Functions of Reserve Bank of India

Main Functions

Monetary Authority:

- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability while keeping in mind the objective of growth.

Regulator and supervisor of the financial system:

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

Manager of Foreign Exchange

- Manages the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

Issuer of currency:

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

Developmental role

- Performs a wide range of promotional functions to support national objectives.

Regulator and Supervisor of Payment and Settlement Systems:

- Introduces and upgrades safe and efficient modes of payment systems in the country to meet the requirements of the public at large.
- Objective: maintain public confidence in payment and settlement system

Related Functions

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

Following are the functions of RBI in detail:

1. **Monetary Policy**
2. **Research and Data**
3. **Issuer of Currency**
4. **Regulation**
5. **Financial Markets**
6. **Financial Inclusion and Development**

7. **Consumer Education and Protection**
8. **Banker and Debt Manager to Government**
9. **Banker to Banks**
10. **Foreign Exchange Management**
11. **Payment & Settlement Systems**

Monetary Policy:

- Monetary policy refers to the policy of the central bank with regard to the use of monetary instruments under its control to achieve the goals specified in the Act.

- The Reserve Bank of India (RBI) is vested with the responsibility of conducting monetary policy. This responsibility is explicitly mandated under the Reserve Bank of India Act, 1934.

Goals of Monetary Policy:

- The primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth. Price stability is a necessary precondition to sustainable growth.

- In May 2016, the Reserve Bank of India (RBI) Act, 1934 was amended to provide a statutory basis for the implementation of the flexible inflation targeting framework.

- The amended RBI Act also provides for the inflation target to be set by the Government of India, in consultation with the Reserve Bank, once in every five years. Accordingly, the Central Government has notified in the Official Gazette 4 per cent Consumer Price Index (CPI) inflation as the target for the period from August 5, 2016 to March 31, 2021 with the upper tolerance limit of 6 per cent and the lower tolerance limit of 2 per cent.

- The Central Government notified the following as factors that constitute failure to achieve the inflation target:(a) the average inflation is more than the upper tolerance level of the inflation target for any three consecutive quarters; or (b) the average inflation is less than the lower tolerance level for any three consecutive quarters.

- Prior to the amendment in the RBI Act in May 2016, the flexible inflation targeting framework was governed by an Agreement on Monetary Policy Framework between the Government and the Reserve Bank of India of February 20, 2015.

Monetary Policy Framework:

- The amended RBI Act explicitly provides the legislative mandate to the Reserve Bank to operate the monetary policy framework of the country.

- The framework aims at setting the policy (repo) rate based on an assessment of the current and evolving macroeconomic situation; and modulation of liquidity conditions to anchor money market rates at or around the repo rate. Repo rate changes transmit through the money market to the entire the financial system, which, in turn, influences aggregate demand – a key determinant of inflation and growth.

- Once the repo rate is announced, the operating framework designed by the Reserve Bank envisages liquidity management on a day-to-day basis through appropriate actions, which aim at anchoring the operating target – the weighted average call rate (WACR) – around the repo rate.

- The operating framework is fine-tuned and revised depending on the evolving financial market and monetary conditions, while ensuring consistency with the monetary policy stance. The liquidity management framework was last revised significantly in April 2016.

The Monetary Policy Process:

- Section 45ZB of the amended RBI Act, 1934 also provides for an empowered six-member monetary policy committee (MPC) to be constituted by the Central Government by notification in the Official Gazette. Accordingly, the Central Government in September 2016 constituted the MPC as under:

1. Governor of the Reserve Bank of India – Chairperson, *ex officio*;
2. Deputy Governor of the Reserve Bank of India, in charge of Monetary Policy – Member, *ex officio*;
3. One officer of the Reserve Bank of India to be nominated by the Central Board – Member, *ex officio*;
4. Shri Chetan Ghate, Professor, Indian Statistical Institute (ISI) – Member;
5. Professor Pami Dua, Director, Delhi School of Economics – Member; and
6. Dr. Ravindra H. Dholakia, Professor, Indian Institute of Management, Ahmedabad – Member.

   (Members referred to at 4 to 6 above, will hold office for a period of four years or until further orders, whichever is earlier.)

- The MPC determines the policy interest rate required to achieve the inflation target. The first meeting of the MPC was held on October 3 and 4, 2016 in the run up to the Fourth Bi-monthly Monetary Policy Statement, 2016-17.

- The Reserve Bank's Monetary Policy Department (MPD) assists the MPC in formulating the monetary policy. Views of key stakeholders in the economy, and analytical work of the Reserve Bank contribute to the process for arriving at the decision on the policy repo rate.

- The Financial Markets Operations Department (FMOD) operationalises the monetary policy, mainly through day-to-day liquidity management operations. The Financial Markets Committee (FMC) meets daily to review the liquidity conditions so as to ensure that the operating target of the weighted average call money rate (WACR).

- Before the constitution of the MPC, a Technical Advisory Committee (TAC) on monetary policy with experts from monetary economics, central banking, financial markets and public finance advised the Reserve Bank on the stance of monetary policy. However, its role was only advisory in nature. With the formation of MPC, the TAC on Monetary Policy ceased to exist.

Instruments of Monetary Policy:

There are several direct and indirect instruments that are used for implementing monetary policy.

- Repo Rate: The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities under the liquidity adjustment facility (LAF).
- Reverse Repo Rate: The (fixed) interest rate at which the Reserve Bank absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities under the LAF.
- Liquidity Adjustment Facility (LAF): The LAF consists of overnight as well as term repo auctions. Progressively, the Reserve Bank has increased the proportion of liquidity injected under fine-tuning variable rate repo auctions of range of tenors. The aim of term repo is to help develop the inter-bank term money market, which in turn can set market based benchmarks for pricing of loans and deposits, and hence improve transmission of monetary policy. The Reserve Bank also conducts variable interest rate reverse repo auctions, as necessitated under the market conditions.
- Marginal Standing Facility (MSF): A facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a limit at a penal rate of interest. This provides a safety valve against unanticipated liquidity shocks to the banking system.
- Corridor: The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.

- Bank Rate: It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. The Bank Rate is published under Section 49 of the Reserve Bank of India Act, 1934. This rate has been aligned to the MSF rate and, therefore, changes automatically as and when the MSF rate changes alongside policy repo rate changes.
- Cash Reserve Ratio (CRR): The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such per cent of its Net demand and time liabilities (NDTL) that the Reserve Bank may notify from time to time in the Gazette of India.
- Statutory Liquidity Ratio (SLR): The share of NDTL that a bank is required to maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.
- Open Market Operations (OMOs): These include both, outright purchase and sale of government securities, for injection and absorption of durable liquidity, respectively.
- Market Stabilisation Scheme (MSS): This instrument for monetary management was introduced in 2004. Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through sale of short-dated government securities and treasury bills. The cash so mobilised is held in a separate government account with the Reserve Bank.

Open and Transparent Monetary Policy Making:

- Under the amended RBI Act, the monetary policy making is as under:
- The MPC is required to meet at least four times in a year.
- The quorum for the meeting of the MPC is four members.
- Each member of the MPC has one vote, and in the event of an equality of votes, the Governor has a second or casting vote.
- The resolution adopted by the MPC is published after conclusion of every meeting of the MPC in accordance with the provisions of Chapter III F of the Reserve Bank of India Act, 1934.
- On the 14th day, the minutes of the proceedings of the MPC are published which include:

a. a. the resolution adopted by the MPC;

b. b. the vote of each member on the resolution, ascribed to such member; and

c. c. the statement of each member on the resolution adopted.

- Once in every six months, the Reserve Bank is required to publish a document called the Monetary Policy Report to explain:

a. a. the sources of inflation; and

b. b. the forecast of inflation for 6-18 months ahead.

Legal Framework:

Reserve Bank of India Act 1934 as amended from time to time.

RESEARCH AND DATA

The Reserve Bank has a rich tradition of generating sound, policy-oriented economic research, data compilation and knowledge-sharing.

The Reserve Bank has the legal obligation under the Reserve Bank of India Act to publish two reports every year: the Annual Report and the Report on Trend and Progress of Banking in India. Besides these and the regular periodical publications, it also publishes reports of various committees appointed to look into specific subjects, and discussion papers prepared by its internal experts. In fact, the Reserve Bank has been, for the last several years, using its website effectively for two way communication. Any major change in policy, for instance, is first put out on its website as a draft and is issued as a final instruction to banks after receiving feedback from all stakeholders.

