Summary Sheet - Functions of RBI

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1 What is a Central Bank?

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

1.1 Distinction between a Central Bank and Commercial Bank

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

2 Evolution of Central Bank

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

3 Evolution of the Reserve Bank of India

- The origins of the Reserve Bank of India (RBI) can be traced to 1926, when **the Royal Commission on Indian Currency and Finance – also known as the Hilton-Young Commission** – recommended the creation of a central bank for India to separate the control of currency and credit from the Government and to augment banking facilities throughout the country. **The Reserve Bank of India Act of 1934 established the Reserve Bank.**
- Since then, the Reserve Bank's role and functions have evolved, as the nature of the Indian economy and financial sector changed. **Though started as a private shareholders' bank, the Reserve Bank was nationalized in 1949.**

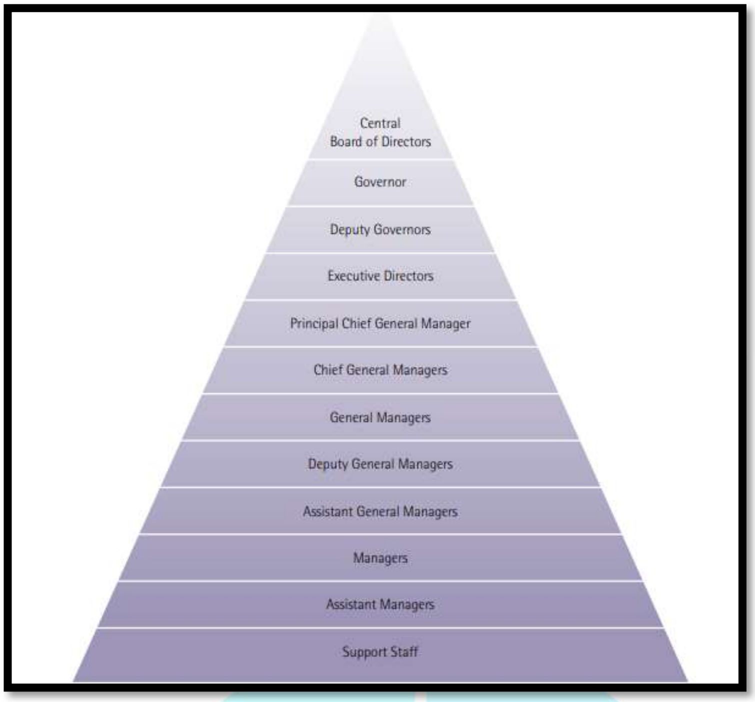
<u>Important Timeline</u>

Origins of the Reserve Bank of India

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

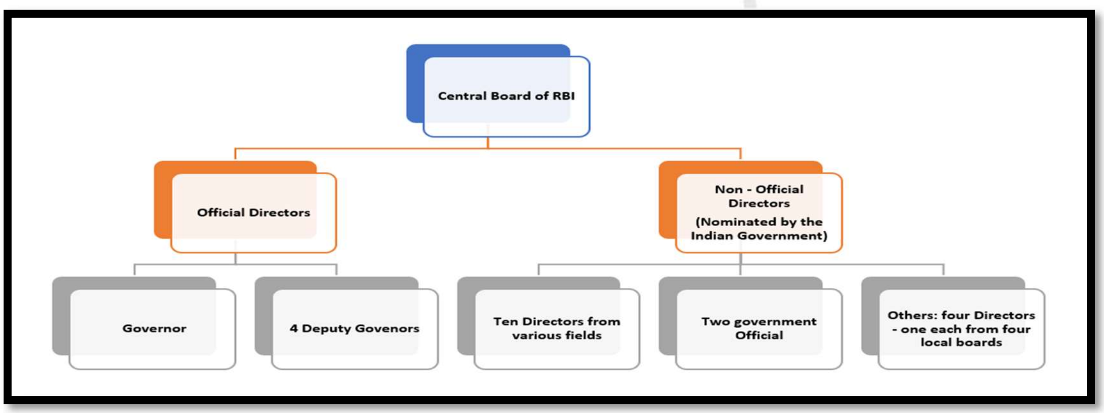
- The Central Office of the Reserve Bank was initially **established in Kolkata** but was permanently moved **to Mumbai in 1937**. The Central Office is where the Governor sits and where policies are formulated. Moreover, **Dr. Osborne Smith was the first governor of RBI and Sir C.D. Deshmukh was the First Indian Governor of RBI.**

4 Organization Structure



Central Board of Directors

- The Central Board of Directors is at the top of the Reserve Bank's organizational structure. Appointed by the Government under the provisions of the Reserve Bank of India Act, 1934, the Central Board has the primary authority and responsibility for the oversight of the Reserve Bank.
- In total **there are 21 members who are present on the Central Board of** Directors.



Local Boards

- The Reserve Bank also has four Local Boards, constituted by the Central Government under the RBI Act**, one each for the Western, Eastern, Northern and Southern areas of the country, which are located in Mumbai, Kolkata, New Delhi and Chennai**.

Central Office Departments

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

4.1 Subsidiaries of the RBI

Currently there **5 wholly owned subsidiary of the Reserve Bank of India (RBI),** now let's discuss regarding them.

1. Deposit Insurance and Credit Guarantee Corporation (DICGC)

Deposit Insurance and Credit Guarantee Corporation (DICGC) is a **wholly-owned subsidiary of the Reserve Bank of India (RBI).** It provides deposit insurance that works as a protection cover for bank deposit holders when the bank fails to pay its depositors.

GICGC insures all kinds of deposit accounts of a bank, **such as savings, current, recurring, and fixed deposits up to a limit of Rs. 5 lakh per account holder per bank**. In case an individual's deposit amount exceeds Rs.5 lakh in a single bank, only Rs.5 lakh, including the **principal and interest**, will be paid by DICGC if the bank becomes bankrupt.

