Reserve Bank of India Act, 1934

Origin of the Reserve Bank of India –

1926 - Royal commission recommended creation of Central Bank for India

→ 1927 - Therefore, bill was moved in legislative assembly but was withdrawn due to lack of agreement among various sections people

→ 1933 - The white paper on Inidan constitutional reforms recommended creation of RBI. for this a fresh bill was introduced.

→ 1934 - Bill was passed and governor's assent was recieved

→ 1935 - RBI commenced business on 1st April with a capital of 5cr rupees

→ 1942 - RBI ceased to be currency issuing authority of Burma (Now Myanmar)

→ 1947 - RBI stopped acting as bank to the government of Burma

→ 1948 - The RBI stopped rendering central banking services to Pakistan

→ 1949 - GOI nationalised RBI

Establishment and Incorporation Of Reserve Bank – Section 3

- Section 3 of the RBI Act states that a bank to be called the Reserve Bank of India.
- RBI shall be constituted for the purposes of taking 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.
- RBI is a body corporate having perpetual succession and a common seal, and can sue and be sued.

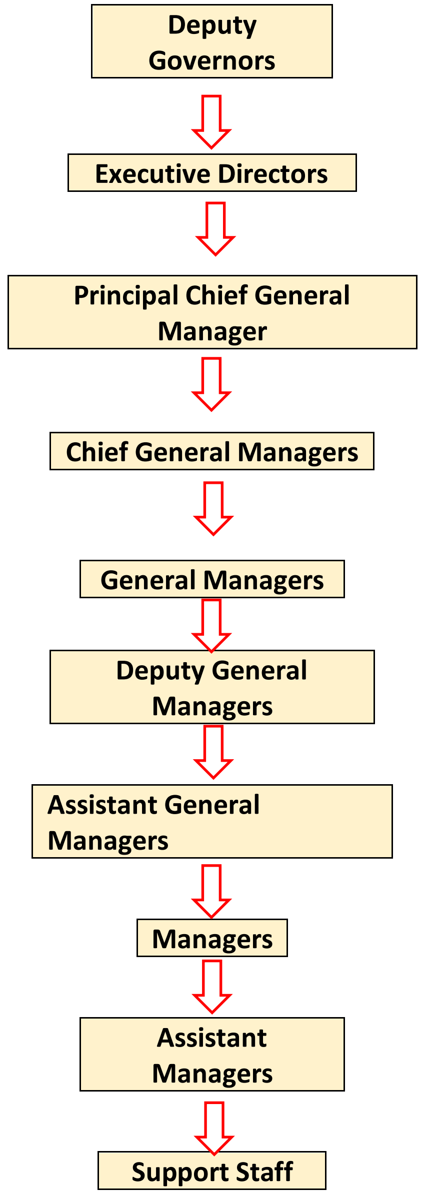
Organisational Structure & Management of RBI –

Central Board of Directors

⇩

Governor

⇩



Central Board of Directors (CBD) – Section 8

A) About Central Board of Directors –

a) The Central Board of Directors is at the top of the Reserve Bank's organisational structure.
b) The Reserve Bank's affairs are governed by a central board of directors.
c) The board is appointed by the Government of India as per Reserve Bank of India Act, 1934.

B) Composition of CBD –

Central Board shall consist of the following Directors –

- **a Governor and not more than 4 Deputy Governors** to be appointed by the Central Government;
- **4 Directors to be nominated by the CG**, one from each of the four Local Boards;
- **10 Directors to be nominated by the CG**; and
- **1 Government officials to be nominated by the Central Government**

Note –

Working of the board or any proceedings before the board cannot be called in question only because of the fact that there is vacancy in the Board or any defect in the constitution of Board.

Important points –

a) **Governor and Deputy Governors shall be full time directors**

b) A Deputy Governor and the government official appointed by the CG may attend any meeting of the Central Board and take part in its discussions but shall not be entitled to vote

c) When the Governor is, for any reason, unable to attend any such meeting, a Deputy Governor authorised by him in this behalf in writing may vote for him at that meeting

C) Maximum Tenure –

Officers	Tenure
Maximum tenure of Governor and Deputy Governor	5 years and shall be eligible for reappointment.
Maximum tenure of 10 Directors nominated by CG –	**4 years** and shall be eligible for reappointment. **Maximum 2 terms is allowed i.e. 8 years**
Maximum tenure of 1 government officials appointed by CG	**Tenure will be decided by CG**

Local Boards – Section 9

The RBI also has 4 Local Boards

- Western Board
- Eastern Board
- Northern Board
- Southern Board

Important Points –

- Each of these Boards has five members appointed by the Central Government.
- Term will be of **maximum 4 years.**
- They are eligible for re-appointment.
- The members of the Local Board shall elect from amongst themselves one person to be the Chairman of the Board.

