Report of the Inter-Departmental Group to study the Rationalisation of Current account Facility with Reserve Bank of India

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INTRODUCTION

Since the prime role of Central Bank is to act as banker to Government and banker to banks, it is traditional for Central Banks to maintain the deposit accounts of Government as well as banks. Having to operate the currency and credit system of the country to its advantage, the Reserve Bank of India (hereinafter referred to as the Bank) has also taken upon itself the responsibility of widening and deepening various segments of the financial market including the securities market as part of discharging debt management function for the Government. This has extended the jurisdiction of the Bank beyond the banking sector and has been reflected with regard to extension of its Current account facility to non-bank entities. In this context, it is felt that it needs to be studied whether there is a genuine economic need for these entities to have a Current account with the Bank and whether the Bank in its role as the Central Banking authority of the country should continue to undertake retail banking function which can very well be taken care of by the commercial banking network. The issue needs also to be examined in the context whether non-bank entities are required for the conduct of core central banking functions of the Bank. The recent amendment to the Insurance Act, 1938 that has necessitated insurance companies to keep account with the Reserve Bank for the purpose of holding statutory deposits needs also to be examined in this context.

Accordingly, an inter-departmental Group was constituted to comprehensively examine the above issues, with terms of reference as under: -

i) Study the objectives enshrined in the DAD Manual vis-à-vis the actual practice in regard to giving non-bank entities access to Current account facility with RBI;
ii) Study international practices in this regard;
iii) Suggest ways for rationalising access to Current account facility with RBI keeping in view RBI's prospective liquidity management facility, the current technology initiatives in the form of launching of Real-time Gross Settlement (RTGS) system, computerisation of PDO/PAD/ DAD, INFINET, establishment of Clearing Corporation etc.
iv) Suggest the minimum balance requirement for banks and other non- bank entities in the context of changed scenario; and
v) Examine such other issues as the Group deems fit for the purpose.

The note constituting the inter-departmental Group is placed at Annexure II and the names and designations of the members of the Group are given in Annexure III.

The Group held six meetings. Apart from the background material prepared by the Group members, the Group had the benefit of perusing old records, dating back to 1943, made available by Current accounts Section of Mumbai Office as well as very fruitful discussions with Shri K.B. Chakraborti, Chief General Manager-in-Charge of Department of Government and Bank Accounts. The Group would like to thank Shri Chakraborti for providing guidance and support to the Group. The Group also benefited from the discussion in the "Report of the Technical Group on Phasing Out of Non-banks from Call/Notice Money Market" set up by the Bank.

Useful reference material was readily made available by the DEAP Library. The Group thanks Dr.D.Kamalavijayan, Chief Librarian, DEAP and the staff of the Library for the co-operation and assistance extended by them.

The Secretariat for the Group was provided by Department of Government and Bank Accounts (DGBA). The Group is immensely thankful to Shri U.C. Jaiswal, Manager for providing excellent secretarial assistance. The Group is also thankful to Shri N. Ramasubramanian, Assistant Manager, Smt. S.R. Goklani, Private Secretary to the CGM-in-Charge, Shri S.N. Vaze, Clerk Gr.II, Smt.R.Sebastian and Shri M. George, Stenographers, S/Shri S. J. Wakadikar, B.S. Dhende, Smt. M.R. Bandekar from the Typing Pool and other staff for providing exemplary support all along the line in preparation of the Group's Report.

Chapter I

Objective and Evolution of the Current account Facility with RBI

Objective of Current account

The Reserve Bank of India Act, 1934 empowers the Reserve Bank of India, to, inter alia, act as bankers' bank and lender of the last resort. Under Section 42 of the Act ibid, a scheduled bank is under obligation to maintain the Statutory Reserve with the Bank. Similarly, under Section 18 of the Banking Regulation Act, 1949, a non-scheduled bank may keep cash balances with the Reserve Bank. Further, in terms of Sections 20 and 21-A of the Act, the Bank is also authorized to be a banker to Central and State Governments.

Keeping all the above legal requirements in perspective, as per the DAD Manual, banks are given access to Current account facility with the Bank to enable them to perform three functions viz., a) to fulfil their statutory obligation, b) to settle their clearing house positions and c) to settle transactions with the Bank /Governments.

Types of Current accounts

The Current accounts maintained by the Bank are of four types –

(a) Principal Account – the Current account maintained by a scheduled bank with the Bank at the centre at which the bank furnishes its fortnightly returns;

(b) Secondary Account – the Current account that a bank is allowed to open at a centre where it maintains the “Principal Account”;

(c) Subsidiary Account – the Current account maintained with the Bank at any centre except where the bank has the "Principal Account"; and

(d) Current account - the account that an entity is allowed to open with the Bank.

