TARGET PRELIMS 2024
BOOKLET-25; ECONOMY-6
RBI, BANKING AND FINANCIAL SECTOR

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2. RBI'S SURPLUS TRANSFER TO GOVERNMENT

- **Background:**
  - » **Where does RBI get its Revenue from?**
    - ▫ **Foreign exchange transactions** (RBI buys when dollar is cheap and sells when it is expensive (i.e. high in demand)
    - ▫ **Interest Income** (from government bonds, Liquidity Adjustment Facilities etc.)
    - ▫ It also earns a **management commission** on handling the borrowing of state governments and the central government.
  - » **Where does RBI spend money?**
    - ▫ Most of the RBI's expenditure is on printing of currency notes, and on staff, besides the commission it gives to banks for undertaking transactions on behalf of the government across the country and to primary dealers, including banks, for underwriting some of these borrowings.

- The **Surplus (Revenue - Expenditure)** is used for transfers to government and increasing the RBI reserves.
  - ▫ **Section 47 of the RBI Act, 1934**: "After making provision for bad and doubtful debts, depreciation in assets, contributions to staff and superannuation fund [and for all other matters for which] provision is to be made by or under this Act or which are usually provided for by bankers, **the balance, of the profits shall be paid to the Central Government**"
  - ▫ **Section 48 of the RBI Act, 1934** exempts the bank from paying any income tax, wealth tax or super tax.

- **RBI's Reserves:**
  - ▫ The RBI has three mains funds that together comprise its reserves. These are:
    - » **Currency and Gold Revaluation Account** (CGRA) (basically the Economic Capital Buffer)
      - ▪ It is mantained by RBI to take care of currency risk, interest rate risk and movement in gold prices risk.
      - ▪ Unrealized gains or losses on valuation of foreign currency assets (FCA) and gold are not taken to the income account but instead accounted for in the CGRA. Net balance in CGRA therefore varies as per the size of the asset base, its valuation and movement in the exchange rate and price of gold.
      - ▪ When CGRA is not sufficient to fully meet exchange losses, it is replenished from the CF.
      - ▪ It is by far the **largest** reserve account of RBI and makes up the significant bulk of RBI's reserve.
    - » **Contingency Fund** (CF):
      - ▪ It is a provision meant to meet **unexpected and unforeseen contingencies**, including depreciation in the value of securities, risks arising out of

monetary/exchange rate operations, systematic risks and any risk arising on account of the special responsibilities enjoined upon the Reserve Bank.

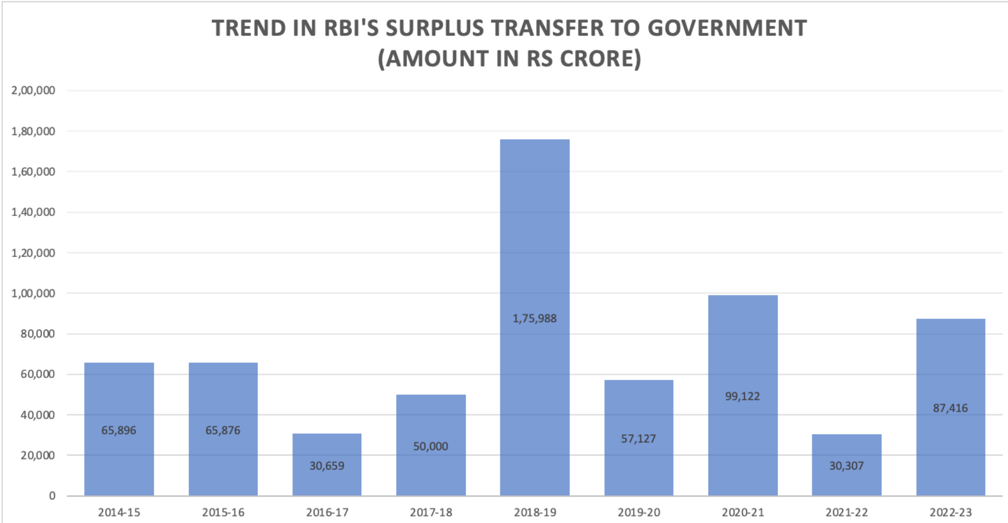
    - The CF is the **second biggest fund** of RBI after the CGRA

  - » **Asset Development Fund** (ADF)
    - It makes up a much smaller share of reserves and is also focused on contingent times.

- **Other RBI Accounts**
  - **Investment Revaluation Account - Foreign Securities** (IRA-FS): The unrealized gains or losses **on revaluation of foreign dated securities** are recorded in the IRA-FS.
  - **Investment Revaluation Account - Rupees Securities (IRA-RS):** The unrealized gains or losses on revaluation of Rupee securities (IRA-RS) is accounted for in Investment Revaluation Account - Rupee Securities (IRA-RS).

- In 2018, there was a difference between RBI and Finance Ministry on the amount of reserve RBI should keep.
- Following this, **RBI in consultation with the Central Government,** had constituted a **committee chaired by former RBI governor Bimal Jalan to review the Extant Economic Capital Framework (ECF) for the RBI**.
  - **Key Recommendations of the Revised Economic Capital Framework** (ECF) for the RBI:
    - » Make a **distinction** in the economic capital of the RBI between '**revaluation reserves**' and '**realized equity**'.
      - **Revaluation Reserves** are risk buffer against market risks and not available for transfers.
    - » **Economic Capital Levels** (basically CGRA) should be in the range of **20-24.5%** of the balance sheet.
    - » RBI should maintain a **Contingent Risk Buffer** - which mostly comes from CF - of between **5.5-6.5%** of the Central Bank's Balance Sheet. **The excess amount** should be transferred to government.
    - » A transfer of surplus from the RBI to the government in a phased manner in accordance with the existing practice
  - **The committee's recommendations** were based on the consideration of the role of central banks' financial resilience, cross-country practices, statutory provisions and the impact of RBI's pubic policy mandate and operating environment on its balance sheet and the risk involved.

- In Aug 2019, **RBI board accepted all the above recommendations of the Bimal Jalan Panel committee to transfer Rs 1.76 lakh crore of surplus to government**.