Offices and Branches –

1) The Reserve Bank has a network of offices and branches through which it discharges its responsibilities.
2) The units operating in the four metros — Mumbai, Kolkata, Delhi and Chennai — are known as offices
3) Currently, the Reserve Bank has its offices, including branches, at 27 locations in India.
4) The offices and larger branches are headed by a **senior officer of the rank of Chief General Manager.**
5) Smaller branches are headed by a **senior officer of the rank of General Manager**.

Functions of The Reserve Bank –

A) Purpose of RBI –
   1) To regulate the issue of banknotes;
   2) To regulate keeping of reserves with a view to securing monetary stability in India;
   3) To operate the currency and credit system of the country to its advantage;
   4) to maintain price stability while keeping in mind the objective of growth;
   5) To look after the monetary policy framework in India.

B) Functions of RBI –
   - ✓ Banking Functions
   - ✓ Issue bank notes
   - ✓ Monetary Policy Functions
   - ✓ Public Debt Functions
   - ✓ Foreign Exchange Management
   - ✓ Banking Regulation & Supervision
   - ✓ Regulation and Supervision of NBFCs
   - ✓ Regulation & Supervision of Co-operative banks
   - ✓ Regulation of Money Market Instruments
   - ✓ Payment and Settlement Functions
   - ✓ Consumer Protection Functions
   - ✓ Financial Inclusion and Development Functions

Banking Functions –

1) CBD exercises all the powers and functions and does all acts for RBI.
2) RBI may transact various businesses such as –
   a) acceptance of deposits without good interest from Central Government and State Governments,
   b) purchase, sale and rediscount of Bills of Exchange, short term Loans and Advances to banks,
   c) annual Contributions to National Rural Credit Funds,

d) dealing in Derivatives,

e) purchase and sale of Government Securities,

f) purchase and sale of shares of State Bank of India, National Housing Bank, Deposit Insurance and Credit Guarantee Corporation, etc.,

g) keeping of deposits with SBI for specific purposes, making and issue of Banknotes, etc.

3) RBI also act as 'Lender of Last Resort'.

4) RBI also act as banker to Central Government and State Governments.

<u>RBI cannot transact following business –</u>

- purchase the shares of any banking company or of any other company, or grant loans upon the security of any such shares
- advance money on mortgage of,immovable property or become the owner of immovable property, except so far as is necessary for its own business premises and residences for its officers and servants;
- make loans or advances;
- draw or accept bills payable otherwise than on demand;
- allow interest on deposits or current accounts.
- engage in trade or have a direct interest in any commercial, industrial or other undertaking except such interest as it may in any way acquire in the course of the satisfaction of any of its claims

Issue Functions –

- Right to issue bank notes is one of the key central banking functions of the RBI.
- This function is performed by the Issue Department and is kept wholly distinct from Banking Department
- The RBI Act gives power to the RBI to recommend to CG the denomination of bank notes i.e. two rupees, five rupees, ten rupees, twenty rupees, fifty rupees, one hundred rupees, five hundred rupees, one thousand rupees, two thousand rupees, five thousand rupees and ten thousand rupees or other denominations not exceeding ten thousand rupees.
- The design, form and material of bank notes is approved by Central Government on the recommendations of Central Board of the RBI.
- Another important function is exchange of mutilated or torn notes, which under the RBI Act is not a matter of right, but a matter of grace.
- The bank notes that are being issued by RBI are exempt from payment of stamp duty.

Monetary Policy Function –

A) Monetary Policy Committee –

- Central Government should constitute a Monetary Policy Committee.
- The Monetary Policy Committee consists of –
  a) the Governor of the RBI;
  b) Deputy Governor of the RBI in charge of Monetary Policy;
  c) one officer of the RBI to be nominated by the Central Board; and
  d) 3 persons to be appointed by the Central Government

B) Important points –

a) MPC have statutory duty to determine the Policy Rate required to achieve the inflation target.
b) The decision of the Monetary Policy Committee is binding on RBI and the RBI is required publish a document explaining the steps to be taken to implement the decisions of the Monetary Policy Committee.

