

FINANCIAL LITERACY



*Build Better Money Habits
for a Brighter Future*



Vertex Research and Technology



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FINANCIAL LITERACY

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PREFACE

In today's rapidly evolving economic landscape, managing personal finances effectively has shifted from an advantageous skill to an essential life necessity. Every day, individuals make choices that directly shape their economic future from tracking routine expenditures and opening bank accounts to choosing insurance coverage and planning for long-term security. Yet, despite easier access to modern financial services, a persistent gap remains between earning an income and managing it prudently. This textbook was crafted to bridge that exact gap, providing students with a clear, practical, and structured roadmap to navigating the world of personal finance.

Designed as a student-centric academic handbook, *Financial Literacy* systematically guides readers through core concepts, operational procedures, and real-world applications. Across six structured chapters, the text covers everything from foundational financial definitions and budgeting techniques to banking operations, KYC compliance, and modern cashless payment ecosystems like UPI. Furthermore, it explores secure post office small savings schemes, life and health insurance protection, pension planning, and capital market fundamentals, including stock market indices like NIFTY and SENSEX.

Written in simple, accessible academic English, this book emphasizes functional understanding over dense technical jargon. By incorporating structured visual guides, comparative tables, and step-by-step explanations, it aims to help students excel in their academic examinations while instilling lifelong behavioural discipline. It is our sincere hope that this textbook serves as an empowering companion on your journey toward true economic independence and security.

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CHAPTER 1: INTRODUCTION TO FINANCIAL LITERACY

1.1 MEANING OF FINANCIAL LITERACY

Concept and Fundamental Definition

In modern economic systems, money serves as the universal medium of exchange, unit of account, and store of value. Virtually every human activity—from acquiring basic necessities like food, clothing, and housing to pursuing long-term aspirations like higher education, entrepreneurship, and post-retirement security—is inextricably linked to monetary resources. However, the mere ability to earn income does not automatically guarantee long-term economic stability. The true determinant of personal financial health is the manner in which an individual manages, allocates, protects, and expands those monetary resources.

Financial literacy represents the foundational body of knowledge, practical capabilities, and behavioral discipline that enables individuals to navigate these monetary decisions with competence and confidence. At its core, financial literacy transforms abstract economic concepts into practical, everyday life skills. It refers to the degree to which an individual understands how money works in the real world: how it is earned, managed, invested, protected, and spent. A financially literate person possesses not only the cognitive capacity to understand financial terms and calculations but also the practical judgment to apply that knowledge to real-life situations. This includes preparing realistic budgets, maintaining emergency funds, choosing appropriate investment avenues, understanding loan commitments, and protecting personal wealth against inflationary pressures and fraudulent schemes.

Standard Academic Definition: *Financial literacy is the comprehensive combination of financial awareness, conceptual knowledge, analytical skills, positive attitudes, and disciplined behavioral habits required by an individual to make sound monetary decisions, adapt effectively to changing economic environments, and achieve lifelong financial independence and security.*

It is essential to distinguish financial literacy from simple numerical literacy (numeracy) or general academic education. A person may hold advanced academic degrees or demonstrate high mathematical proficiency yet remain entirely financially illiterate. Numerical literacy allows a person to calculate interest rates on paper; financial literacy ensures that the person understands whether taking on a loan at that interest rate is financially prudent given their current monthly cash

flows and long-term liabilities. Financial literacy combines numerical ability with economic reasoning, legal awareness, and psychological self-regulation.

1.2 CORE PILLARS OF FINANCIAL LITERACY: KNOWLEDGE, SKILLS, AND MINDSET

Financial literacy is not a single, isolated skill. It is a multi-dimensional construct resting on three structural pillars: Financial Knowledge, Financial Skills, and Financial Mindset. A deficiency in any one of these pillars undermines the entire structure of personal financial management.

1.2.1 Financial Knowledge (The Cognitive Component)

Financial knowledge represents the theoretical and conceptual baseline. It forms the mental library that an individual relies upon when faced with monetary choices. Key elements of financial knowledge include:

- **Understanding Purchasing Power and Inflation:** Grasping the fact that the real value of money changes over time. An individual must understand that holding idle cash in non-interest-bearing accounts causes a continuous loss of purchasing power due to inflation.
- **Interest Mechanics and Compounding:** Distinguishing clearly between simple interest and compound interest. A financially knowledgeable person recognizes that compounding works as a powerful wealth multiplier when saving or investing, but acts as a heavy financial burden when accumulating debt.
- **Risk and Return Relationships:** Understanding the fundamental rule of financial markets: higher potential returns invariably come with higher risks of capital loss. Recognizing the distinct risk-return profiles of various asset classes—such as bank savings, fixed deposits, government bonds, real estate, mutual funds, and equities—is central to this pillar.
- **Institutional and Regulatory Structure:** Understanding the roles, functions, and protections offered by formal financial institutions, including commercial banks, post office savings banks, insurance companies, capital market intermediaries, and regulatory bodies like the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), and the Insurance Regulatory and Development Authority of India (IRDAI).

1.2.2 Financial Skills (The Practical Component)

Financial knowledge remains purely academic unless paired with the practical skills required to

execute financial tasks in daily life. Financial skills enable an individual to interact effectively with the formal financial system. Key practical skills include:

- **Budget Preparation and Cash Flow Management:** The ability to construct a systematic monthly budget, categorize expenditures into fixed and variable items, track daily cash outflows, and calculate net cash flow balances.
- **Credit Evaluation and Debt Management:** The practical ability to evaluate loan offers, calculate Equated Monthly Installments (EMIs), compare annual percentage rates (APR), evaluate processing charges, and monitor personal debt-to-income ratios.
- **Financial Instrument Operation:** The capacity to open and manage bank and postal accounts, execute electronic funds transfers (such as UPI, NEFT, RTGS, and IMPS), fill out deposit and withdrawal documentation, and navigate digital banking interfaces securely.
- **Information Analysis and Document Verification:** The skill to read and interpret financial statements, bank passbooks, credit reports, insurance policy documents, and investment prospectuses, while identifying hidden costs, penalty clauses, or predatory loan conditions.

1.2.3 Financial Mindset (The Behavioral Component)

Financial mindset encompasses the psychological attitudes, emotional self-regulation, and habit patterns that dictate how an individual actually behaves with money. Knowledge and skills are useless if an individual lacks the discipline to execute sound decisions. Key behavioral elements include:

- **Delayed Gratification:** The psychological ability to resist impulse spending today in order to fund significant, long-term security and life goals tomorrow.
- **Financial Discipline and Consistency:** The habit of adhering strictly to personal budget boundaries and savings targets month after month, regardless of lifestyle pressures, social expectations, or marketing inducements.
- **Emotional Control in Volatile Conditions:** Maintaining rational composure during market fluctuations or personal financial setbacks, avoiding panic-driven liquidation of investments during market downturns or reckless speculation during market booms.

1.3 IMPORTANCE OF FINANCIAL LITERACY FOR INDIVIDUALS AND SOCIETY

The significance of financial literacy extends beyond individual household economics; it

serves as a critical driver of broader macroeconomic stability, capital formation, and social welfare.

1.3.1 Importance at the Individual and Household Level

- **Systematic Money Management and Expenditure Control:** Financial literacy provides individuals with the analytical framework needed to manage earnings responsibly. It helps households categorize outlays into mandatory survival needs (food, utilities, rent) and optional discretionary wants (entertainment, luxury goods). This structural separation prevents lifestyle inflation, eliminates wasteful expenditure, and keeps monthly spending safely below total earned income.
- **Cultivation of Regular Savings Habits:** Financial literacy fundamentally alters an individual's perspective on saving. Uninformed individuals view savings as a random leftover amount ($\text{Savings} = \text{Income} - \text{Expenses}$), which frequently results in zero savings due to unchecked spending. Financially literate individuals treat savings as a non-negotiable, first-priority deduction ($\text{Expenses} = \text{Income} - \text{Mandatory Savings}$), ensuring that wealth is accumulated consistently over time.
- **Awareness of Loan Mechanics and Avoidance of Debt Traps:** Borrowing money is a double-edged sword. When used strategically—such as acquiring an appreciating asset or funding higher education—debt serves as a valuable financial tool. However, unmonitored borrowing for non-productive consumption leads to compounding debt traps. Financial literacy equips individuals to understand loan terms, evaluate real borrowing costs, avoid predatory informal moneylenders, maintain healthy credit scores, and keep overall debt servicing within safe limits.
- **Establishment of Personal Financial Security and Independence:** Life is inherently unpredictable. Unforeseen medical emergencies, sudden job losses, economic downturns, or property damage can severely disrupt household stability. Financially literate individuals insulate themselves against such shocks by maintaining liquid emergency reserves and securing adequate insurance coverages. This preparation ensures long-term economic independence and prevents reliance on high-cost distress loans or charity.
- **Effective Retirement and Milestone Planning:** Earning capacity naturally fluctuates across an individual's life cycle, typically reaching a peak during middle adulthood before dropping significantly upon retirement. Financial literacy provides the long-term

perspective required to build dedicated retirement reserves during productive working years, ensuring a comfortable lifestyle and dignity during non-working years.

1.3.2 Importance at the Macroeconomic and Social Level

- **Mobilization of Domestic Savings into Productive Capital:** Unbanked or financially illiterate populations often store their surplus resources in unproductive physical forms (such as idle cash at home) or unorganized, risky schemes. Financial literacy encourages households to channel savings into formal institutions like commercial banks, postal schemes, capital markets, and mutual funds. Financial intermediaries then pool these funds and allocate them as productive loans to industrial, agricultural, and infrastructure sectors, driving national economic development.
- **Prevention of Fraud and Systemic Financial Distress:** Financially educated consumers are far less vulnerable to fraudulent financial operations, fraudulent digital applications, ponzi schemes, and unsustainable informal credit systems. Reducing the prevalence of financial fraud stabilizes the overall financial system and minimizes the need for state-funded bailouts or social safety net expansions.
- **Enhanced Financial Inclusion and Market Efficiency:** A financially literate populace actively uses formal banking, credit, insurance, and investment channels. Increased participation deepens financial markets, encourages healthy institutional competition, lowers service costs, and ensures that government monetary policy measures are transmitted effectively throughout the economy.

1.4 SCOPE OF FINANCIAL LITERACY ACROSS LIFE STAGES

The scope of financial literacy is wide-ranging, covering every functional domain of personal resource management from early adulthood through retirement.

1. Income Management and Optimization

The scope begins with understanding and organizing all earning streams. This includes analyzing gross earnings versus net take-home pay, understanding tax liabilities, evaluating employee benefits, tracking professional fees or business revenues, and identifying opportunities to develop passive income streams (such as interest, dividends, and rental yields).

2. Personal Budgeting and Expenditure Tracking

This domain covers the practical organization of daily cash flows. It involves designing

workable monthly budget models, logging and auditing daily expenses, managing household cash reserves, analyzing budget variances, and making adjustments to maintain a positive monthly cash flow surplus.

3. Formal Banking and Digital Payment Operations

Navigating formal banking systems is a fundamental component of financial literacy. The scope includes selecting appropriate bank account types, fulfilling Know Your Customer (KYC) documentation requirements, managing debit/credit cards safely, operating Automated Teller Machines (ATMs), executing electronic fund transfers (NEFT, RTGS, IMPS), and utilizing Unified Payments Interface (UPI) systems securely.

4. Credit, Borrowing, and Debt Servicing

This area involves managing borrowed capital. It encompasses analyzing loan products (home, education, personal, vehicle loans), evaluating interest calculation methods (flat vs. reducing balance rates), managing Equated Monthly Installments (EMIs), monitoring credit scores, and executing structured debt-paydown strategies.

5. Investment Planning and Asset Allocation

Investment literacy covers the systematic deployment of accumulated savings to generate long-term real returns. It involves understanding various investment vehicles (fixed deposits, government savings certificates, mutual funds, equities, commodities, and real estate), balancing portfolios according to individual risk tolerance, and rebalancing assets periodically.

6. Risk Management and Insurance Coverage

Risk protection is an essential component of comprehensive financial planning. The scope covers identifying major personal and financial risks (loss of life, health emergencies, disability, property damage) and selecting appropriate insurance products (pure term life insurance, health policies, personal accident insurance, property coverages) to mitigate potential financial losses.

7. Retirement, Estate, and Senior-Life Planning

The final phase of financial literacy focuses on securing long-term economic independence. It involves calculating required retirement reserves, building pension streams, managing decumulation strategies during non-working years, drafting wills, designating policy beneficiaries, and structuring smooth estate transitions.

1.5 PREREQUISITES OF FINANCIAL LITERACY

Becoming financially literate is a progressive learning process. An individual cannot effectively master complex financial concepts like portfolio diversification, tax optimization, or derivative markets without first establishing a core foundation of basic capabilities, personal awareness, and disciplined habits. These foundational prerequisites form the bedrock upon which genuine financial competence is built.

1. Fundamental Concept of Money and Value

The primary prerequisite for financial literacy is a clear understanding of currency as a standardized medium of exchange, unit of account, and store of value. An individual must understand that paper currency notes and digital balances have no intrinsic value on their own; their real value lies entirely in their **purchasing power**—the quantity of real goods and services they can command in the market.

Understanding this concept requires a baseline grasp of inflation. An individual must realize that a fixed sum of money sitting idle loses real value over time as prices rise. Recognizing the difference between nominal monetary value and real purchasing power is essential before one can appreciate the need for interest-earning deposits or growth-oriented investments.

2. Personal Financial Self-Awareness

An individual cannot design a roadmap to financial stability without first establishing an accurate picture of their starting point. Financial self-awareness requires an honest assessment of one's current economic situation. This includes:

- Knowing exact net monthly cash inflows from all sources.
- Maintaining complete visibility over total monthly expenditures.
- Cataloging all outstanding liabilities, debts, and loan obligations.
- Calculating personal net worth ($\text{Total Assets} - \text{Total Liabilities}$).
- Recognizing personal spending triggers, emotional buying tendencies, and behavioral weaknesses.

Without this self-awareness, financial planning remains a purely theoretical exercise disconnected from daily choices.

3. Basic Numerical and Quantitative Aptitude

While advanced higher mathematics is not necessary for personal financial management, a basic level of quantitative aptitude is essential. An individual must be capable of performing

fundamental arithmetic operations comfortably, including:

- **Addition and Subtraction:** Needed to balance a daily ledger, compute account balances, and determine monthly surpluses or deficits.
- **Percentages:** Needed to evaluate discount offers, compare interest rates, calculate tax deductions, and understand inflation metrics.
- **Proportions and Ratios:** Needed to determine debt-to-income ratios, calculate asset allocations, and evaluate unit pricing when shopping.
- **Basic Compounding Calculations:** Needed to project how savings grow over time or how debt accumulates when payments are delayed.

4. The Habit of Systematic Saving

Knowledge of savings instruments is useless if an individual lacks the behavioral habit of saving. A fundamental prerequisite for financial literacy is the habit of regularly setting aside a portion of income before making discretionary expenditures. This practice—often summarized as "paying yourself first"—must be established early, regardless of the absolute amount being earned. The habit itself matters far more than the initial sum, as the discipline of setting aside money consistently creates the capital base required for investment, emergency reserves, and long-term security.

5. Basic Budgeting Capabilities

Budgeting is the primary operational tool of personal financial management. A necessary prerequisite for financial literacy is the practical ability to construct and maintain a budget. This requires:

- Classifying outlays systematically into fixed mandatory costs, variable necessities, and discretionary wants.
- Setting realistic, enforceable spending limits for each category based on actual income.
- Logging daily expenditures accurately using a notebook, spreadsheet, or budgeting application.
- Reviewing monthly spending patterns against initial estimates and making necessary adjustments to correct overspending.

6. Institutional and Procedural Familiarity

Modern financial literacy requires comfort with formal institutional environments. An individual must possess basic familiarity with standard financial procedures, such as:

- Fulfilling official identification requirements (Know Your Customer / KYC rules) using government-issued identity documents and proof of address.
- Filling out paper applications, deposit slips, withdrawal forms, and check leaves accurately.
- Operating electronic self-service terminals like ATMs and Cash Deposit Machines (CDMs).
- Navigating digital payment interfaces, online portals, and mobile application dashboards safely.

7. Logical Decision-Making and Critical Analytical Thinking

Money management requires cold, rational evaluation rather than emotional reaction, peer imitation, or impulsive desire. An individual must develop the analytical habit of evaluating choices through a clear cost-benefit framework. This involves:

- Pausing to evaluate whether a purchase satisfies a genuine, essential "need" or merely a temporary, optional "want."
- Reading terms, conditions, penalty clauses, and fine print carefully before signing any agreement or loan contract.
- Comparing competing options from multiple providers rather than accepting the first offer presented.
- Calculating the total long-term cost of borrowing (including interest, processing fees, and insurance) rather than focusing solely on the immediate monthly EMI amount.

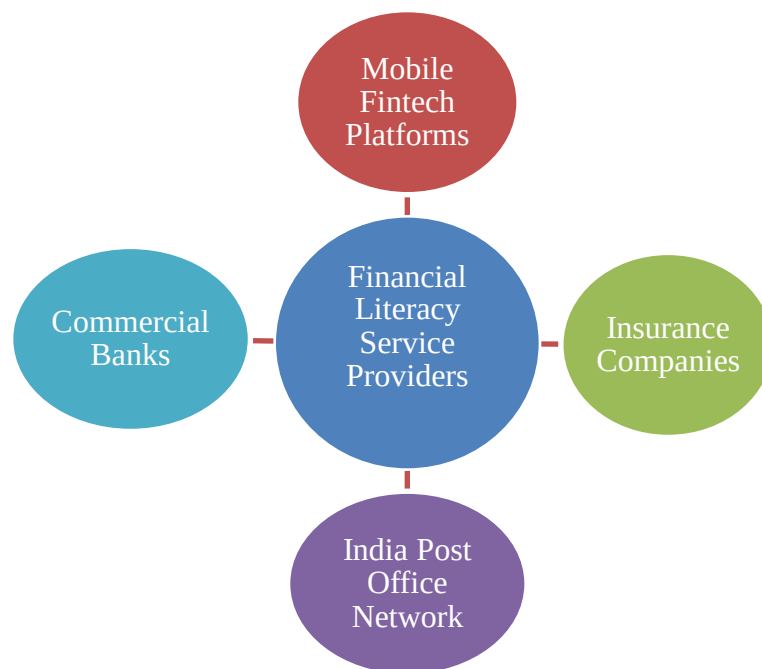
8. Behavioral Self-Control and Financial Discipline

The ultimate prerequisite that holds all other elements together is psychological discipline and emotional self-regulation. Financial discipline is the willpower required to execute sound plans consistently over long horizons. It enables an individual to:

- Resist peer pressure and societal expectations to display lifestyle wealth through expensive material possessions.
- Avoid impulse purchases driven by emotional states or aggressive marketing campaigns.
- Stick strictly to predefined budget limits and savings commitments month after month.
- Maintain regular loan repayment schedules and avoid accumulating high-interest credit obligations.

1.6 NEED OF AVAILING FINANCIAL LITERACY FROM KEY FINANCIAL SERVICE PROVIDERS

While self-study, academic coursework, and personal reading provide a helpful theoretical background, seeking financial literacy directly from formal financial service providers offers practical, real-world value. Commercial banks, post office networks, insurance companies, and fintech mobile service providers serve as key educational channels. They bridge the gap between abstract concepts and actual financial execution, helping consumers understand specific products, operational rules, regulatory protections, and safety protocols.



1.6.1 Need of Availing Financial Literacy from Banks

Commercial banks serve as the cornerstone of the modern financial infrastructure and act as the primary point of entry for individuals entering the formal economy. Acquiring financial literacy directly from banking institutions—through branch consultations, official literature, customer awareness programs, and dedicated Financial Literacy Centres (FLCs)—is essential for several key reasons.

1. Understanding the Mechanics of Diverse Banking Products

Commercial banks offer a wide variety of financial products designed for different life situations, cash flow profiles, and investment goals. Obtaining literacy directly from bank

professionals helps consumers understand the operational differences between various deposit accounts:

- **Savings Bank Accounts:** Designed for regular operational liquidity, offering modest interest returns while maintaining daily access to funds.
- **Current Accounts:** Tailored for business entities and traders requiring unlimited daily transactions without withdrawal restrictions, though typically earning zero interest.
- **Fixed Deposit (FD) Accounts:** Suitable for deploying lump-sum surplus capital for fixed tenures at higher, guaranteed interest rates, with penalties for premature withdrawal.
- **Recurring Deposit (RD) Accounts:** Designed for salaried individuals to build capital by depositing a fixed sum monthly over a specified period, earning compound interest.

Understanding these distinctions prevents individuals from making poor account choices—such as holding excess long-term capital in low-yield savings accounts or locking emergency funds into illiquid fixed deposits.

2. Cultivating Automated and Systematic Saving Habits

Banks provide the operational tools needed to build consistent saving habits. Direct instruction from bank staff teaches customers how to set up automated standing instructions and recurring fund transfers. By automating monthly transfers from a primary transaction account into a recurring deposit or dedicated investment account on salary day, individuals institute a disciplined "pay yourself first" approach effortlessly.

3. Understanding Borrowing Terms, Interest Calculations, and Credit Health

Navigating bank credit operations requires clear, practical understanding. By engaging with banking financial literacy programs, borrowers gain a clear understanding of critical credit terms:

- **Fixed vs. Floating Interest Rates:** How benchmark rate adjustments by central banks alter monthly loan repayments or overall loan tenures.
- **Reducing Balance vs. Flat Rate Interest:** Recognizing that reducing balance calculations lower total interest outlays as the loan principal is paid down, whereas flat rate calculations charge interest on the original loan amount throughout the tenure.
- **Associated Borrowing Charges:** Understanding processing charges, documentation fees, prepayment penalties, and foreclosure conditions before signing loan documents.
- **Credit Score Mechanics:** Learning how credit bureaus evaluate payment histories, credit utilization ratios, and loan mix, and how maintaining a strong credit score lowers future

borrowing costs.

4. Preventing Financial Mistakes and Penalty Charges

Uninformed bank customers often incur unnecessary operational penalties due to simple procedural errors. Banking literacy educates customers on account terms, helping them avoid non-maintenance charges for minimum monthly average balances, auto-debit failure penalties, check bounce charges, and excessive ATM transaction fees.

5. Safe Operation of Digital and Cashless Banking Infrastructure

As banking services move to digital channels, financial literacy from banks provides critical cybersecurity training. Customers learn the technical protocols required to operate online banking portals, mobile applications, Automated Teller Machines (ATMs), and electronic clearing mechanisms safely. Bank-led security guidance teaches users to protect Personal Identification Numbers (PINs), passwords, login credentials, and One-Time Passwords (OTPs), while recognizing phishing scams, social engineering tricks, and fraudulent calls.

1.6.2 Need of Availing Financial Literacy from Post Offices

Post office networks, exemplified by systems like **India Post**, maintain an unmatched physical reach across rural, suburban, and remote areas. For millions of individuals—particularly in non-urban regions, small towns, and low-income communities—the post office serves as the primary gateway to formal financial services. Availing financial literacy directly from postal institutions is essential for deepening financial inclusion and securing state-backed savings opportunities.

1. Access to Accessible Small Savings Schemes

Postal financial services cater to individuals with modest earnings who may feel intimidated by commercial banks or lack access to urban bank branches. Engaging with postal officials provides clear information on accessible small savings instruments, including:

- **Post Office Savings Account (SB):** Offering basic, safe deposit facilities with low minimum balance requirements.
- **Post Office Recurring Deposit (RD):** Allowing small, flexible monthly contributions that help lower-income households accumulate capital gradually.
- **Post Office Time Deposit (TD):** Providing secure fixed-term investment options across flexible durations (1, 2, 3, or 5 years) with competitive, government-backed interest yields.

- **Post Office Monthly Income Scheme (MIS):** Providing a reliable source of regular monthly income for depositors through a lump-sum investment, ideal for retirees or risk-averse individuals.

2. Awareness of Specialized Government Welfare Schemes

Post offices administer specialized, government-backed financial welfare schemes that offer attractive interest yields and tax exemptions. Direct literacy from post offices helps citizens understand and enroll in these beneficial programs:

- **Sukanya Samriddhi Yojana (SSY):** A specialized savings scheme designed to secure the higher education and marriage funds of girl children, offering high interest yields and tax benefits.
- **Senior Citizen Savings Scheme (SCSS):** A dedicated financial safety scheme for individuals aged 60 and above, offering secure, high-yield quarterly interest payouts.
- **Kisan Vikas Patra (KVP):** A government-backed savings certificate that doubles the invested capital over a designated tenure, providing a clear, risk-free long-term savings option.
- **Public Provident Fund (PPF):** A long-term savings instrument combining tax-deductible contributions, tax-free interest accumulation, and tax-exempt maturity withdrawals over a 15-year horizon.

3. Understanding Sovereign Safety and Guaranteed Returns

A key lesson gained from postal financial literacy is the concept of sovereign guarantee. Unlike private financial products where returns depend on market conditions or institutional stability, postal deposits are backed directly by the central government. Understanding this distinction gives risk-averse individuals, retirees, and rural families a safe place to hold their capital without fear of institutional default.

4. Adoption of Modern Postal Banking and Payment Technologies

With the introduction of specialized entities like the **India Post Payments Bank (IPPB)**, post offices have evolved into modern digital payment hubs. Postal financial literacy programs teach rural and semi-urban populations how to use doorstep banking services, Aadhaar-Enabled Payment Systems (AePS), biometric transfers, and mobile postal apps. This enables customers to execute digital transactions without traveling long distances to urban commercial centers.