The Reserve Bank's economic research work is designed to:

- Provide reliable, data-driven information for policy and decision-making
- Supply accurate and timely data for academic research as well as to the general public
- Provide support for collaborative research to research institutions/universities
- To develop and maintain statistical data reporting systems
- To conduct forward-looking surveys for monetary policy
- Educate the public

- The Reserve Bank's economic research focusses on study and analysis of domestic and international macroeconomic issues. This is mainly done by the Department of Economic and Policy Research and the Department of Statistics and Information Management.
- The Reserve Bank has over time established a sound and rich tradition of policy-oriented research and an effective mechanism for disseminating data and information. Like other major central banks, the Reserve Bank has also developed its own research capabilities in the field of economics, finance and statistics, which contribute to a better understanding of the functioning of the economy and the ongoing changes in the policy transmission mechanism.

ISSUER OF CURRENCY

The Reserve Bank is the nation's sole note issuing authority. Along with the Government of India, we are 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.

- Along with 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.
- The Government of India is the issuing authority of coins and supplies coins to the Reserve Bank on demand. The Reserve Bank puts the coins into circulation on behalf of the Central Government.
- In consultation with the Government of India, both work towards maintaining confidence in the currency by constantly endeavouring to enhance integrity of banknotes through new design and security features.

RBI's Approach:

- The Department of Currency Management at Central Office, Mumbai, in cooperation with the Issue Departments of the Reserve Bank's Regional Offices across India oversees currency management. The function includes supplying and distributing adequate quantity of currency throughout the country and ensuring the quality of banknotes in circulation by continuous supply of clean notes and timely withdrawal of soiled notes.
- This is achieved through a wide network of more than 4000 currency chests of commercial banks. Currency chests are extended arms of the Reserve Bank Issue Departments and are responsible for meeting the currency requirements of their respective regions.

Tools of RBI:

- Four printing presses print and supply banknotes. These are at Dewas in Madhya Pradesh, Nasik in Maharashtra, Mysore in Karnataka, and Salboni in West Bengal.
- The presses in Madhya Pradesh and Maharashtra are owned by the Security Printing and Minting Corporation of India (SPMCIL), a wholly owned company of the Government of India. The presses in Karnataka and West Bengal are owned by the Bharatiya Reserve Bank Note Mudran Private Limited (BRBNMPL), a wholly owned subsidiary of the Reserve Bank.
- Coins are minted by the Government of India. The Reserve Bank is the agent of the Government for distribution, issue and handling of coins. Four mints are in operation: Mumbai in Maharashtra, Noida in Uttar Pradesh, Kolkata, and Hyderabad.

RBI's Anti-Counterfeiting Measures:

- Continual upgrades of banknote security features

- Public awareness campaigns to educate citizens to help prevent circulation of forged or counterfeit notes
- Installation of note sorting machines

RBI's Clean Note Policy:

- Education campaign on preferred way to handle notes: no stapling, writing, excessive folding and the like
- Timely removal of soiled notes: use of currency verification and processing systems and sorting machines
- Exchange facility for torn, mutilated or defective notes: at all branches of commercial banks.

Denominations of Coins and Notes in Circulation:

- Coins in circulation: 50 paise, 1, 2, 5 and 10 Rupee

- Notes in circulation: Rs. 5, 10, 20, 50,100, 500 and 2000

- Bank notes are legal tender at any place in India for payment without limit.

As per the Indian Coinage Act:

- (a) a coin of any denomination not lower than one rupee, for any sum not exceeding one thousand rupees;
- (b) a half-rupee coin, for any sum not exceeding ten rupees;
- (c) any other coin, for any sum not exceeding one rupee:
- Provided that the coin has not been defaced and has not lost weight so as to be less than such weight as may be prescribed in its case

Few initiatives taken by RBI:

RBI has taken several initiatives to improve customer service with regard to banknotes. Some of them are:

- Giving incentive to banks for adjudication of cut notes and mopping up of soiled notes
- Transferring currency exchange facility to bank branches
- Permitting banks to engage the services of Business Correspondents and Cash-In-Transit companies for distribution of notes and coins and ensure last mile connectivity
- Withdrawal of old series of banknotes (issued before 2005) keeping in view the standard international practice
- Creating 'Paisa bolta hai' – an educative micro-site, which includes a film for public awareness about banknotes

Focus continues on ensuring availability of clean notes and on strengthening the security features of bank notes. Given the volumes involved and costs incurred in the printing, transport, storage and removal of unfit/soiled notes, the Reserve Bank is evaluating ways to extend the life of bank notes - particularly in lower denominations. We are, for instance, considering issue of Rs. 10 banknotes in plastic.

REGULATIONS / REGULATOR: Commercial Banking/Co-operative Banking/Non-Banking

Commercial Banking: REGULATING COMMERCIAL BANKING

Banks are fundamental to the nation's financial system. The central bank has a critical role to play in ensuring the safety and soundness of the banking system-and in maintaining financial stability and public confidence in this system.

- **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.

Tools of Regulation:

- The tools used for regulation are statutory, prudential regulation, other regulatory guidelines and moral suasion through speeches of Governor, Deputy Governors and periodic meetings, seminars, etc.

Policy Framework:

Focal points for providing framework for regulation:

- Issuance of 'licences' for opening of banks
- 'Authorisations' for opening of branches by banks in India,
- governing foreign banks entry and expansion and approval of Indian banks to operate overseas,
- policy formulation, review and implementation on Prudential Norms, Basel – II and III frameworks, validation of quantitative models on Credit, Market and Operational Risks, Stress testing,
- International Financial Reporting Standards (IFRS), Securitisation,
- Resolution mechanism, etc.
- Monitoring maintenance of SLR and CRR by banks,
- Approving the appointments of Whole Time Directors & Part-Time Chairperson of Private Sector Banks and Chief Executive Officers of foreign banks operating in India, and their compensation packages.
- overseeing the amalgamation, reconstruction and liquidation of banking companies,
- policy issues relating to customer service,

- Anti-Money Laundering and Combating Financing of Terrorism and issuing of instructions regarding KYC
- regulation of financial institutions
- According prior approval for acquisition of 5% or more of the shares or voting rights of Private Sector Bank

Recent Initiatives:

Building a heterogeneous banking system

- The Reserve Bank is striving towards a more competitive, efficient and heterogeneous banking structure. It believes that a heterogeneous banking system can meet varied customer needs in a more efficient manner. As different banks would operate differently based on their reach, liquidity, capitalization and market power considerations, they will be able to offer a wider range of customer service enhancing consumer welfare. The licensing policies regarding Universal Banks, Small Finance Banks and Payments Banks are a step in the direction of building a heterogeneous banking system.

Licensing of Universal Banks

- Two banks viz., IDFC Bank Limited and Bandhan Bank Limited, were issued banking licence in terms of the 'Guidelines on Licensing of New Banks in the Private Sector dated February 22, 2013'. Based on the experience gained from this licensing exercise, the Reserve Bank has moved towards accepting applications for universal bank licence on a continuous basis under the 'Guidelines for 'on tap' Licensing of Universal Banks in the Private Sector dated August 1, 2016.

Licensing of Differentiated Banks

- Guidelines for Licensing of Small Finance Banks and Payments Banks were issued on November 27, 2014. Banking licenses have been issued to Small Finance Banks and Payments Banks under these guidelines. These banks are "niche" or "differentiated" banks, with the common objective of furthering financial inclusion.

Capital for banks

- Basel III Capital Regulations for Indian banks will be fully phased in as on March 31, 2019, closer to the internationally agreed date of January 1, 2019, instead of March 31, 2018 as was announced earlier.

Management of Stressed Assets

- To ensure effective stressed asset management, guidelines were issued to banks which among other things, covered the need to ensure that the banking system recognises financial distress early and takes prompt steps to resolve it.

Special knowledge or practical experience useful to banking companies:

- In the backdrop of innovations in banking and technology, to guide the banks in managing their diversified business portfolios and risks, the areas of special knowledge and practical experience enumerated under various statutory provisions for the directors on the boards of commercial banks (excluding RRBs) have been broadened to include (i) Information Technology (ii) Payment & Settlement Systems (iii) Human Resources (iv) Risk Management and (v) Business Management.

Minimum qualifications and experience for CFO and CTO:

- A Chief Financial Officer and Chief Technology Officer would play a crucial role in strengthening and sustaining the banks' risk governance framework in light of rapid innovations in banking and technology. Therefore, minimum qualification and experience were stipulated for adherence by banks while inviting applications for these positions.

