

## **RESERVE BANK OF INDIA (RBI)**

RBI established on April 1, 1935 under RBI Act 1934 (on the recommendations of John Hilton Young Commission 1926 - called Royal Commission on Indian Currency and Finance), is the central bank of the country and was nationalised w.e.f. Jan 01, 1949. Prior to its existence, Imperial Bank of India from SBI was conducting the Central Bank's functions. Originally it was a shareholders' bank which was taken over by the Central Government under Reserve Bank (Transfer of Public Ownership) Act 1948 (paid up capital Rs.5cr). RBI's central office is in Mumbai.

**1. Management of RBI:** RBI is managed by a Central Board of Directors with 4 local board at Mumbai, Delhi, Calcutta and Chennai. It has one Governor, provision for 4 Dy. Governors and IS other directors.

**2. Functions of RBI:**

**2.1 Issuance of currency:** U/s 22 of RBI Act 1934, RBI has the sole agency/authority in India to issue currency notes (called bank notes) under signatures of Governor, except for one rupee note or coins (which is issued by the Central Govt - signed by Finance Secretary).

Issue Deptt is responsible for issue of fresh notes against security which consists of gold coins, bullion, rupee coins foreign securities, eligible promissory notes and other approved securities (aggregate value of gold and foreign exchange reserves should not be less than Rs.200 crore out of which, gold (coins and bullion) should not be less than Rs.11Score) (See 33). The Banking Department undertakes all banking activities and holds stock of currency, which is distributed with the help of currency chests spread all over the country.

**2.2 Banker to the Govt :** U/s 20 for (Central Govt.) and u/s 21-A (for State Govt), Central Bank transacts govt. business and manages public debt. Where it does not have office, SBI or any other public sector bank is appointed its Agent for this purposes. It advises Govt. on all monetary matters and also provides Ways & Means advances (Section 17(5)).

**2.3 Bankers' bank :** It keeps deposits of commercial banks and acts as lender of last resort by providing financial assistance in various ways. Section 17 (2) and (3) enable banks to approach RBI for rediscounting, refinance etc. It provides export refinance to the extent of IS% of outstanding

export credit eligible for refinance as at the end of 2nd preceding fortnight (wef May OS, 200 I) and also Liquidity Adjustment Facility wef June 05, 2000.

**2.4 Controller of Banks:** Every bank which wants to conduct banking business in India has to obtain licence from RBI. RBI also acts as controller of banks by including the banks in India in 2nd Schedule of the Act (such banks which are incorporated under Companies Act or under any other law in force in India or outside including State Coop Banks and which are included in 2nd Schedule of RBI Act 1934 are called scheduled banks). It grants licences to carry on banking business. It issues directions, carries inspection (on-site as well as off-site) and exercises management control.

**2.5 Controller of credit:** U/s 21 and 3SA, RBI can fix interest rates (including Bank Rate) and also exercise selective credit controls in order to control inflation and money supply for ensuring growth of the economy & ensuring price stability. Various methods such as change in cash reserve ratio, stipulation of margin on securities, directed credit guidelines etc. are used for this purpose. These are also called quantitative and qualitative methods. It also carries sale and purchase of securities, which are known as open market operations.

**2.6 Statutory Reserves:** Banks also maintain certain %age of their assets in liquid/cash form under SLR/CRR requirements.

**2.7 Collection of information:** RBI collects credit information (U/s 4S-C information on borrowers enjoying credit limits up to Rs.1 0 lac on secured basis and RS.5 lac on unsecured basis) and can share this information with other banks (See 45- D). Besides, RBI obtains information on suit-filed accounts and BSR returns.

**2.8 Maintenance of external value :** RBI is responsible also for maintaining external value of Indian currency as well as the internal value. Foreign exchange reserves are held by RBI and it has wide powers to regulate foreign exchange transactions under Foreign Exchange Management Act (FEMA).

### **3. Reserve Bank of India act 1934 Important Provisions**

The Act originally passed during 1934, was amended during 1997 to give proper coverage to NBFCs also.

