assets – Total Liabilities)/Total Number of Units Outstanding

Total Assets include:

- Market value of equity, bonds, and money-market instruments
- Cash and cash equivalents
- Accrued income

Total Liabilities include:

- Pending expenses
- Charges and fees
- Other payables of the scheme

NAV is calculated **once every business day** for open-ended schemes and disclosed by AMCs on their websites and AMFI.

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3. Mark-to-Market (MTM)

SEBI requires funds to value most securities on a **mark-to-market basis**, meaning each security is valued at its *current market price*, not its purchase price.

MTM ensures:

- True and fair valuation of the scheme's portfolio
- Transparent and accurate NAV
- Protection of investor interests

Debt funds follow MTM valuation even for thinly traded instruments using SEBI-prescribed valuation agencies.

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4. Entry and Exit Load

Entry Load

It was a fee charged to investors at the time of purchase.
SEBI abolished entry load in 2009, so no mutual fund in India can charge this now.

Exit Load

A fee charged when an investor exits or redeems units within a specified period.
Exit load helps discourage premature withdrawals and compensates long-term investors.

Examples:

- 1% if redeemed within 1 year
- No load after 12 months

Exit load **does NOT impact NAV**. Instead, it is deducted from the redemption amount.

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5. Expense Ratio and Total Expense Ratio (TER)

Expense ratio refers to the annual fee charged by the AMC for managing the mutual fund scheme. It is expressed as a percentage of the fund’s average assets.

Expense Ratio=Total Expenses of the Scheme/Average AUM

Components of Expense Ratio:

- Fund management fee
- Registrar (RTA) fee
- Custodian fee
- Marketing and distribution expenses
- Administrative expenses

TER Limits as per SEBI:

Equity schemes can charge up to **2.25%**, debt schemes lower depending on AUM slabs.

TER is deducted daily from the scheme's assets, which reduces the NAV accordingly. Lower TER means higher returns for investors.

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5. Types of Mutual Funds

Mutual funds in India are classified in multiple ways based on structure, investment objective, asset class, risk profile, and management style. SEBI has clearly defined the categories to help investors compare and choose funds easily. The following section provides a complete overview of all major types of mutual funds as per Indian market classification norms.

1. Broad Classification of Mutual Funds

A. Open-Ended Funds

- These funds allow investors to buy and sell units at any time.
- There is no maturity period.
- Units are issued or redeemed based on the prevailing NAV.

B. Close-Ended Funds

- These funds are launched for a fixed maturity period (e.g., 3 or 5 years).
- Units can be bought only during the NFO period.
- Listing on stock exchanges provides liquidity for investors.

C. Interval Funds

- These funds combine features of both open-ended and close-ended schemes.
- Transactions (buy/sell) are allowed only during specified intervals.

D. Active vs Passive Funds

- **Active Funds:** Fund manager actively selects securities to outperform the benchmark.
- **Passive Funds:** Mirror an index (e.g., Nifty 50); minimal fund manager involvement.

E. Direct vs Regular Plans

- **Direct Plan:** Lower expense ratio; investor invests directly with AMC.
- **Regular Plan:** Includes distributor commission; slightly higher expense ratio.

2. Equity Mutual Funds

Equity funds invest predominantly (minimum 65%) in equity and equity-related instruments. They are classified based on market capitalization or investment style.

A. Market-Cap Based Funds

- **Large-Cap Funds:** Invest in top 100 listed companies; relatively stable.
- **Mid-Cap Funds:** Invest in companies ranked 101–250; moderate risk and growth potential.
- **Small-Cap Funds:** Invest beyond rank 250; highest risk and highest return potential.

B. Multi-Category Funds

- **Multi-Cap Funds:** Mandatory allocation across large, mid, and small caps.
- **Flexi-Cap Funds:** No mandatory allocation; fund manager can freely shift across market caps.

C. Sectoral / Thematic Funds

- Invest in a specific sector (e.g., IT, Pharma) or theme (e.g., ESG, infrastructure).
- Highly concentrated and high-risk.

D. ELSS (Equity Linked Savings Scheme)

- Tax-saving funds under Section 80C.
- 3-year mandatory lock-in; invests mostly in equities.

3. Debt Mutual Funds

Debt funds invest in fixed-income securities such as government securities, corporate bonds, treasury bills, and money market instruments. Categories are based on maturity profile and risk.

A. Short-Term Funds

- **Overnight Funds:** Invest in securities maturing within 1 day; lowest risk.
- **Liquid Funds:** Maturity up to 91 days; suitable for parking short-term money.
- **Ultra-Short Duration Funds:** Slightly higher maturity and returns.

B. Duration-Based Funds

- **Short-Duration Funds:** Maturity 1–3 years.
- **Medium-Duration Funds:** Maturity 3–4 years.
- **Medium-to-Long Duration Funds:** Maturity 4–7 years.
- **Long-Duration / Gilt Funds:** Invest in long-term government securities.

C. Credit-Oriented Funds

- **Corporate Bond Funds:** Invest at least 80% in high-rated corporate bonds.
- **Credit Risk Funds:** Invest minimum 65% in lower-rated bonds, aiming for higher yields.

D. Key Risk Considerations

- **Interest Rate Risk:** NAV falls when interest rates rise.
- **Credit Risk:** Risk of issuer default.
- **Liquidity Risk:** Difficulty in selling securities at the right price/time.

4. Hybrid Mutual Funds

Hybrid funds combine equity and debt in different proportions to balance risk and return.

A. Aggressive Hybrid Funds

- 65–80% equity
- Higher risk than balanced funds.

B. Conservative Hybrid Funds

- 75–90% debt
- Suitable for risk-averse investors.

C. Balanced Advantage Funds (BAF)

- Dynamic asset allocation; shifts between debt and equity depending on market conditions.

- Lower volatility than pure equity funds.

D. Multi-Asset Allocation Funds

- Invest in **three or more** asset classes (equity, debt, gold, REITs).
- Diversified portfolio to reduce concentration risk.

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5. Other Mutual Fund Products

A. Index Funds

- Passive funds that replicate an index.
- Low cost; transparent structure.

B. Exchange Traded Funds (ETFs)

- Listed on stock exchanges.
- Buy/sell like shares; NAV closely tracks the index price.

C. Fund of Funds (FoF)

- Invests in other mutual funds instead of directly in securities.
- Can be domestic or international FoFs.

D. International Funds

- Invest in global equity markets through direct exposure or foreign ETFs/FoFs.
- Provide geographic diversification but carry currency risk.

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6. Risks in Mutual Funds

Mutual funds are market-linked investment products. While they offer diversification, professional management, and liquidity, they also carry various types of risks. An informed investor must understand these risks because they directly affect returns, NAV fluctuations, and long-term wealth creation. Broadly, mutual fund risks arise from market movements, credit quality, liquidity conditions, and regulatory or behavioural factors.

Below are the major risks associated with mutual fund investments:

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1. Market Risk

Market risk refers to the possibility of losses due to overall market fluctuations. It arises because mutual funds invest in equities, bonds, or other securities whose prices may rise or fall due to economic conditions, interest rates, inflation, geopolitical events, or global financial trends.

- Equity funds face high market volatility.
- Debt funds face interest rate risk (bond prices fall when interest rates rise).
Market risk cannot be eliminated but can be managed through diversification and asset allocation.

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2. Credit Risk

Credit risk is the risk that a bond or debt security issuer fails to pay interest or principal. If the issuer's credit rating is downgraded or if default occurs, the value of the mutual fund's debt portfolio declines.

- Debt schemes such as **corporate bond funds**, **credit risk funds**, and **low-rated paper** carry higher credit risk.
- Gilt funds (which invest in government securities) have negligible credit risk.
NAV of debt mutual funds reflects changes in credit quality.

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3. Liquidity Risk

Liquidity risk arises when a fund is unable to buy or sell securities quickly without impacting their prices.

- It increases during market stress, economic slowdown, or sudden redemption pressure.
- Small-cap equity funds, thinly traded bonds, or credit funds are more exposed.
If a fund cannot sell underlying securities on time, it may have to borrow, delay payments, or impose exit restrictions (in extreme cases).

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4. Concentration Risk

Concentration risk occurs when a mutual fund invests heavily in a single sector, theme, or type of security.

- Sectoral and thematic funds have high concentration risk.
- A downturn in that specific sector can significantly hurt fund performance.
Diversified funds reduce concentration risk by spreading investments across multiple sectors and asset classes.

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5. Interest Rate Risk

(Sub-component of market risk relevant for debt funds)
Interest rate risk refers to the inverse relationship between bond prices and interest rates.

- When interest rates rise → bond prices fall → NAV declines.
- When interest rates fall → bond prices rise → NAV increases.
  Long-duration and gilt funds have the highest interest rate sensitivity.

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7. Mutual Fund Schemes and Plans

Mutual funds in India follow a transparent disclosure framework to protect investors and ensure that every scheme is launched with complete information about risks, objectives, and operational details. SEBI mandates three key offer documents — **SID, SAI, and KIM** — which together help an investor make an informed decision. Alongside these, mutual funds also provide systematic investment mechanisms such as **SIP, STP, and SWP**, allowing investors to plan their finances more effectively.

1. Scheme Information Document (SID)

The SID is the *primary* document that provides comprehensive details about a mutual fund scheme.
It includes:

- Investment objective of the scheme
- Asset allocation pattern
- Risk factors
- Benchmark index
- Fees and expenses (including TER)
- Rights and obligations of unit holders
- Details of the fund manager and investment strategy

SEBI requires AMCs to update the SID regularly, especially when changes occur in risk profile, strategy, or expenses.

2. Statement of Additional Information (SAI)

The SAI is a *secondary* and supplementary document applicable to all schemes of an AMC, not just one.
It contains:

- Constitution of the mutual fund and AMC
- Detailed information on sponsors and trustees
- Code of conduct and internal governance
- AMC's financials, compliance structure, and legal disclosures
- Investor grievance redressal mechanism

While the SID explains a *specific scheme*, the SAI explains the *background and operational framework of the entire mutual fund house*.

3. Key Information Memorandum (KIM)

The KIM is a *concise summary* of the SID and is mandatory to be provided to every investor before purchase.
It contains:

- Basic details of the scheme
- Minimum investment amount
- Load structure (entry/exit load)
- Risk-o-meter indicator
- Performance summary

- Contact information of AMC and service centers

It helps investors quickly understand the essential points without reading the entire SID.

4. Risk-o-meter

SEBI has introduced a standardized **Risk-o-meter** to help investors identify the risk level of each scheme.
The categories are:

- **Low**
- **Low to Moderate**
- **Moderate**
- **Moderately High**
- **High**
- **Very High**

The Risk-o-meter is updated monthly based on portfolio changes and is displayed on:

- AMC website
- AMFI website
- Scheme factsheets

This ensures transparency and assists investors in aligning investments with their risk appetite.

