Reserve Bank of India Act, 1934

Origin of the Reserve Bank of India –

1926 - Royal commission recommended creation of Central Bank for India

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1927 - Therefore, bill was moved in legislative assembly but was withdrawn due to lack of agreement among various sections people

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

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

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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.

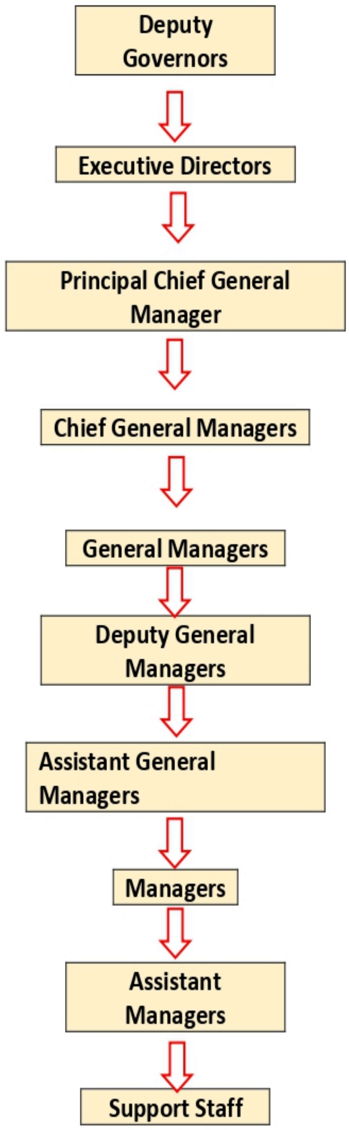
Organisational Structure & Management of RBI –

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.

RBI cannot transact following business –

- 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

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 nationalisedwef Jan 01, I 949. 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 nor be less than Rs.200 crore out of which, gold (coins and buIlion) should not be less than Rs.llScrore) (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 weIl 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 crorcs 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 crorcs 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:

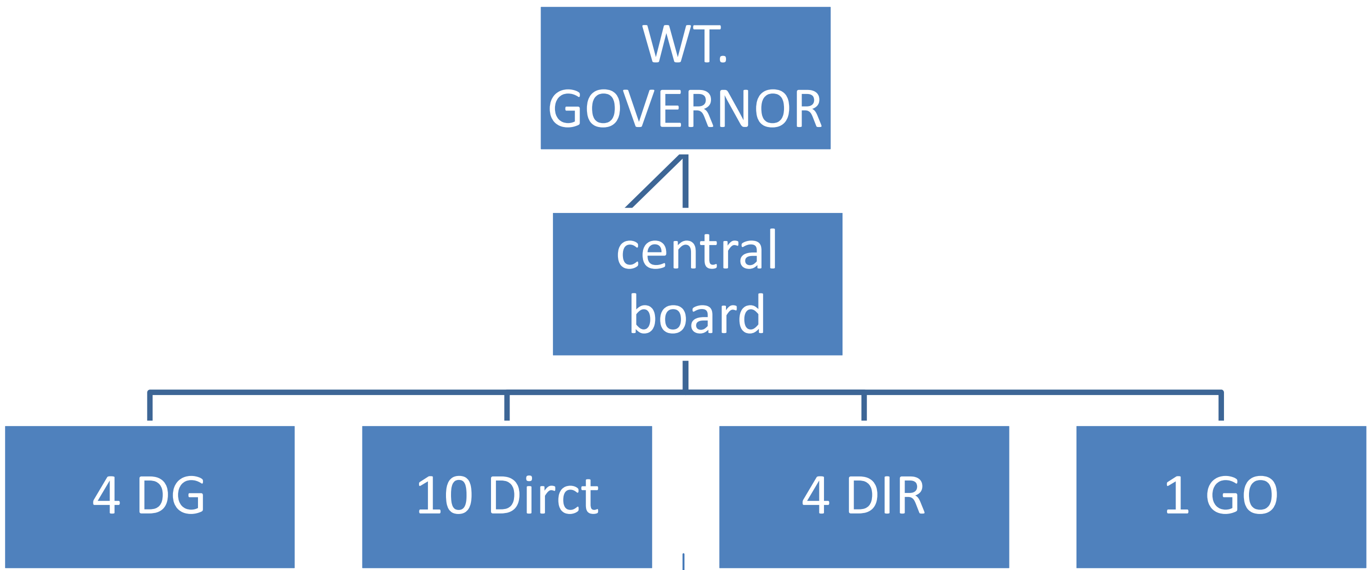
1. Bank of England, which is in theory as stated earlier subordinate to the Treasury but in practice has a relationship of co-operation rather than subordination (Sheldon, p.8). This model can be called (he 'functionally independent' model.
2. Federal Reserve System, USA- This system can be said to be 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 ofPariiament). 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 carmot 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 Locall3oards 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 dependenatia, 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 necessaryto review the organisational structure in the light of experience of other constitutional institutions.

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



Central Office

1 2 3 4 5 6 7 8 9 10 11 12 13 14 15 16 17 18

Department names are below

Local Boards

Delhi Bombay Kolkata Chennai

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 thag 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 .Govemment official to be nominated by the Central Government.

