Banking For Prelims 2018
Brush Your Brains for Prelims

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MONEY MARKET

- It is the market for borrowing and lending of short term funds :-
- Commercial banks
- RRBs
- Bill markets

RBI

- It is the apex regulatory body of Indian banking system.
- It was established in 1935 under RBI Act 1934.
- It was nationalised in 1949
- " ...to regulate the issue of Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage "

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- 1) Bank of issue : All notes except 1Rs note and coins are issued by RBI. One rupee note and coins are issued by Ministry of Finance but circulated by RBI.
  - The amount of new money is based on the prevailing economic condition, the need of economy etc.
  - The issue of money is based on Minimum Reserve System.

- 2) banker and debt manager to government :
  - It keeps deposits of governments and lend to governments.
  - RBI carries out lending and borrowing operations by issuing Govt. securities on behalf of the govt.

3) Banker's Bank

- It keeps the reserves of banks like CRR and SLR.
- It provides financial assistance to banks against mortgaged securities.
- It rediscounts bills of exchange

- 4) Custodian and manager of foreign exchange
- 5) Controller of credit – means control of lending and deposit creating capacity of the banks.
- 6) Supervisory function
- 7) Promotional function

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METHODS OF CREDIT CONTROL

Quantitative methods	Qualitative methods
1) Bank Rate	Regulation of margin requirements
2) Open Market Operations	Regulation of consumer credit
3) CRR	Rationing of credit
4) SLR	Direct action
5) Repo Rate	Moral suasion
6) Reserve Repo Rate	Publicity
7) Marginal Standing Facility 8) Market Stabilisation Scheme	

BANK RATE

- Bill of Exchange : means a written document that assures payment of money by purchaser to seller for the goods purchased, at a future date
- Discount : means the process of converting a bill into money at an earlier date than that is mentioned in the bill of exchange
- Bank Rate : it is the rate fixed by the central bank at which it rediscounts first class bills of exchange and govt. securities held by commercial banks.

OMO

- It refers to the sale and purchase of securities, bills and bonds of govt. as well as private financial institutions by the central bank.
- If the central bank sells these instruments , banks and public will buy it and pay money to the central bank.
- If the central bank buys these instruments from instrument holders, it will pay money to the latter.

CRR

- Scheduled banks are required to keep certain percentage of their Net Time and Demand Deposits with RBI under RBI act 1934.
- To have control over banks credit.
- If this ratio is increased the banks have to deposit more money with RBI and the reverse is the case when the ratio is decreased.

SLR

- Scheduled banks are required to keep certain percentage of their net time and demand deposits in their vault itself.
- It need not be deposited with RBI.
- This reserves has to be kept in the form of cash, gold and bond.

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Liquidity Adjustment Facility

- It is a short term credit control measure.
- Repo Rate :- it is the rate at which commercial banks borrow from RBI by mortgaging its dated govt. securities and treasury bills.
- Reverse Repo Rate :- It is the rate at which RBI borrows from commercial banks by mortgaging its dated govt. securities and treasury bills.

Non Performing Assets

- Any asset that is not returning in the form of principal or interest in the last 90 reporting days is an NPA.
- Assets of a bank are classified in terms of its repayment status.
- Standard assets, substandard assets, doubtful assets and loss assets are the classifications of asset quality.

- **Standard asset**
- Standard Asset is one which does not disclose any problems and which does not carry more than normal risk attached to the business. Such an asset should not be an NPA.
- **Substandard asset**
- A substandard asset would be one, which has remained NPA for a period less than or equal to 12 months.
- **Doubtful asset**
- An asset would be classified as doubtful if it has remained in the sub-standard category for a period of more than 12 months.
- **Loss asset**
- A lost asset is the one which remains as NPA for a period of more than 36 months. Such an asset has been identified by the bank or internal or external auditors or by the RBI inspection but the amount has not been written off wholly. In other words, such an asset is considered uncollectible.

- **Stressed assets**
- A new classification is made in the form of stressed assets that comprises restructured loans and written off assets besides NPAs.
- Stressed assets = NPAs + Restructured loans + Written off assets
- Stressed assets is a powerful indicator of the health of the banking system.

- **What is Restructured loans?**
- Restructured asset or loan are that assets which got an extended repayment period, reduced interest rate, converting a part of the loan into equity, providing additional financing, or some combination of these measures.
- Hence, under restructuring, a bad loan is modified as a new loan. But the real problem is that it was actually an NPA.

