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SUBJECT NAME: FINANCIAL SERVICES

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Core Paper XI - FINANCIAL SERVICES

Objectives **No of Credits : 4**

To enable the students to understand the world of financial services.

To facilitate the understanding of the various Financial Services.

Unit I : Introduction

Financial Services - Concept - Objectives - Functions - Characteristics - Financial Services Market - Concept - Constituents - Growth of Financial Services in India - Financial Services Sector Problems - Financial Services Environment - The Forces - Players in Financial Markets.

Unit II : Merchant Banking and Public Issue Management

Definition - Functions - Merchant Bankers Code of Conduct - Public Issue Management - Concept - Functions - Categories of Securities Issue - Mechanics of Public Issue Management - Issue Manager - Role of lssue Manager - Marketing of Issue - New Issues Market Vs Secondary Market .

Unit III : Money Market and Stock Exchange

Characteristics - Functions - Indian Capital Market - Constituents of Indian Capital Market - New Financial Institutions and Instruments - Investor Protection - Stock Exchange - Functions - Services - Features - Role - Stock Exchange Traders -Regulations of Stock Exchanges - Depository - SEBI - Functions and Working.

Unit IV : Leasing

Characteristics - Types - Participants - Myths about Leasing - Hire Purchase - Lease Financing Vs Hire Purchase Financing - Factoring - Mechanism - Functions of a Factor - Factoring - Players - Types - Operational Profile of Indian Factoring - Operational Problems in Indian Factoring - Factoring Vs bills Discounting - Securitization of Debt- Parties involved- Steps of securitization - Types of securitization- Advantages- Limitations – SARFAESI Act 2002- Background- Purpose of the Act- Main provisions

Unit - V : Venture Capital

Origin and Growth of Venture Capital - Investment Nurturing Methods - Mutual Funds - Portfolio Management Process in Mutual Funds - Credit Rating System - Growth Factors - Credit Rating Process - Global and Domestic Credit Rating agencies - Principles of Insurance - Life and Non - Life Insurance - IRDA - Powers - Pension Fund - Objectives - Functions - Features - Types - Chilean Model - Pension Investment Policy - Pension Financing.

UNIT-I

Financial Services
Financial services may be defined as the products and services offered by financial institutions for the facilitation of various financial transactions and other related activities.

Functions/importance of Financial Services

1. Facilitating transactions (exchange of goods and services) in the economy.
2. Mobilizing savings (for which the outlets would otherwise be much more limited).
3. Allocating capital funds (notably to finance productive investment).
4. Monitoring managers (so that the funds allocated will be spent as envisaged).
5. Transforming risk.

Features/Characteristics of Financial services

1. **Intangibility**: Financial services are intangible. Therefore, they cannot be standardized orreproduced in the same form. The institutions supplying the financial services should have a betterimage and confidence of the customers. Otherwise, they may not succeed. They have to focus onquality and innovation of their services. Then only they can build credibility and gain the trust ofthe customers.
2. **Inseparability:** Both production and supply of financial services have to be performedsimultaneously. Hence, there should be perfect understanding between the financial service institutions and its customers.
3. **Perishability:** Like other services, financial services also require a match between demandand supply. Services cannot be stored. They have to be supplied when customers need them.
4. **Variability:** In order to cater a variety of financial and related needs of different customers indifferent areas, financial service organisations have to offer a wide range of products and services.
5. **Dominance of human element:** Financial services are dominated by human element. Thus,financial services are labour intensive. It requires competent and skilled personnel to market the quality financial products.
6. **Information based:** Financial service industry is an information based industry. It involvescreation, dissemination and use of information. Information is an essential component in the production of financial services.

Challenges faced by the Financial Sector

1. **Lack of qualified personnel** in the financial service sector.
2. **Lack of investor awareness** about the various financial services.
3. **Lack of transparency** in the disclosure requirements and accounting practices relating to financial services.
4. **Lack of specialisation** in different financial services (specialisation only in one or two services).
5. **Lack of adequate data** to take financial service related decisions.
6. **Lack of efficient risk management system** in the financial service sector.

Different types of financial Services.

Asset/Fund Based Services

1.Equipment leasing/Lease financing: A lease is an agreement under which a firm acquires aright to make use of a capital asset like machinery etc. on payment of an agreed fee called leaser entals. The person (or the company) which acquires the right is known as lessee.

2.Hire purchase and consumer credit: Hire purchase is an alternative to leasing. Hire purchase is a transaction where goods are purchased and sold on the condition that payment is made in instalments. The buyer gets only possession of goods. He does not get ownership. He gets ownership only after the payment of the last instalment.

3. Bill discounting: Discounting of bill is an attractive fund based financial service provided by the finance companies. In the case of time bill (payable after a specified period), the holder need not wait till maturity or due date. If he is in need of money, he can discount the bill with his banker. After deducting a certain amount (discount), the banker credits the net amount in the customer's account. Thus, the bank purchases the bill and credits the customer's account with the amount of the bill less discount. On the due date, the drawee makes payment to the banker.

4. Venture capital: Venture capital simply refers to capital which is available for financing the new business ventures. It involves lending finance to the growing companies. It is the investment in a highly risky project with the objective of earning a high rate of return.

5. Housing finance: Housing finance simply refers to providing finance for house building. Till now, a number of specialized financial institutions/companies have entered in the field of housing finance.

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

7. Factoring: Factoring is an arrangement under which the factor purchases the accountreceivables (arising out of credit sale of goods/services) and makes immediate cash payment to the supplier or creditor. Thus, it is an arrangement in which the account receivables of a firm (client)are purchased by a financial institution or banker. Thus, the factor provides finance to the client(supplier) in respect of account receivables. The factor undertakes the responsibility of collecting the account receivables.

8. Forfaiting: Forfaiting is a form of financing of receivables relating to international trade. It is a non-recourse purchase by a banker or any other financial institution of receivables arising from export of goods and services. The exporter surrenders his right to the forfaiter to receive future payment from the buyer to whom goods have been supplied.

9. Mutual fund: Mutual funds are financial intermediaries which mobilise savings from the people and invest them in a mix of corporate and government securities. The mutual fund operators actively manage this portfolio of securities and earn income through dividend, interest and capital gains. The incomes are eventually passed on to mutual fund shareholders.

Non-Fund Based/Fee Based Financial Services

1. **Merchant banking:** Merchant banking is basically a service banking, concerned with providing non-fund based services of arranging funds rather than providing them. The merchant banker merely acts as an intermediary. Its main job is to transfer capital from those who own it to those who need it. Today, merchant banker acts as an institution which understands the requirements of the promoters on the one hand and financial institutions, banks, stock exchange and money markets on the other.

2. **Credit rating**: Credit rating means giving an expert opinion by a rating agency on the relative willingness and ability of the issuer of a debt instrument to meet the financial obligations in time and in full. It measures the relative risk of an issuer's ability and willingness to repay both interest and principal over the period of the rated instrument. It is a judgement about a firm's financial and business prospects. In short, credit rating means assessing the creditworthiness of a company by an independent organisation.

3. **Stock broking**: Now stock broking has emerged as a professional advisory service. Stock broker is a member of a recognized stock exchange. He buys, sells, or deals in shares/securities. It is compulsory for each stock broker to get himself/herself registered with SEBI in order to act as a broker. As a member of a stock exchange, he will have to abide by its rules, regulations and bylaws.

4. **Custodial services**: In simple words, the services provided by a custodian are known as custodial services (custodian services). Custodian is an institution or a person who is handed over securities by the security owners for safe custody. Custodian is a caretaker of a public property or securities.

5.**Loan syndication**: Loan syndication is an arrangement where a group of banks participate to provide funds for a single loan. In loan syndication, a group of banks comprising 10 to 30 banks

participate to provide funds wherein one of the banks is the lead manager. This lead bank is decided by the corporate enterprises, depending on confidence in the lead manager.
6. **Securitisation (of debt):** Loans given to customers are assets for the bank. They are called loan assets. Unlike investment assets, loan assets are not tradable and transferable. Thus loan assets are not liquid. The problem is how to make the loan of a bank liquid. This problem can be solved by transforming the loans into marketable securities. Now loans become liquid. They get the characteristic of marketability. This is done through the process of *securitization*. Securitization is a financial innovation.

New financial instruments

Financial Instruments of India
In this paper we will discuss about the various financial instruments, for example, G-secs, Commercial Papers, Certificate of Deposits, Preference Shares, Call Money Market etc, available in the Indian financial markets. This paper provides a brief description of all of these. Several financial instruments are available in the Indian money market. These are government securities, or G-sec, preference shares, commercial papers, equity shares, certificate of deposits, call money market and industrial securities.

These are discussed below.

1. **Government Securities:**

In India, mainly the institutional investors buy the government securities. The government, both State and Central, and the government authorities, for example, state electricity boards, municipalities etc issue it.
Commercial banks are the biggest investors who buy the G-secs. The government collects money through the G-secs to finance its several new infrastructure development projects or to meet its present needs. The government itself issues the risk of default for G-sec, for it.

2. **Preference Shares:**

These carry a fixed dividend rate and a special right to dividends over the private equity holders. Currently, all the preference shares in the Indian market are `redeemable&rsquo, that is, they have a fixed period of maturity. Therefore, sometimes they are termed as `hybrid variety’.

3. **Commercial Papers (CP):**

These are issued mainly by the corporate businessmen to fund their working capital needs. Commercial Papers are issued generally for short-term maturities. Commercial papers are not secure and subject to market risks, so those corporate bodies that have a good credit history will only be able to use this financial instrument.

4. **Equity Shares:**

It is a “high return risk” instrument. Equity shares don’t have any fixed return rate and thereby, no period of maturity.

5. **Certificate of Deposits (CD):**

These are very similar to the Commercial papers. But the CDs are issued mainly by the commercial banks.

6. **Call Money Market:**

The loans made in the call money market are mainly short term in nature. Call money market mainly deals with the interbank markets. Those banks that are suffering from a short-term cash deficit borrow cap from the call money market. The interest rate varies with the market rate and depends upon the banking system.

7. **Industrial Securities:**
   Normally the big corporate bodies are used to issue this to fulfill their long-term requirements regarding working capital. The • debentures, • equity shares fall under this category.

Financial Market

A financial market is a broad term describing any marketplace where buyers and sellers participate in the trade of assets such as equities, bonds, currencies and derivatives.

Financial markets are the centre that facilitate buying and selling of financial instruments, claims or services. It caters the credit needs of the individuals, firms and institutions. It deals with the financial assets of different types such as currency deposits, cheques, bills, bonds etc. it is defined as a transmission mechanism between investors and the borrowers through which transfer of funds is facilitated. It consists of individual investors, financial institutions and other intermediaries who are linked by a formal trading rules and communication network for trading the various financial assets and credit instruments.

Types Of Financial Markets

1. **Money Market:** it is a market for short-term funds normally up to one year. It refers to the institutional arrangement which deals with the short term borrowing and lending of funds. It is a short-term credit market.

2. **Capital Markets:** it is a market for issue and trading of long-term securities.The term to maturity should be longer than 3 years. The securities traded in capital market are informally classified into short-term, medium-term, and long-term securities depending on their term to maturity.It is market for long term borrowing and lending of funds.

3. **Financial Mortgages Market**: It is a market through which mortgage loans are granted to individual customers. Mortgage loans are granted against immovable property like real estate. Mortgage is the transfer of an interest in the specific immovable property for the purpose of securing loans.

The transferor is called mortgager and transferee is called mortgagee. The common type of mortgage loan, which are seen in india is residential mortgages, housing Development Corporation, National Housing Bank, Housing Finance Companies and Life Insurance Corporation are prominent players in financing residential projects.

4. Financial Guarantees Market:The financial guarantee market is an independent market. It is a financial service market. It is the centre where finance is provided against the guarantee of a reputed person in the financial circle.There are many types of guarantees.

5. Foreign Exchange Market: Foreign exchange refers to the process of conversion of home currencies into foreign currencies and vice versa. According to Kindle Berger: Foreign exchange market is a place where foreign moneys are bought and sold. This market deals with exchange of foreign currency, notes , coins and bank deposits denominated in foreign currency units and liquid claims like drafts, traveler's cheques, letters of credit and bills of exchange expressed in Indian rupee but payable in foreign currency.In india foreign exchange market is the privilege of the Reserve Bank of India.Foreign Exchange Regulation Act (FERA) was passed by the Government of India in 1947, which was later modified in 1973 to regulate foreign exchange market.

Players in Financial Markets

In the financial markets, there is a flow of funds from one group of parties (funds-surplus units) known as investors to another group (funds-deficit units) which require funds. However, often these groups do not have direct link. The link is provided by market intermediaries such as brokers, mutual funds, leasing and finance companies, etc. In all, there is a very large number of players and participants in the financial market. These can be grouped as follows :

The individuals: These are net savers and purchase the securities issued by corporates. Individuals provide funds by subscribing to these security or by making other investments.

The Firms or corporates: The corporates are net borrowers. They require funds for different projects from time to time. They offer different types of securities to suit the risk preferences of investors' Sometimes, the corporates invest excess funds, as individuals do. The funds raised by issue of securities are invested in real assets like plant and machinery. The income generated by these real assets is distributed as interest or dividends to the investors who own the securities.

Government: Government may borrow funds to take care of the budget deficit or as a measure of controlling the liquidity, etc. Government may require funds for long terms (which are raised by issue of Government loans) or for short-terms (for maintaining liquidity) in the money market. Government makes initial investments in public sector enterprises by subscribing to the shares, however, these investments (shares) may be sold to public through the process of disinvestments.

Regulators: Financial system is regulated by different government agencies. The relationships among other participants, the trading mechanism and the overall flow of funds are managed, supervised and controlled by these statutory agencies. In India, two basic agencies regulating the financial market are the Reserve Bank of India (RBI) and Securities and Exchange Board of India (SEBI). Reserve Bank of India, being the Central Bank, has the primary responsibility of maintaining liquidity in the money market. It undertakes the sale and purchase of T-Bills on behalf of the Government of India. SEBI has a primary responsibility of regulating and supervising the capital market. It has issued a number of Guidelines and Rules for the control and supervision of capital market and investors' protection. Besides, there is an array of legislation's and government departments also to regulate the operations in the financial system.

