UNIT – 2

RBI Structure Monetary Policy NBFCs DICGC

Evolution of RBI • Structure • Characteristics • Monetary Tools • NBFC • DICGC Detailed

Banking Law – Expanded Edition

SYNOPSIS

Unit Overview

This expanded unit covers the detailed evolution of the central bank in India, the organisational structure of RBI, characteristics of a central bank, monetary policy tools (CRR, SLR, Repo, Reverse Repo, Bank Rate), regulation of NBFCs, and comprehensive operational details of DICGC including registration, premium, cancellation and the one-rupee note special features.

LEARNING OBJECTIVES

What You Will Learn

01 Evolution

Trace history from Hilton-Young Commission to nationalisation

02 Structure

Explain Central Board, Local Boards and key committees

03 Characteristics

List the classic functions of a central bank

04 Monetary Tools

Master CRR, SLR, Repo, Reverse Repo and Bank Rate

05 NBFC

Understand definition, registration and RBI control

06 DICGC

Know full operational details of deposit insurance

EVOLUTION 1

Evolution of Central Bank in India – Early History

Early Attempts	Several proposals in 19th and early 20th century to establish a central bank
Hilton-Young Commission	1926 – recommended establishment of a central bank for India
Imperial Bank Role	Imperial Bank of India performed some central banking functions before RBI
RBI Act 1934	Reserve Bank of India Act passed in 1934
Commencement	RBI commenced operations on 1 April 1935

EVOLUTION 2

Ownership and Nationalisation of RBI

Original Status	Started as a private shareholders' bank
Nationalisation	RBI was nationalised with effect from 1 January 1949
Present Status	Fully owned by the Government of India
Significance	Complete public ownership aligned RBI fully with national economic policy

STRUCTURE 1

Structure of RBI – Central Board of Directors

Composition	Governor + not more than 4 Deputy Governors + 4 directors from Local Boards + 10 directors nominated by Government + 1 Government official
Governor	Chief Executive; appointed by Central Government
Deputy Governors	Assist Governor; usually four (in charge of different departments)
Tenure	Directors hold office for a term fixed by the Central Government

STRUCTURE 2

Local Boards and Committees of the Central Board

Local Boards	Four Local Boards (Northern, Southern, Eastern, Western) – advise on regional matters
CCB	Committee of the Central Board – meets weekly; transacts current business
BFS	Board for Financial Supervision – oversees supervision of banks and NBFCs
BPSS	Board for Payment and Settlement Systems – regulates payment systems

CHARACTERISTICS

Characteristics / Functions of a Central Bank

Note Issue	Sole authority to issue currency notes (except one-rupee notes)
Banker to Government	Maintains government accounts, manages public debt, ways & means advances
Banker’s Bank	Banks maintain accounts with RBI; settlement of inter-bank obligations
Lender of Last Resort	Provides emergency liquidity to solvent banks facing temporary stress
Controller of Credit	Uses monetary policy tools to regulate money supply and credit
Adviser to Government	Advises on monetary and financial matters
Clearing House	Facilitates clearing and settlement
Controller of Foreign Exchange	Manages foreign exchange reserves and policy under FEMA

FUNCTIONS

Developmental and Supervisory Functions of RBI

Developmental	Promotes financial inclusion, institutions (NABARD, NHB, etc.), banking habits
Supervisory	Licensing, inspection, prudential norms, regulation of NBFCs
Data & Research	Collects and publishes statistical data and reports
Training	Supports bankers’ training institutions

Monetary Policy – Objectives and Framework

Monetary policy is the process by which RBI controls the supply of money, targeting inflation and growth. Reviewed every two months by the Monetary Policy Committee (MPC).

Primary Objective	Price stability while keeping in mind the objective of growth
Tools	CRR, SLR, Bank Rate, Repo Rate, Reverse Repo, Open Market Operations
MPC	Monetary Policy Committee decides the policy rates

Cash Reserve Ratio (CRR)

Meaning	Percentage of Net Demand and Time Liabilities (NDTL) to be kept as cash with RBI
Legal Basis	Section 42(1) of RBI Act 1934
Current Level	Around 4% (changed by RBI from time to time)
Effect of Increase	Reduces lendable resources of banks → controls inflation
No Interest	Banks do not earn any interest on CRR balances

Statutory Liquidity Ratio (SLR)

Meaning	Minimum percentage of NDTL to be maintained in liquid assets (cash, gold, approved securities)
Legal Basis	Section 24 of Banking Regulation Act 1949
Held by Banks	Assets remain with the banks themselves (not deposited with RBI)
Current Level	Around 18% (subject to change)
Returns	Banks earn interest/return on SLR securities

