

Banking in India

An Overview of Banking Institutions in India

01. The banking industry is the pivot of any economy and its financial system. Banks are one of the foremost agents of financial intermediation in an economy like India and, therefore, development of a strong and resilient banking system is of utmost importance. The banking institutions in the country are working in a competitive environment and their regulatory framework is aligned with the international best practices. Thus, financial deepening has taken place in India and continues to be in progress with a focus on orderly conditions in financial markets while sustaining the growth momentum.

As per Section 5(b) of the Banking Regulation Act 1949, "banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, or otherwise. Further, as per Section 5(c) of the said Act, "banking company" means any company which transacts the business of banking and by way of Explanation, states that 'any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause'.

Further, section 6 of the said Act lists down the forms of business in which banking companies may engage. The text of the section is reproduced in **Appendix I** of the Guidance Note.

02. The Reserve Bank of India (hereinafter referred to as RBI) acts as the monetary authority and the central bank of the country. In an effort to bring greater coordination among financial regulators, the Government of India has constituted an over-arching body - the Financial Stability and Development Council ("FSDC" or "Council") in December 2010. The Council is headed by the Honourable Finance Minister and composed of the Governor of the RBI, the chairs of the SEBI, the IRDA and the PFRDA, and other Ministry of Finance ("MoF") officials. It envisages to strengthen and institutionalise the mechanism of maintaining financial stability, financial sector development, inter-regulatory coordination along with monitoring macro-prudential regulation of the Indian

economy. On February 20, 2015 the RBI and Government signed the Monetary Policy Framework Agreement. In addition to it after amendment in RBI Act, the Monetary Policy Committee (MPC) headed by Governor was setup. The MPC is entrusted with the task of fixing the benchmark policy interest rate (repo rate) to contain inflation within the target level.

03. Presently, the following types of banking institutions prevail in India:

- (a) Commercial Banks;
- (b) Regional Rural Banks;
- (c) Co-operative Banks;
- (d) Development Banks (more commonly known as 'Term-Lending Institutions');
- (e) Payment Banks; and
- (f) Small Finance Banks

04. The following paragraphs describe the salient features of different types of banking institutions enumerated above.

Commercial Banks

05. Commercial banks are by far the most widespread banking institutions in India.

Typically, commercial banks provide the following major products and services:

- (a) *Acceptance of Deposits*: Acceptance of deposits from the public is one of the most important functions of a commercial bank. Commercial banks accept deposits in various forms: term deposits, savings bank deposits, current account deposits, etc.
- (b) *Granting of Advances*: This again is an important function of commercial banks. Advances granted by commercial banks take various forms such as cash credit, overdrafts, purchase or discounting of bills, term loans, etc. Apart from granting traditional facilities, banks are also providing facilities like External Commercial Borrowings (ECB) on behalf of bank/borrower, securitisation of receivables, etc.
- (c) *Remittances*: Remittances involve transfer of funds from one place to another. Common modes of remittance of funds are drafts, telegraphic/mail transfers (TT/MT) and Electronic Funds Transfer (EFT). In the case of telegraphic/mail transfer, no instrument is handed over to the applicant; the transmission of the instrument is the responsibility of the remitting branch. Generally, the payee of both the TT and the MT is an account holder of the

paying branch. In the case of Electronic Funds Transfer (EFT), as the name suggests, the funds are transferred electronically between two banks. The common modes of EFT are Real Time Gross Settlement (RTGS), which can be used for remittance of an amount within a prescribed limit of Rs. 2 Lakhs and above and National Electronic Funds Transfer (NEFT), which can be used for transfer of any amount. Another form of EFT is Immediate Payment Service (IMPS).

Pay Orders/Demand Drafts issued against amounts received by a bank, comprise instruments, the liability in respect whereof is discharged at the same or another branch of the bank or other banks.

- (d) *Collections*: The customers can lodge various instruments such as cheques, drafts, pay orders, travellers cheques, dividend and interest warrants, tax refund orders, etc., drawn in their favour and the trade bills drawn by them on their buyers with their bank for collection of the amount from the drawee (the bank or the drawee of the bill). They can also lodge their term deposit receipts and other similar instruments with the bank for collection of the proceeds from the bank with which the term deposit, etc., is maintained. Banks also collect instruments issued by post offices, like national savings certificates, postal orders, etc.

The instruments mentioned above may be payable locally or at outside centres.

Clearing house (CH) settles the inter-bank transactions among the local participating member banks. Generally, post offices are also members of the house. There may be separate clearing for CTS (Cheque Truncation System) and non-CTS instruments. The clearing house is managed by the RBI, State Bank of India or any other bank nominated by RBI. In case a bank has many branches within the area of a clearing house, it nominates one branch to act as the 'nodal' branch of that bank for all the branches within that area. This nodal branch collects instruments to be presented by other branches also. The accounts of all member banks are maintained by the clearing house. All member banks have to pay an agreed sum to the bank managing the clearing house for meeting the cost of infrastructure and services it provides to them.

In addition to the regular clearing houses as discussed above, Electronic Clearing Service (ECS) is also in vogue. ECS takes two forms: ECS credit or ECS debit.

- In the case of ECS credit, there is a single receiver of funds from a large number of customers, e.g., public utilities, mutual funds, etc.

The beneficiary (i.e., the receiver of funds) obtains mandate from its customers to withdraw funds from their specified bank accounts on a particular date. These customers may have accounts with different banks in the same clearing house area. Before the specified date, the beneficiary compiles bank-branch-wise particulars of the accounts to be debited and furnishes the details to its own bank which, in turn, arranges to provide them to the banks concerned, through the clearing house, for verification of particulars of accounts. Any discrepancies are rectified and, on the specified date, the accounts are debited by the respective banks and the beneficiary gets the credit.

- In the case of ECS debit, there is a single account to be debited against which a number of accounts with a number of banks in the same clearing house area are credited. This system is useful for distribution of dividend/interest, payment of salaries by large units, etc.