8. Systematic Plans

Systematic plans help investors automate their investments, transfers, or withdrawals. They promote financial discipline and reduce the impact of market volatility.

SIP — Systematic Investment Plan

A SIP allows an investor to invest a fixed amount at regular intervals (monthly/weekly/quarterly).
Key features:

- Rupee-cost averaging
- Helps build long-term wealth
- Suitable for salaried or regular-income investors
- Reduces timing risk in markets

SIPs are the most popular investment mechanism in Indian mutual funds.

1. Introduction

Pension funds play a crucial role in long-term financial security by helping individuals accumulate savings for retirement in a structured and professionally managed manner. These funds pool contributions from employees, employers, or both, and invest the money in diversified financial instruments such as equity, debt, and government securities. Over time, the invested amount grows, and the accumulated corpus is used to provide post-retirement income in the form of monthly pensions, lump-sum withdrawals, or a combination of both.

Pension funds are essential because they ensure *financial stability* in retirement, reduce dependency on family, and protect the elderly against inflation and rising living costs. In countries like India, where life expectancy has increased and the nuclear family system is growing, the role of pension funds has become even more significant for long-term social and economic security.

Pension funds operate with a defined regulatory structure and follow strict investment guidelines to ensure safety and stability. In India, pension products are regulated by bodies such as the Pension Fund Regulatory and Development Authority (PFRDA), the Employees' Provident Fund Organisation (EPFO), and the Insurance Regulatory and Development Authority of India (IRDAI). Each regulator governs different types of pension schemes based on employment category and product structure.

There are different forms of pension systems that operate globally—**Defined Benefit (DB)** plans, where pension amount is predetermined based on salary and tenure, and **Defined Contribution (DC)** plans, where the contribution amount is fixed but final corpus depends on market performance. India has shifted majorly from DB to DC systems, particularly with the introduction of the National Pension System (NPS).

Pension funds also provide several long-term benefits: professional fund management, diversified portfolios, tax advantages, disciplined savings, and improved retirement planning. However, they also come with limitations such as market-linked risks (in DC plans), lock-in periods, and regulatory constraints on withdrawal.

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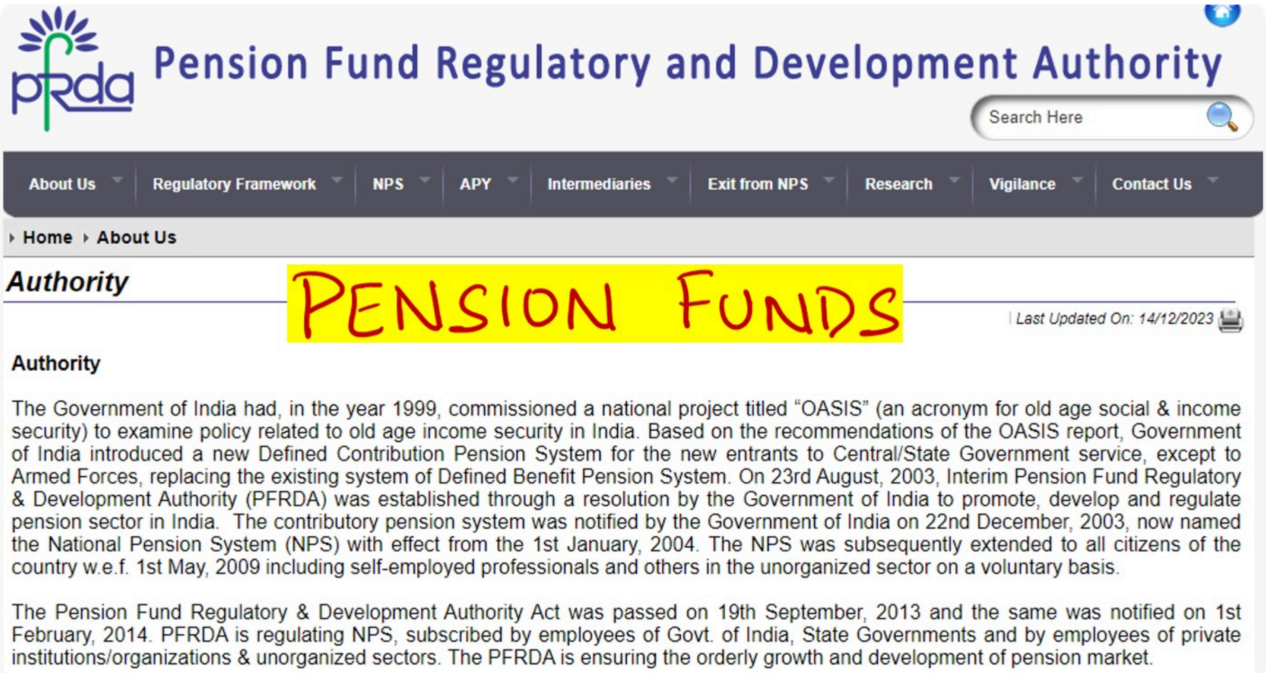
2. PFRDA



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Authority PENSION FUNDS

Last Updated On: 14/12/2023

Authority

The Government of India had, in the year 1999, commissioned a national project titled "OASIS" (an acronym for old age social & income security) to examine policy related to old age income security in India. Based on the recommendations of the OASIS report, Government of India introduced a new Defined Contribution Pension System for the new entrants to Central/State Government service, except to Armed Forces, replacing the existing system of Defined Benefit Pension System. On 23rd August, 2003, Interim Pension Fund Regulatory & Development Authority (PFRDA) was established through a resolution by the Government of India to promote, develop and regulate pension sector in India. The contributory pension system was notified by the Government of India on 22nd December, 2003, now named the National Pension System (NPS) with effect from the 1st January, 2004. The NPS was subsequently extended to all citizens of the country w.e.f. 1st May, 2009 including self-employed professionals and others in the unorganized sector on a voluntary basis.

The Pension Fund Regulatory & Development Authority Act was passed on 19th September, 2013 and the same was notified on 1st February, 2014. PFRDA is regulating NPS, subscribed by employees of Govt. of India, State Governments and by employees of private institutions/organizations & unorganized sectors. The PFRDA is ensuring the orderly growth and development of pension market.

In 1999 the Government commissioned a national project, **OASIS (Old Age Social and Income Security)** to examine policies related to old age income security in India. Based on the recommendations of the OASIS report, the Government of India introduced a new Defined Contribution Pension System for the new entrants to Central/State Government service, except for the armed forces, replacing the existing system of the Defined Benefit Pension System.

On 23 August 2003, the interim Pension Fund Regulatory & Development Authority (PFRDA) was established. The **PFRDA Act was passed in 2013** and notified in Feb 2014, thus setting up PFRDA as the Regulator for Pension Sector in India.

The **Pension Fund Regulatory and Development Authority (PFRDA)**, a statutory body, is the pension regulator of India which was established by Government of India on August 23, 2003 and was authorized by Ministry of Finance, Department of Financial Services. Upon introduction of the PFRDA Bill by the Government of India in the Parliament of India and the subsequent passage of the PFRDA Act in 2013, the Authority became a Central Autonomous Body.

Functions

Following are the function of Pension Fund Regulatory and Development Authority:

- Regulate National Pension Scheme (NPS) and pension schemes to which PFRDA Act applies.
- Establish, develop and regulate pension funds.
- Protect the interest of pension fund subscribers.
- Register and regulate intermediaries.
- Approve schemes, terms and conditions, and laying down norms for management of corpus of pension funds.
- Establish grievance redressal mechanism for subscribers.
- Promote professional organization connected with the pension system.
- Settle disputes among intermediaries and also between intermediaries and subscribers.
- Train intermediaries and educate subscribers and the general public with respect to pension, retirement savings and related issues.
- Regulate the regulated assets.
- Call for information, conduct inquiries, investigation and audit of intermediaries and other entities connected with pension funds.
- to promote old age income security by establishing, developing and regulating pension funds.
- to protect the interests of subscribers to schemes of pension funds.

Prominent Schemes of Government of India are discussed next.

3. National Pension Scheme

The contributory pension system was notified by the Government of India on 22 December 2003, now named as the National Pension Scheme (NPS) (sometimes named National Pension System) with effect from 1 January 2004. The NPS was extended to all citizens of Indian on voluntary basis from May 2009, to corporates in December 2011, to non-Resident Indians in October 2015 and to Overseas Citizen of India in Oct 2019.

The National Pension System (NPS) is being administered and regulated by **Pension Fund Regulatory and Development Authority (PFRDA).**

NPS is a market linked, defined contribution product. Under NPS, a unique Permanent Retirement Account Number (PRAN) is generated and maintained by the Central Recordkeeping Agency (CRA) for individual subscriber.

NPS offers two types of accounts, namely Tier-I and Tier-II. **Tier-I** account is the pension account having restricted withdrawals. **Tier-II** is a voluntary account which offers liquidity of investments and withdrawals. It is allowed only when there is an active Tier-I account in the name of the subscriber. The contributions accumulate over a period of time till retirement grows with market linked returns. Contribution made to the NPS Tier-I account is eligible for tax deduction under the Income Tax Act, 1961.

On exit/retirement/superannuation, a minimum of 40% of the corpus is mandatorily utilized to procure a pension for life by purchasing an annuity from a life insurance company and the balance corpus is paid as lumpsum.

Models

NPS platform offers different models to suit the different segments of users. These include:

1. **Government Model** for the Central and State Government employees: NPS is mandatorily applicable on Central Government employees (except Armed Forces) recruited on or after 01.01.2004. Subsequently, all State Governments excluding West Bengal have also adopted NPS for their employees.
2. **Corporate Model:** Companies can adopt NPS for their employees with contribution rates as per the employment conditions.
3. **Citizens Model:** The All Citizens Model of the NPS allows all citizens of India aged between 18 - 70 years to join NPS on voluntary basis.

