

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

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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 nationalized on Jan 01, 1949. Prior to its existence, Imperial Bank of India from SBI was conducting the Central Bank's functions. Originally it was a shareholders' bank which was taken over by the Central Government under Reserve Bank (Transfer of Public Ownership) Act 1948 (paid up capital Rs.5cr). RBI's central office is in Mumbai.

**Organisation:** -Central Banking as a concept is of fairly recent origin. Though some Latin American countries had a central banking system in the 19th century, this system really became popular in the early 20th Century. Generally speaking, a Central Bank is considered as the leader of the money market, but several economists emphasize different roles for the Central Bank. For example, according to Whawtrey,R.G, the essential characteristic of a Central Bank is its function as the 'lender of last resort'. According to Kische& Elkin. The main function of the Central Bank is to maintain the 'stability of the monetary standard'. On the other hand, Shaw,W.R. lays emphasis on 'credit control' as the major function of Central Bank. The Bank of England founded in 1694 is perhaps the oldest Central Banking institution which provides finance for the government. The first attempt at Central Banking in India dates back to General Bank in Bengal & Bihar estd. in January, 1773 at the instance of Warren Hastings, the then Governor of Bengal. But this experiment was very short lived. Three Presidency Banks were established and started functioning in 1866. Alongwith their commercial functions they undertook some functions on behalf of the Government also. These Presidency Banks were amalgamated in 1921 to form the Imperial Bank of India which was primarily a commercial bank but used to perform certain central banking functions as well. In 1926 the Royal Commission on 'Indian Currency & Finance' (Milton Young Commission) recommended the dichotomy to be ended & the establishment of a Reserve Bank of India as its Central Bank. A Bill was introduced in the Legislative Assembly in 1927, which was later dropped. In the meantime during 1930-31 consideration for constitutional reforms in the country started being debated. Ultimately, the Reserve Bank of India Act was passed in 1934, part of which came into operation in 1935 & the remaining part in 1937. It took over the management of the currency from the Central Government and of carrying on the business of banking in accordance with the provisions of the Act. As stated in the preamble to the Act, the Bank has the responsibilities of (i) regulating the issue of Bank notes; (ii) keeping of reserves with a view to securing the monetary stability in India; and (iii) generally to operate the currency and credit system of the country to its advantage.

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

### **Organisational Model**

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

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

The RBI was initially designed on the pattern of Bank of England, theoretically subordinate to the Treasury. The Governor, 4 Deputy Governors, all Directors of the Central Board & the Local Boards are either appointed or nominated by the Central Government. The Governor & the Deputy Governor are whole time officials and hold office for such term not exceeding 5 years as may be fixed by Central Government and are eligible for re-appointment [S.8(4).] They may however be removed from their office by the Central Government at any time. This legal provision has made RBI an almost subordinate agency of the Ministry of Finance, Government of India.

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

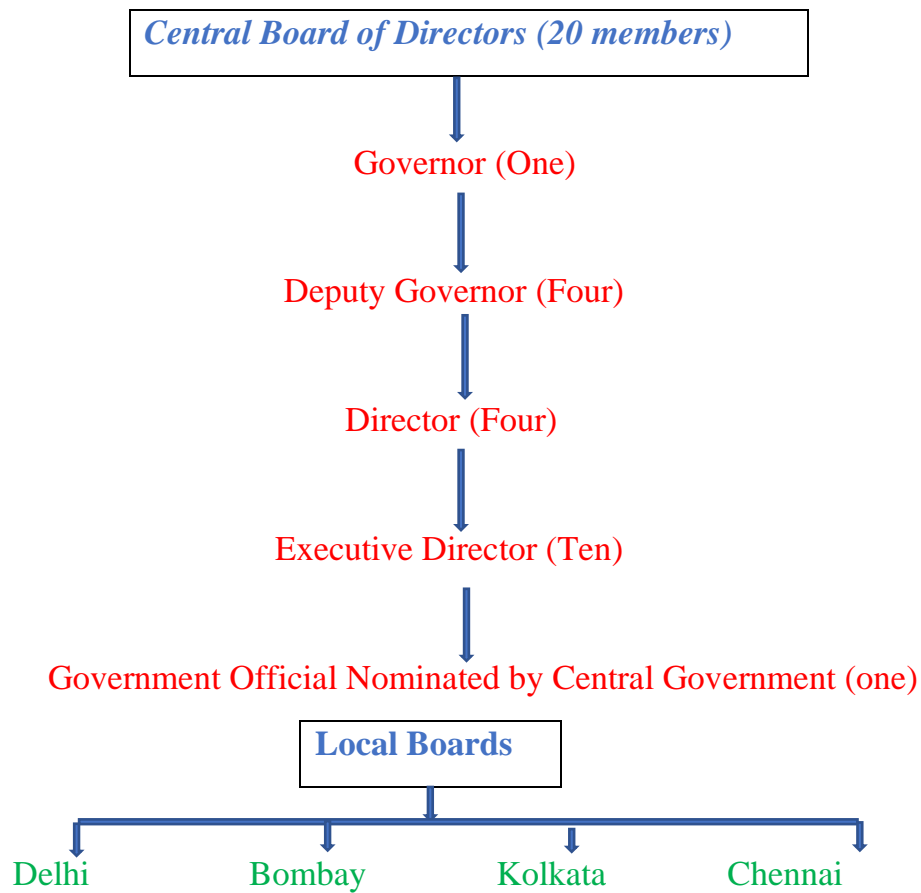
1. Bank of England, which is in theory as stated earlier subordinate to the Treasury but in practice has a relationship of co-operation rather than subordination (Sheldon, p.8). This model can be called (he 'functionally independent' model.
2. Federal Reserve System, USA- This system can be said to be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

