1 RESERVE BANK OF INDIA ACT, 1934

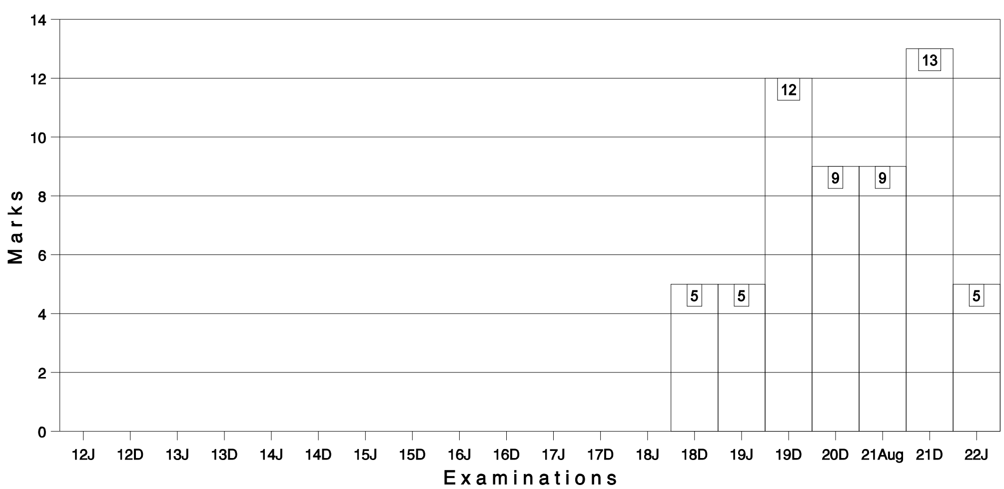
THIS CHAPTER INCLUDES

- Introduction
- Origins of the Reserve Bank of India
- Organisational Structure and Management
- Reserve Bank as Banker to Banks
- Foreign Exchange Reserves Management
- Monetary Policy
- Instruments of Monetary Policy
- Inflation Target
- Monetary Policy Report
- Penalty

Marks of Objective, Short Notes, Distinguish Between, Descriptive & Practical Questions

Legend

Objective Short Notes Distinguish Descriptive Practical



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CHAPTER AT A GLANCE

Objective and Coverage of RBI Act 1934
● RBI Act was enacted with the objective to: • regulate the issue of bank notes • keep reserves to ensure monetary stability of the country • operate effectively the currency and credit system ● The RBI Act deals with: • incorporation, capital, management and business of the RBI • functions of the RBI- issue of bank notes, monetary control, banker to the Central and State Governments and banks, lender of last resort etc • general provisions in respect of reserve fund, credit funds, audit and accounts • issuing directives and imposing penalties for violation of the provisions of the Act
Functions of RBI
• Issue of Bank Notes • Short term Loans to Banks • Purchase and Sale of Government Securities • Purchase and Sale of Shares of SBI, National Housing Bank, Deposit Insurance and Credit Guarantee Corporation • Purchase, sale and rediscount of Bills of Exchange • Accepting Deposits without interest • Annual Contribution to National Rural Credit Funds • Dealing in Derivatives
Banking Policy
• Banking policy is a policy formulated by RBI from time to time • It is made in the interest of banking system, monetary stability and sound economic growth • Takes into account the interests of the depositors, the volume of deposits and other resources of the bank and the need for equitable

allocation and the efficient use of deposits and resources.

Monetary Policy

- Monetary policy is the policy/process by which Reserve Bank controls either the cost of very short-term borrowing or the monetary base.
- Such policy is directed towards achieving a targeted inflation rate or interest rate to ensure price stability and general trust in the currency.

Instruments of Monetary Policy

- Repo Rate
- Reverse Repo Rate
- Liquidity Adjustment Facility (LAF)
- Marginal Standing Facility (MSF)
- Corridor
- Bank Rate
- Cash Reserve Ratio (CRR)
- Statutory Liquidity Ratio (SLR)
- Open Market Operations (OMOs)
- Market Stabilisation Scheme (MSS)

Repo Rate

- Repo rate is the rate at which the RBI lends money to the banks for a short term.
- It is also known as the benchmark interest rate.
- When banking system experiences liquidity shortages and the rate of interest is increasing, the RBI will purchase Government securities from Banks, payment is made to banks.
- When the repo rate increases, borrowing from RBI becomes more expensive.
- If RBI wants to make it cheaper for banks to borrow money it reduces the repo rate.