Roll-out of Speed Clearing is one of the many initiatives taken by RBI for improving efficiency in the time frame for and process of collection of cheques. It implemented Cheque Truncation System (CTS) in phase wise manner starting from February 1, 2008. In CTS, the presenting bank (or its branch) captures the data (on the MICR band) and the images of a cheque using their Capture System (comprising of a scanner, core banking or other application). The collecting bank (Presenting Bank) sends the data and captured images duly signed and encrypted to the central processing location (Clearing House) for onward transmission to the paying bank (destination or drawee bank). For the purpose of participation, the presenting and drawee banks are provided with an interface / gateway called the Clearing House Interface (CHI) that enables them to connect and transmit data and images in a secure and safe manner to the Clearing House (CH). The Clearing House processes the data, arrives at the settlement figure and routes the images and requisite data to the drawee banks. This is called the presentation clearing. The drawee banks through their CHIs receive the images and data from the Clearing House for payment processing. The drawee CHIs also generates the return file for unpaid instruments, if any. The return file / data sent by the drawee banks are processed by the Clearing House in the return clearing session in the same way as presentation clearing and return data is provided to the presenting banks for processing. The clearing cycle is treated as complete once the presentation clearing and the associated return clearing sessions are successfully processed. The entire essence of CTS technology lies in

the use of images of cheques (instead of the physical cheques) for payment processing.

- (e) *Receipt of Foreign Contribution on behalf of the registered persons/ organization*: Scheduled Banks also handle the foreign contribution receipt on behalf of the registered persons/ organization as per the Foreign Contribution (Regulation) Act, 2010. Banks receiving foreign contribution need to ensure that the concerned persons/organization are registered with the Central Government or has obtained the prior permission to receive such foreign contribution if required by law, and that no branch other than the specified branch accepts 'foreign contribution'.
- (f) *Cash Management Product*: It is a derivative of the collection business. This facility is provided for expeditious transfer of funds collected by a customer at the specified centres in the country to his central account with the use of computers/satellites. It is particularly useful for large units which have their sales/collection network in a very wide geographical area. Only selected branches of a bank may handle the business due to the infrastructural requirements.
- (g) *Issuance of Letters of Credit and Guarantees*: These are two important services rendered by banks to customers engaged in business, industrial and commercial activities. A letter of credit (LC) is an undertaking by a bank to the payee (the supplier of goods and/or services) to pay to him, on behalf of the applicant (the buyer) any amount up to the limit specified in the LC, provided the terms and conditions mentioned in the LC are complied with. The guarantees are required by the customers of banks for submission to the buyers of their goods/services to guarantee the performance of contractual obligations undertaken by them or satisfactory performance of goods supplied by them, or for submission to certain departments like excise and customs, electricity boards, or to suppliers of goods, etc., *in lieu* of the stipulated security deposits.
- (h) *Merchant Banking Business*: Many bank branches act as collection agents to issue business for merchant bankers. The customer and the bank have to agree to the modalities of the scheme, like names of branches authorised as collecting branches, the procedure for retaining the subscription and its remittance periodically, the documents required by the customer from the collecting branches, etc.
- (i) *Credit Cards*: The processing of applications for issuance of credit cards is usually entrusted to a separate division at the Central/Head office of a bank. The dues against credit cards are collected by specified branches, preferably by direct debit to accounts of the credit card holders. Many of

them also act as 'cash points' to provide cash to the cardholder on demand up to the specified limits. Most credit cards issued by banks are linked to one of the international credit card networks like VISA, Master or Amex.

- (j) *Technology-based Services:* Banks also provide internet banking services and phone banking services. The fast changing technology has synchronised the banking facility in such a way that the customer need not come physically to the bank for any transactions. The banks are now providing the facility for payment of utility bills, railway reservation, tax deposition through ATM/internet and also provide recharge facility to mobile phone users.
- (k) *Dividend/Interest/Refund Warrants/redemptions:* Many entities require facilities for distribution of funds to their shareholders and others. Direct electronic transmission of funds is made to the accounts of the recipients. In other cases, warrants are issued in favour of shareholders/others, including those payable at designated branches of specified banks. The aggregate amount of the liability to be discharged by the constituent, including warrants or other instruments issued, is funded to the bank by such constituent.
- (l) *Safe-keeping Services:* Banks provide services for safe keeping/custody of the scrips and valuables of customers in their vaults. Appropriate records are maintained in evidence of receipts/delivery and evidence of holdings is verified from time to time.
- (m) *Lockers:* This facility is provided to customers for safe-keeping of their valuables, etc., in lockers. The branch has no knowledge of the contents of the locker. Only the account holder (the hirer) or his *bona fide* representative, duly authorised by the account holder, can operate on the locker. Each access to the locker is properly recorded in the appropriate registers.
- (n) *Handling Government Business:* Banks act as agents of RBI for receipts and payments on behalf of various government departments. There are authorised branches to handle the specified type of work. Normally, a specified branch acts as a nodal branch for a particular segment of the government business within a given geographical area. The responsibility of the nodal branch includes obtaining details of transactions from the linked branches and to reconcile their accounts *inter se* and with the department concerned. Banks are remunerated by Government for handling this business by way of service charges which are usually as agreed or a stated percentage of the collections or payments, as the case may be.
- (o) *Depository Participant (DP) Services:* The depository system is meant to facilitate quick transfer of stock market securities in a dematerialised form from the seller to the buyer by using satellite connectivity. The depository

scheme is operated presently by two depositories – Central Depository Services Limited (CDSL) and National Securities Depository Limited (NSDL). Depository participants, i.e., bank branches providing depository services are in effect agents of the depository concerned. Each participating branch has to get itself registered with a depository. The customer has to open an account with the branch which provides the DP services. This account is credit by the branch with the securities sold by the account holder and debit with the purchases.

- (p) *Automated Teller Machines (ATMs) and Cash Deposits Machines / Recyclers*: Operations on ATMs are through a card which contains information about the cardholder in a magnetic form. The cardholder has to also use the password (also known as Personal Identification Number, i.e., PIN) to carry out any transaction through ATM. Earlier, ATMs were used merely as cash dispensing machines but now-a-days, other services like issue of drafts, deposit of cash and instruments, balance enquiry, etc., are also being provided by many banks. ATMs may be on-site (i.e., housed in the branch premises) or off-site. The transactions routed by the customers through the ATMs may be entered into the books of account of the branch either on-line (i.e., simultaneously with the transactions) or off-line. However, on an off-line mode, the proper recording of transactions needs to be ensured.

RBI has permitted banks to install Cash Deposit Machines (CDM) with specific guidelines w.r.t. security arrangements, handling of suspect / counterfeit notes and availability of audit trail. The recycler machines accepts as well as dispense cash from the same machine.

- (q) *Exchange of Notes*: Following the 'clean note policy' RBI provides the facility of exchange of soiled/mutilated /unusable notes.
- (r) *Debit Cards*: Debit cards are issued by the bank to its account holders to provide facility of access to cash at ATMs/ purchase of goods and services thereagainst, where the debit to the bank account of the holder is simultaneous.
- (s) *Auto Sweep facility in saving accounts*: Banks offer auto sweep facility in saving accounts of their customers where the balances in excess of those stipulated limit, automatically get transferred to term deposit accounts to avail of a higher rate of interest and also automatically get reversed to replenish any shortfall in such stipulated limits.
- (t) *Derivatives*: Financial derivatives are gaining importance in India. Banks are offering derivative options against exchange fluctuation losses.