Meetings of Monetary Policy Committee –

1) The RBI shall organise at least four meetings of the Monetary Policy Committee in a year.
2) The meeting schedule of the Monetary Policy Committee for a year shall be published by the Bank at least one week before the first meeting in that year
3) The meeting schedule may be changed only –
   a) by way of a decision taken at a prior meeting of the Monetary Policy Committee; or
   b) if, in the opinion of the Governor, an additional meeting is required or a meeting is required to be rescheduled due to administrative emergency.
4) Any change in meeting schedule shall be published by the Bank as soon as practicable.
5) Quorum for a meeting shall be four Members out of which atleast one should be governor and in his absence, deputy governor who is the Member of the Monetary Policy Committee..
6) Meeting shall be headed by governor and in his absence by the Deputy Governor who is a Member of the Monetary Policy Committee.
7) Each Member of the Monetary Policy Committee shall have one vote.
8) All questions which come up before any meeting of the Monetary Policy Committee shall be decided by a majority of votes by the Members present and voting, and in the event of an equality of votes, the Governor shall have a second or casting vote.
9) Each Member of the Monetary Policy Committee shall write a statement specifying the reasons for voting in favour of, or against the proposed resolution.
10) The proceeding of the Monetary Policy Committee shall be confidential.

Public Debt Functions –

1) The Parliament of India enacted the Government Securities Act, 2006
2) The GS Act applies to Government securities created and issued by the CG or SG.
3) The GS Act prescribes the procedure and mode to be followed by RBI in the management of public debt and also confers (gives) various powers on RBI including the power to determine the title to a Government security if there exists any doubt in the opinion of RBI.

Foreign Exchange Management –

1) Powers and responsibilities relating to foreign exchange have been conferred on RBI under FEMA Act, 1999.
2) RBI has the power to authorize any person to be known as authorized person to deal in foreign exchange or in foreign securities.
3) Similarly, it has the power to revoke an authorization.

Banking Regulation & Supervision –

1) The power to regulate and supervise banks has been provided to RBI under the provisions of Banking Regulation Act, 1949
2) RBI has the following powers for the purpose of regulation and supervision of banks –

a) Power to issue license and also to cancel licenses of banking companies
b) Power to appoint a Chairman or Managing Director of a banking company under certain situations specified in Banking Regulation Act, 1949
c) Power to appoint additional directors on the boards of banking companies.
d) power to remove Chairman or Managing director of banking company as per the provisions of Banking Regulation Act, 1949.
e) Power to supersede the board of banking companies.
f) Power to issue directions to banking companies in the public interest or in the interest of banking policy or to prevent the affairs of any banking company being conducted in a manner detrimental (injurious) to the interests of the depositors
g) Power to issue directions to banking companies for resolution of stressed assets.
h) Power to inspect banking companies on its own or at the instance of Central Government under the provisions of the BR Act, 1949.

Regulation and Supervision of NBFCs –

- The regulation and supervision of non-banking financial companies is one of the critical functions that the RBI has been entrusted with.
- Every NBFC is **mandatorily required to be registered** with RBI under section **Section 45-IA of RBI Act, 1934.**
- RBI has powers to regulate or prohibit issue of prospectus or advertisements soliciting deposits of money by non-banking financial companies,
- RBI has power to determine policy and issue directions to non-banking financial companies.
- RBI has power to call for information and issue directions to non-banking financial companies
- The RBI has powers to inspect NBFC

Regulation & Supervision of Co-operative banks –

- Regulation and supervision of urban co-operative banks is another area the RBI has been entrusted with.
- The entry relating to Cooperative Societies fall in State List whereas the entry relating to banking falls in the Union List. These results in the duality of jurisdiction over cooperative banks both by the Reserve Bank of India, in terms of Banking Regulation Act, 1949, and the Registrar of Cooperative Societies, in terms of the respective State Cooperative Societies Act, of the State concerned
- Section 56 of the BR Act, 1949, makes it applicable to co-operative societies involved in the business of banking.
- RBI has been entrusted with the powers to issue licenses and cancel licenses of co-operative banks, supersede their boards, inspect them and also issue directions to them in the public interest, interest of banking policy, control over loans and advances, etc.

Regulation of Derivatives and Money Market Instruments –

1) Definition of derivatives –

Derivative is defined as 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 RBI from time to time.

2) **Definition of money market instruments –**
money market instruments have been defined to include call or notice money, term money, repo, reverse repo, certificate of deposit, commercial paper and such other debt instrument of original or initial maturity up to one year as the RBI may specify from time to time.

3) RBI may 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.

