BANKING

BANKING IN INDIA

History of Banking

- Banking in India started in 1770 with the establishment of Bank of Hindustan.
- Later, three Presidency Banks were set up:
  1. Bank of Calcutta in 1806
  2. Bank of Bombay in 1840
  3. Bank of Madras in 1843

  These banks worked as quasi-central banks for many years.
- In 1921, all these three banks were amalgamated to form the imperial Bank of India. Imperial Bank of India continued functioning till 1955, after which it got renamed as State Bank of India.
- In 1922, the Royal Commission on Indian Currency and Finance was established under The chairmanship of Hilton Young. This Commission recommended the operation of money management in 1926. Based on the recommendations of this Commission, The 'Reserve Bank of India (RBI) Act' was passed in 1934 which came into effect on 1 April 1935.
- Initially (1935-37), the headquarters of RBI was located in Kolkata. Thereafter, it is situated in Mumbai.
- RBI continued to work as a Central Bank of:
  - (1) Burma, till 1947
  - (2) Pakistan, till July 1948
- Nationalisation of banks took place in 1969. Fourteen private banks were nationalised in 1969, and in 1980, six more were nationalised.
- Post-1990s, many nationalised banks amalgamated gradually

RESERVE BANK OF INDIA:

- The RBI was set up on the basis of the recommendations of Hilton Young Commission.
- RBI was established in 1935 in accordance with the RBI Act, 1934, and is India's central banking institution. It started its operations on 1 April 1935 during the British rule as per the provisions of the RBI Act, 1934.
- RBI started as a shareholder's company (i.e. privately owned) but it became nationalised in 1949 under RBI (Transfer of Public Ownership) Act, 1948, and, thereafter, is fully owned by the Government of India (GOI).
- The first Governor of RBI was Sir Osborne Smith (1935-37).
- The first Indian Governor of RBI was C.D. Deshmukh (1943-49).
- Manmohan Singh was the only Prime Minister who till now has also served as the Governor of RBI during different spans of time.
- At first, RBI's main office was located in Kolkata. But, it was moved to Mumbai in 1937. It has 4 Zonal Offices and about 22 Regional Offices.
- The emblem of RBI is a Tiger (earlier it was Lion) and a Palm tree.
- The RBI is entrusted with a variety of roles, including overseeing the monetary policy, regulation and supervision of the financial system and the payment systems, management of foreign exchange, issuing currency, promotion of national objectives and credit short-term loans to Government.

- The Preamble of RBI describes the basic functions of RBI as: 'to regulate the issue of bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage'.
- Earlier the accounting year of RBI was from 1st of July to 30th of June. But from 2020 financial year, it has changed to 1st of April to 31st of March.

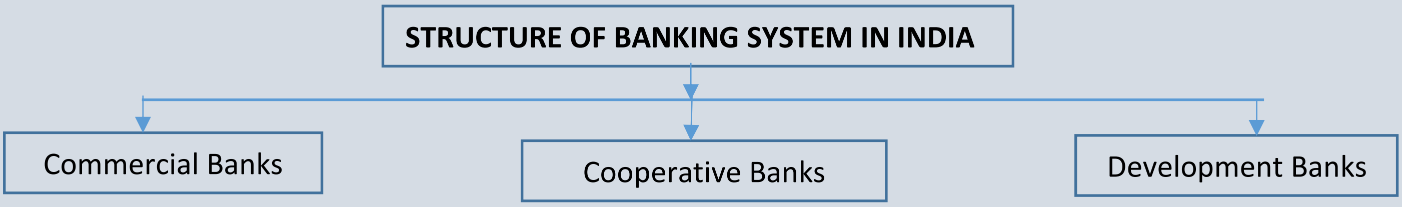
Functions of RBI:

1. **Issuer of Bank Notes**: RBI enjoys the monopoly of issuing currency notes except for 1 rupee note. The 1 rupee note and the coins of all denominations are minted and issued by GOI (and not RBI), but they are circulated through the RBI. The RBI adopted the minimum reserve system for note issue since 1957 according to which it has to maintain gold and foreign currency reserves of worth Rs.200 crores, out of which minimum of 115 crores should be in gold.
2. **Banker to the Government**: RBI acts as a banking agent and financial advisor to the Central as well as the State Governments. It manages Government accounts and treasuries. It performs the functions of crediting loans to the Governments without any interest for short term. RBI buys and sells Government Securities (G-Secs) on Government's behalf. It gives monetary and financial advice to the Governments.
3. **Banker's Bank**: All the other banks in the country keep their part of cash balances with RBI as deposit to meet the liabilities in the time of crisis scheduled. Scheduled Commercial Banks keep cash balance in two ways:
   - **a.** They keep part of cash balance with themselves, and
   - **b.** The other part is kept with the RBI as deposits.
4. **Lender of Last Resort:** RBI is not only last a banker to the banks but also a lender of last resort. That means, in times of crisis, the Scheduled Commercial Banks approach the RBI to get financial assistance. As RBI is the lender of last resort, it gives opportunity, enabling itself to exercise control over the banking system of the country.
5. **Custodian of Foreign Exchange Reserves:** RBI functions as the custodian of nation's foreign exchange reserves. In order to stabilise the rupee's external value, the RBI maintains the reserves of foreign currencies which also helps to stabilise exchange rate and promote international trade.
6. **Controller of Credit or Money Supply:** RBI controls the increase or decrease in the volume of money supply according to the monetary requirement of the nation. This is important so as to control the inflation and deflation in the economy (by controlling the level of money supply in the market). More expansion of credit money or money supply can lead to inflation, whereas huge contraction of credit money results in deflation. While checking these, RBI stabilises general price level and increases the output.
7. **Regulator of the Banks:** RBI is entitled by regulatory powers under the RBI Act, 1934, and the Banking Regulation Act, 1949. Regulations relate to licencing of banks, expansion of the Commercial Banks in terms of their branches in the country or abroad, prescribing minimum requirements of paid-up capital and reserves, etc.

