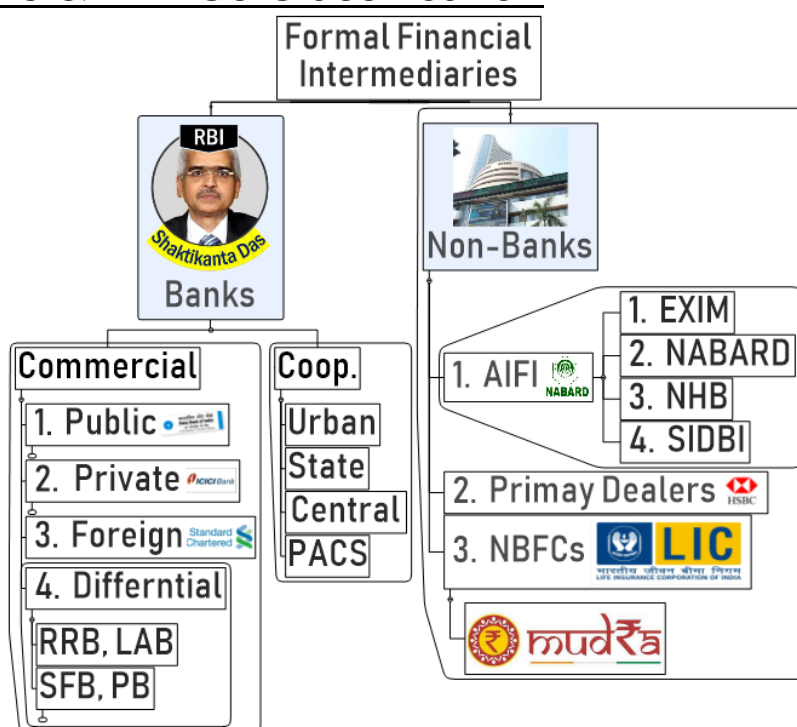




Banks & NBFCs Classification

- A Financial Intermediary (FI: वित्तीय मध्यस्थ) is an entity that acts as the middleman between two parties in a financial transaction- between lenders vs. borrowers, investors vs. entrepreneurs, households vs business firms.
- Such FI can be subdivided into (1) Formal (2) Informal.



5 FORMAL FI ⇒ BANKS

5.1 RESERVE BANK OF INDIA (RBI): भारतीय रिजर्व बैंक

1913	Commercial banks were required to register under the Companies Act, but monitoring was lax. No CRR, SLR, BASEL Norms.
1926	Royal Commission on Indian Currency (_____ Commission) recommends setting up a central bank named 'Reserve Bank of India'.
1929	Great Depression in USA leads to collapse of 450+ banks in India. So British Government becomes serious about setting up RBI.
1934	Reserve Bank of India Act was enacted.
1935, April	RBI becomes operational from 1 st April, with 1 st Governor Sir _____ Government ownership was ~4.4% only.
1935, July	Commercial Banks fulfilling certain conditions were listed in the 2 nd Schedule of RBI Act, & such “ Scheduled Banks ” were required to keep CRR with RBI.
1943-49	_____ becomes the first INDIAN Governor of RBI. He had also participated in the Bretton Woods Conference, USA (1944).
1948-49	All private investors' shares transferred to Gol under the RBI transfer of ownership act 1948. Therefore, RBI governor answerable to Parliament, has to pay dividend to Government from its profits.
19__	Banking Regulation Act (बैंकिंग विनियमन अधिनियम) empowered the RBI to ⇒ Give license to companies to open banks, give permission banks to open new branches. ⇒ Prescribe auditing and liquidity norms for Banks such as SLR. ⇒ Protect interest of depositors. Force elimination / merger of weak banks.



MCQ. In context of independent India's economy, which one of the following was the earlier event to take place? (Asked in UPSC Prelims-2009)

- A) Nationalization of insurance companies B) Nationalization of state bank of India
C) Enactment of Banking regulation Act D) Introduction of first Five year plan

Table 1: RBI Central Board Composition

(Non-Official Directors)	(Official Directors)
<ul style="list-style-type: none"> - 2 Government officials - 10 directors nominated by Government. - 4 directors from RBI's local boards @West, East, North, South 	<ul style="list-style-type: none"> - RBI Governor - 4 Dy. Governors

5.1.1 RBI Governor & Dy Governor

- 25th Governor: Shaktikanta Das (Retd. IAS, Former finance secretary, G20 Sherpa, Member of 15th Finance Commission). He replaced Urjit Patel (2018-Dec).
- RBI Act (Section 8) provides for "NOT MORE than 4" Dy. Governors viz.
 1. B.P. Kanungo: from RBI officer cadre.
 2. N. S. Vishwanathan: from RBI officer cadre.
 3. Mahesh Kumar Jain: Appointed by appointment committee
 4. Dr. Viral V. Acharya: Appointed by appointment committee. also, Ex-officio Member of Monetary Policy Committee.

Their tenure usually 3 years. Re-appointment Possible. They're selected by Financial sector regulatory appointment search committee (FSRASC) headed by the Cabinet Secretary (IAS).

Related Topic: RBI Autonomy, Dividend Controversy, Section 7, PCA/BASEL : all with next NPA Handout.