Appointment of Chief Risk Officers in Banks

- Banks are required to keep the credit risk management function separate from the credit sanction process towards effective risk management. For bringing uniform approach and alignment of risk management system with the best practices, banks are required to frame a Board-approved policy, clearly defining the roles and responsibilities of the Chief Risk Officer (CRO) who shall not have any reporting relationship with business verticals or business targets. Under no circumstances, “dual hatting” will be allowed i.e., CRO shall not function as CEO/COO/CFO/Chief of Internal Audit.

Looking Ahead:

Basel III Leverage Ratio Framework

- The experience drawn from the global financial crisis suggests that the build-up of excessive on-balance sheet, as well as off-balance sheet leverage in the banking system was at the core of the financial fragilities that were witnessed during the global financial crisis. Based on recent recommendations of the Basel Committee on Banking Supervision (BCBS), the Reserve Bank will issue revised guidelines on the leverage ratio .

Review of the exposure limits for single/ group borrowers

- With a view to gradually aligning them with the revised global standards the Reserve Bank proposes to review exposure norms in 2014-15. The tightening of exposure norms will also help in risk mitigation during cyclical downturns as banks exposure under the framework will be more granular and diversified to a large number of unrelated counterparties rather than being concentrated to a handful of large and related counterparties.

Improving the financial system’s ability to cope with distress

- It is important to improve the financial system’s ability to cope with stress and distress by not only providing for counter-cyclical buffers, but also by directly dealing with stress through effective resolution regimes. The Reserve Bank in 2013-14 has taken several initiatives in this regard and plans to carry the agenda forward by strengthening the corporate debt restructuring mechanism, credit information and the resolution regime. In coordination with Financial Stability and Development C ouncil (FSDC), the Reserve Bank intends to take the process forward by seeking necessary legal and institutional changes and by creating of a resolution fund.

Implementation of Ind AS by banks

- The Reserve Bank is in the advanced stages of finalising a roadmap for implementation of Ind Accounting Standards to be adopted by banks and Non-Banking Finance Companies.

Legal FrameworK

- **Reserve Bank of India Act, 1934**
- **Banking Regulation Act, 1949**
- **Deposit Insurance and Credit Guarantee Corporation Act**

REGULATING CO-OPERATIVE BANKING

This role is, perhaps, the most unheralded aspect of RBI activities, yet it remains among the most critical. This 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 Reserve Bank acts in close co-ordination with other regulators, such as, Registrar of Co-operative Societies and Central Registrar of Co-operative Societies. The Reserve Bank enters into Memorandum of Understanding (MoU) with Central Government and all State Governments which have presence of UCBs to ensure greater convergence of policies on regulation and supervision. Starting with signing first MoU with the State of Andhra Pradesh on June 27, 2005 and the last with the State of Telangana on December 30, 2014, today, all the UCBs in the country are covered under MoU.

The rural co-operative credit system in India is primarily mandated to ensure flow of credit to the agriculture sector. It comprises short-term and long-term co-operative credit structures. The short-term co-operative credit structure operates with a three-tier system - Primary Agricultural Credit Societies (PACS) at the village level, Central Cooperative Banks (CCBs) at the district level and 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 A of the Banking Regulation Act (As Applicable to Cooperative Societies) to conduct inspection of State and Central 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.

Duality of Control:

- Though the Banking Regulation Act came in to force in 1949, the banking laws were made applicable to cooperative societies only in 1966 through an amendment to the Banking Regulation Act, 1949. Since then there is duality of control over these banks with banking related functions being regulated by the Reserve Bank and management related functions regulated by respective State Governments/Central Government.

- The Reserve Bank regulates the banking functions of StCBs/DCCBs/UCBs under the provisions of Sections 22 and 23 of the Banking Regulation Act, 1949 (As Applicable to Cooperative Societies (AACS).

Convergence between Regulation & Supervision:

- As part of the arrangements under MoU, the Reserve Bank constitutes a State-level Task Force for Co-operative Urban Banks (TAFCUB) for UCBs which operate only in one State. A Central TAFCUB is constituted for the Multi-State UCBs. TAFCUBs bring all the decision-makers with regard to UCBs on one table, thus facilitating quick decision-making. TAFCUBs identify potentially viable and non-viable UCBs in the states and suggest revival path for the viable and non-disruptive exit route for the non-viable ones. The exit of non-viable banks could be through merger/amalgamation with stronger banks, conversion into societies or liquidation as the last option.

- The State Governments/Central Governments may, for instance, through the MoU, agree to take immediate action on requisitions of the Reserve Bank for supersession of the Board of Directors, appointment of liquidators, initiating action for removal of CEO/Chairman of a bank, enhancing quality of HR and IT resources in the banks on the lines required by the Reserve Bank, work to raise the standards of corporate governance by putting in place certain minimum fit and proper criteria for members to be eligible for seeking election for the post of director, institute special audit by Chartered Accountants and furnish reports of the findings within a given time frame, introduce long form audit reports for conducting statutory audit, modify its audit rating models to bring it on par with the rating system of the Reserve Bank and conduct statutory audit only through external Chartered Accountants in respect of banks with deposits over a specified minimum level.

- The Department of Co-operative Bank Regulation (DCBR) regulates State Co- operative Banks (StCBs), District Central Co-operative Banks (DCCBs) and Urban Cooperative Banks (UCBs).

Legal Framework:

- **Reserve Bank of India Act, 1934**
- **Banking Regulation Act, 1949**
- **Deposit Insurance and Credit Guarantee Corporation Act**

REGULATING NON-BANKING

This role is, perhaps, the most unheralded aspect of RBI activities, yet it remains among the most critical. This 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.

- India has financial institutions which are not banks but which accept deposits and extend credit like banks. These are called Non-Banking Financial Companies (NBFCs) in India.
- NBFCs in India include not just the finance companies that the general public is largely familiar with; the term also entails wider group of companies that are engaged in investment business, insurance, chit fund, nidhi, merchant banking, stock broking, alternative investments, etc., as their principal business. All are though not under the regulatory purview of the Reserve Bank.
- At end-March 2017, there were 11,522 NBFCs registered with the Reserve Bank, of which 178 were NBFCs-D and 220 were NBFCs-ND-SI. The share of NBFCs in terms of assets in total financial sector is 8.3 per cent as on 2016-17

Bringing Diversity in Financial Sector:

- Being financial intermediaries, NBFCs are engaged in the activity of bringing the saving and the investing community together. In this role they are perceived to be playing a complimentary role to banks rather than competitors, as majority population in the country does not yet have access to mainstream financial products and services including a bank account. NBFCs especially NBFC-MFIs (Micro Finance Institutions) and Asset Finance Companies thus have a complimentary role in the financial inclusion agenda of the country.

- Further, some of the big NBFCs, namely, infrastructure finance companies or those in factoring business, give fillip to the growth and development of the important sectors, like infrastructure. NBFCs have carved niche business areas for themselves within the financial sector space and are popular for providing customised products like second hand vehicle financing, mostly at the doorstep of the customer. In short, NBFCs bring the much needed diversity to the financial sector thereby diversifying the risks, increasing liquidity in the markets thereby promoting financial stability and bringing efficiency to the financial sector.

Building a heterogeneous banking system

It is the constant endeavour of the Reserve Bank to enable prudential growth of the sector, keeping in view the multiple objectives of financial stability, consumer and depositor protection, and need for more players in the financial market, addressing regulatory arbitrage concerns while not forgetting the uniqueness of the NBFC sector. The Reserve Bank is, at present, reviewing the regulatory framework for NBFCs.

Regulating NBFC's:

- In the wake of failure of several banks in the late 1950s and early 1960s in India, large number of ordinary depositors lost their money. At this time, the Reserve Bank did note that there were deposit taking activities undertaken by non-banking companies. Though they were not systemically as important as the banks, the Reserve Bank initiated regulating them, as they had the potential to cause pain to their depositors. These institutions have thus been under the regulatory oversight of the Reserve Bank of India since 1963. Since then regulation has generally kept pace with the dynamism displayed by the sector. Later in 1996, in the wake of the failure of a big NBFC, the Reserve Bank tightened the regulatory structure over the NBFCs, with rigorous registration requirements, enhanced reporting and supervision. The Reserve Bank also decided that no additional NBFC will be permitted to raise deposits from the public. Further, in 1999 capital requirement for fresh registration was enhanced from `25 lakh to `200 lakh. Later when the NBFCs sourced their funding heavily from the banking system, it raised systemic risk issues. At the same time, their growing size and interconnectedness also raise concerns on financial stability. Sensing this, the Reserve Bank brought asset side prudential regulations onto the NBFCs. The Reserve Bank's endeavour has been to streamline NBFC regulation, address the risks posed by them to financial stability, address depositors' and customers' interests, address regulatory arbitrage and help the sector grow in a healthy and efficient manner.