Additional Information – DICGC

- DICGC came into existence in 1978 after the merger of Deposit Insurance Corporation (DIC) and Credit Guarantee Corporation of India Ltd. (CGCI) after passing of the Deposit Insurance and Credit Guarantee Corporation Act, 1961 by the Parliament.
- It serves as a deposit insurance and credit guarantee for banks in India. It is a fully owned subsidiary of and is governed by the Reserve Bank of India.
- DICGC charges **12 paise per ₹ 100 of deposits held by a bank**. The premium paid by the insured banks to the Corporation is paid by the banks and is not to be passed on to depositors.
- DICGC last revised the deposit insurance cover to ₹ 1 lakh on May 1, 1993, raising it from ₹ 30,000 since 1980. The protection cover of deposits in Indian banks through insurance is among the lowest in the world.

- The **Damodaran Committee on 'Customer Services in Banks' (2011)** had recommended a five-time increase in the cap to ₹5 lakh due to rising income levels and increasing size of individual bank deposits.

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

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

The BRBNMPL has been registered as a Private Limited Company under the Companies Act, 1956 with its Registered and Corporate Office situated at Bengaluru. **The company manages two Presses, one at Mysore in Karnataka and the other at Salboni in West Bengal**

3. Reserve Bank Information Technology Private Limited (ReBIT)

ReBIT has been set up by the Reserve Bank of India, for its IT and cybersecurity needs and to ensure cyber resilience of Indian banking. **It was established in 2016**. Major role involves, delivering and managing IT projects of RBI; Assist RBI in performing risk-based supervision of regulated entities; Safeguard RBI assets by detecting and responding to cyber-threats. ReBIT's headquarter is located in Navi Mumbai.

It also **Safeguard RBI assets by detecting and responding to cyber-threats** through architecting and operating state-of-the-art security infrastructure and services

4. Indian Financial Technology and Allied Services (IFTAS)

Financial Technology and Allied Services (IFTAS) is a wholly owned subsidiary of the Reserve Bank of India, mandated to design, deploy & support IT-related services to all Banks and Financial Institutions in the country and to the Reserve Bank of India. It manages & operates the financial messaging platform (SFMS) that comprising of Real-Time Gross Settlement and National Electronic Funds Transfer. **Established in 2015 and it's headquartered in Mumbai**.

Powered by state-of-the-art innovation and cutting-edge technology, IFTAS aims to be a long-term partner for the Indian banking and finance community. Through our unremitting focus on excellence, IFTAS ensure that the nation enjoys uninterrupted **banking services 24/7, 365 days a year.**

5. Reserve Bank Innovation Hub (RBIH)

The Reserve Bank Innovation Hub is a wholly owned subsidiary of the Reserve Bank of India (RBI) set-up to promote and facilitate an environment that accelerates innovation across the financial sector. RBIH aim to **foster and evangelize innovation across the financial sector to enable access to suitable, sustainable financial products to a billion Indians in a secure friction-less manner**. In addition, RBIH would create internal capabilities by building applied research and expertise in the latest technology. The hub will collaborate with financial sector institutions, policy bodies, the technology industry, and academic institutions and coordinate efforts for exchange of ideas and development of prototypes related to financial innovations.

The RBI has set up the RBIH as a Section 8 company under Companies Act, 2013, with an initial capital **contribution of ₹100 crore to** encourage and nurture financial innovation in a sustainable manner through an institutional set-up.

Till this point we have covered the basic organization structure of the Reserve Bank of India, now let's understand various functions of RBI.

First, we will start with **Monetary policy function of RBI**.

5 Monetary Policy as the function of RBI.

Monetary policy refers to the use of monetary instruments under the control of the central bank to influence variables, such as interest rates, money supply and availability of credit, with a view to achieving the objectives of the policy.

Monetary Policy could have either a single objective of price stability or multiple objectives. Pursuant to the amendment to RBI Act, 1934, in May 2016, the primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth.

There are various direct and indirect instruments used for implementing monetary policy including Repo Rate, Reverse Repo Rate, Marginal Standing Facility (MSF) under the Liquidity Adjustment Facility (LAF), Bank Rate, Cash Reserve Ratio (CRR), Open Market Operations (OMOs) and Market Stabilization Scheme (MSS)

6 Foreign Exchange Operations as the function of RBI

The Reserve Bank of India is the "**custodian of the country's foreign exchange reserves**" and is vested with the responsibility of managing their investment which means that RBI is encompassing a significant responsibility for overseeing and managing these reserves.

Components of foreign exchange reserves- The components of foreign exchange reserves are:

- **Foreign currency assets:** These are the most important component of foreign exchange reserves, and they can include foreign currency banknotes, foreign bank deposits, and foreign government securities.

- **Gold reserves:** Gold is a traditional safe haven asset, and it is often held by central banks as part of their foreign exchange reserves.

- **Special drawing rights (SDRs):** SDRs are an international reserve asset created by the International Monetary Fund (IMF).

- **Reserve position with the IMF**: This is the amount of money that a country has deposited with the IMF. It can be used to draw on IMF resources in times of ne

Importance of foreign exchange reserves for a country-

- **To meet international payment obligations:** Countries need foreign currency to make international payments, such as for imports, debt service, and foreign investment.
- **To stabilize the exchange rate:** Foreign exchange reserves can be used to intervene in the foreign exchange market to stabilize the value of the domestic currency.
- **To support economic growth:** Foreign exchange reserves can support economic growth by providing a source of liquidity and confidence in the economy.

- **To protect against external shocks**: Foreign exchange reserves can help to protect a country from external shocks, such as a sudden decline in exports or a capital outflow.

- **To build confidence in the economy:** Foreign exchange reserves are a signal to investors and creditors that a country is well-managed and has the ability to meet its financial obligations.

The powers and responsibilities with respect to external trades and payments, development and maintenance of foreign exchange market in **India are conferred on the RBI under the provisions of the Foreign Exchange Management Act, 1999 ('FEMA").**

Section 10 of the FEMA empowers the RBI to authorize any person to be known as authorized person to deal in foreign exchange or in foreign securities, as an authorized dealer, money changer or offshore banking unit or in any other manner as it deems fit.

