Rajeshwar Rao: Reserve Bank of India - navigating 90 years of legacy, regulation, and aspiration

Opening remarks by Mr Rajeshwar Rao, Deputy Governor of the Reserve Bank of India, at the "High-Level Policy Conference of Central Banks in the Global South", organised by the Reserve Bank of India as a part of commemoration of its 90th year, Mumbai, 27 November 2024.

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Governors and senior dignitaries from Central Banks, eminent participants, Ladies and Gentlemen,

I am delighted to be amidst you all at the High-level conference on "Building synergies", organised on this historic occasion as we celebrate the 90th year of our establishment. The conference is a part of our endeavour to develop a meaningful dialogue and foster cooperation on the issues confronting the Central banks of the global south. It gives me an opportunity to share my thoughts with you today, on paths traversed so far and some of the challenges we are likely to face as Regulators going forward.

This year also marks 75 years of our journey as the formal regulator and supervisor of the banking system which flowed from the enactment of the Banking Regulation Act in 1949. Looking back, the formalisation of regulatory powers was a sequel to the large-scale failures of the commercial banks in the mid-1930s and early 1940s and the actions required at that point to safeguard the banking system. The regulatory approach has thus been conditioned and shaped in part by the historical events, deeply intertwined with the Indian growth story.

Traversing the past [1]

As you may be aware, RBI is one of the very few institutions in India which came into existence before independence and has straddled both the pre-and-post independence era. The key assignments of the RBI in its formative years were to regulate the issue of currency, maintain reserves to secure monetary stability, and to operate the credit and currency system to country's advantage.

Even as the RBI was involved in meeting its specified obligations of currency and reserve management, the period of 1930s and 40s witnessed a large number of bank failures in absence of any concrete regulatory jurisdiction or authority. As per broad estimates, more than 570 banks in India failed during 1940s[2]. In this milieu, the Indian parliament enacted Banking Regulation Act ('BR Act'), 1949 to render regulatory and supervisory powers to RBI over the banks. The legal architecture of RBI Act coupled with BR Act provided a solid statutory foundation to the Indian financial system. It also empowered RBI to license the banks and consequently control unwanted mushrooming of institutions in the banking space. Therefore, enactment of BR Act can be considered as one of the most important milestones in the history of Indian financial system.

During the 1950s the regulatory focus continued on consolidation of the banks, while the decade of 1960s bolstered the efforts of institution building, especially in financial sector. For example, legislative amendments were enacted in 1960 to empower RBI for consolidating the banking space, which led to reconstruction and consolidation of over 200 banks in next couple of decades[3], and the episodes of frequent bank failures became events of history. Widening the scope of regulatory jurisdiction, RBI was further empowered to regulate deposit taking activities of non-bank entities and operation of cooperatives banking system during this phase. Building upon this momentum, the next few decades following the nationalisation of major scheduled commercial banks in 1969 (and later in 1980) focused on improving the public access to finance and financial institution in India with launch of lead bank scheme, development of norms for priority sector lending, expansion of branch networks, formation of regional rural banks, among others.

In the same progressive spirit, the decade of 1990s brought forth various reforms which laid the foundation of the modern resilient financial sector as we see today. Following the Liberalisation reforms in 1991, two major developments happened in the industry. First, detailed guidelines were issued in 1993 opening up the banking space to the private sector so as to improve efficiency in delivery and pricing of financial services. And second, a critical legislative measure was introduced in 1997 empowering RBI to regulate NBFCs and prescribe various prudential standards for them. These two measures gave space to the financial sector to get prepared for the ensuing challenges and opportunities of 21st century.

The last decade has seen growth of differentiated banking in India with several unique categories of institutions such as Small Finance Banks and Payment Banks emerging on the horizon. Growth of banking system, along with very vibrant non-banking financial space and cooperative banking has bolstered the financial intermediation in the economy. Just to offer some perspective about their scale, the assets of scheduled commercial banks and NBFCs have reached at about 280 trillion and 50 trillion respectively as on March 31, 2024, and the outstanding credit facilitated by these institutions is roughly 205 trillion[4].

This extensive network of financial institutions has also helped in improvement of the quality of financial inclusion in our country, which is reflected by continuous rise in the financial inclusion index measuring access, usage, and quality of financial services. Another revolution that has happened is in the digital space. Today, the digital payment infrastructure facilitates over 160 billion transactions in a year for a value of over 2400 trillion (FY 2023-24). Retail digital transactions account for over 720 trillion of value, out of which transactions amounting to approximately 265 trillion are being facilitated through indigenous UPI and IMPS alone. These data points give us a glimpse of journey we have travelled from relatively modest beginnings to a world leader of sort, especially in digitalisation.

RBI has actively pursued regulatory policy measures which seek calibration of major policy norms with international standards, while adapting it to the country's requirements. The latter is illustrated by the mix of principle-based / activity-based regulations framed for urban cooperative banks where the regulatory norms are based on the tier-wise categorisation of the cooperative banks; a scale based regulatory framework has been put in place for the NBFCs to categorise them as per their scale of operation and potential for interconnectedness; and norms for the MFI sector.