- **RBI's Central Board** approves the transfer of surplus (i.e dividend) to the Union government for every accounting year.
- **Analysis: Positives**
  i. **As RBI's only shareholder** government has rights over the profits of RBI.
  ii. **Further, RBI is** amongst **the most capitalized central banks** in the world, so reduction of excess capital shouldn't be a bad idea.
  iii. **More productive utilization of RBI's Cash**
  iv. **Helps government deal with economic slowdown.**

3. CURRENT SITUATION: FINANCIAL STABILITY REPORT (2023)

- RBI released 28th issue of **Financial Stability Report** (FSR) in Dec 2023. Key highlights include:
  » The Indian economy and the domestic financial system remain resilient, supported by strong macroeconomic fundamentals, healthy balance sheets of financial institutions, moderating inflations, improving external sector positions and continuing fiscal consolidation.
  » **Capital to Risk Weighted Asset Ratio** (CRAR) and the Common Equity Ratio (CET1) ratio of scheduled commercial banks (SCBs) stood at 16.8% and 13.7%, respectively in Sep 2023.
  » **SCB's** gross NPAs ratio continued to decline to a multi-year low of 3.2% and the net Non-Performing Asset (NNPA) ratio to 0.8% in Sep 2023.
  » **Macro stress tests for credit** risk reveal that SCBs would be able to comply with minimum capital requirements and the system-level CRAR in Sep 2024 projected at 14.8%, 13.5% and 12.2%, respectively, under baseline, medium and severe stress scenarios.
  » The resilience of the NBFCs sector improved with CRAR at 27.6%, GNPA ratio at 4.6% and return on assets (RoA) to 2.9%, respectively in Sep 2023.

4. REGULATION OF BANKING SECTOR

1) BASEL NORMS AND SITUATION IN INDIA

- **What?**
  - Basel norms/standards are **global, voluntary, regulatory framework on bank Capital Adequacy, Stress Testing and Market Liquidity risks**. It is formulated by the Basel Committee on Banking Supervision (BCBS).

    - BCBS aims to enhance the understanding of key supervisory issues and improve the quality of banking supervision worldwide. The committee's **secretariat** is located at the **Bank of International Settlement (BIS) in Basel, Switzerland**.

  - **About Bank of International Settlement (BIS), Basel**
    - BIS, situated at Basel, Switzerland, is a promoter of Central Banks' cooperation in an effort to ensure global monetary and financial stability. It was established in 1930 and is the oldest global financial institution and operates under international law. It is owned by 60 central banks.

  - **Need?**
    - **Ensuring Risk preparedness**
    - **Uniform standards** ensure better understandability of banking system's stability. This helps investors and agencies to better decide their investment opportunities across the world.
    - **Global Village** -> vulnerability in one country affects other countries (e.g. the 2007-08 crisis). Therefore, the banking system should be stable throughout the world.

- **Basic Terms**
  - **Risk Weighted Assets:**
    - **Risk weighted assets** of a bank are its assets weighted by their degree of credit risk.
      - For e.g.in India, according to RBI Regulations loans issued to government are weighted at 0.0%, while those given for housing purposes is given a weight of 50%.
    - Risk weighted assets are **used to determine the minimum amount of capital** that must be held by banks and other institutions to reduce the risk of insolvency.
    - **The financial crisis of 2007-08** was driven by financial institutions investing in subprime home mortgage loans that had a far higher risk of default.
    - **To avoid the problem** moving forward, regulators now insist that each bank must group its assets together by risk category so that the amount of required capital is matched with the risk of each asset.

  - **Capital to Risk Weighted Asset Ratio (CRAR) / Capital Adequacy Ratio (CAR)**
    - CAR is a measurement of a bank's available capital expressed as a percentage of a bank's risk-weighted credit exposure. It is used to protect depositors and promote the stability and efficiency of financial systems around the world.
    - It is calculated by adding a bank's Tier 1 Capital and Tier 2 Capital and dividing the total by its total risk-weighted assets.

The Formula for CAR:

$$CAR = \frac{Tier\ 1\ Capital + Tier\ 2\ Capital}{Risk\ Weighted\ Assets}$$

- CAR = (Tier 1 Capital + Tier 2 Capital) / Risk Weighted Assets

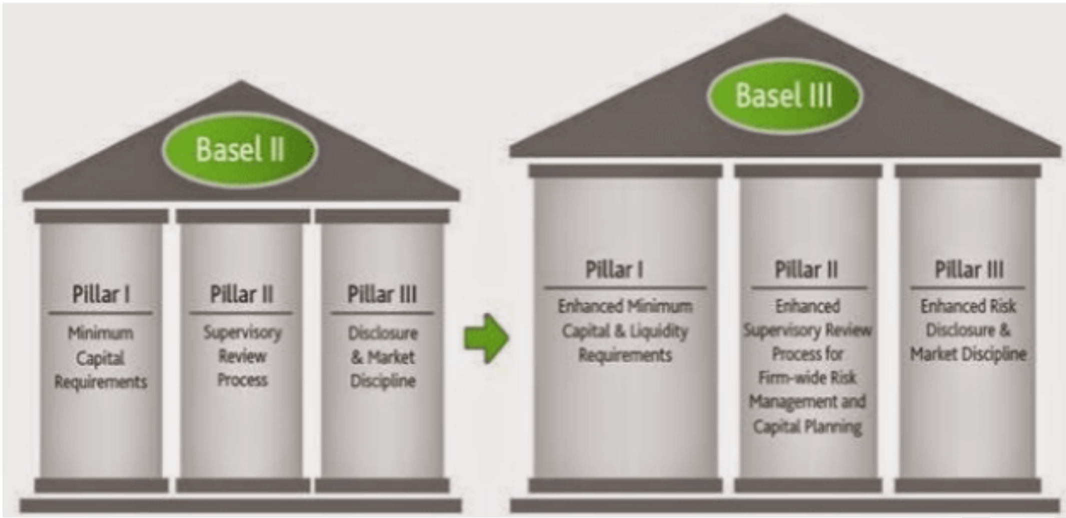
- **Tier 1 Capital**
  - It is bank's **core capital**, which is used when it needs to absorb losses without ceasing its operation.
  - It consists of Paid up Capital, capital reserves out of sale of assets, Balance in P&L account.
  - **Additional Tier-1 capital** are perpetual bonds which carry a fixed coupon payable annually from past or present profits of the bank.

- **Tier 2 Capital**
  - It is bank's **supplementary capital** used to absorb losses **if a bank is winding up its assets**. This provides a lesser degree of protection to depositors.
  - They include revaluation reserves, general provisions, subordinated term debt, and hybrid capital instruments.

- **Significance of CAR**
  - Minimum CAR is critical to make sure that banks have enough cushion to absorb a reasonable amount of losses before they become insolvent and consequently loss depositor's funds.

- **Basel 1 and Basel 2**
  - In **1988**, BCBS introduced capital measurement system called Basel Capital Accord, also called **Basel 1**. It **focused entirely on credit risk**. Here minimum CAR was kept at 8%.
  - **BASEL II**
    - These were introduced in 2004 by BCBS and were considered a refined and reformed version of Basel-I accord.
      - It expanded the scope of regulation to include operational risk and introduced more sophisticated risk assessment methods.
    - **In India** Basel-II was implemented from 2009.
  - **Basel 3**
    - They were released in Dec 2010. These guidelines were a response to the 2007-08 financial crisis where the banking system realized that the BASEL-II guidelines were not enough to protect bank depositors. It was realized that banks were under-capitalized, over-leveraged, and had a greater reliance on short-term funding.