Evolution of Current account Facility

Initially the Bank maintained deposit accounts of only banks and Governments. However, over the years, other non-bank entities have been admitted into the Current account system for some other purposes as well. These include: (i) all non-bank entities who are not members of the Clearing House viz., financial institutions and mutual funds for routing their call money transactions facilitating same day settlement as well as use of funds on the same day, (ii) Primary and Satellite dealers (PDs/SDs) and dedicated Gilt funds facilitating development of Government securities market considered critical for the growth of the financial sector as a whole and (iii) institutions like National Securities Clearing Corporation Ltd. (NSCCL) promoted by National Stock Exchange for handling increasing volume of financial transactions, particularly after liberalisation of financial market and introduction of screen based trading system for capital market transactions. Thus, as on date, a wide variety of financial and non-financial entities are maintaining Current account with the Bank. These include scheduled and non-scheduled banks besides Central and State Governments, local bodies, quasi-Government institutions, foreign central banks, foreign Governments, international organisations, All-India financial institutions such as LIC, GIC, UTI, IDBI, ICICI etc., mutual funds including Gilt funds, Primary Dealers, Satellite Dealers and securities custodial houses like NSDL, SHCIL, etc. Although the Reserve Bank of India Act, 1934 does not prohibit opening accounts even in the name of individuals, the extant Current account network comprises the abovementioned entities.

Why Preference to Current account with the Bank?

As already indicated above, Current account with the Bank ensures same day funds settlement as well as use of funds on the same day and facilitates risk free transfer of funds almost at zero cost with minimum balance of rupees one lakh only to be maintained in the account. There is a tendency to seek settlement on the books of the Bank not only for ensuring same day funds settlement but also for doing away with the huge float that the settlement bank might enjoy. These apart, the existing Current account holders are also using this facility for purposes not intended in the DAD Manual e.g., some times financial institutions / banks are apparently making third party payments (which are strictly prohibited as per extant instructions) for faster settlement than what is available under the high value clearing system. It is also found that PDs use this facility for collection of inter-city cheques not only for faster remittance of their funds but also for high cost effectiveness and risk free transfer that the Bank's system affords compared to that offered by commercial banks.

For all these reasons, as also due to the outmoded payment system infrastructure in the country, the demand for access to Current account facility with the Bank has always been very high. However, in the process, the clientele with which the Bank has been interacting has become unwieldy and retail payments being undertaken by the Bank are stretching the resources of the DAD too.

The All-India profile of the Current account holders with the Bank is summarised below. Further details are furnished in Annexure I.

Profile of Current account holders as on April 30, 2001:

Sr. No.	Category	Total No.
1	Scheduled banks (commercial, state co-operative, co-operative & RRBs)	1194
2	Non-scheduled banks (commercial, state co-operative & co-operative)	145
3	PDs / SDs/ MFs	83
4	Insurance companies	20
5	Financial institutions / local & quasi government bodies	152
6	Others (foreign central banks / supra national bodies)	31

The number of Current accounts against the Sr. No. 1 (i.e. scheduled banks) is large due mainly to these banks generally keeping account at more than one RBI office.

Why Review the Current account Facility?

Central Banking authority of a country is generally required to provide Current account facility only to entities who can act as effective agents for transmission of its monetary policy. However, in the Bank, over the years, this facility got extended to variety of non-bank entities, which are not acting as effective agents in transmission of the policy. Further, some of these entities tend to misuse this facility for making third party payments circumventing the instructions of the Bank. Moreover, technological upgradation being undertaken in the financial system spearheaded by the Bank would also obviate the need for non-bank entities to maintain Current account with the Bank, as would be delineated in detail later in the Report. In this connection, in order to critically judge the past and lay a road map for the future it would be a matter of interest to examine the international practices in respect of affording Current account facility by the Central Banking authorities.

Chapter II

International Practices in relation to Current account With the Central Banking Authority

A survey of the practices followed by select Central Banks was carried out to ascertain whether the Central Banks follow well defined common policy as regards the institutions, which are allowed to maintain Current accounts with them. The results of the survey as indicated below reveal that no uniform policy is adopted by the Central Banks as to who can maintain a Current account with them. The permission granted by Central Banks spreads over a wide spectrum ranging from individuals at one end to non-bank financial institutions at the other, though broadly, there is a tendency to restrict it to deposit taking institutions.

It would be worthwhile to look at the practices followed by some select Central Banks in respect of profile of their clients in their Current account system.

(i) **Norges Bank (Central Bank of Norway)**

Norges Bank does not offer any service to non-bank entities such as insurance companies, mutual funds, pension funds, trust funds etc.

(ii) Bank **of England**

Bank of England (BOE) appears to be liberal in extending Current account facility to variety of parties, both financial and non-financial entities as also individuals in its books. At present, BOE provides Current account facility to as many as 7,370 entities comprising staff and former members of the bank – 7,000, Charity Trusts – 250, Public Corporations – 15, Industrial and Commercial Organisations – 65 and Local authorities – 40.