Reverse Repo Rate

- Reverse Repo rate is the short term borrowing rate at which RBI borrows money from banks.
- The Reserve bank uses this tool when it feels there is too much money floating in the banking system.
- An increase in the reverse repo rate means that the banks will get a higher rate of interest from RBI.

Liquidity Adjusted Facility (LAF)

- Liquidity management operations are aimed at modulating liquidity conditions such that the overnight rates in the money market remains within the informal corridor set by the repo and reverse repo rates for the liquidity adjustment facility (LAF) operations.
- In a repo transaction, the Reserve Bank infuses liquidity into the system by taking securities as collateral, while in a reverse repo transaction it absorbs liquidity from the system with the Reserve Bank providing securities to the counter parties.

Cash Reserve Ratio (CRR)

- Cash Reserve Ratio (CRR) is the mandatory reserve to be maintained with RBI.
- Scheduled Bank (Section 42 of RBI Act) – Every scheduled Bank is required to keep certain percentage of their demand and time liabilities, as cash balances with the RBI.
- Non Scheduled Bank (Section 18 of Banking Reg Act) – are required to maintain the cash reserve.
- There is no maximum ceiling or floor rate in respect of CRR.
- A lag of one fortnight is provided in the maintenance of stipulated CRR by banks.

Statutory Liquidity Ratio (SLR)

- SLR is the mandatory reserve to be maintained by banks held in the form of prescribed securities.
- This is also based on certain percentage of their demand and time

	liabilities of a bank. • As per Section 24 of the Banking Regulation Act, every banking company in India is required to maintain in India, in cash, gold or unencumbered approved securities an amount which should not at close of business on any may be less than the percentage prescribed by RBI of the total of its demand and time liabilities in India.
Open Market Operations (OMO)	
	• Central bank/ RBI uses Open Market Operations as the primary means of implementing monetary policy. • OMO, in short refers to the outright purchase/sale of Government securities. • RBI carries the same in the secondary market on the electronic Negotiated Dealing System – Order Matching platform.
Market Stabilisation Scheme (MSS)	
	• MSS or Market Stabilisation Scheme was introduced in April 2004. • This Scheme provides for issuance of Government of India dated securities/treasury bills to absorb surplus structural/ durable liquidity created by the Reserve Bank's foreign exchange operations. • MSS operations are a sterilisation tool used for offsetting the liquidity impact created by intervention in the foreign exchange markets.

DESCRIPTIVE QUESTIONS

2018 - Dec [1] (d) What are the functions of Reserve Bank of India?

(5 marks)

Answer:

The functions of the Reserve Bank of India are as under:

- Banking Functions.

- Issue bank notes.
- Monetary Policy Functions.
- Public Debt Functions.
- Foreign Exchange Management.
- Banking Regulation & Supervision.
- Regulation and Supervision of Non-Banking Financial Companies (NBFCs).
- Regulation & Supervision of Co-operative banks.
- Regulation of Derivatives and Money Market Instruments.
- Payment and Settlement Functions.
- Consumer Protection Functions.
- Financial Inclusion and Development Functions.

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2019 - June [1] (a) Reserve Bank of India is a banker of banks. Comment. **(5 marks)**

Answer:

Reserve Bank of India performs such functions as mentioned below which entitles it to the crown title of 'Banker of Banks':

- The Reserve Bank of India 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 (RTGS).
- As Banker of Banks, the Reserve Bank provides short-term loans and advances to selected banks, when necessary, to facilitate lending to specific sectors and for specific purposes. These loans are provided against promissory notes and other collateral given by the banks.
- RBI 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.
- 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.