5.1.2 RBI Offices & Departments

- RBI 4 regions: Northern: Delhi, Eastern: Kolkata, Southern: Chennai, Western: Mumbai
- RBI has various departments looking after Banks, NBFCs, Payment Systems, Foreign Exchange Management etc.
- Previously individual departments directly acted against violators. WEF 1/4/2017: A New **Enforcement Dept** was setup in RBI for centralized action against violators.
- This is different from FinMin's **Enforcement Directorate** (प्रवर्तन निदेशालय) that looks after Foreign Exchange Management Act, 1999 (FEMA) and Prevention of Money Laundering Act, 2002 (PMLA)- विदेशी मुद्रा प्रबंधन अधिनियम, और धनशोधन निवारण अधिनियम.

5.1.3 RBI: Functions of

- 1) **Controller** of Money Supply: Issues M0 under RBI Act, Makes Monetary Policy.
- 2) **Controller** of Foreign Exchange: through FEMA Act. (more in Pillar#3)
- 3) **Banker** to Governments & Public Debt Manager.
- 4) **Banker's** _____ : Lender of Last resort, Advises in monetary matters.
- 5) **Regulator** of all "BANKS": through BR Act'49, Payment Systems'07
- 6) **Regulator** of AIFI, NBFC-D & others.
- 7) **Promotional Roles:** Customer protection through Ombudsman, Financial Inclusion through PSL norms, 25% rural branch requirements.
- 8) Data Publication & International Coop. @BASEL, IMF, G20's Financial Stability Board etc.



MCQ. The Reserve Bank of India (RBI) acts as a bankers' bank. What does it mean? (Asked in UPSC-Pre-2012)

- 1) Other banks retain their deposits with the RBI.
- 2) The RBI lends funds to the commercial banks in times of need.
- 3) The RBI advises the commercial banks on monetary matters.

Answer codes: (a) 2 & 3 only (b) 1 and 2 only (c) 1 and 3 only (d) 1, 2 and 3

MCQ. The Reserve Bank of India regulates the commercial banks in matters of (Asked in UPSC-Pre-2013)

- 1) Liquidity of assets
- 2) Branch expansion
- 3) Merger of banks
- 4) Winding-up of banks

Answer Codes: (a) 1 & 4 only (b) 2, 3 & 4 only (c) 1, 2 & 3 only (d) 1, 2, 3 & 4

5.2 SCHEDULED BANKS (अनुसूचित बैंक)

When RBI is satisfied that a bank has (Paid Up Capital + Reserves) = Min __ Lakhs & it is not conducting business in a manner harmful to its depositors, then such bank is listed in the __ Schedule of RBI Act, and known as a Scheduled Bank.

Scheduled Bank	Non-Scheduled Bank
Required to deposit CRR money to RBI	Can maintain the CRR money with themselves.
Eligible to borrow / deposit funds in RBI's window operations.	Depends on RBI's discretion.
are required to protect the interests of depositors and abide to RBI norms.	Ofcourse, they also have to do it, else RBI can shut them down under BR Act.
Can be subdivided into two parts 1) Scheduled Commercial Banks (SCB) e.g. _____ 2) Schedule Cooperative Banks like Haryana Rajya Sahakari Bank, Tamil Nadu State Apex Cooperative Bank	Hundreds of cooperative banks are non-Schedule. But we need not see their list at Rbi.org.in/CommonPerson/English/scripts/banksinindia.aspx

5.3 FI⇒ COMMERCIAL BANKS⇒ PRE-INDEPENDENCE

Table 2: Before Independence (Exact Years Not-IMP.)

1707	Bank of Hindustan, Calcutta (Europeans owned)
1806-42	- Three Presidency Banks at Bengal then Bombay then Madras. - 1861: all three were given the right to issue currency. - 1921: They were combined into Imperial Bank of India⇒ SBI (1955)
1865	Allahabad Bank (Europeans owned)
1894	PNB: Indian owned, Lala Lajpat Rai helped in foundation.
1908	Bank of Baroda by Maharaja Sayajirao Gaekwad III
1913-30s	State Bank of Travancore, State Bank of Patiala, the rise and collapse of Banking industry, then Birth of RBI (1935)
1940s	State bank of Bikaner, Jaipur, Hyderabad, Travancore by the respective princely states / Nawabs. Post-Independence: became 'Associated Banks of SBI', and ultimately, merged in SBI (2017).



5.3.1 Nationalization of Banks After Independence: Reasons

- ⇒ **NEXUS between Banks and Industrialists:** From 1950s to 1960, only 188 elite people controlled the economy by being in board of top 20 banks, 1452 companies, and numerous insurances, finance companies. This led to reckless lending to directors and their firms. So, Banks failed frequently, RBI had to close unviable banks.
- ⇒ Private Banks unwilling to open in rural areas- this did not help in **financial inclusion** of poor, farmers, MSME or achievement of FYP targets or reducing regional imbalance.