NPS Architecture

The National Pension System (NPS) architecture consists of the following entities:

- **NPS Trust**, which is entrusted with safeguarding subscribers' interests. National Pension Scheme Trust (NPST) was established by PFRDA as per the provisions of the Indian Trusts Act of 1882 for taking care of the assets and funds under the NPS in the best interest of the subscribers. The powers, functions and duties of NPS Trust are laid down under the PFRDA Regulations 2015.
- **Central Recordkeeping Agencies (CRAs)** performs Registration of Subscribers, Issuance of Permanent Retirement Account Number (PRAN), Dispatch of Card, Welcome Kit etc. The CRAs are NSDL e-Governance Infrastructure Limited and Karvy Computershare Private Limited.
- **Point of Presence (POP)** are collection, distribution and servicing arms. The functions includes subscriber registration, processing of initial contribution, processing of regular contribution, changes in subscriber details, grievance handling etc.
- **Pension Fund Managers (PFM)** are for managing the investments of subscribers. Some of Pension Fund Managers are SBI Pension Funds, LIC Pension Fund, UTI Retirement Solutions, HDFC Pension Fund, ICICI Prudential Pension Fund, Kotak Pension Fund.
- **Trustee bank** to manage the banking operations. Trustee Bank as an intermediary is responsible for the day-to-day flow of funds and banking facilities. The appointment of Trustee Bank is valid for five (5) years subject to annual review by PFRDA.
- **Annuity Service Providers (ASPs)** are to be appointed by PFRDA, to maintain the annuity contribution of subscribers through their various schemes. ASPs would be responsible for delivering a regular monthly pension (annuity) to the subscriber for the rest of his/her life. Currently some Annuity Service Providers are Life Insurance Corporation of India, HDFC Life Insurance Co. Ltd, ICICI Prudential Life Insurance Co. Ltd, SBI Life Insurance Co. Ltd etc.
- **Subscribers:** An Indian citizen between the age of 18-70 years (increased from 65 to 70 years in Aug 2021), whether resident or non-resident, can join NPS. The subscribers receive a Permanent Retirement Account Number (PRAN) card which has a 12-digit unique number.

3. National Pension Scheme

In August 2021, the PFRDA increased the maximum age of joining under NPS-Private Sector (i.e. All Citizen and Corporate Model) from 65 years to 70 years of age.

Until now, private sector subscribers could choose who will manage their NPS corpus from among the pension fund managers under NPS. The pension savings of government subscribers was mandatorily split equally between three public sector pension fund managers—SBI Pension Funds Pvt. Ltd, LIC Pension Fund Ltd and UTI Retirement Solutions Ltd. Through a notification dated 31 January 2019, the PFRDA permitted the Central Government employees to choose their own pension fund manager from among the fund managers under NPS.

The same notification has also given government employees the freedom to choose between 4 types of asset allocations, which are:

1. Scheme E (Equity)
2. Scheme C (Corporate Debt)
3. Scheme G (Government/Gilt bonds)
4. Scheme A (Alternative Investment)

Alternatively, the subscriber can opt for the default scheme, where his portfolio is rebalanced each year for the proportion of equity, corporate bonds, and government bonds as per the time left to retirement.

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3. National Pension Scheme

The NPS-Lite was basically designed with the intention to secure the future of the people who are economically disadvantaged and who are not financially well to do. The PFRDA introduced the National Pension Scheme-Lite (NPS-Lite) in 2010. It was also named Swavalamban scheme.

The servicing model of NPS Lite is based on group servicing. The people forming part of this low income groups will be represented through their organizations known as "Aggregators" who would facilitate in subscriber registration, transfer of pension contributions and subscriber maintenance functions. Subscribers in the age group of 18 to 60 can join NPS - Lite through the aggregator and contribute till the age of 60.

However, fresh registration under Swavalamban/NPS-Lite Scheme were discontinued in . The subscribers of Swavalamban/ NPS Lite who are in the age group of 18-40 years were migrated to new Atal Pension Yojana in 2015.

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4. Atal Pension Yojana

To encourage people from the unorganised sector to voluntarily save for their retirement the Central Government launched a co-contributory pension scheme, Swavalamban Pension Scheme in the Union Budget of 2010-11. The Atal Pension Yojana replaced the Swavalamban Yojana and was launched in May 2015.

You are eligible to avail the benefits provided to you by Atal Pension Yojana if:

- You are a citizen of India.
- You fall under the age group of 18 to 40 years.
- You will be able to make contributions for at least 20 years.
- You have a bank account that is linked to your Aadhar.
- You have a valid mobile number.

Provides a minimum guaranteed pension ranging from Rs 1000 to Rs 5000 on attaining 60 years of age. The amount of pension is guaranteed for lifetime to spouse on death of the subscriber and, in the event of death of both the subscriber and the spouse, entire pension corpus is paid to the nominee.

Also, people who were registered under **Swavalamban Yojana** will automatically be able to get benefits under Atal Pension Yojana too. Payment of pension and exit from the Pension Yojana is not allowed, except in situations like terminal disease or death of the account holder.

5. National Pension Scheme for the Traders and Self- Employed Persons (NPS-Traders)

Government of India has introduced two voluntary and contributory Pension Schemes, i.e. (1) **Pradhan Mantri Shram Yogi Maan-dhan Yojna,** (PM-SYM), a pension scheme for the Unorganised Workers and (2) **National Pension Scheme for the Traders and Self Employed Persons** (NPS-Traders) (for the Vyapari's) under the Unorganised Workers Social Security Act, 2008 to provide old age protection to them. Both the schemes are being implemented through Life Insurance Corporation (LIC) of India and Common Service Centres. LIC is the Fund Manager and responsible for pension pay-out. Common Service Centre is the enrolment agency responsible for enrolment of the beneficiaries.

The NPS-Traders Scheme is meant for old age protection and social security of Vyapaaris (retail traders/ shopkeepers and self-employed persons) whose annual turnover is not exceeding Rs. 1.5 Crore. These retail traders / petty shopkeepers and self-employed persons are mostly working as shop owners, retail traders, rice mill owners, oil mill owners, workshop owners, commission agents, brokers of real estate, owners of small hotels, restaurants and other Vyapaaris. The entry age for the scheme is 18-40 years and the Vyapaari should not be a member of EPFO/ESIC/NPS/PM-SYM or an income tax payer. Under the scheme, 50% monthly contribution is payable by the beneficiary and equal matching contribution is paid by the Central Government. Subscribers, after attaining the age of 60 years, are eligible for a monthly minimum assured pension of Rs. 3,000. This scheme was earlier named Pradhan Mantri Laghu Vyapari Maan-dhan Scheme.

6. Pradhan Mantri Shram Yogi Maan-dhan (PM-SYM) Scheme

The Government had launched a mega pension scheme for the unorganised sector in the interim Budget 2019. The scheme would ensure old age protection for the workers in this sector. The **category of unorganised workers** include agricultural workers, construction workers, beedi workers, home-based workers, street vendors, mid-day meal workers, head loaders, brick kiln workers, cobblers, rag pickers, domestic workers, washermen, rickshaw pullers, landless labourers, handloom workers, leather workers, audio-visual workers and similar other occupations whose **monthly income is Rs 15,000 per month or less** and belong to the entry age group of 18-40 years. These people should not be under NPS/ESIC/EPFO or income tax payers. The contribution of a subscriber ranges from Rs 55 to Rs 200 depending on his **entry age which is 18 to 40.**

The following benefits lies under the scheme which can be availed by the contributors;

- **Minimum Assured Pension:** After attaining the age of 60 years, minimum assured pension of Rs 3000 per month.
- **Family Pension:** If subscriber dies, the spouse will receive the pension which will be 50% of the pension amount. No other person is applicable for the same.
- **Benefits:** If a beneficiary has given regular contribution and died due to any cause (before age of 60 years), his/her spouse will be entitled to join and continue the scheme subsequently by payment of regular contribution or exit the scheme as per provisions of exit and withdrawal.

The PM-SYM is a voluntary and contributory pension scheme on 50:50 basis where prescribed age-specific contribution shall be made by the beneficiary and the matching contribution by the Central Government. The subscriber will be required to have a mobile phone, savings bank account and Aadhaar number. The eligible subscriber may visit the nearest Common Services Centers (CSC e-Governance Services India Limited (CSC SPV)) and get enrolled for PM-SYM using Aadhaar number and savings bank account/ Jan-Dhan account number on self-certification basis.

LIC will be the Pension Fund Manager and responsible for pension pay out.

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7. Pradhan Mantri Kisan Mandhan Yojana

The Pradhan Mantri Kisan Mandhan Yojana (PM-KMY) is an old age pension scheme **for all land holding Small and Marginal Farmers (SMFs)** in the country with a view to provide social security.

It is a voluntary and contribution-based pension scheme for farmers in the entry age group of 18 to 40 years and a monthly pension of Rs. 3000 will be provided to them on attaining the age of 60 years. The beneficiary is required to contribute **Rs. 100 per month** in the pension fund at median entry age of 29 years, with matching contribution of Rs. 100 by the Central Government.

The **Life Insurance Corporation of India (LIC)** will be the Pension Fund Manager and responsible for Pension pay out. In case of death of the farmer before retirement date, the spouse may continue in the scheme by paying the remaining contributions till the remaining age of the deceased farmer. If the farmer dies after the retirement date, the spouse will receive 50% of the pension as Family Pension. After the death of both the farmer and the spouse, the accumulated corpus shall be credited back to the Pension Fund.

Small and Marginal Farmers (SMFs) are those with age of 18-40 years, having cultivable land up to 2 hectares as per land records of the concerned State/UT. The SMFs covered under any other statutory social security schemes such as NPS/ESIC/PM-SYM/EPFO/ Institutional Land holders etc. are excluded from this scheme.

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8. Pradhan Mantri Garib Kalyan Yojana (PMGKY)

In March 2020, the Government announced Rs. 1.70 Lakh Crore relief package under Pradhan Mantri Garib KalyanYojana (PMGKY) for the poor to help them fight the battle against Corona Virus Pandemic. As part of the said package, the Central Government announced to pay 24% of the monthly wages into EPF accounts for 6 months of Wage-earners below Rs. 15,000 per month, who are employed in establishments having upto 100 employees, with 90% or more of such employees earning monthly wages less than Rs. 15,000. The entire employees EPF contributions (12% of wages) and employers' EPF & EPS contribution (12% of wages), totalling 24% of the monthly wages for 6 months shall be directly paid by the Central Government in the EPF accounts (UAN) of employees, who are already members of EPF Scheme, 1952.

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9. Atmanirbhar Bharat Rojgar Yojana (ABRY)

In December 2020, the Government approved Atmanirbhar Bharat RojgarYojana (ABRY) to boost employment in formal sector and incentivize creation of new employment opportunities during the Covid recovery phase under Atmanirbhar Bharat Package.