The Governor and Deputy Governors are wholetirne officials of the Bank. A Deputy Governor and a Government official nominated as above [under Section 8(l)(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,.ctc.) 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. Khanzode V s. Reserve Bank*[1], 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,

[1]AIR 1982 SC 917

manageme!lt of foreign exchange and rendering of advice to the Central Governmentall 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 oflicense 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 orhas 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 notapplicable to the Governor, Deputy Governor and the Director nominated under Section 8(1)(d). The e iciency of a Central Banking syst is to be judged by its abili to maintain price stability' nside and outside the country. Factors affecting this efficiencyare (i) the strength of autonomous decision making power for leading the whole banking system' ith the basic objeive of money management; (ii) quick inform tion flow a d capability of immediate assessment of the sition; & iii) adequate power of systemcorrections.

(i) An empirical understanding of the men in the managementof RBI can clearly h w the political overtone in the management structure of the RBI. Appointments to various senior positions RBI's management are mere executive functions of th Ministry 0 Finance of Government of India. Instances of appointing persons to the highest post in the Reserve Bank not having adequate experience in banking ar not unknown. Political considerations often dominate ile constituting Central 'Local boards. Suchappointments do not require any legislative or judicial scrutiny There is complete lack of transparency in the constitution & appointment of this highest administrative setup i 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 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 quantityof 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.

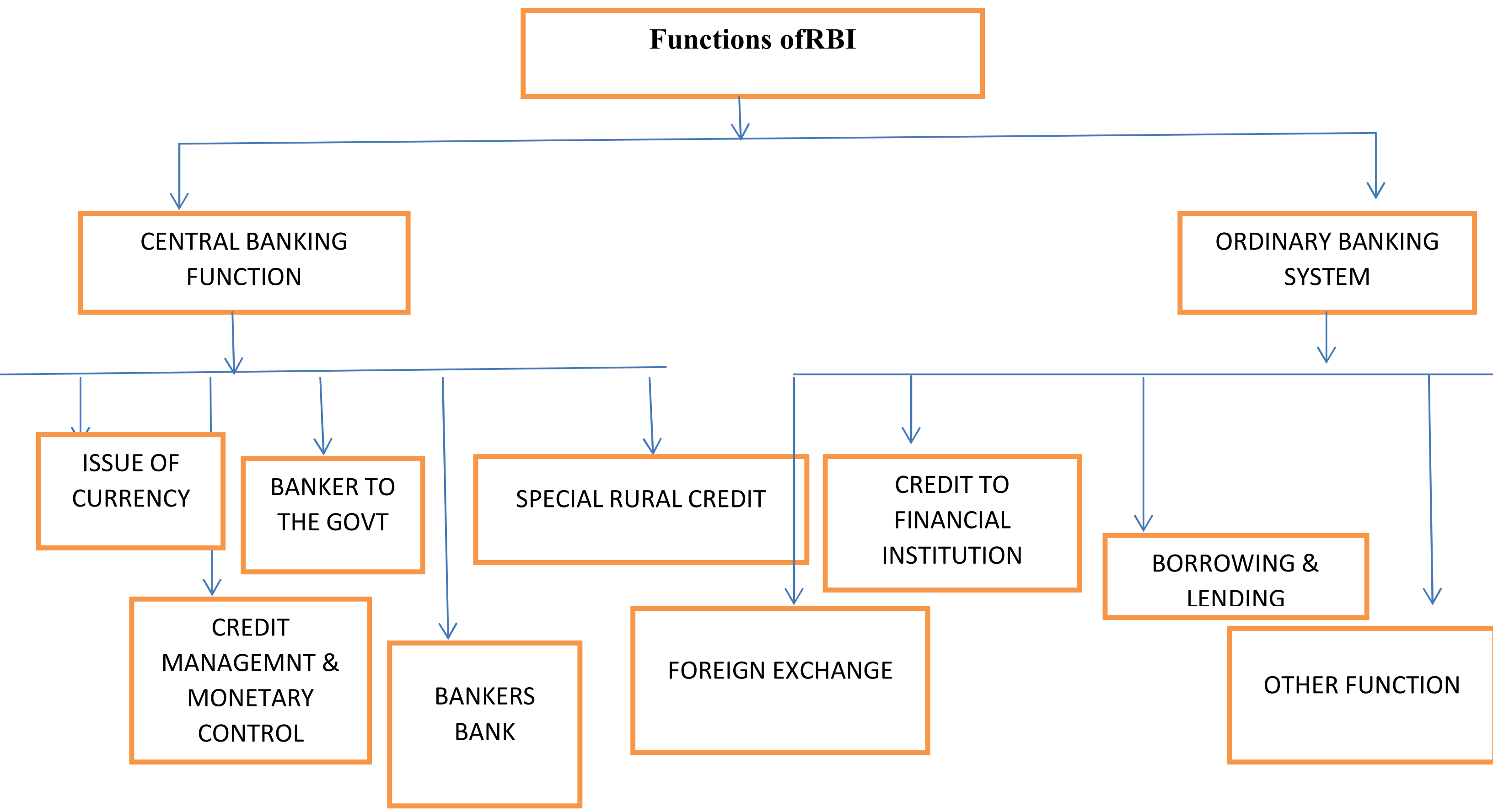
Currency Function: RBI is the sole authority for the issue of the currency. Of course one rupee coins & notes & subsidiary coins are issued by the government of India, they are put into circulation only through RBI. Credit Control & Money Management of currency:

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 NABAD 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.