Market Intermediaries: There are a number of market intermediaries known as financial intermediaries or merchant bankers, operating in financial system. These are also known as investment managers or investment bankers. The objective of these intermediaries is to smoothen the process of investment and to establish a link between the investors and the users of funds. Corporations and Governments do not market their securities directly to the investors. Instead, they hire the services of the market intermediaries to represent them to the investors. Investors, particularly small investors, find it difficult to make direct investment. A small investor desiring to invest may not find a willing and desirable borrower. He may not be able to diversify across borrowers to reduce risk. He may not be equipped to assess and monitor the credit risk of borrowers. Market intermediaries help investors to select investments by providing investment consultancy, market analysis and credit rating of investment instruments. In order to operate in secondary market, the investors have to transact through share brokers. Mutual funds and investment companies pool the funds(savings) of investors and invest the corpus in different investment alternatives. Some of the market intermediaries are:

1. Lead Managers
2. Bankers to the Issue
3. Registrar and Share Transfer Agents
4. Depositories
5. Clearing Corporations
6. Share brokers
7. Credit Rating Agencies
8. Underwriters
9. Custodians
10. Portfolio Managers
11. Mutual Funds

Investment Companies

These market intermediaries provide different types of financial services to the investors. They provide expertise to the securities issuers. They are constantly operating in the financial market. Small investors in particular and other investors too, rely on them. It is in their (market intermediaries) own interest to behave rationally, maintain integrity and to protect and maintain reputation, otherwise the investors would not be trusting them next time. In principle, these intermediaries bring efficiency to corporate fund raising by developing expertise in pricing new issues and marketing them to the investors.

UNIT-II

Merchant Bank
A merchant bank is that engages in underwriting and business loans, catering primarily to the needs of large enterprises and high net worth individuals. In the British market, the term merchant bank refers to an investment bank.

Functions of Merchant Banker.

1. Corporate counseling: One of the important functions of a merchant banker is corporate counseling. Corporate counseling refers to a set of activities undertaken to ensure efficient functioning of a corporate enterprise through effective financial management

(a) Providing guidance in areas of diversification based on the Government's economic and licensing policies.
(b) Undertaking appraisal of product lines, analyzing their growth and profitability and forecasting future trends.
(c) Rejuvenating old-line companies and ailing sick units by appraising their technology andprocess, assessing their requirements and restructuring their capital base.
(d) Assessment of the revival prospects and planning for rehabilitation through modernization anddiversification and revamping of the financial and organizational structure.
(e) Arranging for the approval of the financial institutions/banks for schemes of rehabilitation involving financial relief, etc.
(f) Monitoring of rehabilitation schemes.

2. Project counseling: Project counseling relates to project finance. This involves the study
(a) Undertaking the general review of the project ideas/project profile.
(b) Providing advice on procedural aspects of project implementation.
(c) Conducting review of technical feasibility of the project on the basis of the report prepared by own experts or by outside consultants.
(d) Assisting in the preparation of project report from a financial angle, and advising and acting on various procedural steps
(e) Assisting in obtaining approvals/licenses/permissions/grants, (f) Identification of potential investment avenues.
(g) Arranging and negotiating foreign collaborations, amalgamations, mergers, and takeovers.
(h) Undertaking financial study of the project and preparation of viability
(i) Providing assistance in the preparation of project profiles
(j) Advising and assisting clients in preparing applications for financial assistance

3. Pre-investment studies: Another function of a merchant banker is to guide the entrepreneurs in conducting pre-investment studies.

(a) Carrying out an in-depth investigation of environment and regulatory factors, location of raw material supplies, demand projections and financial requirements in order to assess the financial and economic viability of a given project.
(b) Helping the client in identifying and short-listing those projects which are built upon the client's inherent strength with a view to promote corporate profitability and growth in the long run.
(c) Offering a package of services, including advice on the extent of participation, government regulatory factors and an environmental scan of certain industries in India.

4. Loan syndication: A merchant banker may help to get term loans from banks and financial institutions for projects.
(a) Estimating the total cost of the project to be undertaken.
(b) Drawing up a financing plan for the total project cost
(c) Preparing loan application for financial assistance from term lenders/financial institutions/banks, and monitoring their progress, including pre-sanction negotiations.
(d) Selecting institutions and banks for participation in financing.
(e) Follow-up of term loan application with the financial institutions and banks, and obtaining the approval for their respective share of participation.
(f) Arranging bridge finance.
(g) Assisting in completion of formalities for drawing of term finance
(h) Assessing working capital requirements.

5. Issue management: Issue management involves marketing or corporate securities by offering them to the public.
(a) Public issue through prospectus.
(b) Marketing and underwriting.
(c) Pricing of issues.

6. Underwriting of public issue: In underwriting of public issue the activities performed by merchant bankers are as follows:
(a) Selection of institutional and broker underwriters for syndicating/ underwriting arrangements.
(b) Obtaining the approval of institutional underwriters and stock exchanges for publication of the prospectus.
(c) Co-ordination with the underwriters, brokers and bankers to the issue, and the Stock Exchanges.

Public Issue Managrement

Companies coming with new issue of capital decide about Issue managers after due diligence and carefully analyzing the competence and capabilities of the merchant banker to handle the issue. They provide valuable service in preparation and drafting the prospectus, pricing the issue, marketing and underwriting the issue, coordinating the activities or different agencies/institutions involved in this context to carry out legalities involved in the process, deciding the basis of allotment, making the allotment, despatch of share certificates/refund orders as the case may be, and finally, in listing of shares on stock exchanges and sometimes as market maker as well.

Pre-issue and Post issue activities/Services/Obligations of Public Issue Management.

A) Pre-Issue Activities 1) Memorandum of Understanding In terms of Regulation 18(2), before taking any issue management, every merchant banker (lead manager) must invariably enter into a Memorandum of Understanding (MoU) with the company making the issue (issuer) clearly setting out their mutual rights, liabilities and obligations relating to the issue. A draft of the MoU is prescribed. The lead manager may adopt the draft and incorporate such clauses as may be considered necessary for defining his rights and obligations vis-à-vis the issuer.

2) Obtaining Appraisal Note :
After the contract for issue management is awarded, an appraisal note is prepared either in-house or is obtained from outside appraising agencies viz., Financial Institutions/ Banks etc. The appraisal note thus prepared throws light on the proposed capital outlay on the project and the sources of funding it. Project may be funded either by borrowing money from outside agencies or by injecting capital. Optimum Capital Structure is determined considering the nature and size of the project.

3) Appointment of Other Intermediaries:
Lead manager should ensure that the requisite intermediaries, who are appointed, are registered with SEBI. Before advising the issuer on the appointment of other intermediaries, lead manager shall independently assess the capability and the capacity of the various intermediaries to handle the issue. Wherever required, the issuer shall be advised by the lead manager to enter into a Memorandum of Understanding with the Intermediary(ies) concerned. Lead manager should ensure that bankers to the issue are appointed in the mandatory collection centres.

4) Inter-se Allocation of Responsibilities:
Where an issue is managed by more than one lead manager, the responsibility of each lead manager shall be clearly delineated, preferably as indicated in Annexure

5) Preparing Prospectus:
Lead manager should ensure proper disclosures to the investors, keeping in mind their responsibilities as per Merchant Bankers Rules and Regulations. The lead manager should, therefore, not only furnish adequate disclosures but also ensure due compliance with the Guidelines for Disclosure and Investor Protection issued by SEBI which also specifies the contents of prospectus as well as application form.

6) Submission of Draft Offer Documents The Lead Manager shall hand over not less than 25 copies of the draft offer document to SEBI and also to the Stock Exchange(s) where the issue is proposed to be listed. The Lead Manager shall submit to SEBI the Draft Prospectus in a computer floppy. Copies of the Draft Prospectus will be made available by the Lead Managers/Stock Exchange to prospective investors.

B) Post-Issue Activities:
After the closure of the Issue, Lead Manager has to manage the Post-Issue activities pertaining to the Issue. He is to ensure the submission of the post issue monitoring report as desired by SEBI.
Finalisation of Basis of Allotment (BOA):
In case of a public offering, besides post-issue lead-manager, registrar to the issue and regional stock-exchange officials, association of public representative is required to participate in the finalisation of Basis of Allotment (Annexure 5). Data of accepted applications is finalised and Regional Stock Exchanges are approached for finalisation of BOA.
Despatch of Share Certificates, etc.:
Then follows despatch of share certificates to the successful allottees, demat credit, cancelled stock-invest and refund orders to unsuccessful applicants.

Issue of Advertisement in Newspapers:
An announcement in the newspaper is also made regarding BOA, number of applications received and the date of despatch of share certificates and refund orders, etc.

FINANCIAL SECURITIES

Financial Securities – Definition

A financial security is a document of a certain monetary value. Traditionally, it used to be a physical certificate but nowadays, it is more commonly electronic. It shows that one owns a part of a publicly-traded corporation or is owed a part of a debt issue. In the most common parlance, financial securities refer to stocks and bonds which are negotiable. Derivatives are also considered as a common type of financial security, with its growing popularity in recent years. In current usage, financial securities are no longer an evidence of ownership. Rather, they refer to the financial product themselves i.e. stock, bond, or other product of investment. They are also known as financial instruments or financial assets.

Features of Financial Securities

One of the most important features of financial securities is that they are trade-able i.e. one can convert them into cash quite easily. Holding a financial security gives a right to the holder to receive future monetary benefits under a stated set of conditions. Except for derivatives, securities let you own the underlying asset without taking physical possession. The price of the securities indicates the value of an underlying asset. More the price, higher is the value of the asset.

Types of Financial Securities

Equity Securities

An equity security is a share of interest in the capital of a company, firm or partnership. One can hold an equity interest in other forms of the organization too, other than the ones mentioned above. Holding an equity interest means contributing to the capital of the company. You can do this by buying shares of a company of your choice. A share of a company represents a monetary value. This monetary value is the amount of capital you contribute to the company.

Debt Securities

Debt securities are essentially loans made to a company. As the name suggests, these securities represent a debt owed by a company to lenders. There are different types of debt securities such as bonds, debentures, commercial paper, etc. These securities are different from each other in terms of maturity, collateral, and other characteristics. They are different from equity securities in the sense that debenture holders are creditors of the company. This is unlike equity shareholders, who are owners of the company.

Derivative Securities

Derivative securities are those securities whose value is derived from an underlying asset. These underlying assets can be bonds, stocks, commodities, currencies or other assets. These securities trade on exchanges like other financial securities and their value differ with a change in the value of an underlying asset. They themselves have no value of their own. One must note that ownership of a derivative does not mean ownership of an asset. Derivative securities are more sophisticated as compared to equity and debt securities. They work in a very different manner and therefore require sound financial knowledge to mitigate risk and earn good returns.

New Issues Market Vs Secondary Market

S..No	BASIS FOR COMPARISON	PRIMARY MARKET	SECONDARY MARKET
1	Meaning	The market place for new shares is called primary market.	The place where formerly issued securities are traded is known as Secondary Market.
2	Another name	New Issue Market (NIM)	After Market
3	Type of Purchasing	Direct	Indirect

4	Financing	It supplies funds to budding enterprises and also to existing companies for expansion and diversification.	It does not provide funding to companies.
5	How many times a security can be sold?	Only once	Multiple times
6	Buying and Selling between	Company and Investors	Investors
7	Who will gain the amount on the sale of shares?	Company	Investors
8	Intermediary	Underwriters	Brokers
9	Price	Fixed price	Fluctuates, depends on the demand and supply force
10	Organizational difference	Not rooted to any specific spot or geographical location.	It has physical existence.

ISSUE MANAGER

Issue Managers are required to be registered with SEBI to carry on their Issue Management activities, since setting up of SEBI. SEBI has formulated Rules and Regulations for merchant bankers which bring out the requirements for Registration of issue managers apart from prescribing the conduct rules for them. In terms of these regulations, issue managers are required to mainly comply with the following requirements for registration:

Issue manager should be a corporate body, not being a Non Banking Financial Company (as per RBI).
lHe should have necessary infrastructure like adequate office space, equipments and manpower to effectively discharge his activities.
lHe should have minimum two persons who have the experience to conduct the business of Merchant Banking.
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UNDERWRITING

Underwriting is the process that banks and other financial institutions use to assess the creditworthiness or risk of a potential borrower.

Types of Underwriters

There are two types of underwriters. They are

Institutional underwriters – IDBI, IFCI, UTI, SBI Capital Market

Non-Institutional underwriters – Any NBFC.

Institutional underwriting in India helps companies to raise capital in their early stages. In fact, many companies which may not come to the notice of the public were promoted due to the support given by institutional underwriters.

Many institutional underwriters were responsible for the promotion of infrastructure companies in the area of steel, chemicals, fertilizer, etc.

Responsibilities of Underwriters

1. An underwriter, not only has to underwrite the securities but has to subscribe within 45 days that part of shares which remain unsubscribed by the public.
2. His underwriting obligations should not exceed, at any time, 20 times of his net worth.

Merits and Benefit functions of Underwriters

Merits of Underwriting:

1. Underwriting **ensures success of the proposed issue of shares** since it provides an insurance against the risk.
2. Underwriting **enables a company to get the required minimum subscription**. Even if the public fail to subscribe, the underwriters will fulfill their commitments.
3. The **reputation of the underwriter acts as a confidence to investor**s. The underwriters who are called the lead managers provide financial recognition to the company, whose shares are issued to the public. Thus, the reputation of the issuing company also improves because of the reputation of underwriters.

Benefits due to professional underwriters:

1. Large issues could be undertaken successfully.
2. Companies with a long gestation period cannot raise capital without support of professional underwriters.
3. Technocrats could promote companies with their poor financial knowledge.
4. New projects in the market could be taken boldly.
5. Companies could be promoted in backward areas.
6. Certain projects which are not financially viable in the initial stages, especially in priority sector (agriculture, small scale industry, export oriented units) could be promoted with the support of institutional underwriters.

UNIT-III

Part –A

CAPITAL MARKET

A **capital market** is a financial **market** in which long-term debt (over a year) or equity-backed securities are bought and sold. **Capital markets** channel the wealth of savers to those who can put it to long-term productive use, such as companies or governments making long-term investments.

FEATURES OF CAPITAL MARKET

1. **Link between Savers and Investment Opportunities:**

Capital market is a crucial link between saving and investment process. The capital market transfers money from savers to entrepreneurial borrowers.

2. **Deals in Long Term Investment:**

Capital market provides funds for long and medium term. It does not deal with channelising saving for less than one year.

3. **Utilises Intermediaries:**

Capital market makes use of different intermediaries such as brokers, underwriters, depositories etc. These intermediaries act as working organs of capital market and are very important elements of capital market.