The salient features of the Scheme are listed below:

- The Government will provide subsidy for 2 years in respect of new employees engaged on or after 1st October, 2020 and upto 30th June 2021.
- The Government will pay both 12% employees' contribution and 12% employers' contribution i.e. 24% of wages towards EPF in respect of new employees in establishments employing upto 1000 employees for 2 years.
- The Government will pay only employees' share of EPF contribution i.e. 12% of wages in respect of new employees in establishments employing more than 1000 employee for 2 years.
- An employee drawing monthly wage of less than Rs. 15000 who was not working in any establishment registered with the EPFO before 1st October, 2020 and did not have a Universal Account Number or EPF Member account number prior to 1st October 2020 will be eligible for the benefit.
- Any EPF member possessing Universal Account Number (UAN) drawing monthly wage of less than Rs. 15000 who made exit from employment during Covid pandemic from 01st March 2020 to 30th Sep 2020 and did not join employment in any EPF covered establishment will also be eligible.

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10. Pradhan Mantri Rojgar Protsahan Yojana (PMRPY)

Government of India is implementing the Pradhan Mantri Rojgar Protsahan Yojanaa (PMRPY) to incentivize employers for new employment. The scheme launched on 9th August 2016 provides that Government of India will pay the Employees Pension Scheme (EPS) contribution of 8.33% for all new employees enrolling in EPFO for the first 3 years of their employment. The scheme is applicable to those having earnings Rs. 15,000 per month. For the textile (garmenting) sector, Government of India is paying the complete 12% employers' contribution (8.33% EPS +3.67% EPF) for these new employees.

The business must be registered with the EPFO and must have a Labour Identification Number (LIN) that one can acquire under the Shram Suvidha Portal. Under the PMPRY scheme, the Labour Identification Number will serve as the primary reference number for all official communication.

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1. Introduction

India has financial institutions, which are not banks but perform bank like functions, especially the financial intermediation of mobilisation of deposits and extending credit. These are called Non-Banking Financial Companies (NBFCs).

Definition

A Non-Banking Financial Company (NBFC) as **defined in the Rserve Bank of India Act, 1934** is a Company registered under the Companies Act and engaged in the business of:

- Lending or financing
- Acquisition of shares / stocks / bonds/ debentures/securities issued by Government or local authority
- Leasing & hire-purchase
- Insurance business
- Chit business
- Collection of monies
- Acceptance of deposits

But, **does not include** any company which carries on its principal business in:

- Agriculture operations
- Industrial activity
- Purchase or sale of any goods (other than securities)
- Providing any services and
- Sale / purchase / construction of immovable property.

Only those NBFCs that satisfy the **Principal Business criteria** defined by the RBI will get themselves registered with the RBI and these entities will be regulated and supervised by the RBI. Financial activity as principal business is when a company's financial assets constitute more than 50% of the total assets and income from financial assets constitute more than 50% of the gross income. A company, which fulfils both these criteria, will be registered as NBFC by the RBI.

Such NBFCs should bring in the minimum **Net Owned Fund (NOF)** stipulated for their category by the RBI and obtain a Certificate of Registration (COR) from RBI. As per the regulatory guidelines, only those NBFCs, with a minimum Net Owned Fund (NOF) of Rs. 2 crore are allowed to operate.

Registration

For the purpose of Registration, NBFCs are classified into two categories by RBI, viz.

1. Deposit taking NBFCs (NBFC-D) and
2. Non-Deposit taking NBFCs (NBFC-ND).

The Non-Deposit taking NBFCs (NBFC-ND) are further classified into 2 types based on source of funds and customer interface as follows.

- **Type I - NBFC-ND** not accepting public funds and/or not having customer interface.
- **Type II - NBFC-ND** accepting public funds and/or having customer interface.

The Non-Deposit taking NBFCs (NBFC-ND) are further classified into 2 types, based on the asset size as Systemically Important (SI) and Non-Systemically Important (Non-SI). NBFCs, whose asset size are of Rs. 500 Crore or more, as per last audited balance sheet are considered as “Systemically Important” NBFCs, while those with asset size less than Rs. 500 Crore are considered as “Non-Systemically Important” NBFCs.

2. Categories

The various categories of NBFCs and their nature of activity/principal business are listed below:

Asset Finance Company (AFC) - Financing real physical assets supporting economic activity.

Investment Company (IC) - acquisition of securities.

Loan Company (LC) - Providing loans and advances for any activity (not an AFC).

Investment and Credit Company (NBFC-ICC) - In Feb 2019, the RBI merged above 3 categories of NBFCs viz. Asset Finance Companies (AFC), Loan Companies (LCs) and Investment Companies (ICs) into a new category called NBFC - Investment and Credit Company (NBFC-ICC).

Infrastructure Finance Company (IFC) - Providing loans for Infrastructure development.

Core Investment Company (CIC) - Investing in/lending to group companies.

Infrastructure Debt Fund (IDF) - Facilitation of flow of long-term debt into infrastructure projects.

Micro Finance Institutions (MFI) - Credit to economically disadvantaged groups.

Mortgage Guarantee Companies (MGC) - Providing mortgage guarantees for loans.

Non-Operative Financial Holding Company (NOHFC) - For setting up new banks in private sector through its promoter/promoter groups.

Account Aggregators (AA) – Collecting and providing information about a customer's financial assets in a consolidated, organised and retrievable manner to the customer or others as specified by the customer.

Peer-to-Peer Lending (P2P) - Providing an online platform to bring lenders and borrowers together to help mobilise funds.

NBFC-Factor - Acquisition of receivables of an assignor or extending loans against the security interest of the receivables at a discount.

Asset Reconstruction Companies (ARC) - These companies are registered under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI), 2002 for acquiring and dealing in financial assets sold by banks and financial institutions. ARCs play a crucial role in resolution of non-performing assets (NPAs). They acquire any right or interest of any bank or financial institution (FI) in any financial assistance, for the purpose of realization of such financial assistance.

3. RBI Role

The RBI has put in place a 4 pronged supervisory framework for NBFC, based on:

1. **On-site inspection:** The system of on-site examination put in place during 1997 is structured on the basis of assessment and evaluation of CAMELS (Capital, Assets, Management, Earnings, Liquidity, and Systems and Controls) approach and the same is akin to the supervisory model adopted by the RBI for the banking system.
2. **Off-site monitoring:** In order to supplement information gathered from on-site inspections, several returns have been prescribed for NBFCs as part of the off-site surveillance system.
3. **Market intelligence:** Pro-active market intelligence can help pick up early warning signals about the health of a particular NBFC and trigger supervisory action to protect the interest of the depositors / avoid systemic risks.
4. **Exception reports of statutory auditors of NBFCs:** The Statutory Auditors are required to report to the Reserve Bank about any irregularity or violation of regulations concerning acceptance of public deposits, credit rating, prudential norms and exposure limits, capital adequacy, maintenance of liquid assets and regularisation of excess deposits held by the companies.

The RBI launched a mobile friendly portal **Sachet** (sachet.rbi.org.in) on 4th August 2016, to help the public as well as regulators to ensure that only regulated entities accept deposits from the public.

The Reserve Bank of India has introduced an **Ombudsman Scheme for customers** of Non-Banking Financial Companies (NBFCs) in 2018. It is an expeditious and cost-free apex level mechanism for resolution of complaints of customers of NBFCs, relating to certain services rendered by NBFCs. The NBFC Ombudsman is a senior official appointed by the Reserve Bank of India to redress customer complaints against NBFCs for deficiency in certain services.

Co-origination is a new system introduced by the RBI in 2019, in the wake of the liquidity crisis at NBFCs. Under the co-lending model, the bank will have an exposure between 70% to 80%, while the rest will be borne by the NBFCs, but this arrangement will be "only" for the priority sector lending.

4. Other Regulators

Not all NBFCs are regulated by the RBI. The regulators of other NBFCs are listed in the table below.

Types of NBFCs/Activities	Regulator
Venture Capital Fund; Merchant Banking Companies; Mutual Funds; Collective Investment Schemes (CIS)	Securities and Exchange Board of India (SEBI)
Insurance Companies	Insurance Regulatory and Development Authority (IRDA)
Pension Funds	Pension Fund Regulatory and Development Authority of India (PFRDA)
Mutual Benefit Companies; Nidhi Companies	Ministry of Corporate Affairs (MCA)
Chit Funds	State Governments
Housing Finance Companies	National Housing Bank

5. MUDRA

Micro Units Development and Refinance Agency Ltd. (MUDRA) is registered as an NBFC with the primary objective of developing the micro enterprise sector in the country by extending various types of support including financial support in the form of refinance, so as to achieve the goal of "funding the unfunded". The purpose of MUDRA is to provide funding to the non-corporate small business sector through various Last Mile Financial Institutions like Banks, NBFCs and MFIs.

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1. Concept of Insurance

Insurance is form of contract or an arrangement where one party agrees in return for a consideration to pay an agreed amount of money to another party to make good the loss, damage or injury to something of value in which the insured has an interest. Being a contract of indemnity, it is based on the principle of utmost good faith.

Insurance is a tool of risk management to cover the uncertainties, i.e., the risk of loss of assets or human life. Basically, it means many people paying a little money to create a bigger pool of money so that anyone who is unfortunate enough to suffer a loss is reimbursed financially for that loss.

Thus, the basic purpose for insurance is **spreading risk to make losses more manageable.**

A contract of insurance is an agreement whereby one party, called the **insurer**, undertakes, in return for an agreed consideration, called the **premium**, to pay the other party, namely the **insured**, a sum of money or its equivalent in kind, upon the occurrence of a specified event resulting in a loss to him. The policy is a document, containing the terms and conditions, which is an evidence of the contract of insurance.

An insurance policy is also a contract entered into between two parties, viz., the Insurance Company and the Policyholder and fulfils the requirements enshrined in the Indian Contract Act.

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1. Concept of Insurance

The various functions of Insurance are as follows:

- Insurance provides certainty of payment for the risk of loss.
- It provides protection from probable chances of loss.
- On the happening of a risk event, the loss is shared by all the persons exposed to it. The share is obtained from every insured member by way of premiums.
- The accumulated funds of the insurer received by way of premium payments made by the insured are invested in various income generating schemes.

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2. History of Insurance

In India, insurance has a deep-rooted history. It finds mention in the writings of Manu (Manusmrithi), Yagnavalkya (Dharmasastra) and Kautilya (Arthasastra). The writings talk in terms of pooling of resources that could be re-distributed in times of calamities such as fire, floods, epidemics and famine.

Insurance in India has evolved over time heavily drawing from other countries, England in particular.

In 1666, the Great Fire of London destroyed thousands of houses. To counter such events in future, Fire Office, the first insurance company was started in 1680.

History of Insurance can be divided into history of **Life Insurance** as well as history of **General Insurance** in India.

