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**STANDING COMMITTEE
ON FINANCE
(2005-2006)**

FOURTEENTH LOK SABHA

**MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC AFFAIRS)**

**THE RESERVE BANK OF INDIA
(AMENDMENT) BILL, 2005**

TWENTY FIFTH REPORT



**LOK SABHA SECRETARIAT
NEW DELHI**

December, 2005 / Agrahayana, 1927 (Saka)

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(AMENDMENT) BILL, 2005

Presented to Lok Sabha on 1.12.2005

Laid in Rajya Sabha on 1.12.2005



LOK SABHA SECRETARIAT
NEW DELHI

December, 2005/Agrahayana, 1927 (Saka)

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COMPOSITION OF STANDING COMMITTEE ON
FINANCE—2005-2006

Maj. Gen. (Retd.) B.C. Khanduri — *Chairman*

MEMBERS

Lok Sabha

2. Shri Jaswant Singh Bishnoi
3. Shri Gurudas Dasgupta
4. Shri Bhartruhari Mahtab
5. Shri Shyama Charan Gupta
6. Shri Gurudas Kamat
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20. Shri Vijoy Krishna
21. Shri Magunta Sreenivasulu Reddy

Rajya Sabha

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31. Shri Mangani Lal Mandal

SECRETARIAT

- | | | |
|-----------------------------|---|-----------------------------|
| 1. Shri John Joseph | — | <i>Secretary</i> |
| 2. Dr. (Smt.) P.K. Sandhu | — | <i>Additional Secretary</i> |
| 3. Shri A.K. Singh | — | <i>Joint Secretary</i> |
| 4. Shri S.B. Arora | — | <i>Deputy Secretary</i> |
| 5. Shri T.G. Chandrashekhar | — | <i>Under Secretary</i> |

INTRODUCTION

I, Chairman of the Standing Committee on Finance having been authorised to submit the Report on their behalf present this Twenty Fifth Report on the Reserve Bank of India (Amendment) Bill, 2005.

2. The Reserve Bank of India (Amendment) Bill, 2005, introduced in Lok Sabha on 13th May, 2005, was referred to the Committee on 17th May, 2005 for examination and report thereon, by the Hon'ble Speaker, Lok Sabha under Rule 331E of the Rules of Procedure and Conduct of Business in Lok Sabha.

3. The Committee obtained written information on various provisions contained in the aforesaid Bill from the Ministry of Finance (Department of Economic Affairs), who also briefed them at their sitting held on 14th July, 2005.

4. Written views/memoranda were received from Confederation of Indian Industry (CII), Punjab National Bank, Oriental Bank of Commerce, State Bank of India, HDFC Bank Ltd., ICICI Bank, Fixed Income Money Markets and Derivatives Association (FIMMDA), Indian Banks' Association, All India Bank Officers Confederation, National Confederation of Bank Employees, Bank Employees Federation of India, Corporation Bank Officers Organisation and State Bank of India Officers' Association (Patna Circle).

5. The Committee, at their sitting held on 9 August, 2005 heard the views of the representatives of ICICI Bank Ltd. and Oriental Bank of Commerce. At their sitting held on 10th August 2005, the Committee heard the views of representatives of Punjab National Bank, Indian Banks' Association, Fixed Income Money Markets and Derivatives Association and Confederation of Indian Industry.

6. On 22nd August, 2005 the Committee heard the views of State Bank of India, Bank of India and HDFC Bank Ltd.

7. The Committee took oral evidence of the Ministry of Finance (Department of Economic Affairs) on 30 September, 2005.

8. The Committee considered and adopted the draft report at their sitting held on 7 November, 2005.

9. The Committee wish to express their thanks to the officers of the Ministry of Finance (Department of Economic Affairs), representatives of the Confederation of Indian Industry (CII), Punjab National Bank, Oriental Bank of Commerce, State Bank of India, HDFC Bank Ltd., ICICI Bank, Fixed Income Money Markets and Derivatives Association (FIMMDA), Indian Banks' Association, All India Bank Officers Confederation, National Confederation of Bank Employees, Bank Employees Federation of India, Corporation Bank Officers Organisation and State Bank of India Officers' Association (Patna Circle) for their co-operation in placing before them their considered views and perceptions on the provisions of the Bill and for furnishing written notes and information that the Committee had desired in connection with the examination of the Reserve Bank of India (Amendment) Bill, 2005.

10. For facility of reference, recommendations/observations of the Committee have been printed in thick type.

NEW DELHI;
30 November, 2005
9 Aagrahayana, 1927 (Saka)

MAJ. GEN. (RETD.) B.C. KHANDURI,
Chairman,
Standing Committee on Finance.

REPORT

Background

The Reserve Bank of India was established on April 1 1935 in accordance with the provisions of the Reserve Bank of India Act, 1934. As the Monetary Authority, Regulator and supervisor of the financial system, Manager of foreign exchange and Issuer of currency, the Reserve Bank *inter-alia* discharges the following functions:

- Formulates, implements and monitors the monetary policy.
- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Manages the Foreign Exchange Management Act, 1999.
- Issues and exchanges or destroys currency and coins not in circulation.

2. In addition, the Reserve Bank performs a wide range of promotional functions to support developmental objectives; acts as banker to the Government and to the banks; and performs merchant banking functions for Central and State Governments.

3. The steady progress of financial sector reforms has brought to the fore more products, participants and better liquidity than before in the Indian financial markets. For more operational flexibility, the Reserve Bank is required to have enabling powers to use a larger variety of financial instruments than hitherto. To meet this end, the Reserve Bank of India (Amendment) Bill, 2005 was introduced in Lok Sabha on 13 May, 2005 and referred by the Hon'ble Speaker to the Standing Committee on Finance for examination and report thereon.

4. On the factors that necessitated imitation of the proposals as contained in the Reserve Bank (Amendment) Bill, 2005, the Brief furnished by the Ministry of Finance *inter-alia* reads as under:

- (i) Section 42 (1) RBI Act specifies maintenance of Cash Reserve Ratio (CRR) by the scheduled banks on their demand and time liabilities in the form of cash balances to be kept with RBI. The existing prescription of a 3 per cent floor and a ceiling of 20 per cent of demand and time liabilities towards

CRR restricts manoeuvrability of RBI in its monetary management. 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.

