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THE ROLE OF THE RBI IN THE INDIAN BANKING SYSTEM

AUTHORED BY - PRACHI JOSHI

ABSTRACT

The Reserve Bank of India (RBI) plays a crucial role in maintaining financial stability and promoting the efficient functioning of the Indian banking system. This research paper aims to explore and analyze the multifaceted role of the RBI in regulating, supervising, and developing the banking sector in India. The study examines the RBI's responsibilities, policies, and initiatives to ensure the stability, integrity, and soundness of the Indian banking system. It also investigates the RBI's role in promoting financial inclusion, maintaining monetary stability, and implementing effective regulatory frameworks. The research draws upon various sources, including academic literature, RBI reports, and relevant government publications, to provide a comprehensive overview of the RBI's role in the Indian banking system.

INTRODUCTION

The Reserve Bank of India (RBI) plays a crucial role in maintaining financial stability and promoting the efficient functioning of the Indian banking system. This research paper aims to explore and analyze the multifaceted role of the RBI in regulating, supervising, and developing the banking sector in India. The study examines the RBI's responsibilities, policies, and initiatives to ensure the stability, integrity, and soundness of the Indian banking system. It also investigates the RBI's role in promoting financial inclusion, maintaining monetary stability, and implementing effective regulatory frameworks. The research draws upon various sources, including academic literature, RBI reports, and relevant government publications, to provide a comprehensive overview of the RBI's role in the Indian banking system.¹

¹ Wikipedia. Reserve Bank of India. Last Updated on: 26 May 2023, at 18.06. Available at: https://en.wikipedia.org/wiki/Reserve_Bank_of_India.

HISTORY OF RBI

The Reserve Bank of India was established² following the Reserve Bank of India Act of 1934.³ Though privately owned initially, it was nationalised in 1949 and since then fully owned by the Ministry of Finance, Government of India (GoI).

1935–1949

Reserve Bank of India-10 Rupees (1938), the first year of banknote issue.

The Reserve Bank of India was founded on 1 April 1935 to respond to economic troubles after the First World War. The bank was set up based on the recommendations of the 1926 Royal Commission on Indian Currency and Finance, also known as the Hilton Young Commission. Eventually, the Central Legislative Assembly passed these guidelines as the RBI Act 1934. The original choice for the seal of RBI was the East India Company Double Mohur, with the sketch of the Lion and Palm Tree. However, it was decided to replace the lion with the tiger, the national animal of India. The Preamble of the RBI describes its basic functions to regulate the issue of banknotes, keep reserves to secure monetary stability in India, and generally to operate the currency and credit system in the best interests of the country. The Central Office of the RBI was established in Calcutta (now Kolkata) but was moved to Bombay (now Mumbai) in 1937. The RBI also acted as Burma's (now Myanmar) central bank until April 1947 (except during the years of Japanese occupation (1942–45)), even though Burma seceded from the Indian Union in 1937. After the Partition of India in August 1947, the bank served as the central bank for Pakistan until June 1948 when the State Bank of Pakistan commenced operations. Though set up as a shareholders' bank, the RBI has been fully owned by the Government of India since its nationalisation in 1949. RBI has a monopoly of note issue.

1950–1960

In the 1950s, the Indian government, under its first Prime Minister Jawaharlal Nehru, developed a centrally planned economic policy that focused on the agricultural sector. The administration nationalised commercial banks and established, based on the Banking Companies Act, 1949 (later called the Banking Regulation Act), a central bank regulation as part of the RBI. Furthermore,

² "Reserve Bank of India". www.rbi.org.in. Archived from the original on 16 July 2020. Retrieved 16 July 2020.

³ The Reserve Bank of India Act, 1934 Archived 25 February 2017 at the Wayback Machine. rbi.org.in

the central bank was ordered to support economic plan with loans.⁴

1961–1968

As a result of bank crashes, the RBI was requested to establish and monitor a deposit insurance system. Meant to restore the trust in the national bank system, it was initialised on 7 December 1961. The Indian government founded the funds to promote the economy and used the slogan "Developing Banking". The government of India restructured the national bank market and nationalised a lot of institutes. As a result, the RBI had to play the central part in controlling and supporting this public banking sector.