- (u) Prepaid Payment Instruments in India¹: Pre-paid payment instruments are payment instruments that facilitate purchase of goods and services against the value stored on such 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 instruments can be issued as smart cards, magnetic stripe cards, internet accounts, internet wallets, mobile accounts, mobile wallets, paper vouchers and any such instrument which can be used to access the pre-paid amount (collectively called Prepaid Payment Instruments or PPI hereafter). The pre-paid payment instruments that can be issued in the country are classified under three categories viz. (i) Closed system PPI (ii) Semi-closed system PPI and (iii) Open system PPI. Issuer may be the persons operating the payment systems issuing pre-paid payment instruments to individuals/organizations. The money collected is retained by these persons and they make payment to the merchants who are part of the acceptance arrangement directly, or through a settlement arrangement.

Banks who comply with the eligibility criteria are permitted to issue all categories of pre-paid payment instruments. However, only those banks which have been permitted to provide Mobile Banking Transactions by the Reserve Bank of India shall be permitted to launch mobile based pre-paid payment instruments (mobile wallets & mobile accounts).

Banks are also permitted to issue prepaid instruments to principal agents approved under the Money Transfer Service Scheme (MTSS) of the Reserve Bank of India or directly to the beneficiary under the scheme for loading of the funds from inward remittances

Further, the regulatory guidelines require that other non-bank persons issuing PPI need to maintain their outstanding balance in an escrow account with any scheduled commercial bank subject to the following conditions:

- The amount so maintained be used only for making payments to the participating merchant establishments.
- No interest is payable by the bank on such balances with an exception that the entity can enter into an agreement with the bank where escrow account is maintained, to transfer "core portion" of the amount, in the escrow account to a separate account on which interest is payable, subject to the certain conditions.

¹ RBI vide its circular no. DPSS.CO.PD.PPI.No.01/02.14.006/2016-17 dated July 1, 2016 on "Policy Guidelines for issuance and operation of Prepaid Payment Instruments in India" provides the broad guidelines on this subject.

- A quarterly certificate from the auditors be submitted certifying that the entity has been maintaining adequate balance in the account to cover the outstanding volume of payment instruments issued.
- The entity shall also submit an annual certificate, as above, coinciding with the accounting year of the entity to the Reserve Bank of India.
- Adequate records indicating the daily position of the value of instruments outstanding *vis-à-vis* balances maintained with the banks in the escrow accounts be made available for scrutiny to the Reserve Bank or the bank where the account is maintained on demand.

Further, RBI *vide* its Master Circular No. DPSS.CO.PD.PPI.No. 01/02.14.006/ 2016-2017 dated July 1, 2016 Policy Guidelines on “Issuance and operation of Prepaid Payment Instruments in India – Auditor Certificate on the balances in Escrow account” requires a quarterly certificate on the balances held in the Escrow account in accordance with the above Guidelines, from an auditor within a fortnight from the end of the quarter to which it pertains.

Para-banking Activities

06. Banks also undertake certain eligible financial services or para banking activities either departmentally or by setting up subsidiaries. However, banks can set up subsidiary for undertaking such activities only with prior approval of RBI. Some of those activities are listed below:

- (i) *Equipment Leasing, Hire Purchase and Factoring Services*: Banks also undertake equipment leasing, hire purchase and factoring services as departmental activities.
- (ii) *Investment in Venture Capital Funds (VCFs)*: Bank should obtain prior approval of RBI for making strategic investment in venture capital funds i.e. investment equivalent to more than 10% of the equity/unit.
- (iii) *Mutual fund business*: Banks are not permitted to directly undertake mutual fund business but sponsor mutual funds, subject to the RBI guidelines in this regard. Banks normally refer clients to these mutual funds and earn a commission* in return.

Banks may enter into agreements with mutual funds for marketing the

*Keeping in view the need for transparency in the interest of the customers to whom the products are being marketed / referred, the banks are advised to disclose to the customers, details of all the commissions / other fees (in any form) received, if any, from the various mutual fund / insurance / other financial services companies for marketing / referring their products. This disclosure would be required even in cases where the bank is marketing/ distributing/ referring products of only one mutual fund/ insurance companies, etc.

mutual fund units subject to the terms and conditions specified in the RBI Master Circular on "Para Banking Activities".

- (iv) *Money Market Mutual Funds(MMMFs)*: Banks can also sponsor MMMFs business subject to the prior approval of the RBI. The MMMFs are, however, subject to regulation by the Securities and Exchange Board of India (SEBI). Banks also, at time, provide cheque-writing facilities for MMMFs subject to the RBI guidelines in this regard.
- (v) *Entry of banks into insurance business*: Banks intending to set up insurance joint ventures with equity contribution on risk participation basis or making investments in the insurance companies for providing infrastructure and services support should obtain prior approval of Reserve Bank of India before engaging in such business. However, insurance business will not be permitted to be undertaken departmentally by the banks.
- (vi) *Primary Dealership (PD) Business* – Banks can undertake primary dealership business subject to the approval of the RBI and after satisfying certain eligibility criteria prescribed by the RBI:
 - A) Banks, which do not at present, have a partly or wholly owned subsidiary and fulfill the following criteria:
 - a. Minimum Net Owned Funds of Rs. 1,000 crore.
 - b. Minimum CRAR of 9%.
 - c. Net NPAs of less than 3% and a profit making record for the last three years.
 - B) Indian banks which are undertaking PD business through a partly or wholly owned subsidiary and wish to undertake PD business departmentally by merging/taking over PD business from their partly/wholly owned subsidiary subject to fulfilling the criteria mentioned in A (a) to (c) above.
 - C) Foreign banks operating in India who wish to undertake PD business departmentally by merging the PD business being undertaken by group companies subject to fulfilment of criteria at A (a) to (c).
- (vii) *Pension Funds Management*: Banks have been permitted to undertake Pension Funds Management (PFM) through their subsidiaries set up for the purpose subject to their satisfying the eligibility criteria prescribed by Pension Fund Regulatory and Development Authority (PFRDA) for Pension Fund Managers. PFM cannot be undertaken departmentally. Banks intending to undertake pension funds management should follow the guidelines set out in the RBI Master Circular No.DBR.No. FSD.BC.19/24.01.001/2015-16 dated July 1, 2015 on "Para - Banking

Activities”.