5. Protection Against Unregulated Moneylenders and Fraudulent Schemes

In rural and informal economic sectors, a lack of financial literacy often leaves individuals reliant on high-cost informal moneylenders or deceptive, unregulated deposit schemes. Direct outreach from post offices provides a safe, regulated alternative, protecting vulnerable populations from predatory debt traps and financial exploitation.

1.6.3 Need of Availing Financial Literacy from Insurance Companies

Insurance is an essential component of risk management and long-term financial security. However, insurance remains one of the most misunderstood financial products, with consumers often confusing pure risk protection with investment returns. Seeking financial literacy directly from licensed insurance providers and regulatory awareness initiatives helps individuals understand coverage terms, assess risk exposures, evaluate policy terms, and handle claim procedures effectively.

1. Understanding the Fundamental Purpose of Risk Transfer

The primary benefit of insurance literacy is understanding that insurance is a risk-mitigation tool designed to protect against financial loss, not an investment mechanism for generating high returns. Financial education from insurance providers teaches consumers the principle of risk pooling and transfer: paying a small, known premium to transfer the catastrophic financial risk of rare, severe events (such as premature death, severe illness, or property destruction) to the insurer.

2. Differentiating Between Various Insurance Products

Insurance companies offer a wide variety of policy options designed for distinct risk categories. Literacy programs help consumers differentiate between these offerings and select appropriate coverage:

- **Pure Term Life Insurance:** Provides a high financial payout (sum assured) to nominees upon the policyholder's death during the policy term, with no maturity payout if the policyholder survives. This offers maximum financial protection for dependents at a very low cost.
- **Endowment and Whole Life Plans:** Combine traditional risk coverage with an underlying savings element, returning a lump sum upon policy maturity, though offering lower death cover per rupee of premium paid compared to term plans.
- **Health Insurance (Mediclaim):** Covers hospital costs, surgical expenses, and medical

treatments, protecting family savings from being wiped out by sudden healthcare emergencies.

- **General Property and Casualty Insurance:** Protects physical assets—such as vehicles, homes, crops, and commercial property—against loss from theft, accidents, fires, or natural disasters.

3. Comprehending Fine Print, Waiting Periods, and Policy Exclusions

A major source of frustration in insurance occurs when claims are rejected due to a lack of policy understanding. Educational guidance from insurers clarifies critical policy terms before purchase:

- **Pre-Existing Disease (PED) Clauses:** Understanding that existing health conditions require designated waiting periods (typically 2 to 4 years) before coverage applies.
- **Policy Exclusions:** Clear awareness of specific events, treatments, or conditions that are explicitly excluded from coverage.
- **Deductibles and Co-payment Terms:** Understanding the portion of medical or claim expenses that the policyholder must pay out-of-pocket before insurance coverage kicks in.
- **Grace Periods and Lapses:** Recognizing that missing premium deadlines causes policies to lapse, leaving the individual unprotected and forfeiting accumulated policy benefits.

4. Navigating Claim Settlement Procedures

Insurance literacy arms consumers with practical knowledge of claim settlement workflows. Policyholders learn how to report claim events promptly, assemble required documentation (death certificates, hospital bills, discharge summaries, police reports), follow formal submission channels, and engage with the Insurance Ombudsman if a claim dispute arises.

1.6.4 Need of Availing Financial Literacy through Mobile App-Based Services

The rapid convergence of mobile technology, high-speed telecommunications, and financial innovation (fintech) has transformed how individuals manage money. Smartphone applications now deliver instant access to payments, banking, credit, micro-investments, and insurance products. However, while mobile platforms offer unprecedented convenience, they also introduce new risks related to impulse spending, digital security threats, and algorithmic borrowing. Acquiring digital financial literacy through mobile app platforms is essential for safe, effective navigation of the modern financial ecosystem.

1. Leveraging Instant, 24/7 Financial Visibility and Convenience

Mobile applications remove geographic and time barriers to account management. App-based literacy programs teach consumers how to use real-time account dashboards on their smartphones to monitor balance changes, track daily transaction feeds, view credit card usage, and download account statements anytime, eliminating the need to visit physical branch locations for routine information.

2. Mastering Digital Payment Ecosystems

App-based educational resources guide users through digital payment systems. Consumers learn how to execute seamless, cashless transactions using Unified Payments Interface (UPI) systems, Quick Response (QR) code scanning, Virtual Payment Addresses (VPAs), digital wallets, and contactless payment mechanisms. This knowledge simplifies daily payments while reducing dependence on physical cash.

3. Utilizing Automated Budgeting and Analytics

Modern personal finance applications feature automated expense tracking tools. By categorizing transactions automatically (e.g., groceries, fuel, dining out, utilities) and generating visual charts, these apps give users immediate insight into their spending patterns. App-based literacy teaches users how to set spending alerts, monitor category budgets, and identify areas where expenses can be reduced.

4. Accessing Micro-Investing and Automated Wealth Platforms

Mobile applications have democratized access to capital markets by offering micro-investment platforms. Digital literacy tools within these apps explain how individuals can start investing small amounts through Systemic Investment Plans (SIPs) in mutual funds, fractional equity purchases, digital gold, and automated spare-change investments. This lowers the barrier to entry for first-time investors, helping them build long-term wealth gradually.

5. Adopting Digital Cyber Hygiene and Fraud Prevention Practices

The speed and anonymity of digital channels make mobile app users prime targets for cybercrime. App-based financial literacy plays an essential role in training users on critical cyber safety practices:

- **Credential Protection:** Keeping Application PINs, passwords, biometric credentials, and One-Time Passwords (OTPs) strictly confidential.
- **Recognizing Digital Scams:** Identifying phishing links, fake customer care numbers,

spoofed merchant portals, and fraudulent remote-access software requests.

- **Safe UPI Practices:** Understanding that entering a UPI PIN is required *only* to send money or check account balances—never to receive funds.
- **Device Security:** Maintaining updated operating systems, downloading apps exclusively from official app stores, and avoiding unencrypted public Wi-Fi networks for financial transactions.

6. Evaluating Algorithmic Digital Credit Products

Fintech applications frequently offer instant credit options, such as "Buy Now, Pay Later" (BNPL) schemes and instant digital micro-loans. Digital financial literacy helps consumers evaluate these products critically, ensuring they calculate processing fees, late payment charges, annual interest rates, and short repayment schedules before borrowing money impulsively.

Summary Table: Key Financial Service Providers & Literacy Roles

Financial Service Provider	Primary Financial Literacy Focus	Key Products & Concepts Covered	Primary Target Audience / Benefit
Commercial Banks	Core banking operations, structured credit, and safe digital transactions.	Savings/Current Accounts, Fixed/Recurring Deposits, EMIs, Credit Scores, Online Banking Security.	General public, salaried workers, and businesses seeking formal credit and liquidity.
Post Offices	State-backed small savings, sovereign safety, and long-term welfare schemes.	Post Office Savings, MIS, Sukanya Samriddhi Yojana (SSY), Senior Citizen Scheme (SCSS), PPF, KVP.	Rural populations, low-income earners, risk-averse investors, and senior citizens.
Insurance Companies	Risk mitigation, policy comprehension, and financial safety net creation.	Term Life Insurance, Health (Mediclaime) Cover, Property Insurance, Deductibles, Claim Workflows.	Families and property owners seeking protection against unexpected life and health shocks.
Mobile App Platforms	Real-time tracking, digital payments, micro-investing, and	UPI, QR Payments, Automated Spending Dashboards, SIP Micro-investments, Cyber	Tech-savvy consumers, youth, and smartphone users seeking convenience

Financial Service Provider	Primary Financial Literacy Focus	Key Products & Concepts Covered	Primary Target Audience / Benefit
	cybersecurity.	Hygiene.	and digital safety.

CHAPTER 2: FINANCIAL PLANNING AND BUDGETING

Introduction

Financial planning is the organized process of assessing your current money situation, determining where you want to be financially in the future, and mapping out actionable strategies to reach those goals. Think of it as a personalized financial roadmap. It bridges the gap between your current financial reality and your future aspirations, ensuring that every rupee you earn, save, or spend works towards building lasting stability.

Unlike a one-time setup, financial planning is a continuous, evolving process. As you move through different stages of life—starting your first job, starting a family, advancing in your career, or preparing for retirement—your earnings, living expenses, liabilities, and personal priorities undergo natural changes. A solid financial plan adapts smoothly to these shifting life stages, keeping your money growing and working efficiently to safeguard your long-term independence.

Financial planning brings several distinct money activities under one single umbrella. It integrates daily cash management, tax optimization, risk protection through insurance, debt control, and long-term investment strategy. Without an overarching plan, individual financial actions—like opening a random savings account or buying an isolated insurance policy—remain disconnected steps that may not actually align with your primary life objectives.

2.1 IMPORTANCE OF FINANCIAL PLANNING

Introduction

Financial planning is the process of determining financial goals and preparing a systematic plan to achieve them. It helps an individual or family understand their income, expenditure, savings, investments and financial commitments. Proper financial planning ensures that available financial resources are used effectively. It also helps a person prepare for both present requirements and future financial responsibilities.

1. Helps in Setting Financial Goals

Financial planning helps individuals identify and clearly define their short-term and long-term financial goals. Goals may include purchasing a house, higher education, starting a business, buying a vehicle or planning for retirement. Once the goals are identified, appropriate financial

strategies can be developed. This gives direction to the use of income and savings.

2. Ensures Proper Management of Income

Financial planning helps a person manage available income in a systematic manner. Income can be divided among essential expenses, savings, investments, insurance and other financial commitments. This prevents unnecessary use of income and encourages disciplined financial behaviour. Proper management of income helps maintain financial stability.

3. Helps to Control Expenditure

A financial plan enables individuals to prepare a budget and monitor their spending habits. It helps distinguish between essential and non-essential expenses. By controlling unnecessary expenditure, more money can be allocated towards savings and investments. Thus, financial planning promotes responsible spending.

4. Encourages Regular Saving

Financial planning develops the habit of saving a portion of income regularly. Savings provide funds for future requirements and unexpected situations. A systematic saving approach can help individuals accumulate money for important financial goals. Regular savings also reduce dependence on borrowing for planned expenses.

5. Promotes Investment

Financial planning helps individuals decide how their surplus funds can be invested according to their goals, risk tolerance and time horizon. Different investment avenues may be considered based on the individual's financial circumstances. Proper investment planning can help generate returns and build wealth over time. It therefore connects present savings with future financial objectives.

6. Provides Financial Security

Financial planning helps individuals prepare for uncertain situations such as loss of income, emergencies or unexpected expenses. Maintaining emergency savings and suitable financial protection can reduce financial stress during difficult periods. A well-prepared financial plan provides greater confidence in handling unforeseen circumstances. It therefore contributes to overall financial security.

7. Helps in Retirement Planning

Financial planning is important for preparing financially for life after retirement. It encourages individuals to start saving and investing sufficiently during their earning years. Proper planning can help provide funds for regular expenses after retirement when active income may reduce or

stop. Early planning generally provides a longer period for building retirement resources.

8. Helps in Tax Planning

Financial planning helps individuals organise their financial activities while considering applicable tax obligations and legally available tax benefits. It encourages proper documentation and timely financial decisions. Appropriate tax planning can help manage the tax burden within the framework of law. Thus, tax considerations can be integrated into the overall financial plan.

9. Helps in Managing Debt

Financial planning helps individuals assess their borrowing requirements and repayment capacity before taking loans. It encourages responsible borrowing and timely repayment of instalments. Proper debt management prevents excessive financial obligations from affecting regular expenditure and savings. It therefore contributes to maintaining a healthier financial position.

10. Helps in Risk Management

Financial planning considers the possibility of financial risks arising from unexpected events. Individuals can plan appropriate financial protection and maintain adequate emergency resources. This reduces the impact of unforeseen financial losses on their long-term goals. Risk management is therefore an important part of a comprehensive financial plan.

11. Improves Financial Discipline

A financial plan encourages individuals to follow a systematic pattern of earning, spending, saving and investing. It helps them review whether their actual financial behaviour is consistent with their planned objectives. Regular monitoring promotes better financial habits. Over time, this discipline can improve overall financial well-being.

12. Facilitates Better Decision-Making

Financial planning provides a clear picture of income, expenses, assets, liabilities and future requirements. This information helps individuals make informed decisions regarding saving, borrowing, investing and spending. Instead of making financial decisions without proper consideration, they can compare alternatives and select suitable options. Thus, planning improves the quality of financial decisions.

Conclusion

Financial planning is important for achieving financial goals and maintaining financial stability. It helps in managing income, controlling expenditure, encouraging savings, making investments and preparing for future responsibilities. It also supports risk management, debt management and

retirement preparation. Therefore, effective financial planning enables individuals to use their financial resources wisely and work towards a secure financial future.

2.2 NEED FOR FINANCIAL PLANNING

Introduction

The need for financial planning arises because financial resources are limited while human needs and future responsibilities are numerous. Individuals must make proper decisions regarding earning, spending, saving, investing and borrowing. Without planning, income may be spent without considering future requirements. Financial planning provides a systematic approach to meet present needs while preparing for future financial obligations.

1. To Meet Present Financial Requirements

Financial planning is needed to ensure that regular income is sufficient to meet essential expenses. It helps individuals plan for food, housing, education, transportation, healthcare and other routine requirements. Proper allocation of income prevents financial imbalance. It enables people to meet their present needs without unnecessarily disturbing their future savings.

2. To Prepare for Future Goals

People have several future financial goals that require substantial funds. These may include higher education, marriage, purchasing property, starting a business or retirement. Financial planning helps estimate the amount required and determine how much should be saved or invested. It therefore makes future goals more achievable.

3. To Deal with Inflation

The purchasing power of money may decline over time because of inflation. Therefore, simply keeping money aside may not always be sufficient to meet future requirements. Financial planning encourages appropriate saving and investment strategies to address changing costs. It helps individuals consider the future value of money while setting financial goals.

4. To Handle Emergencies

Unexpected expenses may arise due to accidents, repairs, temporary loss of income or other emergencies. Without adequate financial preparation, such situations may force individuals to borrow money. Financial planning encourages the creation of an emergency fund and appropriate financial protection. This helps manage unforeseen expenses without seriously disturbing long-term financial goals.

5. To Avoid Unnecessary Borrowing

Financial planning helps individuals estimate their financial requirements and arrange funds in advance. Adequate savings and investments can reduce dependence on loans for planned expenses. It also helps assess repayment capacity before borrowing. Thus, financial planning can prevent excessive debt and unnecessary interest burdens.

6. To Build Wealth

The need for financial planning extends beyond meeting daily expenses; it also involves creating long-term financial wealth. By saving and investing systematically, individuals can gradually accumulate financial assets. Planning helps determine suitable investment objectives and time periods. This provides a structured path towards long-term wealth creation.

7. To Plan for Retirement

Active employment income may reduce or cease after retirement, while living expenses continue. Financial planning is therefore necessary to build adequate retirement resources during the earning years. Early planning provides more time to accumulate savings and investments. It helps individuals prepare for a financially independent retirement.

8. To Manage Changing Life Circumstances

Financial needs may change because of changes in income, family responsibilities, education, employment or lifestyle. A financial plan can be reviewed and modified when circumstances change. This flexibility helps individuals adjust their savings, investments and expenditure according to their changing requirements. Thus, planning provides financial adaptability.

9. To Protect Financial Dependants

Individuals may have family members who depend on their income for their financial needs. Financial planning helps consider the financial requirements of dependants and prepare for possible uncertainties. Appropriate savings and financial protection can help reduce the financial burden on family members. This makes financial planning important for family security.

10. To Balance Income and Expenditure

Income and expenditure must be properly balanced to maintain financial stability. Financial planning helps individuals identify their sources of income and major expenditure commitments. It provides a framework for avoiding excessive spending and maintaining sufficient savings. A balanced financial position reduces financial stress.

11. To Make Better Use of Surplus Money

After meeting regular expenses, individuals may have surplus income. Without proper planning, such money may be spent unnecessarily or remain unused. Financial planning helps allocate surplus funds towards suitable savings and investment objectives. This enables available financial resources to contribute towards future financial growth.

12. To Achieve Financial Independence

Financial planning helps individuals gradually develop sufficient savings, investments and financial resources to meet their own requirements. It reduces unnecessary dependence on family members or excessive borrowing. Consistent planning and disciplined financial behaviour can strengthen financial independence. It gives individuals greater confidence in managing their financial affairs.

Conclusion

Financial planning is needed because individuals must manage limited financial resources to meet present needs and future responsibilities. It helps prepare for emergencies, inflation, retirement, education and other major financial goals while reducing unnecessary debt. It also supports wealth creation, financial security and independence. Therefore, financial planning should be treated as a continuous process rather than a one-time financial decision.

2.3 BUDGET

A budget may be defined as a formal, quantitative statement prepared in advance of a defined period of time, which sets out the expected income, expenditure, and other financial or operational plans of an individual, a family, or an organisation, and which serves as a guide for the systematic control of financial activities during that period. It is essentially a plan expressed in financial terms, and it translates the broad goals and intentions of the budget-maker into specific, measurable targets that can be pursued and monitored over the course of the budget period. A budget is prepared before the commencement of the period to which it relates, which distinguishes it from a mere financial statement that records what has already happened, since a budget is fundamentally forward-looking in nature rather than historical. It usually covers a specific and clearly defined period, such as a month, a quarter, or a year, and within that period it lays down, in reasonably precise terms, how much is expected to be earned and how much is expected to be spent, and on what particular items such spending is likely to occur. Although the term budget is most commonly associated with government finance and business organisations, it applies equally well to the

financial planning carried out by an ordinary household, where family members estimate their monthly income from salaries or other sources and plan their spending on essentials such as food, rent, education, and savings well in advance of actually incurring these expenses. In this sense, a budget may be understood as both a plan and a tool, since it not only expresses financial intentions but also becomes the yardstick against which actual performance is subsequently measured and evaluated.

2.4 IMPORTANCE OF BUDGET

1. Importance in Financial Planning

A budget plays a vital role in financial planning because it compels an individual or an organisation to think carefully about future financial activities well in advance, rather than allowing them to react to situations only after those situations have already arisen. Since a budget converts broad and often vague financial ambitions into specific, measurable targets for income and expenditure, it gives a clear and definite sense of direction to whoever is pursuing those goals, and this clarity is something that is very difficult to achieve without a written plan of this kind. The very process of preparing a budget encourages the habit of forward thinking and disciplined financial behaviour, since it requires income and expenses to be estimated carefully before they are actually incurred, and this habit, once developed, tends to stay with a person or an organisation well beyond the immediate budget period. A budget is also of enormous help in achieving long-term financial goals, such as the purchase of a house, the funding of a child's higher education, or the accumulation of a comfortable retirement corpus, because it allows such large and often distant ambitions to be broken down into smaller, manageable, and far less intimidating periodic targets that can be pursued steadily, one step at a time.

2. Importance in Financial Control

Beyond planning, a budget also functions as one of the most effective tools of financial control available to an individual or an organisation, since it allows actual income and actual expenditure to be compared, at regular intervals, with the figures that were originally planned. This comparison makes it possible to identify any significant deviation between what was expected and what has actually happened, and, more importantly, it allows corrective action to be taken in good time, before a small problem is allowed to grow into a serious one. Because every item of expenditure has been planned in advance and is therefore subject to prior scrutiny before it is incurred, a budget

naturally helps in avoiding unnecessary and wasteful spending, since impulsive or unplanned expenses stand out clearly against a backdrop of carefully considered figures. A budget further provides a fair and reliable basis for evaluating performance, whether of an individual, a department within an organisation, or the organisation as a whole, since actual results achieved during the period can always be measured objectively against the targets that were set at the very beginning.

3. Importance in the Allocation of Resources

Another significant contribution of a budget lies in the area of resource allocation, since no individual, family, or organisation ever has unlimited money at its disposal, and a budget ensures that whatever limited financial resources are available are directed towards the needs that matter most, according to their relative priority and importance. A budget also enables the timely identification of a possible shortage or surplus of funds well before the situation actually arises in reality, and this early warning allows corrective action to be taken comfortably in advance, such as arranging additional finance well ahead of a shortfall, or investing surplus funds profitably rather than allowing them to remain idle. At the level of the government, this same principle operates on a much larger scale, since sound budgeting assists in the proper allocation of scarce public funds among numerous competing developmental and welfare programmes, thereby ensuring that public money is used in the manner that brings the greatest overall benefit to society.

4. Importance for the Individual and the Family

At the personal and domestic level, a budget helps a person or a family to live within their income, since it creates a clear and continuous awareness of the limits within which spending must be kept during a given period, and this awareness alone prevents a great deal of the casual overspending that so often leads to financial difficulty. By giving a family a clear picture of its financial position and its ability to meet future obligations, a budget also helps considerably in reducing the financial stress and anxiety that tend to arise whenever income and expenditure are not properly planned or understood. A household budget further encourages preparation for emergencies and unforeseen contingencies, since it allows a portion of income to be consciously and deliberately set aside in advance, so that when an unexpected expense does arise, such as a medical emergency or a sudden repair, the family is able to meet it without disturbing its overall financial stability.

5. Importance for Business Organisations

Within a business organisation, a budget serves as an invaluable basis for coordinating the

activities of different departments, since the individual plans of departments such as sales, production, purchase, and finance are brought together and integrated into a single, consistent overall plan for the organisation as a whole, rather than being allowed to work at cross purposes with one another. A budget also improves communication within the organisation, since financial plans, targets, and priorities are clearly documented in writing and shared among the various levels of management and staff, leaving far less room for misunderstanding than would exist if such plans were communicated only verbally or informally. It assists considerably in effective decision-making as well, since a well-prepared budget provides reliable financial information that can be used while deciding on matters such as new investments, the raising of loans, or major purchases of fixed assets. A sound budget further helps an organisation to raise finance more easily from banks and other financial institutions, since it clearly demonstrates the existence of disciplined financial planning and thereby increases the confidence that lenders and investors place in the organisation's management. Finally, a budget helps considerably in motivating employees, since clearly defined targets give every individual and every department a genuine sense of direction and purpose, and performance can then be meaningfully linked to the achievement of these budgeted goals, often through appropriate systems of recognition or reward.

6. Importance at the National Level

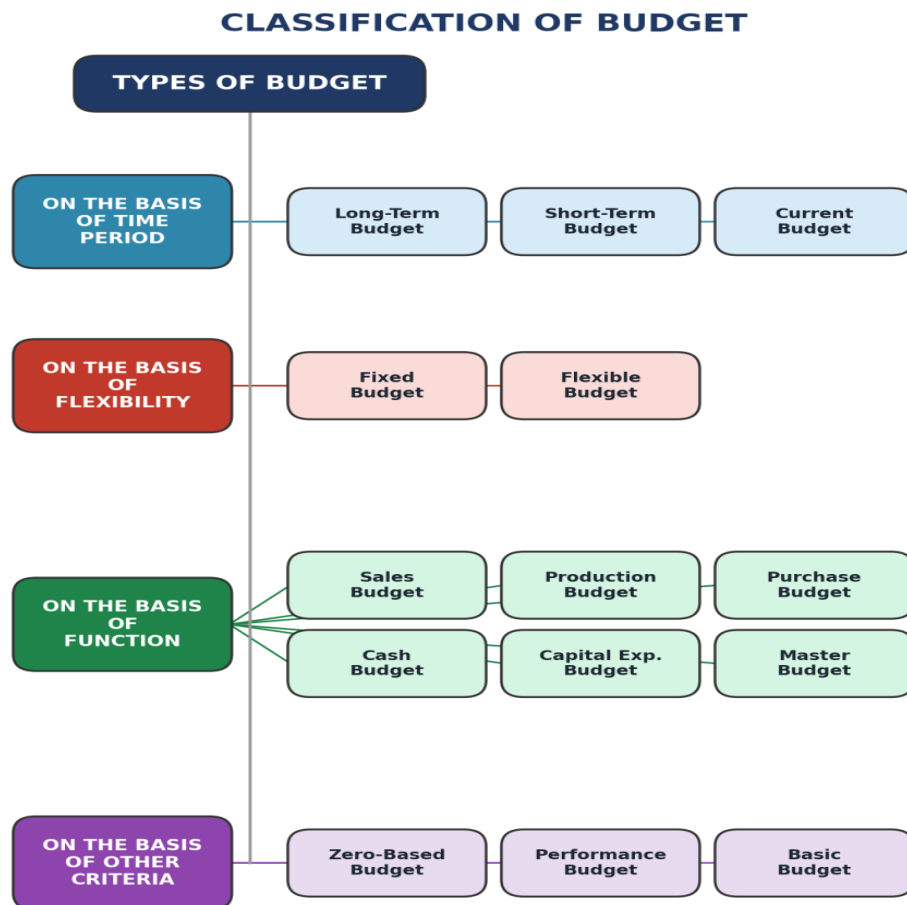
Even at the level of the nation as a whole, the importance of budgeting can hardly be overstated, since the government's own budget determines how the country's resources will be raised through taxation and other means, and how those resources will subsequently be spent on defence, education, health, infrastructure, and numerous other priorities. A national budget, much like a household or business budget, allows the government to plan its finances in advance, to control its expenditure against approved limits, and to be held accountable to the public for the manner in which it has raised and spent the nation's money.

2.5 TYPES OF BUDGETS

Budgets can be classified into several types on the basis of different criteria, such as the time period they cover, the degree of flexibility they allow, the functions they perform, and the capacity they take into account, and a clear understanding of these classifications is essential for effective financial planning.