(iii) Swiss **National Bank**

Swiss National Bank maintains accounts of banks, Government (including Swiss Post), foreign central and commercial banks.

(iv) Reserve **Bank of Australia**

The Reserve Bank of Australia does not allow Current account facility to non-bank entities such as insurance companies, mutual funds, pension funds, trust funds, etc.

(v) Reserve **Bank of New Zealand**

Reserve Bank of New Zealand does not offer Current account facility to non-bank entities like insurance companies, mutual funds, etc.

(vi) Bank **of Japan**

Bank of Japan allows Current account facility to Banks, Securities Companies, and Tanshi Companies (funds and forex brokers). Further, as per the provisions of Bank of Japan Law, 1997, the Bank also handles the affairs of the Government relating to currency and finance and maintains the accounts of Government in its books.

(vii) Bank **Negara Malaysia**

Bank Negara Malaysia provides Current account facility to Government, Banks, Discount Houses, Foreign Central Banks and International Financial Institutions. Over and above, finance companies are also allowed to maintain Current account with the Bank for keeping only statutory deposits. Even though the Bank is both regulator and supervisor for insurance companies, they are not allowed to maintain Current account with it. It also does not allow mutual funds to maintain Current account with it.

(viii) Hong **Kong Monetary Authority**

Hong Kong Monetary Authority (HKMA) offers settlement account facility to Licensed Banks, Restricted Licensed Banks and Deposit Taking Companies for purpose of settlement of transactions.

(ix) Monetary **Authority of Singapore**

The Monetary Authority of Singapore allows Current account facility to Government, Banks, Foreign Central Banks and International Financial Institutions.

(x) Bank **of Canada**

The Bank of Canada (BOC) in accordance with the provisions of the Bank of Canada Act offers Current account facility to Government of Canada, Provincial Government, any agency of Government of Canada and any member of Canadian Payments Association (CPA).

As at present, the CPA has 120 members, grouped into four classes, comprising banks (domestic, foreign and foreign bank subsidiaries), Trust and Loan Companies, Credit Union Centrals and Federations and other deposit taking institutions. Besides, Foreign Central Banks and International Financial Organisations such as BIS, IMF and World Bank are also permitted the facility.

The Bank of Canada Act does not allow BOC to open accounts of insurance companies, mutual funds and pension funds; it is generally guided by the eligibility constraints while opening a Current account.

Overview of International Practices

Though the position emerging from practices followed by some European, Austral-asian, and Asian Central Banks in regard to extension of Current account facility to non-bank entities as indicated above depicts a mixed picture, largely, there is a tendency for Central Banks not to grant non-bank entities access to Current account with them. While one of the European Central Banks, viz. Norges Bank (Central Bank of Norway) does not offer any service to non-bank entities, the other Central Bank viz. Bank of England allows various non-bank entities including individuals to maintain Current account with it. Central Banks from Austral-asia viz. Reserve Bank of Australia and Reserve Bank of New Zealand do not allow Current account facility to non-bank entities. Of the four Asian Central Banks covered by the survey, while Monetary Authority of Singapore does not allow non-bank entities on its books, the Hong Kong Monetary Authority, Bank of Japan and the Bank Negara Malaysia allow non-bank entities to have Current account with them for specified purposes. The only Central Bank from the North American continent, i.e. Bank of Canada in our survey allows only those non-bank entities, apart from banks, which provide payment services to the country. It does not allow insurance companies, mutual funds and pension funds to maintain Current account on account of legal restriction in the Central Banking Act.

Chapter III
Rationalisation of Current account Facility in the context of core functions of the Central Bank and Technological Upgradation

The profile of the Current accounts maintained by the banking sector with the Bank, as indicated in Chapter I of this report, includes, apart from scheduled banks (commercial, state co-operative, co-operative and RRBs), non-scheduled banks (state co-operative and co-operative banks) also. The non-scheduled state co-operative banks have been allowed the Current account facility to enable them to avail of financial accommodation from the Bank and also to avail of the Bank's remittance facility. Other institutions like PDs / SDs and MFs maintain Current accounts with the Bank mainly for enabling them to undertake Government securities/money market transactions. Issues related to Insurance Companies have been examined separately in Chapter IV of the Report. Local bodies/quasi government institutions are allowed to open Current account with the Bank mainly for catering to their receipt and payment requirements. Similarly All-India Financial Institutions like IDBI, NABARD, UTI, SIDBI, etc. maintain Current accounts for availing financial accommodation from the Bank whereas non-scheduled banks (commercial, co-operative) keep the accounts for the purpose of participating in clearing operations and availing of the Bank's remittance facility.