#### **Section**

#### **Summary of provision in the Section**

2(e)	Scheduled Bank means a bank whose name is included in the 2nd schedule of RBI Act 1934
17	Defines various types of business which RBI may transact, which include acceptance of deposit without interest from Central/State government, any other person/institution. purchase/sell foreign exchange, securities,rediscount the bills/promissory notes, grant loans etc.
18	RBI provides emergency loans to banks on liberal terms.
19	Describes business which RBI may not transact.
20	Banker to Govt. It performs various functions for the Gov!. It transacts Gov!.business and manages public debt of the Central Govt.
21	RBI has the right to transact Govt. business inIndiai.e.remittance, exchange, keep it deposit free of int. etc.
22	Sole right to issue bank notes.
23	Bank notes shall be issued by Issue Deptt.
24	Denomination of notes (2, 5, 10, 20, 50, 100, 500. 1000. 5000,10000) Central Govt. maydirect discontinuance or non-issue of bank note of any denomination (2 & 5 already discontinued).
26	Bank notes issued by RBI shall be legal tender and shall be quaranteed by Central Govt.
28	RBI can frame rules for refunding value of mutilated, soiled or imperfect notes as a matter of grace. Rupee coin and one rupee note shall not be a currency note

	for any of the purposes of this Act.
29	Bank note shall be exempted from stamp duty under Indian Stamp Act.
31	Prohibits issue of note payable to bearer. No person in India other than RBI or Central Govt. shall draw, accept, make or issue any Bill of Exchange, hundior promissory note for the payment of money payable to bearer on demand.
33	Assets of Issue Deptt of RBI shall consist of goldcoins, gold bullion and foreign securities not at anytime be less than RS.200 cr, of which gold coin and gold bullion not less than RS.115 cr.
42	Cash Reserve Ratio (CRR) of scheduled banks to be kept with RBI on an average daily balance
42(c)	Empowers RBI to add or delete the name of any bank in 2nd schedule of RBI Act 1934
43	RBI to publish every fortnight a consolidated statement showing aggregate liabilities and assets of all SCBs.
45 A to F	Empowers RBI to collect credit information. (Section 45-C - Return as on last Friday of April & October every year giving information on borrowers njoying secured credit limits of RS.1 0 lac and above and unsecured limits of RS.5 lacand above) RBI also collects details (1/2yearly March/Sept) of all doubtful, loss and suit filed accounts with aggregate outstanding of RS.1 00lac and above and circulates the information amongst banks and financial institutions, Besides, banks submit Basic Statistical Returns i.e. BSR-1 (details regarding borrowal accounts of above RS.2 lac) and BSR-2 (information aboutdeposits with break-up in to current; savings and term deposits).
45H-45T	Regulations relating to non-bank finance-companies. Section 45-S puts banks on acceptance of deposits from public by individualor unincorporated

	body, as per an amendment in 1997.
48	Exemption to RBI from paying income tax or super tax.'
49	Announce/publish Bank Rate. (Bank rate as per this Section is . the standard rate at which RBI is prepared to buy or rediscount bills of exchange or other commercial papers eligible for purchase under this Act).

**Organisation:**Central Banking as a concept is of fairly recent origin. Though some Latin American countries had a central banking system in the 19th century, this system really became popular in the early 20th Century. Generally speaking, a Central Bank is considered as the leader of the money market, but several economists emphasize different roles for the Central Bank. For example, according to Whawtrey,R.G, the essential characteristic of a Central Bank is its function as the 'lender of last resort'. According to Kische& Elkin. The main function of the Central Bank is to maintain the 'stability of the monetary standard'. On the other hand, Shaw,W.R. lays emphasis on 'credit control' as the major function of Central Bank. The Bank of England founded in 1694 is perhaps the oldest Central Banking institution which provides finance for the government. The first attempt at Central Banking in India dates back to General Bank in Bengal & Bihar estd. in January, 1773 at the instance of Warren Hastings, the then Governor of Bengal. But this experiment was very short lived. Three Presidency Banks were established and started functioning in 1866. Alongwith their commercial functions they undertook some functions on behalf of the Government also. These Presidency Banks were amalgamated in 1921 to form the Imperial Bank of India which was primarily a commercial bank but used to perform certain central banking functions as well. In 1926 the Royal Commission on 'Indian Currency & Finance' (Milton Young Commission) recommended the dichotomy to be ended & the establishment of a Reserve Bank of India as its Central Bank. A Bill was introduced in the Legislative Assembly in 1927, which was later dropped. In the meantime during 1930-31 consideration for constitutional reforms in the country started being debated. Ultimately, the Reserve Bank of India Act was passed in 1934, part of which came into operation in 1935

& the remaining part in 1937. It took over the management of the currency from the Central Government and of carrying on the business of banking in accordance with the provisions of the Act. As stated in the preamble to the Act, the Bank has the

responsibilities of (i) regulating the issue of Bank notes; (ii) keeping of reserves with a view to securing the monetary stability in India; and (iii) generally to operate the currency and credit system of the country to its advantage.