Classification Chart

The chart below presents a colour-coded, at-a-glance classification of the different types of budget discussed in this chapter, grouped according to the basis on which each type is classified.



2.5.1 Classification on the Basis of Time Period

1. Long-Term Budget

1. A long-term budget is a budget that is prepared to cover a relatively long period, usually ranging from five to ten years, and it is generally used for planning major, long-term financial objectives.
2. This type of budget is commonly used for planning capital expenditure, research and development activities, and other long-range strategic goals of an organisation or a family.
3. Long-term budgets provide a broad direction for future financial planning, although they are usually less detailed than short-term budgets because of the uncertainty involved in forecasting over such a long period.
4. Examples of long-term budgeting at the family level include planning for a child's higher

education abroad or accumulating a retirement corpus over several decades.

2. Short-Term Budget

1. A short-term budget is a budget that is prepared for a relatively short period, usually not exceeding one year, and it is generally more detailed and specific than a long-term budget.
2. This type of budget is commonly used for planning day-to-day operational expenses, such as monthly household expenses or the annual operating budget of a business enterprise.
3. Short-term budgets are easier to prepare accurately because the period involved is short enough for reasonably reliable estimates of income and expenditure to be made.
4. Examples of short-term budgeting include a monthly household budget prepared by a family or an annual sales budget prepared by a company.

3. Current Budget

1. A current budget is a budget that is prepared and used for a very short period, generally a month or a week, and it is closely related to current operating conditions.
2. This type of budget is prepared to address the immediate financial needs of an individual or an organisation and is adjusted frequently based on actual performance.

2.5.2 Classification on the Basis of Flexibility

1. Fixed Budget

1. A fixed budget is a budget that is prepared for a specific level of activity and remains unchanged regardless of the actual level of activity achieved during the budget period.
2. This type of budget is suitable in situations where the level of activity does not fluctuate significantly, and it is relatively simple to prepare and understand.
3. A major limitation of the fixed budget is that it does not adjust itself to changes in the actual volume of activity, which may reduce its usefulness for control purposes when circumstances change unexpectedly.

2. Flexible Budget

1. A flexible budget is a budget that is designed to change in accordance with the actual level of activity achieved, and it classifies costs into fixed, variable, and semi-variable categories in order to permit such adjustment.
2. This type of budget is particularly useful in industries where the level of production or sales is subject to frequent seasonal or market-related fluctuations.
3. A flexible budget provides a more realistic basis for comparing actual performance with

budgeted performance, since it accounts for changes in the level of activity rather than assuming a fixed level throughout the period.

4. The preparation of a flexible budget is comparatively more complex and time-consuming than that of a fixed budget, since it requires the separation of costs into their fixed and variable components.

2.5.3 Classification on the Basis of Function

1. Sales Budget

1. A sales budget is a budget that estimates the quantity and value of sales expected to be achieved during a given budget period, and it usually forms the starting point for the preparation of other functional budgets.
2. This budget is prepared on the basis of past sales trends, market conditions, and the expected demand for the product or service.

2. Production Budget

1. A production budget is a budget that sets out the quantity of goods that must be produced during the budget period in order to meet the sales budget as well as the desired level of closing stock.
2. This budget takes into account the opening stock of finished goods, the expected sales, and the desired closing stock in order to determine the required level of production.

3. Purchase Budget

1. A purchase budget is a budget that estimates the quantity and value of raw materials or goods that need to be purchased during the budget period in order to support the planned level of production.
2. This budget is prepared with reference to the production budget, the opening stock of raw materials, and the desired closing stock of raw materials.

4. Cash Budget

1. A cash budget is a budget that forecasts the expected cash inflows and cash outflows of an individual or an organisation over a specific period, in order to ensure that sufficient cash is available to meet obligations as they fall due.
2. This budget helps in identifying periods of cash surplus, during which idle funds may be invested, as well as periods of cash deficit, during which additional financing may need to be arranged.

3. At the household level, a cash budget helps a family to plan its monthly income and expenses so that it does not run short of money before the end of the month.

5. Capital Expenditure Budget

1. A capital expenditure budget is a budget that plans for expenditure on the acquisition of long-term or fixed assets, such as land, buildings, machinery, or equipment.
2. This budget is usually prepared for a longer period than an operating budget, since capital expenditure decisions have financial implications that extend over several years.

6. Master Budget

1. A master budget is a comprehensive and summarised budget that consolidates all the individual functional budgets, such as the sales budget, the production budget, and the cash budget, into a single overall plan.
2. This budget provides an integrated picture of the expected financial performance and financial position of an organisation for the budget period, and it is generally presented in the form of a budgeted income statement and a budgeted balance sheet.

2.5.4 Other Important Types of Budget

1. Zero-Based Budget

1. A zero-based budget is a budget in which every item of expenditure must be justified afresh for each new budget period, rather than simply being based on the figures of the previous period.
2. This approach requires every activity to be evaluated on the basis of its necessity and cost-effectiveness before any funds are allocated to it, which helps in eliminating unnecessary or wasteful expenditure.
3. Zero-based budgeting demands considerably more time and effort in preparation as compared to traditional budgeting methods, since every expense must be freshly evaluated and justified.

2. Performance Budget

1. A performance budget is a budget that is prepared with reference to specific objectives, activities, or programmes, and it links the financial allocations made to the physical performance or output expected to be achieved.
2. This type of budget is commonly used by government departments and public sector organisations to evaluate whether the funds allocated to a particular programme have resulted in the desired outcomes.

3. Basic Budget

1. A basic budget is a budget that remains unchanged over a long period and is used as a stable foundation or benchmark against which subsequent budgets can be compared.

Advantages of Classifying Budgets into Different Types

1. Classifying budgets into different types allows an individual or an organisation to select the type of budget that is best suited to its specific needs and circumstances.
2. The use of an appropriate type of budget improves the accuracy of financial planning and enhances the effectiveness of budgetary control.
3. Different types of budgets allow for both long-term strategic planning and short-term operational planning to be carried out within a single, coordinated financial plan.
4. The availability of specialised budgets, such as the cash budget and the capital expenditure budget, allows specific aspects of financial management to be planned and monitored in greater detail.

Conclusion

The classification of budgets into various types, therefore, provides individuals, families, and organisations with the flexibility to choose the most appropriate planning tool for a given purpose, and a sound understanding of these types is essential for anyone seeking to achieve effective financial planning and control, whether at the level of a household or at the level of a large business enterprise.

2.6 PROCEDURE FOR FINANCIAL PLANNING

Introduction

Financial planning is a systematic process of determining financial requirements and arranging financial resources in such a manner that present needs and future financial objectives can be fulfilled. It enables an individual to make proper use of available income, control unnecessary expenditure, accumulate savings and make suitable investment decisions. Financial planning is not limited to earning and saving money; it also involves deciding how income should be allocated among consumption, savings, investment, protection and future requirements.

The procedure for financial planning provides a systematic approach to managing personal finances. A person may have sufficient income but may still face financial difficulties if the income is not properly planned and managed. Therefore, financial planning begins with an understanding

of the person's present financial position and proceeds towards the identification of objectives, estimation of financial requirements, allocation of resources and regular review of the plan.

Determination of Financial Goals

The first stage in financial planning is to determine the financial goals of the individual or family. Financial goals refer to the specific financial purposes for which money is required. These goals may relate to immediate requirements, medium-term needs or long-term objectives. The nature and importance of financial goals differ from person to person depending upon income, age, family responsibilities, lifestyle and future expectations.

Financial goals should be clearly defined because the allocation of income and savings depends upon the purpose for which funds are required. A clear distinction should also be made between essential financial objectives and desirable objectives. Proper identification of goals provides direction to the entire financial planning process and helps in determining the amount of money that needs to be saved or invested.

Assessment of Present Financial Position

After determining financial goals, the present financial position has to be assessed. This involves examining the individual's income, expenditure, savings, investments, assets and liabilities. The assessment provides a clear understanding of the financial resources currently available and the obligations that have to be met.

Income may arise from salary, wages, business, professional activities, rent, interest, dividends or other sources. Expenditure includes regular household expenses, education, transportation, medical expenses, loan repayments and other personal requirements. Existing savings, investments and outstanding liabilities also form an important part of the financial position. A proper assessment helps in identifying whether the existing financial resources are sufficient to meet the desired objectives.

Estimation of Future Financial Requirements

The next stage is to estimate the amount of money that may be required in the future. Financial requirements do not remain constant throughout life. They may increase because of changes in family circumstances, education, housing, healthcare, marriage, retirement and other responsibilities.

Future requirements should be considered in relation to the time at which the money will be needed. The expected increase in the cost of living and the effect of inflation should also be

taken into consideration while estimating future financial needs. A realistic estimation of future requirements enables an individual to determine the level of savings and investment necessary for achieving financial objectives.

Analysis of Income and Expenditure

The income and expenditure pattern of an individual should be analysed carefully. The purpose of this analysis is to understand how the available income is currently being used. Expenditure may be broadly classified into necessary expenditure and discretionary expenditure. Necessary expenditure relates to essential requirements, whereas discretionary expenditure relates to spending that can be reduced or postponed according to circumstances.

Analysis of expenditure helps in identifying areas where unnecessary spending may occur. It also indicates the amount of income that can reasonably be set aside for savings and investment. Financial planning does not mean eliminating all expenditure; rather, it seeks to maintain a suitable balance between present consumption and future financial security.

Determination of Savings Requirements

Savings constitute an important part of financial planning. After assessing income, expenditure and future requirements, the amount that can be saved should be determined. Savings provide financial support for future needs and also act as a source of security during uncertain circumstances.

The level of savings required depends upon the individual's financial goals, income, existing assets, liabilities and time available for achieving the objectives. Regular savings are generally more effective than irregular savings because they create financial discipline and enable long-term objectives to be pursued systematically.

Selection of Suitable Investment Avenues

Savings accumulated through financial planning may be allocated to appropriate investment avenues according to the individual's objectives and financial circumstances. Investment decisions should consider factors such as safety, return, liquidity, time period and the level of risk involved.

Different financial instruments have different characteristics. Therefore, an investment decision should not be made merely on the basis of expected returns. The nature of the financial objective and the period for which the funds can be invested should also be considered. Suitable allocation of funds among different investment avenues forms an important part of financial

planning.

Provision for Risk Protection

Financial planning should also provide protection against unexpected financial losses. Life-related risks, health-related expenses, accidents, loss of income and other unforeseen circumstances can affect the financial stability of an individual or family.

Insurance and other forms of financial protection can be incorporated into the financial plan according to the individual's requirements. Adequate protection reduces the possibility that an unexpected event will disturb savings and investments intended for other financial objectives.

Management of Debt

Borrowing is often necessary for meeting major financial requirements, but excessive or poorly managed debt can create financial pressure. Therefore, existing loans and other liabilities should be examined as part of the financial planning process.

The repayment obligations associated with borrowing should be considered while determining savings and investment capacity. Proper debt management ensures that loan commitments remain within manageable limits and do not adversely affect other financial objectives.

Implementation of the Financial Plan

A financial plan becomes meaningful only when it is properly implemented. Once financial goals, income, expenditure, savings, investments, protection and liabilities have been considered, the decisions taken should be put into practice.

Implementation requires financial discipline and regularity. Planned savings should be made consistently, expenditure should be managed according to the financial plan and investments should be made in accordance with the objectives identified. The success of financial planning therefore depends not only upon preparing a plan but also upon following it systematically.

Review and Revision of the Financial Plan

Financial planning is a continuing process. A financial plan prepared at one point of time may not remain suitable under changing circumstances. Income, expenditure, family responsibilities, employment conditions, financial goals, market conditions and other circumstances may change over time.

Therefore, the financial plan should be reviewed periodically. Necessary changes may be made in savings, investments, expenditure and protection arrangements whenever circumstances

require. Regular review ensures that the financial plan continues to remain relevant to the changing financial needs and objectives of the individual or family.

Conclusion

The procedure for financial planning provides a systematic method for managing personal finances. It begins with the identification of financial goals and assessment of the present financial position and proceeds through estimation of future requirements, analysis of income and expenditure, determination of savings, investment and risk protection. Proper implementation, debt management and periodic review complete the process. Thus, financial planning helps an individual maintain financial discipline and work towards financial security in an organised manner.

2.7 PREPARATION OF A BUDGET

Introduction

A budget is a financial statement prepared in advance showing the expected income and expenditure for a specified period. It is an important instrument of personal financial management because it enables an individual or family to plan the use of available income before expenditure is actually incurred. The preparation of a budget helps in maintaining a balance between income and expenditure and provides a basis for planned savings. Budget preparation is closely associated with financial planning. While financial planning deals with broader financial objectives and the management of resources over time, a budget provides a more specific plan for the allocation of income towards various requirements during a particular period. A properly prepared budget helps an individual understand where income is expected to come from and how it is intended to be used.

Determination of the Budget Period

The preparation of a budget begins with determining the period for which the budget is to be prepared. A budget may be prepared for a month, quarter, year or any other suitable period depending upon the purpose for which it is prepared. In personal financial management, a monthly budget is commonly used because many income and expenditure items are received or paid on a monthly basis. The budget period should be clearly specified because income and expenditure estimates depend upon the length of the period. A fixed budget period also makes it easier to compare the estimated financial position with the actual financial position at the end of the period.

Estimation of Income

The next stage in budget preparation is to estimate the income expected to be received during the budget period. All regular and reasonably predictable sources of income should be taken into consideration. Income may include salary, wages, business income, professional income, rent, interest, dividends and other receipts.

Income estimates should be realistic rather than excessive. Regular income can generally be estimated with greater certainty, whereas irregular or uncertain receipts should be considered carefully. An accurate estimate of income provides the foundation for determining the amount that can be allocated towards expenditure and savings.

Estimation and Classification of Expenditure

After estimating income, the expenditure expected during the budget period should be identified and estimated. Expenditure may arise from food, housing, education, transportation, healthcare, communication, household requirements, loan repayments, personal needs and other purposes.

For effective budget preparation, expenditure may be classified according to its nature. Fixed expenditure consists of expenses that generally remain unchanged or change only slightly during a particular period. Variable expenditure changes according to consumption, circumstances or other factors. Certain expenditure may also be discretionary in nature and can be adjusted according to financial circumstances. Proper classification makes it easier to understand the expenditure pattern and determine which expenses are essential and which can be controlled or postponed.

Allocation of Income

Once expected income and expenditure have been determined, the available income should be allocated among different financial requirements. Priority should normally be given to essential expenditure and important financial commitments. The allocation of income should also provide adequate importance to savings. Savings should not merely be treated as the amount left after all expenditure has been incurred. They should form an integral part of the budget because regular savings are necessary for meeting future financial requirements and maintaining financial security.

Provision for Savings

A well-prepared budget should make provision for savings during the budget period. The amount allocated to savings depends upon income, expenditure, financial obligations and financial objectives. Savings may be maintained for future requirements, emergencies, education,

retirement, investment or other financial purposes. Including savings as a planned component of the budget promotes financial discipline and reduces the possibility of spending the entire available income on current consumption.

Provision for Contingencies

Unexpected expenditure may arise even when regular financial requirements have been properly estimated. Medical expenses, repairs, emergencies and other unforeseen circumstances may create additional financial requirements. Therefore, a budget should make reasonable provision for contingencies. Such provision enables unexpected expenditure to be accommodated without seriously disturbing the regular financial plan. It also reduces the need to depend excessively on borrowing when unforeseen financial requirements arise.

Balancing Income and Expenditure

After estimating and allocating income and expenditure, the budget should be examined to determine whether the proposed expenditure is consistent with the available income. A sound budget should seek to maintain a suitable relationship between income, expenditure and savings. When estimated expenditure is higher than expected income, adjustments have to be made. Unnecessary or discretionary expenditure may be reduced, postponed or rearranged. Where possible, attention may also be given to increasing or strengthening the sources of income. The purpose of balancing the budget is to ensure that financial commitments remain within the available resources.

Recording the Budget

The estimated income, expenditure and savings should be systematically recorded for the selected budget period. Proper recording provides a clear picture of the financial plan and makes it easier to monitor financial activities. A written budget also creates a basis for comparing planned amounts with actual amounts. Without proper recording, it becomes difficult to determine whether financial resources are being used according to the original plan.

Monitoring the Budget

Preparation of a budget does not end with recording estimated income and expenditure. The actual financial transactions during the budget period should be monitored and compared with the amounts originally estimated.

Monitoring helps to identify differences between planned and actual expenditure. If expenditure on a particular item is higher than expected, suitable adjustments may be made in

other areas. Regular monitoring therefore helps maintain control over financial resources throughout the budget period.

Review of the Budget

At the end of the budget period, the budget should be reviewed by comparing the estimated income and expenditure with the actual amounts. The differences between the two provide useful information about the accuracy of the estimates and the individual's spending pattern. The review also helps identify areas in which expenditure was higher or lower than expected. The findings of the review can be used while preparing the budget for the following period. In this manner, each budget becomes a basis for improving subsequent financial planning.

Conclusion

Preparation of a budget is a systematic process of estimating income and expenditure and allocating available resources among present and future financial requirements. It involves determining the budget period, estimating income, identifying and classifying expenditure, providing for savings and contingencies, balancing income and expenditure, and subsequently monitoring and reviewing the budget. A properly prepared budget promotes financial discipline, facilitates effective use of income and provides a foundation for achieving financial objectives.

CHAPTER 3: BANKING SERVICES

3.1 INTRODUCTION

Banking is an essential part of the financial system of every country. In our day-to-day life, banks help us save money, withdraw cash, transfer funds, make payments, borrow money, invest savings and manage financial transactions. A bank acts as a link between people who have surplus money and people who need money. Individuals and institutions deposit their surplus funds with banks, and banks use a major portion of these funds to provide loans and advances to borrowers. Thus, banking is not merely about depositing and withdrawing money. Modern banking provides a wide range of financial products and services that make financial transactions easy, safe, convenient and efficient.

3.2 MEANING OF BANK

A bank is a financial institution that accepts deposits from the public and provides loans and other financial services. Example: Suppose Tharun earns ₹30,000 per month. He does not need the entire amount immediately. He deposits ₹10,000 in his savings account. At the same time, Vimal wants ₹5 lakh to start a small business. He approaches a bank for a business loan.

The bank performs two important functions:

Tharun → Deposits money → Bank → Provides loan → Vimal

In this way, the bank connects savers and borrowers.

3.3 MEANING OF BANKING

Banking refers to the business activities carried out by banks, particularly accepting deposits from the public and providing loans and other financial services. Banking includes activities such as accepting deposits, providing loans and advances, facilitating payments, money transfer, ATM services, Debit and credit card services, Internet banking, Mobile banking, UPI-based payments, Foreign exchange services, Safe deposit locker facilities. Therefore, banking has become an important part of both personal financial management and economic development.

3.4 BANKING SERVICES

Banking services refer to the various financial facilities, activities and support services provided by banks to individuals, businesses, institutions and other customers for managing their money and carrying out financial transactions. In simple words, banking services are the facilities provided by a bank to help customers save, withdraw, transfer, borrow, pay, invest and manage money conveniently and safely. A bank does not perform only the basic function of accepting deposits. Modern banks provide a wide range of services to meet the changing financial needs of customers. These services may be provided through bank branches, ATMs, debit and credit cards, internet banking, mobile banking and digital payment platforms.

Simple Example

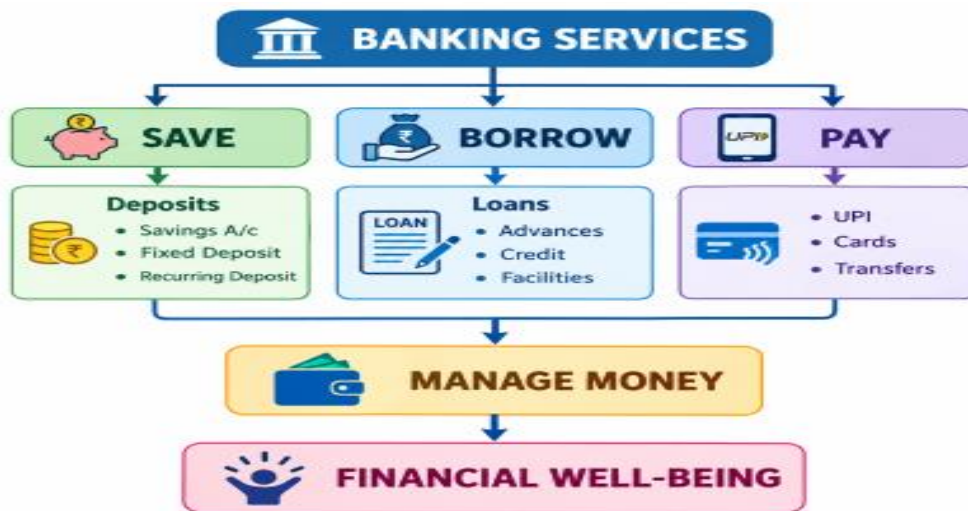
Consider a college student who has a savings account with a bank. The student may use the bank for several purposes:

- Depositing scholarship or other income
- Withdrawing money through an ATM
- Transferring money to another person
- Paying college fees through digital banking
- Making UPI payments
- Checking account balance through a mobile application
- Using a debit card for purchases

All these facilities are collectively known as banking services

3.4.1 BANKING SERVICES AS A COMPLETE FINANCIAL SUPPORT SYSTEM

Banking services can be understood as a system that helps customers at different stages of their financial activities.



1. Banking Services Help in Saving Money

One of the basic purposes of banking services is to provide customers with suitable facilities for saving money. Customers can keep their money in different types of deposit accounts according to their needs. For example, a person may maintain a savings account for regular transactions, while a fixed deposit may be used for keeping money for a specific period. Thus, banking services encourage people to develop the habit of saving.

2. Banking Services Help in Borrowing Money

Banks play an important role in helping individuals, businesses and other organizations meet their financial requirements by providing loans and credit facilities. When a person does not have sufficient money to meet a major financial need, he or she can approach a bank for suitable financial assistance. Banks provide different types of loans for purposes such as education, housing, purchase of vehicles, agriculture, business expansion and personal needs. Similarly, business organizations can obtain working capital and other credit facilities to purchase raw materials, machinery and other resources. The borrower is required to repay the amount borrowed along with applicable interest according to the agreed terms and conditions. Thus, banking services provide timely access to credit and help individuals and businesses meet their financial needs and achieve their economic goals.

3. Banking Services Facilitate Money Transfers

Banks provide convenient facilities for transferring money from one person or account to another. Customers can transfer funds to family members, friends, businesses, educational institutions and other beneficiaries without physically carrying cash. Traditional methods such as cheques and demand drafts, as well as modern electronic methods such as NEFT, RTGS, IMPS and UPI, make money transfers faster and easier. These facilities are particularly useful for personal and business transactions, as they enable funds to be transferred securely from one location to another. Thus, banking services facilitate the smooth and efficient movement of money within the financial system.

4. Banking Services Facilitate Payments

Banks make it easier for customers to make payments for goods, services and various financial obligations. Customers can make payments through cheques, debit cards, credit cards, internet banking, mobile banking and UPI without depending entirely on physical cash. Individuals can use these facilities to pay college fees, electricity bills, telephone bills, insurance premiums, shopping expenses and other regular payments. Businesses can also use banking facilities to make payments to suppliers, employees and service providers. Therefore, banking services make payment transactions more convenient, systematic and efficient.

5. Banking Services Provide Easy Access to Money

Banks provide customers with convenient ways to access their money whenever required, subject to the terms and conditions of their accounts. Customers can withdraw cash through bank branches and ATMs, while digital banking facilities allow them to check account balances, transfer funds and make payments from different locations. ATM services are particularly useful because customers can access cash without having to visit the bank branch during normal working hours. Mobile and internet banking further improve accessibility by allowing customers to manage many banking activities through electronic devices. Thus, banking services provide easy and convenient access to money.

6. Banking Services Provide Convenience

Banking services have made financial transactions easier and more convenient for customers. Earlier, customers had to visit a bank branch for many routine transactions. Today, the development of ATM, internet banking, mobile banking, UPI and card-based services enables customers to perform many banking activities from their homes, workplaces or other locations. Customers can check their account balance, transfer money, make payments and carry out other routine transactions with less time and effort. The availability of digital banking services has therefore reduced the need for frequent visits to bank branches and has made banking more accessible in everyday life.

7. Banking Services Support Financial Management

Banking services help individuals and businesses manage their financial resources in an organized manner. Customers can maintain bank accounts, monitor income and expenditure, save money regularly, make payments, transfer funds and repay loans through banking facilities. Bank statements and transaction records also help customers keep track of their financial activities. Different deposit accounts encourage saving, while credit facilities help customers meet planned financial requirements. By providing facilities for saving, spending, borrowing, transferring and monitoring money, banks support effective financial management and help individuals develop better financial habits.

3.4.2 MAJOR CATEGORIES OF BANKING SERVICES

For easy understanding, banking services can be broadly grouped into the following categories:

Category	Examples
Deposit Services	Savings Account, Current Account, Fixed Deposit, Recurring Deposit
Credit Services	Loans, Advances, Overdraft, Credit Facilities
Payment Services	UPI, Debit Card, Credit Card, Electronic Transfers
Cash Services	Cash Deposit, Cash Withdrawal, ATM
Digital Services	Internet Banking, Mobile Banking, App-Based Payments
Other Services	Locker Facility, Cheque Services, Fund Transfer

3.5 TRADITIONAL AND MODERN BANKING SERVICES

Banking has changed considerably with technological development.

Traditional Banking

Earlier, customers had to visit a bank branch for most transactions.