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2019 - Dec [2] (b) What are the regulations relating to acceptance of deposits by non-banking financial companies conferred under chapter III B of the Reserve Bank of India Act, 1934? **(4 marks)**

Answer:

Chapter III B of Reserve Bank of India Act, 1934 deals *inter-alia* with the regulation and supervision of non-banking financial institutions and with the provisions relating to institutions receiving deposits. Some of the important regulations relating to acceptance of deposits by Non-Banking Financial Companies (NBFCs) are as under:

- The NBFCs are allowed to accept/renew public deposits for a minimum period of 12 months and maximum period of 60 months. They cannot accept deposits repayable on demand.
- NBFCs cannot offer interest rates higher than the ceiling rate prescribed by Reserve Bank of India from time to time.
- NBFCs cannot offer gifts/incentives or any other additional benefit to the depositors.
- NBFCs should have minimum investment grade credit rating.
- The deposits with NBFCs are not insured.
- The repayment of deposits by NBFCs is not guaranteed by Reserve Bank of India.
- Certain mandatory disclosures are to be made about the NBFC in the Application form issued by the NBFC soliciting deposits.
- The said NBFC's are also required to submit various returns from time to time in relation to the said deposits.

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2019 - Dec [2] (e) How is the Monetary Policy Committee constituted under the Reserve Bank of India Act, 1934? What are its functions? Explain. **(4 marks)**

Answer:

- Section 45ZB of the Reserve Bank of India Act, 1934 empowers the Central Government to constitute the Monetary Policy Committee of the Reserve Bank of India. The Monetary Policy Committee shall consist of the following Members, namely:
  - The Governor of the Bank – Chairperson
  - Deputy Governor of the Bank, in charge of Monetary Policy
  - 1 officer of the Bank to be nominated by the Central Board
  - 3 persons to be appointed by the Central Government
  - The Monetary Policy Committee shall determine the Policy Rate required to achieve the inflation target.
  - The decision of the Monetary Policy Committee shall be binding on the Reserve Bank of India.
  - RBI is required to publish a document explaining the steps to be taken to implement the decisions of the Monetary Policy Committee.

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2019 - Dec [2A] (Or) (iv) State the requirements for registration of Non-Banking Finance Company with Reserve Bank of India under the Reserve Bank of India Act, 1934. **(4 marks)**

Answer:

- In terms of Section 45-IA of the RBI Act, 1934, no Non-banking Financial Company can commence or carry on business of a non-banking financial institution without obtaining a certificate of registration from the Reserve Bank of India.
- There are various broad categories of NBFC's which can apply to and be registered with the RBI.
- However, for applying for registration, the NBFC should comply with the following:
  - It should be a company registered under the Companies Act
  - It should have a minimum net owned fund.

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2020 - Dec [1] (a) "Reserve Bank of India, being the custodian of country's foreign exchange reserves, is vested with the responsibility of managing its investments". Comment. **(5 marks)**

Answer:

- RBI acts as the custodian of foreign exchange reserves, manages exchange control and acts as the agent of the government in respect of India's membership of the IMF.
- The foreign exchange regulations requires that all foreign exchange receipts whether on account of export earnings, investment earnings, or capital receipts, whether private account or on government account, must be sold to the RBI either directly or through authorized dealers.
- This resulted in centralisation of country's foreign exchange reserves with the RBI and facilitated planned utilization of these reserves, because all payments in foreign exchange were also controlled by the authorities.
- Further, RBI acts as the ultimate guardian of the foreign exchange value of the rupee and as such intervene, i.e. buy and sell rupees in the foreign exchange market at its discretion.

Space to write important points for revision

2020 - Dec [2] (b) Explain the following instruments which Reserve Bank of India uses for implementing its monetary policy:

(i) Cash Reserve Ratio (CRR)
(ii) Statutory Liquidity Ratio (SLR)
(iii) Reverse Repo Rate (RRR)
(iv) Repo Rate (RR). **(4 marks)**

Answer:

Below is the description of instruments used by RBI:

(i) Cash Reserve Ratio (CRR)

- Cash Reserve Ratio (CRR) is the mandatory reserve to be maintained with RBI.

- Scheduled Bank **(Section 42 of RBI Act)** – Every scheduled Bank is required to keep certain percentage of their demand and time liabilities, as cash balances with the RBI.
- Non Scheduled Bank (**Section 18** of Banking Reg Act) – are required to maintain the cash reserve.
- There is no maximum ceiling or floor rate in respect of CRR.
- A lag of one fort night is provided in the maintenance of stipulated CRR by banks.