- Some of the regulatory measures include identifying systemically important non-deposit taking NBFCs as those with asset size of '100 crore and above in the year 2006 and bringing them under stricter prudential norms (CRAR and exposure norms), issuing guidelines on Fair Practices Code, aligning the guidelines on restructuring and securitisation with that of banks, permitting NBFCs-ND-SI to issue perpetual debt instruments etc. Recently, in November 2014, the entire regulatory framework was reviewed with a view to transitioning, over time, to an activity based regulation of NBFCs. As a first step in this direction, certain changes to the regulatory framework are sought to be made to a) address risks wherever they exist, b) address regulatory gaps and arbitrage arising from differential regulations, both within the sector as well as vis-a-vis other financial institutions, c) harmonise and simplify regulations to facilitate a smoother compliance culture among NBFCs, and d) strengthen governance standards. Threshold for systemic significance has been redefined as Rs. 500 crore from the extant Rs. 100 crore in assets. Systemically important NBFCs along with deposit taking NBFCs would be subject to inter alia, higher minimum Tier 1 capital, higher corporate governance standards and also stricter asset classification norms.

The Challenges:

- The challenge for the NBFC sector is to grow in a prudential manner while not stopping altogether on financial innovations. The key lies in having in place adequate risk management systems and procedures before entering into risky areas.

- It is the constant endeavour of the Reserve Bank to enable prudential growth of the sector, keeping in view the multiple objectives of financial stability, consumer and depositor protection, and need for more players in the financial market, addressing regulatory arbitrage concerns while not forgetting the uniqueness of the NBFC sector.

Legal Framework:

RBI act 1934

FINANCIAL MARKETS

Well-functioning, liquid and resilient financial markets help monetary policy transmission as well as in allocation and absorption of risks entailed in financing India's Growth.

- Major market segments under the regulatory ambit of the Reserve Bank are interest rate markets, including Government Securities market and money markets; foreign exchange markets; derivatives on interest rates/prices, repo, foreign exchange rates as well as credit derivatives.

- In order to ensure the robustness and credibility of the financial system and to minimise the risks, the Reserve Bank has designated industry bodies Fixed Income, Money Markets and Derivatives Association of India (FIMMDA) and Foreign Exchange Dealers Association of India (FEDAI) as the benchmark administrators for the Rupee interest rate and foreign exchange benchmarks, respectively. The FIMMDA, FEDAI and Indian Banks Association (IBA) have since jointly floated an independent company for benchmark administration. Benchmark submission activities of banks and PDs including their governance framework for submission are proposed to be brought under the Reserve Bank's on-site and off-site supervision

Broad Regulatory Framework & Instruments:

- The Reserve Bank derives statutory powers to regulate market segments from specific provisions of the Reserve Bank of India Act, 1934. The prudential guidelines issued to eligible market participants form the broad regulatory framework for Government securities, money market and interest rate derivatives.

- **Government securities market:** The Government securities market, which trades securities issued by Central and State Governments, has seen significant growth in the last two decades. It has a sizeable primary and an active secondary segments. Trading largely takes place on the Negotiated Dealing System-Order Matching (NDS-OM), an anonymous order-matching trading platform. The average daily trading volume in Government securities market has shown significant growth from Rs.32.15 billion in 2005-06 to Rs.433.12 billion in 2014-15. All the secondary market transactions in Government Securities are settled through a central counterparty mechanism under Delivery Versus Payment mode. Multilateral netting is achieved with a single funds settlement obligation for each member for a particular settlement date. The settlement is achieved in the RTGS (Real Time Gross Settlement) Settlement/Current Account maintained by the member in the Reserve Bank.

- **Call money market:** Uncollaterised call money market is restricted to banks and Primary Dealers subject to prudential limits. The collaterised segments include Collaterised Borrowing and Lending Facility (CBLO) and market repo transactions between banks and financial institutions. The money market also includes Commercial Paper (CP) issuances by corporates, PDs and financial institutions and Certificates of Deposit (CD) issued by banks to institutional investors. Detailed guidelines on each segment of the money market are available under the section Master Circulars for financial markets on this website.

- **Foreign exchange market:** In the foreign exchange market, the Foreign Exchange Management Act, 1999 (Act 42 of 1999), better known as FEMA, 1999, provides the statutory framework for the regulation of Foreign Exchange derivatives contracts. Residents can hedge their foreign exchange exposures through various products, such as, forward contracts, options involving rupee and foreign currencies, currency swaps and cost reduction option structures in the OTC market. Foreign investors can also hedge their investments in equity and/or debt in India through forwards and options.

  In addition, trading within specified position limits is permitted on exchange traded currency futures in four currency pairs and in USD for currency options. Residents are also permitted to hedge their commodity price risk, as per specific guidelines, in the overseas OTC markets and exchanges.

  Over the years, the foreign exchange spot as well as forward market has expanded quite significantly. The average daily forex market turnover has grown from approximately USD 16 billion in 2005-06 to nearly US$ 55 billion in 2014-15. The average daily trading volume in the inter-bank USD/INR forwards was at USD 6.43 billion and that of the USD/INR futures was at USD 2.64 billion during the financial year 2014-15.

- **Derivatives:** In the OTC interest rate derivatives (IRD) segment, interest rate swaps (IRS) and forward rate agreements (FRA) are permitted on various benchmarks where banks and primary dealers (PD) take hedging and trading positions. Other regulated entities like insurance companies, mutual funds, Non-Banking Finance Companies can participate in IRD for the purpose of hedging. The activity in IRS market has shown impressive growth with the average daily inter-bank trading volume (notional principal) in Rupee IRS at Rs. 88.60 billion in financial year 2014-15. In addition, there are exchange traded interest rate futures (IRF) which are also open to Foreign Portfolio Investors (FPI). Trading activity in the IRF market has picked up in the recent period with average daily trading volume of Rs. 19.18 billion during the financial year 2014-15.

Implementation of OTC Market Reforms:

- India is committed to implementing OTC derivatives reform measures recommended by G-20/Financial Stability Board and has initiated steps for adoption of these reforms. India was one of the few countries having a formal framework for regulation of OTC markets even before post-crisis, the focus shifted to this area globally. The ongoing efforts focus on improving transparency and reducing counterparty risk in the OTC derivatives markets and fostering development of robust market infrastructure for trading, settlement and reporting of transactions.

- Against this backdrop, the trade reporting arrangement for various OTC interest rate, foreign exchange and credit derivatives has since been completed. The arrangement covers the Rupee IRS/FRA, FX Forwards, Options and Swaps, Currency Swaps, IRS/FRA in foreign currencies and CDS. India is fully compliant under the G-20 commitment of reporting OTC derivative transactions.

- Central Counterparty (CCP) mechanism has been put in place for IRS, forex forward and swaps. In principle approval has been given to Clearing Corporation of India Limited (CCIL) to develop the anonymous trading platform with CCP facility for IRS trades.

Looking Ahead:

- The core objective of the Reserve Bank's regulations for financial markets is to develop safe and stable market which provides appropriate products for trading and risk management. As part of this approach, it is sought to remove structural rigidities for better price discovery and increasing both the depth and width of the financial markets. Efforts are on to develop and strengthen inter-linkages between market segments, fostering competition, increasing menu of choices through innovations in products and market practices. Regulatory, legal, institutional and technological infrastructure is also being strengthened for orderly market activity.

- Improving the liquidity of the G-sec markets remains a priority. Possible ways to revitalise market-making by PDs are being examined. In order to broad base the participation in IRS and reduce settlement risk, an anonymous electronic trading platform is to be launched shortly. Taking into account the feedback received from the market, it has also been announced to introduce new cash settled IRFs on underlying securities with residual maturity between tenor 5-7 year and 13-15 year.

- The foreign exchange market needs more products to help participants manage their foreign exchange risk. Foreign portfolio investors (FPIs) have now been granted access to the domestic exchange traded derivative markets. Further rationalisation of the operational procedure is being considered. Over the medium term, extending access to the OTC market to international stakeholders could also be considered. Besides, options market could be expanded over the coming years to allow market participants to hedge more easily and cheaply.