As provided in Section 3(2) of the Act, the Bank is a body corporate having perpetual succession and common seal and shall sue and be sued in its name. The whole capital of the Bank of RS.5.00 crores is at present held by the Central Government. The Bank has Its Central Office in Bombay and other offices in Bombay. Calcutta. Delhi and Madras and branches in most of the State capitals and departments at a few other important .places. The matters of policy relating to banking, monetary management exchange control, inspection and supervision of banks, credit control, and economic and financial matters are formulated at the Central Office of the Bank at Bombay. The basic function of note issue and general banking business are discharged by the issue department and banking department at the local offices branches.

### **Organisational Model**

The Reserve Bank of India (RBI) was originally constituted as a shareholders' bank with a share capital of 5 crores divided into 5 lakh fully paid-up shares of Rs. 1001- each. Only 2.300 shares were held by the Federal Government. The whole: country was divided into 5 areas for the operation of the Bank. viz., Bombay.Calcutta, Madras, Delhi & Rangoon\*. (\* closed Since 1947). In 1948, RBI was nationalised by the Reserve Bank (Transfer to Public Ownership) Act, 1948, and the entire hare capital was acquired by the Central Government.

With the introduction of the Constitution of India in 1950, RBI was put under entry 38 List I, VII Schedule U/Art226, thereby subjecting RBI to the legislative power of the Parliament. Accordingly, the Act was amended several times by the Parliament to virtually touch every section. There were some extremely important amendments which will be discussed alongwith the concerned subject. It will suffice to give the following outline of the organisational set-up of RB I as it stands today.

The RBI was initially designed on the pattern of Bank of England, theoretically subordinate to the Treasury. The Governor, 4 Deputy Governors, all Directors of the Central Board & the Local Boards are either appointed or nominated by the Central Government. The Governor & the Deputy

Governor are whole time officials and hold office for such term not exceeding 5 years as may be fixed by Central Government and are eligible for re-appointment [S.8(4).] They may however

be removed from their office by the Central Government at any time. This legal provision has made RBI an almost subordinate agency of the Ministry of Finance, Government of India.

There are several models of Central Banking. The dominating models are:

1. Bank of England, which is in theory as stated earlier subordinate to the Treasury but in practice has a relationship of co-operation rather than subordination (Sheldon, p.8). This model can be called (the 'functionally independent' model).
2. Federal Reserve System, USA- This system can be said to be both' functionally & statutorily independent.
3. Deutsche Bundesbank, Germany - This can be said to be constitutionally & functionally independent. The Central Bank Council & the Directorate are headed by the President & Vice President of the Deutsche Bundesbank. The President & Vice President of this' Bank are appointed by the President of Germany on recommendation of the Bundesrat (upper House of Parliament). The Bundesbank is independent of the instructions of the Federal Government. In order to maintain cooperation between the Central Bank & the Federal Government, the government is required under the Constitution to consult the President of Bundesbank on all matters of basic monetary policy. There is an autonomous Central Bank council in whose meetings the Federal government may take part but cannot participate in the voting.

The operational efficiency of an organisation predominantly depends upon the organisation structure of the institution. Several issues are important while determining this organisational structure. The organisation of RBI was modelled on the pattern of Bank of England as being subordinate to the Central Government at a time when imperial power wanted to have a positive & definite power centralisation. Continuation of the

