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AS INTRODUCED IN LOK SABHA

13 MAY 2005

Bill No. 76 of 2005

THE RESERVE BANK OF INDIA (AMENDMENT) BILL, 2005

A
BILL

further to amend the Reserve Bank of India Act, 1934.

Be it enacted by Parliament in the Fifty-sixth Year of the Republic of India as follows:—

1. (1) This Act may be called the Reserve Bank of India (Amendment) Act, 2005.

Short title and commencement.

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(2) It shall come into force on such date as the Central Government may, by notification in the Official Gazette, appoint; and different dates may be appointed for different provisions of this Act.

2 of 1934.

2. In section 17 of the Reserve Bank of India Act, 1934 (hereinafter referred to as the principal Act),—

Amendment of section 17.

(i) after clause (6), the following clause shall be inserted, namely:—

“(6A) dealing in derivatives, and, with the approval of the Central Board, in any other financial instrument.

Explanation.— For the purposes of this clause, “derivative” means an instrument, to be settled at a future date, whose value is derived from change in one or a combination of more than one of the following underlyings, namely:—

(a) interest rate,

(b) price of securities of the Central Government or a State Government or of such securities of a local authority as may be specified in this behalf by the Central Government, 5

(c) price of foreign securities,

(d) foreign exchange rate,

(e) index of rates or prices, 10

(f) credit rating or credit index,

(g) price of gold or silver coins, or gold or silver bullion, or

(h) any other variable of similar nature;

(ii) after clause (12A), the following clauses shall be inserted, namely:—

“(12AA) lending or borrowing of securities of the Central Government or a State Government or of such securities of a local authority as may be specified in this behalf by the Central Government or foreign securities; 15

(12AB) dealing in repo or reverse repo:

Provided that lending or borrowing of funds by way of repo or reverse repo shall not be subject to any limitation contained in this section. 20

Explanation.— For the purposes of this clause,—

(a) “repo” means an instrument for lending funds by purchasing securities of the Central Government or a State Government or of such securities of a local authority as may be specified in this behalf by the Central Government or foreign securities, with an agreement to resell the said securities on a mutually agreed future date at an agreed price which includes interest for the funds lent; 25

(b) “reverse repo” means an instrument for borrowing funds by selling securities of the Central Government or a State Government or of such securities of a local authority as may be specified in this behalf by the Central Government or foreign securities, with an agreement to repurchase the said securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed;” 30

Amendment of
section 42.

3. In section 42 of the principal Act,— 35

(i) in sub-section (1),

(a) for the words, brackets and figure “three per cent. of the total of the demand and time liabilities in India of such bank as shown in the return referred to in sub-section (2)”, the words, brackets and figure “such per cent. of the total of the demand and time liabilities in India of such bank as shown in the return referred to in sub-section (2), as the Bank may from time to time, having regard to the needs of securing the monetary stability in the country, notify in the Gazette of India” shall be substituted; 40

(b) the proviso shall be omitted;

(ii) sub-sections (1AA) and (1B) shall be omitted. 45

4. After Chapter III C of the principal Act, the following Chapter shall be inserted, namely:—

Insertion of new Chapter III D.

“CHAPTER III D

REGULATION OF TRANSACTIONS IN DERIVATIVES, MONEY MARKET INSTRUMENTS
OR SECURITIES, ETC.

45U. For the purposes of this Chapter,—

Definitions.

(a) “derivative” means an instrument, to be settled at a future date, whose value is derived from change in interest rate, foreign exchange rate, credit rating or credit index, price of securities (also called “underlying”), or a combination of more than one of them and includes interest rate swaps, forward rate agreements, foreign currency swaps, foreign currency-rupee swaps, foreign currency options, foreign currency-rupee options or such other instruments as may be specified by the Bank from time to time;

(b) “money market instruments” include call or notice money, term money, repo, reverse repo, certificate of deposit, commercial usance bill, commercial paper and such other debt instrument of original or initial maturity up to one year as the Bank may specify from time to time;

(c) “repo” means an instrument for lending funds by purchasing securities with an agreement to resell the securities on a mutually agreed future date at an agreed price which includes interest for the funds lent;

(d) “reverse repo” means an instrument for borrowing funds by selling securities with an agreement to repurchase the securities on a mutually agreed future date at an agreed price which includes interest for the funds borrowed;

(e) “securities” means securities of the Central Government or a State Government or such securities of a local authority as may be specified in this behalf by the Central Government and, for the purposes of “repo” or “reverse repo”, include corporate bonds and debentures.