Legal Framework:

RBI act 1934

FINANCIAL INCLUSION 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.

The Indian economy has changed since priority sector lending guidelines were conceived. There is a need to reorient guidelines towards today's growth and inclusion agenda. As such, an Internal Working Group was constituted by the Reserve Bank with the objective of revisiting the existing priority sector lending guidelines and suggesting revised guidelines in alignment with the national priorities as well as financial inclusion goals of the country. The objectives also included suggesting ways on how to achieve the priority sector targets in the most effective way as well as measures to be taken in case of under-achievement of the priority sector targets.

The Working Group has focused on channelling credit to segments that get crowded out in the absence of specific targets. These include small and marginal farmers, micro enterprises and the weaker sections while broadening the scope to include other underserved categories of national priority, such as agriculture infrastructure, social infrastructure, renewable energy, exports and medium sized enterprises. The report is currently under examination of the Reserve Bank.

- **Credit flow to priority sectors:** Macro policy formulation to strengthen credit flow to the priority sectors. Ensuring priority sector lending becomes a tool for banks for capturing untapped business opportunities among the financially excluded sections of society.
- **Financial inclusion and financial literacy:** Help expand Prime Minister's Jan Dhan Yojana (PMJDY) to become a sustainable and scalable financial inclusion initiative.
- **Credit flow to MSME:** Stepping up credit flow to micro, small and medium enterprises (MSME) sector, rehabilitation of sick units through timely credit support.
- **Institutions:** Strengthening institutional arrangements, such as, State Level Bankers Committees (SLBCs), Lead bank scheme, etc., to facilitate achievement of above objectives.

RBI's Approach:

- Policy formulation by taking inputs from interaction with stakeholders and robust and timely management information system through collection of reliable data, statutory and otherwise.

Looking Ahead:

- More powerful communication of the Reserve Bank's priority sector definition to stakeholders. More frequent and close monitoring of priority sector target achievement of banks.
- Effective monitoring through State Level Bankers' Committees (SLBCs). Putting in place simple and clear guidelines on evaluation of extent of crop loss where calamity is on account of production effectiveness.
- Assess the regional/sectoral (industry wise) disparities in credit flow to MSEs. Sharing success stories of various players (Private/ PSBs/RRBs/ Co-ops) on stepping up flow of credit to MSMEs.

- Engage with the curriculum setting bodies like the National Council of Educational Research and Training (NCERT), Education Boards like the Central Board for Secondary Education (CBSE), Central and State Governments to try and embed financial concepts in school curriculum.

Legal Framework:

RBI Act 1934

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.

- The Reserve Bank's initiatives in the field of consumer protection include the setting up of a Customer Redressal Cell, creation of a Customer Service Department in 2006 which was recently rechristened as Consumer Education and Protection Department. Further, the setting up of the Banking Codes and Standards Board of India (BCSBI), an autonomous body for promoting adherence to self-imposed codes by banks for committed customer service.

- In order to strengthen the institutional mechanism for dispute resolution, the Reserve Bank in the year 1995 introduced the Banking Ombudsman (BO) scheme. The BO is an Alternate Dispute Redressal mechanism for resolution of disputes between a bank and its customers. There are 20 Banking Ombudsman offices in the country at present. The scheme covers grievances of the customers against Commercial Banks, Scheduled Primary Cooperative Banks and Regional Rural Banks. In 2006, the Reserve Bank revised the BO scheme. Under the revised scheme, the BO and the staff in the offices of the BO are drawn from the serving employees of the Reserve Bank. The new scheme is fully funded by the Reserve Bank and virtually covers all banking transactions related grievances except their business decisions like sanctioning of credit etc.

Some recent initiatives of the Reserve Bank in consumer education and protection are:

- The RBI has formulated a "Charter of Customer Rights" for banks based on global best practices in the area of consumer protection. The Charter enshrines broad, overarching principles for protection of bank customers and enunciates the following five basic rights of bank customers

  1. Right to Fair Treatment
  2. Right to Transparency, Fair and Honest Dealing
  3. Right to Suitability
  4. Right to Privacy
  5. Right to Grievances Redress and Compensation

Banks are required to prepare their own Board approved policy, incorporating the five rights of the Charter, or suitably integrate their existing Customer Service Policy with the "Model Customer Rights Policy" formulated by IBA/BCSBI.

- Internal Ombudsman in Banks- All Public Sector banks and select Private Sector and Foreign Banks are mandated to appoint the Internal Ombudsman for final examination of all rejected partially accepted complaints before conveying the final decision to the complainant.

- Setting up of Consumer Education and Protection Cells at all Regional Offices of RBI for handling of complaints not covered under Banking Ombudsman Scheme.

Other steps recently initiated for customer protection are:

- Effective from July 1, 2017 the scope of Banking Ombudsman Scheme 2006 was widened to include, inter alia, deficiencies arising out of sale of insurance/ mutual fund/ other third party investment products by banks and non-adherence to RBI instructions with regard to Mobile Banking/ Electronic Banking as grounds of complaint. Abolition of foreclosure charges/pre-payment penalties on all floating rate home loans/all floating rate loans

- Levying SMS charges on actual usage basis

- Abolition of penal charges on non-maintenance of minimum balances in inoperative accounts

- Streamlining penal charges levied for non-maintenance of minimum balances in savings bank accounts
- Uniformity in inter-sol charges
- Limiting liability of customers in unauthorised electronic banking transactions

Way Forward:

- Enforcing ethical behavior by financial service providers under the regulatory purview of the Reserve Bank
- Emphasis on "Consumer Education" - Advertisement campaign on fictitious offers/fund transfers, coordination with cyber-crime department etc.
- Spreading awareness about Banking Ombudsman in rural and semi-urban areas
- Improving the Internal Grievances Redress Mechanism of banks for effectiveness and timely response
- Sensitising frontline staff of banks on importance of customer service
- Bringing about continuous systemic improvement by root cause analysis of complaints
- Review of the BO Scheme in the light of emerging changes in the environment
- Conducting thematic surveys/studies/incognito visits on specific areas
- Monitoring Implementation of the Charter of Customer Rights

Legal Framework:

RBI Act 1934

BANKER AND DEBT MANAGER TO 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.

Management of Public Debt

The union budget decides the annual borrowing needs of the Central Government. Parameters, such as, interest rate, timing and manner of raising of loans are influenced by the state of liquidity and the expectations of the market. The Reserve Bank's debt management strategy aims at minimising the cost of borrowing, reducing the roll-over and other risks, smoothening the maturity structure of debt, and improving depth and liquidity of Government securities markets by developing an active secondary market.

Since its inception, the Reserve Bank of India has undertaken the traditional central banking function of managing the government's banking transactions. The Reserve Bank of India Act, 1934 requires the Central Government to entrust the Reserve Bank with all its money, remittance, exchange and banking transactions in India and the management of its public debt. The Government also deposits its cash balances with the Reserve Bank. The Reserve Bank may also, by agreement, act as the banker and debt manager to State Governments. Currently, the Reserve Bank acts as banker to all the State Governments in India (including Union Territory of Puducherry), except Sikkim. For Sikkim, it has limited agreement for management of its public debt.

The Reserve Bank has well defined obligations and provides several banking services to the governments. As a banker to the Government, the Reserve Bank receives and pays money on behalf of the various Government departments. The Reserve Bank also undertakes to float loans and manage them on behalf of the Governments. It provides Ways and Means Advances – a short-term interest bearing advance – to the Governments, to meet temporary mismatches in their receipts and payments. Besides, like a portfolio manager, it also arranges for investments of surplus cash balances of the Governments. The Reserve Bank acts as adviser to Government, whenever called upon to do so, on monetary and banking related matters. The Central Government and State Governments may make rules for the receipt, custody and disbursement of money from the consolidated fund, contingency fund, and public account. These rules are legally binding on the Reserve Bank as accounts for these funds are with the Reserve Bank .

The banking functions for the governments are carried out by the Public Accounts Departments at the offices/branches of the Reserve Bank. As it has offices and sub-offices in 29 locations, the Reserve Bank appoints other banks to act as its agents for undertaking the banking business on behalf of the governments. The Reserve Bank pays agency bank charges to the banks for undertaking the government business on its behalf. As of now, management of public debt, including floatation of new loans, is done by the Internal Debt Management Department at the Central Office and Public Debt Office at offices/branches of the Reserve Bank. Final compilation of Government accounts, of the Centre and the States, is done at Nagpur office of the Reserve Bank which has a Central Accounts Section.