7 Financial Stability Analysis as the function of RBI

- A well-functioning financial system – comprising financial markets, financial intermediaries (such as, banks, insurance companies, non-banking finance companies, etc.) and financial infrastructure (responsible for payment, clearing and settlement) – is critical for economic growth, as it ensures the efficient transfer of resources from lenders to borrowers.
- Stable financial systems, by allocating society's accumulated savings to the most productive available uses, not only provides access to finance, which is essential for economic development, but also plays a key role in **managing risk and promoting entrepreneurship.**

7.1 Institutional and governance structure for financial stability

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

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

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

Financial Stability and Development Council (FSDC):

- It is an apex-level body constituted by the government of India. The idea to create such a super regulatory body was first mooted by the Raghuram Rajan Committee in 2008. Finally in 2010, the then Finance Minister of India, Pranab Mukherjee, decided to set up such an autonomous body dealing with macro prudential and financial regularities in the entire financial sector of India. **An apex-level FSDC is not a statutory body and the chairman of FSDC is Finance Minister.**

RBI - Lender of Last Resort:

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

Financial Stability Unit (FSU):

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

Measuring and Monitoring Systemic Risk

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

Financial Stability Report

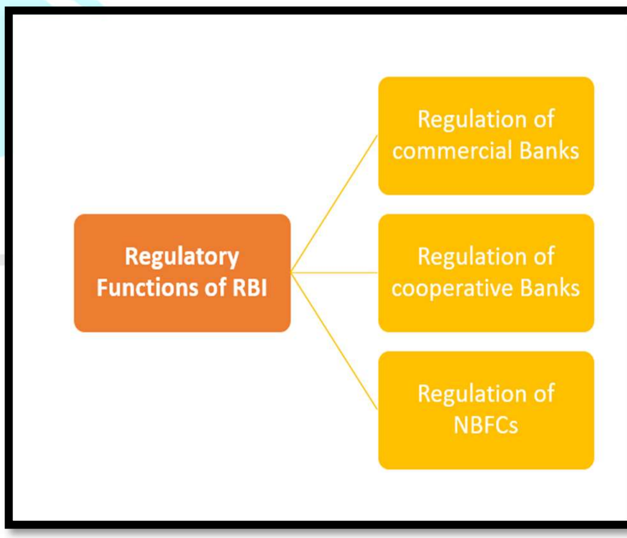
- Financial Stability Report (FSR) acts as a communication tool of the central bank in limiting instability **by pointing out the key risks and vulnerabilities**, which may have systemic impact, to policy makers, market participants and the public at large.

8 Regulatory Functions of RBI

The Reserve Bank is striving towards a more **competitive, efficient and heterogeneous banking structure**.

Difference between Regulation and Supervision

- Bank regulation refers to the written rules that define acceptable behavior and conduct for financial institutions whereas supervision refers to the enforcement of these rules.
- For example, the Reserve Bank of India (RBI) makes rules and regulations for Regional Rural Banks (RRBs) whereas **NABARD is the supervisory authority of the RRBs.**
- In the same manner, all Housing Finance Companies (HFCs) are regulated by RBI, but the supervision of HFCs is done by National Housing Bank (NHB).



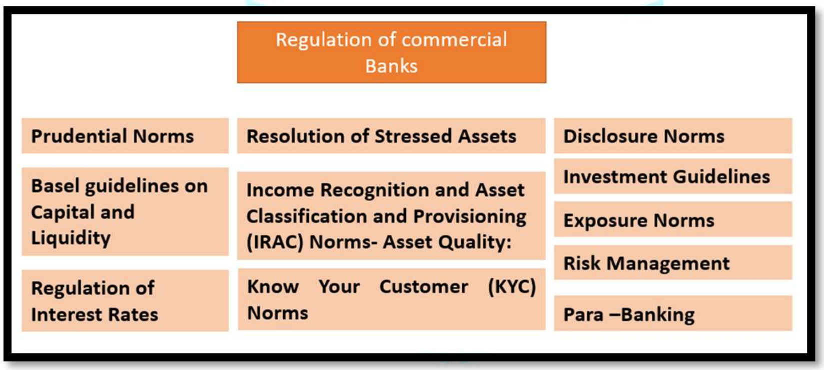
Re-organisation of Regulation and Supervision Departments of RBI

- The Central Board of the Reserve Bank of India in 2019, approved the creation of the separate supervisory and regulatory cadre.

- This decision was taken with a view to having a holistic approach to supervision and regulation of the regulated entities to address growing complexities, size and inter-connectedness as also to deal more effectively with potential systemic risk.
- Accordingly, the RBI decided to integrate the supervision function into a unified Department of Supervision and regulatory functions into a unified Department of Regulation with effect from November 01, 2019.

8.1 Regulation of Commercial Banks

- **Mandate /Goals**: Regulation aimed at protecting depositors' interests, orderly development and conduct of banking operations and fostering of the overall health of the banking system and financial stability.
- **Perimeter:** Commercial banks, Small Finance Banks, Payments Bank, All India Financial Institutions, Credit Information Companies, Regional Rural Banks and Local Area Banks.
- **Evolution:** Regulatory functions have evolved with the development of the Indian banking system and adoption of prudential norms based on international best practices.



Prudential Norms

Prudential norms are the guidelines issued by the banking regulator to ensure safety and soundness of banks. **Prominent prudential norms relate to Income Recognition and Asset Classification, Capital Adequacy, Exposures, etc.**
In the course of their business, banks lend and invest in various classes of assets, some of which may turn non-performing either due to the **systemic factors such as economic downturn or idiosyncratic factors specific to the borrower.**

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

- Banks are required to objectively identify stressed assets and take corrective action. In line with the international norms in this regard, Reserve Bank issued prudential guidelines to ensure greater consistency and transparency in the financial statements of banks.

- Indian banks are required to classify assets as non-performing once they cease to generate income for the bank. Illustratively, if the interest and/or instalment of principal of a term loan remains overdue for a period of **90 days**, the banks are required to classify them as non-performing loans.

Additional Information: Understanding of NPAs

Different types of non-performing assets depend on how long they remain in the NPA category.

a) **Sub-Standard Assets** - An asset is classified as a sub-standard asset if it remains as an NPA for a period less than or equal to 12 months.

b) **Doubtful Assets** - An asset is classified as a doubtful asset if it remains as an NPA for more than 12 months.

c) **Loss Assets** - An asset is considered a loss asset when it is "uncollectible" and recognized them as losses. However, some recovery value may be left in it as the asset has not been written off wholly or in parts.

