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SUMMARY SHEET

Functions of RBI

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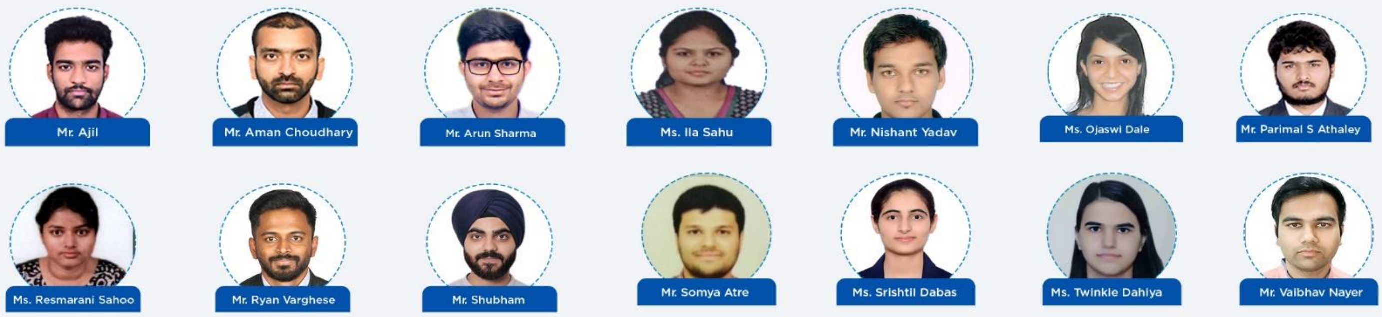
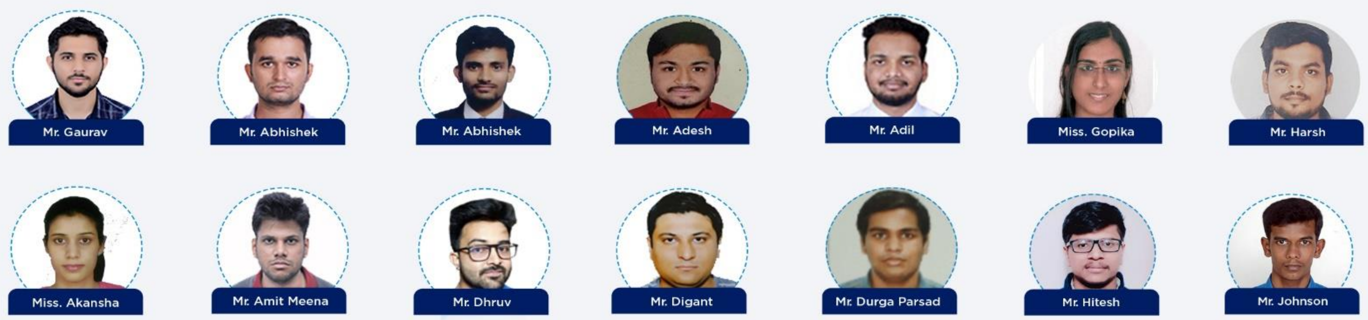
RBI Grade B 2020 - 21

198 Selections Out of 257



SEBI Grade A 2020

63 Selections Out of 80



NABARD Grade A 2020

65 Selections Out of 69

1 What is a Central Bank?

A **central bank, reserve bank, or monetary authority** is an institution that manages the currency and monetary policy of a state or formal monetary union and oversees their commercial banking system.

1.1 Distinction between a Central Bank and Commercial Bank

BASIS	CENTRAL BANK	COMMERCIAL BANK
MEANING	Central bank is the 'apex' body that controls, regulates and operates the entire banking system in the country.	A commercial bank is a bank which accepts deposits and advance loans for the purpose of earning profits.
OWNERSHIP	Owned and governed by government.	Owned and governed generally by private sector.
OBJECTIVE	Operates in public interest.	Operates to maximize profits.
ISSUE OF CURRENCY	Sole monopoly to issue currency.	No powers to issue currency.
PUBLIC DEALING	Does not deal directly with public.	Deals directly with public.
NUMBER OF BANKS	There is only one central bank in every country.	There are multiple commercial banks in a country.
EXAMPLES	Reserve Bank of India (RBI)	PNB, SBI, Kotak Mahindra, ICICI etc....

2 Evolution of Central Bank

- The evolution of central banks can be traced back to the seventeenth century when **Riksbank, the Swedish Central Bank was set up in 1668.**
- **The Bank of England** was founded in **1694**. The Central Bank of the United States, the Federal Reserve established in 1914, was relatively a late entrant to the Central Banking arena.
- **The Reserve Bank of India, India's central bank started operations in 1935.**

2.1 Genesis of Modern Central Banking

- The **eighteenth and nineteenth century witnessed several financial panics.** Panics are a serious problem as failure of one bank may lead to failure of others.
- While the pursuit of sustainable economic growth and low and stable inflation have been fundamental to central banking activities since the early nineteenth century, **the importance of financial stability became more prominent since the**

Great Depression of the 1930s when the world economy faced large bank failures and deep recession.

- The **internationalization of commercial banking activity** brought several risks to the fore. The failure of two banks in 1974, the Franklin National Bank in the United States and Bank Herstatt in Germany, which had international implications necessitated international cooperation and coordination among central banks.
- The **Basel Committee for Banking Supervision (BCBS)** was thus established. The committee sets international regulatory standards, known as Basel Standards, that forms the bedrock for all national and international banking regulations.
- Since the **outbreak of the financial crisis in 2007-08**, the toolbox of central banks has been strengthened. These tools or measures are popularly known as **"unconventional policies",** reflecting their use in extraordinary circumstances.
- Quantitative or credit easing, negative interest rates, forward guidance, etc., are some of the tools employed by central banks to deal with the crisis and its aftermath.
- The central banks also became **"market makers of last resort"** during the crisis as the markets became dysfunctional.

Bagehot's dictum

In **1873, Walter Bagehot**, an editor of the Economist magazine, published a **book titled "Lombard Street"** where he clearly articulated that to avoid panics, central banks should assume the role of **"lender of last resort".**

The **doctrine, which came to be known as Bagehot's dictum** states that a central bank, in periods of panics or crisis, should lend freely, against quality collateral and at a penal rate of interest.

3 Evolution of the Reserve Bank of India

Important Timeline

Origins of the Reserve Bank of India

- 1926: The Royal Commission on Indian Currency and Finance recommended creation of a central bank for India.
- 1927: A bill to give effect to the above recommendation was introduced in the Legislative Assembly, but was later withdrawn due to lack of agreement among various sections of people.
- 1933: The White Paper on Indian Constitutional Reforms recommended the creation of a Reserve Bank. A fresh bill was introduced in the Legislative Assembly.
- 1934: The Bill was passed and received the Governor General's assent
- 1935: The Reserve Bank commenced operations as India's central bank on April 1 as a private shareholders' bank with a paid up capital of rupees five crore (rupees fifty million).
- 1942: The Reserve Bank ceased to be the currency issuing authority of Burma (now Myanmar).
- 1947: The Reserve Bank stopped acting as banker to the Government of Burma.
- 1948: The Reserve Bank stopped rendering central banking services to Pakistan.
- 1949: The Government of India nationalised the Reserve Bank under the Reserve Bank (Transfer of Public Ownership) Act, 1948.

- Initially, the RBI carried out the regulation of foreign exchange transactions under the **Defence of India Rules, 1939 and later, under the Foreign Exchange Regulation Act of 1947.**
- Over the years, as the economy matured, the role shifted from foreign exchange regulation to foreign exchange management.
- The **1991 balance of payment and foreign exchange crisis** was a watershed event in India's economic history.
- Being at the centre of country's monetary and financial system, the **RBI played a key supporting role in helping the Government manage the crisis** and undertake necessary market and regulatory reforms.
- The **Reserve Bank adopted international best practices** in areas, such as, prudential regulation, banking technology, variety of monetary policy instruments, external sector management and currency management to make the new policy framework effective.

4 Legal Framework for different Functions of Reserve Bank

- In India, the RBI is the central banking authority constituted by the Reserve Bank of India Act, 1934 ('RBI Act'), and its duties and responsibilities flow from that statute.
- However, the range of functions, which the RBI is undertaking is not only covered under the RBI Act but is also covered under various other statutes.

4.1 Public Debt Functions

- Discussed later in the chapter.

4.2 Foreign Exchange Management

- The powers and responsibilities with respect to external trades and payments, development and maintenance of foreign exchange market in India are conferred on the RBI under the provisions of the **Foreign Exchange Management Act, 1999 (‘FEMA").**
- **Section 10 of the FEMA empowers the RBI** to authorize any person to be known as authorized person to deal in foreign exchange or in foreign securities, as an authorized dealer, money changer or offshore banking unit or in any other manner as it deems fit.

4.3 Regulation and Supervision of NBFCs

- Discussed Later in the chapter

4.4 Regulation & Supervision of Co-operative bank

- The Bombay High Court has held that “though the control over management of Co-operative Society where it is Co-operative Banking Society or otherwise is vested in the Registrar of Co-operative Societies, but insofar as banking is concerned, by virtue of the Banking Regulation Act, 1949 it will be a subject with which the Reserve Bank of India has full power”.

Other Details are discussed Later in the Chapter.

4.5 Regulation of Derivatives and Money Market Instruments

- The RBI Act defines derivative as an instrument to be settled at a future date, whose value is derived from change in interest rate, foreign exchange rate, credit rating or credit index, price of securities (also called ‘underlying’), or a combination of more than one of them and includes interest rate swaps, forward rate agreements, foreign currency swaps, foreign currency-rupee swaps, foreign currency options, foreign currency rupee options or such other instruments as may be specified by the RBI from time to time.
- The power of RBI to regulate these money market instruments have been provided under Section 45W of the RBI Act.

4.6 Payment and Settlement Functions

- The Parliament of India enacted the **Payment and Settlement Systems Act, 2007** (‘PSS Act, 2007’) with an objective to provide for the regulation and supervision of payment systems in India and to designate the Reserve Bank of India as the authority for that purpose.

- Under the PSS Act, 2007, no person shall commence or operate a payment system except with an authorization issued by the RBI. Similarly, under **Section 8 of the PSS Act, 2007**, RBI has the power to revoke the authorization granted to anyone.

4.7 Credit Information Companies

- Discussed later in the chapter

4.8 Consumer Protection and promotion Functions

- Discussed later in the chapter

5 Organization Structure

Central Board of Directors

- The Central Board of Directors is at the top of the Reserve Bank's organizational structure. Appointed by the Government under the provisions of the Reserve Bank of India Act, 1934, the Central Board has the primary authority and responsibility for the oversight of the Reserve Bank.
- The Governor is the Reserve Bank's chief executive.
- The Central Government nominates **fourteen Directors on the Central Board**, including one Director each from the four Local Boards. The other ten Directors represent different sectors of the economy, such as, agriculture, industry, trade, and professions. All these appointments are made for a period of four years.