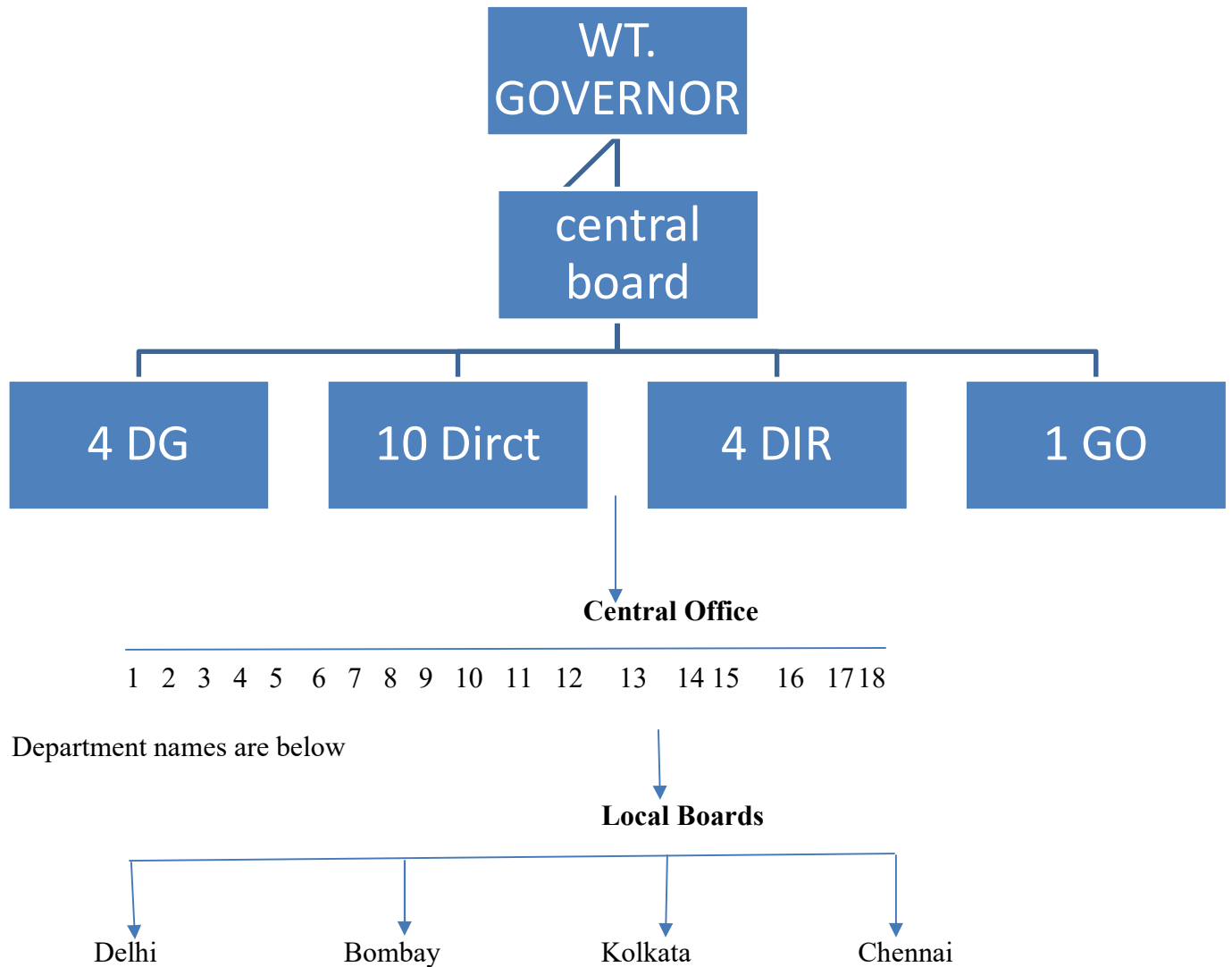
same structure in a democratic set-up may be examined in view of the need for a strong monetary system. This requires an autonomous institution to cooperate with the Central Government for laying down a strong monetary system. But the organisational structure of RBI is entirely subordinated to the Central Government. The Governor, 4 Deputy Governors and all the Directors of the Central Board and Local Boards are

appointed/nominated by the Central Government (CG) and hold office during the pleasure of Central Government. In England a legal prescription of subordination to the treasury is replaced by close cooperation through establishment of sound conventions. In India on the other hand, this led to super control, so much so that even a Deputy Secretary of the Ministry of Finance became more powerful than the Governor of the RBI. This is very unscientific and injurious to the nation's economy. As for example, RBI can't refuse to supply any quantity of money to the government, against Government securities. As a result, it is unable to maintain the value of money and effectively manage the monetary affairs of the country, which is its primary consideration u/s.3 of RBI Act.

The Constitution of India is not merely a political document but it also contains the financial aspiration of the country. Therefore, the responsibility of the leader of the Bank in the national economy is enormous, which in no way is any less important than the resource distribution work of the Finance Commission of the country. As a matter of fact, the present statutory provision has not merely created an atmosphere of dependantia, but has also made the Central Bank (i.e. RBI) gradually weaker. Since the system of governance could not build up a strong convention of autonomy and an institution of co-operation with the Central Government, it may be necessary to review the organisational structure in the light of experience of other constitutional institutions.