Table 3: Nationalization & Merger of Banks after Independence

1948	RBI Transfer of Ownership Act.
1955	Imperial Bank nationalized and became SBI.
1955-56	LIC Act took over private life insurance cos.
1963	State Bank of Jaipur and Bikaner merged together.
1969	'Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969: 14 Private banks with 50 cr/> deposits were nationalized e.g. Bank of Baroda, PNB, Dena, Canara etc. - Catholic Syrian Bank (1920, Kerala), Ratnakar Bank, Dhanlaxmi Bank etc., did not have such large deposits, so they were left out & called “_____ Private Banks ”.
1972-73	GIC Act- took over private Non-Life (=General) insurance cos. Later GIC was re-organized with 4 subsidiaries: National Insurance, New India Assurance, Oriental Insurance and United India Insurance.
1980	6 banks with 200 cr/> deposits were nationalized e.g. Corporation Bank, Vijaya Bank, Oriental bank of Commerce etc.
2008-10	State Bank of Saurashtra and State Bank of Indore merged into SBI.
2013	- _____ was setup as PSB, HQ Delhi, 100% ownership by Union Government. - BMB's Board of Directors:_____. Staff & Deposit Holders: both men and women, Loans given predominantly to women- and that too without collaterals upto Rs.1 crore.
2017, 1st April	BMB & 5 Associated Banks of SBI viz. State Bank of Bikaner and Jaipur (SBBJ), State Bank of Hyderabad (SBH), State Bank of Mysore (SBM), State Bank of Patiala (SBP) and State Bank of Travancore (SBT), merged with SBI from 1 st April by swapping of shares.
2017, Nov	- Alternative Mechanism Panel setup under the FM Jaitley's chairmanship (other members: Piyush Goyal, Nirmala Sitharaman). - They examine the proposals for merger/consolidation of the Public Sector Banks (PSBs) and forward to Cabinet for approval. - Department of Financial Services coordinates the filework.
2019, 1st April	_____ to be merged into Bank of Baroda, by swapping of shares. Then BoB will become India's 3 rd largest bank after #1 SBI and #2 HDFC.



5.4 PRIVATIZATION OF PSBs (सार्वजनिक क्षेत्र के बैंकों का निजीकरण)

- **Pro-Arguments:** Economies of Scale, Geographical & Technological Synergies, Easier compliance with BASEL-III norms, reduced cost of business-> better lending & deposit rates.
- **Anti-Arguments:** Employees worried seniority, promotion, increments; financial burden of Voluntary Retirement Scheme (VRS). Banks may lose regional identities & customer intelligence with transfer of employees. Big customers may shift to other banks for faster service and personalized privileges.

5.4.1 UTI Bank -> Transformed to Axis Bank (2007)

- ⇒ Setup in 60s as a *Sarkaari* Mutual Fund Company through Unit Trust of India Act 1963
- ⇒ 1993: Obtained License to open UTI Bank.
- ⇒ 2001: Ketan Parekh Sharemarket Scam, Govt has to bailout UTI -> further restructuring
- 2007-> Became Axis Bank: 77% private shareholding + 23% by Public sector bodies like LIC, New India Assurance, SUUTI etc. (as of 2019, Jan).

5.4.2 IDBI Bank -> Purchased by LIC (2018)

- ⇒ Setup in 60s as a Development Financial Institution (DFI) through the Industrial Development Bank of India Act, (1964).
- ⇒ 2004: Transformed into a Public Sector Bank, after Narasimham-II suggested DFI abolition.
- ⇒ IDBI Bank shareholding: 81% Government + ~11% LIC + remaining by other investors
- ⇒ 2014: RBI's P.J. Nayak Committee that suggest Govt should exit shareholding in smaller PSBs, to enhance their efficiency.
- ⇒ Budget 2016: Govt agreed to reduce shareholding to <50% in IDBI Bank.
- ⇒ 2018: IDBI has the highest NPA (28%) among PSB, so no mentally-fit investor willing to buy Govt's shares. Govt. forces LIC to buy its 40% for ~9k crores. Thus, LIC will own 51% in IDBI. Deal was approved by the respective financial regulators (RBI and IRDAI) by 2018-July.
- ⇒ **Positive:** Govt. no longer worry about BASEL-recapitalization of IDBI. LIC can market its insurance policies to IDBI consumers (*bancassurance*).
- ⇒ **Negative:** LIC policy holders' money is going into a loss-making Bank. They'll be deprived of optimal returns (opposite to had LIC invested in a profitable company) = this amounts to "Financial Repression of Households" (वित्तीय दमन).

5.5 COMMERCIAL BANKS ⇒ PRIVATE SECTOR BANKS (PVB) निजी-क्षेत्र के बैंक

While the nationalization of banks was done with the lofty objectives, but politicization in Public Sector Banks (PSBs) created new set of problems:

- Government administered loan interest rates for populism= Low profitability for PSBs.
- Low recovery from NPA due to political interference, and legal loopholes.
- Employees unions hampering any innovation or customer responsiveness.
- **1991:** the Balance of Payment crisis finally forced Govt. to set up a committee for Banking Sector Reforms under The **former RBI Governor** _____. He said:
 - Government should ↓ its shareholding in Public Sector Banks.
 - RBI should ↓ CRR and SLR, Govt should not dictate interest rates to Banks, Liberalise the branch expansion policy
 - Allow entry of New Private Banks and New Foreign Banks.



Table 4: Three rounds of private bank licensing in India

Round-1 (1993-95)	Round-2 (2001-04)	Round 3 (2013-16)
1) ICICI 2) HDFC 3) Indus 4) DCB 5) UTI-> later Axis bank 6) IDBI->now owned by LIC 7) Global Trust Bank-> Merged with Oriental Bank #8-9-10: Bank of Punjab, Centurian Bank, Times Bank were merged into HDFC	1) Kotak Mahindra 2) _____ (Founder Rana Kapoor)	Rajan invited applications, Bimal Jalan Committee made selections: 1. _____ (A Microfinance company based in W.Bengal) 2. _____ (An infra finance NBFC based in Maharashtra). Later on, another NBFC "Capital First" merged so renamed into IDFC-First

5.5.1 On-Tap License to open Private Sector Banks

A private entity can open Bank only after getting license from RBI under Banking Regulation Act, 1949. Previously, one had to wait till RBI invited applications. But in the On-Tap system (WEF 2016), one can apply to RBI whenever he wishes, provided that:

1. It's a Resident Indian individual, NBFC, or private company with min. __ years of experience in Banking-Finance Sector, and Min. 500 crore capital, and total assets not more than Rs. 5000 crores. *[Amount / B.com/CA-interpretations not imp. for UPSC]*
2. Proposed Bank will be controlled by Indians & willing to open 25% branches in unbanked rural areas.