- (viii) *Portfolio Management Services (PMS)*: The general powers vested in banks to operate Portfolio Management Services and similar schemes have been withdrawn vide RBI circular DBOD.No.BC.73/27.07.001/94-95 dated June 7, 1994 on Acceptance of Deposits/Funds under Portfolio Management Scheme. No bank therefore is permitted to, restart or introduce any new PMS or similar scheme in future without obtaining specific prior approval of the RBI. However, bank-sponsored NBFCs are allowed to offer discretionary PMS to their clients, on a case-to-case basis. The banks operating PMS or similar scheme with specific prior approval of RBI have to strictly observe the conditions given in RBI Master Circular No. DBR.No.FSD.BC.19/24.01.001/2015-16 dated July 1, 2015 on “Para Banking Activities”.
- (ix) *Referral Services*: Banks can offer referral services to their customers for financial products subject to the following conditions:
- a) The bank/third party issuers of the financial products should strictly adhere to the KYC/AML guidelines in respect of the customers who are being referred to the third party issuers of the products.
 - b) The bank should ensure that the selection of third party issuers of the financial products is done in such a manner so as to take care of the reputational risks to which the bank may be exposed in dealing with the third party issuers of the products.
 - c) The bank should make it explicitly clear upfront to the customer that it is purely a referral service and strictly on a non-risk participation basis.
 - d) The third party issuers should adhere to the relevant regulatory guidelines applicable to them.
 - e) While offering referral services, the bank should strictly adhere to the relevant RBI guidelines.
- (x) *Underwriting of Corporate Shares and Debentures*: Banks can undertake underwriting of corporate shares and debentures within the ceiling prescribed for the bank's exposure to capital markets and subject to the provisions contained in the Section 19(2) and 19(3) of the Banking Regulation Act, 1949. The guidelines contained in the SEBI (Underwriters) Rules and Regulations, 1993 and those issued from time to time are also to be complied with. Moreover, banks should not underwrite issue of Commercial Paper by any Company or Primary Dealer and not extend Revolving Underwriting Facility to short term Floating Rate Notes/Bonds or debentures issued by corporate entities. However, with effect from April 16, 2008, banks may exclude their own underwriting commitments, as also the

underwriting commitments of their subsidiaries, through the book running process for the purpose of arriving at the capital market exposure both on a solo and consolidated basis.

- (xi) *Underwriting of bonds of Public Sector Undertakings:* Banks can play a supportive role in relation to issue of bonds by Public Sector Undertakings (PSUs) by underwriting a part of these issues. They may also subscribe outright initially but sell them later to the public with the aid of their wide branch network. It should, however, be ensured that the increase in the holdings of public sector bonds by banks arising out of their underwriting or subscription is kept within reasonable limits. While undertaking the underwriting of bonds of PSUs, banks should formulate their own internal guidelines as approved by their Boards of Directors on investments in and underwriting of PSU bonds, including norms to ensure that excessive investment in any single PSU is avoided and that due attention is given to the maturity structure of such investments.
- (xii) *Retailing of Government Securities:* Banks are permitted to undertake the business of retailing of Government securities with non-bank clients subject to the following conditions:
 - a) Banks are free to buy and sell Government Securities on an outright basis at prevailing market prices without any restriction on the period between sale and purchase.
 - b) Banks shall not undertake ready forward transactions in Government Securities with non-bank clients.
 - c) The retailing of Government Securities should be on the basis of ongoing market rates / yields emerging out of secondary market transactions.
 - d) No sale of Government Securities should be effected by banks unless they hold the securities in their portfolio either in the form of physical scrips or in the Subsidiary General Ledger (SGL) Account maintained with the Reserve Bank of India.
 - e) Immediately on sale, the corresponding amount should be deducted by the bank from its investment account and also from its (Statutory Liquidity Ratio (SLR) assets.
 - f) Banks should put in place adequate internal control checks/mechanism in this regard.
 - g) These transactions should be subjected to concurrent audit as per RBI's extant instructions and should also be looked into by the auditors at the time of bank's statutory audit.

(xiii) *Sponsors to Infrastructure Debt Funds (IDFs)* - In order to accelerate and enhance the flow of long term funds to infrastructure projects for undertaking the Government's ambitious programme of infrastructure development, scheduled commercial banks have been allowed to act as sponsors to Infrastructure Debt Funds (IDFs). IDFs can be set up either as Mutual Funds (MFs) or as Non-Banking Finance Companies (NBFCs). While IDF-MFs are regulated by SEBI, IDF-NBFCs are regulated by RBI. Banks can sponsor IDF-MFs and IDF-NBFCs with prior approval from RBI subject to the conditions given in the RBI Master Circular No. DBR.No.FSD.BC.19/24.01.001/2015-16 dated July 1, 2015 on "Para - Banking Activities".

(xiv) *Membership of currency derivative segment of SEBI approved Stock Exchanges*: Scheduled commercial banks (AD Category I) have been permitted to become trading / clearing members of the currency derivatives segment to be set up by the Stock Exchanges recognized by SEBI, subject to their fulfilling the following prudential requirements:-

- a) Minimum network of Rs. 500 crores
- b) Minimum CRAR of 10%
- c) Net NPA not exceeding 3%
- d) Net Profit for last 3 years

Banks which fulfill the conditions mentioned above should lay down detailed guidelines with Board's approval for conduct of this activity and management of risks. It should be ensured that the bank's position is kept distinct from the clients' position. In case of supervisory discomfort with the functioning of a bank, the Reserve Bank may impose restrictions on the bank regarding the conduct of this business as it deems fit.

The banks which do not meet the above minimum prudential requirements are permitted to participate in the currency futures market only as clients.

(xv) *Partner in Financial Inclusion programme – Pradhan Mantri Jan Dhan Yojna*: Pradhan Mantri Jan-Dhan Yojana (PMJDY) is National Mission for Financial Inclusion to ensure access to financial services, namely, Banking/ Savings & Deposit Accounts, Remittance, Credit, Insurance, Pension in an affordable manner. Bank Account can be opened in any bank branch or Business Correspondent (Bank Mitra) outlet. PMJDY accounts are being opened with Zero balance and certain other benefits.

(xvi) *MUDRA Loans* - MUDRA loans are extended by banks, NBFCs, MFIs and other eligible financial intermediaries as notified by MUDRA Ltd. The Pradhan Mantri MUDRA Yojana (PMMY) announced by the Hon'ble Prime

Minister on 8th April 2015, envisages providing MUDRA loan, upto Rs. 10 lakh, to income generating micro enterprises engaged in manufacturing, trading and services sectors. The overdraft amount of Rs. 5000 sanctioned under PMJDY has been also classified as MUDRA loans under Prime Minister MUDRA Yojana (PMMY). The MUDRA loans are extended under different categories.