- **Basel II -> Basel III**



» **Pillar -1: Enhanced Minimum Capital & Liquidity Requirements**: It sets out minimum amount of capital that banks must hold to cover their **credit, market and operational risks**. They are also required to hold a capital conservation buffer to absorb losses during period of stress.

» **Pillar -2: Supervisory Review Process**: Regulators are required to conduct a regular supervisory review of a bank's risk management practices and capital adequacy.

» **Pillar-3**: **Market Discipline**: It requires banks to disclose information about their risk profile, capital adequacy, and risk management practices.

- **Objectives**
  - Improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source
  - Improve risk management and governance.
  - Strengthen bank's transparency and disclosure.

– **Major Changes in the Basel Norm for Banking**

» **Better Capital Quality: Minimum Common Equity and Tier 1 Capital Requirements:**

- The **minimum requirement of common equity**, the highest form of loss-absorbing capital, has been raised under Basel-III from **2% to 4.5%** of total risk-weighted assets.
- **The Overall Tier 1 Capital Requirement,** consisting of not only common equity but also other qualifying financial instruments, will also increase from the current minimum 4% **to 6%**.
- Although **the minimum total capital requirement will remain at the current 8%**, yet the required total capital will increase to **10.5%** when combined with **conservation buffer**.

» **Capital Conservation Buffer**

- Now banks are required to hold a capital conservation buffer of **2.5%**. The **aim** of asking to build capital conservation buffer is to ensure that banks maintain a **cushion** of capital that can be used to **absorb losses during period of financial and economic stress.**

» **Counter cyclical Capital Buffer (CCCB)** is another key element of Basel-III norms.

- Objective is to increase capital requirements in good times and decrease them in bad times.
- It will slow banking activities when it overheats and will encourage lending when times are tough.

- The buffer will range from **0% - 2.5%** consisting of common equity or other full loss-absorbing capital and will be stored with Central Bank.

» **Leverage Ratio**
- A leverage ratio is a **relative amount of capital to total assets** (not risk-weighted). The aim is to put a cap on swelling of leverage in the banking sector on a global basis.
  - LR = (Tier1 Capital)/ (Total Assets)
- Banks are expected to maintain a **leverage ratio of 3%** under BASEL-III norms.

» **Liquidity Ratio**
- A new **Liquidity Coverage Ratio** (LCR) and **Net Stable Funding Ratio** (NSFR) got introduced in 2015 and 2018 respectively.
- **Liquidity Coverage Ratio** refers to proportion of highly liquid assets held by financial institutions, to ensure their ongoing ability to meet short-term obligations**. Banks are required to hold an amount of high-quality liquid assets that's enough to fund cash outflow for 30 days**. This is aimed to ensure that financial institutions possess suitable capital preservation, to ride out any short-term liquidity disruptions, that may plague the market.
  - LCR is calculated by dividing a bank's high quality liquid assets by its total net cash flows, over a 30-day stress period.
  - **Note: Urjit Patel Committee** has recommended that India should move onto LCR and do away with Statutory Liquidity Ratio (SLR) mechanism. This will make our system aligned with international mechanism. India is still using SLR.

» **Net Stable Funding Requirement (NSFR)**
- Introduced by BASEL-III it is a liquidity standard requiring banks to **hold enough stable funding to cover the duration of their long term assets**. Banks must maintain **a ratio of 100% to satisfy the requirement**.
  - It is defined as the amount of available stable funding (ASF) in relation to the amount of required stable funding.
- The ratio **ensures** that banks do not undertake excessive maturity transformation, which is the practice of using short-term funding to meet the long-term liability.

» **Systematically Important Financial Institutions (SIFI):** As part of the macro-prudential framework, systematically important banks will be expected to have a **loss absorbing capability beyond the Basel-III requirements**.
- Also called G-SIBs (Globally Systematically important banks)
- **No Indian bank** has been listed in this.

2) CAR NORMS IN INDIA BY RBI

– Norms/guidelines regarding the capital required to be maintained by banks in India including the Basel III capital regulations, are **issued by RBI**.

– RBI had envisaged implementation of BASEL-III in March 2019. But it was pushed to March 2020. Due to COVID-19 pandemic it was again shifted by 6 months.

- **Capital Adequacy Ratio**: 11.5% (stricter than Basel-III norm of 10.5%)
    - Indian banks need to maintain a minimum capital adequacy ratio (CAR) of **9%**, in addition to a **capital conservation buffer**, which would be in the form of common equity at 2.5% of the risk weighted assets.
        - Indian banks as per RBI directions are required to maintain **5.5% of Common Equity Tier 1** (CET1) as against 4.5% required under the BASEL-III framework.
        - **Note: CAR requirements applied by RBI is stricter than the BASEL-III** norms.
        - **Note2:** In case of SFB and PB, the CAR requirement is that of **15%** from 1st March 2019.

- **Countercyclical Buffer**:
    - The RBI introduced a countercyclical buffer (CCB) for Indian banks, which ranges from 0% - 2.5% of risk weighted assets depending on macro-economic conditions.

- **Leverage Ratio**:
    - The RBI introduced a leverage ratio requirement for Indian banks, which measures leverage ratio (LR) = (Tier1 Capital)/ (Total Assets).
        - The minimum requirement was set at 4.5%, with a buffer of 2.5%.
- **LCR** requires banks to hold a minimum amount high-quality liquid assets (HQLA) to meet the short term liquidity needs.
    - In India LCR was introduced in a phased manner with a minimum requirement of 60% in 2015, increasing to 100% by Jan 2019.

- **NSFR** of **at least 100%** has been mandated by RBI
    - Individual banks may have to adopt stricter standards to reflect funding risks and compliance.
    - Date of applicability will be announced later.

- **Disclosure requirements** (under Pillar-3) have also been introduced.

- **RBI has also revised regulation on the implementation of leverage ratio for banks in India** under the BASEL-III capital regulation. (July 2019)
    - RBI has decided that the minimum leverage ratio shall be **4% for D-SIBS** and **3.5%** for other banks.
    - These guidelines shall be effective from the quarter commencing Oct 01, 2019.