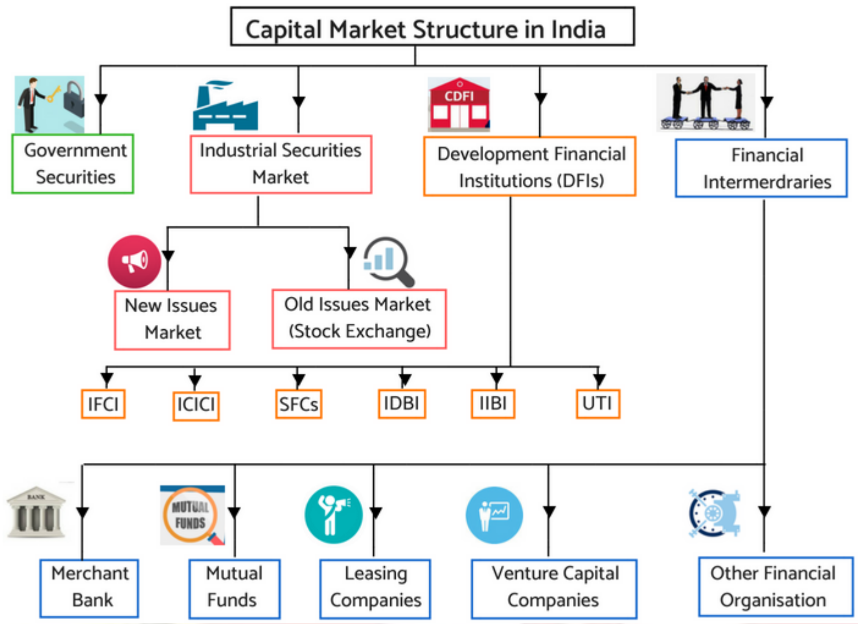
4. **Determinant of Capital Formation:**

The activities of capital market determine the rate of capital formation in an economy. Capital market offers attractive opportunities to those who have surplus funds so that they invest more and more in capital market and are encouraged to save more for profitable opportunities.

5. **Government Rules and Regulations:**

The capital market operates freely but under the guidance of government policies. These markets function within the framework of government rules and regulations, e.g., stock exchange works under the regulations of SEBI which is a government body.

WORKING OF THE CONSTITUENTS OF THE INDIAN CAPITAL MARKET



(1) Gilt- Edged Market: Gilt-edged market is also known as the government securities market. As the securities are risk free, they are known as gilt-edged i.e. the best quality securities. The investors in the gilt-edged market are predominantly institutions. They are required by law to invest a certain portion of their funds in these securities. These institutions include commercial banks, LIC, GIC, and the provident funds. The transactions in the government securities market are very large. Each transaction may run into several crores or even hundred crores of rupees. Since June 1992, government securities have been mostly issued sealed bid auctions. RBI plays a dominant role in the gilt-edged market through its open market operations. Thus, government securities are the most liquid debt instruments.

(2) The Industrial Securities Market:

It is a market of shares, debentures and bonds which can be bought and sold freely. This market is divided into two categories:

Primary Market The new issue market called the primary market and old issue market, commonly known as stock exchange or stock market. It is called the secondary market.

(A) The new issue market is concerned with the raising of new capital in the form of shares, bonds and debentures. Many public limited companies often raise capital through the primary market for expanding their business. It may be noted that the new issue market is important because of its impact on economic growth of the country.

(B) Secondary Market: The stock exchange market or the secondary market is a market of the purchase and sale of quoted or listed securities. It is a highly organized market for regulating and controlling business in buying, selling and dealing in securities.

(3) Financial Institutions:
We have mentioned that there are special financial institutions which provided long-term capital to the private sector in the capital market. These institutions are called Development Financial Institutions.

(4) Financial Intermediaries: The Indian capital market has shown steady improvement after 1951. During the Five-Year Plans, Capital market has witnessed rapid growth. Both the volume of saving and investment have shown phenomenal improvement. In fact, in the last two decades, the volume of capital market transactions has increased substantially. Besides, its functioning has been diversified indicating the growth of the Indian economy.

'MONEY MARKET'

Definition: Money market basically refers to a section of the financial market where financial instruments with high liquidity and short-term maturities are traded. Money market has become a component of the financial market for buying and selling of securities of short-term maturities, of one year or less, such as treasury bills and commercial papers.

Over-the-counter trading is done in the money market and it is a wholesale process. It is used by the participants as a way of borrowing and lending for the short term.

STOCK EXCHANGE

A **stock exchange** is a marketplace, where financial **securities** issued by companies are bought and sold. They are part of the broader capital market ecosystem. **Securities** issued by companies, such as shares and bonds, are traded on the **stock exchanges**, after they have been issued in the primary market.

Features of Stock Exchanges:

1. Organized Market: Stock exchange is an organized market of securities (shares, debentures, bonds, etc.) where the securities are bought and sold on the floor of a stock exchange. All transactions are regulated by the rules and bye-laws of the concerned stock exchange.
2.Formation & Membership: A stock exchange is generally registered as an association or a society or a company. The membership of the stock exchange is restricted to a certain number, and new members are admitted only when there are vacancies. Every member has to pay the prescribed membership fee.

3.Only Members Can Trade: Stock exchange is only open to the members of exchange also known as brokers. Brokers act as an agent of the buyers and sellers of shares, debentures and bonds. In a stock exchange, transactions take place between members or their authorized agents on behalf of the investors.

4.Listed Securities: To be able to trade a security on a certain stock exchange, it must be listed on the respective stock exchange as per the guidelines issued by the exchange. The stock exchanges do not allow trading in each and every company's securities. Companies which want their securities to be traded on the floor of a stock exchange have to fulfill certain conditions. The stock exchange satisfies itself about the genuineness and soundness of the company to protect the investors from being cheated. Exchanges maintain records at a central location of such securities but now the trade is increasingly moving from physical places to electronic networks enabling speed and reducing cost.

FUNCTIONS OF STOCK EXCHANGE

Functions of Stock Exchanges

The stock market occupies an important place in the financial system of our country, which is of vital importance for the proper functioning of the corporate enterprises.

1. Marketability of securities

Stock exchanges are the markets for purchasing and selling securities. As they provide a ready and continuous market for securities, the securities can be converted into cash without delay.

2. Evaluation of securities

In stock exchanges, prices of securities are determined by investors’ demand and suppliers’ preferences. Stock exchanges integrate the demand and supply of securities and determine their prices on a continuous basis. The prices prevailing in the stock exchanges are called quotations.

3. Safety of investment

Stock exchanges operate under the rules, bye-laws and regulations duly approved by the government. The members of stock exchange are bound by them. Stock exchanges provide the most perfect type of market by making the transactions publicly known to the investors. Besides this, they avoid over trading and speculation through various regulatory measures.

4. Capital formation

Capital formation occurs due to savings and investments. Stock exchanges facilitate capital formation in the country. They create the healthy habit of saving, investing and risk bearing among the investors. The prices quoted in stock exchanges indicate the extent of popularity of companies. Investors are attracted towards profitable companies and come forward to invest their savings in the corporate securities.

5. Regulation and Motivation of Companies

Companies wishing to list their shares on a stock exchange should follow certain rules and regulations. For example, every year, they should submit to stock exchange all relevant data relating to their financial affairs. So, the listing companies will safegurad their interest by monitoring their financial performance carefully. Thus, the stock exchanges by quoting the prices of securities motivate the companies concerned to improve their financial performance.

6. Facilitates for healthy speculation
Speculation is taking advantage of fluctuations of price movement. With regard to securities market, healthy speculation is essential to equate demand and supply of securities at different places. Further, it regulates the prices of securities to a great extent. The mechanism of stock exchanges encourages healthy speculation thereby enabling the shrewd investors to benefit from price fluctuations.

7. Barometer of business progress

Stock exchanges reflect the prevailing business conditions in the country. Booms and depressions are reflected by the index prices of various securities traded in the stock exchange. By analyzing the causes for such changes in business conditions, the government can take suitable fiscal measures.

OTCEI.

Definition of OTCEI.

Over The Counter Exchange of India (OTCEI) can be defined as a stock exchange without a proper trading floor. All stock exchange have a specific place for trading their securities through counters. But the OTCEI is connected through a computer network and the transactions are taking place through computer operations. Thus, the development in information technology has given scope for starting this type of stock exchange.

SPECIAL FEATURES OF OTCEI:

1. **Use of Modern technology:** Unlike other stock market, OTCEI does not have any special counters and it is an electronically operated stock exchange.
2. **Restrictions for other stocks:** Stocks and shares listed in other stock exchanges will not be listed in the OTCEI and similarly, stocks listed in OTCEI will not be listed in other stock exchanges.
3. **Minimum issued capital requirements:** Minimum issued equity capital should be Rs. 30 Lakhs, out of which minimum public offer should be Rs. 20 Lakhs.
4. **Restrictions for large companies:** No company with the issued equity share capital of more than Rs. 25 Crores is permitted for listing.
5. **Base Capital requirement for members:** Members will be required to maintain a minimum base capital of Rs. 4 Lakhs to trade on the permitted or on listed segment.
6. **All India Network:** The network of counters links OTCEI members, located in different parts of the country.
7. **Satellite facility**: The satellite required for OTCEI for its operations is jointly held with Press Trust of India (PTI) and hence, PTI-OTCEI scan displays the prices of OTCEI’s scripts.
8. **Computerization of transactions:** Computers at each counter enable to dealers to enter various transactions or queries or quotes through a central OTCEI computer, using telecommunications.

SEBI

Securities Exchange Board of India (SEBI) was set up in 1988 to regulate the functions of securities market. SEBI promotes orderly and healthy development in the stock market but initially SEBI was not able to exercise complete control over the stock market transactions.
Purpose and Role of SEBI:

SEBI was set up with the main purpose of keeping a check on malpractices and protect the interest of investors. It was set up to meet the needs of three groups.

1. Issuers:
For issuers it provides a market place in which they can raise finance fairly and easily.
2. Investors:
For investors it provides protection and supply of accurate and correct information.
3. Intermediaries:
For intermediaries it provides a competitive professional market.

OBJECTIVES OF SEBI:

The overall objectives of SEBI are to protect the interest of investors and to promote the development of stock exchange and to regulate the activities of stock market. The objectives of SEBI are:

1. To regulate the activities of stock exchange.
2. To protect the rights of investors and ensuring safety to their investment.
3. To prevent fraudulent and malpractices by having balance between self regulation of business and its statutory regulations.
4. To regulate and develop a code of conduct for intermediaries such as brokers, underwriters, etc.

FUNCTIONS OF SEBI

The SEBI performs functions to meet its objectives. To meet three objectives SEBI has three important functions. These are:

i. **Protective functions**

ii. **Developmental functions**

iii. **Regulatory functions.**

1. Protective Functions:

These functions are performed by SEBI to protect the interest of investor and provide safety of investment.
As protective functions SEBI performs following functions:

(i) It Checks Price Rigging:
Price rigging refers to manipulating the prices of securities with the main objective of inflating or depressing the market price of securities. SEBI prohibits such practice because this can defraud and cheat the investors.

(ii) It Prohibits Insider trading:
Insider is any person connected with the company such as directors, promoters etc. These insiders have sensitive information which affects the prices of the securities. This information is not available to people at large but the insiders get this privileged information by working inside the company and if they use this information to make profit, then it is known as insider trading, e.g., the directors of a company may know that company will issue Bonus shares to its shareholders at the end of year and they purchase shares from market to make profit with bonus issue. This is known as insider trading. SEBI keeps a strict check when insiders are buying securities of the company and takes strict action on insider trading.

(iii) SEBI prohibits fraudulent and Unfair Trade Practices:
SEBI does not allow the companies to make misleading statements which are likely to induce the sale or purchase of securities by any other person.

(iv) SEBI undertakes steps to educate investors so that they are able to evaluate the securities of various companies and select the most profitable securities.

(v) SEBI promotes fair practices and code of conduct in security market by taking following steps:

(a) SEBI has issued guidelines to protect the interest of debenture-holders wherein companies cannot change terms in midterm.

(b) SEBI is empowered to investigate cases of insider trading and has provisions for stiff fine and imprisonment.

(c) SEBI has stopped the practice of making preferential allotment of shares unrelated to market prices.

2. Developmental Functions:

These functions are performed by the SEBI to promote and develop activities in stock exchange and increase the business in stock exchange. Under developmental categories following functions are performed by SEBI:

(i) SEBI promotes training of intermediaries of the securities market.

(ii) SEBI tries to promote activities of stock exchange by adopting flexible and adoptable approach in following way:

(a) SEBI has permitted internet trading through registered stock brokers.

(b) SEBI has made underwriting optional to reduce the cost of issue.

(c) Even initial public offer of primary market is permitted through stock exchange.

2. **Regulatory Functions:**

These functions are performed by SEBI to regulate the business in stock exchange. To regulate the activities of stock exchange following functions are performed:

(i) SEBI has framed rules and regulations and a code of conduct to regulate the intermediaries such as merchant bankers, brokers, underwriters, etc.

(ii) These intermediaries have been brought under the regulatory purview and private placement has been made more restrictive.

(iii) SEBI registers and regulates the working of stock brokers, sub-brokers, share transfer agents, trustees, merchant bankers and all those who are associated with stock exchange in any manner.

(iv) SEBI registers and regulates the working of mutual funds etc.

(v) SEBI regulates takeover of the companies.

(vi) SEBI conducts inquiries and audit of stock exchanges.

Unit-IV

LEASING

Leasing is a process by which a firm can obtain the use of a certain fixed assets for which itmust pay a series of contractual, periodic, tax deductible payments. The lessee is the receiver of the services or the assets under the lease contract and the lessor is the owner of the assets. The relationship between the tenant and the landlord is called a tenancy, and can be for a fixed or an indefinite period of time (called the term of the lease). The consideration for the lease is called rent.

TYPES OF LEASING

(1) Financial lease:
Long-term, non-cancellable lease contracts are known as financial leases. The essential point of financial lease agreement is that it contains a condition whereby the lessor agrees to transfer the title for the asset at the end of the lease period at a nominal cost. At lease it must give an option to the lessee to purchase the asset he has used at the expiry of the lease. Under this lease the lessor recovers 90% of the fair value of the asset as lease rentals and the lease period is 75% of the economic life of the asset. The lease agreement is irrevocable. Practically all the risks incidental to the asset ownership and all the benefits arising there from are transferred to the lessee who bears the cost of maintenance, insurance and repairs.