Local Boards

- The Reserve Bank also has four Local Boards, constituted by the Central Government under the RBI Act, one each for the Western, Eastern, Northern and Southern areas
- Each of these Boards has five members appointed by the Central Government for a term of four years.

Central Office Departments

Over the last 75 years, as the functions of the Reserve Bank kept evolving, the work areas were allocated among various departments. Currently, the Bank's Central Office, located at Mumbai, has **twenty-seven departments.**

The Central Board has primary authority for the oversight of RBI. It delegates specific functions through it's committees, boards and sub-committees.

Board for Financial Supervision (BFS)

- In terms of the regulations formulated by the Central Board under Section 58 of the RBI Act, the Board for Financial Supervision (BFS) was constituted in November 1994, as a committee of the Central Board, to undertake integrated supervision of different sectors of the financial system.
- The Reserve Bank Governor is the Chairman of the BFS and the Deputy Governors are the ex officio members.

Board for Regulation and Supervision of Payment and Settlement Systems (BPSS)

- The Board for Regulation and Supervision of Payment and Settlement Systems provides an oversight and direction for policy initiatives on payment and settlement systems within the country.
- The Reserve Bank Governor is the Chairman of the BPSS, while two Deputy Governors, three Directors of the Central Board and some permanent invitees with domain expertise are its members.

Subsidiaries of the RBI

1) **Deposit Insurance and Credit Guarantee Corporation (DICGC)**

   The DICGC insures all deposits (such as savings, fixed, current, and recurring deposits) with eligible banks.

   Every eligible bank depositor is insured upto a maximum of Rs.5,00,000 (Rupees Five Lakh) for both principal and interest amount held by him.

2) **Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL)**

The Reserve Bank established BRBNMPL in February 1995 as a wholly owned subsidiary to augment the production of bank notes in India and to enable bridging of the gap between supply and demand for bank notes in the country.

The BRBNMPL has been registered as a Public Limited Company under the Companies Act, 1956 with its Registered and Corporate Office situated at Bengaluru.

The company manages two Presses, one at Mysore in Karnataka and the other at Salboni in West Bengal

6 Functions of RBI

6.1 Monetary Management

- Monetary policy refers to the use of monetary instruments under the control of the central bank to influence variables, such as interest rates, money supply and availability of credit, with a view to achieving the objectives of the policy.
- Monetary Policy could have either a single objective of price stability or multiple objectives. Pursuant to the amendment to RBI Act, 1934, in May 2016, the primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth.
- Topic has been covered in Detail under a separate chapter.

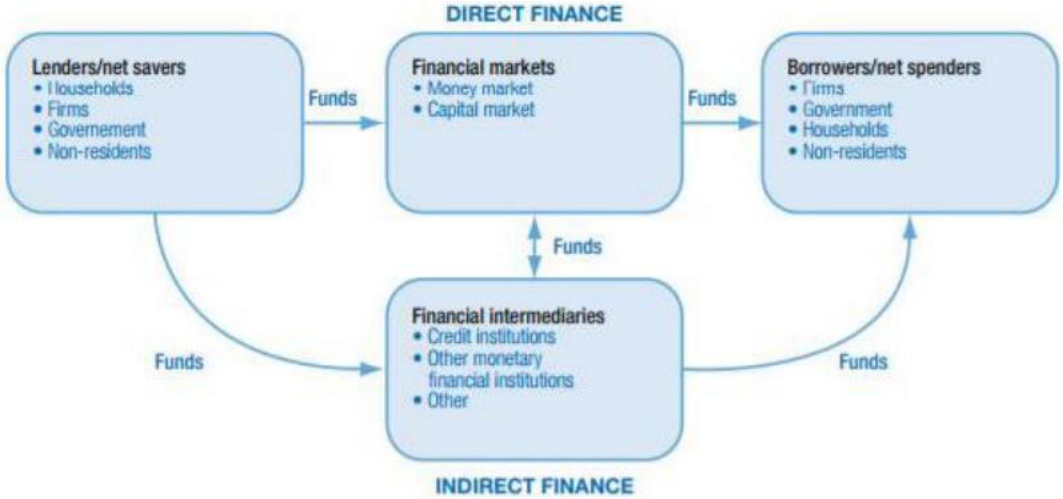
6.2 Foreign Exchange Operations

- The objective and purpose of exchange rate management is to ensure that economic fundamentals are reflected in the external value of the rupee.
- Subject to this general objective, the conduct of exchange rate policy is guided by three major objectives:
  - First, to reduce excess volatility in exchange rates, while ensuring that the market functions in an orderly fashion.
  - Second, to help maintain an adequate level of foreign exchange reserves.
  - Third, to facilitate the development of a healthy foreign exchange market.

6.3 Financial Stability

- Stable financial systems, by allocating society's accumulated savings to the most productive available uses, not only provides access to finance, which is essential for economic development, but also plays a key role in **managing risk and promoting entrepreneurship.**

6.3.1 Channels of Finance



- The two channels are mostly complementary. However, depending upon the nature of development of financial systems in a country, one channel may play a greater role than the other.
- In India, banks not only are the main source of financing for households and corporates, but also are the main saving vehicle. In the absence of a healthy financial system, the intermediation process will not happen, and economic development will stutter.

6.3.2 Systemic Risk

- The financial literature categorizes such an event as Systemic risk – the risk wherein "the provision of necessary financial products and services by the financial system will be impaired to a point where economic growth and welfare may be materially affected".
- A build-up of systemic risk leads to financial instability. Therefore, financial stability is a state whereby the build-up of systemic risk is prevented
- Therefore, the objective of financial stability should be to address the build-up of systemic risk as also to limit the spill over of the consequences of materialization of such systemic risk.

Shadow Banking

- A shadow banking system is the group of financial intermediaries facilitating the creation of credit across the global financial system but whose members are not subject to regulatory oversight.
- The shadow banking system also refers to unregulated activities by regulated institutions.

- Examples of intermediaries not subject to regulation include hedge funds, unlisted derivatives, and other unlisted instruments, while examples of unregulated activities by regulated institutions include credit default swaps.
- The shadow banking system played a major role in the expansion of housing credit in the run up to the 2008 financial crisis but has grown in size and largely escaped government oversight even since then.

6.3.3 Framework for Financial Stability

Objectives of financial stability can be achieved by establishing a framework broadly divided under three categories:

1. establishing an institutional and governance structure for financial stability.
2. measuring and monitoring systemic risk.
3. implementing macroprudential policies to mitigate identified systemic risks.

6.3.4 Institutional and governance structure for financial stability

There are multiple institutional and governance structures working at different levels related to financial stability as highlighted below:

Financial Stability and Development Council (FSDC):

- In India, the Government set up Financial Stability and Development Council (FSDC) in December 2010 as the apex level forum for strengthening and institutionalizing the mechanism for maintaining financial stability, enhancing inter-regulatory coordination and promoting financial sector development.
- The Chairman of the Council is the finance minister and its members include the heads of financial sector Regulators, viz., RBI, SEBI, IRDAI, PFRDA, Finance Secretary and/or Secretary, Department of Economic Affairs (DEA), Secretary, Department of Financial Services, and Chief Economic Adviser
- The Council monitors macro prudential supervision of the economy, including functioning of large financial conglomerates and addresses inter-regulatory coordination and financial sector development issues.
- It also focuses on financial literacy and financial inclusion.

Board for Financial Supervision and the Board for Payment and Settlement Systems:

- The Board for Financial Supervision and the Board for Payment and Settlement Systems, both committees of the Central Board of Directors, were constituted to aggregate information pertaining to the financial system as a whole and take informed decisions to deal with any signs of instability, both at the individual institution level and at the system level.

RBI - Lender of Last Resort:

- The lender of last resort facility as well as Central Bank experience in ensuring price and exchange rate stability makes the Central Banks' role in maintaining financial stability even more significant.

Financial Stability Unit (FSU):

- RBI set up an operationally independent Financial Stability Unit (FSU) in August 2009.
- The FSU prepares half-yearly financial stability reports, which reflect the collective assessment of the subcommittee of the FSDC on risks to India's financial stability.

Measuring and Monitoring Systemic Risk

- Monitoring of systemic risk on an ongoing basis has become a mandate for most of the Central Banks and Financial Sector regulators.
- These monitoring are done with the help of various tools, such as stress tests at micro and macro level, analysis of interconnectedness among various financial market entities and sectors, use of various indicators such as banking stability indicator, systemic liquidity indicator, credit-GDP growth trends for the whole economy as well as for different economic sectors.
- In most of the jurisdictions, these indicators and instruments are published in periodic reports called Financial Stability Reports or Financial Stability Reviews

6.4 Regulatory Functions of RBI

Regulatory and Supervisory structure in India

- The regulatory role of Reserve Bank covers commercial banks, co-operative banks and certain categories of Non-Banking Financial Companies (NBFCs) registered with it. The Ministry of Corporate Affairs (MCA) regulates other financial companies registered with it.
- Further, the Finance Act, 2019 has amended the National Housing Bank Act, 1987 that conferred certain powers for regulation of Housing Finance Companies (HFCs) with Reserve Bank.

Re-organisation of Regulation and Supervision Departments of RBI

- Accordingly, the RBI decided to integrate the supervision function into a unified Department of Supervision and regulatory functions into a unified Department of Regulation with effect from November 01, 2019.

6.5 Regulation of Commercial Banks

6.5.1 Prudential Norms

Prudential norms are the guidelines issued by the banking regulator to ensure safety and soundness of banks. Prominent prudential norms relate to Income Recognition and Asset Classification, Capital Adequacy, Exposures, etc.

Income Recognition and Asset Classification and Provisioning (IRAC) Norms- Asset Quality:

In the course of their business, banks lend and invest in various classes of assets, some of which may turn non-performing either due to the **systemic factors such as economic downturn or idiosyncratic factors specific to the borrower.**

Idiosyncratic factors

- ❑ Idiosyncratic risk **refers to the inherent factors** that can negatively impact individual securities or a very specific group of assets.
- ❑ The opposite of Idiosyncratic risk is a systematic risk, which refers to broader trends that impact the overall financial system or a very broad market.
- ❑ Idiosyncratic risk can generally be mitigated in an investment portfolio through the use of diversification.

- Banks are required to objectively identify stressed assets and take corrective action.
- Indian banks are required to classify assets **as non-performing** once they cease to generate income for the bank.
- Banks are required not to recognize income on such assets on accrual basis and are also required to make provisions out of their profits as a portion of such non-performing assets.
- The classification of non-performing assets is graded based on the age of the non-performing assets and provisions are prescribed depending upon the availability of security, with higher provisioning requirements for higher grades of NPAs.

Basel guidelines on Capital and Liquidity

- Bank's capital acts as loss absorbing buffer protecting depositors in the event of losses faced by the bank. Further, capital also limits leverage of the bank, ensuring its safety.

WHAT IS LEVERAGE?