1969–1984

In 1969, the Indira Gandhi-headed government nationalised 14 major commercial banks. Upon Indira Gandhi's return to power in 1980, a further six banks were nationalised. The regulation of the economy and especially the financial sector was reinforced by the Government of India in the 1970s and 1980s. The central bank became the central player and increased its policies a lot for various tasks like interests, reserve ratio and visible deposits. These measures aimed at better economic development and had a huge effect on the company policy of the institutes. The banks lend money in selected sectors, like agricultural business and small trade companies. The Banking Commission was established on Wednesday, 29 January 1969, to analyse banking costs, effects of legislations and banking procedures, including non-banking financial intermediaries and indigenous banking on Government of India economy; with R.G. Saraiya as the chairman.

The branch was forced to establish two new offices in the country for every newly established office in a town. The oil crises in 1973 resulted in increasing inflation, and the RBI restricted monetary policy to reduce the effects.

1985–1990

A lot of committees analysed the Indian economy between 1985 and 1989. Their results had an

⁴ Jadhav, Narendra; Ray, Partha; Bose, Dhritidyuti; Gupta, Indranil Sen (2003). "The Reserve Bank of India's Balance Sheet: Analytics and Dynamics of Evolution" (PDF). Reserve Bank of India Occasional Papers. 24 (3): 16. Archived (PDF) from the original on 9 February 2022. Retrieved 26 December 2018.

effect on the RBI. The Board for Industrial and Financial Reconstruction, the Indira Gandhi Institute of Development Research and the Security & Exchange Board of India investigated the national economy as a whole, and the security and exchange board proposed better methods for more effective markets and the protection of investor interests. The Indian financial market was a leading example for so-called "financial repression" (Mckinnon and Shaw). The Discount and Finance House of India began its operations in the monetary market in April 1988; the National Housing Bank, founded in July 1988, was forced to invest in the property market and a new financial law improved the versatility of direct deposit by more security measures and liberalisation.

1991–1999

The national economy contracted in July 1991 as the Indian rupee was devalued. The currency lost 18% of its value relative to the US dollar, and the Narsimham Committee advised restructuring the financial sector by a temporal reduced reserve ratio as well as the statutory liquidity ratio. New guidelines were published in 1993 to establish a private banking sector. This turning point was meant to reinforce the market and was often called neo-liberal.

The central bank deregulated bank interests and some sectors of the financial market like the trust and property markets. This first phase was a success and the central government forced a diversity liberalisation to diversify owner structures in 1998.

The National Stock Exchange of India took the trade on in June 1994 and the RBI allowed nationalised banks in July to interact with the capital market to reinforce their capital base. The central bank founded a subsidiary company—the Bharatiya Reserve Bank Note Mudran Private Limited—on 3 February 1995 to produce banknotes.

2000 - 2009

The Foreign Exchange Management Act, 1999 came into force in June 2000. It should improve the item in 2004–2005 (National Electronic Fund Transfer). The Security Printing & Minting Corporation of India Ltd., a merger of nine institutions, was founded in 2006 and produces banknotes and coins.

The national economy's growth rate came down to 5.8% in the last quarter of 2008–2009 and the central bank promotes the economic development.

Since 2010

In 2016, the Government of India amended the RBI Act to establish the Monetary Policy Committee (MPC) to set. This limited the role of the RBI in setting interest rates, as the MPC membership is evenly divided between members of the RBI (including the RBI governor) and independent members appointed by the government. However, in the event of a tie, the vote of the RBI governor is decisive.

In April 2018, the RBI announced that "entities regulated by RBI shall not deal with or provide services to any individual or business entities dealing with or settling virtual currencies," including Bitcoin. While the RBI later clarified that it "has not prohibited" virtual currencies, a three-judge panel of the Supreme Court of India issued a ruling on 4 March 2020 that the RBI had failed to show "at least some semblance of any damage suffered by its regulated entities" through the handling of virtual currencies to justify its decision. The court challenge was filed by the Internet and Mobile Association of India, whose members include some cryptocurrency exchanges whose businesses suffered following the RBI's 2018 order.

COMPOSITION OF CENTRAL BOARD

The Central Board consists of Governor, deputy Governor, Ten Director nominated by the Central Government and two Government official nominated by the Central Government. The deputy Governor and Director are eligible to attend meeting of the Central Board but are not entitled to vote. The Governor and deputy Governor hold office for term of five years and are entitled for a re- appointment. The Directors are appointed for a term of four and hold office during the pleasure of the president. The meeting of the Central Board is convened at least six times in a year.