As a part of our policy framework, we have been following a 'twin-peak approach' towards regulation, assigning importance to both prudential and conduct related issues. From a prudential perspective, banks are required to have robust risk management processes supported by comprehensive credit underwriting practices. The institutions will have to be compliant to standards especially such as capital adequacy, credit quality and liquidity to ensure prudence in their growth.

The challenges associated with conduct related aspects are equally sensitive. When the system grows more complex, the financial products and services also evolve suitably. Therefore, the regulated entities need to manage a tricky quadrant of expectations which means enabling rapid digitalization; enhancing need for strong cybersecurity; ensuring strong KYC norms; and importantly maintaining excellence in customer service.

In this regard, RBI has recently taken some regulatory measures to improve governance and address conduct related issues of our regulated entities. Guidelines related to fair lending practices, guidelines on governance issues relating to the banks such as composition and functioning of board, succession planning, and remuneration have been prescribed to strengthen the governance frameworks. Transparency in lending and lending charges are also being encouraged by mandating disclosure of all necessary fee and charges to empower the borrowers in taking informed decision.

As we retrospect, we observe that the regulatory developments and policy measures initiated in the past have led to development of a robust, resilient, and strong financial system in India which has weathered several crises. But the goals we have for our nation require us to take a quantum leap in the scale and size of the financial institutions. This will also possibly expose the entities and its users to increased amount of risk. In view of this, robust governance and effective risk management are going to be the dual anchors that will keep our financial institutions afloat and help them grow sustainably. From a macro-perspective, our national aspiration to become a developed economy by year 2047 still requires a stronger foundation of financial institutions in a complex and rapidly evolving financial landscape. Besides banks, the existing entities would require easier access to robust capital markets to fund their growing asset books, as along with access to deep financial markets that would enable them to hedge the associated risks on their balance sheets. Further, there will be entry of new players, products, and services (e.g. private credit) to meet the growing credit needs. Therefore, an enabling regulatory system would have to be put in place to meet these challenges and to safeguard financial stability without hindering the process of innovation.

Envisioning the Future

The growth and resilience exhibited by the financial sector in India in the recent past creates a lot of expectations from us to continue this momentum so as to meet our developmental aspirations. This expectation can only be fulfilled when we have necessary ability to anticipate the emerging challenges even while maintaining agility as a regulator to respond to them. In this context let me flag three such emerging risks which are relevant not only for India but for entire world, particularly the global south.

(i) Risks from extreme climate events and climate change: Not very long ago, the discussion regarding climate related risk was more of an intellectual discourse. But things have changed! The extreme weather conditions, longer spells of summer, and uneven monsoon have led policy makers rethink their stance. Today, every international forum discusses the climate risks- both physical and transitional- in detail and deliberate upon possible solutions. Adaptation risks are also being flagged. As a policy maker, it is still a challenge to quantify the climate related risks and its impact of the real economy and the financial sector. The demand for resources to fund the real sector entities to manage physical, transition and adaptation risks can mean new institutions, newer categories of resources and new business models amongst existing institutions. These will be a new challenge for the regulators.

(ii) Risks from emerging technologies: The biggest disruptive change that has occurred in the world is usage of technology. This has definitely made our life easier in unprecedented ways, but it has also led to growth of an entire ecosystem which thrives upon this massive outreach. Advent of new processes backed by block-chain, and AI/ML, new products like tokenized assets, and new entities like BigTechs/FinTechs have compelled policymakers to remain on their toes. We do not want to stifle such progressive practices, but we must provide suitable guardrails to ensure systemic stability. The quest to find the balance between innovation and prudence is thus going to be a challenge.

(iii) Resilience in Non-Banking sector: Given the growing importance, size and scale of NBFCs in Indian financial system, we have been trying to harmonise regulatory approach for them to avoid any potential arbitrage. However, the non-banking space in India involves a lot many diverse entities than just the NBFCs. And, given the complexity in the financial system, the interconnectedness among all such entities will become more profound. This warrants closer coordination among the financial sector regulators to ensure financial stability.

Conclusion

There are not many central banks in the world which have a mandate as broad based as that of RBI. We are a full-service central bank with a mandate spreading across functional areas such as monetary policy, currency management, regulation & supervision, payment system, financial inclusion, management of forex reserves, etc. I can say this with full confidence that despite this humongous responsibility, the nine illustrious decades of RBI's existence and 75 years of our experience as a regulator and supervisor have built a foundation of a strong financial sector which could support the country in fulfilling its developmental aspirations.

Let me now conclude by thanking the organising team for this privilege to share my views, and to all of you for your patient hearing.

Opening remarks delivered by Shri M. Rajeshwar Rao, Deputy Governor on November 22, 2024, at the "High-Level Policy Conference of Central Banks in the Global South" organised by the Reserve Bank of India as a part of commemoration of its 90th year at Mumbai, India. Inputs provided by Khabeer Ahmed and Saurabh Pratap Singh are gratefully acknowledged.

[1] Inputs from RBI History- Chronology of Events (link)

[2] Chapter 12: Crisis, Consolidation, and Growth, RBI History, Volume-II (1951-67) (link)

[3] RBI History- Chronology of Events: 1960 to 1971 (link)

[4] Supervisory returns, RBI CIMS; Food and Non-food credit of Scheduled Commercial Banks (link)