- **What is Written off Assets?**
- Written off assets are those the bank or lender doesn’t count the money borrower owes to it
- **What is Provisioning and Provisioning Coverage Ratio?**
- Under provisioning, banks have to set aside or provide funds to a prescribed percentage of their bad assets. The percentage of bad asset that has to be ‘provided for’ is called provisioning coverage ratio. The provisioning coverage ratio is the percentage of bad assets that the bank has to provide for (keep money) from their own funds –most probably from profit.

- **Who is a willful defaulter?**
- Default means non-payment of a loan availed by a borrower. A willful defaulter is an entity or a person that has not paid the loan back despite the ability to repay it.

SCHEMES FOR REOLVING NPA & STRESED ASSETS

- The 5/25 Refinancing of Infrastructure Scheme
- Private Asset Reconstruction Companies(ARCs
- Strategic Debt Restructuring Scheme
- Asset Quality Review
- Scheme for Sustainable Structuring of Stressed Assets (S4A)
- Joint Lender's Forum
- SARFAESI Act 2002
- Debt Recovery Tribunals (DRTs)

The 5/25 Refinancing of Infrastructure Scheme

- For the revival of stressed assets in the infrastructure sector and 8 core industries.
- Under this scheme, lenders were allowed to extend amortisation periods to 25 years with interest rates adjusted every 5 years.
- Led to evergreening of loans.

- **What are ARCs?**
- it was introduced to India under the SARFAESI act, 2002.
- An Asset Reconstruction Company is a specialized financial institution that buys the NPAs or bad assets from banks and financial institutions so that the latter can clean up their balance sheets. Or in other words, ARCs are in the business of buying bad loans from banks.
- As per amendment made on the SARFAESI Act in 2016, an ARC should have a minimum net owned fund of Rs 2 Cr.

- **Strategic Debt Restructuring (SDR) Scheme**
- Under SDR, banks who have given loans to a corporate borrower gets the right to convert the full or part of their loans into equity shares in the loan taken company.
- **Scheme for Sustainable Structuring of Stressed Assets (S4A)**
- The S4A Scheme aims at deep financial restructuring of big debted projects by allowing lender (bank) to acquire equity of the stressed project. In this context, the scheme makes financial restructuring of large projects at the same time helping the lender's ability to deal with such stressed assets.

- **Asset Quality Review** : to verify that banks were assessing loans in line with RBI loan classification rules.
- **Joint Lender's Forum** : The Joint Lender's Forum is a dedicated body of lender banks that is formed to speed up decisions when an asset of more Rs 100 crore or more turns out to be a stressed asset.

- **SARFAESI Act 2002**
- The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act, 2002 is a legislative provision that helps financial institutions to ensure asset quality in multiple ways.
- The Act was framed to address the problem of NPAs (Non-Performing Assets) or bad assets through different processes and mechanisms.

- **Debt Recovery Tribunals (DRTs)**
- Debt Recovery Tribunals were established to facilitate the debt recovery involving banks and other financial institutions with their customers.
- DRTs can take cases from banks for disputed loans above Rs 10 lakhs.
- At present, there are 33 DRTs and 5 DRATs functioning at various parts of the country.
- Compared to the ordinary court procedures, DRTs were able to handle large number of cases with low delay during the initial phases.

RBI and Government measures for the restructuring of PSBs

- The RBI and Government interventions in the banking sector during the last few years is dominated by initiatives for countering the worsening asset quality – especially that of the PSBs.
- According to Montek Singh Ahluwalia (A 'Sudarshan Chakra' solution for PSU banks, Livemint), efforts to fight bad assets are taking place on four fronts.
- Recognition
- Resolution
- Recapitalization
- Reforms

- **Recognition of bad assets**
- Recognition of asset quality is an important step for treating bad assets.
- Here, the RBI is having a robust asset recognition mechanism supported by prudential norms, inspections and asset quality reviews.
- Norms like NPAs, doubtful assets, lost assets, stressed assets and special mention accounts (SMA) are instrumental to identify the asset quality of banks.

- **Resolution of assets**
- Resolution of bad assets implies solving the NPA problem permanently through several means like recapitalization.
- During the last few years, several initiatives were made by the RBI and the Government to resolve the bad loan problem.
- The most powerful effort towards resolution of bad assets was the power given to the RBI to instruct banks on the use of Insolvency and Bankruptcy Code on large bad assets.

- **Recapitalization**
- Recapitalization is the injection of funds specifically in the form of equity by the owners of the bank.
- Recapitalization is needed to resolve the stressed asset problem.
- Similarly, additional capital is needed to realise Basel III capital norms.
- Recapitalization efforts were implemented by the government over the last one decade in a substantial manner.