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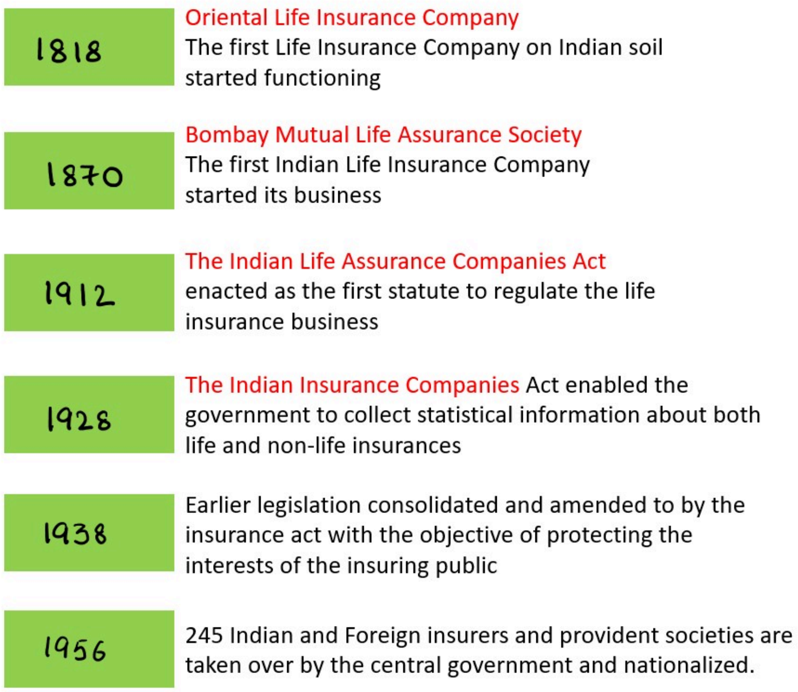
2. History of Insurance

Life Insurance in its modern form came to India from England in the year 1818 with the establishment of **Oriental Life Insurance Company** in Calcutta.

All the insurance companies established during that period were brought up with the purpose of looking after the needs of European community and Indian natives were not being insured by these companies. However, later with the efforts of eminent people like Babu Muttylal Seal, the foreign life insurance companies started insuring Indian lives. But Indian lives were being treated as sub-standard lives and heavy extra premiums were being charged on them. **Bombay Mutual Life Assurance Society** heralded the birth of first Indian life insurance company in the year 1870 and covered Indian lives at normal rates.



The **Swadeshi Movement** of 1905-1907 gave rise to more insurance companies.

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

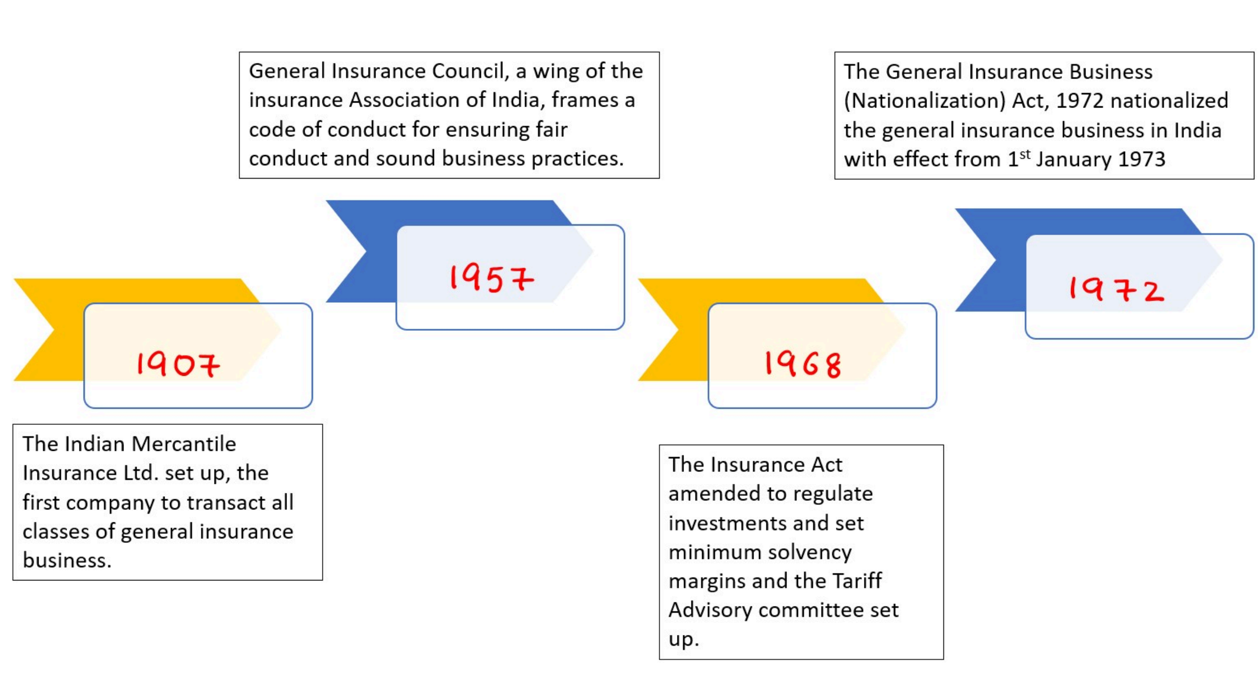
The **Insurance Amendment Act of 1950** abolished Principal Agencies. However, there were a large number of insurance companies and the level of competition was high. There were also allegations of unfair trade practices. The Government of India, therefore, decided to nationalize insurance business.

An Ordinance was issued on 19th January 1956 nationalising the Life Insurance sector and Life Insurance Corporation came into existence in the same year. The Parliament of India passed the Life Insurance Corporation Act on 19th June 1956, and the **Life Insurance Corporation of India** was created on 01st September 1956, with the objective of spreading life insurance much more widely and in particular to the rural areas with a view to reach all insurable persons in the country, providing them adequate financial cover at a reasonable cost.

The LIC absorbed 154 Indian, 16 non-Indian insurers as also 75 provident societies - 245 Indian and foreign insurers in all. The LIC had monopoly till the late 1990s when the Insurance sector was reopened to the private sector.

2. History of Insurance

General Insurance in India has its roots in the establishment of **Triton Insurance Company Ltd.**, in the year 1850 in Calcutta by the British. In 1907, the Indian Mercantile Insurance Ltd. was set up. This was the first company to transact all classes of general insurance business.

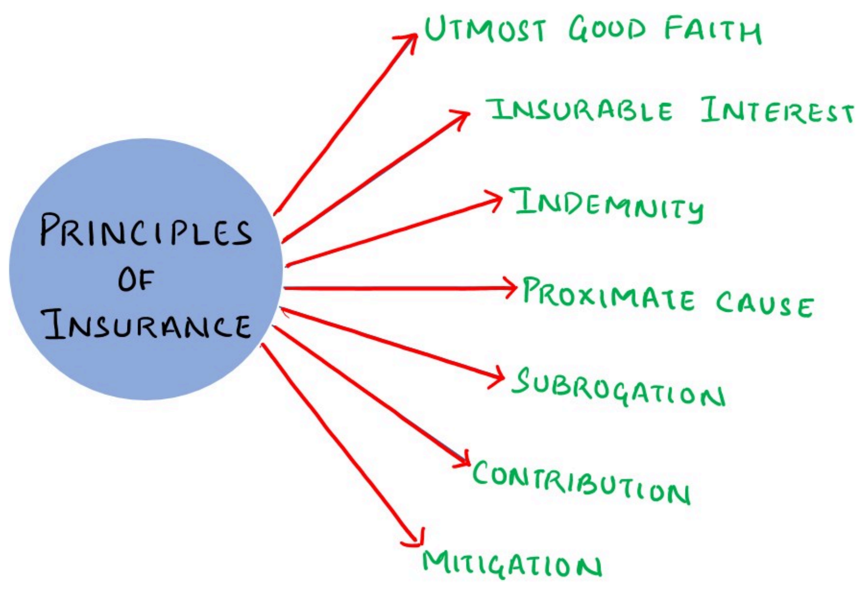


In 1972, with the passing of the **General Insurance Business (Nationalisation) Act**, general insurance business was nationalised with effect from 01st January 1973. 107 insurers were amalgamated and grouped into 4 companies, namely:

1. the National Insurance Company Ltd.,
2. the New India Assurance Company Ltd.,
3. the Oriental Insurance Company Ltd. and
4. the United India Insurance Company Ltd.

In December 2000, the subsidiaries of the General Insurance Corporation of India were restructured as independent companies and at the same time GIC was converted into a national re-insurer. Parliament passed a bill de-linking the 4 subsidiaries from GIC in July 2002.

3. Principles of Insurance



The Principles of Insurance refer to the fundamental concepts and guidelines that form the basis of the insurance industry. These principles are essential for the functioning of insurance contracts and ensuring fairness and reliability in the insurance process.

These principles are discussed next.

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3. Principles of Insurance

In Insurance contracts, the principles of **Uberrimae fidei** i.e., of Utmost Good Faith is observed and simple good faith is not enough. 'Utmost Good Faith' means that "each party to the proposed contract is legally obliged to disclose to the other party all information which can influence the other party's decision to enter the contract".

In Insurance contracts, the seller is the 'insurer' and he has no knowledge about the property to be insured. The proposer on the other hand knows or is supposed to know everything about the property. The seller is entirely dependent upon the buyer to provide the information about the property and hence the need for Utmost Good Faith on the part of the proposer.

Similarly, the Insurer is also obliged to practice Utmost Good Faith in his dealings with the Insured. He cannot and should not make false promises during negotiations.

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3. Principles of Insurance

The insured must have a valid financial interest in the subject matter of the insurance. In other words, the insured should suffer a financial loss if the insured event occurs. For example, an individual has an insurable interest in their car when obtaining auto insurance. They would face a financial loss if their vehicle is damaged in an accident, stolen, or faces other covered perils. This principle ensures that insurance is not used for speculative purposes.

As a rule of thumb, for property insurance, the insurable interest must exist both at the time of purchase of insurance and at the time of occurrence of loss. For life insurance, the insurable interest must exist at the time of purchasing life insurance.

In order to name insurable interest however, it is not necessary that one should be the owner of the property. For example, a trustee holding property on behalf of others has an insurable interest in the property.

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3. Principles of Insurance

All insurance contracts of fire or marine insurance are contracts of indemnity. According to it, the insurer undertakes to put the insured, in the event of loss, in the same position that he occupied immediately before the happening of the event insured against. In other words, the insurer undertakes to compensate the insured for the loss caused to him/her due to damage or destruction of property insured.

The principle of indemnity states that the purpose of insurance is to compensate the insured for the actual financial loss suffered, and not to provide a profit. The insured should be restored to the same financial position as before the loss occurred.