- **RBI extends Basel-III capital framework to AIFIs (All India Financial Institutions)** (Oct 2021)
    - **All India Financial Institutions** include EXIM Bank, NABARD, NHB, SIDBI.
        - The AIFIs are increasingly being seen as key institutions to promote the flow of direct or indirect credit to the economic sectors they cater to.
    - **As per the draft Master Direction on Prudential Regulation or AIFIs**, AIFIs will implement all the three pillars of BASEL-III capital regulations - Pillar 1 covering capital, risk coverage, and containing leverage, pillar 2 covering risk management and supervision and pillar 3 covering market discipline.
    - The RBI wants AIFIs to achieve **minimum total capital of 9% and capital conservation buffer** of 2.5%, with the minimum total capital and CCB adding to 11.5% by 1st April 2022.

- For NHB, since the financial year is July-June, the implementation shall commence on 1st July 2022.

– **Current Situation in India**: ESI 2022-23:
  - The **Provisioning Coverage Ratio (PCR)** has been increasing steadily since March 2021 and reached 71.6% in Sep 2022.
  - The **CRAR** of SCBs has been rising sequentially in the post-asset quality review period.
    - It remains well-above the minimum capital requirement, including Capital Conservation Buffer (CCB) requirements of 11.5%.

3) ADDITIONAL TIER-1 CAPITAL

- **Why in news?**
  - » In Nov 2023, Swiss banking giant UBS sold additional tier-1 (**AT-1) bonds** for the first time and after taking over beleaguered banking peer Credit Suisse in March 2023.
    - Earlier, it was decided to write-off around $17 billion in AT-1 bonds issued by Credit Suisse. This had invoked fury from investors.

- **What are AT-1 Bonds**:
  - » **AT-1 bonds** are **perpetual debt instruments** issued by banks to raise money and build up their core equity capital. There is no maturity date, implying that the issuer doesn't pay the principal amount back to investors but makes periodical interest payments throughout the life of the bond.
  - » **'Call Option'**: In practice, AT-1 bonds typically come with a 'call option', which means that the bank issuing these instruments can redeem them or repay investors after a specified period.
  - » These bonds were **introduced according to Basel banking norm**s made after the Global Financial Crisis. These are a form of "**contingent convertible (cocos)" bonds** which were created to **prevent the need for government-funded bail-out**s of precarious banks.

- **Why the risks for investors?**
  - » Some features of AT-1 Bonds make them **riskier than several other bonds**.
    - AT-1 Bonds have equity like characteristics **(quasi-Equity instruments),** which permit banks to absorb losses.
      - If the bank faces financial stress, with capital requirement dropping below a specific levels, the covenants of AT-1 bonds typically **permit the lender to hold off on interest payments** or pay a lower amount. The bonds may also be **converted into equity**, helping to preserve the capital.
      - Some provisions allow the banks to **write-off** AT-1 bonds in case of severe financial crisis.
      - Further, **AT-1 bond investor** (unlike other bond investors) are **not at the top of pecking order** when it comes to receiving pay-outs from a bank facing financial stress. In fact, details sometimes put equity investors above than the bond investors.

- **How are AT-1 bonds triggered?**
    - These have different trigger mechanisms:
        - For e.g. if the Bank's capitalization level falls below a preset threshold, the bond may be converted to shares, which eliminates bank's liabilities on the AT-1.
        - To compensate for these risks, **banks pay investors a higher rate of interest for AT-1 bonds** than other debt instruments or deposits.

4) AT-1 BOND IN INDIA:

- **How much are the AT-1 bond holdings of Indian Banks?**
    - » Indian Banks don't depend on AT-1 bonds much.
        - In a study, brokerage firm Macquarie sad that while India's **PSU banks** have an exposure of 1-2 percent to AT-1 bonds, private sector banks only have an exposure of 0-1 percent.

- The Indian market for AT-1 bond was **upended in March 2020** following the crisis in Yes Bank.
    - » Following severe financial stress, RBI and Yes Bank had decided to write-off additional tier-1 (AT-1) bonds worth Rs **8,415 crores**. Mutual funds were amongst the biggest sufferers.
        - This was challenged in the court, and Bombay High Court in Jan 2023 ordered quashing of the write-off. But in Sep 2023, Finance Ministry has moved to the Supreme Court against the order.

- **In 2021, SEBI amended valuation rule for perpetual bonds**.
    - » Residual maturity of Basel-III AT-1 bonds will be 10 years until 31st March 2022.
    - » It will be 20 and 30 years for subsequent six months.
    - » From 1st April 2023, the residual maturity of AT-1 bonds will become 100 years from the date of issuance of the bond.
- **SEBI** then provided a phased timeline for mutual funds to value AT-1 bonds as 100-year instruments.
    - » The -100-year valuation kicked in from 1st April, 2023.
    - » Before this, AT-1 bonds were valued according to the call options on the papers - generally 5 to 10 years.
    - » **Impact: Huge decline in mutual fund investments in AT-1 bonds** as a 100 year valuation lead to very sharp movements in market yields of such papers.
- **Note:**
    - » AT-1 bonds are subordinate to Tier-2 bonds.
    - » Tier-2 Bonds are subordinate to unsecured creditors, banks depositors, and senior bonds. They are not perpetual instruments. They have a maturity period of minimum 5 years.

5) DSIBS

- **Why in news?**
  - » RBI releases 2023 list of DSIBs (Dec 2023)

- **Introduction**
  - » D-SIBs means the bank is **too big to fail** i.e. their failure would be significant disruption to the essential services they provide to the banking system and the overall economy.
  - » According to RBI, these banks have become systematically important due to their size, cross jurisdictional activities, complexity and lack of substitution and inter-connection. Banks whose assets exceed **2% of the GDP** are considered part of this group.
  - » **An additional common equity requirement** has to be applied to DSIBs.
  - » Too big to fail indicates that in case of distress **government is expected to support these banks**. Due to this perception, they enjoy certain advantages in funding/investment.
- **Beginning of DSIB-Framework**:
  - » The RBI issued the framework for dealing with D-SIBs in July 2014.
  - » SBI was included in the list in 2015, HDFC in 2016 and ICICI in 2017. But they are placed in different list.
- The list of D-SIBs is as follows (as on Dec 2023)
  - » SBI, HDFC, and ICICI continue to be identified as DSIBs.
  - » While ICICI continues to be in Bucket-1; Both HDFC (from Bucket-1 to Bucket-2) and SBI (from Bucket-3 to Bucket-4) have been shifted to higher bucket.
  - » So, **starting 1st of April 2025**, both SBI and HDFC will have to fulfill higher buffer requirements of the higher bucket.
    - ▪ Till 31st March 2025, surcharge applicable will be 0.60% for SBI and 0.20% for HDFC Bank.
  - »

Bucket	Banks	Additional Common Equity Tier 1 requirement as a percentage of Risk Weighted Assets (RWAs)
5	-	1%
4	State Bank of India*	0.80%
3	-	0.60%
2	HDFC Bank*	0.40%
1	ICICI Bank	0.20%

* The higher D-SIB surcharge for SBI and HDFC Bank will be applicable from April 1, 2025. Hence, up to March 31, 2025, the D-SIB surcharge applicable to SBI and HDFC Bank will be 0.60% and 0.20% respectively.