## Organisation Chart of RBI (s. 8 & 9 of the act)



Departments in the Central Office

- I. Secretariat
2. Banking operations & development Agricultural Credit
3. Industrial Credit

- 4 Expenditure & budgetary control
  5. Rural Planning & Credit
  6. Exchange Control
  7. Currency management
  9. Govt. accounts Economic analysis & policy
- II. Credit planning cell
- 12 Statistical analysis & Computer
  13. Management Service
  - 14 Administration & Personnel
  15. Legal Services
  - 16 Inspection .
  17. Premises
  18. Bankers Training Colleges, one each at Bombay, Pune & Madras

## CENTRAL BOARD & ITS FUNCTIONS

### **Constitution**

The general superintendence and direction of the affairs and business of the Bank are entrusted to a Central Board of Directors under Section 7 of the Act. However, the Board has to abide by any directions that may be given by the Central Government after consultation with the Governor of the Bank. Such directions can be given from time to time in public interest. The Central Board shall consist of the Governor, not more than 4 Deputy Governors to be appointed by the Central Government and other directors to be nominated by the Central Government as under:

- i) four directors to be nominated by Central Government, one each from the Local Boards constituted under Section 9.
- ii) ten directors to be nominated by Central Government.

iii) one .Government official to be nominated by the Central Government.

The Governor and Deputy Governors are wholetime officials of the Bank. A Deputy Governor and a Government official nominated as above [under Section 8(1)(d»)] may attend any meeting of the Central Board and participate in deliberations but do not have voting rights. The Governor and Deputy Governors hold office for a term fixed by the Central Government at the time of appointment, not exceeding 5 years and are eligible for reappointment. The Government official nominated under Section 8(1)( d) shall hold office at the pleasure of the Government. The directors 4 nominated from the Local Board shall continue during their membership of the Local Boards. The other directors shall hold office for 4 years and thereafter until their successors are nominated. TheBRAct prescribes certain qualifications (Chartered Accountant, Lawyer,.etc.) for the Directors of commercial banks, where as there are no such qualifications specified for appointment to the Board of Directors. Under Section 11, the Central Government may remove from, office the Governor or a Deputy Governor or any other director or any member of the Local Board. Central Government has also the power under Section 30 to supercede the Central Board. if the Bank fails to carry out any of the obligations imposed on it by or under the Act. In such a case.the general superintendence and direction of the affairs of the Bank shall be entrusted to any other agency determined by the Central Government. A full report of the circumstances leading to such action has to be laid before the parliament at the earliest and in any case within 3 months.

### **Powers**

The Central Board has wide powers and may exercise all powers and do all acts and things which may be exercised or done by the Bank subject to any directions issued by the Central Government in public interest after consultation with the Governor. Further, the Governor or in his absence, the Deputy Governor nominated by him in this behalf shall also have powers of general superintendence and direction of the affairs and business of the Bank, and may exercise all the powers and functions of the Bank unless otherwise provided in the regulations made by the Central Board.

### **Meetings**

Meetings of the Central Board have to be held at least six times a year and at least once in a quarter, The Governor or a Deputy Governor duly authorised shall preside over such meetings and he shall have casting vote (or second vote) in the event of equality of votes.

## **Regulations**

Under Section 58 of the Act, the Central Board has the power to make regulations forgiving effect to the provisions of the Act. Such regulations are to be made after previous sanction of the Central Government. These regulations are also required to be laid before both the Houses of the Parliament.

## **Functions**

For practical convenience the Board delegated some of its functions by means of statutory regulations to a Committee called the 'Committee of the Central Board' consisting of the Governor, Deputy Governors and such other Directors as may be present at the relevant time in the area where the meeting is to be held. The Committee meets once a week, generally on Wednesday at the office of the Bank in which the Governor has his Head Quarters for the time being, to attend to the current business of the Bank, approval of the Banks weekly accounts pertaining to the issue and the banking departments. This Committee is assisted by two sub-committees: one for dealing with staff and related matters & the other for looking after matters relating to building projects. Of course, the role of these sub-committees is purely advisory in nature.