5.6 COMMERCIAL BANKS ⇒ FOREIGN BANKS (विदेशी बैंक)

In Nehruvian Socialist Economy there was disdain & apprehensions about Foreign Banks. Only a handful of them were allowed to open branches. But, Post-Narasimham-Reform: foreign banks approval policy was liberalized.

Foreign Bank in India	<ul style="list-style-type: none"> - They're Incorporated abroad (i.e. registered under the Companies Act of a foreign nation) & opening branch / subsidiary in India e.g. Citibank, Bank of America, HSBC. - While CRR, SLR & other norms applicable, but PSL norms vary depending on number of branches. <i>[Ref: Prev. Handout: PSL]</i>
Indian Public Sector Bank	<ul style="list-style-type: none"> - Foreigners can invest max. 20% in its shareholding. E.g. BoB (15%), SBI (14%), PNB (13%) - Although Government thinking of raising it to 49% to help capital mobilization for BASEL-III norms. <i>[More in Next NPA handout]</i>
India Private Sector Bank	<ul style="list-style-type: none"> - Upto 49% (automatic) and upto 74% by approval of Government. - e.g. HDFC (73%), ICICI (59%) Axis Bank (52%).. - Although Government thinking of raising it to 100% to help capital mobilization for BASEL-III norms



5.7 COMMERCIAL BANKS ⇒ DIFFERENTIAL BANKS

Difference	Universal Bank (सार्वत्रिक)	Differential Bank (भेदकर)
Branches	Anywhere: example SBI, ICICI [*After opening 25% of branches in unbanked rural areas]	Geographical Restrictions on branch opening for Local Area Bank (LAB), Regional Rural Banks (RRB)
Accept	Both Time & Demand Deposits of any amount.	Payment Bank – Accept Max. _ _ _ _ only.
Give Loans to	Anyone [After 40% PSL]	- SFB, RRB: _ _ _ to PSL - Payment Bank can't give loans;

Chronology of differential banks: RRB(1976) → local area bank (1996) → Small Finance Bank & Payments bank(2015) → Wholesale banks (proposed)

5.7.1 Commercial Banks-> Differential Banks-> RRBs & LAB

Parameters	(Universal) Commercial Banks सार्वत्रिक वाणिज्यिक बैंक	Regional Rural Banks क्षेत्रीय ग्रामीण बैंक	Local Area Bank स्थानीय क्षेत्र बैंक
Examples	_____	Uttar Bihar Gramin Bank (Sponsor bank- Central Bank of India)	*Given @bottom of table
Banking Reg. Act	Applicable	Applicable + RRB act 1976 & its amendment in 2015 to facilitate merger	Only Banking Reg. Act
CRR, SLR, MSF,	Applicable	Applicable but RBI could prescribe separate norms.	They're Non-Sch. Banks so every norm with caveats
PSL	Applicable (40%)	Applicable & higher: 75%	Same as Commercial Bank
Lending Rates	Free to decide within RBI's methodology for Marginal Cost of Funds Based Lending Rate (MCLR). [More under NPA]	Can't be more than prevailing lending rates of Cooperative Banks in the area	
Geographical Presence	Anywhere (India and even overseas branches)	Restricted to few districts. E.g. Baroda Gramin Bank branches confined to Gujarat's southern districts.	Max. 3 geographically contiguous districts. only 1 urban centre per district.
Vote power	Depends on Shareholding.	(Union + State + Sponsor bank) = 51%	Same as UCB
Father	N/A	M.Narasimham's Committee on Financial Inclusion in 70s	Accidental FM _ _ _ _ _ budget 1996
Regulator	Only RBI	RBI + _ _ _ _ _	Only RBI

* **Local Area Banks:** Initially 4: (1) Coastal Bank Andhra Pradesh (first to setup in 99), (2) Subhadra Local Area Bank, Kolhapur; (3) Krishna Bhima Samruddhi (Andhra & Karnataka) and (4) Capital Local Area Bank: Punjab (Largest). But later Capital LAB converted into Small Finance Bank (2016), so now only 3 left.



5.7.2 Commercial Banks ⇒ Differential Banks ⇒ SFB & PB

On Nachiket Mor Committee's recommendations (2013-14), Rajan approved these new types of banks for (1) financial inclusion (2) competition & innovation among players.