- (ii) 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.
- (iii) At present, under Section 29A of Securities contracts (Regulation) Act, 1956, the Central Government has delegated to 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, for 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 the agencies operating in these contracts, securities and derivatives.

5. The amendment proposals contained in the Bill to meet these concerns are briefly delineated as under:

- (a) define the expressions, 'derivative', 'repo' and 'reverse repo' in Section 17 for the purpose of the business of the Bank and differently in new Chapter III D for the purposes of regulatory powers of the Bank.

- (b) empower the RBI 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 Committee had a briefing meeting with the representatives of the Ministry of Finance on the provisions of the Reserve Bank of India (Amendment) Bill, 2005. On the reasons for seeking to enable the Reserve Bank to deal in derivatives, as also repo and reverse repo as proposed in the Bill, a representative of the Ministry stated as follows during the meeting:

“It is not so much the RBI that wanted to be a player but because all these indirect instruments have come into the money market that the RBI’s balance sheet itself is subject to certain risks. So, it is necessary for it to safeguard itself. We have taken particular care to ensure that those shares that are traded under the stock exchanges are regulated by SEBI. The securities are the ones that are being traded over the Counter (OTC) today. Those are the only instruments, largely money market, and credit instruments, which are sought to be covered under the OTC derivatives that have been mentioned in the Amendment Bill. To that extent, the RBI will regulate whether any bank is involved in any deal that is OTC deal of derivatives.”

7. Derivative trading became legalised in India with the enactment of the Securities Laws (Amendment) Act, 1999. In terms of the provisions of the Securities Contracts (Regulation) Act, 1956, as amended by the Securities Laws (Amendment) Act, only such derivative contracts which are traded ‘on a recognised stock exchange’ are legal and valid. Pointing out the limitations on the legal validation of derivative contracts in terms of the Securities Contracts Act and by way of giving the rationale behind the proposal to define the term ‘derivative’ in the Reserve Bank Act and enable the Bank to deal in derivatives, a representative of the Ministry stated as follows during the briefing meeting:

“It is that the RBI in its normal operations—and as we know they do our foreign exchange management—is responsible for managing

our resources. In international markets, when they are going for managing their resources, they cannot participate in interest rate swaps and options. This is creating a difficulty. For example, we are saying that there is wide validity in the foreign exchange market abroad and they have to cover their risk but they cannot participate in interest rate swap or credit derivative.”

8. The Committee received written views/suggestions on the various provisions of the Bill from Fixed Income Money Market and Derivatives Association (FIMMDA), Indian Bank’s Association (IBA), Punjab National Bank, All India Bank Officers’ Federation, HDFC Bank Ltd., Confederation of Indian Industry (CII), ICICI Bank, Oriental Bank of Commerce (OBC) and State Bank of India. The Committee also had personal hearings of the views of the representatives of these organisations and the Reserve Bank of India.

The Committee also received written views/suggestions on the Bill from All India Bank Officers’ Federation, National Confederation of Bank Employees and Corporation Bank Officers Organisation.

9. The Committee took oral evidence of the representatives of the Ministry of Finance (Department of Economic Affairs) and the Reserve Bank of India to further enlighten themselves on various aspects of the proposed legislation.

10. The representatives of the Banking Industry and others who submitted their views and suggestions in writing and also in the course of personal hearings in general, supported the proposals of the Reserve Bank (Amendment) Bill, including the move to do away with the lower floor and upper ceiling of Cash Reserve Ratio (CRR), which as per the Ministry of Finance, is intended for enabling the Reserve Bank to have ‘better manoeuvrability in its monetary management’. The suggestions received on the provisions, mainly center on the scope and ambit of the definitions of the expressions, ‘Derivative’, ‘Repo’ and ‘Reverse Repo’ as provided in the Bill, or the need to align the definitions of these expressions in line with global practices.

11. With the proposals of the Reserve Bank of India (Amendment) Bill, 2005, the Government seeks to empower the Bank to deal in derivatives, repo, and reverse repo; do away with the floor and ceiling limits applicable on prescribing the Cash Reserve Ratio (CRR)—for meeting the flexibility requirements of the Reserve Bank in its monetary management—and validate OTC Derivative Contracts, which, being different from ‘exchange traded derivative transactions’,

are precluded from the purview of the Securities Contracts Regulation Act.

12. The enactment of the legislation would vest the Reserve Bank with substantial operational flexibility and powers, *inter-alia* by enabling the Bank to determine the policy relating to interest rates or interest rate products and give directions in this regard to agencies dealing in money market instruments, foreign exchange as also derivatives. In view of the larger variety of products and participants that have entered the financial market and the need on the part of the Reserve Bank to use newer versions of financial instruments, the Committee agree with the proposals of the Bill.

13. In their deliberations on the provisions of the Bill, certain issues emerged, which mainly relate to the definitions of the expressions, 'Derivative', 'Repo', and 'Reverse Repo' and the method followed in formulating the provisions under various clauses of the Bill. Such issues and the observations and recommendations of the Committee on the proposals of the Bill are detailed in the subsequent paragraphs.

Clause 2-(Amendment of Section 17) and Clause 4 (Insertion of New Chapter III D)

A. Clause 2

14. Section 17 of the Reserve Bank of India Act, 1934 lists out the various kinds of business that the Bank is authorised to carry on and transact. By way of the proposals of Clause 2 of the Bill, Section 17 of the Principal Act is sought to be amended to confer powers on the Reserve Bank to deal in 'derivatives', 'repo' and 'reverse repo' and also define these expressions for the purposes of the business of the bank.

15 The proposals of Clause 2, which seeks to amend Section 17 of the Principal Act in this direction read as under:

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

(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,
- (c) price of foreign securities,
- (d) foreign exchange rate,
- (e) index of rates or prices,
- (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;

(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.

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;

(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;”.