2) Operational lease:
An operating lease stands in contrast to the financial lease in almost all aspects. This leaseagreement gives to the lessee only a limited right to use the asset. The lessor is responsible for the upkeep and maintenance of the asset. The lessee is not given any uplift to purchase the asset at the end of the lease period. Normally the lease is for a short period and even otherwise is revocable at a short notice. Mines, Computers hardware, trucks and automobiles are found suitable for operating lease because the rate of obsolescence is very high in this kind of assets.

3) Sale and lease back:
It is a sub-part of finance lease. Under this, the owner of an asset sells the asset to a party (thebuyer), who in turn leases back the same asset to the owner in consideration of lease rentals.However, under this arrangement, the assets are not physically exchanged but it all happens in records only. This is nothing but a paper transaction. Sale and lease back transaction is suitable for those assets, which are not subjected depreciation but appreciation, say land. The advantage of this method is that the lessee can satisfy himself completely regarding the quality of the asset and after possession of the asset convert the sale into a lease arrangement.

4) Leveraged leasing:
Under leveraged leasing arrangement, a third party is involved beside lessor and lessee. The lessor borrows a part of the purchase cost (say 80%) of the asset from the third party i.e., lender and the asset so purchased is held as security against the loan. The lender is paid off from the

lease rentals directly by the lessee and the surplus after meeting the claims of the lender goes to the lessor. The lessor, the owner of the asset is entitled to depreciation allowance associated with the asset.

5) Direct leasing:

Under direct leasing, a firm acquires the right to use an asset from the manufacture directly. The ownership of the asset leased out remains with the manufacturer itself. The major types of direct lessor include manufacturers, finance companies, independent lease companies, special purpose leasing companies etc

THE ADVANTAGES OF LEASING INCLUDE:

a. Helps in Purchasing New Assets: Leasing helps to possess and use a new piece of machinery or equipment without huge investment.

b. Preservation of cash reserves: Leasing enables businesses to preserve precious cash reserves.

c. Payment in Small amount: The smaller, regular payments required by a lease agreement enable businesses with limited capital to manage their cash flow more effectively and adapt quickly to changing economic conditions.

d.Upgradation of assets: Leasing also allows businesses to upgrade assets more frequently ensuring they have the latest equipment without having to make further capital outlays.

e. Flexibility of repayment period: It offers the flexibility of the repayment period being matched to the useful life of the equipment.

f. Business Certainty: It gives businesses certainty because asset finance agreements cannot be cancelled by the lenders and repayments are generally fixed.

Limitation of leasing:

a. Immediate rent Payment system: It is not a suitable mode of project financing because rental is payable soon after entering into lease agreement while new project generate cash only after long gestation period.

b.No tax Benefit: Certain tax benefits/ incentives/subsidies etc. may not be available to leased equipments.

c. Increase of value of assets: The value of real assets (land and building) may increase during lease period. In this case lessee may lose potential capital gain.

d. High cost of Finance: The cost of financing is generally higher than that of debt financing.

DISTINCTION BETWEEN FINANCIAL LEASE AND OPERATING LEASE.

S.No.	BASIS FOR COMPARISON	FINANCE LEASE	OPERATING LEASE
1	Meaning	A commercial arrangement in which the lessor allows the lessee to use the asset for the maximum part of its economic life against payment of rentals is known as finance lease.	A commercial arrangement in which the lessor allows the lessee to use the asset for a term smaller than the economic life of the asset against the payment of rentals is known as operating lease.
2	Nature	Loan Agreement	Rental Agreement
3	Lease Term	The lease term of finance lease is longer as compared to operating lease.	The lease term of operating lease is short.
4	Risk Bearing for obsolescence	Rests with the lessee	Rests with the lessor
5	Transferability of risk and rewards	From the lessor to the lessee, with the transfer of asset.	Does not transfers from the lessor to the lessee, with the transfer of the asset.
6	Cancellation of the lease	Only on the happening of certain specified event.	Can be done
7	Tax Benefit	Depreciation and finance charges are allowable as a deduction to lessee.	Lease rent is allowable as a deduction to lessee.
8	Cost of Repairs and Maintenance	Are to be borne by the lessee.	Are borne by the lessor.
9	Bargain Purchase Option	The lease contains an option where the lessee can purchase the equipment at the price less than the Fair Market Value.	No such option in this regard

HIRE PURCHASE

The main features of hire purchase finance are:

1. The hire purchaser becomes the owner of the asset after paying the last installment.
2. Every installment is treated as hire charge for using the asset.
3. Hire purchaser can use the asset right after making the agreement with the hire vendor.
4. The hire vendor has the right to repossess the asset in case of difficulties in obtaining the payment of installment.

Advantages of Hire Purchase:

Hire purchase as a source of finance has the following advantages:

i. Financing of an asset through hire purchase is very easy.
ii. Hire purchaser becomes the owner of the asset in future.
iii. Hire purchaser gets the benefit of depreciation on asset hired by him/her.
iv. Hire purchasers also enjoy the tax benefit on the interest payable by them.

Disadvantages of Hire Purchase:
Hire purchase financing suffers from following disadvantages:

i. Ownership of asset is transferred only after the payment of the last installment.
ii. The magnitude of funds involved in hire purchase are very small and only small types of assets like office equipment's, automobiles, etc., are purchased through it.
iii. The cost of financing through hire purchase is very high.

Distinction Lease Financing from Hire Purchase.

S.No	BASIS FOR COMPARISON	HIRE PURCHASING	LEASING
1	Meaning	The deal in which one party can use the asset of the other party for the payment of equal monthly installments is known as Hire Purchasing.	Leasing is an agreement where one party buys the asset and allows the other party to use it by paying consideration over a specified period is known as Leasing.
2	Governing Accounting Standard	No Specific Accounting Standard	AS- 19

3	Down Payment	Required	Not Required
4	Installments	Principal plus interest	Cost of using the asset
5	Asset type	Car, trucks, lorries etc.	Land and Building, Property.
6	Ownership	Ownership of the asset is transferred to the hire purchaser on the payment of the last installment.	Transfer of ownership depends on the type of lease.
7	Repairs & Maintenance	Responsibility of hire purchaser.	Depends upon the type of lease
8	Consideration	Initial payment plus installment.	Lease Rentals
9	Duration	Short Term	Comparatively Long term

RIGHTS OF A HIRER

- To receive a copy of the hire purchase (HP) agreement.
- To obtain any information regarding the account.
- To request a statement of outstanding balance (once every 3 months).
- To settle early the full outstanding amount.
- To terminate the agreement at any time.

DUTIES OF A HIRER

1. Read all the fine print in the written agreement.
2. Check that the purchase price and HP terms in the agreement are as agreed. Do not sign blank or incomplete agreement/ forms.
3. Ensure that you can afford the instalment payments for the duration of the HP financing and pay your instalments on time.
4. Know your rights and obligations under the HP contract so that you do not commit any actions leading to a breach.
5. Keep all documents pertaining to the HP financing such as agreement, receipts, etc. in a safe place.
6. Not to remove, sell or dispose off the motor vehicle without the consent of your banking institution.
7. Inform your banking institution of any change of address.

FACTORING

Factoring is a financial service in which the business entity sells its bill receivables to a third party at a discount in order to raise funds. It differs from invoice discounting.

Salient Features of Factoring:

(i) Credit Cover:
The factor takes over the risk burden of the client and thereby the client's credit is covered through advances.
(ii) Case advances:
The factor makes cash advances to the client within 24 hours of receiving the documents.
(iii) Sales ledgering:
As many documents are exchanged, all details pertaining to the transaction are automatically computerized and stored.
(iv) Collection Service:
The factor, buys the receivables from the client, they become the factor's debts and the collection of cheques and other follow-up procedures are done by the factor in its own interest.
(v) Provide Valuable advice:
The factors also provide valuable advice on country-wise and customer-wise risks. This is because the factor is in a position to know the companies of its country better than the exporter clients.

TYPES OF FACTORING

Types of Factoring:

(i) Recourse Factoring
(ii) Non-Recourse Factoring
(iii) Advance Factoring
(iv) Confidential and Undisclosed Factoring
(v) Maturity Factoring.
(vi) Supplier Guarantee Factoring
(vii) Bank Participation Factoring

The process or steps involved in factoring
Step I. The customer places an order with the seller (the client).
Step II. The factor and the seller enter into a factoring agreement about the various terms of factoring.
Step III. Sale contract is entered into with the buyer and the goods are delivered. The invoice with the notice to pay the factor is sent along with.
Step IV. The copy of invoice covering the above sale is sent to the factors, who maintain the sales ledger.
Step V. The factor prepays 80% of the invoice value.
Step VI. Monthly Statements are sent by the factor to the buyer.

Step VII. If there are any unpaid invoices follow up action is initiated.
Step VIII. The buyer settles the invoices on expiry of credit period allowed.
Step IX. The balance 20% less the cost of factoring is paid by the factor to the client.

Advantage of Factoring:

1. **It is help to improve the current ratio**. Improvement in the current ratio is an indication of improved liquidity. Enables better working capital management. This will enable the unit to offer better credit terms to its customers and increase orders.
2. **It is increase in the turnover of stocks.** The turnover of stock into cash is speeded up and this results in larger turnover on the same investment.
3. It ensures prompt payment and reduction in debt.
4. **It helps to reduce the risk.** Present risk in bills financing like finance against accommodation bills can be reduced to minimum.
5. **It is help to avoid collection department.** The client need not undertake any responsibility of collecting the dues from the buyers of the goods.

Limitations of Factoring:

1. **Factoring is a high risk area**, and it may result in over dependence on factoring, mismanagement, over trading of even dishonesty on behalf of the clients.
2. **It is uneconomical for small companies** with less turnover.
3. **The factoring is not suitable to the companies manufacturing and selling** highly specialized items because the factor may not have sufficient expertise to asses the credit risk.
4. The developing countries such as India are **not able to be well verse in factoring**. The reason is lack of professionalism, non-acceptance of change and developed expertise.

WITH RECOURSE FACTORING.

Recourse factoring is a financial solution used by businesses of all types in many industries. It provides relief in times of tight cash flow or business seasonality. Businesses can often see their invoices funded (minus a fee) in as little as 24 hours in some cases.
The concept of recourse factoring is simple. It is defined as the act of selling accounts receivablesat a discount, with the promise of purchasing them back if the customer does not pay. Most factoring arrangements are of the recourse type because it provides greater protection to the lender. Should an invoice go unpaid, they can turn to you for payment.

Merits:

- Quick access to funds (Can see an invoice funded in as little as 24 hours)
- Easier to obtain than conventional lending
- More flexible than a loan
- Lower fees than other types of factoring

- Can be a cheap form of leverage if your customers are reliable

Demerits:

- Requires greater discretion when extending credit
- High fees compared to a loan or line of credit
- May have to fund a reserve account up front.

'DOMESTIC FACTORING'.

Domestic Factoring:
It is a transaction in which a business sells its accounts receivables, or invoices, to a third party, at a discount, known as a "Factor".

It was introduced in the country in 1989.
The exporter assigns his account receivables in the favor of the factor & give notice of assignment to the debtor.
The factor also provides you back-office support.
The factor undertakes collection/accounting & management of debts of their clients.
Factoring is sometimes called as "Accounts Receivable Financing"
Most factoring companies will purchase your invoices & advance you money within 24 hours.
At first, they will pay you 80-90% of the a/c receivable or invoice value.
Once they receive the payment from the buyer they will pay you the balance amount after deducting the fees.
The factor may either lend against the account receivables or purchase the invoice.
The financing doesn't show up on your balance sheet as debt.
Factoring is based on the quality of your customer credit, not your own credit or business history.
Factoring provides a line of credit based on sales, not your company's net worth.
Factoring allows you to concentrate on your core business rather than running for difference source of funds.

Debt Securitization: Meaning and Process

Meaning of Debt Securitization:
It is the process of converting mortgage loans together with future receivables into negotiable securities or assignable debt is called 'securitization'. The Securitization process involves packaging designated pool of mortgages and receivables and selling these packages to the various investors in the form of securities which are collateralized by the underlying assets and their associated income streams.

DEBT SECURITIZATION PROCESS:

The steps involved in Securitization process are the following:

(a) A company that wants to mobilize finance through securitization begins by identifying assets that can be used to raise funds.

(b) These assets typically represent rights to payment at future dates and are usually referred to as ‘receivables’.

(c) The company that owns the receivables is usually called the ‘originator’.

(d) The originator identifies the assets out of its portfolio for Securitization.

(e) The identification of assets will have to be done in a manner so that an optimum mix of homogeneous assets having almost same maturity forms the portfolio.

(f) Assets originated through trade receivables, lease rentals, housing loans, automobile loans, etc. according to their maturity pattern and interest rate risk are formed into a pool.

TYPES OF SECURITIZATION

The different kinds of receivables determine the type of securitization it requires. Given below are some of the most common types of securitization:

Asset-Backed Securities (ABS)

The bonds which are supported by underlying financial assets. The receivables which are converted into ABS include credit card debts, student loans, home-equity loans, auto loans, etc.

Residential Mortgage-Backed Securities (MBS)

These bonds comprise of various mortgages like of property, land, house, jewellery and other valuables.

Commercial Mortgage-Backed Securities (CMBS)

The bonds that are formed by bundling different commercial assets mortgage such as office building, industrial land, plant, factory, etc.

Collateralized Debt Obligations (CDO)

The CDOs are the bonds designed by re-bundling the personal debts, to be marketed in the secondary market for prospective investors.

Future Flow Securitization

The company issues these instruments over its debts receivable in a future period. The company meets the principal and interest through its routine business operations, though such obligations are secured against its future receivables.

ADVANTAGES OF SECURITIZATION

In the securitization process, the multiple parties involved are borrowers, originator, special purpose vehicle, merchant bank and investors.

Thus, each one these parties benefit from the process, where the originator and the investor have multiple advantages as discussed below:

TO THE ORIGINATOR

The originator derives maximum benefit from securitization since the purpose is to get the blocked funds released to take up other alluring opportunities. Let us discuss each one of these:

Unblocks Capital: Through securitization, the originator can recover the amount lent, much earlier than the prescribed period.

Provides Liquidity: The illiquid assets, such as the receivables on loans sanctioned by the bank, are converted into liquid assets.

Lowers Funding Cost: With the help of securitization, even the BB grade companies can benefit by availing AAA rates if it has an AAA-rated cash flow.

Risk Management: The financial institution lending the funds can transfer the risk of bad debts by securitizing its receivables.