Parameters	Small Finance Banks लघु वित्त बैंक	Payment banks भुगतान बैंक
Examples	Capital Small Finance Bank (Punjab), Ujjivan (Karnataka), Utkarsh (UP): Total 10 list at rbi.org.in/scripts/banklinks.aspx	7 at present: Airtel, India Post, FINO, Paytm, Aditya Birla Idea, Jio, NSDL. (Total 11 were selected)
Eligibility	Min. 100cr. capital-walla Resident Indian, Local Area Bank, NBFC, Micro-finance, with 10 years exp. in banking / finance	Min. 100cr. capital-walla resident Indians, NBFCs, PPI-wallets (pre-paid payment instrument), mobile telephone companies, super-market chains, cooperatives & companies controlled by resident Indians
Area	RBI Committee gave selection preference North East & Central India clusters where Universal Banks' penetration is poor	Anywhere
Selected by?	Usha Throat (Former RBI Dy.Gov)	Nachiket Mor(Ex-RBI Board Member)
CRR, SLR, Repo, FDI?	Same as Indian private banks	Same as Indian Private Banks, but caveats in SLR.
Rural Penetration	Must have 25% branches in unbanked rural areas	No need but 25% access points must be in rural areas like Business correspondence (BC), Kirana Stores
Target Consumers	Unserved, Underserved Farmers, Micro, Small industries	Promoting Small savings Remittance of migrant labors, low income households, unorganized sector, small business.
Accept Deposits	Yes, without any restrictions	- No NRI deposits - Can accept Time & Demand Deposits but max. balance Rs. _ _ _ per year per customer.
Debit cards	YES (but EMV-Chip-walla)	YES (EMV-Chip-walla)
Credit cards	YES (but EMV-Chip-walla)	No (because can't "loan")
Loans	- Yes, but _ _ _ _ in PSL, - 50% of loan portfolio of Rs. 25 lakhs/< loans.	- Can't loan, So no PSL. - Min.75% of Demand deposits in Gsec, T-Bill; - Max.25% of all deposits in other SCBs
Evolve?	Yes, after 5 years can become Universal Commercial Bank.	Not mentioned.

- BASEL-III norms applicable on both of them, and they are tighter than a (universal) commercial scheduled bank.
- Both can sell Mutual Fund (MF), Pension, Insurance policies with approvals of respective regulators.
- **Payment Bank Challenges?** Low profitability due to lending restrictions. 2018: RBI barred Vijay Shekhar Sharma's PayTM Payment Bank from opening new accounts as it could not keep Min.100 crore capital, but the ban lifted in 2018-Dec.



Asked in UPSC-Pre-2016	Asked in UPSC-Pre-2017
Q. Find correct Statement(s) about Payment Banks? 1) Mobile telephone companies and supermarket chains that are owned and controlled by residents are eligible to be promoters of Payment Banks. 2) Payment Banks can issue both credit cards and debit cards. 3) Payment Banks cannot undertake lending activities. Codes: (a) 1 and 2 only (b) 1 and 3 only (c) 2 only (d) 1, 2 and 3	Q. What is the purpose of setting up of Small Finance Banks (SFBs) in India? 1. To supply credit to small business units 2. To supply credit to small and marginal farmers 3. To encourage young entrepreneurs to set up business particularly in rural areas. Codes: (a) 1 and 2 only (b) 2 and 3 only (c) 1 and 3 only (d) 1, 2 and 3

5.7.3 India Post Payment Bank (IPPB)

- Registered as a Public Limited Company under Companies Act, 100% owned by Department of Posts (Ministry of Communication and Information Technology.) -> Obtained RBI's License under Banking Regulation Act to start working as a Payment Bank.
- Airtel Payments Bank was first to launch operations in 2017- Jan. Later, IPPB launched pilot branches at Raipur (Chhattisgarh) and Ranchi (Jharkhand). Then IPPB launched full-fledged operations in 2018. In between, Paytm, Fino, Birla Idea and Jio launched their Ops. *In short IPPB not the first to launch full fledged Ops.*
- **Motto:** _____. Largest customer reach with 1.55 lakh Post offices across India. Doorstep banking through Postmen (but fees applicable).
- IntraBank transfer: no fees. IMPS/NEFT/RGST: fees applicable.
- Bank Account Types: **Safal, Sugam, Saral** (internal differences about ATM withdrawal limits etc. not important for UPSC).
- Account can be opened with zero balance, no minimum balance requirement. Max. Balance ____ per person per year. Customer Age: 10 years / >
- Also partnered with Bajaj Alliance Life Insurance (BALIC) to sell insurance policies.

MCQ. Which of the following statements about the India Post Payments Bank (IPPB) is/are correct? [Asked in UPSC-CDS-2018-1]

- 1) It has been incorporated as a Public Limited Company.
 - 2) It started its operation by establishing two pilot branches at Hyderabad and Varanasi.
- Answer codes: (a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

5.7.4 Wholesale & Long Term Finance Banks (WLTF)

2017: RBI proposed. Entry capital 1000 crores, can't accept deposits less than 10 crores, can give loans only to large corporates & infrastructure projects. Other banks may use it for PSLC-certificate trading.



5.8 FI ⇒ BANKS ⇒ COOPERATIVE BANKS (सहकारी बैंक)

Type	Commercial Banks	Cooperative Banks
Banking Reg. Act	since 1949	Applicable since 1966.
Regulator	RBI	_____, State Registrar of Cooperative Societies
CRR, SLR, BASEL-III	Yes	Yes, but, RBI could keep different slabs/ norms.
Repo, MSF borrow	Eligible	Yes, but only selected category of Cooperative Banks
PSL Lending	Yes 40-75%	---
Who can borrow	Anyone	Only Members
Vote power	Shareholding	1 person 1 vote, irrespective of capital contributed
Profit Motive	Yes	No Profit No Loss motive.
Presence	All India & overseas	Mainly in Guj,MH,Andhra,TN

Table 5: Classification of Cooperative Banks

Urban Cooperative Banks (शहरी)	Rural Cooperative Banks (ग्रामीण)
Further subcategories depending on - Scheduled / Non-Scheduled; - Single State / Multi State. From 2018, RBI allowed them to voluntarily upgrade to Small Finance Banks, with certain conditions.	1) Long term: Land Banks, Cooperative Agriculture & Rural Development Banks 2) Short term: State Cooperative Bank -> District Central Cooperative Bank (____) -> Primary Agriculture Cooperative Society (____)

- **Challenges:** Politicization due to 1 person 1 vote, casteism, poor recovery of loans, scams, money laundering.
- They were prevented from exchanging banned 500-1000 notes due to malpractices.
- **Budget-2017:** provided funds to NABARD for implementing Core Banking Solution (CBS) within PACS & DCCB- this will help in targeted delivery of farm loans and subsidies.