COMPOSITION OF LOCAL BOARD

A local board is formed in each four zones consisting of five members which are appointed by the Central Government. There is Chairperson of the Board who is elected among the member. The members of the Board have a hold office for a term of four years and eligible for

reappointment. The Local Board advice on matters referred to it by the Central Board and performs duties delegated to it by the Central Board.

ORGANISATIONAL STRUCTURE OF THE RBI

The central board of directors is the main committee of the central bank. The Government of India appoints the directors for a four-year term. The board consists of a governor, and not more than four deputy governors; four directors to represent the regional boards two – usually the Economic Affairs Secretary and the Financial Services Secretary – from the Ministry of Finance and ten other directors from various fields. The Reserve Bank – under Raghuram Rajan's governorship – wanted to create a post of a chief operating officer (COO), in the rank of deputy governor and wanted to re-allocate work between the five of them (four deputy governor and COO).⁵

Two of the four deputy governors are traditionally from RBI ranks and are selected from the bank's executive directors. One is nominated from among the chairpersons of public sector banks and the other is an economist. An Indian Administrative Service officer can also be appointed as deputy governor of RBI and later as the governor of RBI as with the case of Y. Venugopal Reddy and Duvvuri Subbarao. Other persons forming part of the central board of directors of the RBI are Nachiket Mor, Y. C. Deveshwar, Prof Damodar Acharya, Ajay Tyagi and Anjuly Duggal.

Executive Directors (ED) consist of M. Rajeshwar Rao, Lily Vadera, Rabi N. Mishra, Smt. Nanda S. Dave, Anil K. Sharma, S. C. Murmu, T. Rabi Shankar, Janak Raj, P Vijayakumar, Indrani Banerjee, O.P. Mall and Sudha Balakrishnan (Chief Financial Officer).⁶

Sudha Balakrishnan, a former vice-president at National Securities Depository Limited, assumed charge as the first chief financial officer (CFO) of the Reserve Bank on 15 May 2018; she was given the rank of an executive director.

The bank's current governor is Shaktikanta Das. There are currently four deputy governors Mahesh Kumar Jain, M. Rajeshwar Rao, Michael Patra and T. Rabi Shankar.

⁵ "RBI Proposes COO Post in Rank of Deputy Governor". NDTV. 14 August 2014. Archived from the original on 3 August 2018. Retrieved 7 April 2021.

⁶ "Reserve Bank of India". m.rbi.org.in. Archived from the original on 6 August 2020. Retrieved 25 June 2020.

OBJECTIVE OF RBI

RBI was nationalised in 1949 and since come under the full ambit of the Ministry of Finance, Government of India.

The purpose of the RBI is to regulate the issuance of banknotes and the maintenance of reserves in order to ensure monetary stability in India and, more generally, to operate the nation's currency and credit system to its advantage.

ROLE OF RESERVE BANK OF INDIA⁷

1. Monetary Management - The development and implementation of monetary policy and ensuring monetary stability in India are two of the RBI's most crucial responsibilities. It makes use of the credit and monetary systems for its benefit.

2. Supervision and Regulation of Banking and Non-Banking Financial Institutions - The RBI serves to protect the interests of depositors through an effective regulatory framework. Keeping a close check on how banking operations are being conducted and the bank's solvency, as well as preserving overall financial stability through a variety of policy actions.

3. Regulation of Foreign Exchange Market, Government Securities Market, and Money Market

- The RBI is in charge of regulating the Indian foreign exchange market. Through the provisions of the FEMA Act 1999, RBI monitors and controls the foreign exchange market.
- The central and state governments' trade securities are governed by the RBI. The RBI Act of 1934 gives it the authority to regulate this.
- The RBI has the authority to regulate short-term and highly liquid debt securities under the terms of the RBI Act of 1934.

4. Foreign Exchange Reserve Management

The RBI is in charge of looking after India's foreign exchange reserves. The RBI Act of 1934

⁷ Role and Functions of Reserve Bank of India. Last Updated on May 17, 2023. Available on: <https://testbook.com/banking-awareness/functions-of-rbi>

contains legal provisions relating to the administration of foreign exchange reserves.