In this context, there is one more terminology which we have to understand, and it is related to Special Mention Account (SMA)

Special Mention Accounts are those that show signs of incipient stress, where the borrower is likely to default on repayment but hasn't defaulted yet. The SMA classification is a way for banks and financial institutions to identify accounts that may be at risk of turning into Non-Performing Assets (NPAs) in the near future.

In India, for instance, the Special Mention Account classification is further divided into three categories:

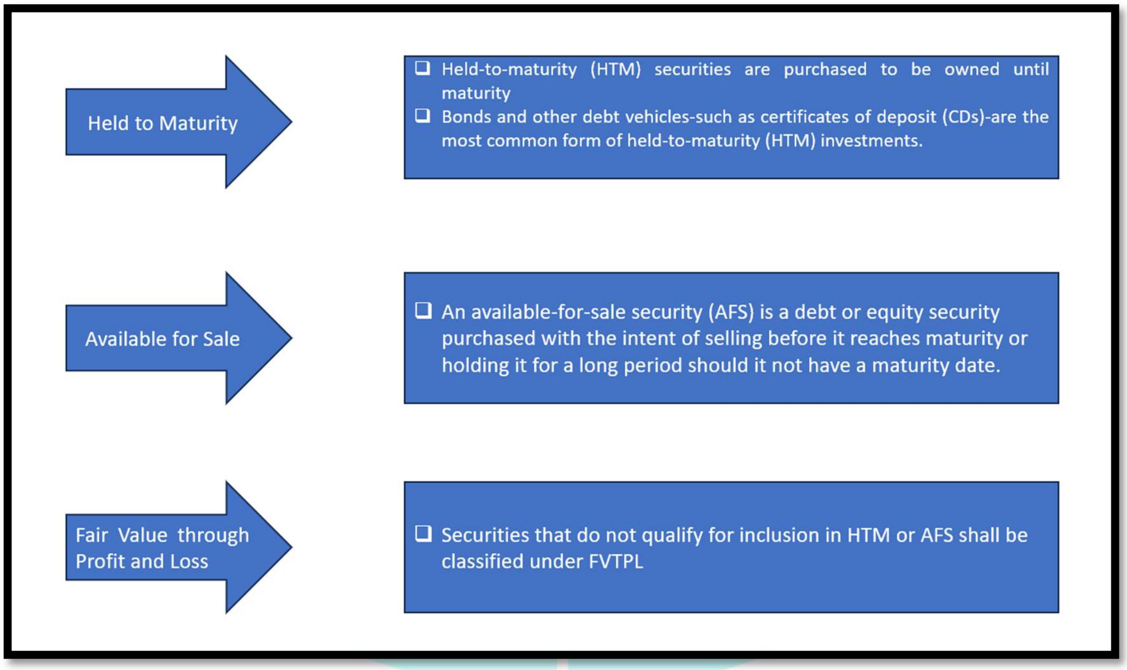
- **SMA-0:** If the principal or interest payment remains overdue for 1-30 days.
- **SMA-1:** If the principal or interest payment remains overdue for 31-60 days.
- **SMA-2:** If the principal or interest payment remains overdue for 61-90 days.

Exposure Norms:

- A bank's exposures to its counterparties may result in **concentration of its assets to a single counterparty** or a group of **connected counterparties.**

Investment Guidelines:

- In terms of these guidelines, **the entire investment portfolio of the banks should be classified under three**
- **categories**, viz, Held to Maturity (HTM), Available for Sale (AFS) and Fair Value through Profit and Loss (FVTPL). Held for Trading (HFT) shall be a separate investment sub-category within FVTPL. The category of the investment shall be decided by the bank before or at the time of acquisition and this decision shall be properly documented.



Resolution of Stressed Assets:

- Swift, **time-bound resolution of stressed assets** is critical for de-clogging bank balance sheets and for efficient reallocation of capital.
- The **Banking Regulation (Amendment) Act, 2017**, empowered the Reserve Bank to issue directions to the banks for resolution of stressed assets, including referring assets to the Insolvency and Bankruptcy Code 2016 (IBC).

Risk Management

- Banks in the process of financial intermediation are confronted with **various kinds of financial and nonfinancial risks**, viz., credit, interest rate, foreign exchange rate, liquidity, equity price, commodity price, legal, regulatory, reputational, operational, etc.

Regulation of Interest Rates

- The interest rates on deposits have been progressively deregulated providing **banks greater flexibility in resource mobilization.**
- However, keeping the customer service under consideration, the **deposit rates are required to be uniform across all branches and for all customers** and no discrimination is permitted in the matter of interest paid on the deposits, between one deposit and another of similar amount and tenor, accepted on the same date, at any of its offices by the banks.

Know Your Customer Norms

- Sound 'Know Your Customer' (KYC) policies and procedures are **critical for protecting the safety and soundness of banks and the integrity of banking systemin the country.** To **prevent money laundering** through the banking system, the Reserve Bank has issued 'Know Your Customer' (KYC), Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT) guidelines. These instructions are **based on the provisions** of Prevention of Money Laundering (PML) Act, 2002 and Prevention of Money Laundering (Maintenance of Records) Rules, 2005.

Additional Information

Financial Intelligence Unit

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

Corporate Governance

With a view to strengthening corporate governance, over a period of time, various guidelines have been issued in matters relating to the role to be played by the Board, fit and proper criteria for the directors of banks in general and for elected directors of Public Sector Banks in particular, calendar of reviews to be undertaken by the Board, broadening the fields of specialization for directors against the backdrop of innovations in banking and technology, qualifications and experience for Chief Financial Officer and Chief Technology Officer, bifurcation of the post of Chairman and Managing Director (CMD), etc.

Disclosure Norms

- Public disclosure of relevant information is an important tool for enforcing **market discipline.** Hence, over the years, the Reserve Bank has strengthened the disclosure norms for banks.
- Banks are now **required to make disclosures in their annual report**, among others, about capital adequacy, asset quality, liquidity, earnings and penalties, if any, imposed on them by the regulator, etc.