B. Clause 4-Insertion of new Chapter III D.

16. The proposals of Clause 4 of the Bill aim to add a new Chapter (Chapter III D) to the Reserve Bank of India Act, 1934 *inter-alia* by defining the terms, ‘derivative’, ‘repo’ and ‘reverse repo’ for the purpose of regulatory powers of the Bank. The objectives of the proposed Chapter III D, which is to be added to Principal Act, are essentially two-fold: (a) to provide legal validity to certain types of OTC derivatives, and (b) to consolidate and strengthen the regulatory oversight of Reserve Bank of India in respect of markets in interest rate, foreign exchange and credit and loan products.

17. The related provisions under Clause 4 of the Bill read as under:

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

“CHAPTER III D

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

45U. Definitions.—For the purposes of this Chapter,—

(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”, included corporate bonds and debentures.

45V. Transactions in derivatives.—(1) Notwithstanding anything contained in the Securities Contracts (Regulation) Act, 1956 (42 of 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 (10 of 1949), the Foreign Exchange Management Act, 1999 (42 of 1999), or any other Act or instrument having the force of law, as may be specified by the Bank from time-to-time.

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

Provide 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 (42 of 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.

45X. Duty to comply with directions and furnish information. 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 of statement or particulars called for under that section."

(i) Definitions of 'Derivative', 'Repo' and 'Reverse Repo'

18. As informed by the Ministry of Finance, in defining the term 'Derivative' for incorporation in Section 17 of Principal Act *viz.*, for the purposes of the business of the bank; and in the proposed Chapter III D *viz.*, for regulation of transactions, due care has been taken to address the need for flexibility for the Reserve Bank for its own financial requirements, and in enabling the Bank to discharge regulatory powers 'in respect of derivatives in interest rate, foreign exchange and credit and loan products.'

19. The Committee received suggestions on the need for making the definition of 'Derivative' as proposed in the Bill more broad based by including 'derivatives based on commodity prices' and on 'underlying debt pool.' Questioned in this regard, the Ministry, in a written response informed:

"The definition of the term 'derivatives' that will apply to Section 17 (6A) includes gold and silver (which are commodities) as underlyings, since, by virtue of the provisions of Section 17 (12). Reserve Bank of India can buy and sell gold and silver. However, for the purposes of Chapter IIID, any particular commodities or commodities, in general have not been included because the regulatory jurisdiction of Reserve Bank of India does not cover commodity markets."

20. The 'essential' or 'operational portion' of the definition of the terms 'Repo' and 'Reverse Repo' as proposed for incorporation in Section 17 (in terms of Clause 2) and also in the Chapter III D (in terms of Clause 4) of the RBI Act *inter alia* read as under:

'Repo' means an instrument for lending funds by purchasing Securities.

'Reverse repo' means an instrument for borrowing funds by selling securities.

21. The IBA and FIMMDA, in particular, emphasised on aligning the definitions of these terms,—as proposed in the Bill—to the international practice and also make them in consonance with the Reserve Bank's Circular dated 27 October, 2004 which relates to the definitions of the terms. As informed by these organisations, on the basis of this Circular, Banks, including the Reserve Bank, had adopted the following definition for the term 'Repo' and 'Reverse Repo':

"Repo" means an instrument for **borrowing** funds by selling securities with the agreement to repurchase the securities on a mutually agreed future date, at an agreed price, which includes interest for the funds borrowed."

"Reverse 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.

22. With a view to align the definitions of the terms in line with international practice, both IBA and FIMMDA suggested that the definitions of the terms, should be modified *inter alia* to read as under:

"'Repo' means an instrument for injecting liquidity into the system by the Bank."

"'Reverse Repo' means an instrument for absorption of liquidity by the bank."

23. On the basis of the suggestions received from the IBA and FIMMDA, the Ministry of Finance were questioned whether it would be necessary to re-word the definitions of the terms as proposed in the Bill—which would, in effect, amount to a total reversal of the meaning assigned to them as per the provisions. In responses, the Ministry, upon considering the matter, informed that the definitions were proposed to be modified to read as under in the Bill:

- "'Repo' means an instrument for borrowing funds by selling securities."
- "'Reverse Repo' means an instrument for lending funds by purchasing securities."

24. On the suggestion for including the expressions 'injecting liquidity/absorption of liquidity to/from the system' in the definitions-as received from IBA and FIMMDA-the Ministry, however, informed that this was 'not a valid one since the definition should capture the generic aspects of 'repo' and 'reverse repo' transactions and not merely the effects of these transactions when done for liquidity management purposes.'

25. In this regard, the Ministry also added:

"The definitions of 'repo' and 'reverse repo', as proposed now conform to the market usage in India and also to the most commonly used definitions internationally in this regard, whereby they are seen as transactions in fund against collateral of securities. 'Repo' is an instrument for borrowing of fund against securities, while 'Reverse repo' is an instrument for lending of fund against securities."

26. The Committee note that for purposes of Section 17 under Clause 2 as also in the new Chapter III D under clause 4 of the Bill the expression 'Repo' has been defined as 'an instrument for lending funds by purchasing securities...' And 'Reverse Repo' to mean 'an instrument for borrowing funds by selling securities...'

27. The Committee took up the matter of appropriateness of the definitions as proposed in the Bill on the basis of the contentions made by the interested associations and after hearing their views feel that the above definitions need to be modified so as to mean:

Repo—"an instrument for borrowing funds by selling securities....."

Reverse Repo—"an instrument for lending funds by purchasing securities..."

28. The Committee find that the modified definitions are aligned with the international practice which also make them in consonance with the stipulations of the related circulars issued by the Reserve Bank of India.

29. The Ministry of Finance after consultation with Reserve Bank of India also informed that the modified expressions of 'Repo' and 'Reverse Repo' are in conformity with the market usage in the country and the common practice followed internationally.

30. In view of the above, the Committee recommend that the definition of the expressions 'Repo' and 'Reverse Repo' be modified in the Bill as per the revised proposal.

(ii) Formulation of the Provisions of the Bill

31. As brought out in the preceding paragraphs, the provisions of Clause 2 of the Bill seek to amend Section 17 of the Principal Act to include, dealing in derivatives, repo and reverse repo amongst the businesses the Reserve Bank is authorised to carry on and transact. Further, the provisions of Clause 4 aim to add Chapter III 'D' to the Principal Act *inter alia* for enabling the Reserve Bank to regulate transactions in Derivatives and money market instruments *viz.*, Repo and Reverse Repo.