Banker to the Central Government

Under the administrative arrangements, the Central Government is required to maintain a minimum cash balance with the Reserve Bank. Currently, this amount is Rs.10 crore on a daily basis and Rs.100 crore on Fridays, as also at the annual account closing day of the Centre and the Reserve Bank (end of March and June).

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 as before, except where it has been nominated as banker to a particular ministry or department.

As banker to the Government, the Reserve Bank works out the overall funds position and sends daily advice showing the balances in its books, Ways and Means Advances granted to the government and investments made from the surplus fund. The daily advices are followed up with monthly statements.

Banker to State Governments

All the State Governments are required to maintain a minimum balance with the Reserve Bank, which varies from state to state depending on the relative size of the state budget and economic activity. To tide over temporary mismatches in the cash flow of receipts and payments, the Reserve Bank provides Ways and Means Advances/Overdraft to the State Governments. The WMA scheme for the State Governments has provision for Special Drawing Facility (SDF) and Normal WMA. The SDF is extended against the collateral of the government securities held by the State Government. To encourage the State's participation to the Consolidated Sinking Fund and Guarantee Redemption Fund, incremental investments in these funds are also eligible to avail SDF. After the SDF limit is exhausted, the State Government is provided a normal WMA. The normal WMA limits are based on three-year average of actual revenue and capital expenditure of the state. The withdrawal beyond the WMA limit is considered an overdraft. A State Government account can be in overdraft for a maximum 14 consecutive working days with a limit of 36 days in a quarter. The rate of interest on WMA is linked to the Repo Rate. Surplus balances of State Governments are invested in Government of India 14-day Intermediate Treasury Bills automatically in accordance with the instructions.

Management of Public Debt:

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.

To formulate borrowing programme for the year, a number of other factors are also taken into account, such as, the amount of Central and State loans maturing during the year, the estimated available resources, market appetite and the absorptive capacity of the market. The Reserve Bank also acts a cash manager to the central and the State governments. For cash management as also for liquidity management purposes, flows or changes in the Governments' cash balances are monitored and projected based on history and experience.

Governments' cash balances are monitored and projected based on history and experienc

Legal Framework

- **Reserve Bank of India Act, 1934**
- Government Securities Regulations, 2007

BANKER TO BANKS

Like individual consumers, businesses and organisation 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.

Banks are required to maintain a portion of their demand and time liabilities as cash reserves with the Reserve Bank. For this purpose, they need to maintain accounts with the Reserve Bank. They also need to keep accounts with the Reserve Bank for settling inter-bank obligations, such as, clearing transactions of individual bank customers who have their accounts with different banks or clearing money market transactions between two banks, buying and selling securities and foreign currencies.

In order to facilitate a smooth inter-bank transfer of funds, or to make payments and to receive funds on their behalf, banks need a common banker. By providing the facility of opening accounts for banks, the Reserve Bank becomes this common banker, known as 'Banker to Banks' function. The function is performed through the Deposit Accounts Department (DAD) at the Reserve Bank's Regional offices. The Department of Government and Bank Accounts oversees this function and formulates policy and issues operational instructions to DAD.

Reserve Bank as Banker to Banks:

The Reserve Bank continuously monitors operations of these accounts to ensure that defaults do not take place. Among other provisions, the Reserve Bank stipulates minimum balances to be maintained by banks in these accounts. Since banks need to settle transactions with each other occurring at various places in India, they are allowed to open accounts with different regional offices of the Reserve Bank. The Reserve Bank also facilitates remittance of funds from a bank's surplus account at one location to its deficit account at another. Such transfers are electronically routed through a computerised system called e-Kuber. The computerisation of accounts at the Reserve Bank has greatly facilitated banks' monitoring of their funds position in various accounts across different locations on a real-time basis.

In addition, the Reserve Bank has also introduced the Centralised Funds Management System (CFMS) to facilitate centralised funds enquiry and transfer of funds across DADs. This helps banks in their fund management as they can access information on their balances maintained across different DADs from a single location. Currently, 75 banks are using the system and all DADs are connected to the system. As Banker to Banks, the Reserve Bank provides short-term loans and advances to select banks, when necessary, to facilitate lending to specific sectors and for specific purposes. These loans are provided against promissory notes and other collateral given by the banks.

Few initiatives - As Banker to Banks, the Reserve Bank focusses on:

- Enabling smooth, swift and seamless clearing and settlement of inter-bank
- Providing an efficient means of funds transfer for banks
- Enabling banks to maintain their accounts with the Reserve Bank forstatutory reserve requirements and maintenance of transaction balances
- Acting as a lender of last resort

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.

Legal Framework:

RBI Act 1934

FOREIGN EXCHANGE MANAGEMENT

With the transition to a market-based system for determining the external value of the Indian rupee the foreign exchange market in India gained importance in the early reform period.

For a long time, foreign exchange in India was treated as a controlled commodity because of its limited availability. The early stages of foreign exchange management in the country focussed on control of foreign exchange by regulating the demand due to its limited supply. Exchange control was introduced in India under the Defence of India Rules on September 3, 1939 on a temporary basis. The statutory power for exchange control was provided by the Foreign Exchange Regulation Act (FERA) of 1947, which was subsequently replaced by a more comprehensive Foreign Exchange Regulation Act, 1973. This Act empowered the Reserve Bank, and in certain cases the Central Government, to control and regulate dealings in foreign exchange payments outside India, export and import of currency notes and bullion, transfer of securities between residents and non-residents, acquisition of foreign securities, and acquisition of immovable property in and outside India, among other transactions.

Extensive relaxations in the rules governing foreign exchange were initiated, prompted by the liberalisation measures introduced since 1991 and the Act was amended as a new Foreign Exchange Regulation (Amendment) Act 1993. Significant developments in the external sector, such as, substantial increase in foreign exchange reserves, growth in foreign trade, rationalisation of tariffs, current account convertibility, liberalisation of Indian investments abroad, increased access to external commercial borrowings by Indian corporates and participation of foreign institutional investors in Indian stock market, resulted in a changed environment. Keeping in view the changed environment, the Foreign Exchange Management Act (FEMA) was enacted in 1999 to replace FERA. FEMA became effective from June 1, 2000.

FEMA aims at facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange markets in India. Emphasising the shift in focus, the Reserve Bank in due course also amended (since January 31, 2004) the name of its department dealing with the foreign exchange transactions to Foreign Exchange Department from Exchange Control Department.

Liberalised Approach:

The Reserve Bank issues licences to banks and other institutions to act as Authorised Dealers in the foreign exchange market. In keeping with the move towards liberalisation, the Reserve Bank has undertaken substantial elimination of licensing, quantitative restrictions and other regulatory and discretionary controls.

Apart from easing restrictions on foreign exchange transactions in terms of processes and procedure, the Reserve Bank has also provided the exchange facility for liberalised travel abroad for purposes, such as, conducting business, attending international conferences, undertaking technical study tours, setting up joint ventures abroad, negotiating foreign collaboration, pursuing higher studies and training, and also for medical treatment. Moreover, the Reserve Bank has permitted residents to hold liberal amount of foreign currency. Residents can now also open foreign currency accounts in India and credit specified foreign exchange receipts into it.

Foreign Investment:

Foreign investment comes into India in various forms. Following the reforms path, the Reserve Bank has liberalised the provisions relating to such investments. The Reserve Bank has permitted foreign investment in almost all sectors, with a few exceptions. In many sectors, no prior approval from the Government or the Reserve Bank is required for non-residents investing in India. Foreign institutional investors are allowed to invest in all equity securities traded in the primary and secondary markets. Foreign institutional investors have also been permitted to invest in Government of India treasury bills and dated securities, corporate debt instruments and mutual funds. The NRIs have the flexibility of investing under the options of repatriation and non-repatriation.

Similarly, Indian entities can also make investment in an overseas joint venture or in a wholly-owned subsidiary abroad upto a certain limit.

External Commercial Borrowings:

Indian companies are allowed to raise external commercial borrowings including commercial-bank loans, buyers' credit, suppliers' credit, and securitised instruments. Foreign Currency Convertible Bonds (FCCBs) and Foreign Currency Exchangeable Bonds (FCEBs) are also governed by the ECB guidelines.

Liberalised Remittance Scheme:

As a step towards further simplification and liberalisation of the foreign exchange facilities available to the residents, the Reserve Bank has permitted resident individuals to freely remit abroad up to liberal amount per financial year for any permissible purposes.