The RBI is allowed to invest these foreign exchange reserves in the following instruments under the RBI Act of 1934:

- Place a deposit with international banks.
- With overseas commercial banks, make a deposit.
- Instruments of Debt

5. Bankers to the Central and State Governments - The RBI serves as the government's banker.

The RBI is in charge of receiving and disbursing funds on behalf of the various government agencies. The Central and State Governments' Consolidated Funds, Contingency Funds, and Public Accounts are all maintained by the RBI. As a lender to the government, the RBI also extends loans to the union and federal governments.

6. Advisor to the Government - The RBI provides financial and banking-related advice to the government as and when requested.

7. Central and State Governments' Debt Manager - The primary goals of the debt management strategy are to reduce borrowing costs and even out the debt's maturity structure. On behalf of the federal government and state governments, the RBI manages the nation's debt and issues fresh loans.

8. Banker to Bank - In order to maintain their SLR and CRR, banks open current accounts with the RBI. The RBI serves as a central banker for all of the individual banks and facilitates the settlement of money transfers between banks. The RBI gives banks emergency loans and short-term credit for certain needs.

9. Issuer of Currency - The RBI is in charge of the printing and overall administration of the national currency, with the aim of releasing a sufficient quantity of authentic notes and maintaining the flow of the economy.

10. Developmental Role - The RBI's role in economic development includes setting up organisations to construct financial infrastructure, ensuring credit to the economy's productive sector, and increasing access to accessible financial systems.

KEY FEATURES RELATED TO THE FUNCTIONS OF RBI⁸

- RBI is authorised to issue various guidelines for bank directors and has the power to appoint additional directors to the board of a banking company.
- Prior approval of RBI is important for the appointment, reappointment, and termination of the Chairman, Managing Director, and CEO of Commercial Banks (except PSBs).
- If the situation arises then RBI with the approval of the Central Government can take the place of the Board of Directors of Commercial Banks.
- Public Sector Banks (PSBs) come under dual regulation of the Central Government and RBI so the RBI's power regarding the PSBs is curtailed as it cannot remove the directors and management and cannot supersede the board of Banks also cannot enforce mergers.
- As per RBI's regulation, Banks needed to maintain certain reserves in the form of CRR and SLR.
- RBI regulates the interest rate on NRI deposits, export credits (loans), and a few other categories. However, the interest rate on most of the categories of deposit and lending have been deregulated so the banks are responsible for determining such rates.
- RBI set up Deposit Insurance and Credit Guarantee Corporation (DICGC) for the protection of the interest of small depositors in case of bank failure or bankruptcy (100% subsidy). It provides insurance cover to all eligible bank depositors up to 5 lakhs per depositor per bank. To provide insurance coverage, it charges premiums from banks. DICGC covers all commercial banks including foreign bank branches as well along with UCBs/StCBs/DCCBs. But it is important to note that it does not cover deposits of foreign governments, deposits of Central and State governments, and interbank deposits.
- RBI has permitted the banks to undertake some non-traditional banking activities such as venture capital, insurance, mutual fund business, etc.
- Cooperative Banks- Cooperative Banks come under the dual regulation of RBI and the Government. Both the authorities have different fields to work on as RBI manages the banking-related functions and Central Government or State Government manages the management-related functions.

⁸ Functions of RBI. Clear IAS. Last Updated on October 31, 2022 by Clearias Team. Available on: <https://www.clearias.com/functions-of-rbi/>

- Financial Institutions, NBFCs, Primary Dealers, and Credit Information Companies (CIC)- The four all-India financial institutions named NABARD, NHB, EXIM Bank, and SIDBI are under full-fledged regulation and supervision of RBI.
- NBFCs, Primary Dealers and CICs also come under the regulation and supervision of RBI.

CONCLUSION

The research paper delves into the comprehensive role of the Reserve Bank of India (RBI) in the Indian banking system. It explores the RBI's regulatory responsibilities, monetary policy formulation, financial inclusion initiatives, development of the banking sector, consumer protection measures, and the challenges faced by the RBI. By analysing these aspects, the paper provides valuable insights into the functioning of the RBI and its impact on the stability and growth of the Indian banking system.