Difference between CRR and SLR

CRR	Cash only with RBI; no return; primary tool for liquidity control
SLR	Cash + gold + government securities held by bank; earns return; ensures solvency
Maximum Limits	CRR up to 20% of NDTL; SLR up to 40%
Purpose	CRR – monetary control; SLR – solvency + credit control

Repo Rate and Reverse Repo Rate

Repo Rate	Rate at which RBI lends short-term funds to banks against government securities
Current Repo	Around 5.25% (indicative – changes with policy)
Reverse Repo	Rate at which RBI borrows from banks (absorbs excess liquidity)
Current Reverse	Lower than repo (around 3.35% indicative)
Impact	Higher repo → costlier credit; higher reverse → banks park more funds with RBI

Bank Rate Policy

Meaning	Rate at which RBI provides funds by discounting or rediscounting bills
Signal	Increase indicates tightening of monetary policy
Present Level	Around 5.50% (indicative)
Difference from Repo	Bank Rate is more of a medium-term signal; Repo is the active short-term liquidity tool

Non-Banking Financial Companies – Definition & Differences

NBFC is a company engaged in loans, advances, acquisition of shares/bonds, leasing, hire-purchase etc. as principal business, but does not accept demand deposits or form part of the payment system.

Principal Business Test	Financial assets > 50% of total assets AND income from financial assets > 50% of gross income
Key Differences	Cannot accept demand deposits; cannot issue cheques; no DICGC cover for depositors
Registration	Compulsory with RBI if net owned fund meets the prescribed threshold (currently ₹10 crore)

RBI Control over NBFCs

Directions	RBI issues detailed directions on acceptance of deposits, capital, governance, etc.
Ceiling on Deposits	Limits prescribed for different categories of NBFCs
Cash Reserves	Certain NBFCs required to maintain liquid assets
Returns	Periodical returns must be submitted to RBI
Inspection	RBI has power to inspect NBFCs

DICGC 1

DICGC – Establishment and Coverage

Establishment	1961; wholly owned subsidiary of RBI
Coverage	All bank deposits (savings, fixed, current, recurring) up to ₹5 lakh per depositor per bank
Premium	Paid by the insured banks; depositors get protection free of cost
Same Right & Capacity	Insurance is calculated per depositor in the same right and same capacity

DICGC – Registration of Different Banks

Commercial Banks	Registered as soon as licence is granted by RBI under Section 22 of BR Act
RRBs	Must be registered within 30 days of establishment
Co-operative Banks	Registered after licence is granted; primary co-operative bank within 3 months of application for licence
Intimation	DICGC sends registration intimation within 30 days

DICGC – Premium, Cancellation & Restoration

Premium Timeline	To be remitted by last day of May and November each year
Delayed Premium	Interest at Bank Rate + 8% from the beginning of the half-year
Cancellation	Registration can be cancelled if premium not paid for three consecutive half-years
Restoration	Possible on request after payment of all dues with interest
Board	Governor of RBI as Chairman + Deputy Governor + Government nominee + two independent directors

One Rupee Note – Special Features

Issuer	Government of India (not Reserve Bank of India)
Signature	Signed by the Finance Secretary
Promissory Clause	Does not contain the promissory clause that appears on RBI notes
Security Thread	No security thread
Legal Status	Still legal tender; forms part of the currency system

SUMMARY TOOLS

Monetary Policy Tools – Quick Recap

CRR	Cash with RBI – no return – liquidity control
SLR	Liquid assets with bank – earns return – solvency + credit control
Repo	RBI lends to banks – short-term
Reverse Repo	RBI borrows from banks – absorbs liquidity
Bank Rate	Medium-term signalling rate

SUMMARY POINTS

Must-Remember Points

- RBI evolved from Hilton-Young Commission recommendations and was nationalised in 1949.
- Structure includes Central Board, Local Boards, CCB, BFS and BPSS.
- Classic central bank functions: note issue, banker to government, banker’s bank, lender of last resort, controller of credit, etc.
- CRR and SLR are the two key reserve requirements; Repo/Reverse Repo are the active liquidity tools.
- NBFCs are regulated by RBI but cannot accept demand deposits or issue cheques.
- DICGC provides deposit insurance up to ₹5 lakh with detailed rules on registration, premium and cancellation.
- One-rupee note is issued by the Government of India, not by RBI.