Overcoming Profit Uncertainty: When the recovery of debts is uncertain, its profitability, in the long run, is equally doubtful. Thus, securitization of such obligations is a suitable option to avoid loss.

Reduces Need for Financial Leverage: Securitization releases the blocked capital to maintain liquidity; therefore, the originator need not seek to financial leverage in case of any immediate requirement.

To the Investor

The investor’s aim is to accelerate the return on investment. Following are the different ways in which securitization is worth investing:

Quality Investment: The purchase of MBS and ABS are considered to be a wise investment option due to their feasibility and reliability.

Less Credit Risk: The securitized assets have higher creditworthiness since these are treated separately from their parent entity.

Better Returns: Securitization is a means of making a superior return on their investment; however, it depends more on the investor's risk-taking ability.

Diversified Portfolio: The investor can attain a well-diversified portfolio on including the securitized bonds; since these are very different from other instruments.

DISADVANTAGES OF SECURITIZATION

Securitization requires proper analysis and expertise; otherwise, it may prove to be quite unsound to the investors. Let us now discuss its various drawbacks:

Lack of Transparency: The SPV may not disclose the complete information about the assets included in a securitized bond to the investors.

Complex to Handle: The whole process of securitization is quite complicated involving multiple parties; also, the assets need to be blended wisely.

Quite Expensive: When compared to share flotation, the cost of a securitized bond is usually high, including underwriting, legal, administration and rating charges.

Investor Bears Risk: The non-repayment of debts by the borrower would ultimately end up as a loss to the investors. Therefore, the investor is the sole risk-bearer in the process.

Inaccurate Risk Assessment: Sometimes, even the originator fails to identify the value of underlying assets or the associated credit risk.

Loss from Prepayment: If the borrower pays off the sum earlier than the defined period, the investors will not make superior gains on their investment value.

SARFAESI Act 2002- Background- Purpose of the Act- Main provisions

The financial sector has been one of the key handlers in India's efforts to achieve success in rapidly developing its economy. Since our existing legal framework relating to commercial transactions has not kept pace with the changing commercial practices and financial sector reforms. This ensures the slow pace of recovery of defaulting loans and escalating levels of nonperforming assets of banks and financial institutions.

APPLICABILITY OF SARFAESI ACT, 2002

The amendment to this Act is "an act to regulate securitization and reconstruction of financial assets and enforcement of security interest and to provide for a central database of security interests created on property rights, and for matters connected therewith or incidental thereto." The Act deals with the following:

1. Registration and regulation of Asset Reconstruction Companies (ARCs) by the Reserve Bank of India.
2. Facilitating securitization of financial assets of banks and financial institutions with or without the benefit of underlying securities.
3. Promotion of seamless transferability of financial assets by the ARC to acquire financial assets of banks and financial institutions through the issuance of debentures or bonds or any other security as a debenture.
4. Entrusting the Asset Reconstruction Companies to raise funds by issue of security receipts to qualified buyers.
5. Facilitating the reconstruction of financial assets which are acquired while exercising powers of enforcement of securities or change of management or other powers which are proposed to be conferred on the banks and financial institutions.
6. Presentation of any securitization company or asset reconstruction company registered with the Reserve Bank of India as a public financial institution.
7. Defining 'security interest' to be any type of security including mortgage and change on immovable properties given for due repayment of any financial assistance given by any bank or financial institution.
8. Classification of the borrower's account as a non-performing asset in accordance with the directions given or under guidelines issued by the Reserve Bank of India from time to time.
9. The officers authorized will exercise the rights of a secured creditor in this behalf in accordance with the rules made by the Central Government.
10. An appeal against the action of any bank or financial institution to the concerned Debts Recovery Tribunal and a second appeal to the Appellate Debts Recovery Tribunal.
11. The Central Government may set up or cause to be set up a Central Registry for the purpose of registration of transactions relating to securitization, asset reconstruction and creation of the security interest.
12. Application of the proposed legislation initially to banks and financial institutions and empowerment of the Central Government to extend the application of the proposed legislation to non-banking financial companies and other entities.
13. Non-application of the proposed legislation to security interests in agricultural lands, loans less than rupees one lakh and cases where eighty per cent, of the loans, is repaid by the borrower

OBJECTIVES OF SARFAESI ACT, 2002

1. Efficient or rapid recovery of non-performing assets (NPAs) of the banks and FIs.
2. Allows banks and financial institutions to auction properties (say, commercial/residential) when the borrower fails to repay their loans.

DOCUMENTS REQUIRED

orm CHG-1 or e-Form CHG-9 is required to be filed for application of a. Registration of creation b. Modification of charge (other than those related to debentures) including particulars of modification of charge by Asset Reconstruction Company in terms of Securitization and Reconstruction of Financial Assets and Enforcement of Securities InterestAct, 2002 [SARFAESI] The documents in this context are as follows:

1. Particulars of charge
2. Certificate of registration
3. An instrument created for the charge
4. Copy of the instrument – creating or modifying the charge
5. Hypothecation Deed
6. Sanction Letter
7. In case of any e-Form to be digitally signed, either of the following is required:
8. DSC of the charge holder
9. Director Identification Number [DIN] of the Director
10. Permanent Account Number [PAN] of the manager, CEO, CFO
11. Membership Number of the Company Secretary

FORMATION OF SARFAESI ACT, 2002

Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) were circulated:

1. To regulate securitization and reconstruction of financial assets.
2. Enforcement of the security interest for.
3. Matters connected therewith or incidental thereto.

It extended to the whole of India. Amendment in the (SARFAESI) Act, 2002 vide the enforcement of the Security Interest and Recovery of Debts Laws and Miscellaneous Provisions (Amendment) Act, 2016. The Enforcement of Security Interest and Recovery of

Debts Laws and Miscellaneous Provisional information in the Official Gazette, s (Amendment) Act, 2016 was published It is an Act further to amend four laws:

1. Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI).
2. Recovery of Debts due to Banks and Financial Institutions Act, 1993 (RDDBFI).
3. Indian Stamp Act, 1899.
4. Depositories Act, 1996, and for matters connected therewith or incidental thereto.

Features of the amendment to the SARFAESI Act in 2016

Government has amended the SARFAESI Act in August 2016 to empower the ARCs (Asset Reconstruction Companies), to rejuvenate Debt Recovery Tribunals (DRTs) and to enhance the effectiveness of asset reconstruction under the new bankruptcy law.

The amendment has given more regulatory powers to the RBI on the working of ARCs. It was also aimed to empower asset reconstruction and the functioning of DRTs in the context of the newly enacted bankruptcy law.

As per the amendment, the scope of the registry that contains the central database of all loans against properties given by all lenders has been widened to include more information.

RBI will get more powers to audit and inspect ARCs and will get the freedom to remove the chairman or any director. It can also appoint central bank officials into the boards of ARCs.

RBI will get the power to impose penalties on ARCs when the latter doesn't follow the central bank's directives. Similarly, it can regulate the fees charged by ARCs from banks while dealing with NPAs. The penalty amount has been increased from Rs 5 lakh to Rs 1 crore.

The amendment has brought hire purchase and financial lease under the coverage of the SARFAESI Act.

Regarding DRTs, the amendment aims to speed up the DRT procedures. Online procedures including electronic filing of recovery applications, documents and written statements will be initiated.

The amendments are important for DRTs as they can play an important role under the new Bankruptcy law. DRTs will be the backbone of the bankruptcy code and deal with all insolvency proceedings involving individuals. The defaulter has to deposit 50 per cent of the debt due before filing an appeal at a DRT.

Unit-V

Venture Capital

It is a private or institutional investment made into early-stage / start-up companies (new ventures). As defined, ventures involve risk (having uncertain outcome) in the expectation of a sizeable gain. Venture Capital is money invested in businesses that are small; or exist only as an initiative, but have huge potential to grow.

Features of Venture Capital investments

1. High Risk
2. Lack of Liquidity
3. Long term horizon
4. Equity participation and capital gains
5. Venture capital investments are made in innovative projects
6. Suppliers of venture capital participate in the management of the company.

Types & Methods of Venture capital financing

A. Equity
B. participating debentures
C. Conditional loan

The venture capital funding process typically involves four phases in the company's development:

1. Idea generation
2. Start-up
3. Ramp up
4. Exit

Step 1: Idea generation and submission of the Business Plan

The initial step in approaching a Venture Capital is to submit a business plan. The plan should include the below points:
There should be an executive summary of the business proposal
Description of the opportunity and the market potential and size
Review on the existing and expected competitive scenario
Detailed financial projections
Details of the management of the company
There is detailed analysis done of the submitted plan, by the Venture Capital to decide whether to take up the project or no.

Step 2: Introductory Meeting

Once the preliminary study is done by the VC and they find the project as per their preferences, there is a one-to-one meeting that is called for discussing the project in detail. After the meeting the VC finally decides whether or not to move forward to the due diligence stage of the process.

Step 3: Due Diligence

The due diligence phase varies depending upon the nature of the business proposal. This process involves solving of queries related to customer references, product and business strategy evaluations, management interviews, and other such exchanges of information during this time period.

Step 4: Term Sheets and Funding

If the due diligence phase is satisfactory, the VC offers a term sheet, which is a non-binding document explaining the basic terms and conditions of the investment agreement. The term sheet is generally negotiable and must be agreed upon by all parties, after which on completion of legal documents and legal due diligence, funds are made available.

Origin and Growth of Venture Capital

Venture capital that originated in India very late is still in its infancy. It was the Bhatt Committee (Committee on Development of Small and Medium Entrepreneurs) in the year 1972, which recommended the creation of venture capital. The committee urged the need for providing such capital to help new entrepreneurs and technologists in settings up industries. A brief description of some of the venture capital funds of India is as follows:

Risk capital foundation: The Industrial Finance Corporation of India (IFCI) launched the first venture capital fund in the year 1975. The fund, ‘Risk Capital Foundation’ (RCF) aimed at supplementing promoters’ equity with a view to encouraging technologies and professionals to promote new industries.

Seed capital scheme: This venture capital fund was launched by IDBI in 1976, with the same objective in mind.

Venture capital schemes: Venture capital funding obtained official patronage with the announcement by the Central Government of the “Technology Policy Statement” in 1983. It prescribed guidelines for achieving technological self reliance through commercialization and exploitation of technologies. The ICICI, an all-India financial institution in the private sector set up a Venture Capital Scheme in 1986, to encourage new technocrats in the private sector to enter new fields of high technology with inherent high risk. The scheme aimed at allocating funds for providing assistance in the form of venture capital to economic activities having risk, but also high profit potential.

PACT: The ICICI undertook the administration of Program for Application of Commercial Technology (PACT) aided by USAID with an initial grant of US$ 10 million. The program aims at financing specific needs of the corporate sector industrial units along the lines of venture capital funding.

Government fund: IDBI, as nodal agency, administers the venture capital fund created by the Central Government with effect from April1, 1986. The government started imposing a Research and Development (R & D) levy on all payments made for the purchase of technology from abroad, including royalty payments, lump sum payments for foreign collaboration and payment for designs and drawings under the R & D Cess Act, 1986. The levy was used as a source of funding the venture capital fund.

TDICI: In 1988, an ICICI sponsored company, viz, Technology Development and Information Company of India Ltd. (TDICI) was founded, and venture capital operations of ICICI were taken over by it with effect from July 1, 1988.

RCTFC: The Risk Capital Foundation (RCF) sponsored by IFCI was converted into Risk Capital and Technology Finance Corporation Ltd. (RCTFC) in the year 1988. It took over the activities of RCF in addition to the management of other financing technology development schemes and venture capital fund.

PLAYERS IN MUTUAL FUNDS

Asset Management Company
An Asset Management Company is a Non-Banking Finance Company licensed by the SECP for the management of mutual fund and for the benefit of the unit holders.

Participants
Participants are the ones investing in a mutual fund and anyone holding valid Pakistani computerized national identity card is eligible to become participant to a mutual fund.

Trustee A trustee in the case of Mutual funds is a holding service who has administrative power for managing the money, property or assets used in mutual funds.

Custodian
A custodian generally acts as a caretaker or watchdog mainly responsible for monitoring the operations of the mutual fund and actions of the fund manager and other parties related to the mutual fund.

MUTUAL FUNDS

Mutual funds are one of the most popular investment options these days. A mutual fund is an investment vehicle formed when an asset management company (AMC) or fund house pools investments from several individuals and institutional investors with common investment objectives. A fund manager, who is a finance professional, manages the pooled investment. The fund manager purchases securities such as stocks and bonds that are in line with the investment mandate.

TYPES OF MUTUAL FUNDS

Mutual funds in India are broadly classified into equity funds, debt funds, and balanced mutual funds, depending on their asset allocation and equity exposure. Therefore, the risk assumed and returns provided by a mutual fund plan would depend on its type. We have broken down the types of mutual funds in detail below:

Equity funds, as the name suggests, invest mostly in equity shares of companies across all market capitalisations. A mutual fund is categorised under equity fund if it invests at least 65% of its portfolio in equity instruments. Equity funds have the potential to offer the highest returns among all classes of mutual funds. The returns provided by equity funds depend on the market movements, which are influenced by several geopolitical and economic factors. The equity funds are further classified as below:

Small-Cap Funds

Small-cap funds are those equity funds that predominantly invest in equity and equity-linked instruments of companies with small market capitalisation. SEBI defines small-cap companies as those that are ranked after 251 in market capitalisation.

Mid-Cap Funds

Mid-cap funds are those equity funds that invest primarily in equity and equity-linked instruments of companies with medium market capitalisation. SEBI defines mid-cap companies as those that are ranked between 101 and 250 in market capitalisation.

Large-Cap Funds

Large-cap funds are those equity funds that invest mostly in equity and equity-linked instruments of companies with large market capitalisation. SEBI defines large-cap companies as those that are ranked between 1 and 100 in market capitalisation.

Multi-Cap Funds

Multi-Cap Funds invest substantially in equity and equity-linked instruments of companies across all market capitalisations. The fund manager would change the asset allocation depending on the market condition to reap the maximum returns for investors and reduce the risk levels.
Sector or Thematic Funds

Sectoral funds invest principally in equity and equity-linked instruments of companies in a particular sector like FMCG and IT. Thematic funds invest in equities of companies that operate with a similar theme like travel.

Index Funds

Index Funds are a type of equity funds having the intention of tracking and emulating the performance of a popular stock market index such as the S&P BSE Sensex and NSE Nifty50. The asset allocation of an index fund would be the same as that of its underlying index.