- **Note: Global SIBS**:
  - » **The Basel - Switzerland based** Financial Stability Board (FSB), an initiative of G20 nations, has identified, in consultation with the Basel Committee on Banking Supervision (BCBS), a list of G-SIBS.
    - • There are 30 G-SIBs currently (no Indian Bank), including JP Morgan, Citibank, HSBC, Bank of America, Bank of China, Barclays, BNP Paribas, Deutsche Bank, and Goldman Sachs.

6) DEPOSIT INSURANCE

- **Introduction: Deposit Insurance Situation in India**
  - » The deposit insurance provisions in India were introduced through the Deposit Insurance Corporation Act, 1962.
    - ▫ This insurance cover is provided by **Deposit Insurance and Credit Guarantee Corporation (DICGC)**, a fully owned **subsidiary of RBI**. The banks pay deposit insurance premium (0.1% per annum i.e. 10 paisa for Rs 100 insured), which is held by the DICGC and in turn is used to pay deposits if needed.
    - ▫ Under the act, the Corporation is liable to pay the insured deposit to depositors of an insured bank. Such liability may arise **when an insured bank undergoes**:
      i. **Liquidation** (sale of assets or closing down of the bank)
      ii. **Reconstruction or any other arrangement under the scheme**
      iii. **Merger or acquisition by another bank**
    - ▫ **Note:**
      - ▪ Deposit Insurance and Credit Guarantee Corporation (DICGC) came into existence in 1978 with the merger of Deposit Insurance Corporation (DIC) and Credit Guarantee Corporation of India Ltd. (CGCI).
      - ▪ It is a fully owned subsidiary of RBI.

- This insurance cover is available to:
  - » **Commercial banks**, including small financial banks, Payment Banks, and Indian branches of foreign banks.
  - » Regional rural banks, Local Area Banks (LABs), and Cooperative Banks
  - » **All bank deposits** - savings, fixed, current and recurring - payable in India are covered. However, deposits of central/state/foreign governments, inter-bank deposits, deposits of the state land development banks with the state cooperative banks etc. are not covered.

- **Budget 2020-21 increased the deposit insurance** to **Rs 5 lakh**.
  - » This is the first time since 1993 that the deposit insurance cover has been raised. In 1993 the insurance cover was revised from Rs 30,000 to Rs 1,00,000.
  - » The **raised cover** will address 98.3% of all deposit accounts by number, and 50.9% of deposits by value.
    - ▪ Globally, deposit insurance coverage is only 80 per cent globally and it covers only 20-30 per cent of deposit value.

- **Note-1**: If the funds are in different types of ownership or are deposited into separate banks they would then be separately insured.

- **Key Features of the 2021 amendment**

- ***Introduced interim payments:*** Interim payment will now be made by DICGC to depositors of those banks for whom any restrictions/ moratorium have been imposed by RBI under the Banking Regulation Act resulting in restrictions on depositors from accessing their own savings.
- ***Timeline for interim payments*:** Clear-cut timeline of maximum of 90 days has been fixed for providing interim payment to depositors.
- ***Repayment by banks to DICGC:*** *Deferment of repayments*: DICGC may defer repayments due to it from an insured bank after insurance pay out, on terms decided by DICGC's Board. It is in spirit with the rationale of interim payments, i.e., to help depositors while also enabling rescue efforts for the bank
- ***Timely repayment by the bank to DICGC*:** To establish the priority of repayment to DICGC (both interest and principal amount), a **provision for penal interest** in case of delay has been put in the act.
- **No ceiling on premium**: The earlier act earlier had a ceiling of 15 paise on premium, which has been removed. Now, the ceiling on premium will be notified by DICGC, with the prior approval of RBI.

7) RBI'S FRAMEWORK ON GREEN DEPOSITS

- **In April 2023**, RBI came up with a framework for banks to accept green deposits from customers. Under this framework, banks that accept green deposits will have to disclose more information on how they invest these deposits.
- **What are Green Deposits?**
  - The deposits which are earmarked green deposits are used only towards environment friendly projects. (e.g. financing renewable energy).
  - As per the RBI framework, depositors, both retail and institutional, will have the option to convert their fixed deposits into "green" deposits.

- **RBI's Framework for the acceptance of green deposits lays down certain conditions that banks must fulfill to accept green deposits from customers**:
  - **i.** **Bank** need to come up with certain rules/policies approved by their respective boards that need to be followed while investing green deposits from customers. These rules have to be available in public domain, on the website of the bank.
  - **ii.** Banks will have to disclose regular information about the amount of green deposits received, how these deposits were allocated towards various projects and the impact of such investment to environment. A **third party** will verify the claims made by banks regarding the projects in which the banks invest their green deposits as well as the sustainability credentials of these business projects.
  - **iii.** RBI has also come up with **list of sectors** that can be classified as sustainable and thus eligible to receive green deposits. They include renewable energy, waste management, clean transportation, energy efficiency and afforestation. Banks will be **barred from investing green deposits** in business projects involving fossil fuels, nuclear power, tobacco, renewable energy projects generating energy from biomass using feedstock originating in protected areas. etc.

- The rules are **aimed at preventing Greenwashing**, which refers to making misleading claims about the positive environmental impact of an activity.
- **Note**: the framework is applicable from 1st June 2023.
- **Applicability**: The framework is applicable on **all scheduled commercial banks** including SFBs (excluding RRBs, Local Area Banks, and Payment Banks) and **all deposit taking NBFCs** including Housing Finance Companies (HFCs).
- **In Jan 2024**, **RBI released a document giving detailed replies to a set of queries investors may have with regard to green deposits**:
  - **Can Green deposits be parked in liquid instruments?**
    - Yes, unallocated proceeds of green deposits can be temporarily parked in liquid instruments for a maximum maturity of one year. But this can be done till the money is invested in green activities/projects and has to be specified under the financing framework.
  - **Green Projects first or deposit first?**
    - The banks can't finance green activities/ projects first and raise green deposits later. Besides the framework is applicable for green deposits raised by banks on or after June 1, 2023.
  - **Are premature withdrawals allowed?**
    - **Yes** (other than being invested only in green projects, it is like other deposit only).
  - **Are investments made in sovereign green bonds covered under the framework?**
    - **Yes** (since the activities listed in the framework for green deposits are the same as given in sovereign green bonds)
  - **Can the green deposits be denominated in foreign currency?**
    - **No,** the framework doesn't permit green deposits to be denominated in any foreign currency.
  - **Are the deposits covered by DICGC?**
    - Yes.
  - **Voluntary Compliance**: it is not mandatory for regulated entity to raise green deposits. But, if REs intend to raise green deposits from their customers they should follow the framework prescribed therein.
- **Wil Green deposits help depositors/investors and the environment**?
  - **Depositors** -> Satisfaction of putting money in green projects
    - **Critics** say that this is a "feel good scam" that enriches only consultants.
    - Secondly, in a complex world where an action involves second order effects that are difficult to see, it can be extremely hard to know whether a project is really environment friendly.
  - **Businesses** -> Will get easier access to green loans, preferably with improved terms and conditions.