Related topics: Jan Dhan Yojana, Lead Bank Scheme etc. later in Pillar#1: Financial Inclusion

6 FORMAL FI ⇒ NON-BANK FINANCIAL INSTITUTIONS

गैर-बैंक वित्तीय संस्थान

6.1 (EXTINCT) DEVELOPMENT FINANCE INSTITUTIONS (DFI)

विकास वित्त संस्थान were meant for Medium to long term loans to industries, including also support services like arranging foreign currency, underwriting, technical / management consultancy, Bank guarantee etc. They did not accept DEPOSITS from ordinary people.

1948	Industrial finance corporation of India Ltd. (IFCI) Act. Later became a Non-Deposit-Taking-Systematically-Important (NBFC-ND-SI).
1951	State Finance Corporation (SFI) Act, because IFCI alone couldn't cater industrial loan demand.
1955	National Small Industries Corporation (NSIC) by Government of India (Gol)
1955	ICICI: Industrial credit and Investment Corporation of India Ltd was setup by Gol, World Bank, and other FI. Later became a Private Sector Bank.



1964	- Industrial development bank of India (IDBI) Act. For a while, it was also given regulatory powers over Industrial finance but then overtaken by SIDBI, EXIM Banks. 2004: Transformed into a Public Sector Bank. 2018: Government sold its majority shareholding to LIC.
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Narasimham-II ('98) recommend there should be only two categories: Bank or non-bank. DFI should join either one.

6.2 NON BANK ⇒ ALL INDIA FINANCIAL INSTITUTIONS (AIFI): अखिल भारतीय वित्तीय संस्थान

All four are setup by respective acts of Parliament.

EXIM (Jan 1982)	NABARD (Jul 1982)	NHB (1988)	SIDBI (1990)
Export-Import Bank of India	-----	National Housing Bank	-----
Boss: Government of India (100%)	Previously RBI had minority-stakes in NABARD but as of 2018: 100% Govt owned.	Boss: RBI (100%). But, Finance Act 2018 amended NHB Act, for transferring RBI's stakes to Govt.	BOSS: SBI, LIC, IDBI other public sector banks, insurance companies etc.
Promotes cross border trade and investment, helps importers-exports with loans and foreign currency.	<ul style="list-style-type: none"> - Regulatory authority: Coop + RRB - + Indirect refinance to farmers, artisans - Operates Rural Infra. Development fund (____) from PSL shortfalls from SCBs. 	<ul style="list-style-type: none"> - Finance to banks and NBFCs for housing projects. - Regulator of Housing Finance Cos (NBFC) - _____ index to monitor residential real estate prices. 	<ul style="list-style-type: none"> - Operates Small Enterprises Development Fund (SEDF), which receives funding from PSL shortfalls of Foreign Banks with <20 branches. - Operates _____ for loans to small entrepreneurs & SME via schemes like Mudra, Stand-up-India.

—5th AIFI = Industrial Investment Bank of India (IIBI) closed in 2012:

- NABARD Amendment Act 2017: 1) increased capital 2) facilitated transfer of RBI shares to Govt 3) MSME definitions updated.
- AIFIs are not 'banks' because can't accept direct deposits from people at large.
- RBI is the regulator over AIFI, BASEL norms applicable but RBI can prescribe different / slabs norms / deadlines.

Asked in UPSC-Pre-2013	Asked in UPSC-Prelims-2004
Q. Which of the following grants/grant direct credit assistance to rural households? <ol style="list-style-type: none"> 1) Regional Rural Banks 2) National Bank for Agriculture and Rural Development 3) Land Development Banks <p>Answer Codes: (a) 1 and 2 only (d) 1 and 3 only (c) 1 and 3 only (d) 1, 2 and 3</p>	Find Correct Statement(s) <ol style="list-style-type: none"> A. NHB, the apex institution of housing finance in India, was setup as a wholly owned subsidiary of RBI B. Small industries development bank of India was established as a wholly owned subsidiary of the Industrial development bank of India C. Both A and B D. Neither A nor B



6.3 FI ⇒ NON-BANK ⇒ PRIMARY DEALERS (PD)- (प्राथमिक विक्रेता)

- They deal in "primary" market. directly buy G-sec from RBI's E-Kuber platform and sell it in the secondary market.
- Total 21 PD licensed by RBI: 14 of them are Banks. E.g. Standard Chartered Bank, HSBC (HongKong), SBI, Kotak etc.