With the changing economic environment as well as new technology initiatives being undertaken in the financial system, a time now has come to rationalise the access to Current account facility with the Bank. The Group feels that access to Current account facility with the Bank to entities should be viewed largely in the context of the core functions of a Central Bank. One of the core functions of the Bank is to conduct monetary policy in such a manner so as to ensure the maintenance of a low and stable order of inflation in the country. In practice, this boils down to modulating systemic liquidity in the economy and is executed essentially through banks and PDs. It is, therefore, perceived that since banks are the eventual payment service providers to the rest of the non-banking community as also the essential conduit through which the Bank effects its Liquidity Adjustment Facility (LAF), apart from PDs, as part of conduct of its monetary policy, ideally it is only these two classes of entities who should be given such access. This view is also consistent with the stance adopted in regard to membership under the Real-time Gross Settlement (RTGS) system – a project for upgradation of the payment system – being undertaken by the Bank. It has been planned that only banks as payment service providers to the country should be granted membership under the RTGS system. In this context, it is worthwhile to indicate that the Bank is envisaging to provide an intra-day credit facility – generally an integral component in any RTGS system – only to banks and PDs. It is, therefore, felt in this context that all other non-bank entities except PDs should come as constituents of banks for their settlement of funds and securities, if any.

The perspective of the emerging view is that the Central Bank should accord the Current account facility with it to sub-serve its core functions only. One of the factors that has contributed to the proliferation of Current accounts is the extension of the facility to non-scheduled banks and banking entities whose operations are marginal and do not have systemic impact. Therefore, it is felt that only those entities whose operations have significant systemic impact should be made direct members of the clearing house and only they should be allowed relationship with the Bank by way of Current account facility. If the access to direct membership of the clearing house is made more stringent and limited to entities whose operations impact systemic efficiency, entities like non-scheduled banks would have to be withdrawn from the clearing house membership and hence from the Current account facility. Sub-membership in the clearing house through a scheduled bank (commercial / state co-operative / co-operative) could be the alternative for such entities. As the primary membership of the clearing house is one of the enabling factors for grant of Current account facility with the Bank, the Group feels that, the issue of restricting primary membership of the clearing house **only to** scheduled banks may be got examined separately.

It is observed that some banks maintain multiple Current accounts with the Bank at the same centre. The banks should be allowed to maintain only one Current account at the Bank's office where they do not have a principal account and at the office where they maintain their principal account, they should be allowed to open only one additional account (i.e. secondary account) for putting through their other transactions.

These apart, the fact that non-bank entities (viz., financial institutions, mutual funds and corporates) are gradually being phased out of call money market and the technological upgradation task taken up in the area of payment system, particularly the establishment of the Clearing Corporation, computerization of Public Debt Offices instituting a Negotiated Dealing System (PDO & NDS), Structured Financial Messaging System (SFMS) and RTGS System, etc. should also enable us to gradually remove these entities from this facility. When these systems are in place, the essential notion behind permitting access to Current account facility with the Bank to non-bank entities, i.e. to have same day settlement as well as same day use of funds arising out of call/notice money transactions, would no longer be applicable. Simultaneously, their transactions in repo/reverse repo market as also in other money market instruments would be largely facilitated by the establishment of Clearing Corporation and hence they would no longer require the Current account facility from the Bank. Since the RTGS system would also provide a facility to non-bank entities to send their transactions for real-time settlement across the banks' accounts, the need currently felt by them for having a Current account with the Bank may, therefore, no longer persist.

It may be worthwhile to indicate here that the Clearing Corporation will be the central counter party on all settlement obligations on the net position arrived at after netting off all transactions undertaken by clearing members in Government securities and other instruments. The final transfer of funds and securities in respect of Government securities transactions will be effected by DAD and PDO respectively of the Bank while in respect of other instruments, this task would be assigned to settlement banks and concerned depositories. Thus, it will not be necessary for non-bank entities to have a Current account/SGL account with the Bank for settlement of funds/securities transactions.
In other words, non-bank entities can ensure settlement of their transactions through their bankers without themselves having a Current account with the Bank. This, however, will be possible to achieve only after Clearing Corporation starts functioning in a full-fledged manner under Delivery versus Payment (DvP) III environment.[1]

[1] Under DvP III environment, both securities and funds are settled on net basis.