- As per Indian Coinage Act, 1906, Coins can be issued up to the denomination of 1,000. As per the Reserve Bank of India Act, 1934, Currency Notes can be issued up to the denomination of 10,000
- The 1-rupee note is the only currency note which bears the signature of the Finance Secretary of the Government of India and not of the Governor of the Reserve Bank of India.

STRUCTURE OF BANKING SYSTEM IN INDIA

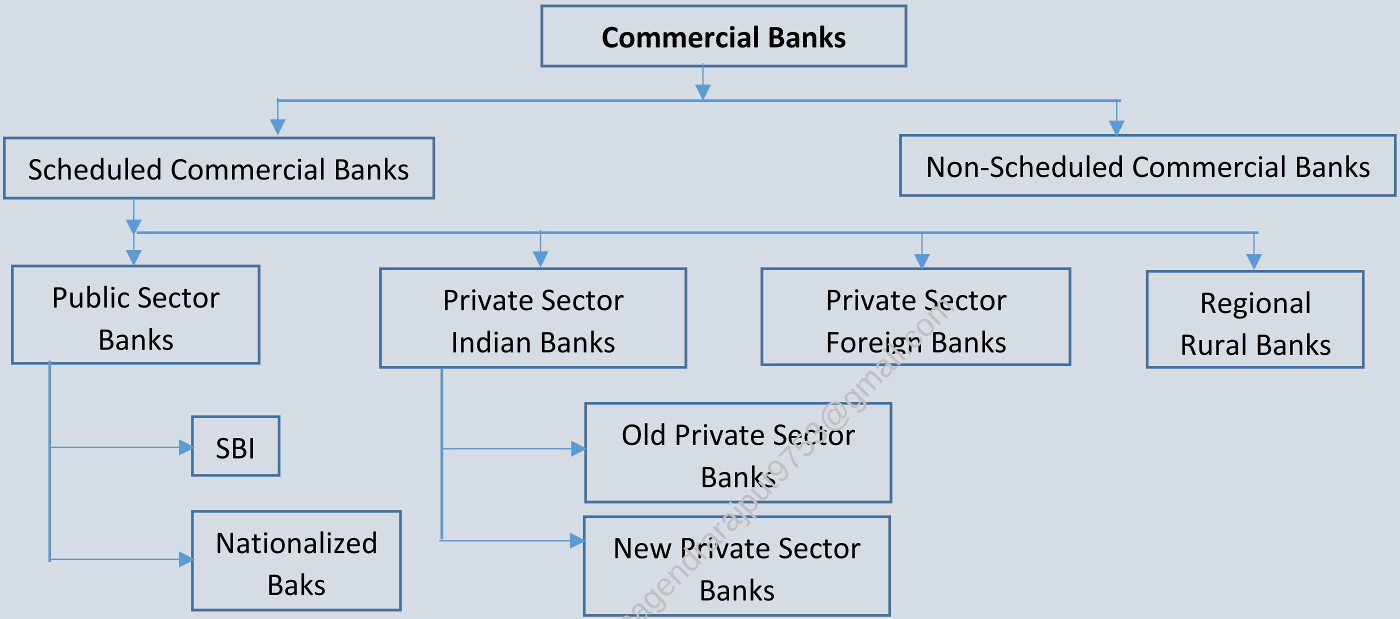
In India, banks can mainly be categorised into:



Commercial Banks:

Commercial Banks comprise Scheduled Commercial Banks (SCBs) and Non-Sch. And Non – Commercial Banks. An SCB refers to a bank which is listed in the Second Schedule of the RBI Act, 1934, SCBs are regulated under the provisions of Banking Regulation Act, 1949

The SCBs enjoy certain benefits such as - they can approach RBI for financial assistance at bank rate, repo rate, MSF, etc. However, they are bound by certain obligations like maintaining CRR and SLR as per the RBI mandate.



Criteria for Recognition as Scheduled Commercial Bank

1. It should have paid-up capital and reserves of not less than5 lakh, and

2 It should satisfy the RBI that their affairs are not being conducted in a manner detrimental to the interest of their depositors.

Banks not listed under this Schedule are called Non-Scheduled Banks.