Para Banking Activities

- Deregulation of the banking sector and the development of the financial sector encouraged many banks to undertake **non-traditional banking activities, also known as para-banking.**
- The Reserve Bank has **permitted banks to undertake diversified activities, such as**, mutual funds business, insurance business, merchant banking activities, factoring services, card business, pension fund management, investment advisory services, agency business, membership of SEBI approved stock exchanges, etc.
- **Banks are also permitted to invest in** equity/unit capital of financial/non-financial companies, Alternative Investment Funds and Real Estate Investment Trust/Infrastructure Investment Trust in line with the Prudential regulations for banks' investments.

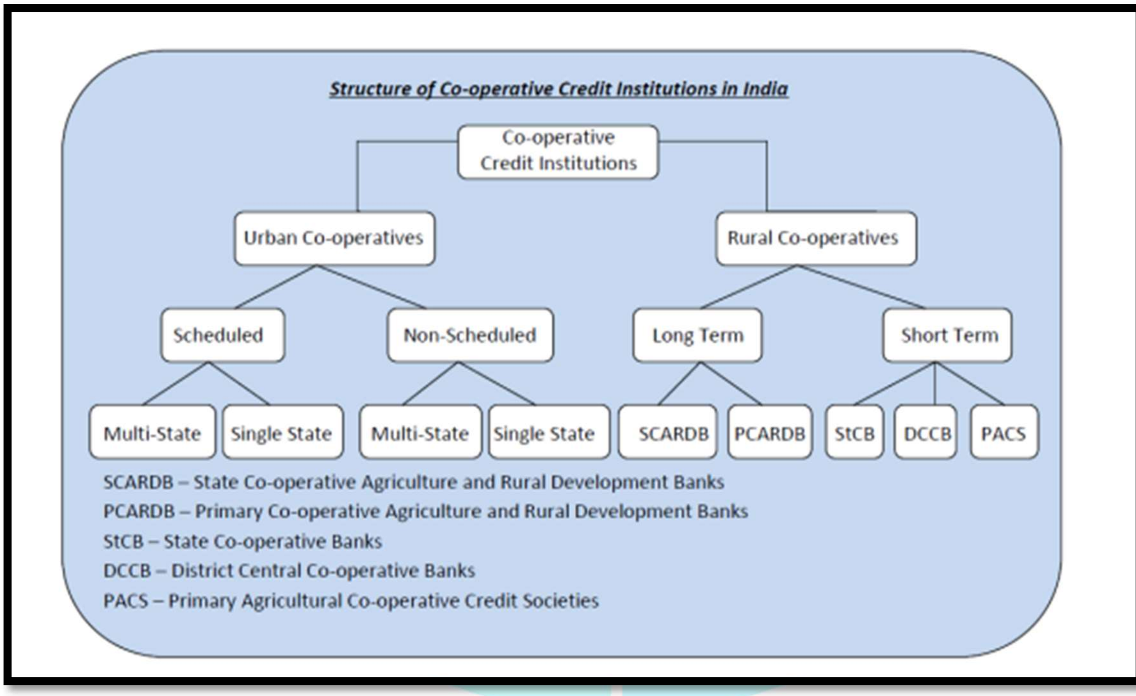
Regulation of All India Financial Institutions

- The (Five) AIFIs, viz. EXIM, NABARD, NHB and SIDBI are under regulation and supervision of the Reserve Bank. (NaBFID)
- These AIFIs have been **constituted under their own statutes which, along with the provisions of the Reserve Bank of India Act, 1934**, provide the legal framework for their regulation.
- As in the case of commercial banks, prudential norms relating to income recognition, asset classification and provisioning, exposures, investments, capital adequacy and disclosures are applicable to the AIFIs as well.

8.2 Regulation of Co-Operative Banks

This role of RBI includes ensuring credit availability to the productive sectors of the economy, establishing institutions designed to build the country's financial infrastructure, expanding **access to affordable financial services and promoting financial education and literacy.**

The structure of co-operative banking in India is multi-tiered, with urban and rural co-operatives as its main pillars.



8.2.1 Rural Cooperative banks

The "short-term" Rural co-operative credit structure operates with a **three-tier system** –

1. **Primary Agricultural Credit Societies (PACS) at the village level,**
2. **District Central Cooperative Banks (DCCBs) at the district level and**
3. **State Cooperative Banks (StCBs) at the State level**.

PACS are outside the purview of the Banking Regulation Act, 1949 and hence not regulated by the Reserve Bank of India. StCBs/DCCBs are registered under the provisions of State Cooperative Societies Act of the State concerned and are **regulated by the Reserve Bank.** Powers have been delegated to National Bank for Agricultural and Rural Development (NABARD) under Sec 35 (6) of the Banking Regulation Act (As Applicable to Cooperative Societies) **to conduct inspection of State and Central Cooperative Banks**.

The **Long Term Rural Co-operatives**, viz., State Co-operative Agriculture and Rural Development Bank (**SCARDB**) and Primary Co-operative Agriculture and Rural Development Bank (**PCARDB**) do not fall under the regulatory or supervisory purview of RBI.

The Vyas Committee argued for the elimination of one of the tiers to bring down costs for ultimate borrowers.

The decision for amalgamation of DCCBs into StCB leading to conversion of a 3 tier structure into a 2 tier structure has to be initiated by the respective State Governments. The request of the State Government will be examined by RBI in consultation with NABARD.

8.2.2 Urban Cooperative banks

Primary Cooperative Banks (PCBs), also referred to as Urban Cooperative Banks (UCBs), cater to the **financial needs of customers in urban and semi-urban areas**.

UCBs are primarily registered as cooperative societies under the provisions of either the State Cooperative Societies Act of the State concerned or the Multi State Cooperative Societies Act, 2002 if the area of operation of the bank extends beyond the boundaries of one state. The sector is heterogeneous in character with uneven geographic spread of the banks. While many of them are unit banks without any branch network, some of them are large in size and operate in more than one state.

New classification

The Reserve Bank of India (RBI) has announced a four-tiered regulatory framework for categorization of Urban Co-operative Banks (UCBs). RBI had constituted the Expert Committee on Urban Co-operative Banks, under the Chairmanship of Shri N. S. Vishwanathan.

Therefore, a new four-tiered regulatory framework, based on size of deposits of the UCBs was introduced

- **Tier 1:** UCB are those banks having deposits up to Rs 100 crore operating in a single district or having branches in contiguous districts.
- **Tier 2:** UCBs with deposits more than Rs.100 crore and up to Rs.1000 crore.
- **Tier 3:** UCBs with deposits more than Rs.1000 crore and up to Rs.10, 000 crore.
- **Tier 4: UCBs** with deposits more than Rs.10, 000 crore.