The operational efficiency of an organisation predominantly depends upon the organisation structure of the institution. Several issues are important while determining this organisational structure. The organisation of RBI was modelled on the pattern of Bank of England as being subordinate to the Central Government at a time when imperial power wanted to have a positive & definite power centralisation. Continuation of the same structure in a democratic set-up may be examined in view of the need for a strong monetary system. This requires an autonomous institution to cooperate with the Central Government for laying down a strong monetary system. But the organisational structure of RBI is entirely subordinated to the Central Government. The Governor, 4 Deputy Governors and all the Directors of the Central Board and Local Boards are appointed/nominated by the Central Government (CG) and hold office during the pleasure of Central Government. In England a legal prescription of subordination to the treasury is replaced by close cooperation through establishment of sound conventions. In India on the other hand, this led to super control, so much so that even a Deputy Secretary of the Ministry of Finance became more powerful than the Governor of the RBI. This is very unscientific and injurious to the nation's economy. As for example, RBI can't refuse to supply any quantity of money to the government, against Government securities. As a result, it is unable to maintain the value of money and effectively manage the monetary affairs of the country, which is its primary consideration u/s.3 of RBI Act.

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

## Organizational Structure of RBI



- 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 (Sec.08)**

The general superintendence and direction of the affairs and business of the Bank are entrusted to a Central Board of Directors under Section 8 of the Act. However, the Board has to abide by any directions that may be given by the Central Government after consultation with the Governor of the Bank. Such directions can be given from time to time in public interest. The Central Board shall consist of the Governor, not more than 4 Deputy Governors to be appointed by the Central Government and other directors to be nominated by the Central Government as under:

(a) Four directors to be nominated by Central Government, one each from the Local Boards constituted under Section 9.

(b) Ten directors to be nominated by Central Government.

(c) One, Government official to be nominated by the Central Government.

The Governor and Deputy Governors are whole time officials of the Bank. A Deputy Governor and a Government official nominated as above [under Section 8(1)(d)] may attend any meeting of the Central Board and participate in deliberations but do not have voting rights. The Governor and Deputy Governors hold office for a term fixed by the Central Government at the time of appointment, not exceeding 5 years and are eligible for reappointment. The Government official nominated under Section 8(1) (d) shall hold office at the pleasure of the Government. The directors 4 nominated from the Local Board shall continue during their membership of the Local Boards. The other directors shall hold office for 4 years and thereafter until their successors are nominated. The BR Act prescribes certain qualifications (Chartered Accountant, Lawyer, etc.) for the Directors of commercial banks, where as there are no such qualifications specified for appointment to the Board of Directors. Under Section 11, the Central Government may remove from, office the Governor or a Deputy Governor or any other director or any member of the Local Board. Central Government has also the power under Section 30 to supersede 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 for giving 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<sup>1</sup>, besides making statutory regulations under Section 58 of the Act, Bank could also lay down service conditions of the staff administratively under Section 7(2) of the Act. Establishments the Central office [Head Quarters (H.Qrs.)] of the Bank is located at Bombay. Formulation of policies concerning banking, money management, inspection & supervision of Banks, extension of banking & credit facilities, management of foreign exchange and rendering of advice to the Central Governmental 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.