In India, all banks are Scheduled banks except for few Local Area Banks (LABs) and few Urban Co-operative Banks (UCBs).

SCBs in India are categorised into five different groups as follows:

1. State Bank of India
2. Nationalised Banks
3. Indian Private Banks
4. Private Sector Foreign Banks
5. Regional Rural Banks

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1. State Bank of India

- Previously called 'Imperial Bank of India', it was created by amalgamating the three Presidency Banks, namely Banks of Calcutta, Bombay and Madras in 1921.
- Later in 1955, Imperial Bank of India was nationalised as State Bank of India.
- In 1960, the SBI acquired control of seven regional banks of former Indian Princely States and they were renamed as State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Indore, State Bank of Mysore, State Bank of Saurashtra, State Bank of Patiala and State Bank of Travancore.
- All of them, along with Bharatiya Mahila Bank, had been gradually merged with SBI.
- State Bank of Saurashtra in 2008 and State Bank of Indore in 2010 merged with SBI.
- The five remaining associate Banks (State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala and State Bank of Travancore) along with Bharatiya Mahila Bank merged with SBI in 2017.
- Thus at present, there does not exist any such associate of State Bank of India.
- Headquarters of the SBI is located at Mumbai (Present Chairman:Dinesh Kumar Khara).
- SBI is the largest bank in India with a 23 per cent market share in assets, besides having a share of around 25 per cent in the loan and deposit market.
- The SBI is not included in the list of nationalised banks as it is already a state-owned financial institution in the country since its inception. GOI has more than 50 per cent shareholding in SBI.

2. Nationalised Banks

- Due to the banking crisis of 1913-17 and the failure of 588 banks in various parts of the country at the end of 1949, it was necessary to regulate and control Commercial Banks.
- The Banking Companies Act was passed in 1949, which later became Banking Regulation Act, 1949. It provides a legal framework for the regulation of banking system in India
- In the year 1969, certain provisions were introduced in Banking Regulation Act, 1949, that brought social control on banks. Thereafter, 14 banks were nationalised in 1969.
- This provision brought some restrictions on advances made by banking companies so that the bank advances were not concentrated only in large-scale industries, and to shift their priorities towards sectors like agriculture, small-scale industries and exports.
- In 1980, six more banks having DTL of minimum Rs. 200 crores were nationalised (now taking the total number of nationalised banks to 20).
- In 1993, New Bank of India was merged with Punjab National Bank. It happened to be the only merger between nationalised banks and that reduced the number of nationalised banks from 20 to 19.

Reasons for Nationalisation:

1. Concentration of economic power in few hands.
2. Private ownership of Commercial Banks.
3. Banks previously located mainly in urban areas, thereby neglecting the development of agricultural and rural areas as it was not the priority sector

Progress after Nationalisation:

1. Expansion of the number of branches (even in rural areas)
2. Priority sector lending increased.
3. Level of deposit mobilisation and bank lending increased

4. Banks started financing schemes which promoted entrepreneurship.

RECENT DEVELOPMENTS:

- In 2020, the Government of India accomplished the mega amalgamation of 10 Public Sector Banks (PSBs) into four PSBs with effect from 1st april 2020.
- Amalgamation of Oriental Bank of Commerce and United Bank of India into Punjab National Bank.
- Amalgamation of Syndicate Bank into Canara Bank.
- Amalgamation of Andhra Bank and Corporation Bank into Union Bank of India.
- Amalgamation of Allahabad Bank into Indian Bank.

Benefits of such amalgamation:

- This mega consolidation would help create banks that can compete with global banks effectively.
- Greater scale and synergy through consolidation would lead to cost benefits to these banks.
- It will also provide impetus to amalgamated banks by increasing their ability to support larger lending and greater financial capacity.
- Access to a wider talent pool and a larger database will enhance their competitive advantage.
- Adoption of best practices across amalgamating entities will facilitate banks in improving their cost-efficiency and risk management.

Therefore, at present, there are following 12 PSBs (11 Nationalised Banks + SBI). They are

1. Punjab National Bank (PNB)
2. Bank of Baroda
3. Bank of India
4. Central Bank of India
5. Canara Bank
6. Union Bank of India (UBI)
7. Indian Overseas Bank
8. Punjab and Sind Bank
9. Indian Bank
10. UCO Bank
11. Bank of Maharashtra
12. State Bank of India (SBI)

After this merger, the PNB stands as the second-largest PSB in India after SBI.

Regional Rural Banks

- As the purpose of nationalisation of banks was not that much served, in 1975 the concept of Regional Rural Bank (RRB) was introduced. The RRBs were established under the provisions of an Ordinance passed in 1975 and the RRBs Act, 1976, to provide sufficient banking and credit facility for agriculture and other rural sectors. RRBs were set up on the recommendations of the M. Narasimham Working Group.
- At present, each RRB is owned by three entities: Central Government, Concerned State Government and the Sponsor Bank in the proportion of 50:15:35, respectively.
- RRBs are SCBs.
- They operate at regional level in various States of India.