While it is envisaged to phase out eventually non-bank entities from the Current account facility with the Bank, with increasing private initiatives in the area of instituting clearing mechanisms viz. Clearing Corporation as well as depository institutions to settle growing volume of financial transactions, it is already becoming apparent that these institutions, particularly the former class, would still like to settle on the books of the Bank not only to ensure risk-free and irrevocable funds settlement but also to eliminate the "float" that might accrue to the settlement bank if it is other than the Bank. Such a trend is already evident as National Securities Clearing Corporation Ltd. (NSCCL) promoted by the National Stock Exchange (NSE) has worked out such an arrangement to have a Current account facility with the Bank. Similar requests from these classes of institutions representing various segments of financial market are likely to be received in future and **in the interest of principled consistency and to ensure that the Current account facility with the Central Banking authority serves its core objectives, it is desirable that the Bank declares that the Current account facility with it will henceforth be available only to two categories of entities which are members of the Bank's payment system and conduits of Open Market Operations.**

The Group, therefore, observes that non-bank entities such as insurance companies, mutual funds etc., should be phased out from the Bank's Current account system gradually. Such phasing out should be in consultation with these non-banking entities in order to ensure their migration from the Bank's Current account system as smooth as possible.

Chapter IV

Access of Insurance Companies to Current account Facility

Under the amended Insurance Regulatory and Development Authority (IRDA) Act, 1999, banks and Non-Banking Financial Companies (NBFCs) have been permitted to enter into insurance business with risk participation subject to certain safeguards. In terms of amended Section 7(1) of the Insurance Act, 1938, all insurance companies (in respect of the insurance business carried on by them in India) are now required to deposit and keep deposited with the Bank in one of its offices in India, for and on behalf of the Central Government a stipulated amount either in cash or in (unencumbered) approved securities or partly in cash and partly in securities. At present insurance companies have been allowed to open Current account and SGL account only for the limited purpose of complying with the provisions of Section 7(1) of the Insurance Act, 1938 (as amended), at New Delhi Office of the Bank with a minimum balance of Rs. one lakh.

Some insurance companies like LIC, GIC etc. have been allowed to maintain regular Current account with the Bank to enable them to put through the call money and Government securities transactions. Consequent to the latest amendments to the Insurance Act, new insurance companies are approaching the Bank with a request to allow them to maintain a regular Current account/SGL account for the same purpose. The question whether insurance companies should be allowed to have an access to the Current account facility with the Bank needs to be examined in the context of the core functions of the Bank.

Even though the amended Insurance Act, 1938 prescribes that all insurance companies have to deposit with the Bank either in cash or in Government securities a stipulated amount as statutory deposit, this requirement can be met by depositing the said amount with an agent of the Bank under Section 45(1) and (2) of the RBI Act, 1934 read with the GOI notification dated 17th April 2000. Therefore, the Group feels that there is no need for insurance companies to keep the required statutory deposits only with the Bank.

As has been analysed more elaborately in Chapter III, restricting the Current account facility to one set of existing constituents of the Bank (i.e. scheduled banks and PDs) and phasing out the rest over a period of time should be looked at essentially from the vantage of a) monetary control exercised by the Bank and, b) entities participating in the payment systems in the economy (primarily banks). On both these counts, insurance companies do not qualify. Therefore, the Group feels that they should be phased out from the Current account facility with the Bank. This was also broadly expressed by the Internal Group set up by MPD to examine the use of RBI's Current account facility for money market operations, wherein Group has observed – "Permitting mutual funds and other non-bank entities to put through call money market transactions through the RBI Current account may facilitate such transactions. However, it would in no way help either the development of the money market or enhance the overall efficiency of the market." The Group further observed – "As the Central Bank of the country, the RBI should primarily concentrate on core central banking functions. It would not be appropriate for a Central Bank to undertake retail banking activities and get into competition in this area with commercial banks, which are working under its overall supervision and control". Moreover, since settlement of funds would improve substantially after establishment of Clearing Corporation and RTGS system as indicated in Chapter III, maintenance of Current account by them with the Bank would no longer be required.

The Group is therefore of the view that the Bank, in consultation with Insurance Regulatory and Development Authority and affected entities, should transfer their existing Current accounts/SGL accounts maintained with the Bank to a scheduled bank identified for the purpose or any other agency bank referred to in Section 45(1) of the Act ibid.

Chapter V
Minimum Balance Requirement for Current account with RBI

The Current accounts maintained by banks and non-bank entities with the Bank under various categories and the purpose for which they are maintained are indicated in Annexure I.

The banks maintaining 'Secondary' accounts are required to keep a minimum balance of Rs.one lakh which is not accounted for the purpose of CRR. The minimum balance for Subsidiary accounts is prescribed by the local clearing houses. For other accounts, the Bank stipulates the minimum balance requirement at the time of opening of the accounts. It would be worth noting that the minimum balance of Rs.one lakh for the 'Secondary' account with the Bank was stipulated at the time of inception of the Bank in 1935 and has remained unchanged over the last 66 years. The same threshold limit of Rs.one lakh was also prescribed for the Current accounts of non-bank entities like Mutual Funds, Insurance Companies, etc. with the Bank.