(ii) Statutory Liquidity Ratio (SLR)

- SLR is the mandatory reserve to be maintained by banks held in the form of prescribed securities.
- This is also based on certain percentage of their demand and time liabilities of a bank.
- As per Section 24 of the Banking Regulation Act, every banking company in India is required to maintain in India, in cash, gold or unencumbered approved securities an amount which should not at close of business on any may be less than the percentage prescribed by RBI of the total of its demand and time liabilities in India.

(iii) Reverse Repo Rate (RRR)

- Reverse Repo rate is the short term borrowing rate at which RBI borrows money from banks.
- The Reserve bank uses this tool when it feels there is too much money floating in the banking system.
- An increase in the reverse repo rate means that the banks will get a higher rate of interest from RBI.

(iv) Repo Rate (RR)

- Repo rate is the rate at which the RBI lends money to the banks for a short term.
- It is also known as the benchmark interest rate.
- When banking system experiences liquidity shortages and the rate of interest is increasing, the RBI will purchase Government securities from Banks, payment is made to banks.

- When the repo rate increases, borrowing from RBI becomes more expensive.
- If RBI wants to make it cheaper for banks to borrow money it reduces the repo rate.

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2021 - Aug [1] (a) In what way the Reserve Bank of India manages foreign exchange reserves as the custodian of the country's foreign exchange reserves, under the provisions of the Reserve Bank of India Act, 1934?

(5 marks)

Answer:

RBI acts as the custodian of foreign exchange reserves, manages exchange control and acts as the agent of the government in respect of India's membership of the IMF.

The foreign exchange regulations under the law requires that all foreign exchange receipts whether on account of export earnings, investment earnings, or capital receipts, whether private account or on government account, must be sold to the RBI either directly or through authorized dealers.

This resulted in centralisation of country's foreign exchange reserves with the RBI and facilitated planned utilization of these reserves, because all payments in foreign exchange are also controlled by the authorities.

Further, RBI act as the ultimate guardian of the foreign exchange value of the rupee and as such intervene, i.e. buy and sell rupees in the foreign exchange market at its discretion.

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2021 - Aug [2] (a) Discuss the market operations used by the Reserve Bank of India for operationalising the monetary policy. **(4 marks)**

Answer:

Following are the Instruments of Monetary Policy that are directly and indirectly used for implementing monetary policy.

Repo Rate: The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities. [GIVES]

Reverse Repo Rate: The (fixed) interest rate at which the Reserve Bank absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities. [TAKES]

Liquidity Adjustment Facility (LAF): The LAF consists of overnight as well as term repo auctions.

Marginal Standing Facility (MSF): A facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a limit at a penal rate of interest. This provides a safety valve against unanticipated liquidity shocks to the banking system.

Corridor: The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.

Bank Rate: It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. This rate has been aligned to the MSF rate and, therefore, changes automatically as and when the MSF rate changes along side policy repo rate changes.

Cash Reserve Ratio (CRR): The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such per cent of its Net demand and time liabilities (NDTL) that the Reserve Bank may notify from time to time in the Gazette of India.

Statutory Liquidity Ratio (SLR): The share of NDTL that a bank is required to maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.

Open Market Operations (OMOs): These include both, outright purchase and sale of government securities, for injection and absorption of durable liquidity, respectively.

Market Stabilisation Scheme (MSS): This instrument for monetary management was introduced in 2004. Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through sale of short-dated government securities and treasury bills. The cash so mobilised is held in a separate government account with the Reserve Bank.

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2021 - Dec [1] (a) The Reserve Bank of India acts as the 'lender of last resorts'. Comment. **(5 marks)**

Answer :

The Preamble to the Reserve Bank of India Act, 1934 under which Reserve Bank of India was constituted, specifies its objective as to regulate the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.

As a Banker to Banks, the Reserve Bank of India also acts as the 'lender of the 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. The Reserve Bank extends this facility to protect the interest of the depositors of the bank and to prevent possible failure of the bank, which in turn may also affect other banks and institutions and can have an adverse impact on financial stability and thus on the economy.

Similarly, Section 18 of the RBI Act facilitates the RBI to act as a 'Lender of Last Resort' permitting grant of loans and advances subject to other terms of Section 18 of the Act.

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2021 - Dec [2] (d) Explain the legal tender character of notes under RBI Act, 1934. **(4 marks)**

Answer :

- Section 26 of RBI Act provides for legal tender character of notes
- As per the provisions, every bank note shall be legal tender at any place in India in payment or on account for the amount expressed therein, and shall be guaranteed by the Central Government.