- **Way Forward: How to further promote green deposits:**

- Higher Interest Rates
- Build capacity in financial institutions to identify and appraise viable green projects.

8) DIGITAL PLATFORM FOR FRICTIONLESS LOANS (AUG 2023)

- **Background:** Need of such platform:
  - Availing formal credit takes a lot of time and involves cumbersome process of document verification and evaluation of credit worthiness of borrowers.
    - For e.g. RBI survey indicated that processing of farm loan took 2-3 weeks and cost about 6% of loan's total value.

- Therefore, the RBI has announced a pilot program for '**Public Tech Platform for Frictionless Credit**' which would strive to deliver frictionless credit by 'facilitating seamless low of required digital information to lender'

- **Details:**
  - RBI observed that data required for the entire process (information from borrowers and lenders; measurement of exposure risk; assessment of default risk) rest with different entities like central and state governments, account aggregators, banks, credit information companies, and digital identity authorities. This creates hinderances in timely delivery of service.
  - **How will the new platform solve the problem?**
    - In 2022, RBI instituted a pilot project of digitalization of KCC loans of less than Rs 1.6 lakhs. This pilot tested "end to end digitalization of the lending process in the paperless hassle free manner". The pilot is currently undergoing in some states and provides for "doorstep disbursement of loans in assisted or self-service mode without any paperwork". The **initial results were encouraging**.
    - A similar pilot is being carried out for **dairy loans** based on milk pouring data with Amul in Gujarat.
  - **Eventually the platform** will learn from all these pilots and the **scope will be expanded to all types of digital loans**. This platform will be developed by and wholly owned by RBI's subsidiary - the **Reserve Bank Innovation Hub (RBIH)**. It will have an open architecture, open application programming interface and standards, to which all financial sector players will be able to connect seamlessly in a 'plug and play' model.
  - It is expected to linkage with services like - Aadhar e-KYC, Aadhar e-signing, land records from onboarded state governments, satellite data, pan validation, account aggregation by account aggregators, milk pouring data from select dairy co-operatives, house/property search data etc. Thus it would cover all aspects of farming operations.
- **Advantages that the platform will bring?**
  - Reduction of costs
  - Quicker disbursements
  - Scalability

9) MONETARY POLICY COMMITTEE (MPC) AND ASSOCIATED ISSUES

- **Introduction**
  - The Monetary policy is generally focused on **regulating supply of money in an economy** by the monetary authority of the country for achieving **GDP growth**, **stable business cycle, price stability,** and **exchange rate stability**. Like fiscal policy, it is an integral arm of public policy. It **cools down the economy** when it overheats (through contractionary monetary policy) and **boosts the economy** during depressed financial activity (through expansionary policy).
    - **Expansionary** monetary policy is achieved by lowering Repo Rate, Reverse Repo Rate, CRR, SLR etc. i.e. by **increasing the availability of money in the economy**.

- **India's Current Monetary Policy**
  - **In the past**, RBI had pursued a **multiple indicator approach** i.e. it tried to control multiple outcomes - inflation, growth, exchange rate, and even balance of payment - through monetary policy.
  - But **RBI Act, 1934** was **amended in 2016** to introduce the framework of **Flexible Inflation Targeting** (FIT).
    - Under FIT, the primary objective of the Monetary Policy is to **ensure price stability** (i.e. ensure inflation in a particular range). Inflation is measured in terms of **Consumer Price Index (CPI),** thus making monetary policy contributes to **welfare of people**.
      - Further, it also **promotes transparency** as lay person can easily judge if the monetary policy is working for the betterment of the people of India.
    - The amendment provides that **inflation target** would be set by Central government, after discussing with the Reserve Bank, **once in every five years**.
      - **For 2016-2021,** the central government had set a target of 4% inflation rate with a **tolerance of +-2%**. Again for 2021-26, the centre has decided to **retain the inflation target of 4%, with a tolerance band of +/- 2 percentage** points for the MPC of RBI.
        - This tolerance band has been provided to deal with supply shocks like vagaries of Monsoon, crude price changes etc.
      - In case of **continuous deviation of actual inflation** from the target's tolerance bands for three consecutive quarters, the **RBI has to write a letter** to the GoI explaining the reasons for deviations and the time it will take to return inflation to its target. It thus **promotes Accountability**.

  - **Section 45ZB** of the RBI Act, 1934 also provides for a **six member Monetary Policy Committee (MPC)** to be formed by government for inflation targeting. MPC consists of:
    a. Governor of RBI - Chairperson of MPC - ex officio
    b. Deputy Governor of the RBI, in charge of Monetary Policy – Member, ex officio.
    c. One officer of the RBI to be nominated by the Central Board – Member, ex officio.

d. 3 external members nominated by GoI.

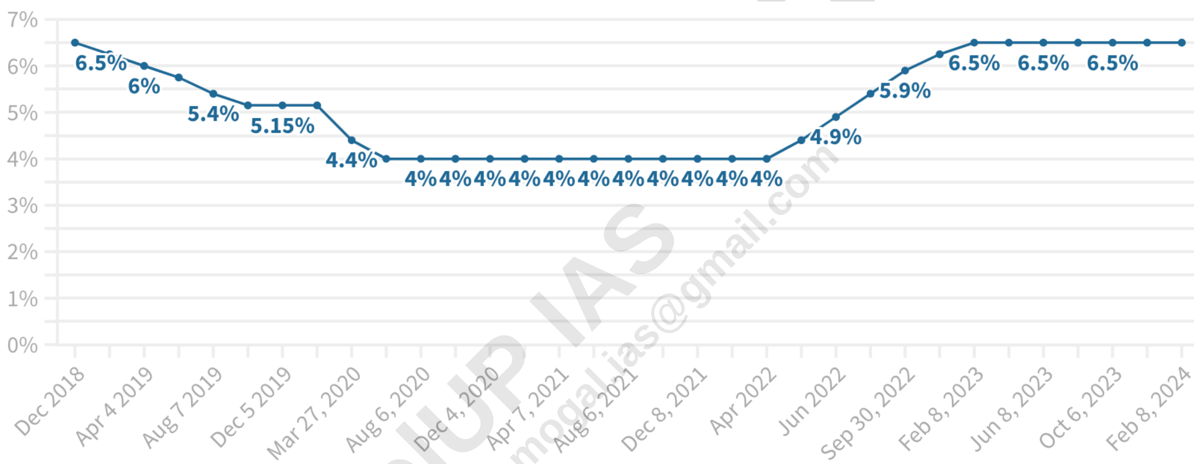
» The **decision is taken by majority** with the Chairperson having the casting vote. MPC conducts meetings at least four times a year (atleast every quarter) and monetary Policy is published after every meeting with each member explaining her opinion.