6.4 FI ⇒ NBFCs (गेर-बैंकिंग वित्तीय कंपनियां)

Parameter	Commercial Banks	Non-Banking Financial Companies (NBFCs)
Registration	Banking Regulation Act	Companies Act
Supervision	RBI	Varies: Mutual funds-SEBI, Insurance Company: IRDA etc.
Entry Capital	500 Cr.	5cr for MicroFin, 2 cr for others; 200 cr. For reinsurer etc. <i>[figures not imp]</i>
Numbers	22 Public Sector (incl. Post Payment Bank), 56 RRBs, 37 private sectors (including SFC, PB), 44 Foreign Banks.	Total 10,190 out of them 108 deposit Taking, remaining are non-deposit-taking (ND).
Deposits	<ul style="list-style-type: none"> - Can accept Time & Demand [chequable deposit] - Their deposits are insured under DICGCI Act. 	<ul style="list-style-type: none"> - Only NBFC-Deposit-Taking (NBFC-D) & even they can accept only Time Deposits. - Can't issue their own chequebook, debit/credit card. - Deposits are not insured.
Prudential Norms	CRR, SLR, applicable	NBFC-D: SLR required but RBI can prescribe different slabs / norms. CRR not applicable on any NBFC.
BASEL	Applicable	<ul style="list-style-type: none"> - Applicable on 108 NBFC-D and - Applicable on 276 NBFCs – ND – SI (non-deposit taking Systematically Important with assets over Rs. 500 crores) e.g. L&T Finance, Cholamandalam etc. But RBI can prescribe different slabs / norms /deadlines.
Investment	They can keep depositor's money in RBI approved securities. But can't invest in share market per se.	Can invest clients' money in share market. E.g. Mutual Funds
Loan Rate	Decided as per RBI's MCLR methodology.	Varies & depends on nature of biz.
Recovery	Loan recovery powers under SARFAESI Act.	<ul style="list-style-type: none"> - Only Housing Finance Companies have SARFAESI powers. - Gold Loan company can auction gold. - Mutual Fund Company may have to wait till liquidation of bankrupt company.
Consumer Complaints	RBI's Ombudsman, Bank's Internal Ombudsman	RBI's separate Ombudsman for NBFCs starting the NBFC-D since 2018.

**MCQ: Find correct Statement(s) about NBFCs in India [Asked in UPSC-Prelims-2010]**

- A. They cannot engage in the acquisition of securities issued by government.
- B. They cannot accept demand deposits like savings account.
- C. Both A and B
- D. Neither A nor B

MCQ: The main functioning of the banking system is to [Asked in UPSC-CDS-2013-II]

- (a) accept deposits and provide credit
- (b) accept deposits and subsidies
- (c) provide credit and subsidies
- (d) accept deposits, give credit and subsidies

6.4.1 NBFCs Regulated by RBI

Asset Finance Company (AFC)	Loans for economically productive assets like truck, bulldozer, tractor, pumpset, E.g. SREI Equipment Finance
Infrastructure Finance Company (IFC)	Gives loan for infra. projects. E.g. Rural Electrification Company Ltd. (REC): PSU under Power Ministry
Infrastructure Debt Fund (IDF)	Long term loans to highway / port developers etc. e.g. L&T IDF, Kotak IDF, IDFC IDF ("IDFC First" has separate license for Bank).
Core Investment Company (CIC)	<ul style="list-style-type: none"> - They do long term investment in Companies. E.g. Tata / Birla / Reliance Capital & Infrastructure Leasing & Financial Services Limited (IL&FS) - IL&FS is owned by SBI, LIC and Corporates from Japan and Abu Dhabi. 2018: In controversy because couldn't repay interest to lenders. <i>More in next NPA handout.</i>
Asset Reconstruction Companies (ARC)	They borrow bad loans / NPA from Banks & other NBFCs, and try to salvage value from the underlying assets. E.g. Anil Ambani's Reliance ARC.
Factoring Companies	They lend short term money to client against his invoices / accounts receivable. E.g. IFCI Factors, Siemens Factoring.
Gold Loan Companies	e.g. Muthoot gold loan, Mannapuram Gold. RBI decides their Loan to Value ratios.
Micro Finance Institutions (MFI)	RBI + Dept Corporate Affairs (<i>given on next page</i>)
Fintech cos: P2P Lenders	Similar to Olx-Quickr connecting sellers of second hand goods with buyers, the P2P lending websites connect borrowers and lenders. E.g. Faircent.com, Cashkumar.com
Fintech cos: Account Aggregators (AA)	<ul style="list-style-type: none"> - They manage information of a customer's financial assets & display it to him or to third party (like loan giver, credit rating company, App like Google pay etc.) - 2018-Nov: RBI said it'll give license to 5 companies. List awaited.
----- (अवशिष्ट)	Any NBFC that is not regulated by any other regulator- falls under RBI's purview.



6.4.2 NBFCs Regulated by SEBI

Stock Broker	They help clients buy-sell shares/bonds (=debentures) depending on his instructions E.g. Motilal Oswal, Indiabulls, Sherkhan etc.
Mutual Funds (MF)	<ul style="list-style-type: none"> - They pool clients' money and MF-manager invests it in shares/bonds using his own discretion & expertise. - E.g. SBI's Shariah Equity Mutual Fund: clients' money invested in Sharia compliant Cos. That don't deal with alcohol, pork, debt, tobacco or weapons.
Investment Banks: (US term) & Merchant Banking Companies: (UK term)	Underwriting, Merger & Acquisition, Wealth Management of rich people: E.g. Kotak Mahindra, Citigroup, Bank of America. DSP Merrill Lynch, Morgan Stanley, Canara Bank, SBI capital (separate license)
Venture Capital Fund VCF	Help startup companies via equity finance e.g. IFCI, IDG.