- There may be one or more RRBs in a particular State.
- RRBs mobilise deposits primarily from rural/semi-urban areas and provide loans and advances mostly to small and marginal farmers, agricultural labourers, rural artisans and other segments of the priority sector.
- The sources of funds of RRBs comprise owned funds, deposits, borrowings from NABARD, Sponsor Banks and other sources, including SIDBI and National Housing Bank.
- The RRBs are supervised by NABARD and have to follow the regulatory norms prescribed by RBI.
- As on 1 February 2021, there are 56 RRBs in India. Uttar Pradesh has the highest number of RRBs (seven) as of now.
- Examples of RRB include Paschim Banga Gramin Bank, Andhra Pragathi Grameena Bank.

➢ CO-OPERATIVE BANKS:

- Co-operative Banks in India are incorporated and registered under the States Co-operative Societies Act (passed by States). The Co-operative Banks are also regulated through the following Acts of Central Government:
  - Banking Regulations Act, 1949
  - Banking Laws (Co-operative Societies) Act, 1955
- Co-operative Banks are involved in all kinds of activities, namely production, marketing, distribution, possessing, servicing and banking in India.
- They function with the rule of 'one member one vote' and on 'no profit no loss' basis. Hence, they do not pursue the goal of profit maximisation.
- Customers are the owners of the Co-operative Banks.
- Co-operative Banks mainly focus on agricultural and rural sector lending.
- For providing short-term credit, Co-operative Banks in India exist in three tiers:
  1. State Co-operative Banks (at the State level)
  2. District Co-operative Central Banks (at the District level)
  3. Primary Agricultural Credit Societies (PACS) (at the village level)
- Co-operative Banks dealing with long-term credit are:
  - Land Development Banks (LDBs) and
  - Co-operative and Rural Development Banks (CARDBs)
- Co-operative Banks are the first Government-sponsored, Government-supported and Government-subsidised financial agency in India.

In 2020, the Government of India has approved to bring regulation of Co-operative Banks under the Reserve Bank of India (RBI) by bringing amendments in Banking Regulation Act, 1949. Before this, they were under the dual control of RBI and State Governments (through Registrar of Co-operative Societies). This amendment was done in the wake of the recent Punjab and Maharashtra Co-operative (PMC) Bank crisis.
The amendments will also apply to all Urban Co-operative Banks. (Primary Co-operative Banks) and Multi-State Co-operative Banks. Urban Cooperative Banks were brought under the purview of the Banking Regulation Act, 1949 through an Amendment in 1966

As per the changes:

- Co-operative Banks should be audited according to RBI's norms.

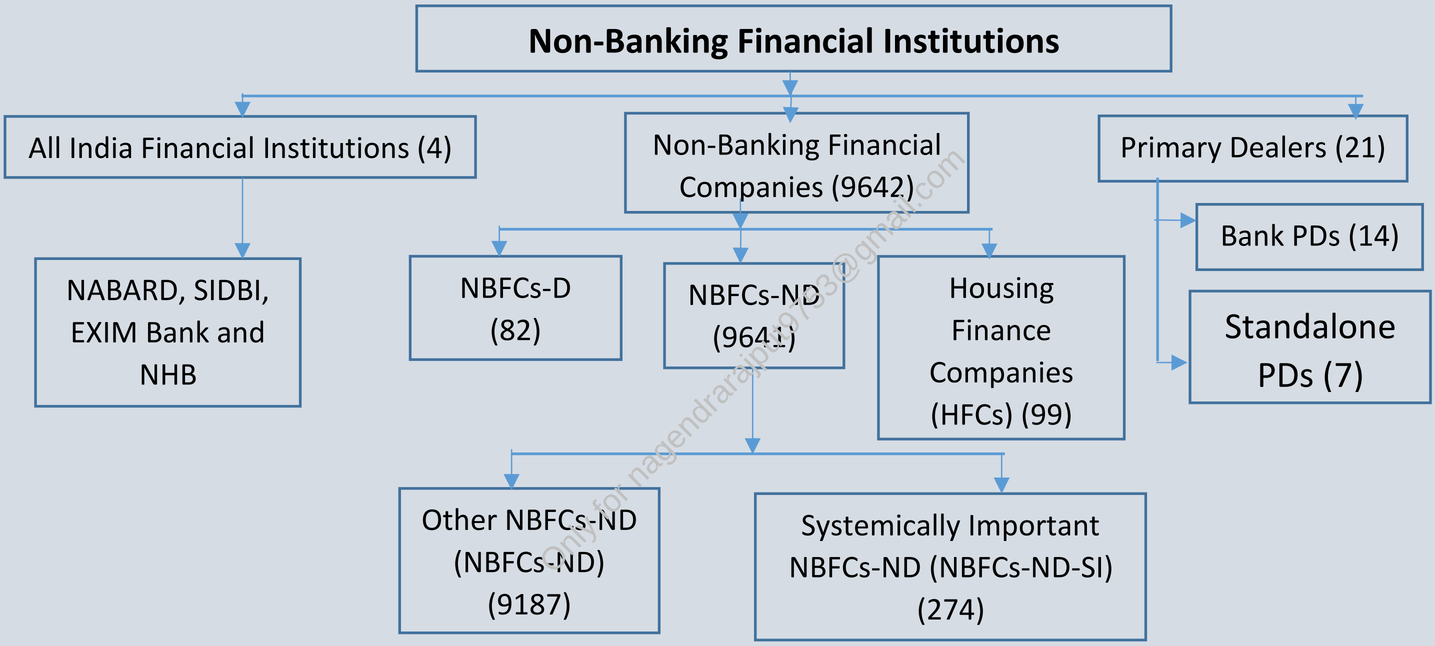
- RBI can supersede the board, in consultation with the State Government, if any Co-operative Bank is under stress.
- Appointment of CEOs of Co-operative Banks will also require permission from RBI