32. The terms, 'Derivative', 'Repo' and 'Reverse Repo' are defined both under the purposed provisions of Clause 2 and Clause 4, albeit with slight variation to meet the purposes of the 'business of the bank' (under Section 17 of the Act) and 'regulatory powers of the Bank. (under the proposed Chapter III)

33. While considering the provisions, as proposed in the Bill, the Committee, in the course of evidence of the representatives of the Ministry of Finance, expressed the opinion that instead of including the definitions of the expressions, 'Derivatives', 'repo' and 'reverse repo' separately in two different places in terms of clauses 2 and 4, the terms could be defined/shown in one place, preferably in the Section relating to 'Definitions' in the Reserve Bank of India Act, 1934. The Committee felt that incorporating the definitions in one place and drawing reference to them in the provisions proposed for enabling the financial activities of the Bank (in Section 17 of Act as proposed under Clause 2) and the regulatory role of the Bank (in the proposed Chapter III D as proposed under Clause 4) would bring in the much more clarity in the objectives and meeting of the proposals, and also avoid the possibility of legal ambiguity and complications.

34. The Ministry, upon considering the suggestions of the Committee, in consultation with the Reserve Bank, *vide* their communication dated 1 September, 2005 (Appendix) proposed as alternate formulation of the provisions of the Bill which *inter-alia* define the terms 'Derivative', 'Repo' and 'Reverse Repo' in one place in Section 2 of the Principal Act.

35. The alternate proposals, as seen from the statement of the Ministry define the expressions 'derivative', 'repo' and 'reverse repo' in Section 2 (b vi a); and section 2 (c vi) and (vii) respectively. The definitions, as proposed read as under:

"Section 2 (b vi a):

'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.
 - (a) Interest rate,
 - (b) foreign exchange rate,
 - (c) credit rating or credit index,
 - (d) 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.
- B.
 - (e) Price of foreign securities,
 - (f) Price of gold or silver coins, or gold or silver bullion, or
 - (g) Any other variable of similar nature;
- C. and includes the following instruments, namely
 - (h) interest rate swaps,
 - (i) forward rate agreements,
 - (j) foreign currency swaps,
 - (k) foreign currency-rupee swaps,
 - (l) foreign currency options,
 - (m) foreign currency-rupee options or
 - (n) such other instruments as may be specified by the Bank from time to time.

Section 2 (cvi) and (cvii).

- (cvi) 'repo' means an instrument for borrowing funds by selling securities being—
 - (A) 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;
 - (B) foreign securities; or
 - (C) corporate bonds and debentures;

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.
- (cvii) 'reverse repo' means an instrument for lending funds by purchasing securities being—
 - (A) 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;

- (B) foreign securities; or
- (C) corporate bonds and debentures;

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.

36. Correspondingly, the provisions of Clause 2 seeking to enable the Reserve Bank to deal in 'Derivatives' 'repo' and 'reverse repo' are proposed to read as follows:

Section 17 (6A): dealing in derivatives specified in paragraphs A and B of Clause (b vi a) of Section 2, and, with the approval of the Central Board, in any other financial instrument;

Section 17 (12) (AB): dealing in repo or reverse repo in respect of securities mentioned in paragraphs (A) and (B) of clause (cvi) or, as the case may be, of Clause (cvii), of Section 2.

37. Similarly, the provisions of the proposed Chapter III D (under Clause 4) for empowering the Reserve Bank to regulate 'derivative', 'repo' and 'reverse repo' contracts are proposed to be re-worded to read as under:

"Section 45 U (a): For the purposes of this Chapter, 'derivative' means the derivatives specified in paragraphs A and C of clause (b vi a) of Section 2.

Section 45 U (c)

'repo' means repo in respect of securities mentioned in paragraphs (A) and (C) of Clause (cvi) of Section 2.

Section 45 U (d):

'reverse repo' means reverse repo in respect of securities mentioned in paragraphs (A) and (C) of Clause (viii) of Section 2.

38. As per the provisions of the Bill, 'Derivative' 'Repo' and 'Reverse Repo' have been defined separately with minor variations—one under Clause 2 for the purposes of financial activities of the Bank in Section 17 and the other under Clause 4 in relation to the regulatory powers of the Bank in the proposed new Chapter III. The Committee was, however, of the view that the expressions 'Derivative', 'Repo' and 'Reverse Repo' should be defined in one

place instead of showing them separately under Section 17 and again in the proposed new Chapter III with minor changes with a view to provide clarity to the provisions as also to avoid possible complications.

39. In deference to the suggestions of the Committee, the Ministry, in consultation with the Reserve Bank, worked out an alternative proposal of formulating the provisions which has been furnished in the form of a statement (appendix) as per which the definitions of the expressions 'Derivative', 'Repo' and 'Reverse Repo' are proposed to be included only in one place in the Section on Definitions of the Reserve Bank of India Act, 1934 with three sub divided paragraphs, namely, A, B and C. The Committee are of the view that the proposed reformulation would not only bring in much more clarity on the objects of the provisions of the Bill but also avoid possible complications. They, therefore, recommend that the provisions of the Bill be redrafted on the lines indicated in the statement.

(i) Derivative Contracts—Regulatory aspects

40. In terms of the provisions of Section 18 A of the Securities Contracts Regulation Act, as amended in 1999, 'derivatives' were brought within the ambit of 'Securities' and the regulatory framework developed for governing trading in derivatives. The Act makes it clear that derivative transactions shall be legal and valid only if such contracts are traded on recognised Stock Exchanges or settled on the clearing house of the recognised stock exchanges.

41. 'Over the Counter' or 'OTC derivatives' as they are called being derivatives traded outside of the recognised stock exchanges, do not come under the regulatory purview of the Securities Contract Act for obtaining legal sanctity.

42. As per the Statements of Objects and Reasons of the Bill, the problem of 'ambiguity regarding the legal validity' that is said to have inhibited the growth and stability of the market for 'Over-the-counter' derivatives is sought to be addressed.