Payment and Settlement Functions –

- The Parliament of India enacted the Payment and Settlement Systems Act, 2007.
- Objective of the Act is to provide for the regulation and supervision of payment systems in India and to designate Reserve Bank of India as the authority for that purpose.
- No person shall commence or operate a payment system except with an authorization issued by the RBI.
- RBI also has the powers to revoke the authorization granted to any person if it contravenes any of the provisions of PSS Act
- The regulatory and supervisory controls include the power to determine standards for the functioning of payment systems, power to call for returns, documents or other information, power to enter and inspect payment systems, power to carry out audit and inspections, power to issue directions, etc.

Right to Issue Bank Notes –

- Along with the Government of India, the Reserve Bank is responsible for the design, production and overall management of the nation’s currency, with the goal of ensuring an adequate supply of clean and genuine notes.
- In consultation with the Government, the Reserve Bank routinely addresses security issues and targets ways to enhance security features to reduce the risk of counterfeiting or forgery of currency notes.
- The Paper Currency Act of 1861 conferred upon the Government of India the monopoly of issuing note, thus ending the practice of private and presidency banks issuing currency.
- Between 1861 and 1935, the Government of India managed the issue of paper currency.
- In 1935, when the Reserve Bank began operations, it took over the function of note issue from the Office of the Controller of Currency, Government of India.

Denominations of Notes –

- The Indian Currency is called the *Indian* Rupee and its sub-denomination the *Paisa.*
- At present, notes in India are issued in the denomination of `5, `10, `20, `50, `100, `200, `500 and `2,000.
- The printing of 1 rupees and 2 rupees denominations has been discontinued.
- However, notes in these denominations issued earlier are still valid and in circulation.

- The Reserve Bank is also authorised to issue notes in the denominations of five thousand rupees and ten thousand rupees or any other denomination, but not exceeding ten thousand rupees that the Central Government may specify.
- The Government of India announced the demonetisation of rupees 500 and rupees 1000 bank notes with effect from midnight of November 8, 2016, making these notes invalid.
- A newly redesigned series of `500 banknote, in addition to a new denomination of`2000 banknote is in circulation since 10 November 2016.

Currency Distribution –

a) The Government of India on the advice of the Reserve Bank decides on the various denominations of the notes to be printed.
b) The Reserve Bank coordinates with the Government in designing the banknotes, including their security features.
c) The printed notes received from Printing Press set up by Government and RBI are issued for circulation both through remittances to banks as also the Reserve Bank counters.

Coin Distribution –

1) The Indian Coinage Act, 1906 governs the minting of rupee coins including small coins of the value of less than one rupee.
2) Coins are legal tender in India for unlimited amounts.
3) Fifty paisa coins are legal tender for any sum not exceeding ten rupees and smaller coins for any sum not exceeding one rupee
4) The Reserve Bank acts as an agent of the Central Government for distribution, issue and handling of the coins and for withdrawing and remitting them back to Government as may be necessary

Combating Counterfeiting (duplicate) –

1) The Reserve Bank, in consultation with the Government of India, periodically reviews and upgrades the security features of the bank notes to deter counterfeiting.
2) It also shares information with various law enforcement agencies to address the issue of counterfeiting.
3) It has also issued detailed guidelines to banks and government treasury offices on how to detect and impound counterfeit notes.

Bank exempt from stamp duty on bank notes –

The Bank is not liable to the payment of any stamp duty under the Indian Stamp Act, 1899, in respect of bank notes issued by it.

Powers of Central Government to supersede Central Board – Section 30

1) If in the opinion of Central Government the Bank fails to carry out any of the obligations imposed on it by or under the Act, by notification in the Gazette of India, declare the Central Board to be superseded, and thereafter the general superintendence and direction of the affairs of the Bank shall be entrusted to such agency at the Central Government may determine, and

such agency may exercise the powers and do all acts and things which may be exercised or done by the Central Board under the Act.

2) When action is taken under this section the Central Government shall cause a full report of the circumstances leading to such action and of the action taken to be laid before Parliament at the earliest possible opportunity and in any case within three months from the issue of the notification superseding the Board.

Issue of demand bills and notes – Section 31

1) No person in India other than the Bank, or, as expressly authorized by the Act the Central Government shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand, or borrow, owe or take up any sum or sums of money on the bills, hundis or notes payable to bearer on demand of any such person.
2) However, cheques or drafts, including hundis, payable to bearer on demand or otherwise may be drawn on a person's account with a banker, shroff or agent.