- However, the Central Government (on recommendation of the Central Board) may, declare that, with effect from such date as may be specified in the notification, any series of bank notes of any denomination shall cease to be legal tender save at such office or agency of the Bank by notification in the Gazette.

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2021 - Dec [2A] (Or) (iii) What are the objectives of Payment and Settlement System Act, 2007? **(4 marks)**

Answer :

Objectives of The Payment and Settlement Systems Act, 2007 are as follows:

- To provide regulation and supervision of payment methods in India.
- To designate RBI for purposes related to payment systems in India.
- To constitute such regularities by RBI to exercise its power and perform its functions.
- To provide a legal basis for “netting” and “settlement finality”

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2022 - June [1] (a) What are the functions of Reserve Bank of India to secure monetary stability in India? **(5 marks)**

TOPIC NOT YET ASKED BUT EQUALLY IMPORTANT FOR EXAMINATION

SHORT NOTES

Q1. Elaborate “Issue Functions” of RBI.

Answer:

- One of the key right of RBI is to Issue Bank Notes.
- This function of issuing Bank Notes is performed by Issue Department wholly separated from Banking function. RBI can recommend to Central Government denominations not exceeding ten thousand rupees.
- The design, form and material of bank notes is approved by Central Government on recommendation by Central Board of RBI.
- Another important function is exchange of mutilated/ torn notes.
- The bank notes issued by RBI are exempt from payment of Stamp Duty.

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Q2. Write short notes on Banking Policy.

Answer:

Banking policy is a policy formulated by RBI from time to time, in the interest of banking system or in the interest of monetary stability or sound economic growth, having due regard to the interests of the depositors, the volume of deposits and other resources of the bank and the need for equitable allocation and the efficient use of these deposits and resource.

—— Space to write important points for revision ——

Q3. Explain Monetary Policy.

Answer:

- Monetary policy refers to the policy of the central bank with regard to the use of monetary instruments under its control to achieve the goals specified in the Act.
- RBI is vested with the responsibility of conducting monetary policy.
- The primary objective of monetary policy is to maintain price stability while keeping in mind the objective of growth. Price stability is a pre condition to sustainable growth.

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Q4. Write short notes on Monetary Policy Report.

Answer:

- Section 45ZM of RBI Act contains provision regarding Monetary Policy Report.
- The frequency of such report to be published is every 6 months.
- Report contains.
  - Sources of inflation.
  - Targets/Forecast of inflation for next 6-18 months.

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Q5. Short notes on functions of Reserve Banks.

Answer:

Functions of RBI include the following:

Issue bank notes	• Section 22 of RBI Act provides RBI with sole right to issue bank notes in India. • RBI to recommend to Central Government 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 Central Board of RBI also recommends the material, design and form of bank notes which is approved by Central Government. • Other noteworthy points relating to issuance of notes: – On recommendation of Board, CG may declare any denomination as not legal tender

	– Bank notes do not attract stamp duty. – Note issue is carried by a separate department called Issue Dept.
Banking functions	• Section 17 of the RBI Act empowers Reserve Bank to carry out banking business. • The section provides that RBI may transact various businesses such as : – Acceptance of deposits from Central/ State Government without any interest. – Short term Loans and Advances to banks. – Purchase, sale and rediscount of Bills of Exchange. – Purchase and sale of Government Securities, purchase and sale of shares of SBI, National Housing Bank, Deposit Insurance and Credit Guarantee Corporation, etc., • Section 18 facilitates the RBI to act as a 'Lender of Last Resort'.
Banking Regulation and Supervision	• Banking Regulation Act 1949, empowers RBI to supervise and regulate the functioning of other banks. • In certain cases RBI can appoint Chairman of the banks and in few listed circumstances can supersede the Board of the bank as well. • By virtue of Section 21 of BR Act, RBI controls advances by banking companies. • RBI enjoys the power to issue licence and cancel the same . • In case where the banking operations are prejudicial to the interest of depositors/ banking company RBI is empowered to issue directions.