(xvii) *Demonetization Scheme* – On 8th November, 2016, the Government announced Demonetization Scheme by declaring withdrawal of legal tender status to currency notes denomination of Rs. 1000 and Rs. 500 herein referred as Specified Bank Notes (SBN). Various guidelines were issued in this regard.

- Facility of exchange of SBN notes to general public for once from 10th November, 2016 to 24th November, 2016. The limit of amount of exchange was fixed at Rs. 4,000 which was later on revised to Rs. 4,500 and then brought down to Rs. 2,000 per person.
- Threshold for Cash Withdrawals – In order to curb imbalance of currency availability and demand, threshold for cash withdrawals (daily as well as weekly) were notified.
- It was prescribed that deposit of old SBN in Bank Account is to be done by account holder or by person duly authorized through an authority letter.
- The balance of SBN and its movement by banks to ensure no misuse by branch officials. Reporting of the said details by banks has been prescribed.
- Deposit of SBN was allowed in excess of Rs. 50,000 in KYC compliant accounts only.
- Deposit of SBN and withdrawals was restricted in Small / Basic Savings Accounts.
- Amendments in Income Tax Rules 114B and 114E were made to report cash deposit transactions in Savings and Current Accounts during the period of 10th November, 2016 to 30th December, 2016, beyond aforesaid limit.

Public Sector and Private Sector Banks

07. Commercial banks operating in India can be divided into two categories based on their ownership—public sector banks and private sector banks. However, irrespective of the pattern of ownership, all commercial banks in India function under the overall supervision and control of the RBI.

08. Public sector banks comprise the State Bank of India, its five subsidiaries (also called 'associate banks of State Bank of India'; these are State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala, and State Bank of Travancore), IDBI Bank Ltd. and the nationalised banks.

09. While the majority stake in the Share Capital of all Public Sector Banks is with the Government of India, there are private individual/institutional shareholders also. The majority stake in the share capital of associate banks of State Bank of India has been subscribed to by the parent i.e. State Bank of India.

10. The ownership of private sector banks is with institutional shareholders, private individuals and bodies corporate. Private Sector Banks are of the following types:

(a) Indian scheduled commercial banks other than public sector banks. These include the 'old' private banks which were in existence before the guidelines for floating new private banks were issued in 1993, the 'new' generation private banks, and the 2 banks that were granted licenses by RBI in March 2014. (The term 'scheduled commercial banks' refers to commercial banks which are included in the Second Schedule to the Reserve Bank of India Act, 1934.) Under Section 2(e) of the RBI Act, a scheduled bank is conferred two main privileges (a) availing of refinance from RBI and (b) permission to participate in the call/notice money market. It may be noted that not all scheduled banks are commercial banks; some co-operative banks are also scheduled banks. Commonly known as 'banking companies', these banks are 'companies' registered under the Companies Act, 1956 (now the Companies Act, 2013), or an earlier Indian Companies Act.

(b) Non-scheduled banks.

(c) Indian branches of banks incorporated outside India, commonly referred to as 'foreign banks'.

11. Some of the banks have set up subsidiaries – wholly-owned or partly-owned – to operate in some specialised spheres of activity such as merchant banking, funds management, housing finance, primary dealership, pension fund management, insurance business, stock broking, credit card activity, factoring, etc. These subsidiaries do not carry on all the principal functions of a commercial bank.

Regional Rural Banks (RRBs)

12. These banks have been established "with a view to developing the rural economy by providing, for the purpose of development of agriculture, trade,

commerce, industry and other productive activities in the rural areas, credit and other facilities, particularly to the small and marginal farmers, agricultural labourers and artisans and small entrepreneurs” (Preamble to the Regional Rural Banks Act, 1976). While regional rural banks can carry on any business in which a bank is legally permitted to engage, section 18 of the Regional Rural Banks Act, 1976, specifically lists the following businesses which such a bank may undertake:

- (a) the granting of loans and advances, particularly to small and marginal farmers and agricultural labourers, whether individually or in groups, and to co-operative societies, including agricultural marketing societies, agricultural processing societies, co-operative farming societies, primary agricultural credit societies or farmers’ service societies, for agricultural purposes or agricultural operations or for other purposes connected therewith;
- (b) the granting of loans and advances, particularly to artisans, small entrepreneurs and persons of small means engaged in trade, commerce or industry or other productive activities, within the notified area in relation to the RRB.

13. In order to strengthen and consolidate RRBs, the government in 2005 initiated the process of amalgamation of RRBs in a phased manner. Consequently, the total number of RRBs has reduced from 196 to 56². Further, the Government of India has issued a notification dated May 17, 2007 specifying ‘Regional Rural Bank’ as ‘bank’ for the purpose of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002.

14. In recent years, in an attempt to strengthen the regional rural banks, several measures have been taken by the Central Government and the RBI. These banks are no longer required to confine their lending to the weaker sections and are permitted to lend to non-target groups also up to specified limits. They can also undertake various types of business such as issuance of guarantees, demand drafts, travellers’ cheques, etc. Moreover, RRBs are no longer required to confine their operations only within local limits notified by the Central Government; they are now permitted, subject to fulfilling service area obligations, to lend monies outside their service area. In the wake of these developments, the distinction between commercial banks and RRBs has become somewhat blurred.

15. Each RRB has a public sector bank as its ‘sponsor bank’. Capital in each such bank is contributed by the Central Government, the sponsor bank and the State Government concerned in proportion of 50, 35 and 15 per cent,

² As per the information available from the website of the Reserve Bank of India at the following URL: <http://www.rbi.org.in/scripts/AboutUsDisplay.aspx?pg=RegionalRuralBanks.htm>.

respectively.

16. Apart from subscribing to the share capital of a RRB sponsored by it, the sponsor bank is also required to train personnel of the RRB as also to provide managerial and financial assistance to such bank during the first five years of the latter's functioning (this period can, however, be extended by the Central Government).

17. Like commercial banks, regional rural banks also function under the overall supervision and control of the RBI. Some of the regulatory functions of the RBI in relation to RRBs have been delegated to the National Bank for Agriculture and Rural Development (NABARD).