NON-BANKING FINANCIAL COMPANIES:

- Non-Banking Financial Company (NBFC) is a company which is engaged in the business of loans and advances, acquisition and selling of shares, bonds, debentures, or leasing, insurance, chit-fund, etc. It is a very broad concept and has many variations.
- In 2016, the Government allowed 100 per cent FDI in 'other financial services carried out by NBFCs.
- NBFC's financial assets should constitute more than 50 per cent of the total assets and income from financial assets should constitute more than 50 per cent of the gross income.
- NBFCs cannot accept demand deposits from the public. However, debentures and bonds are not demand liabilities; therefore, it can be used by NBFC's to raise funds.
- Not all NBFCs are regulated by RBI. For example, the Venture Capital Fund/Merchant Banking Companies/Stock broking companies are regulated by SEBI, Insurance companies by IRDA, etc.

NBFCs Regulated by RBI

Structure of NBFIs under the RBI Regulation (At End-September 2019)



Notes: 1. Data are provisional

D- Deposit taking;
ND Non-deposit taking

2. Figures in parentheses indicate the number of institutions.

Source: RBI.

DIFFERENCE BETWEEN BANKS AND NBFCs

- Unlike Banks, NBFCs cannot accept demand deposits.
- Unlike Banks, NBFCs do not form part of the payment and settlement system and cannot issue cheques drawn on itself.
- Deposit Insurance Facility is not available to investors/depositors of NBFCs.

- NBFCs are not required to maintain Reserve Ratios prescribed by RBI (CRR, SLR, etc.).
- Banks are regulated under Banking Regulation Act, 1949 whereas NBFCs are regulated under Companies Act, 1956 or The Companies (Amendment) Act. 2019.
- Foreign investment allowed is upto 74 per cent for private sector Banks but this limit for NBFCs is up to 100 per cent.

➢ **NBFCs and Liquidity Crisis**

RBI's prudential norms over the years have been to discourage creation and growth of deposit-taking by NBFC (also called NBFC-D) and encouraging the entry of non-deposit-taking NBFCs (also called NBFC-ND). This has been done to protect the depositor's capital (often general public) because deposits of NBFCs-D are not covered by the DICGC and it may result in total loss of deposit.

This has led to increase in wholesale funding (loans from Banks, Debt Mutual Funds, Debentures, Commercial Paper) as the funding sources of the NBFCs, rather than deposits. Financial Institutions and NBFCs prefer short-term financing sources because of its lower cost and easy availability and liquidity. However, dependence on frequent short-term funding causes an Asset Liability Management (ALM) problem and makes NBFCs vulnerable to increase in costs of short-term funding because they have to constantly repay their short-term loans and seek fresh loans.

Liquid Debt Mutual Funds is a primary source of short-term funds to the NBFC sector. Thus, the NBFC sector is deeply connected with the Liquid Debt Mutual Fund (LDME) sector making mutual funds prone to transmission of systemic risk from the NBFC sector. Shocks in the NBFC sector may lead to large-scale redemptions by investors in the LDMF sector at low prices. To Overcome, policy changes have been made by the Government in recent past.

Recent Major Policy changes by Government in the NBFC Sector

In order to maintain stability of the larger financial system and boost confidence, RBI and the government has taken the following major measures in the recent past:

- Amendments in the RBI Act, 1934, to confer powers on the RBI to improve governance of NBFCs, to protect depositors'/creditors' interest and ensure financial stability of the sector.
- Amendment in relevant rules to reduce the cost of raising funds for NBFCs and HFC and deepening of the corporate bond market.
- NBFC-Investment and Credit Company (NBFC-ICC) was created by merging Asset Finance Companies, Loan Companies and Investment Companies. This was done to reduce complexities arising from multiple categories and for greater flexibility in their operations.
- An independent Chief Risk Officer (CRO) to be appointed for large NBFCs (with asset size more than 5,000 crore) for identification, measurement and mitigation of risks.
- Ombudsman Scheme for NBFCs-D extended to NBFCs-ND (with an asset size of 100 crore or above) for resolving grievances.

Recently RBI has proposed new regulations for the NBFCS that include:

1. Making of four layer regulatory framework which comprises of a Base layer, a Middle layer, an Upper layer and a Top layer. There will be a progressive increase in the intensity of regulation with the increasing layer.
2. There will be a change of classification for NPAs. RBI has proposed changing of period from 180 days to 90 days overdue for classification of NPAs for Base layer NBFCs.