Examples:

- Depositing cash
- Withdrawing cash
- Updating passbook
- Obtaining a bank draft
- Transferring money
- Applying for loans

Modern Banking

Today, many banking activities can be performed through digital platforms.

Examples:

- Mobile banking
- Internet banking
- UPI payments
- ATM withdrawals
- Online fund transfers
- Digital account opening
- Online loan applications
- QR-code payments

3.6 EVOLUTION OF BANKING

The evolution of banking is a gradual process through which banking has developed from simple money-lending and deposit activities into a modern, technology-driven financial system. The development of banking has been closely associated with the growth of trade, commerce, industry, and economic activities.

1. Ancient Banking

The origin of banking can be traced back to ancient civilisations, where people began to deposit their valuables and borrow money for personal and business purposes. In ancient India,

moneylenders, merchants, and indigenous bankers played an important role in providing credit facilities. Instruments such as Hundi were used for making payments and transferring money from one place to another.

2. Medieval Banking

During the medieval period, the expansion of trade and commerce increased the need for organised financial services. Merchants and money changers gradually developed banking practices such as deposits, lending, money exchange, and bills of exchange. Banking institutions became increasingly important in facilitating domestic and international trade.

3. Development of Modern Banking

Modern banking emerged with the establishment of organised banking institutions. Banks began accepting deposits from the public and providing loans to individuals, traders, and businesses. They also performed important functions such as credit creation, payment services, money transfer, and financial intermediation. The establishment of central banks further strengthened the regulation and stability of the banking system.

4. Development of Banking in India

The modern banking system in India developed gradually during the colonial period with the establishment of several banking institutions. The Reserve Bank of India (RBI) was established in 1935 and became the central monetary authority of the country. The nationalisation of major commercial banks in 1969 and 1980 expanded banking services to rural and economically weaker sections of society. Banking sector reforms introduced after 1991 further promoted competition, efficiency, and technological advancement.

5. Computerisation of Banking

The introduction of computers brought significant changes to banking operations. Banks gradually replaced manual record-keeping with computerised systems, which improved the speed, accuracy, and efficiency of banking services. The introduction of Core Banking Solutions (CBS) enabled customers to access their accounts and conduct transactions from different branches of the same bank.

6. Electronic Banking

The development of electronic technology led to the introduction of Automated Teller Machines (ATMs), debit cards, credit cards, electronic fund transfers, and electronic clearing systems. These services reduced customers' dependence on physical bank branches and made banking transactions

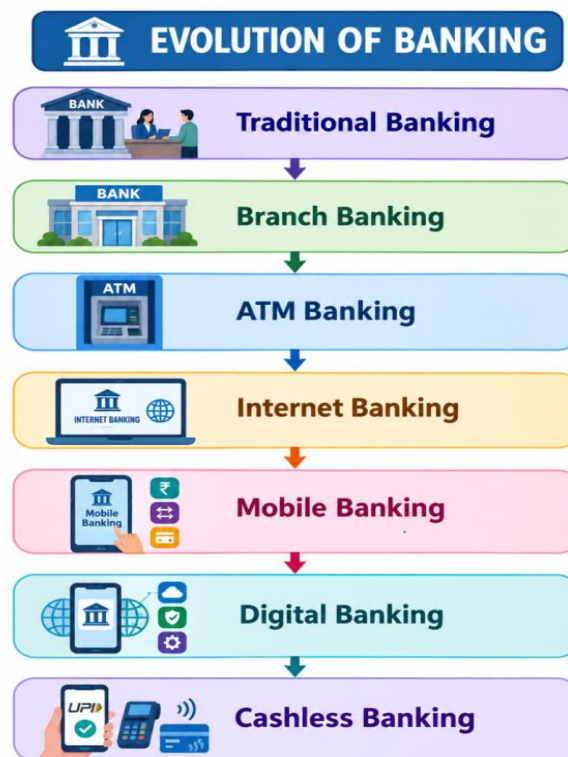
more convenient.

7. Internet and Mobile Banking

The growth of the internet transformed traditional banking into online banking. Customers could access their accounts, transfer funds, pay bills, and obtain banking information through internet-based platforms. The widespread use of smartphones further contributed to the growth of mobile banking, allowing customers to perform banking transactions anytime and anywhere.

8. Digital and Smart Banking

The present banking system is increasingly driven by digital technologies such as Artificial Intelligence, Machine Learning, Data Analytics, Blockchain, Biometrics, and Cloud Computing. In India, digital payment systems such as UPI have significantly transformed the way individuals and businesses make payments. Modern banks are increasingly focusing on personalised, secure, convenient, and data-driven financial services.



3.7 CLASSIFICATION OF BANKS

Banks perform different functions and serve different groups of customers. Therefore, all banks do not perform exactly the same activities. Some banks are responsible for controlling and

regulating the banking system, while others accept deposits, provide loans, support agriculture and rural development, promote industries, or provide specialized financial services. In India, banks can be broadly classified on the basis of their functions, ownership, area of operation and purpose. The major types of banks are explained below.

3.7.1 CENTRAL BANK

MEANING

A Central Bank is the apex monetary and banking institution of a country. It occupies the highest position in the country's banking structure and is responsible for regulating and supervising the monetary and banking system. In India, the central bank is the Reserve Bank of India (RBI). It was established in 1935 and plays a major role in maintaining monetary and financial stability. Unlike commercial banks, the central bank does not primarily operate to accept deposits and provide ordinary banking services to the general public. Its major responsibility is to regulate the banking system and manage monetary conditions in the economy.

MAJOR FUNCTIONS OF THE CENTRAL BANK

1. Issue of Currency:

The Reserve Bank of India has the authority to issue banknotes, subject to the provisions of law. Currency management is an important responsibility of the central bank.

2. Banker to the Government:

The central bank acts as a banker, agent and adviser to the government. It manages government banking transactions and performs various functions relating to public debt.

3. Banker's Bank:

The central bank serves as a banker to commercial banks. Banks maintain certain accounts and reserves with the central bank and can obtain assistance from it when required.

4. Controller of Credit:

The central bank uses monetary policy instruments to influence the availability and cost of credit in the economy.

5. Regulation and Supervision:

The central bank regulates and supervises various banking activities to promote the stability and orderly functioning of the banking system.

6. Foreign Exchange Management:

The central bank performs important functions relating to foreign exchange management and the foreign exchange market.

3.7.2 COMMERCIAL BANKS

Commercial banks are banking institutions that accept deposits from the public and provide loans and other banking services with the objective of conducting banking business. They play a major role in mobilizing savings and providing credit to individuals, businesses, industries and other organizations. Commercial banks are the banks with which people commonly interact for their everyday banking requirements.

Major Functions

Commercial banks perform two broad categories of activities:

A. Accepting Deposits

Commercial banks accept different types of deposits, such as:

- Savings deposits
- Current deposits
- Fixed deposits
- Recurring deposits

B. Providing Loans and Advances

Banks provide credit facilities for different purposes, such as:

- Housing
- Education
- Vehicles
- Agriculture
- Business
- Personal requirements
- Industrial activities

C. Providing Payment Services

Commercial banks facilitate payments through:

- Cheques
- Debit cards
- Credit cards

- UPI
- NEFT
- RTGS
- IMPS

D. Digital Banking

Modern commercial banks provide:

- Mobile banking
- Internet banking
- ATM facilities
- QR-based payments
- Online fund transfers

TYPES OF COMMERCIAL BANKS

Commercial banks can broadly include:

1. Public Sector Banks
2. Private Sector Banks
3. Foreign Banks

1. Public Sector Banks

These are banks in which the government has a significant ownership and control role.

Examples: State Bank of India, Punjab National Bank and Indian Bank.

2. Private Sector Banks

These are banks where private shareholders have a significant ownership role.

Examples: HDFC Bank, ICICI Bank and Axis Bank.

3. Foreign Banks

These are banks incorporated outside India but operating in India through permitted banking arrangements.

3.7.3 CO-OPERATIVE BANKS

Meaning

Co-operative banks are financial institutions organized on co-operative principles to provide banking and financial services to their members and other eligible customers. They play an important role in providing credit, particularly to agriculture, small businesses, rural communities and local economic activities. Co-operative banking is based on the principles of co-operation, mutual assistance and member participation.

Major Features

- Based on co-operative principles
- Member-oriented
- Provide deposits and credit facilities
- Support agriculture and small businesses
- Have an important role in rural and semi-urban areas

Types of Co-operative Banks

Co-operative banks may broadly be classified into:

1. Urban Co-operative Banks

These primarily operate in urban and semi-urban areas and serve individuals, small businesses and local communities.

2. Rural Co-operative Banks

These serve rural communities and are particularly associated with agricultural and rural credit.

3.7.4 Regional Rural Banks (RRBs)

Meaning

Regional Rural Banks (RRBs) are banking institutions established with a focus on providing banking and credit facilities in rural and semi-urban areas.

Their major purpose is to strengthen the rural banking system and improve access to formal financial services among rural communities. RRBs are particularly important for people engaged in:

- Agriculture
- Small businesses
- Rural occupations

- Small-scale industries
- Other productive rural activities

Major Functions

1. Agricultural Credit:

RRBs provide financial assistance to farmers for various agricultural requirements.

2. Rural Credit:

They provide credit to rural households and small economic activities.

3. Deposit Mobilization:

They encourage people in rural areas to save through formal banking channels.

4. Financial Inclusion:

RRBs help bring rural populations into the formal banking system.

5. Support for Rural Entrepreneurship:

They can provide credit facilities to eligible small entrepreneurs and rural businesses.

3.7.5 Development Banks

Meaning

Development banks are specialized financial institutions established to provide financial assistance for the development of particular sectors of the economy.

Unlike ordinary commercial banking, development banking focuses strongly on long-term development and productive investment. They may support sectors such as:

- Agriculture
- Industries
- Small and medium enterprises
- Infrastructure
- Entrepreneurship

Major Functions

1. Providing Long-Term Finance:

Development banks provide financial assistance for projects requiring substantial and relatively long-term funding.

2. Industrial Development:

They support the establishment and expansion of industries.

3. Agricultural Development:

Specialized institutions provide financial support for agriculture and rural development.

4. Entrepreneurship Development:

They encourage new enterprises by supporting eligible entrepreneurs.

5. Infrastructure Development:

Development-oriented financial institutions can support infrastructure and other productive projects.

Examples

- **NABARD** – Agriculture and rural development
- **SIDBI** – Micro, small and medium enterprises and small-business development

3.7.6 Payment Banks

Meaning

Payment Banks are specialized banks designed primarily to provide payment, remittance and deposit-related services, subject to the regulatory framework applicable to them.

They focus on making basic banking and payment services more accessible, particularly through digital and technology-enabled channels.

Payment banks can help customers with:

- Deposits within the permitted framework
- Money transfers
- Remittances
- Digital payments
- Debit card facilities
- Mobile-based banking services

3.7.7 Small Finance Banks

Meaning

Small Finance Banks (SFBs) are specialized banks established to promote financial inclusion by providing banking services to underserved and unserved sections of society.

They focus on customers such as:

- Small businesses
- Small and marginal farmers
- Micro and small enterprises
- Low-income households
- Other underserved groups

Major Functions

Small Finance Banks provide:

- Deposit facilities
- Loans
- Credit facilities
- Payment services
- Digital banking facilities

3.7.8 Foreign Banks

Meaning

Foreign banks are banks that are incorporated outside India but operate in India under the applicable laws and regulatory framework.

They provide banking and financial services to eligible customers and businesses.

Foreign banks can be particularly important in areas involving:

- International business
- Foreign exchange
- International trade
- Corporate banking
- Cross-border financial transactions

Importance

Foreign banks can facilitate international trade and investment by providing services related to foreign exchange and international financial transactions.

3.7.9 Scheduled and Non-Scheduled Banks

Banks may also be cl

assified according to their status under the applicable banking framework.

Scheduled Banks

Scheduled banks are banks included in the Second Schedule of the Reserve Bank of India Act, 1934, subject to the conditions prescribed under the Act.

They operate within the regulatory framework of the RBI and include various categories of banks.

Non-Scheduled Banks

Non-scheduled banks are banks that are not included in the Second Schedule of the Reserve Bank of India Act, 1934.

This classification is based on the bank's status under the relevant legal framework rather than simply on whether the bank is public or private.

3.8 CHARACTERISTICS OF BANKING SERVICES

Banking services have certain distinctive characteristics that differentiate them from ordinary goods and services. These characteristics arise because banking deals with money, financial transactions, customer relationships, technology, security and regulatory requirements. The major characteristics of banking services are explained below.

1. Financial in Nature

Banking services are primarily financial in nature because they are directly associated with money and the management of financial resources. Banks accept deposits, provide loans and advances, facilitate money transfers, process payments and offer various other financial facilities to customers. Unlike physical products, banking services deal with the creation, movement, saving and utilization of money. For example, when a customer deposits money in a savings account, obtains a housing loan or transfers money through a banking application, the transaction involves a financial service. Thus, banking services form an important part of the financial activities of individuals, businesses and institutions.

2. Customer-Oriented

Banking services are customer-oriented because banks design and provide their services according to the different financial requirements of their customers. The needs of a student, salaried employee, farmer, entrepreneur and large business organization may be different. Banks therefore offer different types of accounts, loans, cards, payment facilities and digital services to meet these varied requirements. Banks also provide customer support and guidance to help customers select

appropriate financial products. Customer satisfaction, trust and long-term relationships are important in banking because customers depend on banks for managing their money and meeting their financial needs. Thus, understanding customer requirements is an essential feature of banking services.

3. Continuous Service

Banking is a continuous service because customers require banking facilities regularly throughout the year. People deposit and withdraw money, receive income, make payments, transfer funds and manage their accounts on a regular basis. With the development of ATMs, internet banking and mobile banking, many banking services can be accessed beyond the traditional working hours of a bank branch. For example, customers can check their account balance, make digital payments or transfer funds using available electronic banking facilities. Businesses also depend on banking services for their daily financial transactions. Therefore, banking services are continuously required to support the financial activities of customers.

4. Technology-Based

Modern banking services are increasingly technology-based. Banks use computers, communication networks, mobile applications, digital platforms and electronic payment systems to provide faster and more efficient services. Customers can access many banking facilities through ATMs, internet banking, mobile banking, UPI, debit cards and credit cards without visiting a bank branch. Technology also helps banks maintain customer records, process transactions and provide timely information. The growth of digital banking has transformed the way customers interact with banks and conduct financial transactions. Thus, technology has become an important part of modern banking services.

5. Convenient

Banking services are designed to provide convenience to customers by reducing the time, effort and physical difficulties involved in financial transactions. Customers do not always need to visit a bank branch for routine activities. Through ATMs, internet banking and mobile banking, they can perform many transactions from their home, workplace or other convenient locations. Digital payment facilities also allow customers to make payments quickly without carrying physical cash. For example, a customer can transfer money or pay a bill through a mobile application within a

short period. Therefore, convenience is one of the major benefits of modern banking services.

6. Security-Oriented

Banking services are security-oriented because banks handle customers' money and confidential financial information. Banks adopt various security measures to protect accounts and transactions from unauthorized access, fraud and misuse. Customers may be required to use passwords, PINs, one-time passwords (OTPs), biometric authentication or other verification methods while accessing banking services. Banks also monitor transactions and follow appropriate security procedures to protect customer information and funds. Customers, in turn, must maintain the confidentiality of their PINs, passwords and other authentication details. Therefore, security is a fundamental requirement for maintaining customer confidence and trust in banking services.

7. Regulated

Banking services are regulated because banks deal with public money and play an important role in the financial system of the country. Banks have to operate within the legal and regulatory framework established by the relevant authorities. In India, the Reserve Bank of India (RBI) plays an important role in regulating and supervising the banking system. Banks are required to follow prescribed rules relating to areas such as customer identification, banking operations, lending, reporting and security. Regulation helps promote stability, transparency, discipline and public confidence in the banking system. Therefore, the regulated nature of banking services distinguishes them from many ordinary commercial services.

3.9 BANKING PRODUCTS AND SERVICES

Banks are important financial institutions that provide a wide range of products and services to individuals, businesses and other organizations. In the traditional banking system, the major activities of banks were accepting deposits and providing loans. With the development of technology and changing customer requirements, banks now offer a much wider range of products and services.

Banking products are mainly designed to help customers save money, borrow funds, make payments, transfer money and manage their financial resources. Banking services support customers in carrying out these activities safely, conveniently and efficiently.

Banking Products

Banking products are the financial products offered by banks to meet the saving, borrowing, investment and other financial requirements of customers.

Examples of banking products include:

- Savings Account
- Current Account
- Fixed Deposit
- Recurring Deposit
- Loans
- Advances
- Credit facilities
- Debit Cards
- Credit Cards

These products differ according to their purpose, duration, interest, eligibility and terms and conditions.

Banking Services

Banking services refer to the various facilities and activities provided by banks to customers for managing their financial transactions and requirements.

Examples include:

- Cash deposit and withdrawal
- Money transfer
- ATM services
- Internet banking
- Mobile banking
- UPI payments
- NEFT
- RTGS
- IMPS
- Cheque services
- Locker facilities

Thus, banking products represent the financial products offered by banks, while banking services refer to the facilities and activities through which customers use and manage these financial products.

3.9.1 CLASSIFICATION OF BANKING PRODUCTS AND SERVICES

Banking products and services can be broadly classified as follows:

1. Deposit Products

Deposit products are banking products through which customers keep their money with a bank. They help individuals and organizations save and manage their funds.

The major deposit products are:

a) Savings Account

A savings account is a bank account designed mainly for individuals to save money while allowing them to make regular transactions. It is suitable for students, salaried persons and other individuals.

Customers can generally:

- Deposit money
- Withdraw money
- Transfer funds
- Make digital payments
- Use debit cards
- Access internet and mobile banking

A savings account encourages the habit of regular saving.

b) Current Account

A current account is mainly suitable for businesses and customers who need to carry out frequent financial transactions. It facilitates regular deposits and withdrawals according to the applicable account terms.

Current accounts are particularly useful for:

- Business organizations
- Traders
- Firms
- Institutions

c) Fixed Deposit

A fixed deposit is a deposit in which a customer places a specified amount with the bank for a predetermined period at an applicable interest rate.

It is generally suitable for people who want to keep money aside for a specific period rather than use it for regular transactions.

d) Recurring Deposit

A recurring deposit enables a customer to deposit a fixed amount at regular intervals, usually monthly, for a specified period.

It is useful for individuals who want to develop a regular saving habit and accumulate a larger amount over time.

2. Credit Products

Banks provide credit facilities to individuals, businesses and other eligible customers. Credit products help customers meet financial requirements when their available funds are not sufficient.

a) Loans

A loan is an amount borrowed from a bank for a specific purpose and repaid according to agreed terms and conditions.

Common examples include:

- Education Loan
- Housing Loan
- Vehicle Loan
- Personal Loan
- Agricultural Loan
- Business Loan

b) Advances

Banks provide advances and other credit facilities to eligible customers for various personal and business requirements. The amount and terms depend on the nature of the facility and the customer's eligibility.

c) Credit Facilities

Credit facilities provide customers with access to funds subject to the conditions prescribed by the bank.

Businesses may use credit facilities to meet working-capital requirements, purchase resources or support business operations.

3. Payment Services

Banks provide various payment facilities that allow customers to make payments conveniently without depending entirely on physical cash.

Major payment services include:

a) UPI

Unified Payments Interface (UPI) enables customers to make digital payments and transfer money using supported applications and bank accounts.

b) Debit Card

A debit card enables customers to make payments or withdraw cash using funds available in their bank account, subject to applicable conditions.

c) Credit Card

A credit card provides a customer with access to a predetermined credit facility for eligible purchases and transactions. The customer is required to repay the amount according to the applicable terms.

d) Electronic Fund Transfer

Banks provide electronic methods for transferring money between bank accounts.

Important electronic transfer systems include:

- NEFT – National Electronic Funds Transfer
- RTGS – Real Time Gross Settlement
- IMPS – Immediate Payment Service

4. ATM Services

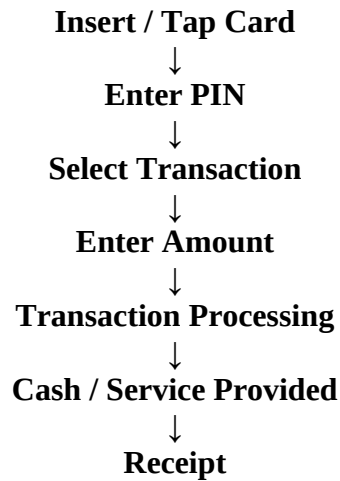
ATM (Automated Teller Machine) is an electronic banking facility that enables customers to perform certain banking transactions without visiting a bank counter.

Common ATM facilities include:

- Cash withdrawal
- Balance enquiry
- Mini statement

- PIN-related services
- Other permitted transactions

ATM Transaction Process



5. Internet Banking

Internet banking refers to banking services accessed through a bank's online platform using the internet.

Customers may be able to:

- Check account balances
- View transaction details
- Transfer funds
- Pay bills
- Download statements
- Manage certain account services

6. Mobile Banking

Mobile banking refers to banking services provided through a mobile device using a bank's mobile application or other permitted mobile-based facilities.

Customers can perform various banking activities through their mobile phones, such as:

- Checking account balance
- Viewing transactions

- Transferring funds
- Making payments
- Managing selected banking services

7. Cheque Services

A cheque is a written instruction given by an account holder to a bank to pay a specified amount according to the terms of the instrument.

Banks provide services relating to:

- Cheque deposits
- Cheque collection
- Cheque payments
- Account-related cheque facilities

8. Locker Services

Banks may provide safe deposit locker facilities to customers for keeping valuables and important items, subject to the bank's rules and availability.

Customers may use lockers for storing items such as:

- Important documents
- Jewellery
- Property-related documents
- Other permitted valuables

3.9.2 IMPORTANCE OF BANKING PRODUCTS AND SERVICES

Banking products and services are important for several reasons.

1. Encourage Savings

Deposit products encourage individuals to save money systematically.

2. Provide Credit

Loans and credit facilities help individuals and businesses meet their financial requirements.

3. Facilitate Payments

Digital payments, cards and electronic fund transfers make payments easier.

4. Promote Financial Management

Bank accounts and transaction records help customers monitor and manage their financial activities.

5. Save Time and Effort

ATM, internet banking and mobile banking reduce the need for frequent visits to bank branches.

6. Promote Digital Transactions

Modern banking products and services encourage electronic and cashless transactions.

7. Support Business Activities

Businesses depend on banking facilities for receiving payments, making payments, obtaining credit and managing funds.

8. Improve Financial Accessibility

Technology-enabled banking allows customers to access many financial services from different locations.

3.10 TYPES OF BANK DEPOSIT ACCOUNTS

A bank deposit account is an account maintained with a bank into which customers deposit money for saving, safekeeping and financial transactions. Banks offer different types of deposit accounts according to the needs, income pattern and transaction requirements of customers. The major deposit accounts are Savings Account, Current Account, Fixed Deposit Account and Recurring Deposit Account.

1. Savings Account

A Savings Account is a deposit account mainly designed for individuals to encourage the habit of saving money. Customers can deposit and withdraw money as permitted under the account terms and generally earn interest on the balance maintained. It is suitable for students, salaried persons, households and other individuals who need both savings and regular access to their money. Savings accounts are generally linked with facilities such as ATM/debit cards, internet banking, mobile banking and digital payments. Thus, a savings account provides a convenient way to save money while meeting routine financial needs.

2. Current Account

A Current Account is primarily designed for businesses, traders, firms and institutions that require frequent financial transactions. It generally permits regular deposits, withdrawals and transfers according to the applicable account conditions. Current accounts are particularly useful for

businesses because they facilitate the smooth movement of money for receiving customer payments and making payments to suppliers, employees and other parties. Interest is generally not paid on the balance in a current account, subject to the bank's applicable terms. Thus, a current account is mainly intended for convenient and frequent business transactions.

3. Fixed Deposit Account

A Fixed Deposit (FD) Account is a deposit account in which a customer places a specified amount with the bank for a predetermined period at an agreed or applicable rate of interest. The money is generally kept until the maturity date, although premature withdrawal may be permitted subject to the bank's rules and applicable conditions. Fixed deposits are suitable for customers who have surplus funds and wish to keep them invested for a specific period. The interest earned provides a return on the deposited amount. Thus, fixed deposits encourage planned saving and investment of surplus funds.

4. Recurring Deposit Account

A Recurring Deposit (RD) Account enables customers to deposit a fixed amount regularly, usually every month, for a predetermined period. It is particularly suitable for individuals who receive regular income and want to build a savings fund gradually rather than deposit a large amount at one time. The deposited amount earns interest according to the applicable bank terms, and the accumulated amount is generally paid at maturity. Recurring deposits help develop financial discipline and regular saving habits. They are useful for students, salaried persons and households planning for future financial requirements.

5. Savings Account for Students

A Student Savings Account is a type of savings facility designed to meet the banking requirements of students, subject to the bank's eligibility and account conditions. It encourages young people to develop the habit of saving and understand basic banking practices. Students can use such accounts for receiving scholarships or other permitted credits, making payments and accessing digital banking facilities. Depending on the bank and applicable rules, these accounts may offer simplified requirements or special features. Thus, student-oriented savings facilities help promote financial literacy and responsible money management among young people.

6. Salary Account

A Salary Account is generally opened by an employer with a bank for the purpose of crediting employees' salaries directly into their accounts. It provides employees with convenient access to

their salary through ATM/debit cards, internet banking and mobile banking facilities. The account may offer certain benefits depending on the bank and the employer's arrangement. Regular salary credits also make it easier for employees to manage their monthly income, payments and savings. Thus, salary accounts facilitate efficient and convenient electronic salary distribution.