Therefore, the returns offered by index mutual funds would be similar to that of its underlying index.

ELSS:
Equity-linked savings scheme (ELSS) is the only kind of mutual funds covered under Section 80C of the Income Tax Act, 1961. Investors can claim tax deductions of up to Rs 1,50,000 a year by investing in ELSS.

Debt Mutual Funds

Debt mutual funds invest mostly in debt, money market and other fixed-income instruments such as treasury bills, government bonds, certificates of deposit, and other high-rated securities. A mutual fund is considered a debt fund if it invests a minimum of 65% of its portfolio in debt securities. Debt funds are ideal for risk-averse investors as the performance of debt funds is not influenced much by the market fluctuations. Therefore, the returns provided by debt funds are very much predictable. The debt funds are further classified as below:

Dynamic Bond Funds

Dynamic Bond Funds are those debt funds whose portfolio is modified depending on the fluctuations in the interest rates.

Income Funds

Income Funds invest in securities that come with a long maturity period and therefore, provide stable returns over time. The average maturity period of these funds is five years.

Short-Term and Ultra Short-Term Debt Funds

Short-term and ultra short-term debt funds are those mutual funds that invest in securities that mature in one to three years. These funds are ideal for risk-averse investors.

Liquid Funds

Liquid funds are debt funds that invest in assets and securities that mature within ninety-one days. These mutual funds generally invest in high-rated instruments. Liquid funds are a great option to park your surplus funds, and they offer higher returns than a regular savings bank account.

Gilt Funds
Gilt Funds are debt funds that invest in high-rated government securities. It is for this reason that these funds possess lower levels of risk and are apt for risk-averse investors.

Credit Opportunities Funds

Credit Opportunities Funds mostly invest in low rated securities that have the potential to provide higher returns. Naturally, these funds are the riskiest class of debt funds.

Fixed Maturity Plans

Fixed maturity plans (FMPs) are close-ended debt funds that invest in fixed income securities such as government bonds. You may invest in FMPs only during the fund offer period, and the investment will be locked-in for a predefined period.

Balanced or Hybrid Mutual Funds

Balanced or hybrid mutual funds invest across both equity and debt instruments. The main objective of hybrid funds is to balance the risk-reward ratio by diversifying the portfolio. The fund manager would modify the asset allocation of the fund depending on the market condition, to benefit the investors and reduce the risk levels. Investing in hybrid funds is an excellent way of diversifying your portfolio as you would gain exposure to both equity and debt instruments. The debt funds are further classified as below:

Equity-Oriented Hybrid Funds
Equity-oriented hybrid funds are those that invest at least 65% of its portfolio in equities while the rest is invested in fixed-income instruments.

Debt-Oriented Hybrid Funds

Debt-oriented hybrid funds allocate at least 65% of its portfolio in fixed-income instruments such as treasury bills and government securities, and the rest is invested in equities.

Monthly Income Plans

Monthly income plans (MIPs) majorly invest in debt instruments and aim at providing a steady return over time. The equity exposure is usually limited to under 20%. You can decide if you would receive dividends on a monthly, quarterly, or annual basis.

Arbitrage Funds
Arbitrage funds aim at maximising the returns by purchasing securities in one market at lower prices and selling them in another market at a premium. However, if the arbitrage opportunities are not available, then the fund manager may choose to invest in debt securities or cash equivalents.

Investment Handled by Experts (Fund Managers)

Fund managers manage the investments pooled by the asset management companies (AMCs) or fund houses. These are finance professionals who have an excellent track record of managing investment portfolios. Furthermore, fund managers are backed by a team of analysts and experts who pick the best-performing stocks and assets that have the potential to provide excellent returns for investors in the long run.

No Lock-in Period

Most mutual funds come with no lock-in period. In investments, the lock-in period is a period over which the investments once made cannot be withdrawn. Some investments allow premature withdrawals within the lock-in period in exchange for a penalty. Most mutual funds are open-ended, and they come with varying exit loads on redemption. Only ELSS mutual funds come with a lock-in period.

Low Cost

Investing in mutual funds comes at a low cost, and thereby making it suitable for small investors. Mutual fund houses or asset management companies (AMCs) levy a small amount referred to as the expense ratio on investors to manage their investments. It generally ranges between 0.5% to 1.5% of the total amount invested. The Securities and Exchange Board of India (SEB) has mandated the expense ratio to be under 2.5%.

SIP (Systematic Investment Plan)

The most significant advantage of investing in mutual funds is that you can invest a small amount regularly via a SIP (systematic investment plan). The frequency of your SIP can be monthly, quarterly, or bi-annually, as per your comfort. Also, you can decide the ticket size of your SIP. However, it cannot be less than the minimum investible amount. You can initiate or terminate a SIP as and when you need. Investing via SIPs alleviates the need to arrange for a lump sum to get started with your mutual fund investment. You can stagger your investments over time with an SIP, and this gives you the benefit of rupee cost averaging in the long run.

Switch Fund Option

If you would like to move your investments to a different fund of the same fund house, then you have an option to switch your investments to that fund from your existing fund. A good investor knows when to enter and exit a particular fund. In case you see another fund having the potential to outperform the market or your investment objective changes and is in line with that of the new fund, then you can initiate the switch option.

Goal-Based Funds

Individuals invest their hard-earned money with the view of meeting specific financial goals. Mutual funds provide fund plans that help investors meet all their financial goals, be it short-term or long-term. There are mutual fund schemes that suit every individual’s risk profile, investment horizon, and style of investments. Therefore, you have to assess your profile and risk-taking abilities carefully so that you can pick the most suitable fund plan.
Diversification

Unlike stocks, mutual funds invest across asset classes and shares of several companies, thereby providing you with the benefit of diversification. Also, this reduces the concentration risk to a great extent. If one asset class fails to perform up to the expectations, then the other asset classes would make up for the losses. Therefore, investors need not worry about market volatility as the diversified portfolio would provide some stability.

Flexibility
Mutual funds are buzzing these days because they provide the much-needed flexibility to the investors, which most investment options lack in. The combination of investing via an SIP and no lock-in period has made mutual funds an even more lucrative investment option. This means that people may consider investing in mutual funds to accumulate an emergency fund. Also, you can enter and exit a mutual fund plan at any time, which may not be the case with most other investment options. It is for this reason that millennials are preferring mutual funds over any other investment vehicle.

Liquidity
Since most mutual funds come with no lock-in period, it provides investors with a high degree of liquidity. This makes it easier for the investor to fall back on their mutual fund investment at times of financial crisis. The redemption request can be placed in just a few clicks, and the requests are processed quickly, unlike other investment options. On placing the redemption request, the fund house or the asset management company would credit your money to your bank account in just business 3-7 days.

Seamless Process
Investing in mutual funds is a relatively simple process. Buying and selling of the fund units are all made at the prevailing net asset value (NAV) of the mutual fund plan. As the fund manager and his or her team of experts and analysts are tasked with choosing shares and assets, investors only need to invest, and the rest would be taken care of by the fund manager.
Regulated

All mutual fund houses and mutual fund plans are always under the purview of the Securities and Exchange Board of India (SEBI) and Reserve Bank of India(RBI). Apart from that, the Association of Mutual Funds in India (AMFI), a self-regulatory body formed by all fund houses in the country, also governs fund plans. Therefore, investors need not worry about the safety of their mutual fund investments as they are safe.

Ease of Tracking
One of the most significant advantages of investing in mutual funds is that tracking investments is easy and straightforward. Fund houses understand that it is hard for investors to take some time out of their busy schedules to track their finances, and hence, they provide regular statements of their investments. This makes it a lot easier for them to track their investments and make decisions accordingly. If you invest in mutual funds via a third party, then you can also track your investments on their portal.

Tax-Saving

ELSS or Equity-Linked Savings Scheme is an equity-oriented mutual fund which provides tax deductions of up to Rs 1,50,000 a year under the Section 80C provision. By making full utilisation of the Section 80C limit, you can save up to Rs 46,800 a year in taxes. ELSS is the most popular tax-saving investment option under Section 80C of the Income Tax Act, 1961. It comes with a lock-in period of just three years, the shortest of all tax-saving investments. Investing in ELSS provides you with the dual benefit of tax deductions and wealth accumulation over time.

RUPEE COST AVERAGING

On investing in mutual funds via an SIP, you get the benefit of rupee cost averaging over time. When the markets fall, you buy more units while you purchase fewer units when the markets are booming. Therefore, over time, your cost of purchase of fund units is averaged out. This is called the rupee cost averaging. Investing in mutual funds via an SIP is beneficial during both market ups and downs, and there is no need to time the markets. This benefit is not available when you invest in mutual funds via a lump sum.

CAUSES FOR THE POOR PERFORMANCE OF MUTUAL FUNDS.

a. **High Expense Ratios and Sales Charges:**
   If you're not paying attention to mutual fund expense ratios and sales charges, they can get out of hand. Be very cautious when investing in funds with expense ratios higher than 1.20%, as they are considered to be on the higher cost end. Be wary of 12b-1 advertising fees and sales charges in general.
b. **Management Abuses**
   Churning, turnover and window dressing may happen if your manager is abusing his or her authority. This includes unnecessary trading, excessive replacement and selling the losers prior to quarter-end to fix the books.
c. **Tax Inefficiency**
   Like it or not, investors do not have a choice when it comes to capital gainpayouts in mutual funds. Due to the turnover, redemptions, gains, and losses in security holdings throughout the year, investors typically receive distributions from the fund that are an uncontrollable tax event.
d. **Poor Trade Execution**
   If you place your mutual fund trade anytime before the cut-off time for same-day NAV, you'll receive the same closing price NAV for your buy or sell on the mutual fund. For investors looking for faster execution times, maybe because of short investment horizons, day trading, or timing the market, mutual funds provide a weak execution strategy.

SEBI'S GUIDELINES TO MUTUAL FUNDS

SEBI Guidelines to invest in Mutual Funds
SEBI keeps in place the regulatory framework and guidelines that govern and regulate the financial markets in the country. The guidelines for investors are listed below.

a) Assessment your personal financial situation

Mutual funds present the most diversified form of investment options and therefore may carry a certain amount of risk factor with it. Investors must be very clear in their assessment of their financial position and the risk-bearing capacity in the event of poor performance of such schemes. Investors must, therefore, consider their risk appetite in accordance with the investment schemes.

b) Obtain researched information on the mutual funds' investment schemes

Before venturing into mutual fund investment, it is imperative for you as an investor to obtain detailed information about the mutual fund scheme option. Having the right information when required to make the necessary decision is the key to making good investments. This may help in choosing the right schemes, knowing the guidelines to follow and also be informed of the investors' rights.

c) Diversify your portfolios

Diversification of portfolios allows investors to spread out their investments over various schemes thereby increasing chances of maximizing profits or mitigating risk of potentially huge losses. Diversification is crucial to gaining long-term and sustainable financial advantage.

d) Avoid the clutter of portfolios

Choosing the right portfolio of funds requires managing and monitoring these schemes individually with care. The investor must not clutter the portfolio and decide on the right number of schemes to hold so as to avoid overlap and be able to manage each one of them equally well. Not sure of the right schemes for your portfolio? Clear Tax can help simplify this for you.

e) Assign a time dimension to the investment schemes

It is advisable for the investors to assign a time frame to each scheme to encourage the financial growth of the plan. It may help in containing the volatility and fluctuations in the market if the plans are maintained stably over a period of time.

UTI

UTI was established by an Act of Parliament on November 26. 1963. It started the sale of its units on July 1, 1964. It was established to encourage and mobilise savings of small investors through the sale of its 'units', and to channelise these resources into corporate securities.

ADVANTAGES:

1. Professional Management

Unit Trusts are managed by a professional fund management team. These managers have access to research and resources that most individual investors do not. They are experts on the economic climate and how it can effect your investments. Fund managers will help research, select and monitor your investments.

2. Diversification
If you were to invest $1,000 into direct shares, you wouldn't be able to do much in terms of diversification. However, if you purchased units in a managed fund (Australian share fund for example) then your $1,000 will be invested across hundreds of Australian companies, giving you the diversification that is required. Without doubt this is the strongest attribute of the managed fund.

3.Affordable
One reason why Unit Trusts are so popular now is that you don't need thousands of dollars to get started. You can buy into most Unit Trusts for as little as $1,000. Many funds will then allow you to go on a savings plan where by you can add an additional $100 into the fund at a time without incurring any fees.

4.Choices
With over 6,000 funds to choose from you are bound to find the funds that will meet your investment objective goals. Unit Trusts can invest in shares, property, bonds and/or the money markets.

5. Liquidity
Like shares, Unit Trusts are liquid assets; this means that if you want, you may redeem parts or all of your share/units on any business day (restrictions may apply). Unlike shares though, you don't need to pair up a buyer and seller in order to establish a buy/sell transaction.

DISADVANTAGES

1. Fees
Probably the biggest drawback with Unit Trusts is the fees involved. These fees usually eat into the returns of the fund and is the main reason why many funds return sub par performances.

2. Lack of control
Unlike shares you cannot select the individual stock. Once the fund is chosen you must place your trust in the management team.

Unit Trust of India: Objectives, Functions and Schemes!
Unit Trust of India (UTI) is a statutory public sector investment institution which was set up in February 1964 under the Unit Trust of India Act, 1963.
Objectives:
The primary objectives of the UTI are:

(i) To encourage and pool the savings of the middle and low income groups.

Functions of UTI:

The UTI functions are discussed below:
(i) To accept discount, purchase or sell bills of exchange, promissory note, bill of lading, warehouse receipt, documents of title to goods etc.,
(ii) To grant loans and advances.
(iii) To provide merchant banking and investment advisory service.
(iv) To provide leasing and hire purchase business.
(v) To extend portfolio management service to persons residing outside India.
(vi) To buy or sell or deal in foreign exchange dealings.
(vii) To formulate unit scheme or insurance plan in association with or as agent of GIC.
(viii) To invest in any security floated by the Central Government, RBI or foreign bank.

STEPS INVOLVED IN STOCK TRADING.