43. The provisions of the Bill, as proposed however, do not specifically define or speak of 'over-the-Counter Derivatives'. Questioned about the nature of 'Over-the-Counter Derivative' contracts that were sought to be given legal validation with the amendments proposed in the Bill; and the reasons for choosing to define the expression 'Derivatives', instead of 'Over-the Counter Derivatives', in

the provisions as proposed under Clause 2 and Clause 4 of the Bill, the Ministry, in a written response inter alia stated as under:

“OTC transactions are usually non-standard and bilateral in nature. On account of these characteristics and also in view of the international experience in this regard, there can be a wide variety of OTC derivatives, as opposed to the finite types of derivatives that are likely to be traded on recognised stock exchanges. Globally, the transaction volumes of different types of OTC derivatives, particularly of those linked to interest rates have been rising over the last several years and exceed the volumes of their exchange-traded counterparts. In India, too, there has been a significant growth of OTC interest rate derivatives, such as interest rate swaps and forward rate agreements over the last few years. Hence, it is an imperative to provide legal validity to OTC derivatives, especially to those linked to interest rate.”

44. On the forms or types of OTC derivative transactions that were sought to be given legal validation with the proposed enactment, the Ministry informed:

“...the proposed Chapter IIID is intended to provide legal validity to OTC derivatives, that are linked to interest rates, foreign exchange credit and loan. In other words, OTC derivatives whose underlying ‘cash’ markets fall under the regulatory domain of Reserve Bank of India are covered under the proposed Chapter IIID.”

45. The Ministry also informed that legal validation to ‘OTC derivatives’ could be achieved through the proposed Section 45V (1) of the Bill ‘without explicitly defining the expression’. As also informed, by the Ministry, since ‘OTC derivatives’ were non-Standard and done bilaterally, it was difficult to frame a clear-cut and proper definition of the expression for inclusion in the provisions. Also, the intension of the proposed amendments was to provide legality to ‘only certain types of OTC derivatives’, which involve at least ‘one party to the transaction’ being a RBI regulated entity.

46. The Indian Bank Association (IBA) expressed the opinion that it was essential to very clearly define in the Bill, the term, ‘derivative’ and also specify the rights, duties, obligations and the respective rules of the regulatory authorities mainly because, apart from the proposals for amendment in the Reserve Bank Act, the Securities Contract Regulation Act, 1956 (SCRA) too defines the term ‘derivative’ and the

Companies Act also defines the term by referring to the definition under the SCRA. It was also pointed out by the IBA that there was a possibility of ambiguity about the validity and enforceability of a derivative transaction because of the two statutes being in force. When questioned on these aspects, the Ministry, *inter alia* submitted as follows:

“The definition of the term ‘derivatives’ used in SCRA, 1956 covers the underlyings and the instruments traded on recognised stock exchanges are regulated by SEBI.”

“By virtue of the opening clause ‘notwithstanding anything contained in the Securities Contracts (Regulation) act, 1956 or any law for the time being in force’ in the proposed Section 45 V(1), provisions of the Section 30 of the Indian Contract Act, 1872 will not be attracted in giving legal validity to derivatives, provided one of the parties involved is the Reserve Bank of India itself or a RBI—regulated entity.”

47. In this regard, the Ministry also added:

“the amendment proposed will not result in any conflict whatsoever between the regulatory jurisdiction of RBI and SEBI. This is so because care has been taken to ensure that there is no overlap between the provisions of Chapter IIID and provisions of SCRA, 1956 which define the domain of SEBI. Moreover, there are institutional arrangements in place which enable co-ordination, exchange of information and discussion on matters of mutual interest between Reserve Bank of India and SEBI.”

48. The Committee note that in terms of the provisions of the Clause 45 V (I), OTC Derivative transactions, which involve a Reserve Bank regulated entity as one of the parties to the transaction, are sought to be given legal validity. While the provisions of Clause 45 V (I) propose to validate OTC Derivative contracts linked to interest rates, foreign exchange, credit and loan, the Reserve Bank is sought to be conferred with specific powers to *inter alia* formulate the policy or regulatory framework for agencies operating in money market instruments as also derivatives. Though OTC derivative contracts are playing a crucial role in mitigating the risks of financial entities, the ambiguity regarding the legality of such contracts is said to be inhibiting their growth. The Committee, therefore, endorse the measures proposed for providing clear legal validity to such contracts.

49. The Committee, however, expect that in formulating the policy measures/regulatory framework for OTC derivative contracts, adequate care would be taken to ensure that there is no scope for ambiguity, particularly in regard to jurisdictional aspects relating to validation of such transactions. This, the Committee feel, is required keeping in view the fact that following the enactment of the present legislation, there would be two statutes governing derivative transactions viz., the Securities Contracts Act for exchange traded derivative transactions and the Reserve Bank of India Act for OTC derivatives, which involve a Reserve Bank regulated entity as a party.

NEW DELHI;
30 November, 2005
9 Agrayana, 1927 (Saka)

MAJ. GEN. (RETD.) B.C. KHANDURI,
Chairman,
Standing Committee on Finance.

APPENDIX I

STATEMENT ON THE SUGGESTIONS BEING MADE *VIS-A-VIS* THE PROVISIONS IN THE BILL

Provisions as per the Bill	Provisions as suggested by RBI
1	2
1. Section 2 (b vi a): Not existing	<p>1. Section 2 (b vi a):</p> <p>‘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:</p> <p>A- (a) interest rate,</p> <p style="padding-left: 20px;">(b) foreign exchange rate,</p> <p style="padding-left: 20px;">(c) credit rating or credit index,</p> <p style="padding-left: 20px;">(d) 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;</p> <p>B- (e) price of foreign securities,</p> <p style="padding-left: 20px;">(f) price of gold or silver coins, or gold or silver bullion, or</p> <p style="padding-left: 20px;">(g) any other variable of similar nature;</p> <p>C- and includes the following instruments, namely—</p> <p style="padding-left: 20px;">(h) interest rate swaps,</p> <p style="padding-left: 20px;">(i) forward rate agreements,</p> <p style="padding-left: 20px;">(j) foreign currency swaps,</p> <p style="padding-left: 20px;">(k) foreign currency—rupee swaps,</p> <p style="padding-left: 20px;">(l) foreign currency options,</p> <p style="padding-left: 20px;">(m) foreign currency—rupee options, or</p> <p style="padding-left: 20px;">(n) such other instruments as may be specified by the Bank from time to time.</p>