45V. (1) Notwithstanding anything contained in the Securities Contracts (Regulation) Act, 1956 or any other law for the time being in force, transactions in such derivatives, as may be specified by the Bank from time to time, shall be valid, if at least one of the parties to the transaction is the Bank, a scheduled bank, or such other agency falling under the regulatory purview of the Bank under the Act, the Banking Regulation Act, 1949, the Foreign Exchange Management Act, 1999, or any other Act or instrument having the force of law, as may be specified by the Bank from time to time.

Transactions in derivatives.

(2) Transactions in such derivatives, as had been specified by the Bank from time to time, shall be deemed always to have been valid, as if the provisions of sub-section (1) were in force at all material times.

45W. (1) The Bank may, in public interest, or to regulate the financial system of the country to its advantage, determine the policy relating to interest rates or interest rate products and give directions in that behalf to all agencies or any of them, dealing in securities, money market instruments, foreign exchange, derivatives, or other instruments of like nature as the Bank may specify from time to time;

Power to regulate transactions in derivatives, money market instruments, etc.

Provided that the directions issued under this sub-section shall not relate to the procedure for execution or settlement of the trades in respect of the transactions mentioned therein, on the Stock Exchanges recognised under section 4 of the Securities Contracts (Regulation) Act, 1956.

(2) The Bank may, for the purpose of enabling it to regulate agencies referred to in sub-section (1), call for any information, statement or other particulars from them, or cause an inspection of such agencies to be made.

Duty to comply with directions and furnish information.

45X. It shall be the duty of every director or member or other body for the time being vested with the management of the affairs of the agencies referred to in section 45W to comply with the directions given by the Bank and to submit the information or statement or particulars called for under that section."

STATEMENT OF OBJECTS AND REASONS

Financial sector reforms are marking steady progress in India. The Indian financial markets now have more products, participants and better liquidity than before. For more operational flexibility, the Reserve Bank of India needs to have enabling powers to use a larger variety of financial instruments than hitherto.

2. The volatility in the influx of foreign exchange and the market conditions in a fast changing economy, can be expected to continue in future as the financial sector makes more and more progress. To cope with any unforeseen eventualities in future, such as excess or lack of liquidity in the banking system and for effective conduct of monetary policy, there is a need to enable Reserve Bank of India to determine the Cash Reserve Ratio (CRR) for scheduled banks without any floor or ceiling. Globally, many Central Banking authorities have such powers. Further, in the context of the conduct of monetary policy becoming more market-based through progressive use of indirect instruments, the Reserve Bank of India needs more flexibility to set Cash Reserve Ratio, which is one of the two statutory pre-emptions in respect of the resources of banks.

3. Over-the-counter derivatives play a crucial role in reallocating and mitigating the risks of corporates, banks and other financial institutions. The ambiguity regarding their legal validity has inhibited the growth and stability of the market for such derivatives. It has become essential to provide for clear legal validity of such contracts.

4. At present, under section 29A of the Securities Contracts (Regulation) Act, 1956, the Central Government has delegated to the Reserve Bank of India, by a notification, the powers exercisable by it under section 16 of that Act, for regulating the transactions in money market and other instruments. Therefore, more effective regulation of the markets for interest rate contracts, including Government securities and money-market instruments as also derivatives, it is necessary to confer specific powers on the Reserve Bank of India, under the Reserve Bank of India Act, 1934, to lay down policy and to issue directions to agencies operating in these contracts, securities and derivatives.

5. It is, therefore, considered necessary to suitably amend the Reserve Bank of India Act, 1934. The salient features of the Bill which seeks to amend the RBI Act are as follows:—

(a) define the expressions, 'derivative', 'repo' and 'reverse repo' in section 17 of the purposes of the business of the Bank and differently in new Chapter IIID for the purposes of regulatory powers of the Bank;

(b) empower the Reserve Bank of India to deal in derivatives, to lend or borrow securities and to undertake repo or reverse repo;

(c) remove the lower floor and upper ceiling of Cash Reserve Ratio (CRR) and to provide flexibility to RBI to specify CRR;

(d) remove ambiguity regarding the legal validity of derivatives;

(e) empower RBI to lay down policy and issue directions to any agency dealing in various kinds of contracts in respect of Government securities, money-market instruments, derivatives, etc., and to inspect such agencies.

6. The Bill seeks to achieve the above objects.

NEW DELHI;
The 9th May, 2005.