Selection of a Broker
The first step is to select a broker, who will buy/sell securities on behalf of the speculator/investor. This is necessary because trading of securities can only be done through SEBI registered brokers, who are members of stock exchange. Brokers may be individuals, partnership firms and corporate bodies.
Opening Demat Account with Depository
The next step is to open a demat account. Demat (Dematerialised) account refers to an account which an Indian citizen must open with the depository participant (banks and stock brokers) to trade in listed securities in "electronic form.
The securities are held in the electronic form by a depository. ‘Depository’ is an institution/organisation which holds securities (e.g. shares, debentures, bonds, mutual funds, etc) in electronic form, in which trading is done.
Placing the Order
The next step is to place the order with the broker. The order can be communicated to the broker either personally or through telephone, cell phone, e-mail, etc.
The instructions should specify the securities to be bought or sold and the price range within which the order is to be executed. Only the securities of listed companies can be traded on the stock exchange.
Executing the Order
According to the instructions of the investor, the broker buys or sells securities. The broker, then issues a contract note. A copy of the contract note contains the name and the price of securities, names of the parties, brokerage charges, etc. It is duly signed by the broker.
Settlement
This is the last stage in the trading of securities done by the brokers on behalf of their clients. The mode of settlement depends upon the nature of the contract. Equity spot markets follow a T + 2 rolling settlement. This means that any trade taking place on Monday gets settled by Wednesday. Stock, exchange operates from Monday to Friday between 9:55am and 3:30pm. Each exchange has its own clearing house, which assumes all settlement risk.

CREDIT RATING

Credit rating is the rating which gives the estimate of the individual company, corporation of country's worth. Credit bureau makes an evaluation of borrower's credit history and then according to that the actions on it take place. Credit rating shows the ability of the borrower to pay the debt to the lender on request to the credit bureau. The calculation of it depends on the financial history, current assets and liabilities. The probability of a borrower to pay back of its loan can be seen by this which tells a lender or investor about it.

The main features which are involved with the credit ratings are as follows:-

1) It is used to estimate the worthiness of the credit for the company, country or any individual company.

2) Credit rating is been done after considering various factors such as finacncial, non-financial parameters, and past credit history.

3) The rating which gets done is simple and it facilitates universal understanding. Credit rating also makes it widely accepted as the symbols which are used are generalized and made common for all.

4) The process of credit rating is very detailed and it involves lots of information such as financial information, client's office and works information and other management information. It involves in-depth study.

RATING METHODOLOGY OF CRISIL.

(1) Business analysis:
All the relevant information concerning the business is covered under the following sub-heads.
(a) Industry risk:
CRISIL evaluates the industry risk by taking into consideration various factors like nature and basis of competition, key success -factors, demand and supply position, structure of industry, government policies etc.
(b) Market position of the company within the industry:
Market position of the company within the industry is evaluated from different angles: i.e., market share and stability of market share; competitive advantage through marketing and distribution strength and weakness; marketing/support service infrastructure;
(c) Operating efficiency:
Operating efficiency of the company is assessed vis-a-vis competitor's comparison.
(d) Legal position:
Legal position of issue of debt instrument is assessed by: letter of offer; terms of debenture trust deed, trustees and their responsibilities; system of timely payment of interest and principal; or protection of forgery and fraud.
(2) Financial analysis:
Under financial analysis all relevant aspects connected with the business and financial position of the company are assessed in the following four important segments. Firstly the accounting

finally is seen as qualifications of auditors; focus on determining extent to which performance is overstated; method of income recognition; depreciation policies and inventory calculations; Under Valued/Over Valuing of assets; or off balance sheet liabilities.

(3) Management evaluation:

The track record of management is evaluated by observing the goals and philosophies; strategies and ability to overcome adverse situations; judgement of management performance based on past operating and financial results; planning and control systems; conservatism or aggressiveness with reference to financial risk; depths of managerial talents and succession plans; shareholding pattern and constitution of Board of Directors; relationship with shareholders; or mergers and acquisition considerations.

(4) Regulatory and competitive environment:

CRISIL evaluates structure and regulatory framework of the financial system in which it works. Trends in regulation/ deregulation and their impact on the company are evaluated.

(5) Fundamental analysis:

It covers aspects on liquidity management; assets quality; profitability and financial position; and interest and tax sensitively. Liquidity management includes aspects on capital structure, matching of assets and liabilities; or policy on liquid asset in relation to financing commitments and maturing deposits

GLOBAL AND DOMESTIC CREDIT RATING AGENCIES

With a view to match the global capital measures and capital standards prescribed by the Basel Committee on Banking Supervision (BCBS) framework, Reserve Bank of India introduced a risk asset ratio system for banks (including foreign banks) in India as a capital adequacy measure. The Basel code on capital adequacy stipulates how much capital a bank should have in place, in relation to the elements of credit risk in various types of assets in the balance sheet as well as off-balance sheet business of the banks. RBI has identified seven domestic and three international rating agencies in India which are accredited for the purpose of risk weighting the banks' claims for capital adequacy purpose. The long term and short term ratings issued by these credit rating agencies have been mapped to the appropriate risk weights applicable as per the Standardized approach under Basel Frame work. Based on ratings assigned by recognized Credit rating agencies banks who are in possession of such rating may assert risk weight of their assets. This is in line with the provisions of the revised structure of risk weight envisaged by RBI.For the purpose of declaration of capital adequacy, banks may use the ratings assigned by any one of the following domestic credit agencies.

a) Credit Analysis and Research Limited(CARE);

b) CRISIL Limited;

c) FITCH India;

d) ICRA Limited;

e) Brickwork Ratings India Pvt. Limited (Brickwork);

f) SMERA ;

g) INFOMERICS Valuation and Rating Pvt Ltd. (INFOMERICS)*

- In terms of RBI notification dated June 13,2017 in addition to above 6 domestic credit rating agencies viz. CARE, CRISIL, FITCH India, ICRA, Brickwork Ratings and SMERA, the banks may also use the ratings of INFOMERICS for the purpose of risk weighting their claims for capital adequacy purposes in addition to the existing six domestic credit rating agencies. The rating-risk weight mapping for the long term and short term ratings assigned by INFOMERICS will be the same as in case of other rating agencies.

Reserve Bank of India also permitted banks in India to use ratings of following international credit rating agencies for their claims for capital adequacy purpose.

a. Fitch;
b. Moody's; and
c. Standard & Poor's

Application of External Ratings

Banks have the options to select credit rating agencies of their choice for both risk weighting and risk management purposes. However Banks do not have permission from RBI to "cherry pick" the assessments provided by different credit rating agencies. If a bank decides to employ the ratings of particular credit rating agencies, for a known type of claim, it can use the ratings of those credit rating agencies. Nevertheless, some of these claims may be rated by other chosen credit rating agencies whose ratings the bank has decided not to use. But banks are not permitted to use one agency's rating for one corporate bond, and at the same time using another agency's rating for another exposure to the same counter-party. Anyway it is allowed, when the respective exposures are rated by one of the selected credit rating agencies, whose ratings the bank has decided to use. External assessments for one entity within a corporate group cannot be used to risk weight other entities within the same group.

INSURANCE

Represented in a form of policy, Insurance is a contract in which the individual or an entity gets the financial protection, in other words, reimbursement from the insurance company for the damage (big or small) caused to their property.

The insurer and the insured enter a legal contract for the insurance called the insurance policy that provides financial security from the future uncertainties.

In simple words, insurance is a contract, a legal agreement between two parties, i.e., the individual named insured and the insurance company called insurer. In this agreement, the insurer promises to help with the losses of the insured on the happening contingency. The insured, on the other hand, pays a premium in return for the promise made by the insurer.

The contract of insurance between an insurer and insured is based on certain principles, let us know the principles of insurance in detail.

PRINCIPLES OF INSURANCE

The concept of insurance is risk distribution among a group of people. Hence, cooperation becomes the basic principle of insurance.

To ensure the proper functioning of an insurance contract, the insurer and the insured have to uphold the 7 principles of Insurances mentioned below:

1. Utmost Good Faith
2. Proximate Cause
3. Insurable Interest
4. Indemnity
5. Subrogation
6. Contribution
7. Loss Minimization

Let us understand each principle of insurance with an example.

Principle of Utmost Good Faith

The fundamental principle is that both the parties in an insurance contract should act in good faith towards each other, i.e. they must provide clear and concise information related to the terms and conditions of the contract.

The Insured should provide all the information related to the subject matter, and the insurer must give precise details regarding the contract.

Example – Jacob took a health insurance policy. At the time of taking insurance, he was a smoker and failed to disclose this fact. Later, he got cancer. In such a situation, the Insurance company will not be liable to bear the financial burden as Jacob concealed important facts.

Principle of Proximate Cause

This is also called the principle of 'Causa Proxima' or the nearest cause. This principle applies when the loss is the result of two or more causes. The insurance company will find the nearest cause of loss to the property. If the proximate cause is the one in which the property is insured, then the company must pay compensation. If it is not a cause the property is insured against, then no payment will be made by the insured.

Example –

Due to fire, a wall of a building was damaged, and the municipal authority ordered it to be demolished. While demolition the adjoining building was damaged. The owner of the adjoining building claimed the loss under the fire policy. The court held that fire is the nearest cause of loss to the adjoining building, and the claim is payable as the falling of the wall is an inevitable result of the fire.

In the same example, the wall of the building damaged due to fire, fell down due to storm before it could be repaired and damaged an adjoining building. The owner of the adjoining building claimed the loss under the fire policy. In this case, the fire was a remote cause, and the storm was the proximate cause; hence the claim is not payable under the fire policy.

Principle of Insurable interest

This principle says that the individual (insured) must have an insurable interest in the subject matter. Insurable interest means that the subject matter for which the individual enters the insurance contract must provide some financial gain to the insured and also lead to a financial loss if there is any damage, destruction or loss.

Example – the owner of a vegetable cart has an insurable interest in the cart because he is earning money from it. However, if he sells the cart, he will no longer have an insurable interest in it.

To claim the amount of insurance, the insured must be the owner of the subject matter both at the time of entering the contract and at the time of the accident.

Principle of Indemnity

This principle says that insurance is done only for the coverage of the loss; hence insured should not make any profit from the insurance contract. In other words, the insured should be compensated the amount equal to the actual loss and not the amount exceeding the loss. The purpose of the indemnity principle is to set back the insured at the same financial position as he was before the loss occurred. Principle of indemnity is observed strictly for property insurance and not applicable for the life insurance contract.

Example – The owner of a commercial building enters an insurance contract to recover the costs for any loss or damage in future. If the building sustains structural damages from fire, then the insurer will indemnify the owner for the costs to repair the building by way of reimbursing the owner for the exact amount spent on repair or by reconstructing the damaged areas using its own authorized contractors.

Principle of Subrogation

Subrogation means one party stands in for another. As per this principle, after the insured, i.e. the individual has been compensated for the incurred loss to him on the subject matter that was insured, the rights of the ownership of that property goes to the insurer, i.e. the company.

Subrogation gives the right to the insurance company to claim the amount of loss from the third-party responsible for the same.

Example – If Mr A gets injured in a road accident, due to reckless driving of a third party, the company with which Mr A took the accidental insurance will compensate the loss occurred to Mr A and will also sue the third party to recover the money paid as claim.

Principle of Contribution

Contribution principle applies when the insured takes more than one insurance policy for the same subject matter. It states the same thing as in the principle of indemnity, i.e. the insured cannot make a profit by claiming the loss of one subject matter from different policies or companies.

Example – A property worth Rs. 5 Lakhs is insured with Company A for Rs. 3 lakhs and with company B for Rs.1 lakhs. The owner in case of damage to the property for 3 lakhs can claim the full amount from Company A but then he cannot claim any amount from Company B. Now, Company A can claim the proportional amount reimbursed value from Company B.

Principle of Loss Minimisation

This principle says that as an owner, it is obligatory on the part of the insurer to take necessary steps to minimise the loss to the insured property. The principle does not allow the owner to be irresponsible or negligent just because the subject matter is insured.

Example – If a fire breaks out in your factory, you should take reasonable steps to put out the fire. You cannot just stand back and allow the fire to burn down the factory because you know that the insurance company will compensate for it.

Types Of Insurance

There are two broad categories of insurance:

1. Life Insurance
2. General insurance

Life Insurance – The insurance policy whereby the policyholder (insured) can ensure financial freedom for their family members after death. It offers financial compensation in case of death or disability.

While purchasing the life insurance policy, the insured either pay the lump-sum amount or makes periodic payments known as premiums to the insurer. In exchange, of which the insurer promises to pay an assured sum to the family if insured in the event of death or disability or at maturity.

Depending on the coverage, life insurance can be classified into the below-mentioned types:

- **Term Insurance**: Gives life coverage for a specific time period.
- Whole life insurance: Offer life cover for the whole life of an individual
- **Endowment policy**: a portion of premiums go toward the death benefit, while the remaining is invested by the insurer.
- **Money back Policy**: a certain percentage of the sum assured is paid to the insured in intervals throughout the term as survival benefit.
- **Pension Plans**: Also called retirement plans are a fusion of insurance and investment. A portion from the premiums is directed towards retirement corpus, which is paid as a lump-sum or monthly payment after the retirement of the insured.
- **Child Plans**: Provides financial aid for children of the policyholders throughout their lives.
- **ULIPS – Unit Linked Insurance Plans**: same as endowment plans, a part of premiums go toward the death benefit while the remaining goes toward mutual fund investments.

General Insurance – Everything apart from life can be insured under general insurance. It offers financial compensation on any loss other than death. General insurance covers the loss or damages caused to all the assets and liabilities. The insurance company promises to pay the assured sum to cover the loss related to the vehicle, medical treatments, fire, theft, or even financial problems during travel.

General Insurance can cover almost anything, and everything but the five key types of insurances available under it are –

- Health Insurance: Covers the cost of medical care.
- Fire Insurance: give coverage for the damages caused to goods or property due to fire.
- Travel Insurance: compensates the financial liabilities arising out of non-medical or medical emergencies during travel within the country or abroad
- Motor Insurance: offers financial protection to motor vehicles from damages due to accidents, fire, theft, or natural calamities.
- Home Insurance: compensates the damage caused to home due to man-made disasters, natural calamities, or other threats

Benefits of Insurance

The insurance gives benefits to individuals and organisations in many ways. Some of the benefits are discussed below:

1. The obvious benefit of insurance is the payment of losses.
2. Manages cash flow uncertainty when paying capacity at the time of losses is reduced significantly.
3. Complies with legal requirements by meeting contractual and statutory requirements, also provides evidence of financial resources.
4. Promotes risk control activity by providing incentives to implement a program of losing control because of policy requirements.
5. The efficient use of the insured's resources. It provides a source of investment funds. Insurers collect the premiums and invest those in a variety of investment vehicles.
6. Insurance is support for the insured's credit. It facilitates loans to organisations and individuals by guaranteeing the lender payment at the time when collateral for the loan is destroyed by an insured event. Hence, reducing the uncertainty of the lender's default by the party borrowing funds.
7. It reduces social burden by reducing uncompensated accident victims and the uncertainty of society.