- **Reforms**
- The Nayak Committee identified some of the important governance problems including:
- Government ownership and problems for commercial operations
- Externally imposed constraints
- Absence of level playing field with private sector banks
- Weak boards of PSBs
- As a follow up to the recommendations of the Nayak Committee, the government launched Indradhanush programme for making some governance reforms. These include the creation of Bank Board Bureau and inducting experienced professionals in the boards of PSBs etc.
- As part of the Indradhanush initiative, the Government separated the post of Chairman and Managing Director. The CEO will get the designation of MD & CEO and there would be another person who would be appointed as non-Executive Chairman of PSBs.

Bank Board Bureau

- To improve the Governance of Public Sector Banks (PSBs).
- It was announced in the Union Budget 2015-16.
- It will constantly engage with the boards of all 22 public sector banks to formulate appropriate strategies for their growth and development.
- The setting-up and structure of Bank Board Bureau (BBB) will replace the Appointment Board for appointment of Whole time Directors as well as Non-Executive Chairman of Public Sector Banks (PSBs).

- The Bureau will recommend for selection of heads - Public Sector Banks and Financial Institutions and help Banks in developing strategies and capital raising plans.
- The Bureau will help Banks in developing differentiated strategies and capital raising plans through innovative financial methods and instruments.
- BBB will also advise banks on strategies for consolidation among them including mergers and acquisitions.
- It will also infuse efficiency and transparency in the Banking sector.

Basel III NORMS

- Basel III is the third version of internationally coordinated regulation guidelines for the banking sector.
- It is designed by Basel Committee on Banking Supervision headquartered at Basel, Switzerland.
- The Basel III norms is an advanced one compared to the previous versions and gives high importance to capital enhancement in banks to overcome different types of financial sector risks.

- **Basel Committee**:
- It is the primary global standard setter for the prudential regulation of banks and provides a forum for cooperation on banking supervisory matters.
- Its mandate is to strengthen the regulation, supervision and practices of banks worldwide with the purpose of enhancing stability.

- **Basel I** : In 1988, the Basel Committee on Banking Supervision (BCBS) in Basel, Switzerland, published a set of minimum capital requirements for banks. These were known as Basel I. One of the major role of Basel norms is to standardize the banking practice across all countries.
- **Basel II** was introduced in 2004, laid down guidelines for capital adequacy (with more refined definitions), risk management (Market Risk and Operational Risk) and disclosure requirements.

- **Basel III** : The Basel III norms were released in December 2010. These accords deal with risk management aspects for the banking sector.
- **Basel 3 measures aim to**:
- Improve the banking sector's ability to absorb shocks arising from financial and economic stress, whatever the source
- Improve risk management and governance
- Strengthen banks' transparency and disclosures.

- **Three Pillars of Basel III**
- The basic structure of Basel III remains unchanged with three mutually reinforcing pillars.
- **Pillar 1**: Minimum Regulatory Capital Requirements based on Risk Weighted Assets (RWAs): Maintaining capital calculated through credit, market and operational risk areas.
- **Pillar 2**: Supervisory Review Process: Regulating tools and frameworks for dealing with peripheral risks that banks face.
- **Pillar 3:** Market Discipline: Increasing the disclosures that banks must provide to increase the transparency of banks

- All commercial banks in India, excluding regional rural banks, come under the Basel-III regulations.
- **Major Changes of Basel III over Basel I and Basel II**
- (a) **Better Capital Quality**: One of the key elements of Basel 3 is the introduction of much stricter definition of capital. Better quality capital means the higher loss-absorbing capacity. This in turn will mean that banks will be stronger, allowing them to better withstand periods of stress.

- (b) **Capital Conservation Buffer**: Another key feature of Basel iii is that now banks will be required to hold a capital conservation buffer of 2.5%. The aim of asking to build conservation buffer is to ensure that banks maintain a cushion of capital that can be used to absorb losses during periods of financial and economic stress.
- (c) **Countercyclical Buffer**: This is also one of the key elements of Basel III. The countercyclical buffer has been introduced with the objective to increase capital requirements in good times and decrease the same in bad times. The buffer will slow banking activity when it overheats and will encourage lending when times are tough i.e. in bad times.

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

- (e) **Leverage Ratio**: A leverage ratio is the relative amount of capital to total assets (not risk-weighted). This aims to put a cap on swelling of leverage in the banking sector on a global basis. 3% leverage ratio of Tier 1 will be tested before a mandatory leverage ratio is introduced in January 2018.

