Today's Prelims Topics

Liquidity Management Framework

Context
The **Reserve Bank of India** published the *Report of the Internal Working Group to Review the Liquidity Management Framework*—an analysis of how India's central bank conducts and fine-tunes liquidity operations.

RBI's Liquidity Management Framework (LMF)
- **About:**
  - The LMF is the RBI's toolkit to regulate the cash/liquidity in the banking system.
  - It helps steer **short-term interest rates** and ensures **smooth monetary policy transmission**.
- **Core Mechanism:**
  - Relies on the **Liquidity Adjustment Facility (LAF)** – using **repo** (inject liquidity) and **reverse repo** (absorb liquidity).
  - Operates within a **corridor system** where the **policy repo rate** is the midpoint.
  - The **Weighted Average Call Rate (WACR)** is the key operating target.
- **Other Tools in LMF:**
  - **Open Market Operations (OMO)**
  - **Cash Reserve Ratio (CRR)**
  - **Statutory Liquidity Ratio (SLR)**
  - Used for longer-term and structural liquidity adjustments.

RBI's Recent Recommendations on LMF (IWG Report, 2025)
- **WACR as Operating Target**
  - Continue using **overnight WACR** as the operating target.
  - *Reason:* Strong correlation with other overnight market rates → ensures effective transmission of policy signals.
- **Discontinue 14-Day VRR/VRRR as Primary Tool**
  - Replace with **7-day repo/reverse repo operations** and other tools (overnight to 14 days).
  - *Reason:* Banks show lower participation in 14-day auctions; shorter-tenor operations are more effective and less disruptive.
- **Advance Notice for Liquidity Operations**
  - RBI should provide **at least one day's notice** before repo/reverse repo auctions.
  - *Exception:* Same-day operations may be conducted if liquidity conditions change suddenly.
  - *Reason:* Helps reduce uncertainty and stabilizes money market rates.
- **Maintain Minimum CRR Requirement**
  - Continue with **90% daily minimum CRR maintenance**.
  - **Reason:** Ensures banks maintain adequate reserves and prevents liquidity shortfalls.

Source: RBI

New GST Reforms

Context
The Centre has proposed a major **GST reform** by eliminating the **12% and 28% tax slabs**, retaining only 5% and 18% (with a few special rates below 1% and a 40% "sin tax"), to simplify the system and boost consumption.

About GST (Goods and Services Tax)
- **Introduced:** 1st July 2017, replacing multiple indirect taxes (VAT, excise, service tax, etc.).
- **Nature:** A **destination-based, comprehensive indirect tax** levied on supply of goods and services across India.
- **Structure:**
  - **CGST (Central GST)** – collected by the Centre.
  - **SGST (State GST)** – collected by the States.
  - **IGST (Integrated GST)** – collected on inter-state supplies & imports.
- **Key Features:**
  - "One Nation, One Tax, One Market."
  - Dual model – Centre and States share powers.
- Input Tax Credit (ITC) mechanism avoids cascading of taxes.

Recent GST Reforms (2025 Proposal)
- **Reduction of Slabs**
  - Current slabs: 0.25%, 3%, 5%, 12%, 18%, 28% + cess.
  - Proposed slabs: **<1% (for precious stones etc.), 5%, 18%, and 40% 'sin tax'**.
  - **12% and 28% slabs to be eliminated.**
- **Reclassification of Items**
  - **99% of items in 12% slab → shifted to 5% slab.**
  - **90% of items in 28% slab → shifted to 18% slab.**
  - Only **5–7 items (tobacco, gutka, luxury goods)** to remain under **40% sin rate**.
- **Impact on Consumption & Revenue**
  - Lower rates expected to **boost consumption, reduce tax evasion, and widen the tax net**.
  - Although revenue may dip initially, higher compliance and consumption likely to **raise revenues later**.
- **Relief on Aspirational Items**
  - Proposal to reduce GST on items like **air conditioners, white goods** (currently at 28%) to 18% → making them more affordable.
- **Ease of Compliance**
  - Use of **technology** to simplify GST registration.
  - **Pre-filled returns** to reduce errors and mismatches.
  - **Faster refunds** to improve cash flow for businesses.
- **Overall Aim**
  - To implement a **simpler, next-generation GST system**.
  - Promote **ease of living and ease of doing business**.
  - Expected to be deliberated in the **GST Council meeting (Sept–Oct 2025)** and rolled out within this financial year.

Source: TheHindu

Mission Sudarshan Chakra

Context
On India's 79th Independence Day, the Prime Minister announced Mission Sudarshan Chakra.