Co-operative Banks

18. These are banks in the co-operative sector which cater primarily to the credit needs of the farming and allied sectors. Co-operative banks include central co-operative banks, state co-operative banks, primary co-operative banks and land development banks. Of these, primary co-operative banks operate in metropolitan cities, urban and semi-urban centres to cater principally to the credit needs of small industrial units, retail traders, etc. Due to their existence primarily in urban areas, primary co-operative banks are more commonly known as 'Urban Co-operative Banks' (UCB). Land development banks provide long-term finance for agriculture and have a two-tier structure – State Land Development Banks and the Primary Land Development Banks, the latter being at District or Block level. In a few states, however, the structure is unitary where the State Land Development Bank directly carries out activities through its own branches at district level.

19. Each co-operative bank operates within a specific geographic jurisdiction as determined by its bye-laws. Co-operative banks can lend monies only to their members or to registered societies. The single most important regulatory and supervisory feature in the co-operative banking sector is the prevalence of dual control. While incorporation/registration and management-related activities are regulated in the states by the Registrar of Co-operative Societies or the Central Registrar of Co-operative Societies (for multi-state co-operative banks), banking-related activities are under the regulatory/supervisory purview of the Reserve Bank of India or NABARD (in the case of rural co-operatives).

Foreign Banks

20. Foreign banks operate in India through a network of branches and do not have a separate legal entity existence in India. However, for all practical purposes, the RBI regulates the functioning of these banks in India, with regards to scale and nature of business they undertake in India. Foreign banks functions

with a CEO or a Country Head as the highest decision making authority based in India. This position generally reports to the regional management Board or the global Board of the bank as the case may be. In comparison to a locally incorporated bank, the management structure of foreign banks is not very 'top' concentrated, i.e., the various boards and committees stipulated by RBI for Indian banks are not mandatory.

21. Foreign banks operate with limited branch network in the country and in a structure wherein most of their operations are centralised. Bank branches operate as customer relationship windows and do not record substantial financial statements impacting transactions. Almost all foreign banks are technologically advanced and use a high level of IT integration into their operations. These systems, in most instances, are similar to those being used by their branches globally. Due to cost-benefit and other considerations, in some instances, foreign banks, get certain financial or other information processed at one of their global centres. This processing of data out of the country is generally with specific consent from the RBI. Due to their existence in global financial centres and their expertise, banks undertake complex treasury transactions (to the extent allowed by RBI regulations). In most cases these transactions are undertaken back to back with their foreign branches and would be hedged from a local risk perspective. Additionally, banks also undertake and participate in international advisory and syndication transactions, in partnership with their international branches, which in effect generates fee revenue for the bank.

22. In the aftermath of the global financial crisis and building on the lessons therefrom, RBI issued a Discussion Paper in January 2011 on the mode of presence of foreign banks in India. Taking into account the feedback received on the Discussion Paper, a Scheme for setting up of locally incorporated Wholly Owned Subsidiary (WOS) by foreign banks in India was finalized in November 2013. The scheme provided, as hitherto, allowing foreign banks to operate in India either through branch presence or setting up a wholly owned subsidiary (WOS) with near national treatment. The foreign banks in India have to choose one of the above two modes of presence and shall be governed by the principle of single mode of presence. The policy is guided by the two cardinal principles of (i) reciprocity and (ii) single mode of presence. As a locally incorporated bank, the WOS will be given near national treatment which will enable them to open branches anywhere in the country at par with Indian banks (except in certain sensitive areas where RBI's prior approval would be required). They would also be able to participate fully in the development of the Indian financial sector. The policy incentivises the existing foreign bank branches which operate within the framework of India's commitment to the World Trade Organisation (WTO) to convert into WOS due to the attractiveness of near national treatment. Such

conversion is also desirable from the financial stability perspective. To provide safeguards against the possibility of the Indian banking system being dominated by foreign banks, the framework has certain measures to contain their expansion if the share of foreign banks exceeds a critical size. Certain measures from corporate governance perspective have also been built in so as to ensure that the public interest is safeguarded.

Payment Banks

23. Payment Banks have been introduced in the Indian financial system since November 2014, with the basic objective of furthering financial inclusion by providing (i) small savings accounts and (ii) payments/remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users. Their scope of activities include the acceptance of demand deposits, presently restricted to holding a maximum balance of Rs. 100,000 per individual customer, payments and remittance services through various channels, acting as Business Correspondents (BC) of another bank etc. Payments Banks cannot undertake any lending activities. Apart from amounts maintained as Cash Reserve Ratio (CRR) with RBI on its outside demand and time liabilities, they are required to invest a minimum of 75 per cent of their "demand deposit balances" in Statutory Liquidity Ratio (SLR) eligible Government securities/treasury bills with maturity up to one year and hold maximum 25 per cent in current and time/fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.

Operating guidelines have been issued vide Circular RBI/2016-17/80 DBR. NBD. No.25/16.13.218/2016-17 Dated October 6, 2016.

Small Finance Banks

24. Small Finance Banks have also been introduced in the Indian financial system since November 2014, with the basic objective of furthering financial inclusion by (a) provision of savings vehicles, and (b) supply of credit to small business units; small and marginal farmers; micro and small industries; and other unorganised sector entities, through high technology-low cost operations. Their scope of activities primarily include undertaking basic banking activities of acceptance of deposits and lending to unserved and under-served sections including small business units, small and marginal farmers, micro and small industries and unorganised sector entities.

Operating guidelines have been issued vide Circular RBI/2016-17/81 DBR. NBD. No.26/16.13.218/2016-17 dated October 6, 2016. Guidelines w.r.t. Investment Classification, Restrictions on Loan and Advances, Income Recognition and Asset Classification as applicable to Scheduled Bank will be applicable to Small Finance Banks. In addition to it, specific guidelines have been issued for Capital Adequacy Framework, Leverage Ratio, Liquidity Coverage Ratio and Net Stable Funding Ratio, etc.

Branch Network of Commercial Banks

25. Commercial banks are arguably the most important constituent of the banking system in India. To carry out their functions effectively, these banks have established a large network of branches in India. Based on their location, these 'domestic' branches are commonly classified into rural branches, semi-urban branches, urban branches and metro branches. Apart from these domestic branches, some banks have also established offices abroad. The foreign offices of banks are generally of the following types:

- *Full-fledged branches* – Such branches transact all kinds of banking business.
- *Off-shore banking units* – Such branches transact foreign exchange business of any kind except domestic banking business with the residents/corporations, etc., domiciled in the country concerned.
- *Branches in International Financial Services Centers* - Indian banks viz. banks in the public sector and the private sector authorised to deal in foreign exchange will be eligible to set up IFSC Banking Units (IBUs). Minimum capital of US\$ 20 million or equivalent is required for opening of a branch at IBU. Operations from IBU are governed by operational guidelines issued by RBI time to time.
- *Subsidiaries* – The laws in some countries do not permit foreign banks to open their branches in those countries. Therefore, Indian banks have to set up wholly or partly-owned subsidiaries in such countries. Further, for operational reasons, commercial banks may prefer to operate through subsidiaries, if permitted, instead of opening branches.
- *Representative offices* – Such offices do not transact any banking business. The objective behind setting up of such offices is to maintain close liaison with the important bodies there to promote mutual business interests.