- (f) **Liquidity Ratios**: Under Basel III, a framework for liquidity risk management will be created. A new Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) are to be introduced in 2015 and 2018, respectively.
- (g) **Systemically Important Financial Institutions (SIFI)**: As part of the macro-prudential framework, systemically important banks will be expected to have loss-absorbing capability beyond the Basel III requirements.

Tier 1 and Tier 2 Capital

- Tier 1 capital will be in the form of equities while Tier 2 capital is more in the form of reserves,debts etc.
- Tier 1 capital is known as core capital while Tier 2 capital represents supplementary capital.

Financial Stability and Development Council

- The FSDC is a non-statutory apex council for coordination among various regulatory bodies, since in our increasingly complex economy, issues arise that straddle multiple financial jurisdictions and so risk falling through the cracks or getting caught in the crossfire.
- The council act as a co-ordination agency between the various financial sector regulators- the RBI, SEBI, IRDA and the PFRDA.

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- **Composition of the Council**
- The Chairman of FSDC is the Finance Minister.
- The Council will have one sub-committee headed by the governor of the RBI.
- The secretariat of the council will be at the of Ministry of Finance.
- Member of the committee include heads of the financial sector regulator institutions- RBI, SEBI, IRDA and PFRDA.

- **Function of the FSDC are:**
- It will focus on financial literacy and financial inclusion.
- It aims strengthening and institutionalizing the mechanism of financial stability and development.
- It will monitor macro-prudential supervision of the economy. It will assess the functioning of the large financial conglomerates.
- It will address intra regulatory coordination issues.

- **What are White Label ATMs (WLAs)?**
- ATMs set up, owned and operated by non-banks are called White Label ATMs. Non-bank ATM operators are authorized under Payment & Settlement Systems Act, 2007 by the Reserve Bank of India.
- **What is the difference between ATM and WLA (White Label ATM)?**

i) In White Label ATM scenario, logo displayed on ATM machine and in ATM premises pertain to WLA Operator instead of a bank. However, for a customer, using WLA is just like using the ATM of other bank (bank other than card issuing bank). ii) Acceptance of cash deposits at the WLAs is not permitted at present.

Insolvency and Bankruptcy Code, 2016

- Insolvency and Bankruptcy Code represents the legal and institutional mechanisms in India for dealing with debt default of companies and limited liability entities, partnership firms and individuals .
- However, this does not automatically cover default by financial service providers, unless notified by the Government.

- **Salient Features of the Code**
- The Code separates commercial aspects of the insolvency proceedings from judicial aspects. While **Insolvency Professionals** (IPs) will deal with commercial aspects such as management of the affairs of the corporate debtor, facilitating formation of committee of creditors, organising their meetings, examination of the resolution plan, etc., judicial issues will be handled by proposed Adjudicating Authorities (National Company Law Tribunal / Debt Recovery Tribunal) . One more important institution created under the Code is the '**Information Utility**' which would store financial information and data and terms of lending in electronic databases. This would eliminate delays and disputes about facts when default does take place.

- The Code also provides a fast track insolvency resolution process for corporates and LLPs. This will be an enabler for start-ups and small and medium enterprises (SMEs) to complete the resolution process in 90 days (extendable to 45 days in deserving cases).
- The Code also addresses the important issue relating to cross border insolvency by providing the enabling mechanism on the subject. The Government, at an appropriate time, may come out with a detailed framework for cross border insolvency.
- The code proposes setting up a regulator to register and regulate the functioning of insolvency professional agencies, insolvency professionals and information utilities.
- The Insolvency and Bankruptcy code was spearheaded by Ministry of Finance. However, the administration of the Insolvency and Bankruptcy Code, 2016 has been transferred to the Ministry of Corporate Affairs w.e.f. 29th July,2016

What is Helicopter Money

- The Economic Survey 2017 mention the concept of helicopter money as a monetary stimulus policy (conceptualized in the developed world).
- The underlying principle of Helicopter Money is that if a central bank wants to raise inflation and output (economic growth) in an economy from a low level, the best way is to give everyone direct money transfers.
- Here, provision of money into the public is like throwing money from a helicopter.

Difference between Helicopter money and QE

- Quantitative Easing is another type of monetary stimulus launched by the Federal Reserve after the financial crisis.
- Under QE, the central bank makes large-scale purchases of assets or bonds from financial markets by supplying money into the banking system.
- As a result, rate of interest comes down and this stimulates lending by banks, consumption, investment and economic growth.
- The working of QE is through the banking system whereas Helicopter money works directly by stimulating demand from the people.