## **Special Provisions**

The Reserve Bank is exempted from income-tax and super-tax on its profits or gains under Section 48 of the Reserve Bank of India Act. Further Section 57 provides that the Bank should not be placed under liquidation except by an order of the Central Government and in such manner as it may direct. Administrative set-up The Governor has the power of general superintendence and direction of the affairs of the Bank and may exercise all powers of the Bank unless otherwise provided in the regulations made

by the Central Board. The Deputy Governors, Executive Directors and other officers in different grades assist the Governor. The delegation of powers to different grades of officers is governed by the Reserve Bank of India General Regulations, 1949, which are statutory regulations made under Section 58 of the Act. The officers and other staff are governed by the Reserve Bank of India (Staff) Regulations, 1948. These regulations are not statutory. As held by the Supreme Court in *V.T. Khazode V s. Reserve Bank*<sup>1</sup>, besides making statutory regulations under Section 58 of the Act, Bank could also lay down service conditions of the staff administratively under Section 7(2) of the Act. Establishments The Central office [Head Quarters (H.Qrs.)] of the Bank is located at Bombay. Formulation of policies concerning banking, money management, inspection & supervision of Banks, extension of banking & credit facilities,

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<sup>1</sup>AIR 1982 SC 917

management of foreign exchange and rendering of advice to the Central Government all these functions are carried out from the Head Quarters. Besides these the Central office has various departments. The department of 'banking operations & development' includes Public Accounts Division (PAD), Public Debt Office (PDO), Deposit Accounts Division (DAD) & Securities Division (SO). The Head Quarters of the 'department of non banking companies' is located in Calcutta.

## 1.4 LOCAL BOARDS AND ITS FUNCTIONS

### **Constitution**

Section 9 of the Act provides for four regional Local Boards consisting of 5 members each appointed by the Central Government to represent, as far as possible, territorial and economic interest and the interests of co-operative and indigenous banks. The Local Boards have their headquarters at Bombay, Calcutta, Delhi and Madras. The Local Board has a Chairman elected from the members. The members of the Local Boards hold office for 4 years and thereafter until their successors are nominated. They are also eligible for reappointment.

### **Functions**

The function of the Local Board is to advise the Central Board on matters generally or specially referred to it by the Central Board and also to perform any duties delegated to it by the Central Board. The advice of the Local Boards is sought on various matters of local importance, for ego applications for opening new branches of commercial banks, opening of offices in India by foreign banks, directions to be given to the banks on basis of inspection, granting of license to commercial banks.etc., In 1976, financial powers were also delegated to the Local Boards enabling them to take final decisions in matters relating to purchase of land, buildings, etc. within the limits fixed by the Central Board.

### **Disqualifications**

There are certain disqualifications under Section 10 applicable to Directors of both Central Board and Local Boards. Thus (i) a person who is a salaried government official;

(ii) an adjudicated insolvent or one who has suspended payment or has compounded with his creditors; (iii) a person of unsound mind;

(iv) an officer or employee of any bank or

(v) a director of a banking company or co-operative bank is disqualified to be a director.

However, this stipulation prohibiting a director from being a government employee or salaried government official is not applicable to the Governor, Deputy Governor and the Director nominated under Section 8(1)(d). The efficiency of a Central Banking system is to be judged by its ability to maintain price stability inside and outside the country. Factors affecting this efficiency are (i) the strength of autonomous decision making power for leading the whole banking system with the basic objective of money management; (ii) quick information flow and capability of immediate assessment of the situation; & (iii) adequate power of system corrections.

(i) An empirical understanding of the men in the management of RBI can clearly show the political overtone in the management structure of the RBI. Appointments to various senior positions in RBI's management are mere executive functions of the Ministry of Finance of Government of India. Instances of appointing persons to the highest post in the Reserve Bank not having adequate experience in banking are not unknown. Political considerations often dominate while constituting Central & Local boards. Such appointments do not require any legislative or judicial scrutiny. There is complete lack of transparency in the constitution & appointment of this highest administrative setup in the RBI. As such, in designing the monetary policy,

## **FUNCTIONS**

It has already been pointed out that RBI has been constituted as Central Bank of the country. Classification of functions of the Central bank are the following:

**Banker to the Government:** Reserve Bank of India is the banker of the Central & State Governments as such it has treasury functions. It collects money for & on behalf of the Government and meets the expenses, whereas in the case of Central Government it may demand any quantity of money and the RBI is obliged to meet the demand. In case of State governments the RBI extends a time credit facility to a maximum limit which is required to be set off against future collections.

