

Principles and Practices of Banking

Reserve Bank of India (RBI)

In every country there is one organization which works as the central bank. The function of the central bank of a country is to control and monitor the banking and financial system of the country. In India, the Reserve Bank of India (RBI) is the Central Bank

The RBI was established in 1935. It was nationalized in 1949. It is the oldest among the central banks operating in developing countries. The RBI plays role of regulator of the banking system in India. The Banking Regulation Act 1949 and the RBI Act 1953 has given the RBI the power to regulate the banking system. RBI's Internal management is based on functional specialization and coordination amongst about 20 departments. It has one Governor, four Deputy Governor and 15 Directors nominated by Union Government. The RBI has different functions in different roles. Below, we share and discuss some of the functions of the RBI.

❖ Role and Function of the Reserve Bank of India (RBI)

✓ Regulator of Financial System

The RBI regulates the Indian banking and financial system by issuing broad guidelines and instructions. The objectives of these regulations include:

- Controlling money supply in the system,
- Monitoring different key indicators like GDP and inflation
- Maintaining people's confidence in the banking and financial system
- Providing different tools for customer's help, such as acting as the "Banking Ombudsman."

❖ Issuer of Monetary Policy

The RBI formulates monetary policy twice a year. It reviews the policy every quarter as well. The main objectives of monitoring monetary policy are:

- Inflation control
- Control on bank credit
- Interest rate control

The tools used for implementation of the objectives of monetary policy are:

- Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR),
- Open market operations,
- Different Rates such as repo rate, reverse repo rate, and bank rate.

❖ Issuer of Currency Notes

RBI has the sole authority for the issuance of currency notes. Section 22 of the RBI Act gives this authority to the RBI. The RBI also takes action to control circulation of fake currency. RBI has Issued and put in circulation notes in denomination of Rs. 2, 5, 10, 20, 50, 100, 500, 1000. Note Rs. 1 and all coins are issued by government of India.

❖ Banker's Bank and Supervisor

The RBI has been assigned the role of controlling and supervising the bank system in India. The RBI is responsible for controlling the overall operations of all banks in India. These banks may be:

- Public sector banks
- Private sector banks
- Foreign banks
- Co-operative banks, or
- Regional rural banks

❖ Control and Supervisory Roles of RBI

- Issue of License: Under the Banking Regulation Act 1949, the RBI has been given powers to grant licenses to commence new banking operations. The RBI also grants licenses to open new branches for existing banks. Under the licensing policy, the RBI provides banking services in areas that do not have this facility.
- Prudential Norms: The RBI issues guidelines for credit control and management. The RBI is a member of the Banking Committee on Banking

Supervision (BCBS). As such, they are responsible for implementation of international standards of capital adequacy norms and asset classification.

- **Foreign Exchange Control:** The RBI plays a crucial role in foreign exchange transactions. It does due diligence on every foreign transaction, including the inflow and outflow of foreign exchange. It takes steps to stop the fall in value of the Indian Rupee. The RBI also takes necessary steps to control the current account deficit. They also give support to promote export and the RBI provides a variety of options for NRIs.
- **KYC Norms:** To curb money laundering and prevent the use of the banking system for financial crimes, The RBI has “Know Your Customer” guidelines. Every bank has to ensure KYC norms are applied before allowing someone to open an account.
- **Risk Management:** The RBI provides guidelines to banks for taking the steps that are necessary to mitigate risk. They do this through risk management in base norms.
- **Audit and Inspection:** The procedure of audit and inspection is controlled by the RBI through off-site and on-site monitoring system. On-site inspection is done by the RBI on the basis of “CAMELS”. Capital adequacy; Asset quality; Management; Earning; Liquidity; System and control.
- **Corporate Governance:** The RBI has power to control the appointment of the chairman and directors of banks in India. The RBI has powers to appoint additional directors in banks as well.

RBI – Functions and Policies

- **Development:** Being the banker of the Government of India, the RBI is responsible for implementation of the government's policies related to agriculture and rural development. The RBI also ensures the flow of credit to other priority sectors as well. Section 54 of the RBI gives stress on giving specialized support for rural development. Priority sector lending is also in key focus area of the RBI.
- **Transparency Norms:** This means that every bank has to disclose their charges for providing services and customers have the right to know these charges.

❖ **Government's Banker**

RBI acts as the banker to the Central and State Government. It provides Banking Services of deposits, withdrawal of Funds, making receipts and payments, collection and transfer of funds and management of public debt.

Some more Important Terms

❖ **Commercial bank**

Commercial banks include public sector banks, foreign Bank and private sector banks. Acceptance of deposits from the public for the purpose of lending or investment is the main area of activity.

❖ NBFC

NBFCs are allowed to raise moneys as deposits from the public and lend moneys through various instruments including leasing, higher purchase and bill discounting. These are licensed and supervised by the Central Banking Authority.

❖ PDS(Primary Dealers)

Primary dealers also known as PDs, deal in government securities and deal in both the primary and secondary markets. Their basic responsibility is to provide markets for government securities and strengthen the government securities market.

❖ Cooperative bank

These are allowed to raise deposits and give advances from and to the public. Urban cooperative banks are controlled by State Government and RBI, while other Cooperative banks are controlled by National Bank for Agriculture and Rural Development (NABARD) and State governments.

❖ IRDA (Insurance Regulatory and Development Authority)

Regulator for Insurance business, both general and life assurance. Regulates all aspects of insurance business, including licensing of insurance companies, framing regulations about the conduct of business and supervising all insurance activities in the country etc.

❖ CRR

Cash Reserve Ratio (CRR) is mandatory deposit to be held by Banks with the requisite monetary authority (RBI). It is a percentage of their Demand and Time Liabilities.

❖ SLR (Statutory Liquidity Ratio)

Statutory Liquidity Ratio (SLR) is the prescribed percentage of Demand and Time Liabilities of a bank to be held in prescribed securities, mostly government securities. The increase or decrease in CRR and SLR, contracts and enhances credit creation.