As an illustration, suppose Akash's car, valued at Rs. 5,00,000, sustains Rs. 50,000 in damages in an accident. According to the Principle of Indemnity, the insurance company disburses Rs. 50,000 to Akash to cover the precise financial loss. Akash utilizes this amount to repair the car, thus restoring him to the financial position she held before the loss.

Note that, the principle of indemnity is not applicable to life insurance.

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3. Principles of Insurance

According to this principle, an insurance policy is designed to provide compensation only for such losses as are caused by the perils which are stated in the policy.

In insurance law, '*causa proxima et Non Remota Spectrum*' means the immediate and not the remote cause is to be considered. For the purpose of claiming any insurance policy, the loss or injury caused must be as a result of any one of the insured perils. Peril is basically the cause of loss or the prime cause of what will give rise to a loss. The immediate and not the remote cause is to be regarded as proximate cause, the insurer always considers the proximate cause while paying the claim.

For example, if a farmer has a crop insurance policy that covers hail damage, in that case, if a hailstorm damages the insured crops, the insurance company will provide compensation, as hail is a peril explicitly covered in the policy.

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3. Principles of Insurance

Subrogation refers to the right of the insurer to stand in the place of the insured, after settlement of a claim, as far as the right of insured in respect of recovery from an alternative source is involved. After the insured is compensated for the loss or damage to the property insured by him/her, the right of ownership of such property passes on to the insurer. This is because the insured should not be allowed to make any profit, by selling the damaged property or in the case of lost property being recovered.

For example, after settling of claim of accidental car of the insured person, the damaged car shall become the property of the insurance company. The insurance company will have the right to sell the car and receive whatever amount that can be realised.

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3. Principles of Insurance

If a person gets an object insured by more than one company, then this is termed **Double Insurance**. Double insurance does not mean that in case of damage to the object insured, the person insured earns profit by being compensated by all the insurance companies. In such a situation, all the companies together compensate for the loss, and the compensation amount cannot be more than the actual loss. All the insurers shall contribute proportionately towards the compensation amount. The rule in this context is, “All insurance companies are legally liable to contribute their proportionate share towards the payment of risk”.

The principle can be summarized as if a person has more than one insurance policy covering the same risk, each insurer shares the loss proportionately. It ensures that the insured does not profit from the loss.

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3. Principles of Insurance

This principle states that it is the duty of the insured to take reasonable steps to minimise the loss or damage to the insured property. Suppose goods kept in a store house catch fire, then the owner of the goods should try to recover the goods and save them from fire to minimise the loss or damage. The insured must behave with great prudence and not be careless just because there is an insurance cover. If reasonable care is not taken like any prudent person, then the claim from the insurance company may be lost. This can be understood through an example given below.

Let's suppose, a homeowner has a policy covering theft, and the house is equipped with a burglar alarm system. If the homeowner frequently leaves the alarm system turned off and experiences a burglary, the insurance company may argue that the insured failed to take reasonable steps to minimize the loss. As a result, the claim might be denied or reduced.

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4. Terminologies

Certain significant insurance terms are given below.

Proposal

Proposal (or) Proposal form denotes the application for insurance which solicits information from the Proposer to enable the Insurer to take a decision on whether to accept the risk or not. **Proposer** is the person who submits Proposal form for insurance to the insurance company and who is interested in taking an Insurance Policy.

Underwriting

Underwriting is the process of assessment of risk on a proposal by the Insurance company and arriving at the decision (to accept, reject, rate-up, postpone) and the terms and conditions upon which an insurance contract may be accepted.

Underwriters refer to individuals or teams within an insurance company responsible for assessing and evaluating the risks associated with insuring a particular person, property, or entity. The role of underwriters is crucial in the underwriting process, where they analyze information provided in insurance applications to determine the terms, conditions, and pricing of insurance policies.

Following factors are considered while underwriting lives:

- Personal health history
- Family history
- Occupation history
- Personal habits and lifestyle
- Financial status and capacity to pay
- Country or Place risk.

As per the Outsourcing Regulations of IRDAI, the activity of Underwriting, viz., acceptance of risk on a Proposal form, cannot be outsourced to a third party, but has to be undertaken within the insurance company only.

Policyholder

Policyholder (or insured) is the person who is issued an Insurance Policy document by the Insurance Company consequent to underwriting and issuance of Insurance Policy to cover the risk stated in the Proposal form on such terms and conditions as mentioned in the Insurance Policy document issued by the Insurer to the Policyholder.

Insurance Policy document

Insurance Policy document (or) Policy document (or) Policy constitutes the contract between the Insurance company and the Policyholder, stating the terms and conditions of the Insurance coverage provided by the Insurance company to the Policyholder.

Subject matter of insurance

Subject matter of insurance is the Person or object upon whose loss or upon the loss of which object, the insurance company agrees to pay a specified sum as compensation to the Policyholder.

Life insured

Life insured (or) Life assured under a Life insurance Policy is the subject matter of insurance on whose death a specified sum of money is paid by the Life insurance company.

Note that a Policyholder and Life assured may be the same person or different persons. Where a person takes a Policy on his own life, both Policyholder and Life assured constitute the same person. Where a Policyholder takes a Policy on another's person's life (on whom the Policyholder has insurable interest), the Policyholder and Life assured will be different persons.

Sum Assured

Sum Assured (or) Sum Insured means the amount promised to be paid by the Insurer upon the death of the Life insured.

Nominee

Nominee is the person appointed, only for Policies taken on one's own Life, by the Policyholder to receive the Sum Assured or any other policy benefit upon death of the Life assured.

Note that, where Policyholder and Life assured are different persons, upon death of the Life assured, the Policyholder is the person entitled to receive the Sum assured or other Policy benefits.

Also, in General insurance, since the subject matter of insurance can be anything other than one's life, the Policyholder always receives the benefit upon loss or damage to the subject matter of insurance, subject to establishing the insurable interest at the time of claim.

Counteroffer

Counteroffer denotes the extra premium proposed by the Insurer upon underwriting the proposal to accommodate for the extra risk taken by the insurance company on a Proposal. This can be understood through an example as given below.

Let's suppose, Manish applies for a life insurance policy and declares that he is a non-smoker. However, during underwriting, the insurance company discovers evidence suggesting that Manish is a smoker. In response to the increased risk associated with smoking, the insurance company may provide a counteroffer by proposing a higher premium for Manish's life insurance policy to account for the elevated health risk.

Benefits illustration

Benefits illustration is the document provided to the Policyholder at the point of sale giving the details of premiums payable by the Policyholder year-wise along with the benefits payable at the end of each Policy year. This is provided to Policyholder before a sale is completed and signed by the Policyholder in confirmation of his/ her understanding of the Policy benefits.

Assignment

Assignment is transfer of Insurance Policies to another person with or without consideration.

Mortality

Mortality is the rate of death of the population. It is usually calculated for every thousands of population. The Mortality Table of Indian Assured lives is published based on the investigation of mortality of Indian lives and this Table forms the basis for calculation of premiums for Life insurance Policies. Mortality rates denote the rate of death of assured lives for various ages.

Morbidity

Morbidity refers to the frequency or incidence of diseases, illnesses, or other adverse health conditions within a specific population. Morbidity rates provide insights into the overall health status of a group of individuals and help assess the prevalence of various health conditions. Morbidity rates denote the rate of sickness for various ages. Morbidity Table is useful for calculating the Premiums for Hospitalisation benefits, including Critical illness benefits under Insurance Policies.

Standard lives & Sub-standard lives

A Standard life is one which exposes to the insurer to a normal risk, i.e. the predictive morality on the life does not deviate significantly when compared to the mortality indicated in the mortality table.

However, if the individual life which is considered by the insurer, shows a higher mortality than the standard lives in the mortality table, it would be termed as a Sub-standard life and the insurer takes extra risk and will have to therefore put additional risk controls like imposing extra premiums etc.

Annuity

Annuity is a series of regular and periodic payment payable in consideration of usually a lump sum. For example, under Pension Policies, upon the attainment of superannuation age, the corpus available is utilised to purchase a Single Premium (lump sum) Annuity Policy under which the Policyholder gets a periodic pay-out on a monthly basis till his survival.

Annuities are also life insurance policies as they cover the risk of living longer and the continuation of benefits payable is contingent upon human life.

Bonuses

Bonuses are the additional sum that the Policyholder will get during the term of the insurance plan or at maturity of the plan, provided he has paid all premium amounts due for a specified minimum number of years. Bonus is the amount added to the basic sum assured under a with-profit life insurance policy.

Participating Products and Non-Participating Products

Participating Products (With profits products or Par Policy) are Life insurance products which are eligible for Policyholder bonus as and when declared. It allows the Policyholder to participate in the profits of the life insurance company. These benefits are paid out to the policyholder in the form of bonuses or dividends. Under Participating products, share in the surplus, are in addition to the guaranteed benefits payable (upon death or maturity, as the case may be).

Non-Participating Products (Without profits products) are those Life insurance products which are not eligible for any surplus and are eligible only for the guaranteed benefits payable upon death, survival etc.

Linked Insurance Products

Linked Insurance Products are those life insurance products which combine a Term insurance policy with investments. Under Linked insurance products, the benefits payable are a Sum Assured on death plus the marked-to-market value of the investments made on behalf of the Policyholder by the Life Insurance Company. However,the risk on investments portion is borne by the Policyholder and not by the Life Insurance Company.

Individual Insurance Products

Individual Insurance Products are Insurance Policy contracts entered into directly by the Individual Policyholder with the Insurance Company. This can be compared for example, with equity shares directly purchased in the secondary market by an Investor.

Group Insurance Products

Group Insurance Products are Insurance Policy contracts entered into by an Organization with the Insurance Company. The organization covers the members of the Group under the Group insurance policy by contributing premiums to the Insurance Company which in turn provides benefits upon death or other contingencies covered under the Group Policy, to the Nominee or beneficiary.

Premium

Premium is the consideration money that a policyholder has to pay in lieu of the benefit that the insurer promises to confer on the happening of the scheduled eventuality. Premium forms the obligation on the part of the insured. The premium that you have to pay for a life insurance policy depends on various factors like age, total coverage (sum assured), your medical history, gender, lifestyle, and job.

Risk Premium

Risk Premium is the pure premium needed to cover the expected risks but with no allowance for expenses, commission or contingencies is to be made. Thus, the cost to meet the risk of death for one year at a particular age is known as risk premium. The risk premium is based on the probabilities of death at various ages.

Net Premium

Net Premium or Pure Premium is the premium calculated on the basis of the valuation assumptions to provide the contractual benefits at outset. Its calculation only allows explicitly for interest and mortality. Thus, the net premium covers the risk factor as well as interest earned on investment of fund by the insurers. Net premium is always less than the risk premium.