The office noting dated July 21, 1943 in regard to stipulation of minimum balance of Rs.one lakh in respect of 'Secondary' account with the Bank reads as under:
" ……The Reserve Bank was bound under the Act to accept only one account in the name of each scheduled bank and that it would consent to second one being opened if it was a remunerative one carrying a reasonable balance".
The noting reads further, as -
"We should not do away with the minimum deposit of Rs.one lakh required to be maintained in the secondary account which restricts to a certain extent the opening of a secondary account and also remunerates us partially for the labour and expense involved in maintaining the 'Secondary' account."

It may be noted that the minimum balance of Rs.one lakh required to be maintained by the scheduled banks in 'Secondary' account is excluded for the purpose of maintaining statutory deposit under Section 42(1) of the RBI Act. Moreover, the stipulation of minimum balance requirement in respect of 'Secondary' account has been allowed to remain unchanged at Rs.one lakh for many years. Even when the issue to allow mutual funds to maintain Current account with the Bank was examined in 1998, the minimum balance requirement for the purpose did not undergo any upward revision.

Taking into account the rate of inflation during the long intervening years as also the need to recover at least partially the service cost of the account, the Group maintains that the present minimum balance requirement for Current account with the Bank needs to be adjusted upward. The operational problem for undertaking such exercise is that price indices are not available on a continuous, consistent basis since 1935. Taking into account the price rise between the period 1935 to 1970 and the rise in inflation reflected by variations in price indices from 1971 to 2001, the Group is of the view that the minimum balance for maintaining any Current account with the Bank other than for the purpose of keeping statutory deposits, should be raised from the present level of Rs. one lakh to Rs.100 lakhs with immediate effect. It is worthwhile to indicate here that this would also be consistent with the practice followed in other countries that with the progressive scaling down of CRR, the Central Bank should start charging reasonable commercial rates for the services rendered by it so as to remain strong in terms of its Balance Sheet.

Chapter VI

Summary and Recommendations of the Group

Background

The facility of Current account with the Bank was initially extended to Scheduled commercial banks to facilitate (i) fulfilment of their Statutory obligation, (ii) settlement of their clearing house positions and (iii) transactions with the Bank/Government. Scheduled banks and Government of India were the first entities that were given this facility. Over a period however, diverse entities like State Governments, insurance companies, financial institutions, mutual funds, Primary Dealers, etc., were extended this facility. The perceived advantage in having Current account with the Bank is the fast and risk free transfer of funds at almost zero cost. The Bank assuming the role of being depository for Government Securities has been another factor. In the interregnum, the role of the Bank has also seen substantial change leading to the Bank taking proactive measures for development of money market, Government Securities market, etc. Due to these, the number of Current accounts maintained by the Bank for various banking and non-banking entities at 1625 has become unwieldy.

It has been observed that the Current account facility with the Bank has been helping various entities in settlement of their transactions rather than contributing to the conduct of core functions by the Bank. It has also been observed, of late, that more and more entities desire to have Current account with the Bank for faster settlement of their transactions almost at no cost as stated above.

It was, therefore, felt necessary at this juncture to make critical assessment of the need to continue the Bank's Current account facility to various entities stated above in the context of conduct of its core central banking functions as also in the context of technological developments in the financial system spearheaded by the Bank.

Keeping in view the fact that Current account facility should be extended only to those entities who can act as effective agents for transmission of the Bank's monetary policy, it is felt that the essential objectives behind granting this facility are gradually being diluted. (Chapter I)

International Experiences

With regard to international experiences, the position emerging from practices followed by some European, Austral-asian and Asian Central Banks in this regard depicts a mixed picture. **However, there is, largely a tendency for Central Banks not to grant non-bank entities access to Current account with them.(Chapter II)**

Reasons for Rationalisation of Access to Current account Facility

As could be seen from the profile of Current accounts with the Bank given in Annexure I, that a large number of Current accounts are maintained by the Bank on behalf of diverse entities for diverse purposes. Some entities whose operations do not have major systemic impact also maintain account with the Bank. In addition to these, certain institutions, other than the Government, also maintain Current accounts with the Bank to meet their receipt and payment requirements.

The existence of a large bank network and current technological upgradation, including proposed introduction of Clearing Corporation, PDO/s computerization, NDS, SFMS and RTGS, would obviate the need for having Current account with the Bank by some of the above entities. Further, the Bank should allow the Current account facility for facilitating the conduct of its core functions and hence such facility should be restricted to only those entities through whom the Bank transmits its monetary policy measures. It is, therefore, perceived that since banks are the eventual payment service providers to the rest of the non-banking community as also the essential conduit through which the Bank effects its Liquidity Adjustment Facility (LAF) apart from PDs for monetary policy transmission and to meet an efficient payment system obligation, ideally it is only these two classes of entities who should be given such access. This view is also consistent with the stance adopted in regard to membership under Real-time Gross Settlement (RTGS) system. It is, therefore, felt, in this context, that all other non-bank entities except PDs should come as constituents of banks for settlement of their funds and securities, if any.
There is also a need for reviewing the direct membership criteria for clearing house as such membership, where the Bank has an office, entitles an entity to have a Current account with the Bank. Further, an entity should not be allowed to maintain multiple Current accounts at a centre, other than the centre where it maintains its principal account.