## **LOCAL BOARDS AND ITS FUNCTIONS**

### **Constitution**

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

### **Functions**

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

## **Disqualifications**

There are certain disqualifications under Section 10 applicable to Directors of both Central Board and Local Boards. Thus,

- (i) a person who is a salaried government official;
- (ii) an adjudicated insolvent or one who has suspended payment or has compounded with his creditors;
- (iii) a person of unsound mind;
- (iv) an officer or employee of any bank or
- (v) a director of a banking company or co-operative bank is disqualified to be a director.

However, this stipulation prohibiting a director from being a government employee or salaried government official is not applicable to the Governor, Deputy Governor and the Director nominated under Section 8(1)(d). The deficiency of a Central Banking system is to be judged by its ability to maintain price stability' inside and outside the country. Factors affecting this efficiency are,

- (i) the strength of autonomous decision-making power for leading the whole banking system' it the basic objective of money management;
- (ii) quick information flows a d capability of immediate assessment of the adequate power of system corrections.

## **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 quantity of money and the RBI is obliged to meet the demand. In case of State governments, the RBI extends a time credit facility to a maximum limit which is required to be set off against future collections.

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

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



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

### **Functions of RBI (The India's Central Bank)**

Reserve Bank of India being an apex court of the center enjoys enormous power and functions under banking system in India. It has monopoly over the issue of bank-notes and monetary system of the country. These power and functions as to issue of bank notes and currency system are governed by the Reserve Bank of India Act, 1934. Besides it the Banking Regulation Act, 1949 also empowers certain power and Function of the Reserve Bank.

Reserve bank of India as a Central Bank of the country its Functions may be broadly discussed in the following headings:

- **Main Functions of RBI**

Main functions are those functions which every central bank of each nation performs all over the world. Basically, these functions are in line with the objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the following tasks.

**1. Issue of Currency Notes:** The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 2, 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.

**2. Banker to other Banks:** The RBI being an apex monetary institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every commercial bank has to maintain a part of their reserves with

its parent's viz. the RBI. Similarly, in need or in urgency these banks approach the RBI for fund. Thus, it is called as the lender of the last resort.

**3. Banker to the Government:** The RBI being the apex monetary body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.

**4. Exchange Rate Management:** It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also, it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability, it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.

**5. Credit Control Function:** Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability. Thus, it regulates the credit creation capacity of commercial banks by using various credit control tools.

**6. Supervisory Function:** The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new branches, to decide minimum reserves, to inspect functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India. It can have periodical inspections an audit of the commercial banks in India.

- **Developmental / Promotional Functions of RBI**

Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. The RBI has been performing as a promoter of the financial system since its inception. Some of the major development functions of the RBI are maintained below.

**1. Development of the Financial System:** The financial system comprises the financial institutions, financial markets and financial instruments. The sound and efficient financial system is a precondition of the rapid economic development of the

nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of the economy.

**2. Development of Agriculture:** In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has successfully rendered service in this direction by increasing the flow of credit to this sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).

**3. Provision of Industrial Finance:** Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special financial institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANK etc.

**4. Provisions of Training:** The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e NIBM, Bankers Staff College i.e BSC and College of Agriculture Banking i.e CAB are few to mention.

**5. Collection of Data:** Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policy makers.

**6. Publication of the Reports:** The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaper rates.

**7. Promotion of Banking Habits:** As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD-1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.

**8. Promotion of Export through Refinance:** The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

- **Supervisory Functions of RBI**

The reserve bank also performs many supervisory functions. It has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

**1. Granting license to banks:** The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.

**2. Bank Inspection:** The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.

**3. Control over NBFIs:** The Non-Bank Financial Institutions are not influenced by the working of a monetary policy. However, RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.

**4. Implementation of the Deposit Insurance Scheme:** The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.

- **Reserve Bank of India's Credit Policy**

The Reserve Bank of India has a credit policy which aims at pursuing higher growth with price stability. Higher economic growth means to produce more quantity of goods and services in different sectors of an economy; Price stability however does not mean no change in the general price level but to control the inflation. The credit policy aims at increasing finance for the agriculture and industrial activities. When credit policy is implemented, the role of other commercial banks is very important. Commercial banks flow of credit to different sectors of the economy depends on the actual cost of credit and availability of funds in the economy.