- ❑ Leverage results from using borrowed capital as a funding source when investing to expand the firm's asset base and generate returns on risk capital.
- ❑ Leverage is an investment strategy of using borrowed money—specifically, the use of various financial instruments or borrowed capital—to increase the potential return of an investment.
- ❑ Leverage can also refer to the amount of debt a firm uses to finance assets.

- Under the Basel Capital Adequacy framework, banks' capital requirements have been linked to the risk profile of their asset classes, **requiring riskier banks to keep larger buffers.**
- The Basel framework evolved over a period since the introduction of Basel I framework in 1988, which required the banks to hold capital as a percentage of their credit risk exposures.
- Gradually the framework was expanded to include other risks on the banks' balance sheet such as market risk (Systematic Risk) and operational risk. The comprehensive Basel II guidelines issued in 2006 provided banks with a flexibility to assess risks using their internal models in addition to the standardized models.
- The global financial crisis led to the introduction of Basel III. It addresses shortcomings of the pre-crisis regulatory framework.
- It seeks to increase the **quantity and quality** of capital, enhance the **risk coverage** and introduce **macro prudential elements** such as leverage ratio, countercyclical capital buffers and liquidity ratios (Liquidity Coverage Ratio and Net Stable Funding Ratio).
- While LCR has already been implemented in India, the implementation of NSFR was scheduled to be adopted from April 1, 2020 but has been differed briefly.

Note: Basel Norms are covered in detail Separately in the course.

6.5.1.1 Exposure Norms:

- A bank's exposures to its counterparties may result in **concentration of its assets to a single counterparty** or a group of **connected counterparties.**
- Reserve Bank of India has fixed limits on bank's exposures to an individual business concern and to business concerns of a group.

6.5.1.2 Investment Guidelines:

- The **Reserve Bank of India issues guidelines for the investment portfolio of the banks**.
- In terms of these guidelines, **the entire investment portfolio of the banks should be classified under three categories**, viz, Held to Maturity (HTM), Available for Sale (AFS) and Held for Trading (HFT).

Held to Maturity?

- Held-to-maturity (HTM) securities are purchased to be owned until maturity.
- Bonds and other debt vehicles—such as certificates of deposit (CDs)—are the most common form of held-to-maturity (HTM) investments.

Available for Sale?

- An available-for-sale security (AFS) is a debt or equity security purchased with the intent of selling before it reaches maturity or holding it for a long period should it not have a maturity date.

Held for Trading?

- A held-for-trading security is a debt or equity investment that investors purchase with the intent of selling within a short period of time, usually less than one year. Within that time frame, the investor hopes to see appreciation in the value of the security and sell it for a profit.

6.5.1.3 Resolution of Stressed Assets:

- The **Banking Regulation (Amendment) Act, 2017**, empowered the Reserve Bank to issue directions to the banks for resolution of stressed assets, including referring assets to the Insolvency and Bankruptcy Code 2016 (IBC).
- Unlike previous schemes for restructuring, **complete discretion and flexibility has been given to banks to formulate their own ground rules** in dealing with borrowers who have exposures with multiple banks.
- **The lenders can implement resolution plans** that are tailored to their internal policies and risk appetites.

6.5.2 Risk Management

- Reserve Bank issues guidelines from time to time to banks to ensure that the banks' management gives considerable importance to improve the ability to identify, measure, monitor and control the overall level of risks undertaken.
- Further, banks are also required to **operationalize formal stress testing framework** to help them in building a sound and forward-looking risk management framework.

6.5.3 Regulation of Interest Rates

- The interest rates on deposits have been progressively deregulated providing **banks greater flexibility in resource mobilization.** However, keeping the customer service under consideration, the **deposit rates are required to be uniform across all branches and for all customers.**
- Banks **can allow higher interest in respect of deposits of** senior citizens, and additional interest in respect of deposits of bank's own staff and executives,

including retired staff (subject to conditions) and associations of staff (except associations of retired staff).

- The banks have been **mandated to link all new floating rate personal or retail loans and floating rate loans extended to MSMEs to external benchmarks**
- To avert the delays in transmission of monetary policy, banks have been advised to **reset the interest rates under external benchmark system at least once in three months.**

6.5.4 Know Your Customer Norms

- Sound 'Know Your Customer' (KYC) policies and procedures are **critical for protecting the safety and soundness of banks and the integrity of banking systemin the country.** To **prevent money laundering** through the banking system, the Reserve Bank has issued 'Know Your Customer' (KYC), Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT) guidelines.

Financial Intelligence Unit

- Financial Intelligence Unit – India was **set by the Government of India in November 2004** as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is **also responsible for** coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes.
- FIU-IND is an **independent body** reporting directly to the Economic Intelligence Council (EIC) headed by the finance minister.

6.5.5 Corporate Governance

With a view to strengthening corporate governance, over a period of time, various guidelines have been issued in matters
Covered Separately as a chapter.

6.5.6 Disclosure Norms

- Banks are now **required to make disclosures in their annual report**, among others, about capital adequacy, asset quality, liquidity, earnings and penalties, if any, imposed on them by the regulator, etc.

6.5.7 Deposit Insurance

- All **commercial banks, including the branches of foreign banks** functioning in India, local area banks and regional rural banks are covered under the Deposit Insurance Scheme.

- Under the Scheme the **insurance cover is limited to ₹5,00,000/- per depositor** for deposits held in 'the same capacity and in the same right' at all the branches of the bank taken together.

DICGC

- DICGC came into existence in 1978 after the merger of Deposit Insurance Corporation (DIC) and Credit Guarantee Corporation of India Ltd. (CGCI) after passing of the ***Deposit Insurance and Credit Guarantee Corporation Act, 1961*** by the Parliament.
- It serves as a deposit insurance and credit guarantee for banks in India. It is a **fully owned subsidiary of and is governed by the Reserve Bank of India.**
- DICGC charges 12 paise per ₹ 100 of deposits held by a bank.

6.5.8 Para Banking Activities

- Deregulation of the banking sector and the development of the financial sector encouraged many banks to undertake **non-traditional banking activities, also known as para-banking.**
- The Reserve Bank has **permitted banks to undertake diversified activities, such as**, mutual funds business, insurance business, merchant banking activities, factoring services, card business, pension fund management, investment advisory services, agency business, membership of SEBI approved stock exchanges, etc.

6.5.9 Regulation of All India Financial Institutions

- The four AIFIs, viz. EXIM, NABARD, NHB and SIDBI are under regulation and supervision of the Reserve Bank.
- These AIFIs have been **constituted under their own statutes which, along with the provisions of the Reserve Bank of India Act, 1934**, provide the legal framework for their regulation.
- **AIFIs are also subject to on-site inspection and off-site surveillance.**

6.5.10 Credit Information Companies

- **Credit Reporting System in India is** governed by the provisions of Credit Information Companies (Regulation) Act, 2005, Credit Information Companies Rules 2006 and Credit Information Companies Regulation, 2006.
- The **credit information reports (CIR)** of borrowers can be obtained from the CICs by specified users listed under CIC regulations which include credit institutions, telecom companies, other regulators, insurance companies, stockbrokers, credit rating agencies, resolution professionals, etc.

- **Individual borrowers can also obtain credit report from CICs.** RBI has directed CICs to furnish Free Full Credit Report (FFCR) which includes credit score to individual borrowers once in a calendar year.

6.5.11 Supervision of Commercial Banks

- **RBI undertakes supervision** of the commercial banks located in India as well as branches of Indian banks located outside India **under various provisions of the Banking Regulation Act, 1949.**
- The **Department of Supervision (DoS)** is responsible for supervision of all RBI regulated entities.

6.5.11.1 Approach Used for Supervision

- **Reserve Bank of India constituted a High-Level Steering Committee** under the Chairmanship of former Deputy Governor, Shri K C Chakrabarty, in August 2011, to review the supervisory processes for commercial banks.
- All the **scheduled commercial banks in India are now under the Risk Based Supervisory (RBS) framework and the erstwhile CAMELS framework is no longer in vogue.**

6.5.11.2 Risk-based Supervision (RBS)

❑ RBS may be defined as "*an ongoing process wherein **risks of a bank are assessed and appropriate supervisory plans designed and implemented by the supervisor***"**.**

❑ The **substantive objectives of supervision**, risk-based or otherwise, are two-fold:

- ✓ Ensuring safety and soundness of the individual banks and thereby protecting the interest of depositors.
- ✓ Safeguarding the stability of the financial system.

❑ The **RBS framework as adopted by RBI is called SPARC** (Supervisory Program for Assessment of Risk and Capital).

❑ The **three key objectives of SPARC are:**

1. to apply differentiated supervision based on risk profile of the bank. i.e., different banks will be subjected to varying degrees of supervision
2. focus on areas deemed as higher risk for the bank. i.e., within a bank the focus will be given to areas that are identified to have significant material risks; and
3. to help banks in improving their risk management systems, oversight and controls.

6.5.11.3 Tools of Supervision

A) Onsite Supervision

Onsite inspection of banks is carried out on an annual basis. The Annual Financial Inspection (AFI) focusses on statutorily mandated areas of solvency, liquidity and operational health of the bank. It is based on internationally adopted CAMEL model modified as CAMELS, i.e., capital adequacy, asset quality, management, earning, liquidity and system and control. Indian commercial banks are rated as per supervisory rating model approved by the BFS which is based on ‘ CAMELS ‘ concept.

B) Offsite Supervision

- The **objective of off-site supervision** is to make a preliminary risk assessment of the bank and discover key risk areas. **This involves assessment of** their business plan/ strategies, group structure, financial statements, compliance and internal audit/plans and reports, observations of external auditors, etc. In this context, an **Off-site Monitoring and Surveillance (OSMOS) system** was set up as a complementary tool to on-site inspection. Under OSMOS, **various returns are collected** at different periodicities, viz., fortnightly, monthly, quarterly, half yearly and annual.
- **Central Repository of Information on Large Credits (CRILC)** has been introduced in 2014 as part of Framework for Revitalizing Distressed Assets in the economy. Credit information on large borrowers are collected from the banks under this system.

A) Para-Supervisory Activities

Central Fraud Registry

❑ Keeping this objective in mind, a Central Fraud Registry (CFR) has been operationalised with effect from **January 20, 2016.**

❑ The CFR will provide **“a searchable centralised database for use by banks”**, which in turn can alert banks to take necessary steps to develop a sound and robust fraud risk management system.

Cyber Security Framework

❑ Accordingly, an Expert Panel on Cyber Security and IT Examination was constituted.

❑ Under the aegis of the Expert Panel, a comprehensive circular, “Cyber Security Framework in Banks”, covering the best practices pertaining to various aspects of cyber security was issued.

❑ A dedicated **Cyber Security & IT Examination Cell (CSITE Cell) was also established** in June 2015 within the RBI.

Early Warning System and Action

❑ Early warning indicators are critical to detect the build-up of vulnerabilities in the banking system.

❑ At a macro level, this involves looking at aggregate indicators such as credit-to-GDP ratio, economy-wide debt service ratios (DSRs), etc., to identify systemic risk. At a micro level, banks are subject to stress testing, capital planning, asset quality review, liquidity monitoring, etc.