Management of Public Debt –

1) The Reserve Bank manages the public debt and issues new loans on behalf of the Central and State Governments.
2) It involves issue and retirement of rupee loans, interest payment on the loan and operational matters about debt certificates and their registration.
3) The union budget decides the annual borrowing needs of the Central Government.
4) The Reserve Bank's debt management policy aims at minimising the cost of borrowing, reducing the roll-over risk, smoothening the maturity structure of debt, and improving depth and liquidity of Government securities markets by developing an active secondary market.

Reserve Bank as Banker to Banks –

- The Reserve Bank to fulfill this function, opens current accounts of banks with itself, enabling these banks to maintain cash reserves as well as to carry out inter-bank transactions through these accounts.
- Inter-bank accounts can also be settled by transfer of money through electronic fund transfer system, such as, the Real Time Gross Settlement System.
- Reserve Bank has also introduced the Centralised Funds Management System (CFMS) to facilitate centralised funds enquiry and transfer of funds across Deposit Accounts Department (DADs).
- This helps banks in their fund management as they can access information on their balances maintained across different DADs from a single location.
- As Banker to Banks, the Reserve Bank provides short-term loans and advances to select banks, when necessary, to facilitate lending to specific sectors and for specific purposes.
- The Reserve Bank also acts as the 'lender of last resort'.
- It can come to the rescue of a bank that is solvent but faces temporary liquidity problems by supplying it with much needed liquidity when no one else is willing to extend credit to that bank.

Financial Regulation and Supervision –

1) The Reserve Bank's regulatory and supervisory domain extends not only to the Indian banking system but also to the development financial institutions (DFIs), non-banking financial companies (NBFCs), primary dealers, credit information companies and select segments of the financial markets
2) The Reserve Bank has a critical role to play in ensuring the system's safety and soundness on an ongoing basis.
3) The objective of this function is to protect the interest of depositors through an effective prudential regulatory framework and to maintain overall financial stability through various policy measures.

Prudential Norms for Banks –

1) **Capital Adequacy –**
   a) The Reserve Bank has instructed banks to maintain adequate capital on a continuous basis.
   b) Banks are required to maintain adequate capital for credit risk, market risk, operational risk and other risks

2) **Loans and Advances –**
   a) In order to maintain the quality of their loans and advances, the Reserve Bank requires banks to classify their loan assets as performing and non-performing assets (NPA), primarily based on the record of recovery from the borrowers.
   b) NPAs are further categorised into Sub-standard, Doubtful and Loss Assets depending upon age of the NPAs and value of available securities.
   c) Banks are also required to make appropriate provisions against each category of NPAs.

3) **Investments –**
   a) The Reserve Bank requires banks to classify their investment portfolios into 3 categories for the purpose of valuation –
      - Held to Maturity (HTM),
      - Available for Sale (AFS) and
      - Held for Trading (HFT).
   b) The securities held under HFT and AFS categories have to be marked-to-market periodically and depreciation, if any, needs appropriate provisions by banks.
   c) Securities under HTM category must be carried at acquisition / amortised cost, subject to certain conditions.

Important Terms –

1) **Repo Rate –**
   Repo rate refers to the **rate** at which commercial banks borrow money by selling their securities to Reserve Bank of India (RBI) to maintain liquidity, in case of shortage of funds.
2) **Reverse Repo Rate –**
   Reverse Repo Rate is when the RBI borrows money from banks when there is excess liquidity in the market
3) **Liquidity Adjustment Facility (LAF) –**

A **liquidity adjustment facility** (**LAF**) is a tool used in monetary policy by the RBI that allows banks to borrow money through repurchase agreements (repos) or to make loans to the RBI through reverse repo agreements.

4) **Marginal Standing Facility (MSF) –**
   Marginal standing facility (MSF) is a window for banks to borrow from the Reserve Bank of India in an emergency situation when inter-bank liquidity dries up completely
5) **Corridor –**
   The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.
6) **Bank Rate –**
   It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers
7) **Cash Reserve Ratio (CRR) –**
   Cash Reserve Ratio (**CRR**) is the amount of funds that banks have to maintain with the Reserve Bank of India (RBI) at all times.
8) **Statutory Liquidity Ratio (SLR) –**
   Statutory Liquidity Ratio or **SLR** is a minimum percentage of deposits that a commercial bank has to maintain in the form of liquid cash, gold or other securities.
9) **Open Market Operations –**
   An open market operation is an activity by a central bank to give liquidity in its currency to a bank or a group of banks
10) **Market Stabilisation Scheme (MSS) –**
   Market Stabilization scheme (MSS) is a monetary policy intervention by the RBI to withdraw excess liquidity (or money supply) by selling government securities in the economy