26. Generally, branches of banks conduct a variety of banking business under one roof. The trend of creating 'thrust-based' or 'focus-based' branches/ market segmentation has led to setting up of branches by banks exclusively for a

specified segment of their clients. Presently, such specialised branches are generally of the following types (nomenclature may, however, vary from bank to bank):

- Personal Banking branches, catering to the needs of individual customers only.
- Commercial or Industrial Finance branches, catering to the needs of industries in the small, medium and/or large sectors.
- Recovery branches, which deal only with the recovery aspects of non-performing advances which were originally granted at other branches of the bank.
- Housing Finance branches which deal only with housing loan proposals – from individuals, and in some cases, also from the developers of housing units.
- Agricultural Finance branches, catering to the needs of the agriculture sector only.
- Service branches, handling only the local clearing instruments received from outstation branches or from other local branches of the bank for collection.
- Commodity specific branches, which handle the accounts, predominantly borrowal accounts, of the units belonging to a particular industry, e.g., leather, diamonds.
- Overseas or International Banking or Foreign Exchange branches catering to the banking needs of those enterprises which are engaged in imports into/exports from India.
- Corporate Banking/SME/SSI branches, catering exclusively to the requirements of the large, medium and small scale industrial units respectively.
- NRI (Non-Resident Indian) branches, catering exclusively to the banking needs of NRIs.
- Securities / treasury branches, dealing only with the securities portfolio of the bank.

Organisational Structure of Banks

27. While the exact organisational structure may differ from one bank to another, most large-sized public sector banks have a four-tier structure – head office, zonal offices, regional offices and branches (the nomenclature may, however, vary among banks) – each tier of the structure being responsible for performing the functions specified by the Head Office.

28. At the apex level is the head office of the bank whose main functions are:

- Laying down policies and procedures for smooth and efficient functioning of the bank and to review them periodically.
- Deciding on the extent of powers – financial and administrative – which may be vested in various functionaries of the bank.
- Planning and performance budgeting.
- Asset-liability management.
- Laying down lending policy of the bank, the risk management guidelines, and the rehabilitation and recovery guidelines including policies for compromise, settlement and write-off.
- Deciding about the interest rates on both the deposits and the loans as well as about charges for various services and review interest rates and charges periodically.
- Treasury and investment management (usually handled by the head office, though in some cases, select large branches may also be involved in this function).
- Monitoring and controlling the functioning of various offices of the bank. Periodic inspections and internal audit are important constituents of such monitoring and control mechanism.
- Reconciling the transactions among various offices of the bank.
- Introducing new products and services and reviewing the existing ones.
- Issuing instructions to branches and other offices from time to time on matters deserving their attention or requiring compliance by them.

29. At the second level are the zonal offices which are responsible for overall working of the branches in their areas of operation. Zonal offices act as a link between the branches and the head office, either directly or through regional offices.

30. Below the zonal offices are the regional offices which are the immediate controllers of the branches under their jurisdiction. They are responsible for business development, compliance with the laid down systems and procedures, satisfactory customer service, quick redressal of complaints and submissions of the required statements/reports/returns by branches under their jurisdiction. They are also responsible for smooth functioning of the branches under them.

31. Branches are lowest in the hierarchy of the banking organisation structure. In fact, the banking operations (i.e., accepting deposits and making loans) actually take place at the branch level. Their jobs are numerous, practically everything in relation to banking, except the pricing of products/services and the policy formulation.

32. Some branches have extension counters and sub-offices functioning under

them. The extension counters/sub-offices are meant for specific locations like airports, large institutions, large project sites, etc., and cater exclusively to the banking needs (either all or limited) of the concerned locale.

Role of the Reserve Bank of India as the Central Bank

33. The RBI is the central bank of our country. As such, RBI is responsible for development and supervision of the constituents of the Indian financial system (which comprises banks and non-banking financial institutions) as well as for determining, in conjunction with the Central Government, the monetary and credit policies keeping in with the need of the hour. Among its important functions are issuance of currency; regulation of currency issue; acting as banker to the central and state governments; and acting as banker to commercial and other types of banks including term-lending institutions. Besides, RBI has also been entrusted with the responsibility of regulating the activities of commercial and other banks. No bank can commence the business of banking or open new branches without obtaining licence from RBI. The RBI also has the power to inspect any bank. The Banking Regulation Act, 1949 provides the legal framework for regulation and supervision of banks. This statute, together with some provisions in the Reserve Bank of India Act, 1934, State Bank of India Act, 1955, State Bank of India (Subsidiary Banks) Act, 1959 and Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970 & 1980, empowers the RBI to prescribe standards and monitor liquidity, solvency and soundness of banks, so as to ensure that depositors' interests are protected at all times.

34. Periodic inspections of banks under section 35 of the Banking Regulation Act, 1949 are undertaken as a follow-up of the bank licensing regulation and objectives as laid down in section 22 of the Banking Regulation Act, 1949. The substantive objective of the statutory inspections has been to verify whether the conditions subject to which the bank has been issued licence to undertake banking business in terms of sub-section (3) of section 22 [including sub-section (3A) for foreign banks] continue to be fulfilled by it. The conditions include:

- (a) the bank "is or will be in a position to pay its present or future depositors in full as their claims accrue" (i.e. it is solvent and has adequate liquidity);
- (b) the bank "has adequate capital structure and earning prospects";
- (c) "the affairs of the (banking) company are not being, or are not likely to be, conducted in a manner detrimental to the interests of its present or future depositors"; and
- (d) "the general character of the management of the bank is not prejudicial to the public interest or the interest of its depositors" (i.e. it has sound operational systems and adequate controls operated by a prudent management).

Section 22(4) of the Banking Regulation Act, 1949 authorises the RBI to cancel the banking licence “if at any time, any of the conditions referred to in sub-section (3) and sub-section (3A) is not fulfilled”.