Prompt Corrective Action (PCA)

❑ The revised PCA framework was notified in April 2017 and **applies without exception to all banks operating in India** including small banks and foreign banks operating through branches or subsidiaries based on breach of risk thresholds of identified indicators.

❑ The key areas for monitoring banks under the revised framework continue to be capital, asset quality and profitability, while leverage is monitored additionally as part of PCA framework.

❑ **Certain risk thresholds have been defined**, breach of which result in invocation of PCA and result in certain mandatory and discretionary actions.

❑ In addition, the **PCA framework does not preclude the RBI** from taking any other action as it deems fit in addition to the corrective actions prescribed in the framework.

Stress Testing:

❑ In **December 2013, RBI issued guidelines** on stress testing and made it mandatory for all banks to carry out stress tests involving shocks prescribed in the guidelines at a minimum.

❑ The guidelines stated that banks should be able to survive at least the base line shocks and adopt stress testing programmes that is commensurate with the degree of sophistication.

What is Stress Testing?

❑ Stress testing is a computer-simulated technique to analyze how banks and investment portfolios fare in drastic economic scenarios.

❑ Stress testing helps gauge investment risk and the adequacy of assets, as well as to help evaluate internal processes and controls.

❑ Regulations require banks to carry out various stress-test scenarios and report on their internal procedures for managing capital and risk.

Red Flagged Accounts (RFA)

❑ To **prevent the incidence of financial frauds**, the concept of a Red Flagged Account (RFA) was introduced in 2015 as part of the early warning system.

❑ "A RFA is one where a suspicion of fraudulent activity is thrown up by the presence of one or more early warning signals (EWS).".

❑ Accordingly, **banks must set up systems for identifying EWS** and flagging the accounts as RFA for exposures of ₹50 crore and above.

6.6 Regulation and Supervision of Co-Operative Banks

6.6.1 Co-operative Principles

❑ **Voluntary and Open membership:** Without discrimination on basis of gender, social inequality, racial, political ideologies or religious consideration.

❑ **Democratic Member control:** Elected representative of these co-operatives are responsible and accountable to their members.

❑ **Member's Economic Participation** – Members contribute equally and control the capital of their Cooperative democratically.

❑ **Autonomy and Independence** - Co-operatives are autonomous, self-help organisations controlled by their members.

❑ **Education, Training and Information** - Co-operatives provide education and training to their members, elected representatives and employees so that they can contribute effectively to the development of their co-operatives.

❑ **Co-operation among Co-operatives.**

❑ **Concern for Community.**

6.6.2 Difference between Co-operative Credit Societies and Co-operative Banks

❑ **'Co-operative societies' appear at Entry 32 in the State List**, whereas **'Banking' appears at Entry 45 in the Union List** under the Seventh Schedule to the Constitution of India. Hence, Co-operative Societies in India are a state subject and they **do not fall under the regulatory purview of RBI.**

❑ Co-operative Credit Societies, which are licensed to carry out banking activities function as a co-operative bank and are eligible to accept deposits from the public.

6.6.3 Urban Co-operative Banks

❑ **Urban Co-operative Banks (UCBs) are primarily registered as** Co-operative Societies under the provisions of either the State Co-operative Societies Act of the respective State or the Multi-State Co-operative Societies Act, 2002, if the area of operation of the bank extends beyond the boundaries of one State.

❑ The **UCBs are divided into Tier-I and Tier-II UCBs** depending upon the size of deposits and area of operation.

❑ **UCBs satisfying the following criteria are defined as Tier-IUCBs:**

- Deposit base below ₹100 crore and operating in a single district.
- Deposit base below ₹100 crore and operating in more than one district, provided that the branches are in contiguous districts, and deposits and advances of branches in one district separately constitute at least 95 per cent of the total deposits and advances, respectively, of the bank.
- Deposit base below ₹100 crore, with branches originally in a single district, which subsequently became multi-district due to a re-organisation of the district.

❑ **All other UCBs** are defined as Tier-II UCBs

6.6.4 Legal framework for regulating Cooperative banks

- Though the Banking Regulation Act came into force in 1949, the **banking laws were made applicable to cooperative societies in 1966** through an amendment to the Banking Regulation Act, 1949.
- While **administrative aspects** like registration, management, recruitment, audit, write-offs, amalgamation and liquidation are regulated by the State/Central Governments, **matters related to banking** are regulated by the Reserve Bank under the Banking Regulation Act, 1949.
- While **UCBs are regulated and supervised by RBI**, Rural Co-operative Banks, viz., the State Co-operative Banks (StCBs) and the District Central Co-operative Banks (DCCBs) are regulated by RBI but supervised by NABARD.
- **The Long-Term Rural Co-operatives, viz., State Co-operative Agriculture and Rural Development Bank** (SCARDB) and Primary Co-operative Agriculture and Rural Development Bank (PCARDB) do not fall under the regulatory or supervisory purview of RBI.

6.6.5 Approach to Regulation of UCBs

- **To enabling UCBs to offer banking services on par with commercial banks, RBI has permitted them to** provide **universal banking services** in a niche geographical area, whereas commercial banks are mandated to provide niche services throughout India.

6.6.6 Present Status of UCBs

Due to mergers/amalgamations, conversion to credit societies and cancellation of licenses of UCBs over the years, the **number of UCBs in the country** has come down to 1538 as on

May 31, 2020. In terms of total assets, **UCBs contributed 3.2% of total banking system assets** as at March 2019.

6.6.7 Initiatives Taken by RBI

- **For better coordination between the co-regulators**, the Reserve Bank of India entered into Memoranda of Understanding (MoU) with all State Governments and the Central Government since 2005.
- As part of the arrangements under MoU, the Reserve Bank constituted, in each State, a **State-level Task Force for Co-operative Urban Banks (TAFCUB)** for UCBs which operate only in one State. A Central TAFCUB was constituted for the Multi-State UCBs.
- TAFCUBs **identify potentially viable and non-viable UCBs** in the states and suggest revival path for the viable and non-disruptive exit route for the non-viable ones.
- Reserve Bank has recently also brought out guidelines for **voluntary transition of UCBs into Small Finance Banks (SFBs**) subject to certain conditions.
- UCBs continue to **remain outside the Lead Bank Scheme** of RBI and not represented in various fora of SLBC.

Financial Assistance for implementation of Core Banking Solution in UCBs:

- Reserve Bank announced a **scheme of financial assistance in April 2016**, whereby the initial **set up cost of up to ₹4 lakh** would be borne by RBI.
- Technical support for implementation of CBS would be provided by the **Indian Financial Technology and Allies Services (IFTAS),** a wholly owned subsidiary of RBI.
- This initiative has been taken to bring the cooperative banks into a technology platform on par with commercial banks.

6.6.8 Supervision of UCBs

UCBs are subject to both (i) on-site inspection and (ii) off-site surveillance.

6.6.8.1 Supervisory Action Framework

- RBI has put in place a **Supervisory Action Framework (SAF) under BR Act, 1949** for UCBs experiencing financial stress.
- Financial **triggers are based on** the required level of Net NPA (Asset Quality), Profitability and Capital to Risk-Weighted Assets Ratio (CRAR).
- Depending on area and extent of weakness and financial triggers, **actions may include** restriction on opening new branches, capital expenses, declaring/disbursing

dividend, reducing exposure norms for loans or freezing the limit of total advances to the level existing on a particular day, etc.

- The **banks whose financial conditions continue to severely deteriorate are** brought under **All Inclusive Directions (AID)** under Section 35A of the Act, which entails, inter-alia complete prohibition on accepting fresh deposits and grant of fresh loans, besides restricting repayment of deposits to a specified ceiling.
- The banks under AID are monitored closely with an advise to either have robust revival plan or explore possibilities of merger/conversion to a Society.

6.6.9 Rural Co-operatives

- The **long-term co-operative credit structure** has the **State Co-operative Agriculture and Rural Development Banks (SCARDBs)** at the apex level and **the Primary Co-operative Agriculture and Rural Development Banks (PCARDBs)** at the district or block level.
- These institutions were conceived with the objective of meeting long-term credit needs in agriculture and they are **not under the regulatory purview of Reserve Bank of India.**
- The **short-term co-operative credit structure (STCCS)** of the country primarily meets the crop and working capital requirements of farmers and rural artisans. The pyramid of STCCS is primarily 3- tier and is federal in nature within a State.
- **Primary Agricultural Credit Society (PACS)** are outside the purview of the Banking Regulation Act, 1949 and hence not **regulated by the Reserve Bank of India.** They are **regulated and monitored by** the respective State Governments.
- While **regulation** of **State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs)** vests with Reserve Bank, their **supervision** is carried out by NABARD.

6.6.9.1 Moving towards a 2-tier structure for STCCS

- The **structure of STCCS is not uniform across the States.** It has a 3-tier structure in some States and 2-tier structure in some. In a 3-tier credit structure, each tier adds to the cost and margins leading to an escalation in the cost of credit for the ultimate borrowers.
- **The Vyas Committee argued for the elimination of one of the tiers** to bring down costs for ultimate borrowers. The decision for amalgamation of DCCBs into StCB leading to conversion of a 3 tier structure into a 2 tier structure **has to be initiated by the respective State Governments.** The request of the State Government will be examined by RBI in consultation with NABARD.

6.7 Regulation and supervision of Non-Banking Financial Companies in India

An NBFC is defined under section 45 I(f) of the Reserve Bank of India Act, 1934 ('RBI Act') as a:

I. a **financial institution**, which is a company.
II. a non-banking institution which is a company, and its **principal business** is receiving of deposits, or lending.
III. Such other non-banking institution, as RBI may, with the **previous approval of the Central Government** specify**.**

Thus, a 'financial institution' that is a company is an NBFC. The term 'financial institution' is defined under Section 45 of the RBI Act**.**

Briefly, a financial institution means any non-banking institution that carries on any of the following financial activities:

i. Lending or financing for activities other than its own.
ii. Acquisition of shares/stocks/bonds/debentures/securities issued by Government or local authority.
iii. Leasing or hire-purchase.
iv. Insurance business.
v. Chit business.
vi. Collection of monies.
vii. Acceptance of deposits.

But does not include any institution,which carries on its principal business in

i. Agriculture operations.
ii. Industrial activity.
iii. Purchase or sale of any goods (other than securities).
iv. Providing any services.
v. Sale/purchase/construction of immovable property.