1	2
<p>2. Section 17 (6A): dealing in derivatives, and, with the approval of the Central Board, in any other financial instrument.</p>	<p>Section 17 (6A): dealing in derivatives, specified in paragraphs A and B of clause (b vi a) of section 2, and, with the approval of the Central Board, in any other financial instrument;</p>
<p>Explanation:-For the purpose 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:</p> <ul style="list-style-type: none"> (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, (c) price of foreign securities, (d) foreign exchange rate, (e) index of rates or prices, (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. 	<p>Section 2 (cvi) (cvii):</p> <p>(cvi) 'repo' means an instrument for borrowing funds by selling securities being—(A) 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;</p> <p>(B) foreign securities; or</p> <p>(C) corporate bonds and debentures;</p> <p>with an agreement to repurchase the said securities on a mutually agreed future date</p>

1	2
<p data-bbox="363 1039 778 1099">Section 17 (12 AB): dealing in repo or reverse repo:</p> <p data-bbox="363 1128 778 1249">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.</p> <p data-bbox="363 1272 778 1332">Explanation.—For the purposes of this clause,—</p> <p data-bbox="363 1355 778 1749">(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 maybe 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;</p> <p data-bbox="363 1771 778 1861">‘reverse repo’ means an instrument for borrowing funds by selling securities of the Central Government or a State</p>	<p data-bbox="802 461 1233 521">at an agreed price which includes interest for the funds borrowed.</p> <p data-bbox="802 544 1233 633">(cvii) ‘reverse repo’ means an instrument for lending funds by purchasing securities being—</p> <p data-bbox="802 656 1233 777">(A) 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;</p> <p data-bbox="802 799 1050 828">(B) foreign securities; or</p> <p data-bbox="802 851 1174 880">(C) corporate bonds and debentures;</p> <p data-bbox="802 902 1233 1023">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.</p> <p data-bbox="802 1046 1233 1189">Section 17 (12) (AB): dealing in repo or reverse repo in respect of securities mentioned in paragraphs (A) and (B) of clause (cvi) or, as the case may be, of clause (cvii), of section 2.</p>

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.

Section 45U (a): For the purposes of this Chapter,

(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;

Section 45U (c): 'repo' means an instrument for lending funds by purchasing 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;

Section 45U (d): 'reverse repo' means an instrument for borrowing funds by selling 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.

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

Section 45U (a): For the purposes of this Chapter, 'derivative' means the derivatives specified in paragraphs A and C of clause (b vi a) of section 2.

Section 45U (c): 'repo' means repo in respect of securities mentioned in paragraphs (A) and (C) of clause (cvi) of section 2.

Section 45U (d): 'reverse repo' means reverse repo in respect of securities mentioned in paragraphs (A) and (C) of clause (cvii) of section 2.

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.

(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 of 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:

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.

APPENDIX II

MINUTES OF THE THIRTY-EIGHTH SITTING OF STANDING COMMITTEE ON FINANCE

The Committee sat on Thursday, 14th July, 2005 from 1030 to 1200 hours and 1215 to 1320 hours.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri—*Chairman*

MEMBERS

Lok Sabha

2. Shri Bhartruhari Mahtab
3. Shri Shyama Charan Gupta
4. Dr. Rajesh Kumar Mishra
5. Shri Madhusudan Mistry
6. Shri K.S. Rao
7. Shri Lakshman Seth
8. Shri G.M. Siddeshwara
9. Shri M.S. Reddy

Rajya Sabha

10. Shri Yashwant Sinha
11. Shri Chittabrata Majumdar
12. Shri C. Ramachandraiah
13. Shri Mangani Lal Mandal

SECRETARIAT

1. Shri R.K. Jain — *Deputy Secretary*
2. Shri T.G. Chandrasekhar — *Under Secretary*

WITNESSES

**Ministry of Finance (Department of Economic Affairs—
Banking Division)**

1. Shri A.K. Jha, Secretary
2. Shri Vinod Rai, Additional Secretary (FS)
3. Shri Amitabh Verma, Joint Secretary (BOA)
4. Shri U.K. Sinha, Joint Secretary (CM)

2. At the outset, the Chairman welcomed the witnesses from the Ministry of Finance (Department of Economic Affairs—Banking Division) to the sitting of the Committee and invited their attention to the provisions contained in the Direction 55 of the Directions by the Speaker.

3. Then the representatives of the Ministry of Finance (Department of Economic Affairs-Banking Division) briefed the Committee on the various provisions contained in the Banking Regulation (Amendment) Bill, 2005 and the Reserve Bank of India (Amendment) Bill, 2005. The Members asked clarificatory questions which were replied to by the representatives. The Chairman, then, directed the representatives of the Ministry that the information with regard to queries of the Members which were not readily available with them might be furnished to the Committee later on.

4. The evidence was concluded.

5. A verbatim record of proceedings has been kept.

The witnesses then withdrew

Part-II
(1215 to 1320 hours)

2.	**	**	**	**	**
3.	**	**	**	**	**

(The Committee then adjourned.)

MINUTES OF THE FIRST SITTING OF STANDING
COMMITTEE ON FINANCE

The Committee sat on Tuesday, 9th August, 2005 from 1500 to 1620 hrs.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri—*Chairman*

MEMBERS

Lok Sabha

2. Shri Shyama Charan Gupta
3. Shri A. Krishnaswamy
4. Shri Bir Singh Mahato
5. Shri Rupchand Pal
6. Shri Danve Raosaheb Patil
7. Shri K.S. Rao
8. Shri Lakshman Seth
9. Shri G.M. Siddeshwara
10. Shri M.A. Kharabela Swain
11. Shri Magunta Sreenivasulu Reddy

Rajya Sabha

12. Shri Yashwant Sinha
13. Shri Chittabrata Majumdar
14. Shri C. Ramachandraiah

SECRETARIAT

1. Dr. (Smt.) P.K. Sandhu — *Additional Secretary*
2. Shri R.K. Jain — *Deputy Secretary*
3. Shri T.G. Chandrasekhar — *Under Secretary*

WITNESSES

ICICI Bank Ltd.