35. Based on the recommendations of a High Level Steering Committee (HLSC) for Review of Supervisory Processes of Commercial Banks, the Reserve Bank of India had in September 2012, introduced a Supervisory Program for Assessment of Risk and Capital (SPARC) for commercial banks. This Risk Based Supervision (RBS) approach, helps the regulator in focusing on evaluating both present and future risks, identifying incipient issues and facilitating prompt intervention/ early corrective action - as against the earlier compliance-based and transaction testing approach (CAMELS) which was more in the nature of a ‘point in time’ assessment. The RBS approach also benefits the regulator by optimizing its use of supervisory resources and assisting the regulated entities in improving their risk management systems, oversight and controls.

36. RBI is empowered under section 21 of the Banking Regulation Act, 1949, to control advances by banks in general or by any bank in particular. Among the measures that the RBI can adopt for this purpose are to prescribe purposes and extent of advances, margin requirements, maximum exposure to a single borrower, rate of interest and other terms and conditions, etc. Besides these measures (which are usually called ‘selective credit control’ measures), RBI also controls the total volume of bank credit by varying bank rate through open market operations or by varying cash reserve and similar requirements.

37. Bank rate refers to the rate of interest at which the RBI re-discounts the first class bills of exchange or other eligible instruments from banks. Variations in bank rate affect the interest rates charged by banks – generally, interest rates of banks move up or down *in tandem* with movements in bank rate.

38. Under Base Rate system which came into effect from July 1, 2010, all categories of domestic rupee loans of banks are priced only with reference to the Base Rate, subject to certain conditions. For monetary transmission to occur, lending rates have to be sensitive to the policy rate. At present, banks follow different methodologies for computing their Base Rate like average cost of funds method, marginal cost of funds, blended cost of funds (liabilities) etc.

39. Open market operations involve sale or purchase of government securities in the open market. When RBI buys government securities from banks in the open market, the funds in the hands of selling banks increase, enabling them to expand credit, and *vice versa*.

40. Banks are required to maintain at least a prescribed minimum percentage of their demand and time liabilities in India in the form of cash and/or current account balances with the RBI (called ‘cash reserve ratio’). Additionally, they are required to maintain a further percentage in the form of cash and/or other liquid

assets (called 'statutory liquidity ratio'). Varying the cash reserve ratio and/or statutory liquidity ratio enables the RBI to increase or decrease (as the case may be) the funds available to banks for lending and other similar purposes.

41. A major development that has implications for banks throughout the world is the "International Convergence of Capital Measurement and Capital Standards" generally known as the Basel Accord. Basel III ensures better quality of capital and robust liquidity risk management.

42. The smooth functioning of the payment and settlement systems is a pre-requisite for stability of the financial system. In order to have focused attention on payment and settlement systems, a Board for Regulation and Supervision of Payment Systems (BPSS) was set up in March, 2005. The launch of the Real Time Gross Settlement System (RTGS) and NEFT (National Electronic Funds Transfer) has led to a reduction of settlement risk in large-value payments in the country. Similarly, IMPS (Inter bank Mobile Payment Service/Immediate Payment Service) is a mobile based payment mechanism introduced by the National Payments Corporation of India to allow customers to transfer money instantly, facilitating instant remittance across multiple platforms. The setting up of NSDL and CDSL for the capital market settlements and CCIL for G-sec, forex and money market settlements have improved efficiency in market transactions and settlement processes. A series of legal reforms to enhance the stability of the payment systems have been carried out. With the introduction of the Payments and Settlement Act in 2008, the Reserve Bank has the legislative authority to regulate and supervise payment and settlement systems in the country.

43. In India, deposit insurance is provided by the Deposit Insurance and Credit Guarantee Corporation (DICGC), a wholly owned subsidiary of the Reserve Bank of India. Deposit insurance in India is mandatory for all banks (commercial/co-operative/RRBs/LABs). It covers all kinds of deposits except those of foreign governments, Central/State Governments, inter-bank, deposits received abroad and those specifically exempted by DICGC with prior approval of the Reserve Bank. The premium charged for deposit insurance is on a flat rate basis, which is currently 10 paise per Rs.100 of assessable deposits with a statutory ceiling on premium at 15 paise. The premia to be paid by the insured banks are computed on the basis of their assessable deposits. Insured banks pay advance insurance premia to the Corporation semi-annually within two months from the beginning of each financial half year, based on their deposits as at the end of previous half year. The amount of coverage is presently limited to Rs.1 lakh per depositor and extends to deposits held in the same right and in the same capacity.

44. Banks and financial institutions (FIs) have also been advised by RBI to follow certain customer identification procedure for opening of accounts and monitor transactions of suspicious nature for the purpose of reporting the same

to appropriate authority. These 'Know Your Customer' (KYC) guidelines have been revisited in the context of the recommendations made by the Financial Action Task Force (FATF) on Anti Money Laundering (AML) standards and on Combating Financing of Terrorism (CFT). Detailed guidelines based on the recommendations of FATF and the paper issued on Customer Due Diligence (CDD) for banks by the Basel Committee on Banking Supervision (BCBS), with suggestions wherever considered necessary, have been issued. Banks/FIs have been advised by RBI to ensure that a proper policy framework on 'Know Your Customer' and Anti-Money Laundering measures is formulated and put in place with the approval of their Boards. The objective of KYC/AML/CFT guidelines is to prevent banks/FIs from being used, intentionally or unintentionally, by criminal elements for money laundering or terrorist financing activities. KYC procedures also enable banks/FIs to know/understand their customers and their financial dealings better and manage their risks prudently. Foreign Account Tax Compliance Act (FATCA) is a US law, which was enacted in March 2010 by the US Government which was aimed at preventing tax evasion through off shore assets by US citizens and US residents. Foreign Financial Institutions (FFIs) such as the Bank that enter into a FATCA FFI agreement with the US government are required to conduct certain due-diligence to identify its US clients (individual and entity) and report on their accounts to the US Internal Revenue Service (IRS).

45. India has signed the Inter-Governmental Agreement (IGA) with USA for improving international tax compliance and implementing the Foreign Account Tax Compliance Act (FATCA). India has also signed a multilateral agreement on June 3, 2015, to automatically exchange information based on Article 6 of the Convention on Mutual Administrative Assistance in Tax Matters under the Common Reporting Standard (CRS), formally referred to as the Standard for Automatic Exchange of Financial Account Information (AEOI).

46. Apart from directions relating to operational matters, RBI also issues, from time to time, guidelines on accounting matters to be followed by banks. These guidelines have a profound effect on annual accounts of banks. The text of the notifications/circulars/guidelines, etc., issued by RBI are normally also available on its website www.rbi.org.in.