Foreign Exchange functions	• Section 10 of the FEMA empowers RBI to authorize any person to be known as authorized person to deal in foreign exchange/securities. • RBI is further empowered to revoke the authorisation as well.
Monetary policy functions	• RBI provides recommendation on inflation target in terms of the Consumer Price Index, once in every five years, which is then notified by Central Government.
NBFC-Regulation and Supervision	• Section 45-IA of RBI Act provides that every non-banking financial company to obtain a certificate of registration from the RBI before carrying out operations. • Net owned fund as may be specified by RBI needs to be maintained by NBFCs. • RBI is further empowered to call for information and issue directions to NBFC.
Cooperative Bank-Regulation and Supervision	• RBI has been entrusted with the powers to issue 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 Derivative and Money Market Instruments	• RBI is empowered to regulate the transactions relating to derivatives, money market instruments.
Consumer Protections Functions	• RBI is also responsible for ensuring consumer protection in banking modes. • It has to formulate the Banking Ombudsman Scheme for the redressal of grievances of depositors.

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DESCRIPTIVE QUESTIONS

Q1. Give a brief on the history of establishment of RBI.

Answer:

- Reserve Bank of India was established under the Act of 1934 and its operations began in the year 1935.
- The history for establishment of RBI however dates back to 1926, when Hilton Young Commission / Royal Commission on Indian Currency and Finance advocated separation of currency and credit from Government's purview.
- Initially RBI was established as a private shareholder's bank.
- It was in the year 1949 that the operations got nationalised.
- The scope of Central Bank has increased manifold and it plays a crucial role in balancing banks and customers, handling customer grievances and providing robust banking platform.
- In the current scenario maintaining financial stability is one of the key agenda of this Apex body.

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Q2. What does the Preamble of RBI states?

Answer:

- RBI is established by virtue of RBI Act, 1934.
- The Preamble to the Act dictates its objective as:
  – To regularise the issue of Bank notes and the keeping of reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.

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Q3. Describe the network of RBI in terms of its spread.

Answer:

- The Reserve Bank has a network of offices and branches
- The ones, operating in the 4 metros (Mumbai, Delhi, Kolkata and Chennai) are referred as offices.
- The other units located in other cities and towns are called branches.
- The offices and larger branches are headed by a senior officer of the rank of Chief General Manager, designated as Regional Director
- The smaller branches are headed by office of rank of General Manager.

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Q4. Describe the role of Reserve Bank in Foreign exchange management.

Answer:

- FEMA Act has been established. It empowers RBI to authorise person to deal in foreign exchange or foreign securities. (Section 10 of FEMA).
- RBI has power to revoke authorization issues to an authorised dealer if there is in contravention as prescribed in Section 13 of FEMA. Such revocation is done following prescribed procedure in FEMA. (Section 15 of FEMA)

—— Space to write important points for revision ——

Q5. What denomination of notes can be issued by RBI?

Answer:

- Currently notes of ₹ 5, ₹ 10, ₹ 20, ₹ 50, ₹ 100, ₹ 500 and ₹ 2,000 are being issued by RBI.
- Printing of ₹1 and ₹ 2 notes is discontinued but old notes in circulation is valid currency.
- The RBI may issue notes in any other denomination but not exceeding ₹ 10,000
- The government announced demonetisation of ₹ 500 and ₹ 1,000 notes on November 8, 2016 and new redesigned notes of ₹ 500 and ₹ 2,000 were launched on November 10, 2016.

Space to write important points for revision

Q6. What are the various Banking Functions that can be under taken by RBI?

Answer:

As prescribed under Section 17, RBI may take up the following banking functions:

- Accepting Deposits without interest.
- Purchase, sale and rediscount of Bills of Exchange.
- Short term Loans to Banks.
- Annual Contribution to National Rural Credit Funds.
- Dealing in Derivatives.
- Purchase and Sale of Government Securities.
- Purchase and Sale of Shares of SBI, National Housing Bank, Deposit Insurance and Credit Guarantee Corporation.
- Making and Issue of Bank Notes.

Space to write important points for revision

Q7. What are the instruments of Monetary Policy?

Answer:

Following are the Instruments of Monetary Policy that are directly and indirectly used for implementing monetary policy.