Specifically, a minimum net **worth of ₹2 crore for Tier 1 UCBs operating in single district and ₹5 crore for all other UCBs (of all tiers) has been stipulated**

8.2.3 Co-operative Principles

❑ **Duality of control**

In terms of Article 246 of the Constitution of India, the legislative powers of the Union and the State are given in three Lists, viz., **the Union List the State List and the Concurrent List respectively of Schedule VII to the Constitution**. The entry relating to incorporation, regulation and winding-up of Cooperative Societies fall in State List whereas the entry relating to banking fall in the Union List. **This results in the duality of jurisdiction over cooperative banks by the Reserve Bank of India and the Registrar of Cooperative Societies**.

Cooperative banks are currently under the dual control of the Registrar of Cooperative Societies and RBI. **While the role of registrar of cooperative societies includes incorporation, registration, management, audit, supersession of board and liquidation and RBI is responsible for regulatory functions such as maintaining cash reserve and capital adequacy, among others.**

To address this problem the government of India came out with the Banking Regulation (Amendment) Ordinance, 2020.

- The Bill proposes amendments to the Banking Regulation Act, 1949.
- With this new Bill, the central government aims to bring cooperative banks under the supervision of the Reserve Bank of India (RBI).
- The **Ordinance states that the BR Act will not apply to primary agricultural credit societies and cooperative societi**es whose principal business is long term financing for agricultural development. Further, these societies shall not use the words 'bank', 'banker' or 'banking' in their name or in connection with their business
- The **amendments also allow cooperative banks to raise money via public issues and private placements of equity or preference shares** as well as unsecured debentures, with the central's bank's nod.

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

- **'Co-operative societies' appear at Entry 32 in the State List**, whereas **'Banking' appears at Entry 45 in the Union List** under the Seventh Schedule to the Constitution of India.
- Hence, **Co-operative Societies in India are a state subject and they do not fall under the regulatory purview of RBI.**
- Co-operative Credit Societies, which are licensed to carry out banking activities function as a co-operative bank and are eligible to accept deposits from the public.

Note: For Regulations related to NBFCs, please move ahead in the course, therein you will understand that how RBI regulates different types of NBFCs working in the Indian Financial System.

9 Supervision as a function of RBI

Supervision, in simple terms, is the **enforcement of rules and regulations that are formulated by the regulator to govern the behaviour of regulated institutions** and at the same time spot loopholes or grey areas where regulatory reinforcement may be due.

9.1 Supervision of Commercial Banks

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

9.1.1 Approach Used for Supervision

- **Reserve Bank of India constituted a High-Level Steering Committee** under the Chairmanship of former Deputy Governor, Shri K C Chakrabarty, in August 2011, to review the supervisory processes for commercial banks.
- The Committee, inter alia, **recommended a shift to a risk-based approach** to supervision from the existing compliance-based approach.
- Based on the recommendations of the committee, a risk-based approach to supervision was implemented from 2013 onwards in a phased manner.
- All the **scheduled commercial banks in India are now under the Risk Based Supervisory (RBS) framework and the erstwhile CAMELS framework is no longer in vogue.**

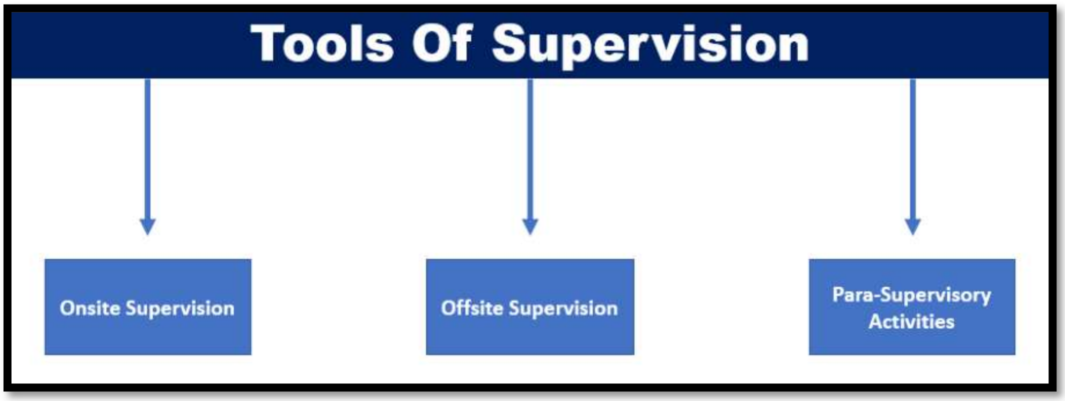
9.1.2 Risk-based Supervision (RBS)

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

❑ RBS can thus be seen as a structured process, which **identifies material and critical risks that a bank may potentially face**, and through a focused supervisory review process, **assesses the bank's ability to manage** the potential risks along with its financial vulnerability

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

9.1.3 Tools of Supervision



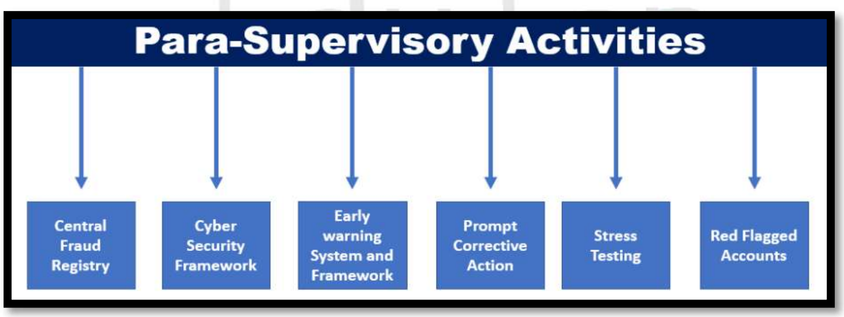
A. Onsite Supervision

Onsite inspection of banks is carried out on an annual basis. Besides the head office and controlling offices, certain specified branches are covered under inspection so as to ensure a minimum coverage of advances.