6.7.1 Principal Business Criteria (PBC)

- The **term "principal business" is not defined in the RBI Act.** However, the bank tried to explain it in one of its press releases.
- A **company is treated as an NBFC, if** its financial assets are more than 50 per cent (excluding fixed deposits) of its total assets (netted off by intangible assets) and income from financial assets should be more than 50 per cent of the gross income

6.7.2 Exemption From RBI Regulations

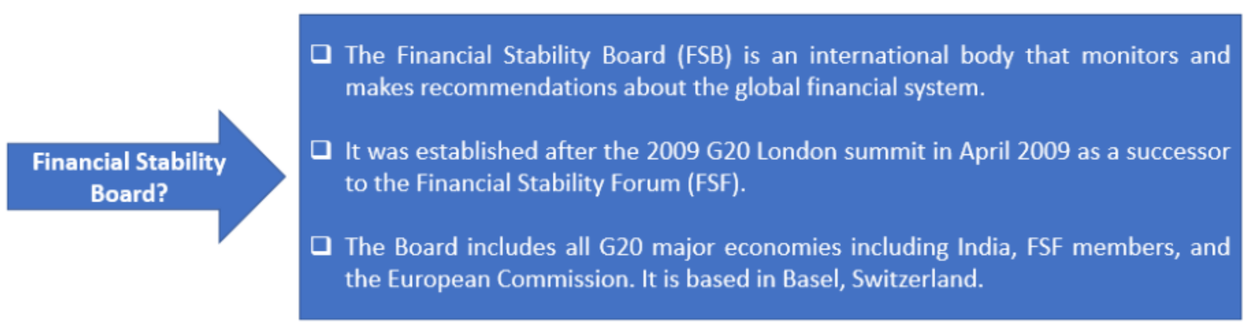
- Observing the definition of NBFC in the RBI Act, **even entities such as insurance companies and stock broking companies are NBFCs.**

- However, these entities are **regulated by other regulators** as part of their statutory function.

Types of NBFCs/Activities	Regulated by
Venture Capital Fund, Merchant Banking Companies, Stock Broking Companies, Mutual Funds, Collective Investment Schemes (CIS)	Securities and Exchange Board of India (SEBI)
Insurance Companies	Insurance Regulatory and Development Authority (IRDA)
Pension Funds	Pension Fund Regulatory and Development Authority (PFRDA)
Mutual Benefit Companies, Nidhi Companies	Ministry of Corporate Affairs (MCA)
Chit Funds	State Governments

6.7.3 Are NBFCs Shadow Banks?

- Financial Stability Board (FSB) defined shadow banking as ***"credit intermediation involving entities and activities (fully or partly) outside the regular banking system".***



- However, in 2018, the **FSB announced its decision to replace the term "shadow banking"** with the term "non-bank financial intermediation" (NBFI) in future communications.
- Every year the **FSB publishes a Global Monitoring Report on Non-Bank Financial Intermediation.**

6.7.4 Types of NBFC

Based on acceptance of public funds and customer interface

Applications for registration of deposit accepting NBFCs (NBFC-D) are not considered since 1997. In respect of non-deposit accepting NBFCs (NBFC-NDs), there are two types of applications based on sources of funds and customer interface.

Type I –

- NBFC-NDs not accepting public funds and not having customer interface. However, in case these companies intend to avail public funds or have customer interface in future, they are required to seek approval from the Department of Regulation (DoR).

Type II –

- NBFC-ND accepting public funds or having customer interface.

Based on Size

- An NBFCs-ND is **categorised as systemically important** (i.e. NBFC-ND-SI) if its asset size is ₹ 500 crore or more.
- Given the sensitivity towards public deposits, **deposit taking NBFCs (i.e. NBFC-Ds) are clubbed along with NBFC-ND-SIs irrespective of their size.** Indeed, some regulations for NBFC-Ds are restrictive and stringent as compared to NBFC-ND-SIs.

Based on Activity

- NBFCs are heterogeneous in their activities. Consequently, it is difficult to have a **'one size fits all' regulatory framework and NBFCs need to be categorised based on their principal activities.**
- This does **make the regulatory framework complex.** Today almost 99 per cent of NBFCs by number fall under the Investment and Credit Category (ICC)

Sl. No.	Type of NBFC	Nature of activity / Principal Business	Key Qualifying Criteria
1.	Investment and Credit Company (ICC)	i) Lending (erstwhile Loan companies) ii) Financing of physical assets including automobiles, tractors and generators (erstwhile Asset Finance Companies) iii) Acquisition of securities (erstwhile Investment Companies) Includes Gold Loan companies which are NBFCs primarily engaged (i.e. 50 percent or more of financial assets0 in lending against gold jewellery.	Does not qualify (or has not registered) to be in any other category

Sl. No.	Type of NBFC	Nature of activity / Principal Business	Key Qualifying Criteria
2	Infrastructure Finance Company (IFC)	Providing long term loans for Infrastructure development	(i) Infrastructure loans should be at least 75 per cent of total assets. (ii) Minimum NOF of ₹ 300 crore. (iii) Minimum credit rating of 'A'. (iv) CRAR of 15 per cent with min. Tier 1 of 10 per cent.

Sl. No.	Type of NBFC	Nature of activity / Principal Business	Key Qualifying Criteria
3.	Core Investment Company (CIC)	Investing in / lending to group companies	(i) 90 per cent of total assets to be investments in group companies and 60 per cent of investments in group companies to be in equity shares of group companies (ii) Does not trade in its investments in shares, bonds, debentures, debt/loans of group companies except through block sale for dilution/disinvestment. (iii) Does not carry out any other financial activity

Sl. No.	Type of NBFC	Nature of activity / Principal Business	Key Qualifying Criteria
4.	Infrastructure Debt Fund (IDF)	Refinancing existing debt of infrastructure companies	(i) Minimum NOF of ₹ 300 crore. (ii) Invests only in Public Private Partnerships (PPP) and post commencement of operations date (COD) in infrastructure projects which have completed at least one year of satisfactory commercial operation and become a party to tripartite agreement.
5.	Micro Finance Institutions (MFI)	Collateral free loans to small borrowers	(i) Minimum NOF of ₹5 crore (for North East: ₹ 2 crore). (ii) Invests only in Public 85 per cent of assets to be in qualifying assets criteria.

Sl. No.	Type of NBFC	Nature of activity / Principal Business	Key Qualifying Criteria
6.	NBFC – Factors	Factoring business i.e. financing of receivables. Registered under section 3 of the Factoring Act	(i) Minimum NOF of ₹5 crore. (ii) Financial assets in factoring business at least 50 per cent of total assets and income derived there from not less than 50 per cent of total income.
7.	Mortgage Guarantee Companies (MGC)	Providing mortgage guarantees for loans	90 per cent of business turnover in principal business and 90 per cent of gross income from this business.
8.	Non-Operative Financial Holding Company (NOFHC)	For setting up new banks in private sector through its promoter/promoter groups	Should have first received an in-principle approval for setting up a commercial bank from RBI.

Sl. No.	Type of NBFC	Nature of activity / Principal Business	Key Qualifying Criteria
9.	Account Aggregators (AA)	Providing under contract the service of retrieving, consolidating, organising and presenting financial information to its customer.	Can only provide account aggregation services. Only those financial assets that are under the regulatory ambit of financial sector regulators can be aggregated. These aggregators cannot support the transactions of customers and cannot take services of third-party service providers.
10.	Peer-to-Peer (P2P) Lending Platforms	Carries on the business of a P2P lending platform i.e. providing loan facilitation services to participants on the platform.	Can only provide platform. No lending from its own books.

Sl. No.	Type of NBFC	Nature of activity / Principal Business	Key Qualifying Criteria
11.	Housing Finance Company (HFC)	Registered under section 29A the NHB Act to carry on the business of providing finance for housing and housing projects.	Minimum NOF 20 crores
12.	Standalone Primary Dealers (SPD)	Primary Dealers are expected to play an active role in the G-Sec market, both in its primary and secondary market segments through various obligations like participating in Primary auction, market making in G-Secs, predominance of investment in G-Secs, achieving minimum secondary market turnover ratio, etc.	Minimum NOF of ₹150 crore for undertaking core activities and ₹250 crore for undertaking diversified activities.

13. Residuary Non-Banking Companies (RNBCs):

The principal business of such companies is receiving deposits under any scheme or arrangement or in any other manner. However, no fresh registrations for this category are being issued.

14. Miscellaneous Non-Banking Companies (MNBCs):

- NBFCs that manage **chit fund business.**
- Chit funds are primarily **regulated by State Governments** and NBFCs carrying on chit fund business are exempt from registration requirements.
- Further, **MNBCs have been barred from accepting fresh public deposits since July 1, 1977,** and the extant RBI regulatory framework deals with protecting the interest of depositors of the existing depositors of such companies.

15. Asset Reconstruction Companies (ARC):

- These are **registered and regulated under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002** for acquiring and dealing in financial assets sold by banks and financial institutions.
- The **minimum NOF stipulated** for these companies was increased from ₹.2 crore to **₹.100 crore in April 2017**.
- Prudential guidelines on maintenance of capital adequacy, deployment of funds, asset reconstruction, asset classification norms, disclosure norms, etc., have been stipulated for these companies also by RBI.

6.7.5 Regulation of NBFCs

- RBI acquired regulatory and supervisory powers over NBFCs with the insertion of **Chapter III-B in the RBI Act in 1963.**
- **In 2019, certain amendments enumerated below were again carried out to Chapter III-B of the RBI Act, which has *inter-alia* strengthened RBI's supervisory powers:**

- Reserve Bank may notify different amount of NOF to different categories of NBFCs with minimum NOF between ₹.25 lakh and ₹.100 crore.
- RBI can remove Directors of NBFC (other than Government owned NBFCs).
- RBI can supersede the BOD of NBFC (other than Government owned NBFCs).
- RBI can remove or debar an auditor of NBFC for a max. period of 3 years at a time.
- Resolution of NBFCs through amalgamation, reconstruction, splitting into various activities, etc.
- Power to call for information of Group Companies and inspection of Group Companies

- With the notification of the Insolvency and Bankruptcy Rules, 2019 by the Government of India, the RBI is also entrusted with insolvency resolution process of NBFCs (including HFCs) under the Insolvency and Bankruptcy Code (IBC) from November 2019 onwards.

6.7.6 Regulatory Framework

The regulatory framework for NBFC-NDs is lighter as compared to NBFC-ND-SI and NBFC-Ds.

- Instead of capital to risk weighted assets ratio (CRAR), NBFC-NDs are required to adhere to a simpler to compute leverage ratio.
- Similarly, a six-month overdue norm is followed for classification of an asset as non-performing for NBFCNDs as compared to a three-month overdue norm for NBFC-ND-SIs and NBFC-Ds.
- Further, credit concentration norms as applicable to NBFC-ND and NBFC-D have not been made applicable for NBFC-NDs.