- **Repo Rate:** The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks against the collateral of government and other approved securities. [GIVES]
- **Reverse Repo Rate:** The (fixed) interest rate at which the Reserve Bank absorbs liquidity, on an overnight basis, from banks against the collateral of eligible government securities. [TAKES]
- **Liquidity Adjustment Facility (LAF):** The LAF consists of overnight as well as term repo auctions.
- **Marginal Standing Facility (MSF):** A facility under which scheduled commercial banks can borrow additional amount of overnight money from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a limit at a penal rate of interest. This provides a

safety valve against unanticipated liquidity shocks to the banking system.

- **Corridor:** The MSF rate and reverse repo rate determine the corridor for the daily movement in the weighted average call money rate.
- **Bank Rate:** It is the rate at which the Reserve Bank is ready to buy or rediscount bills of exchange or other commercial papers. This rate has been aligned to the MSF rate and, therefore, changes automatically as and when the MSF rate changes along side policy repo rate changes.
- **Cash Reserve Ratio (CRR):** The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such per cent of its Net demand and time liabilities (NDTL) that the Reserve Bank may notify from time to time in the Gazette of India.
- **Statutory Liquidity Ratio (SLR):** The share of NDTL that a bank is required to maintain in safe and liquid assets, such as, unencumbered government securities, cash and gold. Changes in SLR often influence the availability of resources in the banking system for lending to the private sector.

- **Open Market Operations (OMOs):** These include both, outright purchase and sale of government securities, for injection and absorption of durable liquidity, respectively.
- **Market Stabilisation Scheme (MSS):** This instrument for monetary management was introduced in 2004. Surplus liquidity of a more enduring nature arising from large capital inflows is absorbed through sale of short-dated government securities and treasury bills. The cash so mobilised is held in a separate government account with the Reserve Bank.

Space to write important points for revision

Q8. What is Monetary Policy Committee/ MPC? Discuss the constitution of this committee.

Answer:

- MPC stands for Monetary Policy Committee.

- Section 45ZB of RBI Act provides for constitution of MPC.
- MPC determines the policy interest rate required to achieve the inflation target.
- Members of MPC are:
  - RBI Governor.
  - Deputy Governor (in charge of Monetary Policy).
  - 1 Officer of RBI nominated by Central Board of Directors.
  - 3 persons nominated by Central Government.
- Frequency of Meetings of MPC :
  - 4 meetings in a year.
- Functions of MPC :
  - MPC works upon the Monetary policy framework.
  - Recommends to Central Government inflation targets.

Space to write important points for revision

Q9. What was the objective of enactment of Banking Regulation Act, 1949 and how it empowered Reserve Bank?

Answer:

- The Banking Act was enacted in February, 1949 with the following objectives:
  - The provision of the Indian Companies Act, 1913 was found inadequate to regulate banking companies in India. Therefore a need was felt to have a specific legislation having comprehensive coverage on banking business in India.
  - Due to inadequacy of capital many banks failed. The banking regulation act brought in minimum capital requirements for banks.
  - To prevent indiscriminate opening of new branches and ensure balanced development of banking companies by system of licensing.
  - To protect the interest of depositors and public at large by incorporating certain provisions, viz. prescribing cash reserve and liquidity reserve ratios. This enable bank to meet demand depositors.
  - Provider compulsory amalgamation of weaker banks with senior banks, and thereby strengthens the banking system in India.

- Introduce few provisions to restrict foreign banks in investing funds of Indian depositors outside India.
- Provide quick and easy liquidation of banks when they are unable to continue further or amalgamate with other banks.

- Banking Regulation Act, 1949 empowered RBI to appoint, reappoint and removal of chairman, director and officers of the banks. This could ensure the smooth and efficient functioning of banks in India.
- Amendments to Banking Regulation Act brought cooperative banks and other regional rural banks under the jurisdiction of RBI.

Space to write important points for revision

Q10. Discuss the role of RBI in Banking Regulation and Supervision.

Answer:

- The power to regulate and supervise banks has been conferred on RBI by Banking Regulation Act.
- RBI has power to formulate the banking policy.
- RBI has power to appoint Chairman or Managing director of banking company.
- RBI has the power to appoint additional director to exercise control over management.
- RBI also has powers to remove the existing management of the bank.

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Q11. What does Central Board of Directors of RBI consists of ?