B. Offsite Supervision.

Central Repository of Information on Large Credits (CRILC) has been introduced in 2014 as part of Framework for Revitalizing Distressed Assets in the economy. Credit information on large borrowers are collected from the banks under this system. Borrower level credit information reported in the CRILC system and sharing relevant information among the banks has eliminated information asymmetry and brought in much needed transparency.

A) Para-Supervisory Activities



Central Fraud Registry

A Central Fraud Registry (CFR) has been operationalized with effect from **January 20, 2016.** The CFR will provide **"a searchable centralized database for use by banks"**, which in turn can alert banks to take necessary steps to develop a sound and robust fraud risk management system.

Cyber Security Framework

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

Early Warning System and Action

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

Prompt Corrective Action (PCA)

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

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

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

Stress Testing:

❑ The **role of stress testing has rapidly evolved and grown** in importance since the Global Financial Crisis of 2007-09.

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

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

Red Flagged Accounts (RFA)

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

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

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

9.2 Supervision of UCBs

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

i. On-site Inspection: The statutory inspections conducted under Section 35 of the Banking Regulation Act, 1949 follows the CAMELS pattern to assess the Capital Adequacy (C), Asset Quality (A), Management (M), Earnings (E), Liquidity (L) and Systems & Control (S) of the UCBs.

ii. Off-site surveillance: In order to have continuous supervision over the UCBs, the Reserve Bank has supplemented the system of periodic on-site inspections with off-site surveillance (OSS) through a set of periodical prudential returns that will be submitted by UCBs to RBI.

9.3 Supervision of NBFCs

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

A. Onsite and Offsite Supervision

Already Covered

B. Market Intelligence

- Pro-active market intelligence can help pick up early warning signals about the health of a particular NBFC and trigger supervisory action to protect the interest of the depositors/avoid systemic risks.

C. The Sachet Portal

- The Reserve Bank launched a mobile friendly portal Sachet (sachet.rbi.org.in) on August 4, 2016 to help the public as well as regulators to ensure that only regulated entities accept deposits from the public.
- The portal can be used by the public to share information wherein they can also upload photographs of advertisements/publicity material, raise queries on any fund raising/investment schemes that they come across and lodge complaints.
- The portal has links to all the regulators and the public can easily access information on lists of regulated entities.

D. Exception Report of Statutory

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

E. Interaction with Stakeholders

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

Now, let's cover the next RBI function.

10 RBI's Function of Acting as a Banker to Banks and Government.

Now, this function has been divided into two parts, the first is **RBI acting as banker to banks and RBI acting as banker to the government**

First, we will cover the RBI acting as a banker to the Banks

10.1 RBI as a banker to the Banks

Like individual consumers, businesses and organization of all kinds, banks need their own mechanism to transfer funds and **settle inter-bank transaction-such** as borrowing from and lending to other banks-and **customer transactions. As the banker to banks, the Reserve Bank fulfills this role.**

As Banker to Banks, the Reserve Bank focusses on:

Role 1 - Enabling smooth, swift and seamless clearing and settlement of inter-bank

Role 2 - Providing an efficient means of funds transfer for banks

Role 3 - Enabling banks to maintain their accounts with the Reserve Bank for statutory reserve requirements and maintenance of transaction balances

Role 4 - Acting as a lender of last resort

- As a Banker to Banks, the Reserve Bank **also acts as the 'lender of the last resort'**. It can come to the rescue of a bank that is solvent but faces temporary liquidity problems by supplying it with much needed liquidity when no one else is willing to extend credit to that bank.
- The Reserve Bank extends this facility **to protect the interest of the depositors of the bank and to prevent possible failure of the bank**, which in turn may also affect other banks and institutions and can have an adverse impact on financial stability and thus on the economy.

Bagehot's dictum
In **1873, Walter Bagehot**, an editor of the Economist magazine, published a **book titled "Lombard Street"** where he clearly articulated that to avoid panics, central banks should assume the role of **"lender of last resort".**   The **doctrine, which came to be known as Bagehot's dictum** states that a central bank, in periods of panics or crisis, should lend freely, against quality collateral and at a penal rate of interest.

10.2 RBI as a banker to the Government

Managing the government's banking transactions is a key RBI role. Like individuals, businesses and banks, **governments need a banker to carry out their financial transactions in an efficient and effective manner, including the raising of resources from the public.**

10.2.1 Banker to Central Government

- Under the administrative arrangements, the **Central Government is required to maintain a minimum cash balance with the RBI.** The following accounts of Central Government are maintained in E-Kuber (CBS) system in all the Regional Offices of RBI and the **Principal account of these accounts are maintained at Central Accounts Section (CAS), RBI, Nagpur.**
    - Central Government - Civil;
    - Railway Fund;
    - Post Fund;

- Telecommunication Fund;
- Defence Fund;
- Departmentalized Ministries;
- Agency Transaction Account

- All receipts, payments /disbursements, clearing/remittance transactions take place through these accounts.

10.2.2 Banker to State Government

The principal account of all State Governments except Sikkim is maintained at CAS, Nagpur under the account titled "Government Deposit Account – State".

The **minimum balance required to be maintained by each State varies from State to State** depending on the relative size of the State budget and economic activity

10.2.3 Appointment of Agency Banks

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

10.2.4 Public Debt Management

- The Reserve Bank **manages public debt on behalf of the Central and the State Governments.**
- It involves issue of new rupee loans, payment of **interest and repayment of these loans and other operational matters such as debt certificates and their registration**.
- The borrowing programme is planned taking into account a number of factors such as the amount of Central and State loans maturing during **the year, the estimated available resources, market demand for securities in various tenors, etc**..

10.2.4.1 Ways and Means Advances

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

WMA for Central Government:

- The limit and period of the limit of these advances is decided by RBI, in consultation with the Central Government.

- If the Government borrows over and above this limit, then it amounts to Overdraft (OD).
- The Reserve Bank **may trigger fresh floatation of market loans when the Government utilizes 75 per cent of the WMA limit**.

WMA for State Governments:

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

11 Functions of RBI – Consumer Education and Protection

The Reserve Bank's approach to customer service focusses on protection of customers' rights, enhancing the quality of **customer service, spreading awareness and strengthening the grievance redressal mechanism in banks and also in the Reserve Bank**.