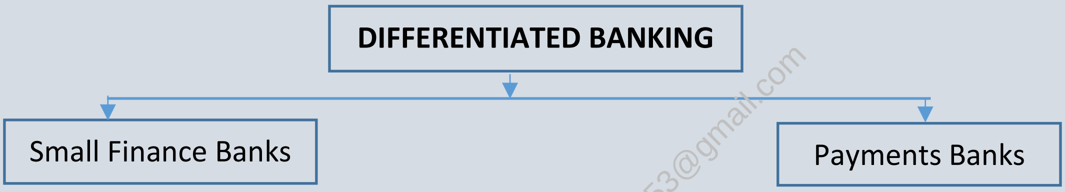
➢ SHADOW BANKING

- It comprises a set of markets and institutions that operate partially (or fully) outside the traditional commercial banking and are either lightly regulated or unregulated. Simply, it is not illegal. it is just not strictly monitored as Commercial Banks are monitored by the RBI. Examples include Housing Finance Companies (HFCs), Retail-NBFCs and Liquid Debt Mutual Funds (LDMFs)
- Shadow Banks do not have direct access to central bank liquidity. The shadow banking system is highly leveraged with risky and illiquid assets, whereas its liabilities are disposed to 'bank run.

Note: Bank Run occurs when many clients withdraw their money from a bank because they believe the bank may become insolvent or cease to function in near future.

➢ DIFFERENTIATED BANKING

- The concept of differentiated banking was introduced by RBI, based on the recommendations of Nachiket Mor Committee in 2013.
- Differentiated Banks are banks which cater or serve a specific segment of customers unlike other normal universal banks (who offer all financial products).
- The differentiation may be based on capital requirement, scope of activities or areas of operations.
- This differentiated banking concept was introduced in order to offer specialised services or unique products designed to very much suit that particular sector.
- The Differentiated Banks offer limited range of services/products as compared to universal banks.
- Therefore, the following two types of Differentiated Banks were launched:



➢ Small Finance Banks

- Small Finance Banks (SFBs) are SCBs that lend to small business units, small and marginal farmers, micro and small industries, unorganised sector entities, etc.
- They are private financial institutions established as a Public Limited Company under the Companies (Amendment) Act, 2019. They are licenced under the Banking Regulation Act, 1949, and are governed by the RBI Act, 1934.
- They can be promoted by individuals, corporate, trusts or by societies. Existing NBFCs, Micro Finance Institutions (MFIs) and Local Area Banks (LABs) can also opt for conversion into SFB.
- In 2019, RBI started the 'On Tap Facility under which RBI can accept applications and grant licence for SFBs through out the year.
- **Following are the guidelines related to SFBs:**
  1. Eligible promoters of SFBs could be resident individuals/professionals with 10 years of banking and finance experience, including companies controlled by them.
  2. They shall primarily undertake basic banking activities of acceptance of deposits and lending to unserved and underserved sections.
  3. The minimum paid-up equity capital for SFBs shall be Rs. 100 crore.
  4. All prudential norms and regulations of RBI as applicable to existing Commercial Banks including requirement of maintenance of CRR and SLR shall apply.

5. Their 75 per cent of loan is to be for priority sector lending, and
6. Atleast 50 per cent of loans and advances should be upto 25 lakh.

Examples of SFB include Capital Small Finance Bank (first SFB and it started in 2016), Ujjivan Small Finance Bank, etc.

- **Payments Banks**

The guidelines for Payments Banks provide the following:

1. Eligible prómoters can be non-bank Prepaid Payment Instrument (PPI) issuers and other entities like mobile telephone companies, etc.
2. Shall primarily accept demand deposits up to maximum balance of Rs. 1,00,000 per individual customer.
3. Can issue ATM/Debit Cards, payments and remittance services.
4. Maintain CRR with the RBI on its outside Demand and Time Liabilities and invest at least 75 per cent of its 'demand deposit balances' in SLR eligible G-Secs/Treasury bills
5. Payments Banks also have to comply with all regulatory and supervisory frame works that are applicable to Commercial Banks.

Examples of Payments Bank include India Post Payments Bank, Airtel Payments Bank, Paytm Payment Bank.

Small Finance Banks	Payments Banks
Can accept all types of deposits like a Commercial Bank (Current Account, Savings Account, Fixed Deposit, Recurring Deposit, etc.).	Take deposit only on Current Account, Savings Account and cannot accept Fixed Deposits (FD). They also cannot issue Credit Card but can issue a Debit Card.
They can give out depositor's money as loans to other customers, but have small area operation.	They cannot give depositor's money as loans. They can invest depositor's money in Government Securities (G-Secs) only.
Focus: Deposits and loans.	Focus: Payment/remittances only, including cross border remittances.
Conditions: 75% of the loans is to be for Priority Sector Lending.	Conditions: Maximum balance per customer: 1 lakh. Minimum leverage ratio to be 3%, i.e. liabilities should not exceed 33 times of its net worth.