P. CHIDAMBARAM.

ANNEXURE

EXTRACTS FROM THE RESERVE BANK OF INDIA ACT, 1934

(2 OF 1934)

Business which
the Bank may
transact.

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17. The Bank shall be authorised to carry on and transact the several kinds of business hereinafter specified, namely:—

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Cash reserves
of scheduled
banks to be
kept with the
Bank.

42. (1) Every bank included in the Second Schedule shall maintain with the Bank an average daily balance the amount of which shall not be less than three per cent. of the total of the demand and time liabilities in India of such bank as shown in the return referred to in sub-section (2):

Provided that the Bank may, by notification in the Gazette of India, increase the said rate to such higher rate as may be specified in the notification so however that the rate shall not be more than twenty per cent. of the total of the demand and time liabilities.

Explanation.—For the purposes of this section,—

(a) "average daily balance" shall mean the average of the balances held at the close of business on each day of a fortnight;

(b) "fortnight" shall mean the period from Saturday to the second following Friday, both days inclusive;

(c) "liabilities" shall not include—

(i) the paid-up capital or the reserves or any credit balance in the profit and loss account of the Bank;

(ii) the amount of any loan taken from the Bank or from the Exim Bank or from the Reconstruction Bank or from the National Housing Bank or from the National Bank or from the Small Industries Bank;

(iii) in the case of a State co-operative bank, also any loan taken by such bank from a State Government or from the National Co-operative Development Corporation established under the National Co-operative Development Corporation Act, 1962 and any deposit of money with such bank representing the reserve fund or any part thereof maintained with it by any co-operative society within its area of operation;

26 of 1962.

(iv) in the case of a State co-operative bank, which has granted an advance against any balance maintained with it, such balance to the extent of the amount out-standing in respect of such advance;

(v) in the case of a Regional Rural Bank, also any loan taken by such bank from its Sponsor Bank;

(d) the aggregate of the "liabilities" of a scheduled bank which is not a State co-operative bank, to,—

(i) the State Bank;

(ii) a subsidiary bank as defined in section 2 of the State Bank of India (Subsidiary Banks) Act, 1959;

38 of 1959.

(iii) a corresponding new bank constituted by section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970;

5 of 1970.

40 of 1980. (iii) a corresponding new bank constituted by section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980;

10 of 1949. (iv) a banking company as defined in clauses (c) of section 5 of the Banking Regulation Act, 1949;

(v) a co-operative bank; or

(vi) any other financial institution notified by the Central Government in this behalf,

shall be reduced by the aggregate of the liabilities of all such banks and institutions to the scheduled bank;

(e) the aggregate of the "liabilities" of a scheduled bank which is a State Co-operative Bank, to,—

(i) the State Bank;

38 of 1959. (ii) a subsidiary bank as defined in section 2 of the State Bank of India (Subsidiary Banks) Act, 1959;

5 of 1970. (iii) a corresponding new bank constituted by section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970;

40 of 1980. (iiiia) a corresponding new bank constituted by section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980;

10 of 1949. (iv) a banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949; or

(v) any other financial institution notified by the Central Government in this behalf,

shall be reduced by the aggregate of the liabilities of all such banks and institutions to the State co-operative banks.

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(IAA) Notwithstanding anything contained in sub-section (1) or sub-section (1A), it shall not be necessary for any scheduled bank to maintain with the Bank any balance which shall be more than twenty per cent. of the total of its demand and time liabilities as shown in the return referred to in sub-section (2).

(1B) Where any scheduled bank maintains, in pursuance of a notification issued under the proviso to sub-section (1) or under sub-section (1A), any balance with the Bank the amount of which is not less than that required to be maintained by such notification, the Bank may pay to the scheduled bank interest at such rate or rates as may be determined by the Bank from time to time on the amount by which such balance actually maintained is in excess of the balance which the scheduled bank would have to maintain, if no such notification was issued:

Provided that no interest shall be payable on any such amount actually maintained as is in excess of the balance required to be maintained by or under sub-section (1) or under sub-section (1A):

Provided further that where the Bank does not, under sub-section (5), demand the payment of the penalty imposed by sub-section (3), it may pay interest at such rate or rates as may be determined by the Bank from time to time on the amount actually maintained with it by the scheduled bank, notwithstanding that such amount is less than the balance required to be maintained in pursuance of a notification issued under the proviso to sub-section (1) or under sub-section (1A).

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further to amend the Reserve Bank of India Act, 1934.

(Shri P. Chidambaram, Minister of Finance)