**Currency Function:** RBI is the sole authority for the issue of the currency. Of course one rupee coins & notes & subsidiary coins are issued by the government of India, they are put into circulation only through RBI. **Credit Control & Money Management of currency:**

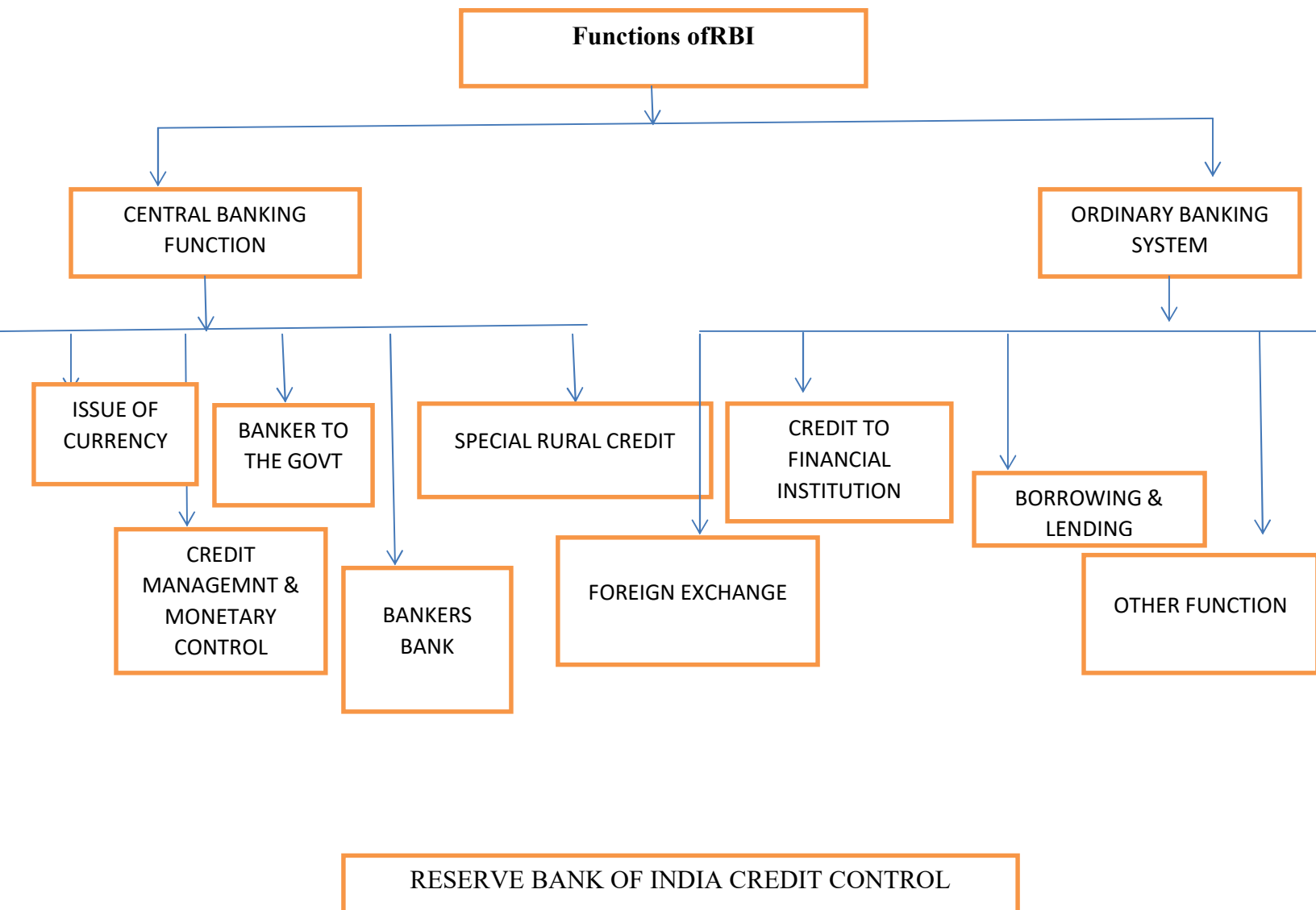
RBI regulates the value of money & controls the credit system through manipulation of cash reserve ratio, bank rate, open market buying & selling of securities & statutory liquidity ratio. **Banker's Bank:** RBI is the apex bank regulating, controlling & creating opportunities for ordinary commercial banks to function