- **NON-PERFORMING ASSETS**

At banks, loans made to customers are listed as assets. A Non-Performing Asset (NPA) in that asset of a bank which is not producing any income, i.e. a loan or lease that is not meeting its Stated principal and interest payments. As per RBI, a loan/advance on which interest or principal amount is pending for 90 days or more is considered NPA. Categories of NPA:

1. Sub-standard assets: When the NPAs have aged < 12 months.
2. Doubtful assets: When the NPAs have aged> 12 months.
3. Loss assets: When the bank or its auditors have identified the loss, but it has not been written off.

Note: Stressed assets = NPAs + Restructured loans + Written-off assets

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- **Impact of NPAs**

- It leads to scarcity of funds in the Indian securities market as banks become unwilling to give loans.
- The shareholders of the banks will lose a lot of money as banks themselves will find it tough to survive in the market.
- It leads to a crisis of confidence in the market. The interest rates shoot up which directly impact the investors who wish to take loans for setting up industrial projects.
- Low offtake of funds from the security market hurts the overall demand in the Indian economy.
- Ultimately, high NPAs lead to lower economic growth rates and higher inflation because of the higher cost of capital. This trend may continue in a vicious circle and deepen the crisis.

- **Reasons for Rising NPAs**

- Falling debt servicing ability of Indian firms.
- Lack of due diligence and background checks by Public Sector Banks (PSBs) before giving loans and incorrect classification of assets by them.
- Delay in projects implementation.
- Review of decisions by Vigilance Committee prevents strong decision-making.
- Banks do not have a large buffer set aside for absorption of losses.

In tackling NPAs, the following measures were taken by the Government in the past:

S/25 Scheme 2014

Flexible refinancing and repayment option for long-term infrastructure projects to the existing ones where the total exposure of lenders is more than 500 crore.

Refinancing was done at a higher rate of interest so that banks could preserve the Net Present Value (NPV) of the loan amount. There were few disclosures of the accounts getting refinanced under the scheme, and it was perceived that this was a tool deployed by banks to cover NPAs.

Strategic Debt Restructuring (SDR) - 2015
Banks who have given loans to a corporate borrower gets the right to convert the complete or part of their loans into equity shares in the loan taken company

It was observed that difficulties in finding buyers and disagreement over valuations were challenges in implementation.

Asset Quality Review- 2015
To classify stressed assets and undertaking provisioning for them so as to secure the future of the banks and further early identification of the assets and prevent them from becoming stressed by taking appropriate action.

Helpful in increasing transparency, but provides no solution.

Scheme for Sustainable Structuring of Stressed Assets (S4A)-2016
Optional framework which involves the determination of sustainable debt level for a stressed borrower and bifurcation of the outstanding debt into sustainable debt and equity/quasi-equity instruments which are expected to provide upside to the lenders when the borrower turns around

Banks were unwilling to grant write-downs as there were no incentives to do so, and write downs of large debtors could quickly exhaust banks' capital cushions.

In spite of the above measures taken, reduction in NPA could not be achieved. NPA rose from around Rs. 2.8 lakh crore in 2014-15 to around Rs. 8.9 lakh crore in 2017-18. Thus, some more effective measures were undertaken in the form of 4R strategy, which included the following:

1. Recognition of NPAS transparently
2. Resolution and recovery of value from stressed accounts
3. Recapitalising PSBs
4. Reforms in PSBs and wider financial ecosystem for a responsible and clean system

As a Result of this 4R strategy. the NPAs instead of increasing has reduced from Rs. 8.9 lakh crore in 2017-18 to Rs. 7.89 lakh crore in 2018-19

➢ **BAD BANK:**

- A Bad Bank is a bank set up to buy the bad loans stressed assets of a financial institution. The banks sell their NPAs to bad bank at market price. By transferring such assets to the bad bank, the original institution clears its balance sheet - although it is still forced to take write-downs.
- Bad banks are typically set up in times of crisis when long-standing financial institutions are trying to recuperate their reputations and wallets.
- The concept of bad bank' was first mooted in India by the then Chief Economic Adviser Arvind Subramanian in 2017.
- A bad bank is termed so simply because it houses bad loans, or in financial parlance, Non-Performing Assets (NPAs). It is basically a Public Sector Asset Rehabilitation Agency that would take on public sector banks' chronic bad loans and focus on their resolution and the extraction of any residual value from the underlying asset.
- Unlike a private Asset Reconstruction Company, a Government-owned bad bank would be more likely to purchase loans that have no salvage value from Public Sector Banks.
- It would thus work as an indirect bailout of these banks by the Government.