1. Shri K.V. Kamath, Managing Director & CEO
2. Smt. Kalpana Morparia, Deputy Managing Director

Oriental Bank of Commerce

1. Shri K.N. Prithviraj, Chairman & Managing Director
2. Shri M.D. Mallya, Executive Director

2. At the outset, the Chairman welcomed the Members to the First sitting of the newly constituted Committee. The Chairman informed the Members that a separate sitting will be convened for selection of subjects for examination during the year.

3. Thereafter, the Chairman welcomed the representatives of ICICI Bank Ltd. and Oriental Bank of Commerce to the sitting of the Committee and invited their attention to the provisions contained in the Direction 55 of the Directions by the Speaker.

4. The Committee then took oral evidence of the representatives of ICICI Bank Ltd. and Oriental Bank of Commerce on the provisions of the Banking Regulation (Amendment) Bill, 2005 and the Reserve Bank of India (Amendment) Bill, 2005. The Members asked clarificatory questions which were replied to by the representatives. The Chairman, then, directed the representatives of ICICI Bank Ltd. and Oriental Bank of Commerce that the information with regard to queries of the Members which was not readily available with them might be furnished to the Committee later on.

5. The evidence was concluded

6. A verbatim record of proceedings has been kept.

The witnesses then withdrew.

The Committee then adjourned.

MINUTES OF THE SECOND SITTING OF STANDING
COMMITTEE ON FINANCE

The Committee sat on Wednesday, 10th August, 2005 from 1500 to
1620 hrs.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri—*Chairman*

MEMBERS

Lok Sabha

2. Shri Gurudas Dasgupta
3. Shri Bhartruhari Mahtab
4. Shri A. Krishnaswamy
5. Shri Bir Singh Mahato
6. Shri Rupchand Pal
7. Shri Shriniwas D. Patil
8. Shri K.S. Rao
9. Shri Jyotiraditya Madhavrao Scindia
10. Shri M.A. Kharabela Swain

Rajya Sabha

11. Shri C. Ramachandraiah

SECRETARIAT

1. Shri R.K. Jain — *Deputy Secretary*
2. Shri T.G. Chandrasekhar — *Under Secretary*

WITNESSES

Punjab National Bank

Shri S.C. Gupta, Chairman & Managing Director

Indian Banks' Association (IBA)

Shri M.R. Umarjee, Consultant

Fixed Income Money Markets and Derivatives Association (FIMMDA)

1. Shri Sudhir Joshi, Chairman
2. Shri C.E.S. Azariah, CEO

Confederation of Indian Industry (CII)

1. Shri Jayant Bhuyan, Dy. Director General
2. Shri Rana Kapoor, Chairman, CII-Banking Committee
3. Shri Vikram Badshah, Sr. Consultant

2. At the outset, the Chairman welcomed the representatives of Punjab National Bank, Indian Banks' Association (IBA), Fixed Income Money Markets and Derivatives Association (FIMMDA) and Confederation of Indian Industry (CII) and invited their attention to the provisions contained in the Direction 55 of the Directions by the Speaker.

3. The Committee then took oral evidence of the representatives of Punjab National Bank, Indian Banks' Association (IBA), Fixed Income Money Markets and Derivatives Associations (FIMMDA) and confederation of Indian Industry (CII) on the provisions of the Banking Regulation (Amendment) Bill, 2005 and the Reserve Bank of India (Amendment) Bill, 2005. The Members asked clarificatory questions which were replied to by the representatives. The Chairman, then, directed the representatives that the information with regard to queries of the Members which was not readily available with them might be furnished to the Committee later on.

4. The evidence was concluded
5. A verbatim record of proceedings has been kept.

The witnesses then withdrew

The Committee then adjourned.

MINUTES OF THE THIRD SITTING OF STANDING
COMMITTEE ON FINANCE

The Committee sat on Monday, 22nd August, 2005 from 1500 to 1630 hrs.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri—*Chairman*

MEMBERS

Lok Sabha

2. Shri Gurudas Dasgupta
3. Shri A. Krishnaswamy
4. Shri Rupchand Pal
5. Shri Shriniwas D. Patil
6. Shri K.S. Rao
7. Shri Lakshman Seth
8. Shri G.M. Siddeshwara
9. Shri Magunta Sreenivasulu Reddy

Rajya Sabha

10. Shri Chittabrata Majumdar
11. Shri C. Ramachandraiah

SECRETARIAT

1. Dr. (Smt.) P.K. Sandhu — *Additional Secretary*
2. Shri R.K. Jain — *Deputy Secretary*

WITNESSES

State Bank of India

Shri A.K. Purwar, Chairman

Bank of India

Shri M. Balachandran, Chairman & Managing Director

HDFC Bank Ltd.

1. Shri Aditya Puri, Managing Director
2. Shri Rajender Sehgal, Senior Vice-President

2. At the outset, the Chairman welcomed the representatives of State Bank of India, Bank of India and HDFC Bank Ltd. to the sitting of the Committee and invited their attention to the provisions contained in Direction 55 of the Directions by the Speaker.

3. The Committee then took oral evidence of the representatives of State Bank of India, Bank of India and HDFC Bank Ltd. on the provisions of the Banking Regulation (Amendment) Bill, 2005 and the Reserve Bank of India (Amendment) Bill, 2005. The Members asked clarificatory questions which were replied to by the representatives. The Chairman, then, directed the representatives that the information with regard to queries of the Members which was not readily available with them might be furnished to the Committee later on.

4. The evidence was concluded

5. A verbatim record of proceedings has been kept.

The witnesses then withdrew.

- | | | | | | | |
|----|-----|-----|-----|-----|-----|-----|
| 6. | *** | *** | *** | *** | *** | *** |
| 7. | *** | *** | *** | *** | *** | *** |

The Committee then adjourned.