Loading

Loading is the amount added to the pure premium to cover the administrative expenses of the insurer which have to be borne out of the premium received from the insured. When these expenses are added to the net/pure premium, it becomes the gross premium/office premium which is actually charged from the customer.

Level Premium

The insurer cannot ask the insured to pay extra premium every year, however in the latter years, the cost of insurance would become unaffordable resulting in lapse of policies. Thus, insurers charge a level premium, and the cost is distributed evenly over the period during which premiums are paid. The premium remains the same and is more than the actual cost of protection in the earlier years of the policy and less than the actual cost in the latter years. The excess paid in the early years builds up the reserve.

Extra Premium

A separate mortality study is done for people who are rated sub-standard. In other words, these rated people suffer from some disease or other physical deformity because of which the expected mortality rate for these people would be higher than what is expected of standard lives. This special study by actuarial method thus leads to an estimation of extra premium which shall adequately take care of the extra mortality in this substandard group.

Rider Premiums

These are also extra premiums, for conferring extra benefits, to the insured. For example, a prospect wants to get double the sum assured, in case of a death due to accident. The rider premiums are payable separately under the policy.

Actuarial Valuation

Premium is calculated based on some assumptions. The experience in future may not be exactly as assessed. So, the process of checking the validity of assumptions from time to time is known as actuarial valuation.

Rule of Thumb approach (for Sum assured)

A simple rule of thumb would be that the Sum assured should be 6 to 8 times the gross annual income of the breadwinner. For example, is someone is earning a gross salary of Rs. 12 lakhs per annum, the Sum assured must be somewhere between Rs. 72 lakhs and Rs. 96 lakhs.

Solvency Margin

Solvency Margin denotes the excess of assets over liabilities of an insurance company. This is equivalent of Net worth which denotes the financial health of the Company. As per IRDAI Regulations, the minimum statutory solvency ratio must be 1.5 at all times for an insurance company. That is to say, the Assets must be 1.5 times of Liabilities at all times. If there is a threat of solvency margin falling below the threshold level of 1.5, the Shareholders will have to bring in extra capital to boost solvency.

Endorsement for Insurance

Endorsement for insurance refers to a change in an insurance policy made by the insurer on the request of the Policyholder. It acts like a tailpiece to already existing policy. When an endorsement is made, the policy will incorporate the changes that have been asked for.

Policy Lapsation and Renewal

An insurance policy is considered ‘lapsed’, if the premium is not paid within the grace period, which is 30 days in case of annual, half-yearly and quarterly renewals and 15 days for monthly renewals. However, lapsed policies can be revived by paying the past premiums, and additional charges as levied by the insurer. Often, insurers come up with special schemes or campaigns to revive lapsed policies. In such schemes, they would typically waive any penalties or additional charges.

Surrender

Surrender is voluntary termination of a policy contract only by the Policyholder. If the Policy has acquired surrender value, then surrender value is paid to the Policyholder and the contract comes to an end.

Key Person (or Keyman) Insurance

This is an insurance policy taken by a Company (or Partnership firm) on the life of a ‘key person’ who can be an employee or a director of the Company. There is no limit to the number of Key persons in a Company. This depends on the needs of the Company.

The following factors are considered while considering the need for Key person insurance:

- age
- level of expertise
- Successful track record, and
- Earning or profit-making track record of the Company.

Reinsurance

Reinsurance is a risk transfer mechanism where under an insurance company passes on the risk on an insurance policy to another entity called ‘Reinsurer’ for a consideration under a Reinsurance contract. Under reinsurance, one direct insurance company (also called Ceding company) transfers (cedes) part of the risk to another insurance company (called Reinsurer). This helps in reducing the liability of the direct insurer to a large extent. If there is no reinsurance, it could result in a dent in the financial position of an insurance company, especially when a natural calamity happens.

Reinsurers take a proportion of the premium paid by the Policyholder and promises to pay the proportionate amount of any claims insured under the Policy.

Thus, reinsurance can be said to be “sharing or spreading of risks”. The reinsurance arrangements minimise the financial impact of death claims on a direct insurer. The quantum of liability which a direct insurance company (ceding company) takes on is known as the retention limit.

In other words, retention limit is the risk retained by the Ceding company and any excess above the retention limit is passed on to the reinsurance companies. Retention limits of insurers depends on the age of the insurer (i.e., years of existence) as prescribed.

Unclaimed amounts

These are amounts due to Policyholders which cannot be paid for certain reasons such as Disputes between Legal heirs Vs. Nominees, Cheques issued but not encashed, failure of NEFT etc.

Peril

A specific risk or cause of loss covered by an insurance policy.

5. IRDAI

Background

In 1993, the Government set up a **Committee under the chairmanship of R. N. Malhotra**, former Governor of RBI, to propose recommendations for reforms in the insurance sector. The objective was to complement the reforms initiated in the financial sector. The committee submitted its report in 1994 wherein, among other things, it recommended that the private sector be permitted to enter the insurance industry. They stated that foreign companies should be allowed to enter by floating Indian companies, preferably a joint venture with Indian partners.

Following the recommendations of the **Malhotra Committee report, in 1999**, 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 (IRDA Act, 1999) for overall supervision and development of the Insurance sector in India.

The powers and functions of the Authority are laid down in the **IRDA Act, 1999 and Insurance Act, 1938.** 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 Insurance sector. Section 14 of the IRDA Act, 1999 specifies the duties, powers and functions of the Authority.

The key objectives of the IRDAI include protecting the interest of policyholders, speedy and orderly growth of insurance industry, speedy settlement of genuine claims, effective grievance redressal mechanism, promoting fairness, transparency and orderly conduct in financial markets dealing with insurance, prudential regulation while ensuring the financial security of the Insurance Market.

Legislations

Beside IRDA Act, 1999 and Insurance Act, 1938, there are some common Act/Regulation to the General and Life Insurance Business in India and some Acts have been made for specific requirement of Life Insurance/ General Insurance.

The following Acts regulate the Insurance Business in India:

- Insurance Act, 1938
- IRDA Act, 1999 & Regulations passed thereunder
- Insurance Amendment Act, 2002
- Exchange Control Regulations (FEMA)
- Indian Stamp Act, 1899
- Consumer Protection Act, 1986 (now 2019)
- Insurance Ombudsman Rules, 2017
- Labour Law legislations.

The following Acts govern/regulate the life insurance business in India:

- LIC Act, 1956
- Amendments to LIC Act.

Regulations affecting General Insurance Business in India:

- General Insurance Nationalization (GIN) Act, 1972.
- Amendments to GIN Act, 1972.
- Multi-Modal Transportation Act, 1993.
- Motor Vehicles Act, 1988.
- Inland Steam Vessels Amendment Act, 1977.
- Marine Insurance Act, 1963.
- Carriage of Goods by Sea Act, 1925.
- Merchant Shipping Act, 1958.
- Bill of Lading Act, 1855.
- Indian Ports (Major Ports) Act, 1963.
- Indian Railways Act, 1989.
- Carriers Act, 1865.
- Indian Post Office Act, 1898.
- Carriage by Air Act, 1972.
- Public Liability Insurance Act, 1991.
- Employee State Insurance Act,1948
- Aircraft Act, 1934.

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5. IRDAI

Insurance Regulatory and Development Authority of India (IRDAI) is the Regulator for Insurance Companies operating in India. The mission of IRDAI is to protect the interests of Policyholders and to promote orderly growth of the Indian insurance industry.

Every Insurance Company will have to register themselves with IRDAI and obtain a Certificate of Registration for doing insurance business in India. Besides the Insurance Companies, IRDAI also regulates the Insurance Intermediaries like Corporate Agents, Insurance Brokers and other intermediaries by requiring them to have a Certificate of registration before they start doing any insurance solicitation.

MISSION STATEMENT OF THE AUTHORITY

- 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.

IRDAI have issued many Regulations and Guidelines under the framework provided under the Insurance Act, 1938. They have powers of inspection and investigation and to prevent any insurer or intermediary to stop doing business if it is expedient to do so in the interests of the Policyholders or in public interest.

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5. IRDAI

The members of the IRDAI are appointed by the Central Government from amongst persons of ability, integrity and standing who have knowledge or experience in life insurance, general insurance, actuarial science, finance, economics, law, accountancy, administration etc.

Composition

Section 4 of the IRDAI Act, 1999 specifies the authority's composition. It is a **10- member body** consisting of a chairman/chairperson, 5 full-time and 4 part-time members.

Every Chairperson and every other whole-time member of IRDAI appointed shall hold office **for a term of 5 years** and every part time member shall hold office for a term not exceeding 5 years. However, Chairperson shall not hold office once he or she **attains 65 years** while whole time members shall not hold office once he or she attained the age of 62 years.

Disqualification

The Central Government may remove any member from office, if he or she is adjudged insolvent or is physically or mentally incapacitated or has been convicted of an offence involving moral turpitude or has acquired financial or other interests or has abused his position.

Chairperson and the whole-time members shall not **for a period of 2 years** from the date of cessation of office in IRDAI, hold office as an employee with Central Government or any State Government or with any company in the insurance sector.

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5. IRDAI

Under Section 14 of the IRDAI Act, 1999, IRDAI has the following powers:

- Issue of Certificate of Registration to insurance companies, renew, modify, withdraw, suspend or cancel the certificate of registration.
- Protection of interests of policy holders.
- Specification of requisite qualifications, practical training and code of conduct for insurance agents and intermediaries.
- Specification of code of conduct for surveyors and loss assessors.
- Promoting efficiency in the conduct of insurance businesses.
- Promoting and regulating professional organizations connected with insurance and reinsurance industry.
- Levying fees and other charges for carrying out the purposes of the Act.
- Calling for information from or undertaking inspection of insurance companies, intermediaries and other organisations connected with insurance business.
- Control and regulation of rates, advantages, terms and conditions that may be offered by insurers.
- Specifying the form and manner in which books of account shall be maintained by insurance companies and intermediaries.
- Regulation of investments of funds by insurance companies.
- Regulation of maintenance of margin of solvency.
- Adjudication of disputes between insurers and insurance intermediaries.
- Supervising the functioning of Tariff Advisory Committee.
- Specifying the percentage of premium income of the insurer to finance schemes for promoting and regulating professional organizations.
- Specifying the percentage of life- and general- insurance business to be undertaken by insurers in rural or social sectors.
- Such other powers as may be prescribed.

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6. Life Insurance (LI) Council

Life Insurance (LI) Council is a forum that connects the various stakeholders of the Insurance sector. It develops and coordinates all discussions between the Government, Regulatory Board and the Public. In short, it is the face of the Life Insurance industry.

Constituted under the Insurance Act 1938, the Life Insurance Council functions through several sub-committees and includes all life insurance companies in India.