6.7.6.1 Comparison of Regulatory Framework for NBFCs and Banks

	NBFC-ND	NBFC-ND-SI and NBFC-D	Banks
Legal Basis	Chapter IIIB of the RBI Act		Banking Regulation Act, 1949
Capital Adequacy	No CRAR. Leverage Ratio of 7 times	Min. CRAR of 15 per cent (akin to Basel 1 i.e. uniform risk weights and no capital charge for market or operating risks)	Min CRAR of 9 per cent + Capital Conservation Buffer +Counter cyclical Buffer (Basel 3 based)

	NBFC-ND	NBFC-ND-SI and NBFC-D	Banks
NPA classification norms	6 months overdue (except NBFC-MFI)	3 months overdue (90 days for NBFC-MFI)	90 days
Credit concentration	No specific norms	Limits reckoned as percentage of owned funds Single Borrower Limit: 25 per cent (Lending:15 per cent, Investment: 15 per cent) Group Borrower Limit: 40 per cent (Lending:25 per cent, Investment: 25 per cent)	Large exposure framework –Limit reckoned as per centage of Tier I capital Single counterparty: 20 per cent Groups of connected counterparties: 25 per cent

	NBFC-ND	NBFC-ND-SI and NBFC-D	Banks
Liquidity Coverage Ratio (LCR)	Not applicable	Applicable for all NBFC-D and those NBFC-ND-SI with asset size of ₹5,000 crore or more.	Applicable for all Commercial Banks (excluding Regional Rural Banks, Local Area Banks and Commercial Banks)
			Rural Banks) when effective.

	NBFC-ND	NBFC-ND-SI and NBFC-D	Banks
KYC/AML-CFT	Same norms uniformly applicable to banks and NBFCs.		
Accounting Norms	Based primarily on Companies Act, 2013. Listed NBFCs and other NBFCs with net worth of ₹ 250 crore or more are required to prepare financial statements as per IFRS converged Indian Accounting Standards (Ind AS)		Melange of statutory requirements, accounting standards, RBI instructions and guidance notes issued by self-regulatory organisations.

6.7.7 Fintech developments in the NBFC sector

A. Digital-only lending platform

- Though Digital-only lending platform are not a new category of NBFC, they have adopted a business model wherein the **NBFI activity is carried out only over a digital platform without any brick-and-mortar presence**.
- It **also caters to such customers who** do not have credit history, but their creditworthiness can be ascertained through their spending pattern, which in turn would bring more customers in the formal financial fold.

B. P2P Lending Platform

- An intermediary bringing the **borrowers and lenders** over an electronic platform.

C. Account Aggregator

- It retrieves or collects information related to financial assets of a customer from the holders of such information and aggregates the same before presenting it to the customers or users specified by customers.
- The larger goal of AA is to attain data empowerment or data democratization in an emerging market economy like India.
- In order to ensure that movement of data is seamless across systems in a safe and secured environment, technical specifications for AA have been prescribed.

6.7.8 Supervision of NBFCs

The RBI has put in place a five-pronged supervisory framework based on:

A. Onsite and Offsite Supervision

Already Covered

B. Market Intelligence

- With the objective to control the incidents of unauthorized acceptance of deposits by unscrupulous entities, State Level Coordination Committees (SLCC) are formed in all States to facilitate information sharing among the Regulators viz. RBI, SEBI, IRDA, NHB, PFRDA, Registrar of Companies (RoCs) etc., and Enforcement Agencies of the States viz., Home Department, Finance Department, Law Department, Economic Offences Wing (EOW) etc.

C. The Sachet Portal

- The Reserve Bank launched a mobile friendly portal Sachet (sachet.rbi.org.in). The portal can be used by the public to share information wherein they can also upload photographs of advertisements/publicity material, raise queries on any fund raising/investment schemes that they come across and lodge complaints.

D. Exception Report of Statutory

- The Statutory Auditors are required to report to the Reserve Bank about any irregularity or violation of regulations concerning acceptance of public deposits, credit rating, prudential norms and exposure limits, capital adequacy, maintenance of liquid assets and regularization of excess deposits held by the companies

E. Interaction with Stakeholders

- In order to develop a closer understanding of the emerging risks and developments in the sector to facilitate prompt action Supervision department interacts with various stakeholders like Management of NBFCs, Statutory Auditors, Credit Rating Agencies, Credit Information Companies, Mutual funds etc.

6.8 Banker to Banks and Government

6.8.1 Introduction

- As a banker to banks, the Reserve Bank fulfills this role. **While discharging this role, RBI focusses on:**

enabling smooth, swift and seamless clearing and settlement of inter-bank transactions

providing an efficient means of funds transfer for banks

enabling banks to maintain their accounts with the Reserve Bank for statutory cash reserve requirements and maintenance of transaction balances

acting as a lender of last resort in case of need

6.8.2 Legal Provisions guiding RBI to act as a Banker to the Banks

- **Sec.17 of RBI Act, 1934** – Business which the bank can transact including transactions with banks.
- **Sec.42 of RBI Act, 1934** – Maintenance of Cash Reserves by banks with RBI.

6.8.3 Maintenance of Current Account

- Banks and financial institutions which are eligible to open account with the Reserve Bank can open only a single Current Account.

6.8.3.1 Purpose of Current Account

Current accounts are opened in the E-Kuber system (CBS). The current accounts are used for the following purposes:

- Maintenance of CRR by banks

- Inter-institutional funds transfer among the entities maintaining current accounts with RBI
- Inter-bank settlements
- Making payments to RBI and Govt. Departments.

6.8.3.2 Restrictions on Current Accounts

- Third party transactions are not allowed in the current accounts. Overdrafts, including intra-day overdrafts are also not permitted in the current accounts.

6.8.4 Special Purpose Account

- Financial Institutions/banks maintaining current account with RBI may require an **additional account for some specific purpose. Example of such accounts** are Line of Credit (LOC) account, SBI DD/TT Payable Account, CCIL Multi Modal Account etc.

6.8.5 RTGS Settlement Account

In addition to current account, the banks also maintain a separate ***'Settlement Account'*** for RTGS transactions.

6.8.6 Accounts of Institutions incorporated outside India

- In **terms of Section 17(13) of RBI Act 1934**, RBI is authorised to act as agents/correspondents of banks and institutions incorporated outside India and can open Rupee Accounts for them.

6.8.7 Granting loans and advances to banks and others

- The **Bank is authorized to make** loans, grant advances to and discount bills of scheduled banks, State Cooperative Banks and various other institutions, details of which are given in of the Reserve Bank of India Act, 1934.
- Accordingly, the **banks can avail liquidity facility from RBI under** Repo / Term Repo / Marginal Standing Facility (MSF) against the Government Securities as collateral.
- The **Primary Dealers maintaining current accounts with RBI can also** avail liquidity support facility and avail Repo/Term Repo.

6.8.8 Banker to the Government: Legal Provisions

- Under Sections 20 and 21 of the RBI Act, the **RBI shall have an obligation and right respectively to accept monies for account of the Central Government** and to make payments up to the amount standing to the credit of its account, and to carry out its exchange, remittance and other banking operations, including the management of the public debt of the Union.

- In terms of Sec.21A of the Act, the RBI can transact the banking business of State Government through an agreement with the respective State Governments.
- **Sec.45 of the RBI Act, 1934, empowers RBI to appoint agency banks** for conduct of Government Business as RBI has limited presence across the country.

6.8.8.1 Banker to Central Government

- Under the administrative arrangements, the **Central Government is required to maintain a minimum cash balance with the RBI.**

6.8.8.2 Banker to State Government

- The principal account of all State Governments except Sikkim is maintained under the account titled "Government Deposit Account – State".
- The **minimum balance required to be maintained by each State varies from State to State** depending on the relative size of the State budget and economic activity.

6.8.9 Types of Accounts Maintained by Government

Personal Ledger Account

- These are in the nature of **current account.**
- Such accounts will be opened in the name of Government Officers specified, for the purpose of booking receipts and drawings on their behalf.

Drawing Account

- These accounts will be maintained for Government Officers who are permitted to **operate on Government balances without limit of amount.**
- Most of the government accounts maintained with the Bank pertain to this category.

Assignment Accounts / Letter of Credit Account

- These are only drawing accounts, which will be **maintained by offices for Government Officers to whom a certain sum is allotted** by the Pay and Accounts Officer/audit office concerned **for a specified period.**
- Payments on behalf of drawing and disbursing officers during the specified period will not exceed the amount of assignment or letter of credit.

6.8.10 Appointment of Agency Banks

- Under a **scheme introduced in 1976**, every ministry and department of the Central Government has been allotted a specific public sector bank for handling its transactions.
- Hence, the **Reserve Bank does not handle Government's day-to-day transactions** except where it has been nominated as banker to a particular ministry or department.

- The **agency banks are paid agency commission** for the Government business work being handled by them. Inspection of these agency banks are also carried out at periodic intervals by RBI.

6.8.11 Provision for Safe Custody of Articles

- **Articles for safe deposit are also accepted** from Government Ministries/Departments of Central/ State Governments/ Union Territories who are banking with the RBI.

6.9 Public Debt Management

6.9.1 Legal Background

- **Article 292 of the constitution** provides for debt issuance by the Government of India on the security of Consolidated Fund of India.
- In terms of **Section 20 and 21 of the RBI Act**, it is incumbent upon the Central Government to entrust Reserve Bank of India with its debt and cash management functions and it is the responsibility of the Reserve Bank of India to conduct the debt& cash management functions of Government of India.
- The matters related to issue and servicing of Government debt are dealt as per the provisions of this **Government Securities Act 2006.**
- **Article 293 of Constitution of India** empowers State Governments to issue bonds within the territory of India, on the security of consolidated fund of the State.
- However, explicit **sanction of Government of India is required** in case State Government owes any money to the Central Government.
- The **State Government can enter into an agreement with RBI** in terms of Section 21A of RBI Act for their banking and debt management functions.

6.9.2 Role of RBI as Debt Manager

- IDMD (internal debt management department) manages the Market Borrowing Programme (MBP) of the Centre as well as States and Union Territories (UTs) and maintains the accounting/ reporting related to these operations.

6.9.2.1 Instruments of Market Borrowing

Fixed rate bonds (most popular)

These bonds pay **same coupon rate on the face value of the bond held**, throughout the life of the bond. Because of its simple structure, they are the most popular form of debt security issued by GoI.

Floating Rate Bonds (FRBs):

Such bonds **pay coupon based on some benchmark rate** and the coupon is reset at periodic interval. Most floating rate bonds issued by GoI are linked to yield of 91/182/364 day treasury bills.

Zero Coupon bonds (Treasury Bills, Cash Management Bills)

Zero coupon **bonds pay no periodic coupon**, rather they are issued at a discount and redeemed at full face value. The difference in discounted issue price and face value accounts for the return on these bonds.

Sovereign Gold bonds (SGB)

- These are newer type of GoI offering which is aimed primarily at retail investors to provide them gold linked return and a substitute to investment in physical gold.
- These bonds pay periodic coupon on the issue price of the bond.

Inflation Indexed Bonds (Retail & Wholesale)

Such bonds **provide protection from erosion of real returns due to inflation**, wherein inflation is measured through inflation index such as CPI & WPI. Issuance of such bonds is very infrequent, and the same were last issued in 2013/2014.

Bonds with call/put Options

- Bonds with call & put option provide **additional flexibility to issuer and investor respectively to better manage the interest rate risk.**
- Issuance of such bonds by GoI is rare.