While it is envisaged to phase out eventually non-bank entities from the Current account facility with the Bank, with increasing initiatives in the area of instituting clearing mechanisms viz. Clearing Corporation as well as depository institutions to settle growing volume of financial transactions, it is already becoming apparent that these institutions, particularly the former class, would still like to settle on the books of the Bank not only to ensure risk-free and irrevocable funds settlement but also to eliminate the "float" that might accrue to the settlement bank if it is other than the Bank.
Therefore, in the interest of principled consistency and to ensure that the Current account facility with the Central Banking authority serves its core objectives, it is desirable that the Bank declares that the Current account facility with it will henceforth be available only to two categories of entities who are members of the Bank's payment system and conduits for open market operations.

The Group, therefore, also commends that non-bank entities such as insurance companies, mutual funds, etc., should be gradually phased out from the Bank's Current account system. Such phasing out should be in consultation with these non-banking entities in order to ensure their migration from the Bank's Current account system as smooth as possible.(Chapter III)

<u>Case for Insurance Companies</u>

The question whether Insurance companies, one of the non-bank constituents, should be allowed to have an access to the Current account facility with the Bank has been examined with reference to Section 45(1) and (2) of the RBI Act, 1934 read with the GOI notification dated 17th April, 2000 and the Group feels that there is no obligation for Insurance companies to keep the statutory deposit **<u>only</u>** with the Bank. Further, they neither act as effective agents for transmission of the Bank's monetary policy nor provide payment services to the public. Since on both these counts Insurance companies do not qualify, **the Group is of the view that the Bank, in consultation with the Insurance Regulatory and Development Authority and affected entities, should transfer their existing Current accounts / SGL accounts maintained with it to a scheduled bank identified for the purpose or any other agency bank referred to in Section 45(1) of the Act ibid.**

<u>Minimum Balance Requirement for Current account with RBI</u>

All banks maintaining 'Secondary' account with the Bank as also non-bank entities maintaining Current account with the offices of the Bank are required to maintain a minimum balance of Rs one lakh. It may be worthwhile to note that the minimum balance of Rs one lakh for having 'Secondary' account with the Bank was stipulated at the time of inception of the Bank in 1935 and has remained unchanged over the last 66 years. However, taking into account the rate of inflation during the long intervening years as also the need to recover at least partially the service cost of the account, the Group maintains that the present minimum balance requirement for Current account with the Bank needs to be adjusted upward. Therefore, considering the price rise between the period 1935 to 1970 and the rise in inflation reflected by variations in price indices from 1971 to 2001, **the Group is of the view that the minimum balance for maintaining any Current account with the Bank other than for the purpose of keeping statutory deposits, should be raised from the present level of Rs. one lakh to Rs.100 lakhs with immediate effect. (Chapter V)**

Annexure I

Profile of Current accounts with the Bank as on April 30, 2001

Type of A/c	A/c holders	Total No.	Purpose	Proposed change
Principal A/c	Scheduled Commercial Banks	99	CRR	Continue
	Scheduled State Co-operative Banks	16	CRR	Continue
	Scheduled Co-operative Banks	51	CRR	Continue
	Regional Rural Banks	196	CRR	Continue
Secondary A/c	Scheduled Commercial Banks	39	Clg / Gsec /CM/Misc.	Continue
	Scheduled State Co-operative Banks	2	- do -	Continue
	Scheduled Co-operative Banks	-	- do -	Continue
	Regional Rural Banks	-	- do -	Continue
Subsidiary A/c	Scheduled Commercial Banks	750	- do -	Continue
	Scheduled State Co-operative Banks	11	- do -	Continue
	Scheduled Co-operative Banks	30	- do -	Continue
Current A/c	Non-scheduled Commercial Banks	-	- do -	Close
	Non-scheduled State Co-operative Banks	12	- do -	Close
	Non-scheduled Co-operative Banks	133	- do -	Close
	Primary Dealers	33	CM	Continue
	Satellite Dealers	10	Gsec	Close
	Mutual Funds	40	CM	Close
	Insurance Companies	20	CM /Gsec	Close
	Domestic Financial Institutions	118	CM/ Gsec	Close
	Foreign Central Banks / Supra National Bodies	31	Invt. in Gsec,Tran	Continue
	Other Institutions	34	Tran	Close

CRR: Cash Reserve Ratio
Clg : Inter-bank clearing and returns
Misc: Government payments- inter-Current account transactions approved by RBI
CM : Call Money market operations
Gsec: Government securities transactions
Tran: Receipt and payment

Annexure II

DEPARTMENT OF GOVERNMENT AND BANK ACCOUNTS
(Division of Bank Accounts)

Rationalisation of Current account Facility in RBI -
Constitution of a Group

At present the Bank maintains Current accounts of (i) Scheduled Commercial Banks (ii) Non-Scheduled Commercial Banks (iii) Scheduled State Co-operative Banks (iv) Non-Scheduled State Co-operative Banks (v) State Land Development Banks (vi) Other Co-operative Banks and (vii) Scheduled Co-operative Banks.