Currency Futures:

Exchange-traded currency futures are permitted in India. Such trading facilities are currently being offered by the National Stock Exchange, the Bombay Stock Exchange and the MCX-Stock Exchange. As the product is exchange traded, the conduct of currency futures trading facility is being regulated jointly by the Reserve Bank and the Securities and Exchange Board of India.

Exchange Rate Policy:

India's exchange rate policy has evolved in tandem with the domestic as well as international developments. The period after independence was marked by a fixed exchange rate regime, which was in line with the Bretton Woods system prevalent then. The Indian Rupee was pegged to the Pound Sterling on account of historic links with Britain. After the breakdown of Bretton Woods System in the early seventies, most of the countries moved towards a system of flexible/managed exchange rates. With the decline in the share of Britain in India's trade, increased diversification of India's international transactions together with the weaknesses of pegging to a single currency, the Indian Rupee was de-linked from the Pound Sterling in September 1975.

The exchange rate subsequently came to be determined with reference to the daily exchange rate movements of an undisclosed basket of currencies of India's major trading partners. As the basket-linked management of the exchange rate of the Rupee did not capture the market dynamics and the developments in the exchange rates of competing countries fully, the Rupee's external value was allowed to be determined by market forces in a phased manner following the balance of payment difficulties in the nineties.

A significant two-step downward adjustment in the exchange rate of the Rupee was made in 1991. In March 1992, Liberalised Exchange Rate Management System (LERMS) involving the dual exchange rate was instituted. A unified single market-determined exchange rate system based on the demand for and supply of foreign exchange replaced the LERMS effective March 1, 1993.

The Reserve Bank's exchange rate policy focusses on ensuring orderly conditions in the foreign exchange market. For the purpose, it closely monitors the developments in the financial markets at home and abroad. When necessary, it intervenes in the market by buying or selling foreign currencies. The market operations are undertaken either directly or through public sector banks.

In addition to the traditional instruments like forward and swap contracts, the Reserve Bank has facilitated increased availability of derivative instruments in the foreign exchange market. It has allowed trading in Rupee-foreign currency swaps, foreign currency-Rupee options, cross-currency options, interest rate swaps and currency swaps, forward rate agreements and currency futures.

Foreign Exchange Reserves Management:

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. The legal provisions governing management of foreign exchange reserves are laid down in the Reserve Bank of India Act, 1934.

The Reserve Bank's reserves management function has in recent years grown both in terms of importance and sophistication for two main reasons. First, the share of foreign currency assets in the balance sheet of the Reserve Bank has substantially increased. Second, with the increased volatility in exchange and interest rates in the global market, the task of preserving the value of reserves and obtaining a reasonable return on them has become challenging.

The basic parameters of the Reserve Bank's policies for foreign exchange reserves management are safety, liquidity and returns. The Reserve Bank of India Act permits the Reserve Bank to invest the reserves in the following types of instruments:

1) Deposits with Bank for International Settlements and other central banks
2) Deposits with foreign commercial banks
3) Debt instruments representing sovereign or sovereign-guaranteed liability of not more than 10 years of residual maturity
4) Other instruments and institutions as approved by the Central Board of the Reserve Bank in accordance with the provisions of the Act
5) Certain types of derivatives

While safety and liquidity continue to be the twin-pillars of reserves management, return optimisation has become an embedded strategy within this framework. The Reserve Bank has framed policy guidelines stipulating stringent eligibility criteria for issuers, counterparties, and investments to be made with them to enhance the safety and liquidity of reserves. The Reserve Bank, in consultation with the Government, continuously reviews the reserves management strategies.

Legal Framework:

Reserve Bank of India Act, 1934 &

Foreign Exchange Management Act, 1999

PAYMENT AND SETTLEMENT SYSTEMS

Payment and settlement systems play an important role in improving overall economic efficiency. They consist of all the diverse arrangements that we use to systematically transfer money-currency, paper instruments such as cheques, and various electronic channels.

- The central bank of any country is usually the driving force in the development of national payment systems. The Reserve Bank of India as the central bank of India has been playing this developmental role and has taken several initiatives for Safe, Secure, Sound, Efficient, Accessible and Authorised payment systems in the country. The Board for Regulation and Supervision of Payment and Settlement Systems (BPSS), a sub-committee of the Central Board of the Reserve Bank of India is the highest policy making body on payment systems in the country. The BPSS is empowered for authorising, prescribing policies and setting standards for regulating and supervising all the payment and settlement systems in the country. The Department of Payment and Settlement Systems of the Reserve Bank of India serves as the Secretariat to the Board and executes its directions. In India, the payment and settlement systems are regulated by the Payment and Settlement Systems Act, 2007 (PSS Act) which was legislated in December 2007. The PSS Act as well as the Payment and Settlement System Regulations, 2008 framed thereunder came into effect from August 12, 2008. In terms of Section 4 of the PSS Act, no person other than the Reserve Bank of India (RBI) can commence or operate a payment system in India unless authorised by RBI. The Reserve Bank has since authorised payment system operators of pre-paid payment instruments, card schemes, cross-border in-bound money transfers, Automated Teller Machine (ATM) networks and centralised clearing arrangements.

  - **Oversight of Payment and Settlement Systems**
    - Oversight of the payment and settlement systems is a central bank function whereby the objectives of safety and efficiency are promoted by monitoring existing and planned systems, assessing them against these objectives and, where necessary, inducing change. By overseeing payment and settlement systems, central banks help to maintain systemic stability and reduce systemic risk, and to maintain public confidence in payment and settlement systems. The Payment and Settlement Systems Act, 2007 and the Payment and Settlement Systems Regulations, 2008 framed thereunder, provide the necessary statutory backing to the Reserve Bank of India for undertaking the Oversight function over the payment and settlement systems in the country.

Payment System Initiatives:

- The Reserve Bank has taken many initiatives towards introducing and upgrading safe and efficient modes of payment systems in the country to meet the requirements of the public at large. The dominant features of large geographic spread of the country and the vast network of branches of the Indian banking system require the logistics of collection and delivery of paper instruments. These aspects of the banking structure in the country have always been kept in mind while developing the payment systems.

- At present, there are payments in India can be made through **paper based instruments** , **electronic instruments** and **other instruments** , such as, pre-paid systems, mobile banking, ATM based, Point-of-sale terminals, online transactions.

Paper Based Payments:

- Use of paper-based instruments (like cheques, drafts, and the like) accounts for nearly 60% of the volume of total non-cash transactions in the country. In value terms, the share is presently around 11%. This share has been steadily decreasing over a period of time and electronic mode gained popularity due to the concerted efforts of the Reserve Bank of India to popularize the electronic payment products in preference to cash and cheques.

- Since paper based payments occupy an important place in the country, Reserve Bank had introduced Magnetic Ink Character Recognition (MICR) technology for speeding up and bringing in efficiency in processing of cheques.
- Later, a separate High Value Clearing was introduced for clearing cheques of value Rupees one lakh and above. This clearing was available at select large centres in the country (since discontinued). Recent developments in paper-based instruments include launch of Speed Clearing (for local clearance of outstation cheques drawn on core-banking enabled branches of banks), introduction of cheque truncation (CTS) system (to restrict physical movement of cheques and enable use of images for payment processing), framing CTS-2010 Standards (for enhancing the security features on cheque forms) and the like.
- While the overall thrust is to reduce the use of paper for transactions, given the fact that it would take some time to completely move to the electronic mode, the intention is to reduce the movement of paper – both for local and outstation clearance of cheques.