MINUTES OF THE SIXTH SITTING OF STANDING COMMITTEE
ON FINANCE (2005-06)

The Committee sat on Thursday, 30 September, 2005 from 1100 to 1300 hrs. and 1530 to 1640 hrs.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri—*Chairman*

MEMBERS

Lok Sabha

2. Shri Jaswant Singh Bishnoi
3. Shri Gurudas Dasgupta
4. Shri Bhartruhari Mahtab
5. Shri Madhusudan Mistry
6. Shri K.S. Rao
7. Shri M.A. Kharabela Swain

Rajya Sabha

8. Shri M. Venkaiah Naidu
9. Shri Mangani Lal Mandal

SECRETARIAT

1. Smt. (Dr.) P.K. Sandhu — *Additional Secretary*
2. Shri A.K. Singh — *Joint Secretary*
3. Shri S.B. Arora — *Deputy Secretary*
4. Shri T.G. Chandrasekhar — *Under Secretary*

Part I

(at 1130 hours)

2. *** *** *** *** *** *** ***

Part II

(at 1530 hours)

WITNESSES

Ministry of Finance

- (i) Shri Ashok Jha, Secretary (DEA)
- (ii) Shri Vinod Rai, Additional Secretary (FS)

(iii) Shri Amitabh Verma, Joint Secretary (BOA)

(iv) Shri U.K. Sinha, Joint Secretary (CM)

Reserve Bank of India

(i) Shri H. Bhattacharya, CGM

(ii) Shri Anand Sinha, CGM

(iii) Shri G.S. Hegde, Joint Legal Advisor

2. At the outset, the Chairman welcomed the representatives of the Ministry of Finance and Reserve Bank of India to the sitting of the Committee and invited their attention to the provisions contained in Direction 55 of the Directions by the Speaker.

3. *** *** *** *** *** ***

4. The Committee then took oral evidence of the representatives of the Ministry on the provisions of the (1) Banking Regulation (Amendment) Bill, 2005 and (ii) Reserve Bank of India (Amendment) Bill, 2005. The Members asked clarificatory questions which were replied to by the representatives of the Ministry. The Chairman, then, directed the representatives that the information with regard to queries of the Members which was not readily available with them might be furnished to the Committee later on.

5. The evidence was concluded.

6. A verbatim record of proceedings has been kept.

The witnesses then withdrew.

The Committee then adjourned.

MINUTES OF THE SEVENTH SITTING OF STANDING
COMMITTEE ON FINANCE

The Committee sat on Monday, 7 November, 2005 from 1030 to 1145 hrs. and thereafter from 1145 to 1330 hours.

PRESENT

Maj. Gen (Retd.) B.C. Khanduri—*Chairman*

MEMBERS

Lok Sabha

2. Shri Jaswant Singh Bishnoi
3. Shri Gurudas Dasgupta
4. Shri A. Krishnaswamy
5. Shri Bir Singh Mahato
6. Shri Madhusudan Mistry
7. Shri Rupchand Pal
8. Shri Shriniwas D. Patil
9. Shri K.S. Rao
10. Shri Jyotiraditya Madhavrao Scindia
11. Shri G.M. Siddeshwara
12. Shri Ajit Singh
13. Shri M.A. Kharabela Swain
14. Shri Vijoy Krishna
15. Shri Magunta Sreenivasulu Reddy

Rajya Sabha

16. Shri R.P. Goenka
17. Shri Jairam Ramesh
18. Shri M. Venkaiah Naidu
19. Shri Yashwant Sinha
20. Shri Amar Singh

SECRETARIAT

1. Dr. (Smt.) P.K. Sandhu — *Additional Secretary*
2. Shri S.B. Arora — *Deputy Secretary*
3. Shri T.G. Chandrasekhar — *Under Secretary*

Part I

(at 1030 to 1145 hrs.)

2. At the outset, the Chairman welcomed the Members to the sitting of the Committee.

3. The Committee then took up for consideration the draft reports on:

- (i) The Banking Regulation (Amendment) Bill, 2005 and
- (ii) The Reserve Bank of India (Amendment) Bill, 2005

4. ** ** ** ** ** ***

5. ** ** ** ** ** ***

6. The Committee then took up for consideration the draft report on the Reserve Bank of India (Amendment) Bill, 2005 and adopted the same with the modifications/amendments as shown in Annexure.

Part II

(1145 to 1330 hrs.)

2. ***

3. ***

4. ***

5. ***

The witnesses then withdrew.

The Committee then adjourned.

ANNEXURE

[MODIFICATIONS/AMENDMENTS MADE BY STANDING
COMMITTEE ON FINANCE IN THEIR DRAFT REPORT ON
THE RESERVE BANK OF INDIA (AMENDMENT) BILL, 2005
AT THEIR SITTING HELD ON 7 NOVEMBER, 2005]

Page 5

Add sub para to
para no. 8

The Committee also received written
views/suggestions on the Bill from All
India Bank Officers' Federation,
National Confederation of Bank
Employees and Corporation Bank
Officers Organisation.

ANNEXURE

AS INTRODUCED IN LOK SABHA

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.

(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 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,

(c) price of foreign securities,

(d) foreign exchange rate,

(e) index of rates or prices,

(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 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;

(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.

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;

(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;”.

3. In section 42 of the principal Act,

Amendment
of Section
42.

(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;

(b) the provision shall be omitted;

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

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

Insertion of
new
Chapter
IIID.

“CHAPTER IIID

REGULATION OF TRANSACTIONS IN DERIVATIVES,
MONEY MARKET INSTRUMENTS 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.

Transactions
in
derivatives.

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, 42 of 1956.

10 of 1949. a scheduled bank, or such other agency falling
42 of 1999. 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.

(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.

42 of 1956. Provide 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.

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 of statement or
particulars called for under that section.”.

Duty to
comply
with
directions
and furnish
information.

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 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 the 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 for the purposes of the business of the Bank and differently in new Chapter III D 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.

EXTRACTS FROM THE RESERVE BANK OF INDIA ACT, 1934

(2 OF 1934)

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

*	*	*	*	*
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;

26 of 1962. (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;

(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 outstanding 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;

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

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

(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.

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

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

(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.

* * * * *

(1AA) 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 of 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).

* * * * *

LOK SABHA

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

(Shri P. Chidambaram, Minister of Finance)