Mission Sudarshan Chakra
- A **national security mission** to build an advanced, multi-layered defence shield around critical installations across India.
- Inspired by **Lord Krishna's Sudarshan Chakra**, blending cultural heritage with modern defence strategy.
- **Nodal Ministry:** Ministry of Defence.
- **Objectives:**
  - Develop an **indigenous, research-driven security system** to neutralise threats from **air, land, sea, and cyber domains**.
  - Strengthen **self-reliance (Aatmanirbhar Bharat)** in defence technologies.
  - Provide **integrated, proactive protection** for vital infrastructure, major cities, and sacred sites.
- **Key Features:**
  - **Multi-Layered Defence:** Combines surveillance, interception, and counter-attack capabilities.
  - **Wide Coverage:** Safeguards strategic, civilian, and religious locations.
  - **Advanced Technology:** Utilises radar networks, AI-powered tracking, cyber-defence tools, and physical security systems.
  - **Indigenous Development:** Entirely conceptualised, designed, and manufactured in India.
  - **Future-Oriented Plan:** Expansion and modernisation targeted up to **2035**.

Source: DDNews

News in Short

Easter Island	
	News? Rising seas could put Easter Island's iconic statues at risk by 2080 according to a study. **About it** • **Location**: The island is the **easternmost part of Polynesia**, situated in the Southeastern Pacific Ocean. • **Political Status**: Functions as a special territory of **Chile**. • **Capital:** Hanga Roa. • **Geographical Features**: Created by three extinct volcanoes. • **Climate**: Experiences a subtropical maritime climate with warm summers and mild winters. • **Global Recognition**: **Rapa Nui National Park (15 iconic moai statues)** – designated as a UNESCO World Heritage Site. **Source: Al Jazeera**

Editorial Summary

Reasons for Flash Floods and Rain in J&K

Context
At least 65 people were killed and over 50 reported missing after torrential rain triggered a flash flood in Chasoti village, Kishtwar district, Jammu & Kashmir.

Impact
- **Loss of lives**: Dozens killed and many missing.
- **Community destruction**: Remote villages like Chasoti, with poor access and infrastructure, face severe disruption.
- **Cultural impact**: The disaster struck during the pilgrimage route to Machail Mata, affecting religious travel.
- **Wider pattern**: The incident is part of an **increasing trend of extreme weather events** in J&K.
    - Between 2010 and 2022, J&K recorded **2,863 extreme weather events** and **552 deaths**.
    - **Heavy snow** caused the highest fatalities (182 deaths), followed by **flash floods (119)**, **heavy rain (111)**, and **landslides (71)**.
- **District-level risk**: Kishtwar, along with Anantnag, Ganderbal, and Doda, has seen the **highest casualties from flash floods**.

Reasons for its occurrence
- **Rising Temperatures**
    - Western Himalayas are warming at **twice the rate** of the Indian subcontinent post-2000.
    - Warmer air holds more moisture (7% more per 1°C rise), leading to **intense precipitation**.
    - Glacier retreat creates unstable **glacial lakes**; heavy rainfall can cause them to overflow, triggering **glacial lake outburst floods (GLOFs)**.
- **Changing Pattern of Western Disturbances**
    - Western disturbances, traditionally active in **winter months (Dec–Mar)**, now impact weather **year-round** due to global warming.
    - Extra moisture from the **Arabian Sea** strengthens these systems, producing **heavier rainfall and flash floods** in the Himalayas.
- **Topography of J&K**
    - Mountainous terrain makes the region prone to **orographic rainfall** (when moist air is forced to rise over hills, cooling and condensing into heavy precipitation).
    - Steep slopes and fragile soils intensify the risk of **landslides and flash floods**.

Way Forward
- **Strengthen early warning systems**: Expand Doppler radars and real-time rainfall monitoring in J&K.
- **Disaster-resilient infrastructure**: Reinforce roads, bridges, and housing in high-risk zones.
- **Glacial lake monitoring**: Map vulnerable glacial lakes using satellites and implement controlled drainage where necessary.
- **Community preparedness**: Train local communities in disaster response and evacuation drills.
- **Climate adaptation policies**: Integrate climate risk assessment into regional planning, tourism, and pilgrimage management.

Source: Indian Express

To Count Everyone in

Context
- The **Supreme Court in Association for Democratic Reforms vs ECI (2025)** has directed the **Election Commission of India (ECI)** to:
  - Make the draft electoral roll more **accessible and searchable**.
  - Provide **reasons for exclusion** of voters so that they can challenge the decision.