Electronic Payments:

- The initiatives taken by the Reserve Bank in the mid-eighties and early-nineties focused on technology-based solutions for the improvement of the payment and settlement system infrastructure, coupled with the introduction of new payment products by taking advantage of the technological advancements in banks. The continued increase in the volume of cheques added pressure on the existing set-up, thus necessitating a cost-effective alternative system.
- ***Electronic Clearing Service (ECS) Credit***
- The Reserve Bank introduced the ECS (Credit) scheme during the 1990s to handle bulk and repetitive payment requirements (like salary, interest, dividend payments) of corporates and other institutions. ECS (Credit) facilitates customer accounts to be credited on the specified value date and is presently available at all major cities in the country.
- During September 2008, the Bank launched a new service known as National Electronic Clearing Service (NECS), at National Clearing Cell (NCC), Mumbai. NECS (Credit) facilitates multiple credits to beneficiary accounts with destination branches across the country against a single debit of the account of the sponsor bank. The system has a pan-India characteristic and leverages on Core Banking Solutions (CBS) of member banks, facilitating all CBS bank branches to participate in the system, irrespective of their location across the country.
- ***Regional ECS (RECS)***
- Next to NECS, RECS has been launched during the year 2009.RECS, a miniature of the NECS is confined to the bank branches within the jurisdiction of a Regional office of RBI. Under the system, the sponsor bank will upload the validated data through the Secured Web Server of RBI containing credit/debit instructions to the customers of CBS enabled bank branches spread across the Jurisdiction of the Regional office of RBI. The RECS centre will process the data, arrive at the settlement, generate destination bank wise data/reports and make available the data/reports through secured web-server to facilitate the destination bank branches to afford credit/debit to the accounts of beneficiaries by leveraging the CBS technology put in place by the bank. Presently RECS is available in Ahmedabad, Bengaluru, Chennai and Kolkata
- ***Electronic Clearing Service (ECS) Debit***
- The ECS (Debit) Scheme was introduced by RBI to provide a faster method of effecting periodic and repetitive collections of utility companies. ECS (Debit) facilitates consumers / subscribers of utility companies to make routine and repetitive payments by 'mandating' bank branches to debit their accounts and pass on the money to the companies. This tremendously minimises use of paper instruments apart from improving process efficiency and customer satisfaction. There is no limit as to the minimum or maximum amount of payment. This is also available across major cities in the country.
- ***Electronic Funds Transfer (EFT)***
- This retail funds transfer system introduced in the late 1990s enabled an account holder of a bank to electronically transfer funds to another account holder with any other participating bank. Available across 15

major centers in the country, this system is no longer available for use by the general public, for whose benefit a feature-rich and more efficient system is now in place, which is the National Electronic Funds Transfer (NEFT) system.

- ***National Electronic Funds Transfer (NEFT) System***
- In November 2005, a more secure system was introduced for facilitating one-to-one funds transfer requirements of individuals / corporates. Available across a longer time window, the NEFT system provides for batch settlements at hourly intervals, thus enabling near real-time transfer of funds. Certain other unique features viz. accepting cash for originating transactions, initiating transfer requests without any minimum or maximum amount limitations, facilitating one-way transfers to Nepal, receiving confirmation of the date / time of credit to the account of the beneficiaries, etc., are available in the system.
- ***Real Time Gross Settlement (RTGS) System***
- RTGS is a funds transfer systems where transfer of money takes place from one bank to another on a "real time" and on "gross" basis. Settlement in "real time" means payment transaction is not subjected to any waiting period. "Gross settlement" means the transaction is settled on one to one basis without bunching or netting with any other transaction. Once processed, payments are final and irrevocable. This was introduced in in 2004 and settles all inter-bank payments and customer transactions above ` 2 lakh.
- ***Clearing Corporation of India Limited (CCIL)***
- CCIL was set up in April 2001 by banks, financial institutions and primary dealers, to function as an industry service organisation for clearing and settlement of trades in money market, government securities and foreign exchange markets.
- The Clearing Corporation plays the crucial role of a Central Counter Party (CCP) in the government securities, USD –INR forex exchange (both spot and forward segments) and Collaterised Borrowing and Lending Obligation (CBLO) markets. CCIL plays the role of a central counterparty whereby, the contract between buyer and seller gets replaced by two new contracts - between CCIL and each of the two parties. This process is known as ‘Novation’. Through novation, the counterparty credit risk between the buyer and seller is eliminated with CCIL subsuming all counterparty and credit risks. In order to minimize the these risks, that it exposes itself to, CCIL follows specific risk management practices which are as per international best practices. In addition to the guaranteed settlement, CCIL also provides non guaranteed settlement services for National Financial Switch (Inter bank ATM transactions) and for rupee derivatives such as Interest Rate Swaps.
- CCIL is also providing a reporting platform and acts as a repository for Over the Counter (OTC) products.

Other Payment Systems:

- ***Pre-paid Payment Systems***
- Pre-paid instruments are payment instruments that facilitate purchase of goods and services against the value stored on these instruments. The value stored on such instruments represents the value paid for by the holders by cash, by debit to a bank account, or by credit card. The pre-paid payment instruments can be issued in the form of smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers, etc.
- Subsequent to the notification of the PSS Act, policy guidelines for issuance and operation of prepaid instruments in India were issued in the public interest to regulate the issue of prepaid payment instruments in the country.
- The use of pre-paid payment instruments for cross border transactions has not been permitted, except for the payment instruments approved under Foreign Exchange Management Act,1999 (FEMA).
- ***Mobile Banking System***
- Mobile phones as a medium for providing banking services have been attaining increased importance. Reserve Bank brought out a set of operating guidelines on mobile banking for banks in October 2008, according to which only banks which are licensed and supervised in India and have a physical presence in India are permitted to offer mobile banking after obtaining necessary permission from Reserve Bank. The guidelines focus on systems for security and inter-bank transfer arrangements through Reserve Bank's authorized systems. On the technology front the objective is to enable the development of inter-operable standards so as to facilitate funds

transfer from one account to any other account in the same or any other bank on a real time basis irrespective of the mobile network a customer has subscribed to.

- ***ATMs / Point of Sale (POS) Terminals / Online Transactions***
- Presently, there are over 61,000 ATMs in India. Savings Bank customers can withdraw cash from any bank terminal up to 5 times in a month without being charged for the same. To address the customer service issues arising out of failed ATM transactions where the customer's account gets debited without actual disbursal of cash, the Reserve Bank has mandated re-crediting of such failed transactions within 12 working day and mandated compensation for delays beyond the stipulated period. Furthermore, a standardised template has been prescribed for displaying at all ATM locations to facilitate lodging of complaints by customers.
- There are over five lakh POS terminals in the country, which enable customers to make payments for purchases of goods and services by means of credit/debit cards. To facilitate customer convenience the Bank has also permitted cash withdrawal using debit cards issued by the banks at PoS terminals.
- The PoS for accepting card payments also include online payment gateways. This facility is used for enabling online payments for goods and services. The online payment are enabled through own payment gateways or third party service providers called intermediaries. In payment transactions involving intermediaries, these intermediaries act as the initial recipient of payments and distribute the payment to merchants. In such transactions, the customers are exposed to the uncertainty of payment as most merchants treat the payments as final on receipt from the intermediaries. In this regard safeguard the interests of customers and to ensure that the payments made by them using Electronic/Online Payment modes are duly accounted for by intermediaries receiving such payments, directions were issued in November 2009. Directions require that the funds received from customers for such transactions need to be maintained in an internal account of a bank and the intermediary should not have access to the same.
- Further, to reduce the risks arising out of the use of credit/debit cards over internet/IVR (technically referred to as card not present (CNP) transactions), Reserve Bank mandated that all CNP transactions should be additionally authenticated based on information not available on the card and an online alert should be sent to the cardholders for such transactions.

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

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

1	Shri Shaktikanta Das	Governor	Chairperson
2	Shri B. P. Kanungo	Deputy Governor	Vice-Chairperson
3	Shri N. S. Vishwanathan	Deputy Governor	Member
4	Shri Mahesh Kumar Jain	Deputy Governor	Member
5	Shri N. Chandrasekaran	Central Board Member	Member
6	Shri Manish Sabharwal	Central Board Member	Member

- Shri S. Ganesh Kumar, Executive Director, Ms. Mona Anand, Principal Legal Adviser, Reserve Bank of India, Dr. Deepak B. Phatak, formerly Subrao M. Nilekani Chair Professor IIT, Bombay and Shri Suresh N. Patel, Ex-CMD, Andhra Bank are permanent invitees to BPSS.

Payment System Vision in India:

Payment and Settlement Systems in India: Vision – 2019-2021
Payment and Settlement Systems in India: Vision-2018
Payment Systems in India: Vision 2012-15

Regulation and Supervision of Financial Market Infrastructures

- 1. **Policy**
- 2. **Entities**

Legal Framework

- Reserve Bank of India Act, 1934
- Payment and Settlement Systems Act, 2007
- Payment and Settlement Systems Regulations, 2008 and Amended up to 2017 and BPSS Regulations, 2008
- The Payment and Settlement Systems (Amendment) Act, 2015 - No. 18 of 2015
- Others
- RTGS System Regulations 2013
- Authorisation Applications from Overseas Principals for cross border in-bound money transfer services to India
- Exchange Houses
- Interbank- Cheque Drawing Arrangements
- Procedural Guidelines for Cheque Truncation System (CTS) approved by the Bank for the concerned system provider

Source: rbi.org.in