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (IRDA)

The Insurance Regulatory and Development Authority is the main organization or supervisory body that regulates the insurance sector in the country. It sets rules and regulations for the functioning of the insurance industry. Its sole purpose is to protect the interest of policyholders and to develop the industry on the whole.

The IRDA or IRDAI regularly issues advisories to insurance companies in case of changes to the rules and regulations. The regulator guides the insurance industry in promoting the efficiency in the conduct of insurance business all the while controlling the rates and other charges related to insurance. This article dwells on the functioning of the IRDA, features and benefits as well as answers to frequently asked questions at the end of this reading.

Establishment of IRDA:

The Government of India was the regulator for the insurance industry until 2000. However, to institute a stand-alone apex body, the IRDA was established in 2000 following the recommendation of the Malhotra Committee report in 1999. In August 2000, the IRDA began accepting applications for registrations through invites and allowed companies from other countries to invest up to 26% in the market.

The IRDA has outlined several rules and regulations under Section 114A of the Insurance Act, 1938. Regulations range from registration of insurance companies for operating in the country to protecting policyholder's interests. As of September 2020, there are 31 General Insurance companies and 24 Life Insurance companies who are registered with the IRDA.

Objective of IRDA:

The main objective of the Insurance Regulatory and Development Authority of India is to enforce the provisions under the Insurance Act. The mission statement of the IRDA is:

- To protect the interest and fair treatment of the policyholder.
- To regulate the insurance industry in fairness and ensure the financial soundness of the industry.
- To regularly frame regulations to ensure the industry operates without any ambiguity.

Important Role of IRDA in the Insurance Sector in India:

The insurance industry in India dates back to the early 1800s and has grown over the years with better transparency and focus on protecting the interest of the policyholder. The IRDA plays an integral role in emphasizing the importance of policyholders and their interest while framing rules and regulations. **Here are the important roles of the IRDA:**

- To protect the policyholder's interests.
- To help speed up the growth of the insurance industry in an orderly fashion, for the benefit of the common man.
- To provide long-term funds to speed up the nation's economy.
- To promote, set, enforce and monitor high standards of integrity, fair dealing, financial soundness and competence of the insurance providers.
- To ensure genuine claims are settled faster and efficiently.

- To prevent malpractices and fraud, the IRDA has set up a grievance redress forum to ensure the policyholder is protected.
- To promote transparency, fairness and systematic conduct of insurance in the financial markets.
- To build a dependable management system to make sure high standards of financial stability are followed by insurers.
- To take adequate action where such high standards are not maintained.
- To ensure the optimum amount of self-regulation of the industry.

FUNCTIONS OF IRDA:

Below are the important functions of the IRDAI in the insurance industry in India:

- Grant, renew, modify, suspend, cancel or withdraw registration certificates of the insurance company.
- Protecting the interests of the policyholder in matters concerning the grant of policies, settlement of claims, nomination by policyholders, insurable interest, surrender value of the policy and other terms and conditions of the policy.
- Specify code of conduct, qualifications and training for intermediary or insurance agents.
- Specify code of conduct for loss assessors and surveyors.
- Levying fees and charges for carrying out the provisions of the Act.
- Undertaking inspection, calling for information, and investigations including an audit of insurance companies, intermediaries, and other organizations associated with the insurance business.
- Regulate and control insurance rates, terms and conditions, advantages that may be offered by the insurance providers.

Apart from the above-mentioned core functions of the IRDA, there are several functions that the regulator performs keeping the policyholder's interest as its priority.

IRDA Working System

The apex body of the insurance industry, the IRDA, ensures it frames rules and regulations without any ambiguity towards any particular insurance company. To ensure fairness and the financial soundness of the industry, the main work of IRDA revolves around the policyholder's interests. Refer to the following roles that the IRDA is mainly involved in:

- Issues certificate of registration to new insurance companies.
- Sets rules and regulations to ensure the interests of the policyholder are taken care of.
- Monitors all claims are settled in all fairness and that no insurer will deny any claim on their own free will.
- Regulates the code of conduct of the insurance companies, insurance intermediaries, and others associated with the insurance industry.
- Provides solutions in case of disputes through the IRDA ombudsman.
- Controls and regulates the rates of insurance to prevent unwanted price hikes in the insurance premium.
- The apex body is responsible for setting the minimum percentage limit of insurance companies for General and Life Insurance, thereby developing both urban and rural sectors.

FEATURES & BENEFITS OF IRDA:

Following are the salient features of the apex body, the Insurance Regulatory and Development Authority of India:

- Acts as a regulator for the insurance industry.
- Protects the policyholder’s interests.
- Rules and regulations are framed by the apex body under Section 114A of the Insurance Act, 1938.
- It is entrusted under the Insurance Act to grant the certificate of registration to new insurance companies to operate in India.
- Oversees the insurance industry’s activities to ensure sustained development of insurers and policyholders.

TYPES OF INSURANCES REGULATED BY THE IRDAI:

Insurance is mainly divided into Life and Non-Life/General Insurance. These are further classified into other types of insurance. Below are the types of insurance regulated by the IRDAI:

- Life Insurance
    - Term Plans
    - Endowment Policies
    - Unit-linked Insurance Policies

- Retirement Policies
- Money-back Policies

General Insurance

- Health Insurance Policies
- Vehicle/Motor Insurance Policies
  - Car insurance
  - Bike Insurance
- Property Insurance Policies
- Travel Insurance Plans
- Gadget Insurance Plans

DIFFERENCE BETWEEN IRDA AND SEBI ON THEIR FUNCTIONS:

Different industries or sectors are regulated by an apex body. They frame rules and regulations, monitor the functions of companies and ensure that they protect the stakeholders. Hence, the apex body for the insurance sector is the IRDA or Insurance Regulatory and Development Authority. As for SEBI or Securities Exchange Board of India, it regulates securities and commodity sectors in the country. Below is the comparison between IRDA and SEBI:

IRDA	SEBI
Regulates the insurance industry	Regulates the securities and commodity industry
Established in 1999	Established in 1992
Protects the interests of insurance policyholders	Protects the interests of investors in securities
Grant certificate of registration to insurance companies to issue insurance policies.	Grant certificate of registration to stockbrokers, bankers, sub-brokers to issue deeds.
Frames rules and regulations under the Insurance Regulatory and Development Authority Act	Frames rules and regulations under the Securities and Exchange Board of India Act

PENSION PLANS : FEATURES, BENEFITS, TYPES

Pension Plans

Pension or retirement plans offer the dual benefit of investment and insurance cover. By investing a certain amount regularly towards your pension plan, you will accumulate a considerable sum in a phase-by-phase manner. This will ensure a steady flow of funds once you retire. Public Provident Fund is one of the most popular retirement planning schemes in India. When you start contributing to your retirement early, the funds build a secure golden year money-wise over the years. A well-chosen retirement plan can help you rise above inflation, thanks to the power of compounding.

Who should opt for Pension Plans?

Every individual should invest in pension plans to secure their retired life financially. Section 80C of the Income Tax Act, 1961, covers several retirement plans and taxpayers are eligible for tax deductions of up to Rs.1.5 lakh. Any plan you choose must be in sync with your investment goals (or retirement plans). For example, if you wish to retire early, then your corpus upon maturity should be enough to support your retired life. Hence, the key is to choose the retirement plan smartly.

3. Features & Benefits of Pension Plans

a. Guaranteed Pension/Income

You can get a fixed and steady income after retiring (deferred plan) or immediately after investing (immediate plan), based on how you invest. This ensures a financially independent life after retiring. You can use a retirement calculator to have a rough estimate of how much you might require after retiring.

b. Tax-Efficiency

Some pension plans provide tax exemption specified under Section 80C. If you wish to invest in a pension plan, then the Income Tax Act, 1961, offers significant tax respite under Chapter VI-A. Section 80C, 80CCC and 80CCD specify them in detail. For instance, Atal Pension Yojana (APY) and National Pension Scheme (NPS) are subject to tax deductions under Section 80CCD.

c. Liquidity

Retirement plans are essentially a product of low liquidity. However, some plans allow withdrawal even during the accumulation stage. This will ensure funds to fall back on during emergencies without having to rely on bank loans or others for financial requirements.

d. Vesting Age

This is the age when you begin to receive the monthly pension. For instance, most pension plans keep their minimum vesting age at 45 years or 50 years. It is flexible up to the age of 70 years, though some companies allow the vesting age to be up to 90 years.

e. Accumulation Duration

An investor can either choose to pay the premium in periodic intervals or at once as a lump sum investment. The wealth will simultaneously accumulate over time to build up a sizable corpus (investment+gains). For instance, if you start investing at the age of 30 and continues investing until you turn 60, the accumulation period will be 30 years. Your pension for the chosen period primarily comes from this corpus.

f. Payment Period

Investors often confuse this with the accumulation period. This is the period in which you receive the pension post-retirement. For example, if one receives a pension from the age of 60 years to 75 years, then the payment period will be 15 years. Most plans keep this separate from accumulation period, though some plans allow partial/full withdrawals during accumulation periods too.

g. Surrender value

Surrendering one’s pension plan before maturity is not a smart move even after paying the required minimum premium. This results in the investor losing every benefit of the plan, including the assured sum and life insurance cover.

Pension Plan Types in India

It is never too early or late to start investing in retirement plans. However, it is sooner, the better. Whether you are salaried or entrepreneurial, there is a slew of pension plans you can choose from as listed below.

SL No.	Plan Type	In Detail
1	Deferred Annuity	Systematic premium or one lump sum premium over the tenure Pension begins after completing the term No taxation (unless you withdraw the corpus)
2	Immediate Annuity	Only lump sum investment allowed Pension begins immediately after investment Income tax exempts tax on the premiums The nominee can claim the pension or the corpus after the passing of policyholder
3	Annuity Certain	The pension is disbursed for a specific period The policyholder can choose a period (say, age 65-70) The nominee can claim the pension after the demise of the policyholder

4	With Cover Pension Plan	Comes with a ‘cover’ policy – policyholder’s dependents are entitled to a lump sum after he/she expires The insurance amount is not large a most of the premium goes towards building the corpus
5	Life Annuity	Pension paid till death ‘With spouse’ option – spouse continues to receive after the policyholder’s demise
6	National Pension Scheme (NPS)	Launched and managed by the Central Government Your money will be distributed in equity and debt markets as your preference. Withdraw 60% when you retire, and the rest should be used to buy the annuity The tax levied on the 20% of the corpus you withdraw upon maturity
7	Pension Funds	Better returns once it matures Regulated by the government body, Pension Fund Regulatory & Development Authority (PFRDA) Currently, six fund houses in India are authorised to offer pension funds. Example, SBI
8	Guaranteed Period Annuity Plan	

CHILEAN MODEL

In 1981, Chile introduced a new system of privately managed individual accounts, also called capitalization, replacing its public pay-as-you-go pension system (PAYG). Since 1990, 10 other countries in the region have adopted some form of what has become known as the "Chilean model": Argentina (1994), Bolivia (1997),Colombia (1993), Costa Rica (1995), Dominican Republic (2003), El Salvador (1998), Mexico (1997), Panama (2008), Peru (1993), and Uruguay (1996).

Over the years, Chile made some major changes to its capitalization system, such as liberalizing investment rules and increasing the type and number of pension funds that a pension fund management company (AFP) must offer its account holders. However, despite these and other changes, a number of policy challenges remain unresolved including large groups of workers who are not covered and irregular worker participation rates, both of which could lead to inadequate retirement benefits. Also, according to international standards, the administrative fees the AFPs are charging account holders are high and could significantly decrease the size of a worker's pension.

System Overview

In 1981, Chile implemented its mandatory individual retirement account system allowing workers to choose between the public PAYG and the privately managed system, except those workers eligible to retire within 5 years. Since December 31, 1982, new entrants to the labor force must join the new capitalization system and set up individual accounts with the AFP of their choice. The public PAYG system is being phased out as the number of beneficiaries declines and is expected to close by 2050.

PENSION REFORM: POLICY CHALLENGES AND REFORM PROVISIONS

Law 20.255 is based largely on the July 2006 President's Pension Advisory Commission Report (Marcel Commission 2006).13 According to the Commission, the capitalization system is geared toward workers with stable jobs who regularly contribute to an individual account for their entire working lives. The report contends that the system needs to adapt to the changing social conditions in Chile.

The nature of the labor force has been evolving over the past 25 years. Workers are relying less on indefinite labor contracts and more on fixed-term contracts and temporary and part-time jobs. Also, typically, workers in less stable jobs do not regularly contribute to individual accounts. Chile's population is aging and life expectancy is increasing. The population aged 60 or older currently represents 12 percent of the total population and is expected to increase to 17 percent by 2020 and 28 percent by 2050. Since 1980, life expectancy at birth has grown from 70.7 years to 78.5 years and life expectancy at age 60 increased from 16.8 years to 20.7 years for men and 20.2 years to 24 years for women. In addition, more workers are postponing their entrance into the labor force because higher education is available for more individuals aged 15 to 24. As a result, workers are spending fewer years in the accumulation phase for retirement.

The report identified several goals for reforming the 26-year old system of individual accounts including expanding pension coverage, providing an adequate pension, and encouraging competition among the AFPs to lower workers' costs, which would result in a higher net rate of return and a higher pension. This section describes each policy challenge or set of challenges followed by a summary of the reform measure that addresses those issues.

PENSION FINANCING.

Pension funding is still a relatively unknown product and offers the ability to raise funds based upon the pensions accrued by one or more owners or directors of the business they control. Any money lend to the business is paid back with interest and will increase the size of the pension.

It is a complex product, but in essence any amount borrowed works like a business loan, i.e. the amount is borrowed from the personal pension pot(s) and paid back with interest by the business. This means that a growing business can also increase the pension pot(s) of its director(s). There are alternative ways for the pension to invest directly in the business, to find out more please ask for a call back by our advisors.

Advantages of pension finance
Advantages include:
Borrowing from personal pensions means the interest paid back increases the pension pot
HMRC compliant scheme
Personal guarantees and charges over property may not be required
Disadvantages of pension finance

Disadvantages include:

- Pensions are a long-term savings vehicle to provide retirement provision for its members
- The amount you can borrow is limited by the size of the pension pot(s)
- The set up time is several weeks

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