More in News
- This came in the backdrop of the **Special Intensive Revision (SIR)** exercise in Bihar, intended to "remove non-citizens" from voter lists.
- The SC's order is being compared to its **1995 judgment in Lal Babu Hussain vs ERO**, where the Court struck down arbitrary attempts by the ECI to declare voters as "non-citizens" without credible evidence.

Impact of the SC's Order
- **Protection of voters' rights**: Citizens cannot be arbitrarily excluded without explanation.
- **Transparency and accountability**: ECI is compelled to disclose reasons for exclusions, preventing misuse.
- **Shift of focus**: From questioning citizenship to ensuring **accuracy of electoral rolls**.
- **Institutional balance**: Continues the history of the SC nudging the ECI toward fairness rather than rebuking it.

Reasons for the Issue
- **Lack of legal basis for SIR:** Neither the **Representation of the People Act, 1950** nor the **Registration of Electors Rules, 1960** mentions "Special Intensive Revision."
  - The exercise seems to rest on administrative discretion rather than statutory mandate.
- **Burden of proof shifted to citizens:** Citizens are being asked to **prove citizenship afresh**, despite already being in the rolls.
  - Aadhaar cards and EPIC cards (issued by the ECI itself) were initially not accepted as valid proof.
- **Historical parallels:** Similar attempts in **Delhi and Mumbai (1994)** – nearly 3 lakh people asked to prove citizenship, with limited documents accepted.
  - SC in 1995 ruled that proof could only be demanded when credible evidence suggested someone was not a citizen.

Significance of the Judgment
- **Reinforces universal franchise:** India's electoral history is marked by **immediate universal suffrage (1950)**, unlike many countries where franchise was gradually extended.
  - The judgment reaffirms this commitment to **inclusivity and equality in voting rights**.
- **Constitutional balance:** By directing reforms rather than invalidating the SIR outright, the SC maintained **institutional balance**.
  - It avoided direct confrontation with the ECI but ensured that citizens' rights remain protected.
- **Strengthens democratic legitimacy:** Elections are meaningful only if **electoral rolls are accurate and fair**.
  - Wrongful deletions risk disenfranchising large sections of society, weakening democratic legitimacy.
- **Judicial continuity:** The 2025 ruling is consistent with earlier cases (1995 Lal Babu Hussain, 2017 People's Union for Civil Liberties) where the SC emphasized **natural justice, transparency, and procedural safeguards**.

- **Broader message:** The verdict highlights that **citizenship verification cannot override democratic participation**.
    - It reflects India's ethos that even the poor, the homeless, or those without fixed identity documents have a **right to be heard and represented**.

Source: Indian Express

FREE AI Committee Report

Context
Framework for Responsible and Ethical Enablement of Artificial Intelligence Committee (FREEAI Committee) of Reserve Bank of India (RBI) recently released its report.

About FREE AI Committee
- In **2024**, the **Reserve Bank of India (RBI)** set up an **Internal Committee on Artificial Intelligence** to frame a governance framework for the safe and ethical adoption of AI by **Regulated Entities (REs)** like banks, NBFCs, and insurers.
- The Committee's report in **August 2025** titled: **"Framework for Regulated Entities for Effective AI (FREE AI)"**.
- The aim was to strike a **balance between innovation and risk mitigation**, ensuring that AI adoption enhances efficiency without undermining fairness, accountability, or financial stability.

Significance of AI in Finance
- **Revenue Growth**: AI is expected to be a major growth driver, with financial sector investments projected to touch ₹8 lakh crore by 2027.
- **Efficiency and Personalization**: By automating routine and data-heavy processes, AI enables faster and more accurate operations, such as loan processing and customer support.
- **Boosting Financial Inclusion**: Through the use of alternative data sources like utility payments and GST records, AI helps assess creditworthiness of "thin-file" or first-time borrowers often excluded by traditional systems.
- **Strengthening Digital Infrastructure**: AI enhances India's digital public platforms such as Aadhaar and UPI, enabling more personalized and adaptive financial services.
- **Improved Risk Management**: AI supports fraud detection, early-warning systems, and better decision-making, thereby strengthening overall risk management.
- **Example:** J.P. Morgan's AI-based payment validation reduced fraud and cut account rejection rates by 15–20%.
- **Synergy with Emerging Technologies**: When combined with quantum computing and advanced privacy tools, AI can deliver superior performance, security, and resilience in financial services.