7. Term Deposit Account

A Term Deposit refers to a deposit kept with a bank for a specified period under agreed terms. Fixed deposits are a common form of term deposit, where the customer invests a lump sum for a predetermined tenure. The customer receives the principal along with applicable interest according to the deposit terms at maturity. Term deposits are generally suitable for customers who do not require immediate access to their surplus funds. They provide an organized method of keeping money aside for a specific financial goal or period.

3.11 FORMALITIES TO OPEN VARIOUS TYPES OF BANK ACCOUNTS

Opening a bank account is the first step in establishing a formal banking relationship with a bank. The customer has to complete certain formalities prescribed by the bank and regulatory authorities. These formalities help the bank verify the identity and address of the customer and maintain proper records. The requirements may vary slightly depending on the type of account and the bank's rules.

1. General Formalities for Opening a Bank Account

The customer must approach the bank and select the appropriate type of account according to their needs. An account-opening form has to be filled in with personal details such as name, address, occupation and contact information. The customer must complete the applicable KYC requirements and submit the required documents. The bank verifies the details before opening the account. After successful verification, the account number and other banking facilities are provided.

2. KYC Requirements

Know Your Customer (KYC) is an important formal requirement for opening a bank account. The customer has to provide acceptable documents for identity and address verification as prescribed by the bank. The bank may also require recent photographs, PAN or applicable tax-related details and other information depending on the account. KYC helps banks prevent fraudulent transactions and misuse of banking facilities. Existing customers may also be required to update their KYC

details when applicable.

3. Savings Account – Formalities

To open a Savings Account, the customer has to complete the bank's account-opening form and provide the required KYC documents. The applicant normally provides identity, address and other required personal details along with a photograph, wherever applicable. The customer may have to deposit the minimum amount prescribed by the bank, if any. After verification, the bank opens the account and provides facilities such as passbook, debit card and digital banking. The exact requirements differ among banks and account variants.

4. Current Account – Formalities

A Current Account is generally opened by businesspersons, firms, companies, institutions and other customers requiring frequent transactions. The applicant has to submit the account-opening form and complete KYC requirements. Business entities may need to provide additional documents such as registration, partnership, incorporation, authorization or constitutional documents, as applicable. Details of proprietors, partners, directors or authorised signatories may also be verified. After satisfactory verification, the bank activates the account and provides the permitted transaction facilities.

5. Fixed Deposit Account – Formalities

For opening a Fixed Deposit Account, the customer first needs to have a banking relationship with the bank or complete the required customer identification formalities. The depositor provides the amount to be invested, the desired period and other necessary details. The bank records the applicable interest rate, maturity date and instructions regarding repayment or renewal. KYC requirements must be satisfied before the deposit is created. The bank issues a deposit receipt or provides an electronic record containing the important details of the fixed deposit.

6. Recurring Deposit Account – Formalities

To open a Recurring Deposit Account, the customer submits the prescribed application and completes the applicable KYC requirements. The depositor selects the monthly instalment amount and the period for which the deposit will be maintained. The customer must ensure that the instalment is paid regularly according to the terms of the account. The bank records the instalment schedule, interest rate and maturity details. On completion of the deposit period, the maturity

amount is paid according to the bank's terms and instructions.

7. Documents Generally Required

Banks generally require documents for establishing the customer's identity and address, along with other information prescribed for the particular account. A photograph and tax-related identification details may also be required where applicable. For business accounts, additional entity-related documents and authorisations may be necessary. For accounts opened in the name of minors, trusts, firms or other organisations, specific documents and declarations may be required. The exact document list depends on the bank, customer category and type of account.

8. Nomination Facility

The customer may register a nominee for eligible deposit accounts according to the applicable banking rules. Nomination enables the bank to identify the person entitled to receive the deposit proceeds in the event of the customer's death, subject to applicable law and procedures. The customer has to provide the nominee's required details in the prescribed form. The nominee can generally be changed during the period of the account by following the bank's procedure. Nomination provides convenience in the settlement of deposit claims.

9. Initial Deposit and Account Activation

Depending on the account type, the customer may be required to make an initial deposit as prescribed by the bank. Some account categories may have no minimum balance requirement, while others may prescribe a minimum balance. After completing the application, document verification and other formalities, the bank processes the account-opening request. Once approved, the account becomes operational according to the bank's procedures. The customer can then use the facilities permitted for that particular account.

10. Verification and Due Diligence by the Bank

After receiving the application and documents, the bank verifies the information provided by the customer. It checks the identity, address and other relevant details and performs the required due diligence. For business and institutional accounts, the bank may verify the legal status and authority of the persons operating the account. The bank may seek additional information whenever required. The account is opened only after the bank is satisfied with the prescribed requirements.

11. Special Formalities for Different Customers

Different categories of customers may require additional formalities while opening an account. A minor account may involve a guardian or other arrangements permitted by the bank. Partnership firms, companies, trusts and societies generally have to submit their constitutional and authorisation documents. Joint account holders must provide the required details and select the operating instructions. Non-resident customers and other special categories are subject to additional requirements applicable to them.

12. Selection of Account Operating Instructions

For joint accounts and certain organisational accounts, customers have to specify how the account will be operated. The bank may provide options such as operation by all holders jointly or by one or more authorised persons, depending on the account category. Authorised signatories must provide the required identification and signatures. The operating instructions determine who can conduct transactions on behalf of the account holder. Any subsequent change must be made according to the bank's prescribed procedure.

13. Issue of Banking Facilities

After the account is successfully opened, the bank may provide facilities according to the customer's eligibility and account type. These may include a passbook, cheque book, debit card, ATM facility, internet banking and mobile banking. The customer may have to separately register or activate certain digital services. The bank provides the necessary instructions for safe use of these facilities. Customers should carefully follow security procedures while using banking channels.

14. Important Precautions While Opening an Account

Customers should read the account terms, charges, interest conditions and service facilities before opening an account. They should provide only correct and complete information to the bank and should not share confidential banking credentials with anyone. The customer should verify the account number and other details after opening the account. Any change in address, mobile number or other important information should be updated with the bank. Proper precautions help maintain a safe and effective banking relationship.

Overall Procedure for Opening a Bank Account



3.12 KYC NORMS

Meaning

KYC means “Know Your Customer”. It refers to the procedure through which a bank obtains and verifies information about the identity and address of its customers. The customer is required to provide prescribed information and documents to establish their identity. KYC enables the bank to understand who its customers are and maintain proper records throughout the banking relationship.

Objectives of KYC

The main objective of KYC is to establish the true identity of a customer and prevent the misuse of banking facilities. It helps banks detect suspicious transactions, reduce financial fraud and prevent money laundering. KYC also supports compliance with applicable laws and regulatory requirements. Thus, KYC contributes to maintaining the integrity, transparency and security of the banking system.

Customer Identification

Customer identification is an important part of the KYC process. At the time of opening an account, the bank collects relevant details such as the customer's name, date of birth, address, occupation and contact information. The bank verifies these details using documents or permitted identification methods. Proper identification helps the bank establish that the account is being opened by the genuine customer.

Verification of Identity

Banks verify the identity of customers using officially accepted documents or other permitted KYC procedures. The document or information submitted should establish the customer's identity as required under applicable regulations. The bank checks the information provided and records the necessary details. Identity verification helps prevent impersonation, fictitious accounts and fraudulent use of banking services.

Verification of Address

Address verification is another important component of KYC. Customers may be required to provide an acceptable document or other permitted evidence relating to their address. The bank records and verifies the relevant address information according to its KYC procedure. Accurate address details enable the bank to maintain proper customer records and communicate important information when required.

Permanent Account Number (PAN)

PAN is an important tax-related identification detail used in banking and financial transactions where applicable. Customers may be required to provide their PAN or the prescribed alternative declaration, depending on the nature of the account and transaction. The bank records such information as required under applicable rules. PAN also helps in maintaining transparency in financial and tax-related transactions.

KYC Documents

Customers are required to submit documents or information prescribed by the bank and applicable regulations for KYC verification. These may include officially valid identity and address documents, PAN or applicable alternative documents, and photographs or other information where required. The exact documents may vary according to the customer and account type. Banks verify the documents before establishing or continuing the banking relationship.

Customer Due Diligence

Customer Due Diligence (CDD) refers to the process of identifying and verifying customers and understanding the nature of their banking relationship. Banks assess the customer and the associated risks according to applicable regulatory requirements. Appropriate due diligence helps banks identify unusual or suspicious activities. It is an important measure for preventing the misuse of banking channels.

Beneficial Owner Identification

In certain accounts, particularly those involving legal entities or arrangements, the bank needs to identify the **beneficial owner**. A beneficial owner is the individual who ultimately owns or controls the customer or has effective control over the relevant relationship. Identifying the beneficial owner prevents persons from hiding behind companies, firms or other legal structures. This strengthens transparency in financial transactions.

KYC for Different Types of Customers

KYC requirements may differ according to the category of customer. Individuals, joint account holders, minors, companies, partnership firms, trusts and other organisations may have different documentation and verification requirements. Business entities may need to submit documents relating to their legal status and authorised persons. The bank completes the appropriate KYC process based on the nature of the customer and account.

Periodic Updation of KYC

KYC information is not necessarily collected only once; it may need to be updated periodically according to applicable requirements and the customer's risk category. Customers should provide updated information when there is a change in relevant details. Banks may also request customers to submit updated documents or information when required. Regular updating helps banks maintain accurate and current customer records.

Risk-Based Approach

Banks follow a risk-based approach while applying KYC and customer due diligence requirements. Customers and accounts may be assessed according to factors such as the nature of the relationship, transactions and other relevant risk considerations. The level of monitoring and due diligence may vary according to the assessed risk. This approach enables banks to focus greater

attention on higher-risk relationships.

KYC and Prevention of Money Laundering

KYC plays an important role in preventing money laundering through the banking system. By identifying customers and monitoring transactions, banks can detect activities that may appear unusual or suspicious. Proper customer records assist banks and competent authorities in tracing financial transactions when legally required. Therefore, KYC is an important component of the broader framework for preventing financial crimes.

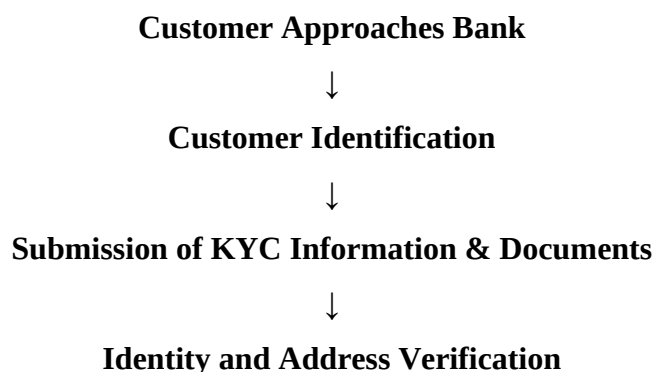
KYC and Safe Banking

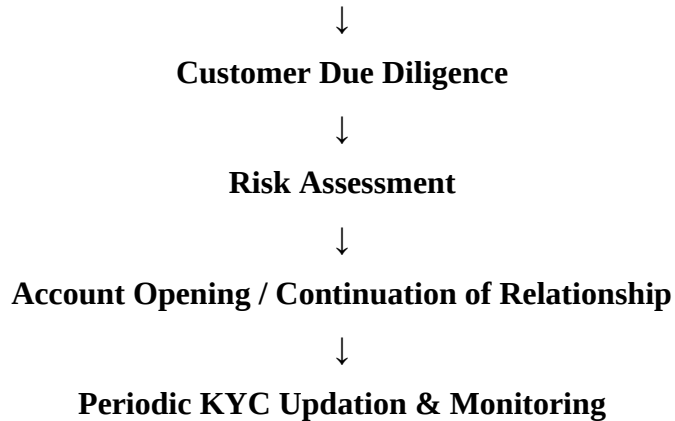
KYC contributes to the safety and reliability of banking operations by ensuring that accounts are linked to properly identified customers. It reduces the possibility of opening fictitious or fraudulent accounts and helps banks monitor unusual activity. Customers should provide genuine information and promptly update important changes. Banks must also protect customer information and follow applicable privacy and security requirements.

Importance of KYC Norms

KYC norms are important for maintaining a secure, transparent and trustworthy banking system. They help prevent identity fraud, money laundering, terrorist financing and other forms of financial misuse. KYC also enables banks to maintain reliable customer records and comply with regulatory requirements. Ultimately, effective KYC protects both the banking institution and genuine customers.

KYC Process – Simple Diagram





3.13 CASHLESS BANKING – ATM, DEBIT CARD AND CREDIT CARD

Cashless banking refers to conducting financial transactions without using physical cash. Customers can withdraw money, make payments, transfer funds and purchase goods and services through electronic banking instruments. ATM, Debit Card and Credit Card are important facilities that support cashless and convenient banking. These services reduce dependence on cash and provide customers with faster access to banking facilities.

3.13.1 ATM – Automated Teller Machine

An Automated Teller Machine (ATM) is an electronic banking machine that allows customers to perform selected banking transactions without visiting a bank branch. Customers can use an ATM with their debit or ATM card and Personal Identification Number (PIN). It mainly facilitates cash withdrawal, balance enquiry and other permitted services. ATMs are generally available beyond normal banking hours.

Features of ATM

ATMs provide round-the-clock access to selected banking services, subject to availability and bank rules. Customers can withdraw cash, check account balances and obtain transaction information. Many ATMs also provide services such as cash deposit, PIN change and fund transfer, depending on the machine and bank. Transactions are generally authenticated using a card and PIN or other permitted methods.

Advantages of ATM

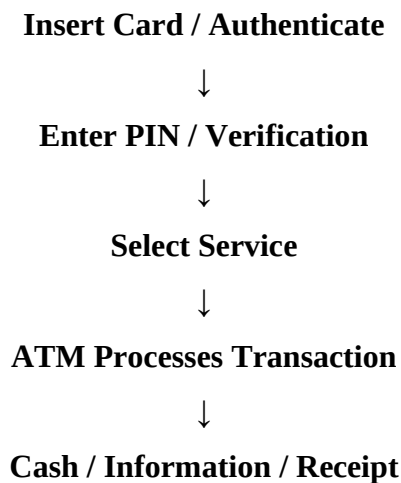
ATMs provide convenient access to cash without requiring customers to visit a bank branch. They save time by enabling transactions quickly and are available beyond regular branch working hours. Customers can use ATMs at different locations, subject to applicable network and bank conditions.

They are particularly useful during emergencies and outside normal banking hours.

Disadvantages of ATM

ATM transactions may be affected by machine failure, network problems or insufficient cash availability. Certain transactions may attract charges depending on the bank, account and applicable limits. Customers may also face security risks if they disclose their PIN or use an unsafe ATM. Card retention, fraudulent transactions and technical errors can create inconvenience.

ATM – Simple Diagram



3.13.2 Debit Card

A Debit Card is a payment card linked directly to the customer's bank account. It enables the customer to make payments or withdraw cash using the funds available in the linked account. When a transaction is successfully completed, the amount is generally deducted from the customer's account. Debit cards can be used at ATMs, Point-of-Sale (POS) terminals and online platforms, subject to applicable facilities and limits.

Features of Debit Card

A debit card is linked to a bank account and can be used for cash withdrawal and electronic payments. It may be used at ATMs, shops, online websites and other authorised payment channels. Transactions are generally protected through PIN, authentication or other security mechanisms. Debit cards may have daily or transaction-wise limits prescribed by the bank.

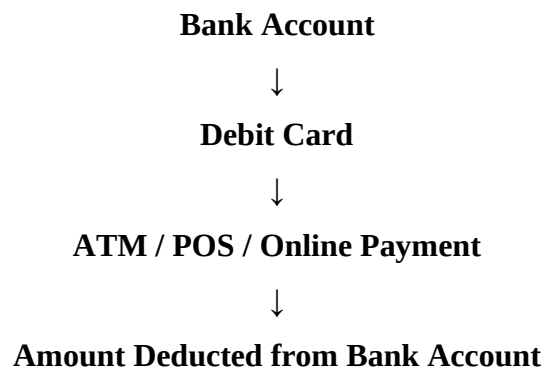
Advantages of Debit Card

Debit cards allow customers to make cashless payments without carrying physical currency. Since payments are made from the linked bank account, customers can generally spend only the available balance, subject to applicable overdraft or other arrangements. They provide convenient access to ATM withdrawals and digital purchases. Debit cards are widely accepted for everyday transactions.

Disadvantages of Debit Card

Debit card transactions depend on the availability of sufficient funds in the linked account, subject to applicable arrangements. Lost or stolen cards may create a risk of unauthorised transactions if security credentials are compromised. Some transactions or services may involve charges depending on the bank and applicable rules. Technical failures, network problems or merchant acceptance issues may also affect transactions.

Debit Card – Simple Diagram



3.13.3 Credit Card

A Credit Card is a payment instrument issued by a bank or authorised financial institution that allows an eligible customer to make purchases using a predetermined credit limit. Unlike a debit card, the payment is made using credit provided to the cardholder rather than directly from the available bank-account balance. The customer is required to repay the amount according to the card terms and billing cycle. Interest and other charges may apply when applicable.

Features of Credit Card

A credit card provides a predetermined credit limit based on the issuer's assessment and applicable policies. It can be used for purchases at POS terminals, online platforms and other authorised

locations. Transactions are accumulated and presented in a periodic statement for payment. Credit cards may provide features such as reward programmes, offers and instalment facilities, depending on the issuer and card type.

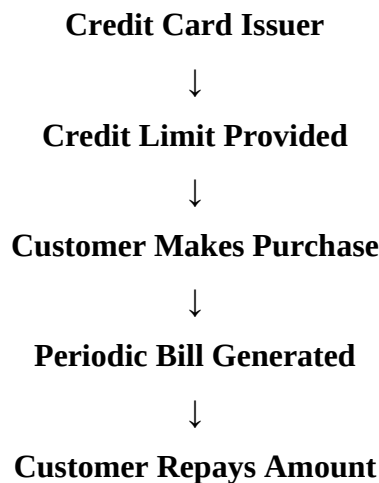
Advantages of Credit Card

Credit cards provide customers with convenient access to short-term credit for eligible purchases. They reduce the need to carry cash and are useful for online and emergency transactions. Timely repayment can help customers maintain a good credit history, subject to the applicable credit-reporting system. Some cards may also provide rewards, discounts, cashback or other benefits according to their terms.

Disadvantages of Credit Card

Credit cards can encourage excessive spending because customers are using a credit facility rather than immediately available funds. Interest and other charges may become costly when dues are not paid according to the agreed terms. Failure to repay on time can adversely affect the customer's credit history and may result in additional charges. Fraudulent transactions and misuse of card details are also potential risks.

Credit Card – Simple Diagram



Difference Between ATM, Debit Card and Credit Card

Basis	ATM	Debit Card	Credit Card
Purpose	Mainly provides ATM-based banking services	Payments and withdrawals using linked account funds	Payments using an approved credit limit
Source of	Customer's bank account	Customer's bank account	Credit provided by card

Money	for withdrawals		issuer
Main Use	Cash withdrawal and selected banking services	Cashless payments and ATM withdrawals	Purchases and other permitted credit-card transactions
Repayment	Not applicable for normal withdrawals	No separate repayment; account is debited	Customer must repay the billed amount
Interest	Normally not applicable to ordinary ATM withdrawal	Normally not applicable to ordinary debit transactions	May apply to unpaid amounts according to terms
Credit Limit	Not applicable	Generally based on available account balance and applicable limits	Predetermined credit limit
Major Risk	ATM fraud and technical problems	Unauthorised transactions and card misuse	Overspending, debt and interest charges

3.14 APP-BASED PAYMENT SYSTEM:

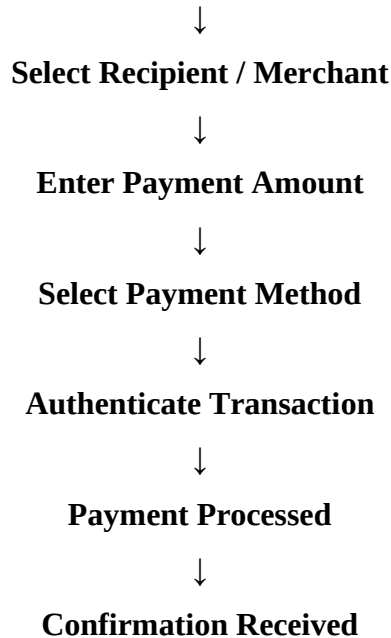
An App-Based Payment System is a digital payment facility that enables customers to send, receive and make payments through applications installed on smartphones or other supported devices. It has become an important part of modern cashless banking by providing fast and convenient payment services. Customers can use payment applications for shopping, bill payments, fund transfers and other transactions. These systems reduce dependence on physical cash and support the growth of digital banking.

Working of App-Based Payment System

The customer first downloads and registers with a suitable payment application using the required details. The bank account, card or other permitted payment facility is then linked according to the application's procedure. To make a payment, the customer selects the recipient or merchant and enters the amount. After authentication through a PIN, OTP or other permitted method, the transaction is processed electronically and confirmation is displayed.

Simple Working Diagram

Open Payment App



Features of App-Based Payment System

App-based payment systems provide convenient digital access to payment services through smartphones. They support different types of transactions such as person-to-person payments, merchant payments, bill payments and fund transfers. Many applications provide transaction history and instant notifications. Security features such as authentication, device verification and transaction limits are commonly used to protect users.

Types of App-Based Payments

App-based payments can include **person-to-person payments**, where money is transferred from one individual to another, and **merchant payments**, where customers pay businesses electronically. They may also support utility bill payments, mobile recharges, online purchases, ticket bookings and other services. Depending on the application, payments may be made through UPI, debit cards, credit cards, bank accounts or other permitted methods.

UPI-Based App Payments

The **Unified Payments Interface (UPI)** enables customers to make instant digital payments through participating banking and payment applications. Users can generally make payments using a UPI ID, QR code or other supported methods. UPI-based applications can facilitate both person-

to-person and merchant transactions. This has made smartphone-based payments simple and widely accessible.

QR Code Payments

QR code payment is an important feature of many app-based payment systems. The customer opens the payment application and scans the QR code displayed by the merchant. The merchant details are displayed, after which the customer enters the amount and authenticates the payment. QR payments reduce the need for cash and are particularly convenient for small-value everyday transactions.

Mobile Wallet Payments

A mobile wallet is a digital facility that can store payment value or payment credentials according to the applicable system. Customers can use the wallet application to make eligible purchases and payments. Wallet-based systems may be used for shopping, recharges, bill payments and other permitted services. The availability and features of wallet services depend on the provider and applicable regulations.

Advantages of App-Based Payment System

App-based payments provide **speed, convenience and accessibility** because transactions can be initiated from a smartphone without visiting a bank branch. They reduce the need to carry physical cash and provide digital records of transactions. Customers can make payments at any time, subject to service availability. They are also useful for online shopping, bill payments and everyday merchant transactions.

1. Convenience and Accessibility

One of the major advantages of app-based payments is that banking and payment facilities can be accessed through a smartphone. Customers can make payments while travelling, shopping or performing routine activities. Small businesses can also accept digital payments without depending entirely on cash transactions. This convenience supports greater adoption of cashless banking.

2. Faster Transactions

App-based payment systems enable many transactions to be completed within a short period.

Customers can transfer funds or make merchant payments without physically visiting a bank or payment counter. Digital confirmation is generally generated after a successful transaction. Faster payment processing saves time for both customers and businesses.

3. Digital Record Keeping

App-based payment systems normally maintain a record of transactions carried out through the application. Customers can review payment history, transaction status and other available details. Digital records help customers monitor their spending and identify transactions when necessary. They can also reduce dependence on physical receipts for certain transactions.

4. Supports Cashless Economy

App-based payments contribute to the development of a cashless economy by encouraging electronic transactions. Customers and businesses can conduct payments without exchanging physical currency. Greater use of digital payments can improve transaction efficiency and promote formal financial activities. It also supports the wider adoption of digital banking services.

Disadvantages of App-Based Payment System

App-based payment systems depend on smartphones, internet connectivity, electricity and supporting digital infrastructure. Network failure or application-related technical problems may delay transactions. Users who are unfamiliar with digital technology may find some processes difficult. There are also risks associated with fraudulent applications, phishing, social engineering and unauthorised access.

Security Risks

Security is an important concern in app-based payments because transactions are conducted digitally. Customers may become victims of phishing, fake payment links, fraudulent QR codes or social-engineering attacks. Sharing OTPs, UPI PINs, passwords or other confidential information can increase the risk of financial loss. Therefore, users must use only trusted applications and follow safe digital banking practices.

1. Importance of Authentication

Authentication ensures that the payment is authorised by the genuine user. Depending on the payment system, authentication may involve a UPI PIN, password, OTP, biometric verification or device-based security. Customers should never disclose confidential authentication information to another person. Strong authentication helps reduce the risk of unauthorised transactions.

2. Role in Business Transactions

App-based payment systems are useful for businesses because they enable customers to make payments electronically. Small shops, service providers and other businesses can accept digital payments through QR codes or other supported methods. Digital transaction records can also make payment tracking easier. Thus, app-based payments support faster collection of money and greater convenience for businesses.

3. Role in Financial Inclusion

App-based payment systems can improve access to formal financial services for people who have smartphones and suitable banking or payment facilities. Customers can make payments and transfer money without frequently visiting bank branches. Digital payment facilities can be particularly useful in areas where physical banking access is limited. However, effective financial inclusion also requires digital literacy, connectivity and awareness.