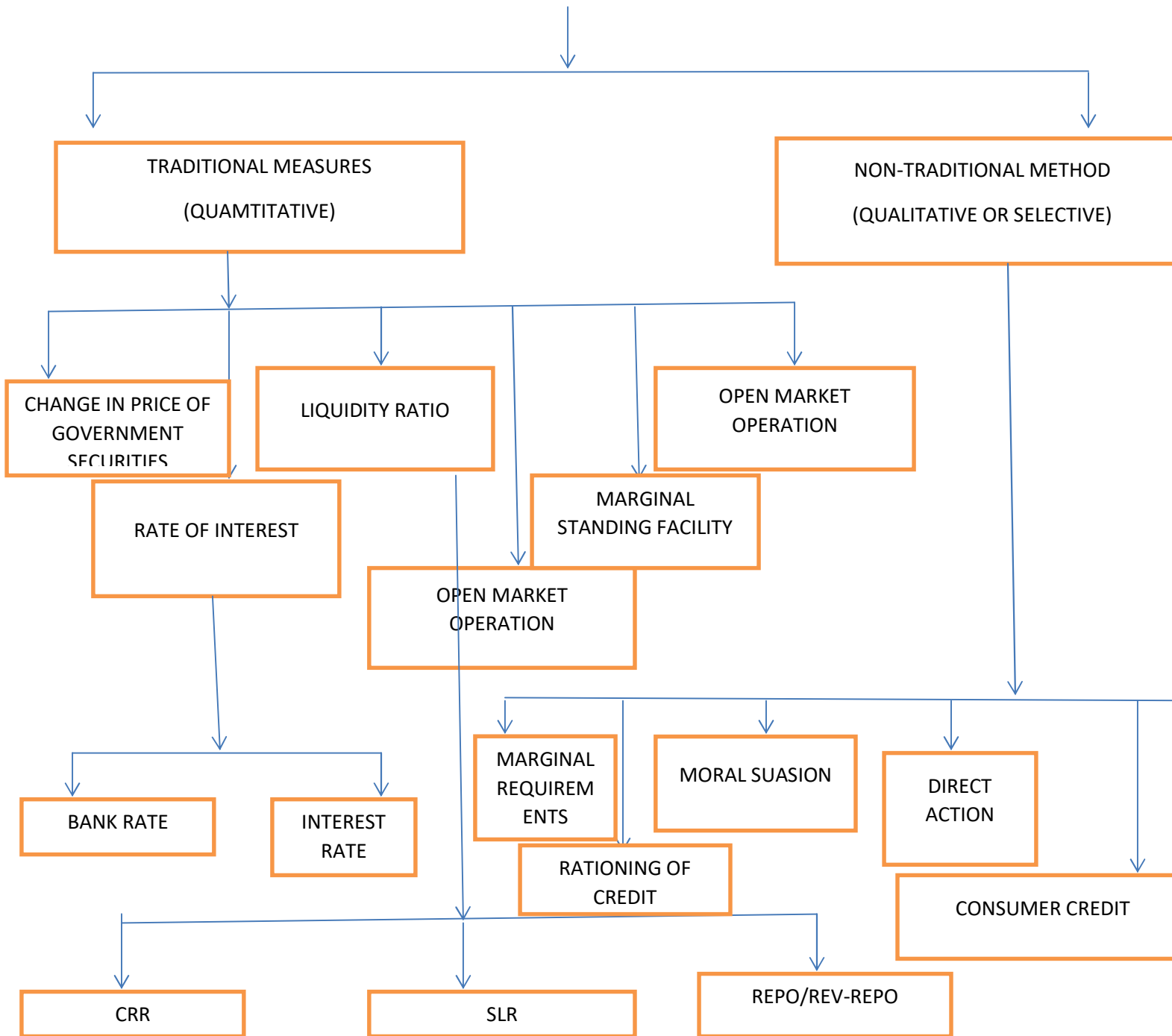
efficiently. It also gives constant advice about the various goals of lending, borrowing & other banking functions. It also monitors the banking functions of the institutions of commercial banks & institutional banks. Leadership in institutional banking: RBI provides leadership to all institutional banking such as NABARD Rural Bank, IBRD, IFC in industrial banking, National Housing banking so on & so forth. These banks look forward to RBI for their policies on loans & advances. Ordinary Commercial Banking Function: RBI carry on ordinary commercial banking functions for the commercial banks and the government which many central banks of other countries do not do. These functions include bill discounting, giving loans & advances to financial institutions, dealing with foreign exchange & the like.

### OUTLINE OF THE FUNCTIONS

The following table gives the outline of the functions of the

Reserve Bank of India:





REFERENCE:



- 1.M.L.Tannen, Tannen's Banking Law & Practice in India.
2. Dr. Avtar Singh, Negotiable Instrument Act.
3. S.N. Gupta, The Banking Law in Theory & Practice.
4. Sharma and Nainta, Banking Law & Negotiable Instruments Act.

ACTS:

1. RESERVE BANK OF INDIA ACT,1934
2. BANKING REGULATION ACT, 1949