6.4.3 NBFCs Regulated by Others

Regulator	Example NBFC Companies
-----	<ul style="list-style-type: none"> - Life Insurance companies e.g. LIC, HDFC Standard Life Insurance - Non-Life (=General) insurance companies e.g. IFFCO-Tokio General Insurance
-----	All Pension Funds, except EPFO
-----	Housing Finance Companies such as DHFL, Muthoot Housing finance etc. <u>(have SARFAESI Powers)</u>
Dept of Company Affairs	<ol style="list-style-type: none"> 1. NIDHI Companies: Mutual benefit club, only members can borrow. e.g. South Madras Benefit Fund Ltd, Maben Nidhi Ltd (of Mannapuram group) 2. Microfinance Companies: They give loan to poor without collateral, flexible EMI, But no loans above 50k. e.g. Bandhan (WB- got PvB license), Disha (A'Bad: got SFB license), SKS (Andhra), Cashpor (UP), Ujjivan (Karnataka).
State Registrar of Chit Funds	Chit fund is a type of collective investment scheme with monthly contributions & borrowing by contributing members e.g. Shriram Chits. <i>(More in Pillar#1: Financial Inclusion)</i>



6.4.4 NBFC⇒ Mudra (2015, 100% SIDBI subsidiary)

- Micro Units Development & Refinance Agency. (सूक्ष्म इकाई विकास एवं पूनः वित्तपोषण एजेंसी)
- **Objective?** provides indirect lending via SCB, RRB, Cooperatives, MFI & other NBFCs through refinancing.
- **Ownership?** It's wholly owned by _ _ _ _ , and also receives the funding from PSL-shortfalls via RBI and budgetary support via Department of Financial Services.
- **Beneficiary?** Non-Farm-Non-Corporate type Micro Enterprises.

Table 6: Definitions in Micro, Small and Medium Enterprises Development Act / Bill

Category	Micro, Small and Medium Enterprises Devlp Act, 2006		Bill 2018: Only annual turnover
	Msg: Investment in Plant and Machinery	Services: Investment in Equipment	
	Upto 25 lakh	Upto 10 lakh	Upto 5cr
	>25 lakh upto 5 crore	>10 lakh upto 2 crore	>5cr upto 75 cr
	>5cr upto 10 crore	>2cr upto 5 crore	>75cr to 250cr

Table 7: Mudra-Products:

Pradhan Mantri MUDRA Yojana (PMMY) 1) Shishu : loans upto _ _ _ _ 2) Kishor : >50,000/- upto 5 lakh 3) Tarun : > 5 lakh and upto _ _ _ _	MUDRA Rupay Card - ATM cum Debit Card issued against MUDRA loan account. - For working capital component. - Can be accessed in all modes like a routine debit card (ATM, MicroATM, PoS, Online)
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- Mudra loans are collateral-free. If borrower defaults on loan, then lender's losses are covered through Credit Guarantee Fund for Micro Units [CGFMU] operated by National Credit Guarantee Trustee Company Ltd. [NCGTC]- a private ltd company by Dept of Financial Services (setup in 2016).
- **MUDRA Challenges?** (1) Loan Interests are high (2) Rising NPA/Bad loans.

MCQ. Pradhan Mantri MUDRA Yojana is aimed at (Asked in UPSC-Pre-2016)

- bringing the small entrepreneurs into formal financial system
- providing loans to poor farmers for cultivating particular crops.
- providing pensions to old and destitute persons.
- funding the voluntary organizations involved in the promotion of skill development and employment generation.

6.4.5 Stand Up India Scheme, 2016 (उत्तिष्ठ भारत)

- **Boss?** FinMin's Dept of Financial Services (वित्तीय सेवा विभाग)
- **Objective?** Each SCB bank branch to give Greenfield Loans between 10 lakh and 1 Crore to at least 1 _ _ _ _ and atleast 1 _ _ _ _ entrepreneur with tenure upto 7 years.
- **Collateral?** Bank can ask collaterals. If loan without collaterals, then Credit Guarantee Fund for Standup India (CGFSI) operated by **NCGTC**.



6.5 NBFC: ISLAMIC BANKING

- Interest (*Riba*) is prohibited (Haram) in Islam. So, Islamic Banking operates through *Ijara*, *Murbaha*, *Musharaka* mechanisms- in which depositors' money is invested in borrower's property / business and returns are shared in form of rent / profit but not in the form of _ _ _ _ _.
- While previous committees said give permission to Islamic Banks in India, but _ _ _ is opposed (2017).
- **Pro-Arguments?** Financial inclusion of Muslims. Mobilization of deposits from Islamic countries for Indian Economy.
- **Anti-Arguments?** Specialized Manpower Required. PM-Jan-Dhan Yojana, Post Office Payment bank efforts will dissipate. USA authorities say it's used for terror finance & money laundering.

7 INFORMAL FINANCIAL INTERMEDIARIES (अनौपचारिक वित्तीय मध्यस्थ)

- They provide loans without KYC, PAN or Aadhar card but require property/vehicle/home/ goods/crop/gold etc. as collaterals/pawn. They charge very high compound interest rates & use muscle power for recovery, hence their NPA is minimal.
- They don't fall under RBI/SEBI purview, but State Governments have individual laws against them e.g. Bombay Moneylenders Act 1947, Kerala (1958), Gujarat (2011). These laws require such informal lenders to register, impose ceiling on the interest rate & prohibit strong-arm tactics.

Types	Indigenous Banker	Moneylender / Brokers
Medieval time known as	Shroff, Shikarpuri, Chettiar, Marwari, Aiyar, Rastogi	Kabuli Pathan, Quistwala, Arhatia, Village Bania, Soni, Mahajan & Seth, Pawnbrokers, Financial Brokers
Money mobilization	They used to mobilize money from Public via: 1) Hundi: bill of exchange; 2) Commercial bills	They use their own money (or some villain's blackmoney)

Mains Q: “Discuss the evolution / structure / function / objective of particular FI”- will be a rather too simplistic Mains Question for UPSC. These institutions have to be seen in the context of GDP/Economic Growth, Investment/NPA & Inclusive Growth/Financial Inclusion. So, we'll try some Mock Mains Qs once we've completed those topics.