4. Safety Measures for App-Based Payments

Users should download payment applications only from trusted and official sources and keep their mobile operating system and applications updated. They should never share UPI PINs, passwords, OTPs or card security details with anyone. Payment requests should be checked carefully before approval, especially when using QR codes or payment links. Customers should immediately report suspicious or unauthorised transactions to the concerned bank or payment service provider.

CHAPTER 4: POST OFFICE FINANCIAL SERVICES

4.1 INTRODUCTION TO POST OFFICE FINANCIAL SERVICES

MEANING

Post Office Financial Services refer to the wide range of savings, investment, and deposit schemes offered by the Department of Posts, Government of India, through its extensive network of post offices, with the objective of promoting the habit of saving among citizens and extending banking-like facilities to every part of the country.

IMPORTANCE OF POST OFFICE FINANCIAL SERVICES

1. Post offices are present in almost every village, tehsil, and small town across India, which makes these financial services accessible even in areas where commercial banks have not established branches.
2. Since every post office scheme carries a sovereign guarantee from the Government of India, the risk of losing invested money is virtually eliminated, which makes these schemes particularly suitable for risk-averse investors.
3. These schemes cater to almost every stage of a person's financial life, ranging from a savings account for a small child to a monthly income scheme for a retired senior citizen.
4. Post office schemes play a significant role in mobilising domestic savings, which the government subsequently uses to finance various developmental and welfare programmes.
5. The minimum investment required to open most of these accounts is very small, which allows even low-income individuals and daily-wage earners to participate in formal saving.
6. These schemes promote financial inclusion by bringing unbanked and underbanked populations, particularly in rural areas, into the fold of formal financial services.
7. Many post office schemes offer tax benefits under the Income Tax Act, which makes them useful not only as savings instruments but also as tools for tax planning.
8. The simple procedures and minimal documentation required to open these accounts make them accessible even to individuals with limited financial literacy.

4.2 POST OFFICE SAVINGS BANK (POSB) ACCOUNT

MEANING

The Post Office Savings Bank Account is a basic deposit account offered by the Department of Posts that allows individuals to deposit and withdraw money safely while earning a modest rate of interest, in a manner similar to a savings account maintained with a commercial bank.

FEATURES

1. The account can be opened individually by a single person, jointly by two adults, or on behalf of a minor by a guardian.
2. The account holder is provided with a passbook, a cheque book, and, in most branches, an ATM-cum-debit card that can be used for cash withdrawals.
3. Interest on the account is calculated on the minimum balance maintained between the tenth day and the last day of every month, and it is credited to the account once a year.
4. Interest income earned up to ten thousand rupees in a financial year is exempt from tax under Section 80TTA of the Income Tax Act.
5. A nomination facility is available, which ensures that the balance in the account is transferred smoothly to the nominee in the event of the account holder's death.
6. The Basic Savings Account variant allows a depositor to open and maintain the account without keeping any minimum balance.
7. Funds in the account can be transferred electronically through internet banking and mobile banking facilities offered by India Post Payments Bank.
8. The account can be linked to various government welfare schemes for the direct transfer of subsidies and benefits.

ELIGIBILITY

- The Post Office Savings Bank account is available to individuals who are eligible to open a savings account under the Post Office rules.
- Minors can also be eligible to hold a Post Office Savings Bank account, subject to the conditions prescribed for minors.
- A minor above the prescribed age may be permitted to operate the account independently according to the applicable rules.

- A minor below the prescribed age can hold an account through a parent or guardian.
- The account is available to individual and joint account holders, subject to the eligibility conditions prescribed under the scheme.

PROCEDURE TO OPEN THE ACCOUNT

1. The applicant must first visit the nearest post office and collect the prescribed account-opening form.
2. The applicant must then submit valid Know Your Customer documents, which include proof of identity, proof of address, and a recent passport-size photograph.
3. The applicant is required to deposit the minimum initial amount, if applicable, at the time of opening the account.
4. The applicant should complete and submit the nomination form so that a nominee is recorded against the account.
5. Once the formalities are completed, the post office issues a passbook, which serves as the official record of all deposits and withdrawals made in the account.

ADVANTAGES

High Liquidity

The Post Office Savings Bank Account provides a high degree of liquidity because the depositor can withdraw money whenever required without giving prior notice. This makes the account suitable for individuals who need regular access to their savings.

Safety of Investment

The account is backed by the Government of India. Therefore, it provides a high level of safety and carries virtually no risk of default. This makes the account suitable for individuals who prefer secure savings options.

Wide Accessibility

The extensive network of post offices makes the account accessible to people living in remote and rural areas. Individuals can use the financial services even in places where commercial banks may not have branches.

Simple Documentation

The account requires minimum documentation and has a low entry barrier. Therefore, it is suitable for first-time savers and individuals who may have limited financial experience.

Encourages Regular Saving

The account encourages individuals to develop the habit of saving regularly. It provides a simple and convenient method through which people from different sections of society can keep their money safely.

Suitable for Low-Income Groups

The account can be opened with a small initial deposit. Therefore, it is affordable and accessible to individuals belonging to low-income groups.

LIMITATIONS

Low Rate of Interest

The rate of interest offered on a Post Office Savings Bank Account is relatively low when compared with certain long-term investment options. Therefore, individuals seeking higher returns may find the account less attractive.

Limited Digital Facilities

The digital banking facilities available through the account are comparatively limited when compared with the extensive digital facilities offered by many private sector banks. This may reduce convenience for customers who prefer fully digital banking services.

Not Suitable for Wealth Creation

The account is primarily designed for safe savings and liquidity rather than long-term wealth creation. Therefore, it may not be suitable for individuals who are looking for substantial capital appreciation over a long period.

4.3 RECURRING DEPOSIT (RD) ACCOUNT

MEANING

A Recurring Deposit Account is a savings scheme that enables a depositor to invest a fixed sum of money every month over a specified period, generally five years, so that the depositor accumulates a lump sum amount along with compound interest at the time of maturity.

FEATURES

1. The minimum monthly deposit required to open and maintain this account is one hundred rupees, and further deposits must be made in multiples of ten rupees, with no upper limit prescribed.
2. The account has a fixed tenure of five years, and it can be extended in further blocks of five years once the original term is completed.
3. The interest earned on the deposited amount is compounded on a quarterly basis, which increases the effective yield over the tenure of the account.
4. A depositor who has paid at least twelve regular monthly instalments becomes eligible to take a loan of up to fifty per cent of the balance standing in the account.
5. The account holder is permitted to close the account prematurely after a minimum period of three years, although this results in a reduced rate of interest being paid.
6. The account can be opened either in cash at the post office counter or through standing instructions linked to a savings account for automatic monthly debit.
7. A rebate is often allowed if the depositor chooses to pay several months of instalments in advance at the time of opening the account.
8. A penalty is charged for each delayed or missed monthly instalment, which is deducted from the maturity value of the account.

ELIGIBILITY

- The Recurring Deposit scheme is available to eligible individual account holders who wish to maintain an RD account.
- Adults are eligible to open a Recurring Deposit account in their own name.
- The scheme also permits joint account holders to open an account subject to the applicable rules.
- Minors are eligible to have a Recurring Deposit account through their parent or legal guardian.
- The eligibility of minors and other account holders is subject to the conditions prescribed under the Post Office RD scheme.

PROCEDURE TO OPEN THE ACCOUNT

1. The depositor must first fill in the prescribed Recurring Deposit account-opening form available at the post office.
2. The depositor must then submit the required Know Your Customer documents along with the form.
3. The depositor is required to deposit the first monthly instalment at the time of opening the account.
4. The depositor must continue to deposit the same fixed amount every month, either in cash or through an automatic debit instruction, until the account reaches maturity.

ADVANTAGES

Encourages Disciplined Saving

The Recurring Deposit scheme encourages disciplined and regular saving because the depositor is required to contribute a fixed amount every month. It is especially useful for people who cannot invest a large amount of money at one time.

Suitable for Regular Income Earners

The scheme is suitable for individuals who receive a limited but steady monthly income. Salaried employees and small traders can regularly set aside a fixed amount from their income.

Safety of Investment

The scheme is backed by the government and provides a high level of safety. Therefore, it is suitable for individuals who prefer secure investment options rather than high-risk market-linked investments.

Loan Facility

The loan facility available under the scheme provides liquidity during emergencies. A depositor can obtain a loan against the balance after satisfying the prescribed conditions without immediately closing the account.

Useful for Financial Goals

The scheme is useful for achieving short-term and medium-term financial goals. Regular monthly savings can be accumulated for purposes such as meeting family-function expenses or paying a child's admission fees.

LIMITATIONS

Penalty for Delayed Instalments

A penalty is imposed when the depositor fails to pay the monthly instalment on time. Such penalties reduce the overall return received from the account.

Lower Return on Premature Withdrawal

When the account is closed before maturity, the depositor receives interest at a lower rate. Therefore, premature withdrawal can reduce the expected return.

Lower Returns Compared with Market-Linked Investments

The returns offered by the Recurring Deposit scheme may be lower than the potential returns available from market-linked instruments such as mutual funds and equity shares.

4.4 TERM DEPOSIT (TD) ACCOUNT

MEANING

A Term Deposit Account, which is also commonly known as a post office fixed deposit, is a scheme under which a depositor invests a lump sum of money for a fixed period ranging from one year to five years and earns a predetermined rate of interest on the amount invested.

FEATURES

1. The minimum amount required to open a Term Deposit Account is one thousand rupees, and any amount above this must be deposited in multiples of one hundred rupees, with no maximum limit prescribed.
2. The depositor may choose from four tenure options, namely one year, two years, three years, and five years, depending on individual financial needs.
3. The interest on the deposit is calculated every quarter, although it is actually paid out to the depositor on an annual basis.
4. The five-year Term Deposit is eligible for a deduction under Section 80C of the Income Tax Act, subject to the overall limit prescribed under that section.
5. Premature withdrawal of the deposit is permitted only after a minimum period of six months has elapsed from the date of deposit.
6. The rate of interest offered generally increases with the length of the tenure selected by the depositor.

7. The interest earned on the deposit, except in the case of the five-year deposit's principal, is fully taxable in the hands of the depositor.
8. The depositor has the option to reinvest the maturity proceeds into a fresh Term Deposit Account for a further period.

ELIGIBILITY

- A Term Deposit account is available to eligible individual investors under the Post Office savings scheme.
- Adults are eligible to open a Term Deposit account in their own name.
- Joint account holders are also eligible to open a Term Deposit account subject to the prescribed conditions.
- Minors can be eligible to hold a Term Deposit account through a parent or legal guardian.
- The account can therefore be held by individuals, joint holders, or eligible minors through their guardians, according to the applicable rules.

PROCEDURE TO OPEN THE ACCOUNT

1. The applicant must select the desired tenure and complete the prescribed account-opening form.
2. The applicant must submit the required Know Your Customer documents along with the application.
3. The applicant is required to deposit the entire lump sum amount at the time of opening the account.
4. The post office then issues a passbook or certificate that confirms the deposit amount, the applicable rate of interest, and the date of maturity.

Advantages

Fixed and Assured Returns

The Term Deposit provides fixed and assured returns throughout the selected tenure. Since the rate is predetermined, the depositor can estimate the expected return in advance.

Tax Benefit

The five-year Term Deposit provides a tax benefit under Section 80C, subject to the prescribed overall limit. Therefore, it can be useful for individuals who want to combine investment with tax planning.

High Safety

The scheme is backed by the Government of India and therefore provides a high degree of safety. It is suitable for individuals who do not want to take substantial investment risk.

Suitable for Lump-Sum Investment

The scheme is particularly suitable for individuals who have a lump sum amount and want to invest it in a low-risk instrument for a predetermined period.

LIMITATIONS

Penalty or Reduced Interest on Premature Withdrawal

Premature withdrawal results in the depositor receiving a lower rate of interest. Therefore, investors who may require their money before maturity may find the scheme less suitable.

Inflation Risk

The returns may not always be sufficient to keep pace with inflation over a long period. As a result, the real purchasing power of the returns may be affected.

Limited Liquidity

The Term Deposit is less flexible than a savings account because the money is invested for a fixed period. Accessing the money before maturity may result in reduced interest.

4.5 MONTHLY INCOME SCHEME (MIS)

MEANING

The Monthly Income Scheme is a post office savings instrument that provides depositors with a fixed monthly income on a lump-sum investment made for a period of five years, and it is particularly suitable for retired individuals who require a regular and predictable source of income.

FEATURES

1. The maximum amount that can be invested under this scheme is nine lakh rupees in an individual account and fifteen lakh rupees in a joint account held by up to three adults.
2. The minimum amount required to open the account is one thousand rupees.

3. The scheme has a fixed tenure of five years, at the end of which the original invested amount is returned to the depositor.
4. The interest earned under this scheme is paid out every month and is credited directly to a Post Office Savings Bank Account linked to the Monthly Income Scheme account.
5. No deduction is available under Section 80C or under any other section of the Income Tax Act for the amount invested in this scheme.
6. No tax is deducted at source by the post office on the monthly interest that is paid to the depositor.
7. A bonus was earlier paid on maturity under this scheme, although this feature has since been discontinued by the government.

ELIGIBILITY

- The Monthly Income Scheme is available to eligible individual investors under the Post Office savings framework.
- An individual adult can be eligible to open an MIS account in his or her own name.
- Joint holders are also eligible to open an MIS account according to the prescribed conditions.
- A minor can also be eligible to have an MIS account through a parent or legal guardian.
- Eligibility is subject to the conditions prescribed for individual, joint and minor accounts under the Monthly Income Scheme.

PROCEDURE TO OPEN THE ACCOUNT

1. The applicant must complete the prescribed Monthly Income Scheme account-opening form.
2. The applicant must submit the required Know Your Customer documents, along with the details of a linked Post Office Savings Bank Account.
3. The applicant is required to deposit the lump-sum amount at the time of opening the account.
4. The monthly interest is thereafter credited automatically to the linked savings account on a regular basis.

ADVANTAGES

Regular Monthly Income

The Monthly Income Scheme provides a steady and predictable source of income throughout the tenure. This makes it useful for individuals who need regular financial support.

Suitable for Retired Persons

The scheme is particularly beneficial to retired persons and individuals who do not have regular salary or business income. The monthly interest can be used to meet routine household and personal expenses.

Safety of Principal

Since the scheme is backed by the government, the principal amount invested is highly secure. This makes the scheme suitable for individuals who prefer safety over high-risk investment opportunities.

No Tax Deduction at Source

The post office does not deduct tax at source from the monthly interest paid under the scheme. Therefore, the depositor receives the full monthly interest amount, subject to the depositor's overall tax liability.

LIMITATIONS

Taxable Interest

The interest earned under the Monthly Income Scheme is fully taxable in the hands of the depositor. Therefore, the depositor must consider the tax liability while evaluating the actual return.

No Section 80C Deduction

The amount invested under this scheme does not qualify for a deduction under Section 80C. Therefore, the scheme does not provide an investment-linked tax deduction.

Restriction on Early Withdrawal

Withdrawal before completion of one year from the date of deposit is not permitted. This restriction reduces the liquidity available to the depositor during the initial period.

Penalty on Early Withdrawal

Withdrawal between one year and three years from the date of deposit attracts a penalty on the principal amount. Therefore, premature withdrawal may reduce the amount ultimately received by the depositor.

4.6 KISAN VIKAS PATRA (KVP)

MEANING

Kisan Vikas Patra is a certificate-based savings scheme offered by the post office under which the amount invested by the depositor doubles over a specified period, which is currently fixed at approximately one hundred and fifteen months.

FEATURES

1. The minimum amount required to purchase a Kisan Vikas Patra certificate is one thousand rupees, and there is no maximum limit prescribed on the amount that can be invested.
2. The certificate is available in various denominations, which makes it accessible even to small investors with limited savings.
3. The certificate can be transferred from one person to another, and it can also be transferred from one post office to another, subject to the completion of certain formalities.
4. The certificate may be purchased by an individual in their own name, jointly by two or three adults, or by a guardian on behalf of a minor.
5. Premature encashment of the certificate is permitted only after a minimum lock-in period of two and a half years, or thirty months, from the date of issue.
6. The certificate can be used as security while applying for a loan from a bank or other financial institution.
7. In the event of the death of the certificate holder, the certificate can be encashed prematurely by the nominee or legal heir before the completion of the lock-in period.

ELIGIBILITY

- Kisan Vikas Patra is available to eligible resident Indian individuals.
- An adult individual can purchase Kisan Vikas Patra in his or her own name.
- Joint holders are also eligible to invest in Kisan Vikas Patra under the prescribed conditions.

- A minor can be eligible to hold Kisan Vikas Patra through a parent or legal guardian.
- Thus, the scheme provides eligibility to individuals, joint holders and eligible minors through guardians, subject to the applicable rules.

PROCEDURE TO OPEN THE ACCOUNT

1. The applicant must fill in the prescribed Kisan Vikas Patra purchase application form at the post office.
2. The applicant must submit the required Know Your Customer documents along with the application form.
3. The applicant is required to deposit the desired amount in cash, by cheque, or by demand draft.
4. The post office then issues a certificate that clearly specifies the amount invested, the date of maturity, and the maturity value.

ADVANTAGES

Simple and Easy to Understand

Kisan Vikas Patra is a simple savings instrument because the investor can clearly understand the maturity value and the basic nature of the investment. This makes it suitable even for individuals with limited financial literacy.

Doubling of Investment

The scheme provides a clearly defined maturity benefit in which the invested amount doubles after the specified period. This makes the expected return easy for investors to understand and calculate.

Transferability

The certificate can be transferred from one person to another and from one post office to another, subject to prescribed formalities. This provides a certain degree of flexibility to the investor.

Safety

Kisan Vikas Patra is backed by a sovereign guarantee from the Government of India. Therefore, it provides a high level of safety and is suitable for risk-averse investors.

LIMITATIONS

No Section 80C Deduction

The amount invested in Kisan Vikas Patra does not qualify for deduction under Section 80C. Therefore, it does not provide the tax-saving benefit associated with certain other investment schemes.

Taxable Interest

The interest earned under the scheme is fully taxable. Therefore, the actual return received after considering the investor's tax liability may be lower than the nominal return.

Long Lock-in Period

The lock-in period of two and a half years restricts the liquidity of the investment. Investors who may need immediate access to their money may find this limitation significant.

4.7 SENIOR CITIZEN SAVINGS SCHEME (SCSS)

MEANING

The Senior Citizen Savings Scheme is a government savings scheme that has been designed specifically to provide senior citizens with a safe investment option that offers a high and regular rate of interest.

FEATURES

1. The scheme is available to individuals who have attained the age of sixty years or above, with relaxed age limits provided for certain categories of retired persons.
2. The minimum amount that can be invested under this scheme is one thousand rupees, while the maximum amount that can be invested has been raised to thirty lakh rupees.
3. The scheme has a fixed tenure of five years, which can be extended by a further period of three years once the original term has been completed.
4. The interest earned under this scheme is paid out to the depositor every quarter rather than being compounded and reinvested.
5. The amount invested under this scheme qualifies for a deduction under Section 80C of the Income Tax Act, subject to the overall limit prescribed under that section.
6. The account can be opened at any post office or authorised bank branch by submitting the prescribed application form.

7. Only one deposit is permitted in the account, and additional deposits cannot be made into the same account after it has been opened.

ELIGIBILITY

- The Senior Citizen Savings Scheme is primarily meant for senior citizens who have attained the prescribed age of eligibility.
- Individuals who have retired under the specified retirement conditions may also be eligible before attaining the general senior-citizen age.
- Retired defence personnel may be eligible under the special age conditions applicable to them.
- Persons becoming eligible through retirement-related provisions must satisfy the conditions prescribed for such applicants.
- Therefore, SCSS eligibility is mainly based on age or qualifying retirement status, unlike ordinary Post Office savings schemes.

PROCEDURE TO OPEN THE ACCOUNT

1. The applicant must complete the prescribed Senior Citizen Savings Scheme account-opening form, along with proof of age and, where applicable, proof of retirement.
2. The applicant must submit the required Know Your Customer documents along with the application.
3. The applicant is required to deposit the lump-sum amount, subject to the maximum limit prescribed under the scheme.
4. The post office issues a passbook that confirms the amount deposited and the applicable rate of interest.

ADVANTAGES

High Rate of Interest

The Senior Citizen Savings Scheme offers one of the highest rates of interest among government-backed small savings schemes, according to the given material. This makes it attractive for senior citizens seeking regular returns from their retirement savings.

Tax Benefit and Regular Income

The scheme provides a tax deduction at the time of investment under Section 80C, subject to the prescribed limit. In addition, it provides regular interest income, making it useful for senior citizens who require periodic financial support.

Quarterly Income

Interest is paid every quarter. This payment pattern is particularly useful for senior citizens because the income can be used to meet regular expenses such as medical expenses and household requirements.

Safety of Investment

The scheme is backed by a sovereign guarantee from the Government of India. Therefore, it provides a high level of safety and is suitable for senior citizens who generally prefer secure investments.

LIMITATIONS

Taxable Interest

The interest earned under the Senior Citizen Savings Scheme is taxable. Tax may also be deducted at source when the interest exceeds the applicable threshold. Therefore, the investor must consider the tax liability while assessing the actual return.

Penalty on Premature Closure

Premature closure before completion of the prescribed tenure attracts a penalty on the amount withdrawn. Therefore, investors should consider their liquidity requirements before making the investment.

Maximum Investment Limit

The scheme has a prescribed maximum investment limit. Therefore, individuals who have accumulated a very large retirement corpus may not be able to invest their entire retirement savings through this scheme.

4.8 SUKANYA SAMRIDDHI YOJANA (SSY) ACCOUNT

MEANING

The Sukanya Samriddhi Yojana is a government savings scheme that was introduced under the Beti Bachao, Beti Padhao initiative with the aim of encouraging parents to build a financial corpus for the education and marriage expenses of their girl child.

FEATURES

1. An account under this scheme can be opened for a girl child at any time from the date of her birth until she attains the age of ten years.
2. The minimum amount that must be deposited in the account each year is two hundred and fifty rupees, while the maximum amount that can be deposited in a financial year is one and a half lakh rupees.
3. Deposits into the account must be made for a period of fifteen years from the date on which the account is opened.
4. The account matures twenty-one years after it is opened, or earlier if the girl child gets married after attaining the age of eighteen years.
5. The scheme falls under the Exempt-Exempt-Exempt, or EEE, category of taxation, under which the amount deposited, the interest earned, and the maturity amount are all completely exempt from tax.
6. A maximum of two accounts can generally be opened per family, corresponding to two daughters, although a third account is permitted in the case of twin or triplet daughters.
7. Partial withdrawal of up to fifty per cent of the balance is permitted once the girl child has attained the age of eighteen years or has passed the tenth standard examination, whichever occurs earlier.
8. The account can be transferred from one post office or bank branch to another anywhere in India without any additional charge.

ELIGIBILITY

- Sukanya Samriddhi Yojana is exclusively intended for an eligible girl child.
- The girl child must satisfy the prescribed age condition for opening the account.

- The account is opened for the benefit of the girl child, who is the eligible beneficiary of the scheme.
- A parent or legal guardian is eligible to open the account on behalf of the girl child.
- The eligibility of the account is therefore determined mainly by the girl child's age and her relationship with the parent or legal guardian.

PROCEDURE TO OPEN THE ACCOUNT

1. The guardian must complete the prescribed Sukanya Samriddhi Yojana account-opening form.
2. The guardian must submit the birth certificate of the girl child along with the required Know Your Customer documents of the guardian.
3. The guardian is required to deposit the minimum initial amount at the time of opening the account.
4. The guardian must continue to make annual deposits for a period of fifteen years, subject to the minimum and maximum limits prescribed under the scheme.

ADVANTAGES

Attractive Interest Rate

The Sukanya Samriddhi Yojana offers one of the highest rates of interest among small savings schemes, according to the given material. This helps parents build a substantial financial corpus for the future requirements of their daughter.

Complete Tax Exemption

The scheme provides tax exemption on the amount deposited, the interest earned, and the maturity amount received. This makes it an attractive long-term savings instrument from a tax planning perspective.

Encourages Long-Term Financial Planning

The scheme encourages parents to plan financially for their daughter's future. Regular deposits over a long period help create a dedicated corpus for important future requirements.

Partial Withdrawal Facility

The scheme permits partial withdrawal of up to fifty per cent of the balance subject to the prescribed conditions. This facility can provide financial support when the girl child requires funds for higher education.

LIMITATIONS

Long Lock-in Period

The scheme has a long maturity period of twenty-one years. Therefore, the depositor cannot freely access the entire accumulated amount for ordinary short-term financial needs.

Penalty for Failure to Maintain Minimum Deposit

A penalty is imposed if the guardian fails to maintain the minimum annual deposit required under the scheme. Therefore, the guardian has to ensure that the required annual contribution is made regularly.

Limited Applicability

The scheme is specifically available for a girl child. Therefore, its applicability is limited to families who have an eligible daughter.

5. PROTECTION-ORIENTED FINANCIAL SERVICES: INSURANCE

5.1 INTRODUCTION TO INSURANCE

Uncertainty is an inherent aspect of economic life. Individuals, families, and business enterprises constantly face exposure to unforeseen risks such as illness, accidents, loss of property, natural disasters, or premature death. While risk itself cannot be eliminated entirely, its financial consequences can be managed and mitigated through the institution of insurance.