Special Securities e.g. Oil bonds, fertilizer bonds, UDAY recapitalization bonds etc

- These securities are issued by GoI **to specific entities for specific purposes.**
- For example, power bonds (or UDAY Bonds) are result of restructuring of loans of Discoms through partial takeover of the liability by the States.

6.9.3 Investors in Government Securities

- **Commercial banks in India are the largest investor** class in Government securities, followed by insurance companies.
- Recently, **Voluntary Retention Route (VRR) scheme** has been announced allowing greater operational flexibility to FPIs in Government Securities market.
- Further, **Fully Accessible Route (FAR) in certain specified categories of Government securities** have been started, to enable non-residents to invest in specified Government securities without any restrictions.

6.9.4 Ways and Means Advances

- To tide over temporary mismatches in the receipts and payments of Governments, **Sec.17 (5) of RBI Act** empowers RBI to grant Ways and Means Advances to Central Government and State Governments, which is a **collateral free clean advance.**
- The advance is granted as and **when required** by the Government (Central/State).

WMA for Central Government:

- The limit and period of the limit of these advances is decided by RBI, in consultation with the Central Government.
- If the Government borrows over and above this limit, then it amounts to Overdraft (OD).
- The Reserve Bank may trigger fresh floatation of market loans when the Government utilises 75 per cent of the WMA limit.

WMA for State Governments:

- The limit of WMA varies from State to State.
- In addition to WMA, State Governments are also eligible for a Special Drawing Facility (SDF), which is granted against collateral of Government Securities held by State Governments. As this is a collateralized advance, the interest rate for SDF is less than that of WMA.
- State Governments have to exhaust the SDF limit before availing WMA.
- When the advances to the State Governments exceed their SDF and WMA limits, overdraft (OD) facility is triggered.

6.9.5 Consolidated Sinking Fund (CSF) and Guarantee Redemption Fund (GRF)

- State Governments maintain the Consolidated Sinking Fund (CSF) and the Guarantee Redemption Funds (GRF) with the Reserve Bank as buffers for repayment of their liabilities.

6.10 Consumer Education and Protection

6.10.1 Legal Background

- RBI is, inter alia, entrusted with a responsibility under **the Banking Regulation Act, 1949**, which provide in detail the **"Power of the Reserve Bank of India to give directions in the public interest; or in the interest of banking policy; or to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors".**
- RBI derives similar powers under the **RBI Act, 1934** for Non-Banking Financial Companies and **Payment and Settlement Systems Act, 2007** for System Participants.

6.10.2 Important Initiatives of RBI

- **Mandating the Board of the banks** to discuss the customer service aspects and the implementation of regulatory instructions on a half-yearly basis

- Advising banks to constitute a **Customer Service Committee of the Board**
- Mandating banks to set up **Standing Committee on Customer Service**
- Advising banks for setting up of **Customer Service Committees in branches** to encourage a formal channel of communication between the customers and the bank
- Requiring banks to designate **Nodal department and Nodal officer** in the bank for handling customer service and grievances of Customers.
- **Mandating Board approved policies** on Customer Service, Customer Rights, Deposits, Cheque Collection, Customer Compensation and Customer Grievance Redressal.

Banking Ombudsman Scheme

- It was **introduced by the RBI in the year 1995** in India for expeditious and inexpensive redress of customers' grievances against deficiencies in banking services. **The Scheme, so far, has undergone five revisions since its inception, the latest being in July 2017.**

<u>SALIENT FEATURES OF THE SCHEME:</u>

- Pecuniary Jurisdiction of BO for issuing an Award- 20 Lac.
- Compensation of one lakh rupees for loss of time, expenses, harassment and mental anguish in all type of complains.
- Additional grounds for filing complaints to the BOs introduced viz:
  - i) Mis-selling of third-party products
  - ii) Deficiency in Mobile Banking/ Electronic Banking Services have been included under the BO Scheme.

<u>Ombudsman Scheme for Non-Banking Financial Companies, 2018:</u>

- The Scheme that was notified under Section 45-L of RBI Act, 1934 was **initially made applicable** NBFC-D with effect from Feb, 2018 and then **extended to all NBFC-ND having asset size of ₹100 crore** and above and having customer interface with effect from April, 2019.
- The Scheme also provides for an **Appellate mechanism** under which the complainant / NBFC has the option to appeal against the decision of the Ombudsman before the Appellate Authority, in case of award or rejection under certain clauses.

<u>Ombudsman Scheme for Digital Transactions, 2019:</u>

- The Scheme, launched under Section 18 of the Payment and Settlement Systems Act, 2007, provides a cost-free and expeditious complaint redressal mechanism relating to deficiency in services for customers of non-bank entities regulated by RBI.

<u>Internal Ombudsman in Banks</u>

- RBI had instructed all Scheduled Commercial Banks (excluding Regional Rural Banks) having more than 10 banking outlets in India to appoint Internal Ombudsman (IO).
- The IO has been mandated to examine all the grievances wholly/ partially rejected by the banks.

6.10.3 Charter of Customer Rights

RBI in the year 2014-15, formulated a ***"Charter of Customer Rights"*,** which is in the nature of overarching principles of customer protection and primarily applicable for bank customers. The Charter consists of five rights.

Right to fair treatment

Right to transparency, fair and honest dealings.

Right to Suitability

Right to Privacy

Right to grievance redress and compensation

6.10.4 Consumer Education and Protection Cells at Ros

During the year 2015-16, Consumer Education and Protection Cells (CEP Cells) were set up in all the Regional Offices of RBI to facilitate **grievance redressal of customers with regard to grounds not covered under the Ombudsman Scheme** and of entities regulated by the RBI but not covered under the Ombudsman Scheme.

6.11 Financial Inclusion and Development

6.11.1 Major Role and Function of RBI for FI

- **Policy formulation** relating to rural credit and priority sector lending with special emphasis on increasing credit flow to agriculture, micro and small enterprises and the weaker sections.
- Financial Inclusion initiatives and **monitoring of Financial Inclusion Programmes**
- Implementation and monitoring of **Lead Bank Scheme.**
- Forming policies and guiding the flow of credit to the MSME sector
- **Dealing with NABARD**, based on various statutory provisions
- Promoting **financial literacy.**

6.11.2 Institutional Mechanism for FI

- The **Financial Stability and Development Council (FSDC)** chaired by the Union Finance Minister and involving heads of all financial sector regulators that has financial inclusion and financial literacy as one of its important mandates.
- A high-level **Financial Inclusion Advisory Committee (FIAC)** set up by RBI to focus on providing strategic direction to FI initiatives across various stakeholders.

6.11.3 Business Correspondents

- RBI, in **January 2006** permitted banks to use intermediaries as Business Facilitators (BF) or Business Correspondents (BC) for providing financial and banking services.
- Scheduled Commercial Banks (SCBs) including Regional Rural Banks (RRBs), Local Area Banks (LABs), the Payments and Small Finance Banks have been permitted to use the services of BCs.
- The **BCs are allowed to** conduct banking business as agents of the banks at places other than the bank premises.
- A scheme for **graded certification programme for BCs** has also been mandated by RBI to enable the BCs to acquire necessary skills and knowhow to handle complex tasks that are beyond deposits and remittances.
- A **Two-Tier Skill Upgradation** for Performance of Resources- Business Correspondents (SUPER-B) programme for capacity building and sensitisation of BCs has been introduced.

6.11.4 Increasing Brick and Mortar Presence

- It is mandated to open **physical bank branches or Banking Outlets** in all unbanked villages above a population of 5000 in a phased manner.
- **Fixed point BC** locations are also recognised as Banking Outlets of banks.

6.11.5 National Strategy for Financial Inclusion

- RBI has launched the **National Strategy for Financial Inclusion (NSFI) 2019-2024**, which sets forth the vision and key objectives of the financial inclusion policies in India to help expand and sustain the financial inclusion process at the national level through a broad convergence of action involving all the stakeholders in the financial sector.

6.11.6 Priority Sector Lending

The **objective of priority sector lending (PSL) has been to ensure that vulnerable sections of society get access to credit** and there is adequate flow of resources to those segments of the economy which have higher employment potential and help in making an impact on poverty alleviation.

PSL is covered in detail separately in the course.

6.11.7 Interest Subvention Schemes

- With the approval of Government of India, **RBI announces Interest Subvention Schemes related to Agriculture and MSME sectors.**
- Such subvention schemes are thus aimed at bringing certain sections of society into formal banking channels thereby **promoting financial inclusion.**

6.11.8 Kisan Credit Card

- The Kisan Credit Card (KCC) has emerged as an innovative credit delivery mechanism to provide **adequate and timely bank credit to farmers under a single window** for their cultivation and other needs, including consumption, investment and insurance.
- The **KCC Scheme has now been extended to** farmers involved in animal husbandry and fishery to enable them to meet their working capital requirements.

6.11.9 RBI Initiatives for Financial Literacy

- Instructions have been issued to banks to open and operationalize **Financial Literacy Centres (FLCs)** and also undertake financial education through the rural bank branches across the country. **Financial Support for the same is also made available from the Financial Inclusion Fund managed by NABARD.**
- Financial Education outreach through the Regional Offices of RBI through the Financial Literacy Architecture for Regional Environment- Unified Programme **(FLARE-UP) guidelines.**
- Creation of financial education literature which has been uploaded on the **Financial Education website of RBI.** The content is available in 13 languages.
- Observing **Financial Literacy Week (FLW) every year** since 2016 to propagate financial education messages on a particular theme across the country.

- In addition to the above, the **Reserve Bank of India is a full member of the OECD-INFE** which is a global forum to bring together policy makers from across the globe to guide on strengthening financial education.

6.11.10 National Centre for Financial Education (NCFE)

- National Centre for Financial Education (NCFE) has been incorporated as a **Section 8 (Not for Profit)** Company promoted by all regulators, viz., RBI, SEBI, IRDAI and PFRDA.
- It has **two main objectives** as detailed below:
  - To promote Financial Education across India for all sections of the population
  - To create financial awareness and empowerment through financial education campaigns across the country.

6.12 Research, Surveys and Data Dissemination

6.12.1 Important Publications

- Brief analytical reports on contemporary issues prepared by the staff are disseminated through **Mint Street Memos (MSM).**
- The RBI is under legal obligation to **publish two other reports every year -**
  1. **Annual Report**
  - The Annual Report, which provides detailed accounts on the working and operations of the Bank, is submitted to the Central Government in terms of Section 53(2) of the RBI of India Act, 1934.
  2. **The Report on Trend and Progress of Banking in India -**
  - Submitted under Section 36(2) of the Banking Regulation Act, 1949, provides detailed accounts on the operations and performance of Scheduled Commercial Banks, Co-operative Banks and Non-Banking Financial Institutions.