2. The Bank also maintains Current accounts in the "Other Deposit Ledger” of local bodies, Quasi-Government Institutions, Foreign Central Banks, International Organisations, Indian and Foreign Financial Institutions, Mutual Funds, Primary Dealers, Satellite Dealers etc.

Current account facility in RBI is generally extended to banks to fulfil their statutory obligations, settlement of transactions with RBI / Government and inter-bank transactions. Over the years, certain non-bank entities are being extended Current account facility for some other purposes such as settlement of transactions in call money/securities markets.

3. We have received requests from certain newly set-up insurance companies for extending Current account facility to them. As per guidelines issued by IRDA, insurance companies are required to make investments in Government securities or maintain Current account with RBI in conformity with Regulation (Section-7) of Insurance Act. Such deposits being of statutory nature, we have allowed insurance companies to open Current account and/or SGL account for holding statutory balances. In addition to this, these companies are now asking for regular Current account facility for settlement of securities transactions and participation in call money market. It appears from the telephonic conversation with IRDA Authorities that they are in favour of extending Current account / SGL account facility to newly set-up insurance companies.

4. The INFINET Regulations stipulate that membership of INFINET shall be opened to all the financial institutions that are maintaining Current account and / or SGL account with the Bank.

5. Thus it is likely that we will be receiving number of requests from various entities for extending Current account facility to them. At present there are about 300 entities maintaining Current account at our Mumbai DAD. This number is likely to increase further if we consider extending facilities to the newly opened insurance companies as also entities, which may be seeking membership of INFINET. This demand for access to Current account facility is showing an increasing trend as it enables account holders in channeling their funds through the RBI with speed, risk free and almost at zero cost.

6. Our instructions now stipulate that banks as also other institutions for maintaining their accounts with RBI (other than principal account and subsidiary account) should

maintain a minimum balance of Rs.one lakh. There is a need for raising this threshold of the minimum balance in the Current account as the same was fixed long time back almost 2/3 decades ago.

7. It appears that the Bank should move away from the area of retail banking which can very well be taken care of by the commercial banking net-work and should concentrate on core central banking functions including acting as the final settlement agency for the payment system in the country. It is also generally accepted view that RBI as a central bank should reduce areas where customer has to come in direct contact with the Bank.

8. It is, therefore, suggested that an inter-departmental Group comprising representatives (officers of the rank of General Manager) from DGBA, DBOD, DIT, MPD, IDMC and Mumbai Office should be constituted to comprehensively examine these issues. The terms of reference for this Group could be as follows:

i) Study the objectives enshrined in the DAD Manual vis-à-vis the actual practice in regard to giving non-bank entities access to Current account facility with RBI;

ii) Study International practices in this regard;

iii) Suggest ways for rationalising access to Current account facility with RBI keeping in view RBI's prospective liquidity management facility, the current technology initiatives in the form of launching of Real Time Gross Settlement (RTGS) system, computerisation of PDO/PAD/DAD, INFINET, establishment of Clearing Corporation etc;

iv) Suggest the minimum balance requirement for banks and other non-bank entities in the context of changed scenario; and

v) Examine such other issues as the Group deems fit for the purpose.

9. The Group may be advised to submit its report within a period of two months from the date of its first meeting. However, it should submit a report on the desirability of extending Current account facility to the newly set-up insurance companies within a period of one week from the date of its first meeting. DGBA will be Co-ordinator for the inter-departmental Group.

For consideration please.

Sd/-

(K.B. Chakraborti)
CGM-in-Charge
16.02.2001

Annexure III

Inter-Departmental Group to Study Rationalisation of Current account Facility with Reserve Bank of India

Members of the Group

1. Shri K.W. Korgaonkar, General Manager, Department of Government and Bank Accounts, RBI, Mumbai, Co-ordinator

2. Shri R.C. Agrawal, General Manager, Department of Banking Operations and Development, RBI, Mumbai

3. Shri G.M. Devasahayam, General Manager (Banking), RBI, Mumbai Office

4. Sheri Amitava Sardar, Director, Monetary Policy Department, RBI, Mumbai

5. Shri A. Narayana Rao, General Manager, Department of Information Technology, RBI, Mumbai

6. Shri A. Sambasiva Rao, General Manager, Internal Debt Management Cell, RBI, Mumbai