At its core, insurance is a financial arrangement based on the principle of risk pooling and transfer. Under this arrangement, a large number of individuals exposed to similar risks contribute relatively small sums of money—known as premiums—into a central fund. When a member of this group suffers an actual financial loss due to a specified uncertain event (a peril), compensation is paid from this common pool to restore the affected individual to approximately the same financial position they occupied prior to the event.

5.1.1 Legal and Economic Definitions

From a legal perspective, insurance is a legal contract (the policy) between two parties:

- **The Insurer:** The entity (insurance company) that agrees to assume the risk and compensate for loss.
- **The Insured / Policyholder:** The individual or entity that pays the premium in exchange for financial protection.

From an economic perspective, insurance serves as a risk-transfer mechanism that converts a large, unpredictable, and potentially catastrophic loss into a small, predictable, fixed cost (the premium).

Definition (Sir William Athole Beveridge): *"The collective bearing of risks is insurance."*

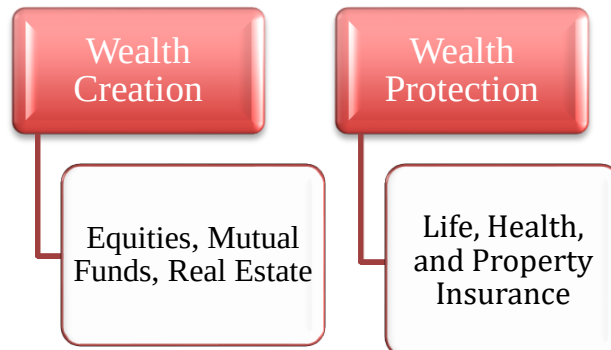
Definition (Justice Tindal): *"Insurance is a contract in which a sum of money is paid to the assured as an indemnity against loss from the loss of property, or against the happening of a specified event."*

5.1.2 Fundamental Purpose of Insurance

1. **Risk Pooling and Spreading:** Insurance operates on the statistical Law of Large Numbers. As the number of insured exposure units increases, the actual loss experience approaches the expected loss experience, allowing insurers to calculate probabilities and spread losses equitably across the group.
2. **Financial Loss Compensation:** It replaces economic uncertainty with certainty by ensuring that an individual or entity does not face complete financial ruin following an adverse event.
3. **Peace of Mind and Confidence:** By transferring severe financial risks to an insurer, individuals and businesses can plan for the future without constantly setting aside disproportionate reserves for contingencies.

5.1.3 Economic and Social Role of Insurance in Personal Financial Planning

Insurance forms the foundational layer of any prudent personal financial plan. Before an individual can effectively build wealth through investments like equities, mutual funds, or real estate, they must first protect their existing earning capacity and assets against catastrophic loss.



1. Economic Role

- **Capital Formation:** The vast accumulation of premiums collected by insurance companies creates substantial capital reserves. Insurers deploy these funds into long-term national development, including infrastructure projects, government securities, and corporate bonds.
- **Business Continuity and Credit Facilitation:** For commercial entities, insurance protects capital investments against perils like fire, theft, or liability claims. Banks and financial institutions routinely require insurance coverage on collateral assets before sanctioning

commercial or personal loans.

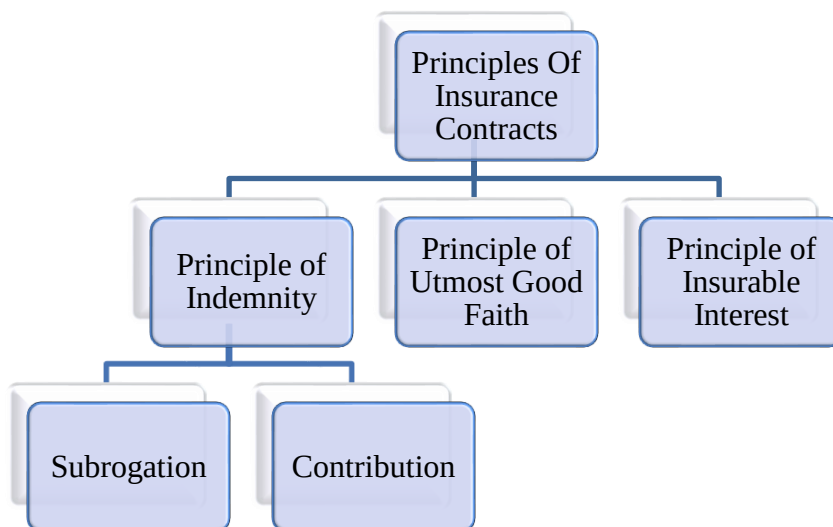
- **Inflation-Proof Safety Net:** Insurance products structure financial security so that families do not need to distress-sell real assets or liquidate long-term investments during emergency situations.

2. Social Role

- **Family Stability and Social Security:** The loss of a primary breadwinner can push a household into severe economic distress. Life insurance provides immediate capital liquidity, ensuring that dependents can maintain their standard of living, fund education, and meet daily obligations.
- **Healthcare Accessibility:** Medical emergencies are a major cause of personal debt and insolvency. Health insurance enables individuals to access quality healthcare without exhausting their life savings or accumulating high-interest debt.
- **Reduction of Burden on State Resources:** A well-insured society relies less on state-funded welfare schemes during health crises or major disasters, freeing public resources for development initiatives.

5.2 BASIC PRINCIPLES GOVERNING INSURANCE CONTRACTS

Because insurance contracts deal with future contingent events and asymmetric information between parties, they are subject to strict legal principles beyond general contract law. A clear understanding of these principles is essential for proper contract execution and claim settlement.



5.2.1 Principle of Utmost Good Faith (*Uberrimae Fidei*)

Unlike standard commercial contracts governed by the rule of *caveat emptor* (let the buyer beware), insurance contracts are governed by *uberrimae fidei* (utmost good faith).

- **Duty of Material Disclosure:** Both the insurer and the proposer must voluntarily disclose all material facts relevant to the contract. A material fact is any information that would influence a prudent underwriter in deciding whether to accept a risk and at what premium rate.
- **Examples of Material Facts:** Pre-existing medical conditions, family health history, tobacco or alcohol consumption habits, dangerous occupations, or past property loss records.
- **Consequence of Non-Disclosure:** If either party conceals, misrepresents, or fraudulently omits a material fact, the contract becomes voidable at the option of the aggrieved party from its inception.

5.2.2 Principle of Insurable Interest

To prevent an insurance contract from becoming a mere gambling or wagering agreement, the policyholder must possess an insurable interest in the subject matter of insurance.

- **Definition:** Insurable interest exists when the policyholder derives a financial benefit from the safety or preservation of the subject matter, and suffers a direct financial loss from its damage, destruction, or death.
- **Timing of Insurable Interest:**
 - **Life Insurance:** Insurable interest must exist at the time the policy is taken. It does not need to exist at the time of claim. (e.g., A person has an unlimited insurable interest in their own life; spouses have insurable interest in each other).
 - **General/Property Insurance:** Insurable interest must exist both at the time of policy inception and at the time the loss occurs.
 - **Marine Insurance:** Insurable interest must exist at the time of loss.

5.2.3 Principle of Indemnity

The principle of indemnity states that an insurance contract aims to compensate the insured for the exact actual financial loss suffered, putting them back in the same financial position they

occupied immediately before the loss occurred.

- **No Profit Principle:** An insured cannot make a profit from an insurance claim. The maximum payout is limited to whichever is lower: the actual loss or the sum insured.
- **Applicability:** Applies strictly to marine, fire, motor, and general property insurance.
- **Non-Applicability to Life Insurance:** Life insurance contracts are contracts of guarantee or assurance, not indemnity, because a human life cannot be assigned a precise monetary value. Upon death, the full agreed Sum Assured is paid regardless of financial status.

5.2.4 Principle of Subrogation

Subrogation is a natural corollary of the Principle of Indemnity.

- **Definition:** Once the insurer compensates the insured in full for damage or loss to the insured property, the legal rights to recover damages from any third party responsible for causing the loss automatically transfer to the insurer.
- **Purpose:** Prevents the insured from collecting double compensation for the same loss (once from the insurer and once from the negligent third party).

Illustration: If an individual's parked car is damaged by a negligent third-party driver and the insurer pays ₹50,000 for repairs, the insurer steps into the policyholder's shoes to sue the negligent driver to recover that ₹50,000. The policyholder cannot claim compensation twice.

5.2.5 Principle of Contribution

The principle of contribution applies when an individual takes multiple insurance policies on the same property or subject matter with different insurers. Proportional Sharing: In the event of a loss, all insurers contribute proportionally to cover the actual loss based on their respective coverage amounts. The insured cannot claim full compensation from every insurer to realize an aggregate payout higher than the total loss.

5.3 LIFE INSURANCE POLICIES

Life insurance is fundamentally a contract between a policyholder and an insurer wherein the insurer promises to pay a designated sum of money (Sum Assured) to the policyholder or their named beneficiaries upon the occurrence of a specified event—typically the maturity of the policy or the premature death of the life assured.

In India, the Life Insurance Corporation of India (LIC), established under the Life Insurance Corporation Act of 1956, historically pioneered and structured the life insurance landscape. Even in a competitive market today, LIC's policy framework serves as the standard benchmark for classifying life insurance products across the country. Understanding the specific features, mechanism, and suitability of various life insurance policies is essential for creating a structured personal financial plan.

Core Components of a Life Insurance Contract

Before evaluating specific policy categories, it is necessary to examine the basic elements that define any life insurance agreement:

- **Life Assured:** The individual whose life is covered by the policy. The payout is directly linked to the survival or death of this individual.
- **Proposer / Policyholder:** The person who enters into the contract with the insurance company, pays the periodic premiums, and owns the policy. The policyholder and the life assured can be the same person or different individuals (provided insurable interest exists).
- **Nominee / Beneficiary:** The person named by the policyholder to receive the claim proceeds (Sum Assured plus accrued bonuses, if applicable) in the event of the life assured's demise during the policy term.
- **Sum Assured:** The guaranteed minimum amount that the insurance company agrees to pay upon maturity or death, as specified in the policy document.
- **Premium:** The regular or lump-sum consideration paid by the policyholder to keep the insurance policy active. Premium rates depend on factors such as age, health status, occupation, sum assured, policy term, and lifestyle habits.
- **Policy Term:** The total duration for which the insurance cover remains active.
- **Riders:** Supplementary add-on covers that can be attached to a base life insurance policy for an additional premium to enhance protection (e.g., Accidental Death Benefit Rider, Critical Illness Rider, Premium Waiver Benefit).

5.3.1 Term Life Insurance Policies

Term life insurance represents the purest, most straightforward form of life protection. It is designed solely to cover the risk of premature death during a specified duration, without any

investment or savings component attached to it.

Detailed Features and Working Mechanism

In a standard term plan, the policyholder pays a fixed periodic premium for a chosen tenure (such as 10, 20, or 30 years). If the life assured passes away during this policy term, the insurer pays the complete Sum Assured to the designated nominee, after which the policy terminates. However, if the life assured survives till the end of the policy tenure, the contract simply expires, and no money is returned to the policyholder.

Because the insurer does not need to accumulate a maturity fund or pay investment returns, term insurance premiums are significantly lower than those of any other insurance product. A young individual can secure a substantial risk cover (e.g., ₹10,000,000) for a relatively nominal annual premium.

Major Variants of Term Insurance

4. **Level Term Assurance:** The most common form, where both the Sum Assured and the annual premium remain constant throughout the policy duration.
5. **Increasing Term Assurance:** The Sum Assured automatically increases by a fixed percentage each year (e.g., 5% or 10%) to help offset the impact of inflation on the family's future financial requirements.
6. **Decreasing Term Assurance:** The Sum Assured gradually decreases over the policy term according to a pre-determined schedule. This variant is frequently linked with home loans or major liabilities, ensuring that if the borrower dies, the remaining loan balance is automatically cleared by the policy proceeds without burdening the surviving family.
7. **Term Return of Premium (TROP):** A hybrid variant created to cater to policyholders who dislike losing paid premiums upon survival. If the life assured survives the policy term, the insurer returns the total aggregate base premiums paid over the years (excluding taxes and rider charges). However, the premium charged for a TROP plan is considerably higher than that of a pure term plan.

Practical Suitability

Term insurance is indispensable for primary breadwinners, young working professionals with financial dependents, and individuals carrying substantial financial debts or mortgage liabilities. It ensures that the family's living standard, children's education, and long-term goals remain financially secure even in the sudden absence of the earning member.

5.3.2 Endowment Policies

An Endowment Policy is a conventional financial product that combines risk protection with systematic long-term savings. Unlike pure term insurance, an endowment plan guarantees a payout whether the life assured survives the policy term or dies prematurely.

Detailed Features and Working Mechanism

When a policyholder pays premiums toward an endowment plan, the insurance company allocates one portion of the premium to cover the risk of life (mortality charges and administration costs) and invests the remaining portion in safe, conservative instruments like government securities, corporate bonds, and debt instruments.

Endowment plans operate under two distinct structures:

- **With-Profit (Participating) Plans:** The policyholder participates in the financial profits generated by the life insurer. Profits are declared annually in the form of Reversionary Bonuses (expressed as a rate per thousand Sum Assured). These bonuses accrue every year and are paid out along with the base Sum Assured at maturity or upon death. Additionally, a Final Additional Bonus (FAB) may be declared at the end of the term.
- **Without-Profit (Non-Participating) Plans:** These plans do not share in the insurer's profits. Instead, they offer pre-determined, guaranteed maturity benefits that are explicitly stated in the policy contract at inception.

Prominent LIC Endowment Product Frameworks

- **Standard Endowment Assurance** (e.g., LIC's New Endowment Plan): Provides a double benefit where the Sum Assured along with simple reversionary bonuses is paid upon maturity or in the event of death during the term.
- **Money-Back Policies** (A specialized variant of Endowment): Standard endowment policies lock in capital until the end of the term. To provide liquidity during the tenure, Money-Back policies pay periodic cash payouts (a pre-defined percentage of the Sum Assured) at regular intervals (e.g., every 5 years). At final maturity, the remaining percentage of the Sum Assured along with the accumulated bonuses is paid out. If the life assured dies at any point during the policy term, the full Sum Assured is paid to the nominee without deducting any survival benefits already paid out earlier.
- **Whole Life Assurance** (e.g., LIC's Umang): Combines endowment benefits with coverage

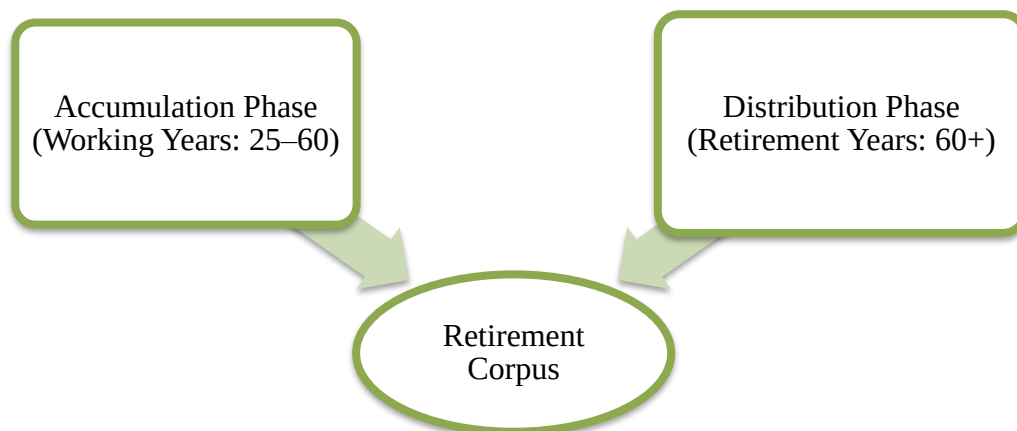
up to age 100. It offers annual survival payouts after the premium payment term ends, alongside a full maturity or death payout.

Practical Suitability

Endowment plans suit risk-averse individuals looking for guaranteed, disciplined savings coupled with basic life protection. They are commonly utilized to fund fixed future goals with defined timelines, such as a child's higher education, marriage, or securing a baseline retirement nest egg.

5.3.3 Pension Policies (Annuity Plans)

Pension plans, also referred to as annuity plans or retirement plans, are designed to eliminate longevity risk—the financial risk of outliving one's savings in old age. Their primary objective is to build a retirement corpus during an individual's working years and convert that corpus into a steady, regular income stream (a pension) during retirement.



The Two Phases of a Pension Plan

- **Accumulation Phase:** During this phase, the policyholder makes regular monthly or annual contributions to the plan over their working life. The accumulated funds earn compound interest or investment growth, building a significant retirement fund.
- **Annuity Phase (Distribution Phase):** Upon reaching retirement age (known as the Vesting Date), the policyholder uses the accumulated retirement corpus to purchase an annuity contract from the insurer. The insurer then pays a regular guaranteed pension (monthly, quarterly, half-yearly, or annually) to the individual (now termed the Annuitant) for the rest of their life.

Types of Annuity Options

In products such as LIC's Jeevan Umay or Jeevan Akshay, policyholders can select from several annuity options:

- **Immediate Annuity:** The policyholder pays a lump-sum amount (purchase price) to the insurer, and pension payouts begin immediately (e.g., the very next month). This option is tailored for individuals who have just retired and received their retirement gratuity or provident fund payouts.
- **Deferred Annuity:** Pension payouts start after a chosen deferment period (e.g., 5, 10, or 15 years). The individual contributes during the deferment period to build the corpus before payouts commence.
- **Annuity for Life:** Pension is paid to the annuitant for as long as they live. Upon death, payouts stop and the initial investment is retained by the insurer.
- **Annuity for Life with Return of Purchase Price:** Pension is paid to the annuitant for life. Upon the annuitant's death, the pension stops, and the original lump-sum purchase price is refunded in full to the nominee.
- **Joint Life Last Survivor Annuity:** Pension is paid to the primary annuitant for life. After their demise, the pension continues to be paid to the surviving spouse for the rest of their life.

Practical Suitability

Pension policies are vital tools for retirement planning, particularly for self-employed individuals, private-sector employees lacking employer-backed pensions, and anyone seeking a stable, guaranteed income stream in their senior years.

Comparative Summary: Key Life Insurance Types

Policy Type	Core Purpose	Payout Mechanism	Return on Investment Element	Ideal For
Term Insurance	Pure Life Protection	Sum Assured paid only on death during the policy term.	None (Zero maturity return in pure plans).	Income earners needing maximum life cover at minimal cost.
Endowment Policy	Savings + Protection	Paid on maturity or on death during the term (plus accrued bonuses).	Low to Moderate (Conservative guaranteed/bonus returns).	Risk-averse savers planning for specific long-term milestones.

Policy Type	Core Purpose	Payout Mechanism	Return on Investment Element	Ideal For
Pension Annuity Policy	Income Security in Retirement	Regular pension payouts starting from the vesting date for life.	Stable Pension Yield (Focused on cash flow generation).	Individuals building a structured retirement plan.

5.4 HEALTH INSURANCE PLANS

While life insurance addresses the financial risk of death, health insurance addresses the financial impact of medical emergencies, severe illnesses, and accidents. Healthcare costs in India continue to rise significantly, making unexpected medical events a major source of financial distress and debt for families.

Health insurance acts as an essential financial buffer, ensuring that individuals and families can access quality healthcare services without exhausting their savings or liquidating assets.

5.4.1 Importance of Health Insurance

Incorporating health insurance into personal financial planning offers several key advantages:

- **Mitigation of Medical Inflation:** Healthcare expenditures regularly outpace general economic inflation. Specialized treatments, surgeries, and prolonged hospital stays can quickly deplete personal savings. Health insurance transfers these escalating costs to the insurer.
- **Protection of Built Savings and Investments:** Without health insurance, sudden hospitalizations force individuals to liquidate long-term investments (such as mutual funds, fixed deposits, or equity holdings) or accumulate high-interest debt, derailing long-term wealth creation.
- **Access to Quality Healthcare:** Health insurance provides policyholders with access to network hospitals, enabling them to seek timely, quality medical treatment without compromising due to immediate financial constraints.
- **Tax Benefits under Section 80D:** Under the Indian Income Tax Act, premiums paid toward health insurance policies qualify for tax deductions under Section 80D, offering a tax incentive alongside health protection.

5.4.2 Features of Health Insurance

Understanding health insurance policies requires familiarity with specific technical terms and conditions used during claim processing:

1. **Inpatient Hospitalization:** Coverage provided when a patient is admitted to a hospital for a minimum period (typically **24 consecutive hours**) to undergo treatment.
2. **Daycare Procedures:** Medical treatments, surgeries, or procedures that do not require 24-hour hospitalization due to advanced medical technology (e.g., cataract surgery, chemotherapy, dialysis).
3. **Pre-Hospitalization and Post-Hospitalization Expenses:** Medical expenses incurred prior to admission (e.g., diagnostic tests, doctor consultations) and following discharge (e.g., follow-up medications, physical therapy). Policies standardly cover pre-hospitalization costs up to 30 or 60 days, and post-hospitalization costs up to 60, 90, or 180 days.
4. **Waiting Period:** A specified duration during which certain claims are not payable:
 - *Initial Waiting Period:* Typically 30 days from policy inception, during which no claims are covered (except accidental injury).
 - *Pre-Existing Disease (PED) Waiting Period:* A mandatory period (usually 1 to 4 years) before coverage applies to health conditions that existed prior to buying the policy (e.g., diabetes, hypertension).
 - *Specific Disease Waiting Period:* A 1 to 2-year waiting period for specific scheduled conditions like hernia, joint replacements, or cataracts.
5. **Co-Payment (Co-Pay):** A predefined percentage of the total claim amount (e.g., 10% or 20%) that the policyholder agrees to pay out-of-pocket, while the insurer covers the remaining balance. Co-pay clauses are common in senior citizen health policies.
6. **Deductible:** A fixed dollar or rupee amount that the insured must pay out-of-pocket before the insurance policy starts paying for covered medical expenses.
7. **No Claim Bonus (NCB):** A reward given by insurers for every claim-free year, usually offered as an increase in the Sum Insured (e.g., 10% or 20% increase per year) without a corresponding increase in the annual premium, up to a maximum specified cap.
8. **Exclusions:** Conditions, treatments, or circumstances strictly excluded from policy coverage (e.g., cosmetic surgery, intentional self-injury, experimental therapies, or routine dental care unless caused by accident).

5.4.3 Classifications of Health Insurance Plans

Health insurance policies in India are structured into distinct categories tailored to different life stages and family requirements.

1. Individual Health Insurance Plan

An Individual Health Insurance Plan covers a single person up to a chosen Sum Insured.

- **Mechanism:** The entire Sum Insured is available exclusively for that designated individual. If a person holds an individual cover of ₹500,000 and incurs a medical bill of ₹400,000, the policy covers the bill, leaving ₹100,000 available for any subsequent claim during the policy year.
- **Suitability:** Ideal for unmarried individuals, people with specific pre-existing health conditions, or senior family members who require a dedicated risk pool separate from younger family members.

2. Family Floater Health Insurance Plan

A Family Floater Plan extends coverage to an entire family (typically self, spouse, and dependent children) under a single, shared Sum Insured.

- **Mechanism:** The total Sum Insured floats across all covered family members. Any member listed in the policy can draw from the total Sum Insured during the policy year. For example, if a family Floater plan has a Sum Insured of ₹1,000,000, one member can utilize up to ₹1,000,000 for a major surgery, or multiple members can make multiple smaller claims up to the combined limit of ₹1,000,000.
- **Cost Efficiency:** Family Floater premiums are significantly lower than buying individual plans for every family member because the premium is calculated based on the age of the oldest family member, assuming that not all family members will require simultaneous hospitalization in the same year.
- **Suitability:** Best suited for young nuclear families without major pre-existing illnesses.

3. Senior Citizen Health Insurance

Designed specifically for individuals aged 60 and above.

- **Mechanism:** These plans address age-related health conditions, offering lower initial waiting periods for pre-existing diseases, annual health check-ups, and tailored coverage. Because risk is higher in advanced age, these plans frequently feature mandatory co-payment clauses (e.g., 10% to 30%) and sub-limits on room rents or specific treatments.

- **Suitability:** Elderly individuals who need targeted medical coverage as health risks increase with age.

4. Critical Illness & Personal Accident Cover

- **Critical Illness Cover:** Unlike regular health policies that reimburse actual hospital bills, a Critical Illness policy is a **benefit-based policy**. Upon diagnosis of a listed critical illness (such as cancer, stroke, major organ transplant, or kidney failure), the insurer pays the entire Sum Assured as a lump-sum amount, regardless of actual treatment costs. This payout helps replace lost income, fund out-of-country treatment, or settle debt.
- **Personal Accident Cover:** Provides financial protection against accidental death, permanent total disability, permanent partial disability, or temporary total disability resulting from an accident.

5.4.4 Claim Settlement Mechanisms

In health insurance, claim settlement occurs through two primary operational methods handled by the insurer or a Third-Party Administrator (TPA):

1. Cashless Facility Procedure

The cashless facility allows the policyholder to receive treatment at a designated Network Hospital without paying hospital bills out-of-pocket (except for non-medical expenses, deductibles, or co-pays).

- **Process:**
 - **Pre-Authorization:** For planned hospitalization, a pre-authorization form is submitted to the hospital's TPA desk 48 to 72 hours in advance. For emergency admissions, authorization is sent within 24 hours of admission.
 - **Approval:** The TPA / Insurer verifies policy details and issues an initial approval letter stating the authorized amount.
 - **Direct Settlement:** Upon discharge, the hospital sends final bills directly to the insurer, who settles the bill directly with the hospital.