Emerging Risks and Sectoral Challenges of AI in Finance
- **Model Risks:** AI outputs may **deviate from expectations**, leading to losses or reputational harm.
  - Risk sources include:
    - **Data risk** – incomplete, biased, or faulty datasets.
    - **Design risk** – flawed algorithms or misaligned objectives.
    - **Calibration risk** – incorrect parameter weights.
    - **Implementation risk** – poor integration into financial processes.
  - **Model-on-model risk**: AI systems used to supervise other AI models can themselves fail, creating cascading effects.
  - **GenAI risks**: "Hallucinations" (false outputs), lower explainability, and misleading communications to customers.
- **Operational Risks – Systems Under Stress:** Automation reduces human error but **amplifies faults at scale**.
  - **Examples:** AI fraud detection misclassifying genuine transactions → loss of customer trust.
    - Credit scoring models failing due to **data pipeline corruption**.
    - "Model drift" when performance degrades over time without monitoring.
- **Third-Party Risks – Vendor Dependencies:** Financial institutions rely on **external AI vendors and cloud providers**.

○ **Risks:** Service interruptions, software bugs, or security breaches.
  ■ **Concentration risk** if a few dominant vendors control critical infrastructure.
  ■ Limited visibility of subcontractors' practices → compliance gaps.

Liability and Accountability Risks: AI systems are **probabilistic, not deterministic**. This blurs lines of responsibility.
● **Risk of AI-Driven Collusion:** Theoretical but significant: autonomous AI systems **colluding to maintain high prices** or manipulate markets.
  ○ Particularly relevant in **high-frequency trading** or dynamic pricing.
  ○ Could breach competition laws and distort markets.
● **Financial Stability Concerns:**
  ○ **Procyclicality**: AI models trained on historical data may amplify boom-bust cycles.
  ○ **Herding effect**: If multiple institutions use similar AI strategies, synchronized behavior can increase volatility.
  ○ Example: **2010 Flash Crash**, where automated trading algorithms wiped out nearly **$1 trillion in minutes**.
● **Cybersecurity Risks – A Double-Edged Sword:**
  ○ **Offensive use**: AI can power advanced cyberattacks like data poisoning, adversarial inputs, deepfake fraud, or phishing.
  ○ **Defensive use**: AI improves detection through anomaly monitoring, predictive analytics, and real-time response.
● **Data Security and Privacy Risks:**
  ○ **Over-collection of data**: AI systems often gather more data than necessary, breaching **data minimization principles**.
  ○ **Data aggregation risks**: Innocent data points, when combined, can reveal sensitive info (mosaic effect).
  ○ **Cloud dependency conflicts**: Global AI infrastructure may clash with India's **data localization** norms.
● **Consumer and Ethical Concerns: Bias** may exclude vulnerable groups (rural poor, women, minorities).
  ○ **Opacity** leaves customers unable to understand decisions.
  ○ **Manipulation risks**: AI-driven nudges may push consumers into choices not aligned with their best interests.
  ○ Raises ethical issues around **informed consent, exploitation, and fairness**.
● **AI Inertia – Risks of Non-Adoption: Not adopting AI** is itself a risk:
  ○ Institutions may fall behind in competitiveness and efficiency.
  ○ Widening financial access gaps if rural/underserved areas miss AI-driven inclusion tools.
  ○ Without AI, institutions lack the ability to counter **AI-driven cyberattacks**.

RBIS Recommendations
● **7 Sutras for AI adoption:**
  ○ **Trust is the Foundation:** Trust is non-negotiable and should remain uncompromised.
  ○ **People First:** AI should augment human decision-making but defer to human judgment and citizen interest.
  ○ **Innovation over Restraint:** Foster responsible innovation with purpose.
  ○ **Fairness and Equity:** AI outcomes should be fair and non-discriminatory.
  ○ **Accountability:** Accountability rests with the entities deploying AI.
  ○ **Understandable by Design:** Ensure explainability for trust.
  ○ **Safety, Resilience, and Sustainability:** AI systems should be secure, resilient, and energy efficient.

- **Innovation Enablement**: Build a robust financial sector data infrastructure as part of the digital public infrastructure, linked with *AI Kosh*.
- **AI Innovation Sandbox**: Set up a secure sandbox (similar to the GenAI Digital Sandbox) where financial institutions can test AI models on anonymized data, with built-in tools to detect bias, errors, and ensure compliance with AML, KYC, and consumer protection standards.
- **Consumer Protection and Security**: Require proportionate AI red-teaming through both regular and event-triggered testing. Introduce incident reporting frameworks with good-faith disclosures to manage risks effectively.
- **Capacity Building in Regulated Entities (REs)**: Design structured training programs for AI governance and risk management across all institutional levels.
- **Knowledge Sharing**: Create mechanisms for exchanging AI use cases and best practices across the financial sector to encourage responsible adoption.
- **AI Incident Reporting**: Develop a dedicated framework for timely detection, reporting, and disclosure of AI-related incidents.