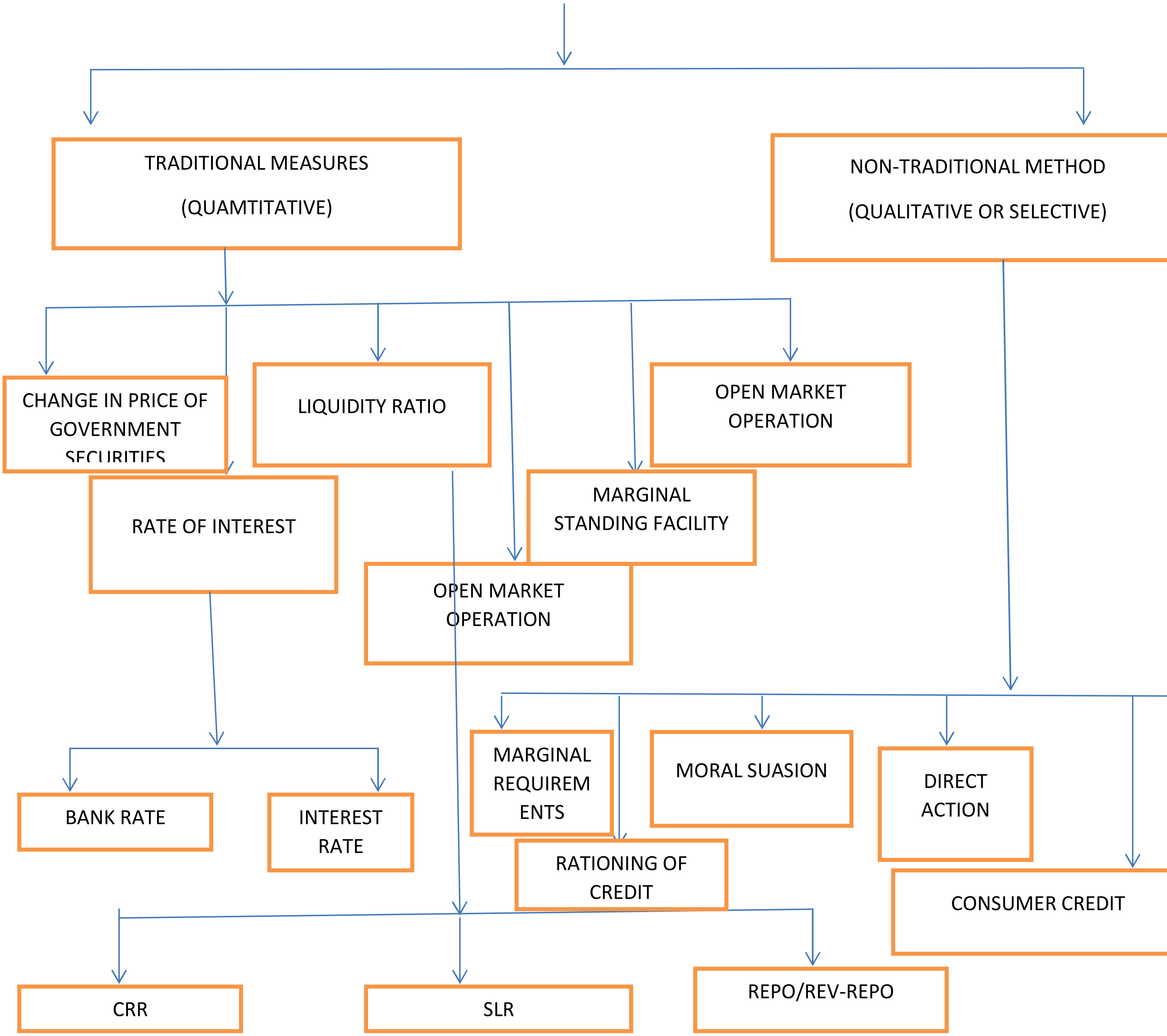
OUTLINE OF THE FUNCTIONS

The following table gives the outline of the functions of the

Reserve Bank of India:



RESERVE BANK OF INDIA CREDIT CONTROL


TRADITIONAL MEASURES
(QUAMTITATIVE)
NON-TRADITIONAL METHOD
(QUALITATIVE OR SELECTIVE)
CHANGE IN PRICE OF GOVERNMENT SECURITIES
LIQUIDITY RATIO
OPEN MARKET OPERATION
MARGINAL STANDING FACILITY
RATE OF INTEREST
OPEN MARKET OPERATION
BANK RATE
INTEREST RATE
MARGINAL REQUIREM ENTS
MORAL SUASION
DIRECT ACTION
RATIONING OF CREDIT
CONSUMER CREDIT
CRR
SLR
REPO/REV-REPO

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