2. Reimbursement Claim Procedure

If the policyholder undergoes treatment at a Non-Network Hospital, or if a cashless pre-authorization request is denied, the patient must settle all bills directly with the hospital at the time of discharge and seek reimbursement later.

- **Process:**

- The insured pays all hospital charges out-of-pocket and collects all original documents, including discharge summaries, diagnostic reports, bills, receipts, and prescriptions.
- The policyholder submits a completed claim form along with all original documents to the insurer/TPA within a specified period (usually 15 to 30 days post-discharge).
- The insurer scrutinizes the documents, verifies coverage, and transfers the approved amount directly into the policyholder's bank account.

Comparative Analysis: Individual vs. Family Floater Health Plans

Feature	Individual Health Plan	Family Floater Health Plan
Coverage Scope	Covers one single person per policy.	Covers multiple family members under a single plan.
Sum Insured	Dedicated exclusively to one individual.	Shared mutually among all covered family members.
Premium Basis	Calculated strictly on the age and risk profile of the individual.	Calculated based on the age of the oldest family member.
Cost	Higher total cost if individual plans are bought for every member.	Cost-effective for nuclear families.
Reinstatement Impact	One member's claim does not affect another member's Sum Insured.	A large claim by one member reduces the available balance for others.

6 INVESTMENT-ORIENTED FINANCIAL SERVICES: PORTFOLIO MANAGEMENT AND CAPITAL MARKETS

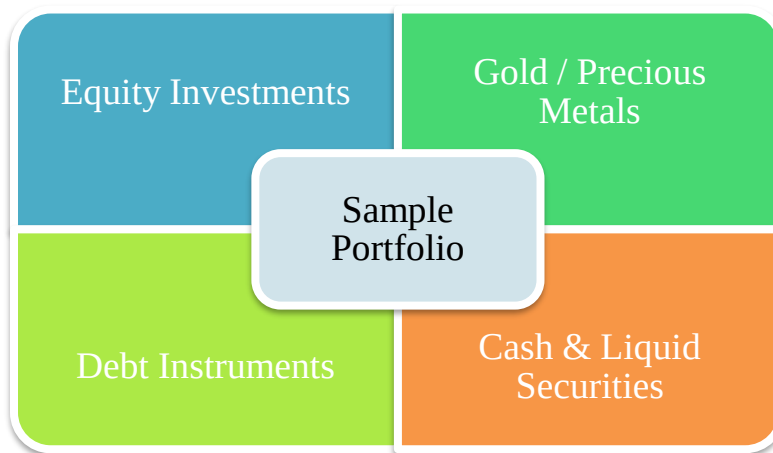
6.1 FUNDAMENTALS OF PORTFOLIO MANAGEMENT

In personal financial planning, wealth creation requires moving beyond traditional low-yield savings accounts into capital growth assets such as equities, bonds, mutual funds, real estate, and commodities. However, investing in a single asset class or individual security exposes an investor to significant financial risk. If that specific asset underperforms or suffers a structural decline, the investor's entire capital suffers.

To mitigate this risk, modern financial theory emphasizes the concept of a portfolio.

What is a Portfolio?

A portfolio is a purposefully designed collection or bundle of financial assets—such as equities, debt securities, cash equivalents, mutual funds, gold, and real estate—held by an individual investor or institutional entity. Rather than evaluating an investment in isolation, portfolio theory evaluates how individual investments perform collectively as a unified group.



What is Portfolio Management?

Portfolio Management is the systematic process of selecting, prioritizing, and managing a mix of financial assets to meet the specific long-term financial goals of an investor while balancing their risk tolerance and time horizon.

It involves a continuous cycle of decision-making:

- Evaluating investor objectives and constraints.
- Determining the optimal allocation across different asset classes.
- Selecting individual securities within those classes.
- Monitoring performance and rebalancing the portfolio periodically to maintain desired risk-return levels.

Key Distinction: While *investing* refers broadly to putting money into an asset to generate returns, *portfolio management* focuses on how individual investments interact with one another to optimize total performance relative to overall risk.

6.1.1 Need and Objectives of Portfolio Management

Without structured portfolio management, individual investors frequently succumb to emotional decision-making—buying assets at peak valuation out of market optimism or selling panic-driven at market bottoms. Portfolio management provides a disciplined, strategy-driven framework to achieve consistent financial outcomes.

Primary Objectives of Portfolio Management

1. **Risk Minimization:** The primary objective of portfolio management is to reduce overall investment risk without sacrificing potential returns. By spreading capital across distinct asset classes, the losses incurred in one underperforming asset can be offset by gains in another.
2. **Capital Appreciation (Growth):** Portfolios aim to grow the real purchasing power of capital over time. Equities and real estate are integrated into portfolios specifically to deliver long-term growth that outperforms inflation.
3. **Liquidity and Regular Yield:** A well-managed portfolio maintains sufficient liquidity to meet an investor's short-term income requirements or unexpected emergencies without forcing the distress sale of long-term assets. Fixed-income instruments (like corporate bonds or government treasury bills) provide predictable periodic payouts (dividends or interest).
4. **Tax Efficiency:** Portfolio management structures asset holdings to take full advantage of statutory tax provisions, minimizing capital gains tax liabilities and optimizing post-tax real returns.

6.1.2 Core Elements of Portfolio Building

Building a resilient portfolio requires a firm understanding of three foundational financial concepts: the risk-return trade-off, diversification, and asset allocation.

1. The Risk-Return Trade-Off

In capital markets, risk and return share a direct structural relationship: higher expected returns are invariably accompanied by higher overall risk.

Higher Risk $\Leftrightarrow$ Higher Expected Return

- **Return:** The financial gain or loss generated by an investment over a specific period, expressed as a percentage of the initial investment. Return consists of two components: periodic cash income (dividends/interest) and capital appreciation (price increase).
- **Risk:** The uncertainty or variability regarding the actual returns of an investment compared to its expected returns.

The objective of portfolio management is not to eliminate risk entirely, but rather to optimize the risk-return balance—achieving the maximum possible return for a given level of risk tolerance, or minimizing risk for a targeted level of expected return.

2. The Concept of Diversification

Diversification is the operational heart of portfolio management, summarized by the age-old financial adage: *"Don't put all your eggs in one basket."*

- **Systematic vs. Unsystematic Risk:**
 - **Systematic Risk (Market Risk):** Factors that affect the broader financial system as a whole—such as interest rate changes, inflation, geopolitical conflicts, or economic recessions. Systematic risk cannot be eliminated through diversification.
 - **Unsystematic Risk (Specific Risk):** Factors specific to a single company or industry—such as a management change, labor strike, or product recall. Unsystematic risk **can** be largely eliminated by spreading investments across different companies and sectors.

Total Risk = Systematic Risk (Unavoidable) + Unsystematic Risk (Diversifiable)

When a portfolio contains assets that are not perfectly correlated (i.e., assets that do not move in the exact same direction at the exact same time), the overall volatility of the portfolio decreases. For example, stock prices and gold prices often move in opposite directions during economic uncertainty; combining both in a portfolio stabilizes overall portfolio value.

3. Asset Allocation

Asset allocation is the process of dividing an investment portfolio among different asset categories based on an investor's financial goals, risk tolerance, and investment horizon. Empirical studies show that overall asset allocation drives over 90% of a portfolio's long-term performance variability—far more than individual stock selection or market timing.

- **Strategic Asset Allocation:** Establishing a long-term target baseline asset mix based on risk profile (e.g., an "Aggressive Growth" profile might allocate 70% to Equities, 20% to Bonds, and 10% to Gold).
- **Tactical Asset Allocation:** Making short-term, dynamic adjustments to the baseline mix to take advantage of temporary market opportunities or protect against economic downturns.

Comparative Summary: Major Asset Classes for Portfolio Building

Asset Class	Primary Function	Risk Level	Return Potential	Liquidity
Equities (Stocks)	Capital Growth	High	High	Very High
Debt / Fixed Income	Capital Preservation & Income	Low to Moderate	Moderate / Fixed	High to Moderate
Gold / Commodities	Hedge against Inflation & Uncertainty	Moderate	Moderate	High
Real Estate	Income & Long-term Appreciation	Moderate	Moderate to High	Low
Cash Equivalents	Emergency Liquidity	Very Low	Low	Immediate

6.2 INTRODUCTION TO SHARE MARKETS

An economy requires a steady flow of capital to grow. While commercial banks provide short-term and medium-term debt, capital markets serve as the financial engine for long-term equity and debt funding. At the center of the capital market is the share market (or stock market)—an organized platform where buyers and sellers trade financial securities, primarily corporate shares.

Concept, Definition, and Role of Share Markets in the Economy

A share represents a unit of fractional ownership in a company's equity. When a corporation raises capital from the public, it divides its total equity capital into equal units. An individual or institution that purchases these units becomes a shareholder (part-owner) in the company, sharing

in both its financial profits (via dividends and capital growth) and its business risks.

What is a Share Market?

A **share market** is a structured marketplace which is operating physically or electronically, where equity shares, bonds, derivatives, and other financial instruments issued by companies or government bodies are issued, bought, and sold under predefined regulatory guidelines.

6.2.1 Economic Role of the Share Market

- **Capital Mobilization:** The stock market pools small savings from individual retail investors across the nation and channels them into productive business enterprises that require large-scale capital for expansion, research, and infrastructure.
- **Efficient Allocation of Capital:** By continuously reflecting real-time prices based on supply, demand, earnings performance, and growth prospects, the market ensures that capital flows preferentially toward efficient, well-managed, and profitable companies.
- **Barometer of Economic Health:** Stock market indices serve as a reliable leading indicator of a country's macroeconomic health. A sustained upward movement (bull market) generally reflects economic growth, business confidence, and industrial expansion, whereas a prolonged decline (bear market) signals economic slowdown or uncertainty.
- **Wealth Creation and Financial Inclusion:** Stock markets enable common retail investors to participate directly in the wealth created by leading industrial and technology corporations, generating long-term capital appreciation that helps beat inflation.

6.2.2 Functions of Stock Markets for Retail Investors

For individual or retail investors, the stock market serves several practical financial functions:

1. **Liquidity Provision:** Stock markets transform long-term corporate capital into highly liquid personal assets. An investor can sell listed shares and convert them into cash almost instantaneously during trading hours.
2. **Transparent Price Discovery:** Automated electronic trading systems aggregate millions of buy and sell orders continuously, determining fair market prices transparently without manual manipulation.
3. **Income Generation (Dividends & Capital Gains):** Investors benefit from two distinct revenue streams—periodic cash dividends declared from corporate profits and capital gains resulting from increases in stock prices over time.
4. **Regulatory Protection:** Modern stock markets operate under stringent legal frameworks

overseen by statutory regulators (such as the Securities and Exchange Board of India - SEBI). This ensures mandatory corporate disclosures, fair trading practices, and protection against fraud or insider trading.

6.2.3 Types of Share Markets

The share market is divided into two major operational segments: the Primary Market and the Secondary Market. Understanding the distinction between these two segments is fundamental to stock market literacy.

1. Primary Market (New Issues Market)

The **Primary Market** is the venue where securities are created and sold for the very first time. In this market, the transaction occurs directly between the issuing company and the investor. The primary objective is to raise fresh long-term capital directly from the public or institutional entities to fund business setup, expansion, debt repayment, or acquisitions.

Methods of Floating New Issues in the Primary Market

- **Initial Public Offering (IPO):** The process by which an unlisted private company offers its shares to the general public for the first time, transforming into a publicly listed corporate entity.
- **Follow-on Public Offer (FPO):** An offer of additional new shares to the public by a company that is already publicly listed on a stock exchange.
- **Rights Issue:** An offer made by a listed company to its existing shareholders to purchase additional new shares at a discounted price in proportion to their current holding, before offering them to the broader public.
- **Private Placement:** The direct sale of shares or securities to a select group of institutional investors (such as banks, insurance companies, or mutual funds) rather than through an open public offering.

2. Secondary Market

Once securities are issued in the primary market and allotted to investors, they are listed on recognized stock exchanges where they enter the Secondary Market.

The secondary market is what is commonly referred to as the "stock market" or "stock exchange." In this market, existing shareholders trade shares directly with other investors.

Key Characteristics of the Secondary Market

- **Inter-Investor Trading:** The issuing company is not a direct party to the transaction, nor does it receive any fresh capital from secondary market trades. Money simply transfers from the buyer to the seller, while ownership of the share transfers from the seller to the buyer.
- **Continuous Liquidity:** It provides a continuous marketplace where investors can buy or sell previously issued securities whenever they choose.
- **Price Volatility:** Prices in the secondary market fluctuate continuously throughout the trading day based on prevailing market supply and demand, news, financial results, quarterly corporate earnings, and broader macroeconomic factors.

Comparative Analysis: Primary Market vs. Secondary Market

Attribute	Primary Market	Secondary Market
Nature of Securities	New, freshly issued securities.	Previously issued, existing securities.
Direct Parties Involved	Issuing Company and Investor.	Investor and Investor (via Licensed Stockbroker).
Flow of Funds	Money flows directly from the Investor to the Company.	Money flows from the Buying Investor to the Selling Investor.
Company Capital Gain	Direct capital expansion for the company.	No fresh capital raised by the company.
Price Determination	Fixed price or book-building price range set by the company/underwriters.	Variable market price determined continuously by supply and demand forces.
Intermediaries Involved	Merchant Bankers, Underwriters, Registrar to the Issue.	Depository Participants, Clearing Corporations, Stockbrokers.

6.3 MAJOR INDIAN STOCK EXCHANGES AND MARKET INDICES

To trade equity shares efficiently and safely, investors require robust institutional infrastructure. In India, capital market operations are regulated by a central statutory body and executed through nationwide electronic stock exchanges.

Understanding the regulatory framework, the structure of major stock exchanges, and the working of market indices is essential for analysing financial market trends.

6.3.1 Structure of Indian Capital Markets and SEBI

The Indian capital market operates under a multi-tiered structural framework designed to ensure market integrity, protect investor interests, and facilitate smooth capital formation.

The Role of SEBI (Securities and Exchange Board of India)

Established as a statutory body under the **SEBI Act of 1992**, the Securities and Exchange Board of India functions as the primary regulator of the securities market in India. SEBI's mandate revolves around three core objectives:

- **Protecting Investor Interests:** Safeguarding retail and institutional investors against market manipulation, fraudulent trade practices, insider trading, and deceptive corporate disclosures.
- **Promoting Market Development:** Modernizing market infrastructure, encouraging digital trading, introducing dematerialization of physical shares, and fostering financial literacy.
- **Regulating Market Intermediaries:** Registering, monitoring, and auditing stock exchanges, brokers, sub-brokers, merchant bankers, mutual fund houses, credit rating agencies, and depositories.

6.3.2 BSE (Bombay Stock Exchange) and SENSEX

Profile and Historical Context of BSE

Established in 1875 as the "*Native Share & Stock Brokers' Association*," the **Bombay Stock Exchange (BSE)** is Asia's oldest stock exchange. Based in Mumbai, BSE has played a historic role in developing India's corporate equity culture. Today, it hosts the highest number of listed companies among stock exchanges globally, providing trading facilities in equity, debt, derivatives, mutual funds, and SME (Small and Medium Enterprises) platforms.

Meaning and Significance of SENSEX

The **SENSEX** (a portmanteau of *Sensitive Index*), officially known as the **S&P BSE SENSEX**, was introduced on January 1, 1986. It is the flagship benchmark index of the BSE, designed to reflect the overall movement and market sentiment of the Indian economy.

SENSEX Composition and Calculation Methodology

1. **Composition:** SENSEX comprises **30 large, established, and financially sound companies** listed on the BSE, spanning key industrial sectors of the Indian economy.
2. **Selection Criteria:** Companies included in the 30-stock basket must be listed on BSE, possess large market capitalization, exhibit high trading liquidity, generate significant

revenue from core business operations, and maintain a balanced sectoral representation.

3. Calculation Methodology: SENSEX is calculated using the Free-Float Market Capitalization Weighted Method:

- *Total Market Capitalization* = Total Outstanding Shares × Current Market Price per Share.
- *Free-Float Market Capitalization* = Total Market Capitalization × Free-Float Factor (Investible Weight Factor). (Free-float shares exclude promoter holdings, government stakes, strategic cross-holdings, or locked-in shares that are not readily available for public trading).
- **Base Year and Base Value:** The base period for SENSEX is 1978–79, with a Base Value of 100.

$$SENSEX\ Value = \frac{Current\ Free - Float\ Market\ Cap\ of\ 30\ Companies}{Base\ Market\ Capitalization} \times 100$$

6.3.3 NSE (National Stock Exchange) and NIFTY 50

Profile and Features of NSE

Incorporated in 1992 and recognized as a stock exchange in 1993, the **National Stock Exchange of India (NSE)** revolutionized Indian capital markets by introducing a fully automated, screen-based electronic trading system. This replaced traditional physical open-outcry trading floor systems with nationwide electronic trading terminals, ensuring complete price transparency and rapid order matching.

Meaning and Significance of NIFTY 50

The **NIFTY 50** (derived from *National Stock Exchange* and *Fifty*), managed by NSE Indices, is the benchmark stock index of the NSE. (*Note: In some introductory academic curricula, this index may occasionally be cited with a typographical shorthand as "NIFT", but its official standard designation is NIFTY 50*).

NIFTY Composition and Calculation Methodology

- **Composition:** The NIFTY 50 comprises 50 top-tier blue-chip companies listed on the NSE, representing major sectors of the domestic economy.
- **Selection Criteria:** To qualify for NIFTY 50, a company must be allowed to trade in the Futures & Options (F&O) segment, exhibit low impact cost (high liquidity), and maintain a

minimum listing history. The index is rebalanced semi-annually.

- **Calculation Methodology:** Like SENSEX, the NIFTY 50 uses the Free-Float Market Capitalization Weighted Method.
- **Base Year and Base Value:** The base period for NIFTY 50 is **November 3, 1995**, with a **Base Value of 1,000** (representing a base capital of ₹2.06 trillion).

$$\text{NIFTY 50 Value} = \frac{\text{Current Free – Float Market Cap of 50 Companies}}{\text{Base Market Capitalization}} \times 1000$$

Comparative Analysis: SENSEX vs. NIFTY 50

Feature	S&P BSE SENSEX	NSE NIFTY 50
Stock Exchange	Bombay Stock Exchange (BSE).	National Stock Exchange (NSE).
Number of Constituents	30 constituent stocks.	50 constituent stocks.
Base Year / Date	Fiscal Year 1978–79.	November 3, 1995.
Base Value	100.	1,000.
Calculation Method	Free-Float Market Capitalization.	Free-Float Market Capitalization.
Managing Entity	Asia Index Private Limited (BSE Joint Venture).	NSE Indices Limited (Subsidiary of NSE).

How Investors Read and Interpret Market Indices in Daily Life

For retail investors and financial analysts, tracking index movements provides quick insights into market performance without needing to analyze thousands of individual stock tickers separately:

- **Directional Market Sentiment:**
 - **Bull Market Movement:** When indices like SENSEX or NIFTY 50 show a sustained upward trend, it indicates positive investor sentiment, high corporate profitability expectations, and general economic growth.
 - **Bear Market Movement:** A sustained downward trend signals economic pessimism, rising interest rates, corporate earnings contraction, or geopolitical distress.
- **Measuring Portfolio Performance:** Investors use benchmark indices to measure the performance of their mutual fund schemes or personal stock portfolios. For instance, if NIFTY 50 yields a 12% annual return, a equity mutual fund delivering a 15% return has

outperformed the benchmark index.

- **Understanding Sectoral Health:** In addition to broad market indices (SENSEX/NIFTY 50), stock exchanges calculate Sectoral Indices (such as *NIFTY Bank*, *NIFTY IT*, *NIFTY Pharma*, *BSE Auto*). These specialized indices track specific industries, allowing investors to identify which economic sectors are expanding or contracting.

6.4 BASICS OF INVESTING IN SECURITIES

For beginner investors, entering the stock market requires moving beyond theoretical concepts into practical execution. Investing directly in capital markets involves specific structural requirements, legal procedures, and risk management strategies to safeguard personal wealth.

Prerequisites for Stock Trading

To buy or sell shares, corporate bonds, or government securities in the Indian stock market, an individual investor must establish an operational account infrastructure. This framework connects the investor's bank account to electronic market depositories via licensed intermediaries.



1. Permanent Account Number (PAN Card)

A PAN card issued by the Income Tax Department of India is the primary identity document mandatory for opening any trading or demat account. It acts as a central tracking identifier for all financial transactions, ensuring tax compliance and anti-money laundering (AML) monitoring.

2. Bank Account

A standard savings or current account in a scheduled commercial bank is required to fund stock purchases and receive cash pay-outs (such as dividends or sale proceeds).

3. Dematerialized (Demat) Account

In 1996, India introduced the dematerialization system to replace physical share certificates with

electronic record-keeping.

- **Function:** A Demat account functions similarly to a digital bank account, but instead of storing money, it holds financial securities (shares, bonds, ETF units, mutual fund units) in safe, electronic form.
- **Depositories:** Demat accounts are maintained by two central depositories registered with SEBI:
 - a. **NSDL** (National Securities Depository Limited).
 - b. **CDSL** (Central Depository Services Limited).
- **Depository Participants (DPs):** Investors do not interact directly with NSDL or CDSL. Instead, they open Demat accounts through registered Depository Participants (DPs)—which can be banks, financial institutions, or stockbroking firms.

4. Trading Account

While a Demat account holds securities, a Trading Account provides the digital interface to execute buy or sell orders on stock exchanges (BSE or NSE).

- **Function:** When an investor places a buy order through their trading account, the broking platform matches the order on the exchange, debits money from the linked bank account, and credits the purchased shares to the investor's Demat account upon settlement (T+1 settlement cycle).

6.5 MUTUAL FUNDS

For individuals who lack the time, financial expertise, or risk appetite required to analyze individual stocks directly, Mutual Funds offer an ideal indirect entry point into equity and debt markets. A mutual fund is a professionally managed financial collective investment scheme that pools money from numerous individual and institutional investors with a shared financial objective. The pooled capital is invested across a diversified portfolio of stocks, bonds, money market instruments, or other assets managed by an Asset Management Company (AMC) and led by a professional Fund Manager.

Key Advantages of Investing via Mutual Funds

- **Professional Management:** Experienced fund managers analyze company balance sheets, financial statements, and macroeconomic indicators to make informed investment decisions on behalf of unit holders.
- **Built-in Diversification:** Purchasing a single mutual fund unit gives the investor instant

fractional exposure to dozens of underlying companies across multiple industries, lowering unsystematic risk.

- **Affordability and Systematic Investment Plans (SIP):** Investors do not need large sums to start investing. Through a Systematic Investment Plan (SIP), individuals can invest fixed, small amounts (e.g., ₹500 per month) automatically at regular intervals, benefiting from Rupee Cost Averaging (buying more units when prices fall and fewer units when prices rise).
- **High Liquidity:** Open-ended mutual fund schemes allow investors to redeem their units at the prevailing Net Asset Value (NAV) on any business trading day.

Guidelines for Safe and Smart Investing for Beginners

Capital markets offer high growth potential, but they also expose untrained investors to financial risk if approached without sound guidelines:

- **Invest Based on Fundamental Analysis, Not Rumors:** Avoid speculative market tips, unverified social media stock recommendations, or "get-rich-quick" promises. Base equity investments on a company's fundamental strength—evaluating revenue growth, debt levels, profit margins, management credibility, and competitive advantage.
- **Follow Asset Allocation and Diversification:** Never allocate an entire investment budget to a single stock, sector, or asset class. Spread investments across equities, fixed income, and gold aligned with personal age, income, and risk appetite.
- **Maintain a Long-Term Investment Horizon:** Equity markets exhibit volatility in the short term due to economic noise and news sentiment. Over long horizons (5 to 10+ years), stock prices tend to mirror underlying corporate earnings growth, generating compounded real returns.
- **Maintain an Emergency Fund First:** Before deploying funds into market-linked securities, build a liquid emergency cash reserve equal to 3 to 6 months of living expenses in a bank savings account or liquid mutual fund to avoid panic selling during personal emergencies.
- **Beware of Unregistered Financial Intermediaries:** Conduct all financial transactions exclusively through SEBI-registered stockbrokers, research analysts, and asset management companies. Verify registration credentials directly on the official SEBI portal before transferring funds.

FINANCIAL LITERACY

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Dr.K.R.Sakthidevi is an accomplished academician, researcher, and Associate Professor & Head of the Department of Commerce (Business Analytics) at Vellalar College for Women, Erode, with over 19 years of rich in teaching and research experience across UG & PG Levels. Holding a Ph.D. in Commerce from Bharathiar University with expertise in Marketing, Accountancy and Finance, she has published extensively in UGC CARE Listed Journal and peer-reviewed journals. Also she served as a Chief Editor for conferences, and presented her research internationally in Singapore. Beyond guiding 2 Ph.D. scholars, she leads national and international academic events. Recognized for her commitment to research and student empowerment, she was honored with the Best Teacher Award 2026 and the International Award of Excellence – Eminent Academician Award 2026.



Dr. B.S. Vanetha is an experienced academician, and Assistant Professor in the Department of Commerce (Business Analytics) at Vellalar College for Women (Autonomous), Erode. Holding a Ph.D. in Commerce, she brings over 17 years of rich teaching, research, and administrative experience. Her core areas of specialization include Accountancy, Finance, and Management. She has published research papers extensively in journals, presented research papers at various platforms, and actively participated in national and international conferences, seminars, workshops, and Faculty Development Programmes. Committed to institutional development and academic excellence, she contributes significantly to curriculum enhancement, research mentorship, and student development initiatives.



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