Executive Committee

As per Section 64F(1) of the Insurance Act, 1938, an Executive Committee of the Life Insurance Council shall be formed comprising of the following persons, namely:

- 4 representatives of members of the Life Insurance Council, one of which shall be elected as the Chairperson of the Executive Committee of Life Insurance Council;
- an eminent person not connected with insurance business, nominated by IRDAI;
- 3 persons to represent Insurance agents, Intermediaries and Policyholders, respectively, as may be nominated by the Authority; and
- 1 representative each from Self-help groups and Insurance Co-operative Societies.

7. General Insurance Council

The General Insurance (GI) Council has been constituted under section 64C of the Insurance Act, 1938 since 2001 by IRDAI. The General Insurance Council is an important link between the IRDAI and the non-Life insurance industry. It also pushes for the industry's issues with the Government.

Functions

As per Insurance Act, 1938, the GI Council has the following functions:

- to aid and advise insurers, carrying on general insurance business, in the matter of setting up standards of conduct and sound practice and in the matter of rendering efficient service to holders of policies of general insurance;
- to render advise to IRDAI in the matter of controlling the expenses of such insurers carrying on business in India in the matter of commission and other expenses; and
- to bring to the notice of IRDAI the case of any such insurer acting in a manner prejudicial to the interests of holders of general insurance policies.

While the Council plays the role envisaged for it by the Insurance Act, it also facilitates overall growth for the industry in a fair and equitable manner in the interest of all stake holders.

Composition

As per Section 64F (2) of the Insurance Act, 1938, an Executive Committee of the General Insurance Council shall consist of the following persons, namely:

- 4 representatives of members of the General Insurance Council, one of which shall be elected as the Chairperson of the Executive Committee of General Insurance Council;
- an eminent person not connected with insurance business, nominated by the Authority; and
- 4 persons to represent Insurance agents, Third party administrators, Surveyors and Loss Assessors and Policyholders respectively, as may be nominated by the Authority.

Members of the Executive Committees constituted as per Section 64F of Insurance Act, 1938 would serve **for a period of 3 years** after which the Executive Committee would be dissolved, and fresh elections will be held to elect new Members.

Each of the said Executive Committees may make byelaws for the transaction of any business at any meeting of the said Committee.

The Secretary of the Executive Committee of the Life Insurance Council and of the Executive Committee of the General Insurance Council shall in each case be appointed by the Executive Committee concerned.

8. Dispute Resolution

A Policyholder or Nominee may have a complaint on the Insurance Policy he has purchased or on the benefits paid/payable under the Policy. These are the 2 main category of complaints, viz., Policy he has purchased, e.g., mis-selling by distributor, misunderstanding on terms and conditions or non-receipt of Policy bond. On the Benefits paid/payable, it could be on non-payment, short-payment or delayed payment of Policy benefits.

A **Grievance** is defined as an expression of dissatisfaction by a customer on the action or inaction on the standard of service or deficiency of service of an insurance company or any intermediary and asks for remedial action. It is distinguished from inquiry or a request which is seeking information or requesting for a service and are not considered as Grievances.

Every insurance company shall have a designated senior officer at the level of CEO or Compliance Officer of the Company as the **Grievance Officer**. Further, every office of the insurer shall also have a designated Grievance officer for such office.

8. Dispute Resolution

Following are the ways by which one can raise a complaint against an insurance company:

1. A policyholder should first approach the insurance company itself to get their grievance addressed. He can approach the **Grievance Redressal Officer (GRO)** of the insurance company, by giving his complaint in writing along with the necessary supporting documents.

2. As per IRDAI, the insurance company should ideally **address the concern within 15 days**. However, if the grievance is not resolved within 15 days, or if the person is not satisfied with the resolution provided by the insurer, he can take it to the insurance regulator, IRDAI. One can approach the **Grievance Redressal Cell** of the Consumer Affairs Department of IRDAI.

Also, one has the option to use the online portal managed by IRDA called **Integrated Grievance Management System (IGMS).** If the person is not able to access the insurance company directly for any reason, IGMS provides a gateway to register complaints with insurance companies.

3. If the person is unable to use the online methods, he can go for use the offline route, by submitting IRDAI's complaint form.

4. If the complaint is still not addressed to one's satisfaction, he can approach the appellate authority or the **Insurance Ombudsman**. The Insurance Ombudsman scheme was created by the Government for individual policyholders to have their complaints settled out of the courts system in a cost-effective, efficient and impartial way.

However, there are certain conditions to be fulfilled, before approaching Insurance Ombudsman.

- One must first approach to the insurance company with the complaint.
- If the company has rejected it or did not resolve it to the complainant's satisfaction or have not responded to it at all for 30 days, then he may approach the Insurance Ombudsmen.
- Moreover, the complaint should be related to a policy, which he has taken in his individual capacity and the value of the claim including expenses claimed is not above Rs. 30 lakhs.

5. If the grievance is still left unresolved after exhausting all other available options and the complainant feels that his claim is justified, then he has the option to approach a **consumer forum or a civil court.**

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8. Dispute Resolution

In order to protect long-terms 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, 2013 (erstwhile 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.

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9. Insurance Ombudsmen Rules 2017

The object of Insurance Ombudsmen Rules, 2017 is to resolve all complaints of all personal lines of insurance, group insurance policies, policies issued to sole proprietorship and micro enterprises on the part of insurance companies and their agents and intermediaries in a cost effective and impartial manner.

The ultimate objective of these Rules is to provide for a speedy redressal of certain grievances specific to insurance sector.

The Offices of Insurance Ombudsman are under the administrative control of **Council for Insurance Ombudsmen (CIO)**, which has been constituted under the Insurance Ombudsman Rules, 2017. CIO was earlier known as Executive Council of Insurers.

Office of Insurance Ombudsman is an alternate Grievance Redressal platform which has been setup with an aim to resolve grievances of aggrieved policyholders against Insurance Companies and its Intermediaries or Insurance Brokers in a speedy and cost-effective manner.

The Ombudsman shall act as counsellor and mediator relating to matters specified, provided there is written consent of the parties to the dispute.

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9. Insurance Ombudsmen Rules 2017

An Executive Council of Insurers shall be established, which shall comprise of 9 members including the Chairperson and other members as:

- 2 persons representing life insurers to be nominated by the Life Insurance Council;
- 2 persons representing General insurers, other than stand-alone health insurers, to be nominated by the General Insurance Council;
- 1 person representing stand-alone health insurers to be nominated by the General Insurance Council;
- 1 representative of the IRDAI;
- 1 representative of the Central Government in the Ministry of Finance from the Department of Financial Services not below the rank of Director; and
- Chairman, Life Insurance Corporation of India (LIC of India).

The Chairperson of the Executive Council of Insurers shall be either the Chairman of the LIC of India or the Chairman of the GIPSA (General Insurer’s Public Sector Association (India)) by rotation. The term of the Chairperson and members of the Executive Council of Insurers shall be 3 years from the date of assumption of charge.

A member of the Executive Council of Insurers shall not be eligible for re-nomination for a period of 3 years from the date he ceases to be a member (not applicable to IRDAI representative, Central Government representative, LIC & GIPSA representatives).

The functions of the Executive Council of Insurers is to issue such guidelines, including, inter-alia, relating to the procedure for the day to day administration, secretariat staffing, secretariat administrative infrastructure, and such other related aspects of functioning of insurance Ombudsman system.

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9. Insurance Ombudsmen Rules 2017

An ombudsman is an independent and impartial official who serves as a mediator or investigator, usually appointed by the government or a specific organization, to address and resolve complaints or disputes raised by individuals against that entity.

Selection

An Ombudsman shall be selected by a Selection Committee comprising of:

- Chairperson of the IRDAI, who shall be the Chairman of the Selection Committee.
- one representative each of the Life Insurance Council and the General Insurance Council from the Executive Council of Insurers – members.
- A representative of the Government of India not below the rank of a Joint Secretary or equivalent, in the Ministry of Finance, from the Department of Financial Services - member.

Term

An Insurance Ombudsman is appointed for a term of 3 years. However, no person can continue as Insurance Ombudsman after he/she has attained 65 years of age.

Duties

The Ombudsman shall receive and consider complaints or disputes relating to:

- delay in settlement of claims, beyond the time specified in the regulations, framed under the Insurance Regulatory and Development Authority of India Act, 1999;
- any partial or total repudiation of claims by the life insurer, General insurer or the health insurer;
- disputes over premium paid or payable in terms of insurance policy;
- misrepresentation of policy terms and conditions at any time in the policy document or policy contract;
- legal construction of insurance policies in so far as the dispute relates to claim;
- policy servicing related grievances against insurers and their agents and intermediaries;
- issuance of life insurance policy, general insurance policy including health insurance policy which is not in conformity with the proposal form submitted by the proposer;
- non-issuance of insurance policy after receipt of premium in life insurance and general insurance including health insurance; and
- any other matter resulting from the violation of provisions of the Insurance Act, 1938 or the regulations, circulars, guidelines or instructions issued by the IRDAI.

The Ombudsman shall be barred from handling any matter if he is an interested party or having conflict of interest.

An Ombudsman may be removed from office on the ground of gross misconduct during his term of office.

No complaint before the Insurance Ombudsman shall be maintainable on the same subject matter on which proceedings are pending before or disposed of by any court or consumer forum or arbitrator.

9. Insurance Ombudsmen Rules 2017

Governance related control is done through Investment Committee and Investment Policy.

Investment Committee

Every insurer is required to form an Investment Committee which consists of a minimum of 2 non-executive directors, Chief Investment Officer, Chief Financial Officer and Appointed Actuary to oversee the performance of the Investment function.

Investment Policy

The Board, on the basis of approval of Investment Committee, has to approve an Investment Policy for the Company on an yearly basis, with a half yearly review mechanism. The policy shall address the issues relating to prudential norms, liquidity, management of assets and liabilities, scope of internal and concurrent audit and all other internal control of investment operations. It shall ensure adequate return on policyholders' funds and shareholders' funds. The Board shall review fund wise and product wise investment performance on a quarterly basis.

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9. Insurance Ombudsmen Rules 2017

Settlement by Recommendation

The Ombudsman will act as mediator and will arrive at a fair recommendation based on the facts of the dispute. If the complainant accepts this as a full and final settlement, the Ombudsman will inform the company which should comply with the terms in 15 days.

Settlement by Award

If a settlement by recommendation does not work, the Ombudsman will pass an award within 3 months of receiving all the requirements from the complainant and which will be binding on the insurance company. Once the award is passed, the insurer shall comply with the award within 30 days of the receipt of award and intimate the compliance of the same to the Ombudsman.