<u>Other Important Reports/Surveys/Data Disseminated by RBI:</u>

1. **THE FINANCIAL STABILITY REPORT:**
   - The Financial Stability Report reflects the overall assessment on the stability of India's financial system and its resilience to risks emanating from global and domestic factors. The Report also discusses issues relating to development and regulation of the financial sector.
2. **HANDBOOK OF STATISTICS ON INDIAN STATES**
   - Provides state-wise information on a wide range of socio-economic indicators of the regional economy of India, *viz.*, social and demographic characteristics, state domestic product, agriculture, industry, infrastructure, banking and fiscal developments.
3. **STATE FINANCES: A STUDY OF BUDGETS:**

- Provides information and analysis of the fiscal position of the state governments based on primary state level data.

4. **THE ANNUAL CENSUS ON FOREIGN LIABILITIES AND ASSETS OF INDIAN COMPANIES (FLA):**
   - It is conducted to facilitate India's participation in the IMF's Co-ordinated Direct Investment Survey (CDIS) and Co-ordinated Portfolio Investment Survey (CPIS) as well as for items in BoP and IIP.
5. **SURVEY OF PROFESSIONAL FORECASTERS ON MACROECONOMIC INDICATORS:**
   - The Bank has been conducting the Survey of Professional Forecasters (SPF) since September 2007
   - The SPF panelists provide annual and quarterly forecasts of around 20 key macroeconomic indicators such as growth, inflation, banking sector indicators, external sector variables.
6. **INDUSTRIAL OUTLOOK SURVEY (IOS)**
   - This quarterly survey captures the business sentiments for the current quarter and expectations for the ensuing quarter.
   - The Survey is being conducted since 1998.
7. **ORDER BOOKS, INVENTORIES AND CAPACITY UTILIZATION SURVEY**
   - This quarterly survey is being conducted since 2008 to fill the data gap on capacity utilisation, order books and inventories in the Indian manufacturing sector.
   - This data provides estimates of capacity utilization.
8. **INFLATION EXPECTATION SURVEY:**
   - The Bank has been conducting Inflation Expectations Survey of Households (IESH) since September 2005.
9. **CONSUMER CONFIDENCE SURVEY:**
   - The changes in consumer confidence have the potential to affect real economic activities through changes in business sentiments.
   - The Bank is conducting its consumer confidence survey since 2010 to capture perceptions of consumers on the general economic situation, prices, employment, financial situation and their own income and spending for the current year as well as expectations for the ensuing year using two-stage probability sampling design.
   - The survey covers around 5,400 households in 13 cities and its periodicity is aligned with the bi-monthly monetary policy.
10. **HOUSE PRICE INDEX:**
    - Changes in housing prices are related to real estate activities, credit market, household balance sheet and are, therefore, important for macroeconomic policy and maintenance of financial stability.
    - The Reserve Bank compiles quarterly House Price Index (HPI) (base 2010-11=100) at all India level and for ten major cities (*viz.*, Mumbai, Delhi, Chennai, Kolkata, Bengaluru, Lucknow, Ahmedabad, Jaipur, Kanpur and Kochi).

- These indices are based on property price transactions collected from registration authorities of respective state governments. The index is compiled using Laspeyres' Price index formula.

6.13 Currency Management

6.13.1 Legal Provisions

Currency Management is one of the core functions of the RBI by virtue of the statutory **responsibility conferred on the central bank by the Reserve Bank of India Act, 1934**,

Under Section 22 of the RBI Act, 1934 **"Right to Issue Bank notes",** RBI has the sole right to issue bank notes of various denominations except one-rupee notes, which is issued by the Government of India.

- As per the **Coinage Act, 2011**, the Government of India has the sole right to produce / mint coins.
- Although the responsibility for minting coins vests with the Government of India, the **coins are issued for circulation only through the Reserve Bank of India** under the provisions of Section 38 and Section 39 of RBI Act, 1934.
- Currency includes the bank notes issued by RBI in various denominations from time to time ranging between ₹2 to ₹10000 (**Section 24 of RBI Act**).

6.13.2 Evolution of Paper Currency in India

- Paper currency **made its appearance in the later part of the 18th century**, when it was introduced in the form of promissory notes by the royal Treasuries / banks.
- These **notes were issued by** Bank of Hindostan (1770-1832), General Bank of Bengal and Bihar (1773-75), Bengal Bank (1784-91), the Commercial Bank (1819-1828), etc.
- In 1913, the **Office of Controller of Currency was established** replacing the Currency Department in the Government.
- With the **enactment of the RBI Act, 1934**, the function of issue of notes was taken over by the RBI from the Controller of Currency in 1935.
- The initial notes were printed in England and the production of currency notes in India started with the establishment of the **currency printing press at Nashik in Maharashtra in 1928.**
- The same was augmented with the setting up of another government press at **Dewas in Madhya Pradesh (MP) in 1974.**
- To bridge the gap in demand and supply of currency notes necessitated by the increasing currency requirements of growing economy, the RBI, in 1995 established a wholly owned subsidiary **Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL).**
- In 1996, **BRBNMPL established two currency presses** - one in Mysuru in Karnataka and the other at Salboni in West Bengal to augment the country's bank note production capacity.

6.13.3 Designing of Notes

- **The design, form and material of bank notes are decided by the Government of India based on the recommendations of the Central Board of RBI**, as specified in Section 25 of the RBI Act, 1934.
- Currently, bank notes of various denominations are issued in the Mahatma Gandhi (New) series.

Denomination	Colour	Size	Motif	Identification mark	Bleed Lines
2000	Magenta	66mm x 166mm	Mangalyaan	Horizontal Rectangle	Seven angular bleed lines
500	Stone Grey	66mm x 150mm	Red Fort	Circle	Five angular bleed lines
200	Bright Yellow	66mm x 146mm	Sanchi Stupa	H	Four angular bleed lines with two circles in between
100	Lavender	66mm x 142mm	Rani ki Vav	Triangle	Four angular bleed lines
50	Fluorescent Blue	66mm x 135mm	Hampi with Chariot	-	-
20	Greenish Yellow	63mm x 129mm	Ellora Caves	-	-
10	Chocolate Brown	63mm x 123mm	Sun Temple, Konark	-	-

6.13.4 Distribution of Currency

- **Wholesale model** – Under the wholesale model, as prevalent in Australia, the commercial banks purchase bank notes directly from the central bank. These banknotes are transported and stored by the banks at approved cash centres located throughout Australia.
- **Retail model** – Under the retail model, as practised in China and France, the central bank opens its own stocking points to take care of the currency needs of the public and other institutions.
- **Semi-retail model** – Like most central banks, India has adopted the semi- retail model under which its currency notes are made available to currency chest branches of banks at their doorsteps. The transportation and other moving costs are borne by the central bank. The banks are required to bear only the static cost of maintaining the currency chest.

Clean Note Policy

RBI has a mandate as per the Section 27 of the RBI Act, 1934, to ensure that only clean notes are in circulation and to fulfil this mandate the soiled notes are taken out of circulation

6.13.5 Fake Indian Currency Notes

- In India, section 489 A to 489 E of the Indian Penal Code deals with counterfeiting currency notes or bank notes.

- The **definition of 'counterfeiting' in the Indian Penal Code also** covers currency notes issued by a foreign government authority as well. The Government of India has also framed Investigation of High-Quality Counterfeit Indian Currency Offences Rules, 2013 under Unlawful Activities (Prevention) Act (UAPA), 1967.

Security Features of the New MG Series

1. **Watermark:**
- This consists of an image that is visible when the bank note is held up against the light, which is created during the manufacturing process such that it is an integral part of the paper.
- The Bank notes contain the Mahatma Gandhi portrait with the denomination numeral (electrotype) watermark.
2. **Security Thread:**
- Colour shifting windowed security thread is present in denomination of ₹100 and above the colour of which changes from green to blue when the note is tilted.
- The inscriptions 'भारत' 'RBI' is present in denominations of ₹100, 200, and 500. In ₹2000 the inscriptions are 'भारत' 'RBI' '2000'.
- For ₹10, 20 and 50 denominations, windowed demetallized security thread with inscriptions 'भारत' and 'RBI' is present.
3. **Latent Image:** The latent image is a security feature that is concealed within the note. It is visible only when it is held horizontally at eye level.
4. **Micro lettering:** Micro lettering are minute inscriptions which can be only read under a microscope / magnifying lens of higher capacity. This feature appears on the left shoulder of the Mahatma Gandhi portrait with inscriptions 'India' and 'भारत'. Micro letters can also be seen on the motifs in the reverse side of the notes.
5. **Intaglio Printing:** Raised printing which are due to deposits of ink and can be felt on touch are called intaglio printing.
6. **See through Register:** The see-through register is a design that is printed partially on both sides of the note, exactly opposite of each other, and looks like one single design when seen against the light.
7. **Fluorescence:** This is a special security feature in which optical fibres and florescent ink is used which glows when exposed to ultraviolet light. The number panels of the notes are printed in fluorescent ink and the note also contains optic fibres, both of which glow when the note is held under an ultraviolet lamp.
8. **Ascending font of numbers:** This is a new feature wherein the font size of the number (excluding prefix) in the number panel is increasing from left to right.
9. **Angular Bleed Lines:** This feature is seen in the notes issued since 2016. It is a set of lines in raised prints at the left had corner of the note slightly above the Ashoka Emblem.
10. **Identification Mark:** There is an identification mark on the left-hand side of each note on the front side which is in raised print (intaglio) and has different shapes for different denominations for eg. square for Rs 50, rectangle for Rs 20 etc.

6.13.6 Salient Features of Bank Notes

- **Name of the Issuer –** Name of the issuing authority, viz., the Reserve Bank of India in Hindi and English at the top of the note.
- **Guarantee Clause –** The clause which states that the note is guaranteed by the Govt of India.
- **Promissory Clause –** The clause by which the signatory of the note promises to pay the bearer the sum of the amount mentioned in the note.
- **Signature of the Issuer –** The signature of the Governor of RBI.
- **Number Panel -** The unique number for each note which is a six digit one, prefixed by three alpha numerical digits.
- **Denomination –** The denomination of the currency in numerals.
- **Portrait of Mahatma Gandhi** – Portrait of Mahatma Gandhi at the centre.
- **Language Panel** – Denomination written in 15 languages on the reverse of the note.

Recent Developments

Laboratory for Banknote Quality Assurance:

- The Bank has set up a laboratory at Mumbai in October 2018 for bank note quality assurance.
- The lab has been set up to ensure standardisation and objectivity in approval of the banknotes in pre and post printing stage for all the printing presses.

MANI (Mobile Aided Note Identifier):

- In January 2020, it launched the mobile application "MANI Mobile Aided Note Identifier" thereby making Indian banknotes more accessible for the visually impaired and facilitating their day-to-day transactions.

6.14 Development and Regulation of Financial Market

- The Money market, Government Securities market, Foreign Exchange market, certain elements of the Corporate Debt market and derivatives relating to interest rate, credit and foreign exchange fall under the regulatory domain of the Reserve Bank.
- The Bank has been discharging both the developmental as well as regulatory roles for these markets.
- The concept is covered in more details under Primary and Secondary Market Chapter.

6.15 Other Functions

- Regulation of payment and settlement system.
- FOREX Management.

Both the topics are covered separately in the course.