Answer:

- Provisions relating to Central Board of Directors, their constitution and functions are captured under Section 8 of the RBI Act , 1949:
- **What:**
  - Central Board of Directors is the top most authority in organizational structure of RBI.
- The Central Board shall consist of the following Directors, namely:

  - a Governor and not more than four Deputy Governors to be appointed by the Central Government.
  - 4 Directors to be nominated by the Central Government, one from each of the four Local Boards.
  - 10 Directors to be nominated by the Central Government.
  - 1 Government official to be nominated by the Central Government
    - The Governor and Deputy Governors shall devote their whole time to the affairs of the Bank, and shall receive such salaries and allowances as may be determined by the Central Board, with the approval of the Central Government.
    - The Governor and a Deputy Governor shall hold office for such term not exceeding five years.
    - Director nominated shall hold office for a period of four years.
- This body is primarily responsible for proper functioning of Reserve Bank.

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Q12. What does Local Boards of RBI consists of ?

Answer:

- Provisions relating to Local Boards, their constitution and functions are captured under Section 9 of the RBI Act, 1949.
- A Local Board shall be constituted for each of the four areas, one each for the Northern, Southern, Eastern and Western parts of India.
- Each of the Local Board consists of 5 members to be appointed by the Central Government to represent, as far as possible, territorial and economic interests and the interests of co-operative and indigenous banks.
  - The members of the Local Board shall elect from amongst themselves one person to be the chairman of the Board.
  - Every member of a Local Board shall hold office for a term of four years and thereafter until his successor shall have been appointed and shall be eligible for re-appointment.
- A Local Board shall advise the Central Board on such matters as may be generally or specifically referred to it and shall perform such duties as

the Central Board may delegate to it.

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Q13. Discuss the organisational structure of the Reserve Bank.

Answer:

The organisational structure of Reserve Bank consists of:

Central Board of Directors	• Has the primary authority and responsibility for overseeing the functioning of Reserve Bank. • It can delegate specific functions to local bodies and various committees. • Central Government nominates 14 Directors on the Central Board, including one Director each from the 4 Local Boards. • The other 10 Directors represent different sectors of the economy, like agriculture, industry, trade, and profession. • All these appointments are made for a period of 4 years.
Governor	• Governor is the RBI's Chief Executive. • Supervises and directs the affairs of RBI. • Holds office for term not exceeding 5 years.
Deputy Governor	• Holds office for term not exceeding 5 years. • May attend any meeting of the Central Board and take part in its deliberations but not be entitled to vote. • However Governor can authorize him to vote on his behalf if the Governor is unable to attend meetings.
Executive Directors	Constitutes the management team.

Others	Consists of Principal Chief General, Chief General Managers, General Managers, Dy. General Managers, Assistant Managers, Managers, Assistant Managers, Support staff.

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Q14. What is meant by Monetary Policy and what are its various instruments.
Answer:

- Monetary policy is the policy of central bank to use monetary instruments under its control to achieve the goals specified under this act.
- The primary objective is to maintain the price stability while keeping the objective of growth in mind.
- Instruments of monetary policy are Repo rate, Reverse Repo rate, Liquidity Adjustment Facility, Marginal Standing Facility, Corridor, Bank Rate, Cash Reserve Ratio (CRR), Statutory Liquidity Ration (SLR), Open Market Operations, Market Stablisation Scheme.

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Q15. Describe the penalty provisions provided under the RBI Act.
Answer:
There are various provisions for penalty under RBI Act:

For making any false application, statement, declaration or return + Giving false material particulars in any prospectus or advertisement	3 years imprisonment + Fine
For failing to produce book, account or document as required	₹ 2,000 ; If Continuous offence: ₹ 100 per day
Contravenes the provisions of Section 31	Fine (upto amount of the bill of exchange/hundi/promissory note/engagement for payment of money)
Discloses any credit information prohibited under Section 45E	6 month imprisonment or ₹ 1,000 Fine or both

Contravenes the provisions of Section 45-IA	1 year to 5 years imprisonment or ₹ 1,00,000 to ₹ 5,00,000 Fine or both
Contravention of provisions of Section 45 MA by auditor	₹ 5,000
Contravenes the provisions of Section 45S	2 years imprisonment or ₹ 2,000 or twice the amount of deposit received whichever is higher as Fine or both
Contravention of any other provision	₹ 2,000 ; If Continuous offence : ₹ 100 per day

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