SARFAESI ACT, 2002

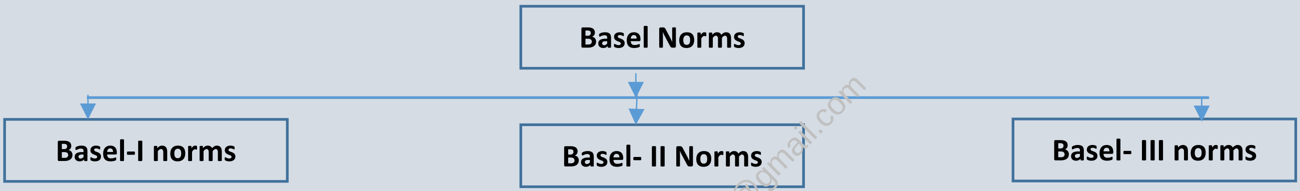
The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, or also as SARFAESI Act, is a legislation that allows banks and other financial organisations to recover bad loans effectively. The act enables the banks and financial institutions to tackle the Problem of Non-Performing Assets (NPAs) through different procedures.

Provisioning for NPA

- Provisioning norms, a part of RBI's prudential regulation, is one of the several mechanisms to tackle the NPA or bad assets problem in the banking sector.
- Under provisioning, banks have to set aside or provide funds to a prescribed percentage of their bad assets.
- Provisioning Coverage Ratio (PCR) is essentially the ratio of provisioning to gross NPAs and indicates the extent of funds a bank has kept aside to cover loan losses.
- Thus, PCR is the percentage of bad assets that the bank has to provide for (keep money) from their own funds.

➢ BASEL NORMS

These norms are prescribed by the Bank for international Settlements (BIS) as a set of global standards which prescribe tor assets to minimum capital requirements for Commercial Banks. Foreign Banks or even RRBs.
Basel is a city in Switzerland which is also the headquarters of BIS. The BIS, established in 1930, the world's oldest international financial organisation.
In total, BIS is owned by 62 Central Banks representing countries from all over the world and covers approximately 95 per cent of the world's GDP.
Till now, three Basel Norms have been released by BIS:



Basel-I Norms

- In 1988, the Basel Committee on Banking Supervision (BCBS) introduced capital measurement system called Basel Capital Accord, also known as Basel- I.
- It focussed only on credit risk.
- It prescribed minimum capital requirement at 8 per cent of the Risk Weighted Assets (RWA) for banks.
- India adopted Basel-I norms in the year 1999. Under Basel-I, the RBI issued guidelines to maintain a CRAR (Capital to Risk Assets Ratio) or CAR (Capital Adequacy Ratio) of 9 per cent by every SCB.

CRAR-It is defined as the proportion of bank's total risk-weighted assets that are held in the form of shareholders equity and certain other defined class of capital.
Mathematically, CAR or CRAR = (Tier-1 + Tier-ll capital)/Total risk-weighted assets.

Where,

- **Tier-1 Capital** is the core measure of a bank's financial strength from a regulator's point of view. It is composed of core capital and consists of mainly share capital and disclosed reserves. It is the highest quality capital because it is fully available to cover losses.
- **Tier-ll Capital** consists of remaining reserves and certain types of subordinate debts.

The debt absorption capacity of Tier-ll capital is less than Tier-l capital.

Basel- II Norms

- BCRS published the Basel II nom in 2004
- **Basel- II** was considered to be the refined and reformed version of **Basel- I**
- It took a three pillared approach:
    1. **Minimum capital requirement** of 8 per cent of risk assets: Concerned with three types of risks- operational risk, market risk and capital risk.
    2. **Supervisory review:** focuses on bank's internal processes and systems.
    3. **Market discipline**: under it, the banks were needed to develop and use better risk management techniques in monitoring and managing all the three types of risks.
- Implementation of Basel-II norms was done in India by RBI following a gradual approach.
- As per RBI, all SCBs were bound to comply with Basel-II norms.

Basel- III Norms

- It became operational from 1 January 2013 in a phased manner.
- Banks are required to increase and maintain the Tier I capital ratio of 4.5 per cent.
- Banks are required to maintain capital conservation buffer of 2.5 per cent.
- Also, counter cyclical buffer to be maintained in the range of 0-2.5 per cent to prevent excess credit growth in the banking sector.
- Total CRAR proposed to be maintained is 9.5 per cent.
- As per RBI, Basel-III norms have to be complied by all commercial banks (both scheduled and non-scheduled).
- RBI directed for a phased manner implementation of Basel-III guidelines by commercial banks. The deadline has recently been deferred by RBI to 1 April 2022.
- Basel-III Framework also introduced liquidity standards in the form of Liquidity Coverage Ratio (LCR).
- The framework of Countercyclical Capital Buffer (CCCB) was also introduced (as an extension of capital conservation buffer). CCCB is a mandatory capital that is required to be set aside by the banks during boom when loans are growing rapidly and use it when there is distress in the economy. It helps a bank to counteract distress economic conditions and restricts the banking sector from indiscriminate lending in the periods of excess credit growth.

Strategic Pillars of National Strategy for Financial Inclusion

To make financial services available, accessible, and affordable to all the citizens in a safe and transparent manner to support inclusive and resilient multi-stakeholder led growth

- Universal access to financial services
- Providing basic bouquet of Financial services
- Access to Livelihood and skill development
- Financial Literacy and Education
- Customer protection and Grievance Redressal
- Effective Coordination

Leveraging technology and adopting a multi-stakeholder approach for sustainable financial inclusion