11.1 Important Initiatives of RBI

- **Mandating the Board of the banks** to discuss the customer service aspects and the implementation of regulatory instructions on a half-yearly basis
- Advising banks to constitute a **Customer Service Committee of the Board** and include experts and representatives of customers as invitees to strengthen the corporate governance structure in the banking system and also to bring about ongoing improvements in the quality of customer service provided by the banks.
- Mandating banks to set up **Standing Committee on Customer Service** cutting across various departments in the bank.

Banking Ombudsman Scheme

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

SALIENT FEATURES OF THE SCHEME:

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

Ombudsman Scheme for Non-Banking Financial Companies, 2018:

- The Scheme that was notified under Section 45-L of RBI Act, 1934 was **initially made applicable** NBFC-D with effect from Feb, 2018 and then **extended to all NBFC-ND having asset size of ₹100 crore** and above and having customer interface with effect from April, 2019.
- A few categories of NBFCs viz., the Non-Banking Financial Company-Infrastructure Finance Company (NBFC-IFC), Core Investment Company (CIC), Infrastructure Debt Fund-Non-banking Financial Company (IDF-NBFC) and an NBFC under liquidation, are **excluded from the ambit of the Scheme.**

Ombudsman Scheme for Digital Transactions, 2019:

- The Scheme, launched under Section 18 of the Payment and Settlement Systems Act, 2007, provides a cost-free and expeditious complaint redressal mechanism relating to deficiency in services for customers of non-bank entities regulated by RBI.
- Complaints relating to digital transactions conducted through banks continue to be handled under the BOS 2006.

Internal Ombudsman in Banks

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

Integrated Ombudsman Scheme

The Integrated Ombudsman Scheme merges the three ombudsman schemes of RBI. Namely, the Banking Ombudsman Scheme (2006), Ombudsman Scheme for NBFCs of 2018, and Ombudsman Scheme of Digital Transaction of 2019.

We have covered the integrated Ombudsman scheme in the current affairs section, kindly refer to the same.

11.2 Charter of Customer Rights

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

The Charter of Customer Rights **outlines overarching principles of customer rights based on global best practices. The five rights for bank customers according to this Charter are:**

- Right to Fair Treatment
- Right to Transparency, Fair and Honest Dealing
- Right to Suitability
- Right to Privacy
- Right to Grievances Redress and Compensation

12 RBI's Function in Financial Inclusion (FI) and Development

This role **encapsulates the essence of renewed national focus on Financial Inclusion**, promoting **financial education and literacy and making credit available** to productive sectors of the economy including the rural and MSME sector.

Now let's cover this function of RBI in Detail

12.1 Institutional Mechanism for FI

- The **Financial Stability and Development Council (FSDC)** chaired by the Union Finance Minister and involving heads of all financial sector regulators that has financial inclusion and financial literacy as one of its important mandates.
- A high-level **Financial Inclusion Advisory Committee (FIAC)** set up by RBI to focus on providing strategic direction to FI initiatives across various stakeholders.
- A strong **institutional mechanism at the level of banks** through State Level Bankers' Committees (SLBC) in all the States, District Consultative Committees (DCC) and District Level Review Committee (DLRC) in all the Districts, Block Level Bankers' Committee (BLBC) in all the Blocks in the country

Increasing Brick and Mortar Presence

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

Banking Outlet → A **'Banking Outlet'** for a bank is a fixed point service delivery unit, manned by either bank's staff or its Business Correspondent (BC) where services of acceptance of deposits, encashment of cheques/ cash withdrawal or lending of money are provided for a minimum of 4 hours per day for at least five days a week.

National Strategy for Financial Inclusion

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

Priority Sector Lending

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

Other RBI Initiatives for Financial Literacy

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

National Centre for Financial Education (NCFE)

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

13 Research, Surveys and Data Dissemination

The Reserve Bank has a rich tradition of generating accurate and timely data, policy-oriented and topical economic research, publication of statutory and other theme-based reports, and knowledge-sharing.

13.1 Important Publications

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

14 Currency Management

The Reserve Bank is the nation's sole note issuing authority. Along with the Government of India, RBI is responsible for the design, production and overall management of the nation's currency, with the goal of ensuring an adequate supply of clean and genuine notes.

14.1 Legal Provisions

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

- *regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage;*
- *to have a modern monetary policy framework to meet the challenge of an increasingly complex economy, to maintain price stability while keeping in mind the objective of growth."*

- Under Section 22 of the RBI Act, 1934 **"Right to Issue Bank notes",** RBI has the sole right to issue bank notes of various denominations except one-rupee notes, which is issued by the Government of India.
- As per the **Coinage Act, 2011**, the Government of India has the sole right to produce / mint coins.
- Although the responsibility for minting coins vests with the Government of India, the **coins are issued for circulation only through the Reserve Bank of India** under the provisions of Section 38 and Section 39 of RBI Act, 1934.
- Currency includes the bank notes issued by RBI in various denominations from time to time ranging between ₹2 to ₹10000 (**Section 24 of RBI Act**).

Evolution of Paper Currency in India

The initial notes were printed in England and the production of currency notes in India started with the establishment of the **currency printing press at Nashik in Maharashtra in 1928.** The same was augmented with the setting up of another government press at **Dewas in Madhya Pradesh (MP) in 1974.**

To bridge the gap in demand and supply of currency notes necessitated by the increasing currency requirements of growing economy, the RBI, in 1995 established a wholly owned subsidiary **Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL).**

14.1.1 Distribution of Currency

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

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

15 Development and Regulation of Financial Market

The Money market, Government Securities market, Foreign Exchange market, certain elements of the Corporate Debt market and derivatives relating to interest rate, credit and foreign exchange fall under the regulatory domain of the Reserve Bank.

The Bank has been discharging both the developmental as well as regulatory roles for these markets.

We have covered this function of RBI earlier in our course.

16 Regulation of payment and settlement system as the functions of RBI

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

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

The regulatory and supervisory controls include power to determine standards for the functioning of payment systems, power to call for returns, documents or other information, power to enter and inspect payment systems, power to carry out audit and inspections, power to issue directions, etc.

We have covered this function of RBI earlier in our course.