- **Before MPC**, all the interest rate related decisions were taken by Governor of RBI.
- Thus, the **MPC system replace individualistic decision-making by a collegial process** that brings in variety of experience, expertise and independence while avoiding groupthink and free-riding.

- **Current Rates:**

» **In Feb 2024**, in the bi-monthly monetary policy announcement, RBI has decided to keep the repo rate **unchanged at 6.5%**. This is the sixth monetary policy on the trot when the MPC has kept the repo rate unchanged. Last time it was in Feb 2023 when the rates were changed.

- **Why?**
  - The **retail inflation continues to remain above 4%** target of RBI. It was 5.69% in Dec 2023 and even for FY25 RBI forecasts a 4.5% retail inflation.



- The central bank also retained the **stance of the monetary policy as 'withdrawal of accommodation'** in a **5:1 majority decision**.
  - However, Jayanth Verma, member of MPC, differed with other members and voted for **25 basis point reduction in repo rate** and changing the policy stance to 'neutral' from 'withdrawal of accommodation'.

- **The MPC** in Feb 2024, after detailed assessment decided to keep the policy repo rate **under LAF** unchanged at **6.5%**. (note the last raise was made in Feb 2023)

10) CRR

- Under **RBI Act, 1934 -** Scheduled Banks are required to keep **a % of their net time and demand deposits (i.e. total deposits of customers)** in the form of cash deposits with RBI.
- **Objectives of CRR:**

- Since a part of total deposits in bank is available in the form of cash, it can be used to **readily make money available to customers when they demand it**.
- Further, RBI also **controls the amount of money in market** and thus **inflation** through CRR.

- **Note:**
  - Banks **don't get any interest** for this money deposited with RBI.
  - CRR has to be **maintained in cash only**.

A) INCREMENTAL CRR

In Aug 2023, RBI **introduced Incremental CRR** to **absorb the surplus liquidity** created in the system due to multiple factors, including the return of Rs 2,000 notes.

» It was decided that wef from the fortnight beginning Aug 12, 2023, scheduled banks shall maintain an I-CRR of 10% on the increase in their net demand and time liabilities (NDTL) between May 19, 2023 and July 28, 2023.
» This was **purely a temporary measure** for managing the liquidity overhang.
» **Existing CRR** remained unchanged at 4.5%.
» **Impact:**
  - Reduce the supply of money and thus curtail inflation.

In Sep 2023, RBI announced that it will discontinue the I-CRR in a phased manner.

» **Why release in phased manner?**
  - So that system liquidity is not subjected to sudden shocks and money markets function in a orderly fashion.
» **RBI released 25% of I-CRR** on 9th, Sep; 25% on 23rd Sep and remaining 50% of the I-CRR on 7th October 2023.

B) REDUCING CRR ON GREEN DEPOSITS

SBI in talks with RBI to lower CRR requirement on Green Deposits (Feb 2024)

- **In Jan 2024**, SBI announced a **green deposit scheme**, a first in the domestic banking, to attract long term retail deposits to be used only to fund green transition projects or climate friendly projects.
  - The bank has said that such deposits will be priced **10 basis points** lower than normal deposit rates.
- **SBI** is engaging with RBI for a reduction in CRR for green deposits and, if at all as a policy, it can be incorporated in the regulator policy mechanism.

5. PUBLIC SECTOR BANKS

1) EFFORTS TO IMPROVE THEIR FUNCTIONS

A) FINANCIAL SERVICES INSTITUTIONS BUREAU (FSIB)

- **Background: Why was Bank Board Bureau Needed?**

- **To Improve the governance of PSBS:** Committee to Review Governance of Boards of Banks in India **(Chaired by Dr. P J Nayak) recommended** setting up of Bank Board Bureau (BBB).
- Bank Board Bureau (BBB) was constituted in 2016 and started functioning from 1st April 2016 as a body of eminent professionals and officials to make recommendations for appointment of **whole-time-directors** as well as **non-executive chairpersons** of PSBs and State owned financial institutions.
    - This was earlier done by the **Board of Appointment**.
    - Central government notified the amendment to the **Nationalized Banks** (Management and Miscellaneous Provisions) Scheme, 1980 providing the legal framework for the composition of BBB.
- It was also entrusted with the task of engaging with the board of directors of all PSBs to **formulate appropriate strategies for their own growth**.
- **In 2019**, Scope of Bureau functions was extended to cover appointments of Chairman, MD & CMD and other board positions of Public Sector Insurance companies.

- **What was the need of the change in BBB**?
    - The Change was needed after the 2021 Delhi High Court verdict which had said that the BBB was not a competent body to select the general managers and directors of state owned general insurers. This has led to at least 6 newly appointed directors of non-life insurers vacating their positions.

- **Changes?**
    - The Appointments Committee of the Cabinet (ACC) has asked the Department of Financial Services to carry out necessary modifications in the **Nationalized Banks (Management and Miscellaneous Provisions) Scheme of 1970/1980** with the approval of Finance Minister and then notify the government resolution for establishing FSIB as a single entity for making recommendations for appointments of whole time directors and non-executive chairman of banks and financial institutions.

- **Financial Services Institutions Bureau (FSIB)**
    - FSIB has been constituted effective from 1st July 2022 by Central Government for the purpose of recommending persons for appointment as **whole-time directors** and **non-executive chairpersons** on the Boards of financial service institutions and for advising on certain other matters relating to personnel management of these institutions. Guidelines for selection of general managers and directors of public sector general insurance companies have been made part of FSIB
    - **Mission**: To promote excellence in Corporate Governance in Public Sector Financial Institutions
    - **How is it different from BBB?**
        - **Broader Scope**: While BBB was primarily focused on PSBs, FSIB will focus on wider range of financial institutions.

- **Stronger Legal Foundation**: Addresses concerns raised by the Delhi High Court regarding BBB's selection process.

B) AN AUTOMATED SEARCH PORTAL (FEB 2024)

- **Background**:
    - Under the framework for timely detection, reporting, investigation relating to large value bank frauds, **the Department of Financial Services under the Ministry of** Finance has mandated all the PSBs to seek a report from **the Central Economic Intelligence Bureau (CEIB)** before sanctioning loans **exceeding Rs 50** crores in the case of new borrowers and if the existing borrower's accounts into NPAs.
- **To fast-track** this mandatory intelligence clearance process, the Bureau, in tandem with SBI, has developed an **"automated search portal"** which is a digital platform which will help PSBs to obtain mandatory intelligence clearance from the CEIB in a prompt manner. PSBs will be able to check antecedents of large borrowers and ascertain the **existence of any non performing assets** against their name at the click of a button
- **Significance**:
    - Expedite lending process
    - Prevent loans to defaulters

6. INSURANCE SECTOR

- **Insurance Sector and its significance:**
    - Insurance is an integral part of financial sector. It plays a significant role in economic development. Apart from protection against mortality, property, and casualty risks and providing a safety net, the insurance sector encourages savings and provide long term funds for infrastructure development.

1) INSURANCE REGULATORY DEVELOPMENT AUTHORITY OF INDIA

- **IRDAI** is an autonomous and statutory body formed under an act of Parliament (i.e. IRDAI Act, 1999). It is responsible for managing and regulating insurance and reinsurance sector in India. It is also responsible for supervision and development of insurance sector in the country.

- **Key objective** of the IRDAI is to **promote competition** so as to enhance customer satisfaction through increased customer choices and fair premiums, while ensuring the financial security of the insurance market.
- **Composition**
    - As per the section 4 of the IRDAI Act, 1999 the composition of the authority is:
        1. Chairman
        2. Five whole-time members

3. Four part-time members
   (Appointed by government of India)

- IRDAI is headquartered in **Hyderabad**.

- **Entities regulated by IRDAI**
  - **Life Insurance companies**:
    - Insures life of a person. This kind of insurance may also have an insurance component.
  - **General Insurance companies**
    - Insures health, property, car etc.
  - **Re-insurance companies**
    - **Note**: Reinsurance companies provide insurance to insurance companies. For e.g. during a huge disaster, an insurance companies may face a large number of claims. In this scenario, a reinsurance company helps them spread the risk by sharing the cost of those claims.
  - **Agency Channel**
  - **Intermediaries**
    - Corporate agents
    - Brokers
    - Etc.

2) SITUATION OF INDIA'S INSURANCE SECTOR: ESI 2022-23

- Potential and Performance of insurance sector are generally assessed based on **2 parameters**,
  - **Insurance penetration** which refers to the **ratio of total insurance premiums to GDP in a year** and;
  - **Insurance density** which refers to **ratio of insurance premium to population** that is insurance premium per capita and is measured in U.S. dollar as they reflect the level of development of insurance sector in a country.

- **India poised to emerge as one of the fastest growing insurance markets in the coming decade**
  - **Insurance Penetration in India** has steadily increased from 2.7% around the turn of millennium to 4.2% in 2020.
    - **Life insurance penetration in India was 3.2% in 2021**, almost twice more than the emerging markets and slightly above the global average
    - However **most life insurance products sold in India are saving linked** with just a small protection component. Therefore households remain exposed to a significant financing gap in the event of premature death of the primary breadwinner.

- **Insurance Density in India** has increased from **US $11.1** in 2001 to **US $91** in 2021.

3) IMPORTANT INSURANCE RELATED INITIATIVES

A) BIMA VISTAAR:

- The IRDAI is planning to launch a **unique all-in-one insurance product** called **Bima Vistaar** in first quarter of **FY2025**.
- Bima Vistaar will provide life, health and property coverage in a single affordable policy. It will be a valuable tool for retirement planning as it eliminates the need to purchase separate policies for life, health and property coverage, providing affordability and convenience.

- Bima Vistaar is a critical component part of IRDAI's **"Insurance Trinity"** initiative that also comprise **Bima Sugam** ((a one stop digital platform)) and **Bima Vaahak** (a women led distribution channel) aimed at **ensuring insurance for all by 2047** by bridging the gap in product design, pricing and distribution.

B) BIMA VAAHAK SCHEME:

- **Bima Vaahaks** are registered individuals or legal entities providing services as outlined in the guidelines. The goal is to establish a dedicated distribution channel to enhance insurance inclusion and raise awareness in every village and gram panchayat.
    - » The main **objective** is to establish **women centric dedicated distribution channel** that is focused on enhancing inclusion and creating awareness in **every village/gram Panchayat**, and thus improving accessibility and availability of insurance in every nook and corner of the country.
    - » They will be involved in **various activities** - completing the proposal forms, fulfilling KYC requirements using handheld electronic communication devices, issuing insurance policies, and providing support for policy and claims related services.

- The 2023 guidelines for the women centric insurance distribution channel will be implemented concurrently with Bima Vistaar, which is in the final stages of development. In Oct 2023, IRDAI had said that the guidelines will be effective from the **date of launch of BIMA Vistaar**.
- **Bima Vaahaks** will be deployed in each gram panchayat by Dec 31, 2024.

C) BIMA SUGAM:

- The plan is to develop relatively small platform to launch Bima Vistaar and Bima Vahak effectively before integrating them into a larger platform.

D) OTHER PAST INITIATIVES

- To **facilitate penetration of insurance to the lower income segments** of the population the IRDAI issued **IRDAI micro insurance regulations 2015** which provide a platform for distributing insurance products that are affordable for rural and urban poor and promote financial inclusion.

- Further, the **IRDAI obligation of insurance to rural and social sector regulations 2015** stipulate obligation for insurers in rural and social sector and has contributed to developing and promoting micro insurance products in India.

E) VARIOUS GOVERNMENT INSURANCE SCHEME

- **AB-Jan Arogya Yojna** (Health Insurance)
- **Pradhan Mantri Suraksha Bima Yojana**:
  - » Under the scheme, risk coverage of Rs 2 lakh for accidental death and complete disability and Rs 1 lakh for partial disability is given to beneficiary.
- **Pradhan Mantri Jeevan Jyoti Bima Yojana**:
  - » Risk coverage of Rs 2 lakh is credited to the savings bank account of the holder in case of the death of the insured.
- **Pradhan Mantri Vaya Vandan Yojna**:
  - » Old age income security is provided to senior citizens through the provision of an assured pension/return linked to the subscription amount based on a government guarantee to LIC.
- **Pradhan Mantri Fasal Bima Yojna** (already covered in agriculture sector)

7. NEXT BOOKLET

Nationalization, Consolidation of Banks, Privatization of PSBs, IBC, NPA, Financial inclusion, digital payment, types of banks, NFBCs, Fintech, Pension sector