Financial Institutions and Markets
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Lecture - 17
RBI – Structure and Functions

So, in the previous class we discussed about the theoretical foundations of the regulation. And here we have seen that we have two regulatory systems one is multiple regulatory system, then we have a single regulatory system then every regulatory system has his own advantages and disadvantages. But in general sense if you observe in India we have a multiple regulatory system and there are multiple regulatory bodies which exist to regulate the different type of institutions and the markets. So, out of the all those regulatory bodies the oldest regulatory body is the Reserve Bank of India, which regulates the commercial banks.

And the commercial banks is the most important financial organization or financial institutions in the Indian system as well as the other system. That is why let us start the discussion on how the commercial banks are regulated and what exactly the reserve bank of India does to regulate this commercial bank and what is the basic role of the reserve Bank of India what is the structure of the Reserve Bank of India how it basically functions.

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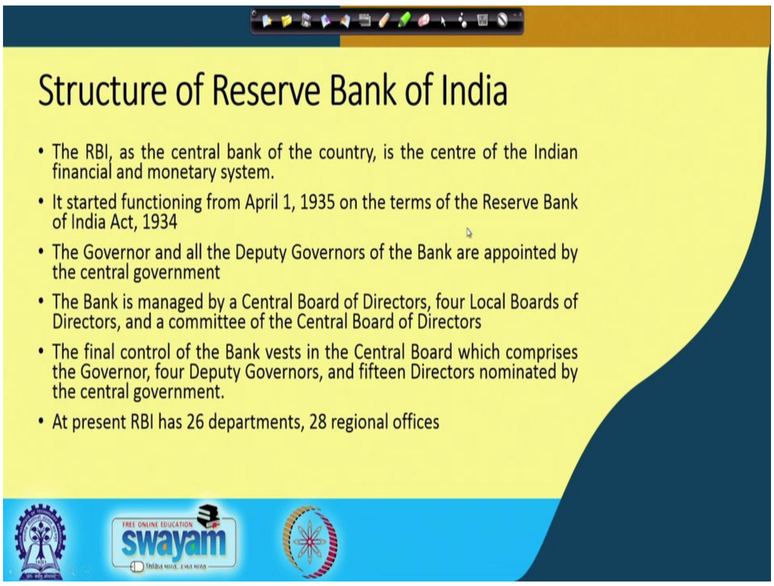

So, this is the basic objective of today's discussion. So, let us start with that what do you mean by or what is Reserve Bank of India and when it was established and what is the structure of that organization then we can move into the functional part? You see that whenever we talk about the Reserve Bank of India or the structure of the Reserve Bank of India already I told you the Reserve Bank of India is central bank of this country or of India.

And is the centre of the Indian financial and monetary system all kind of financial and monetary mechanism basically works with this Reserve Bank of India or starts with this is the apex body who takes care of all monetary and financial aspects of that of this particular country. This functioning of the Reserve Bank of India started from April 1st in 1935 on the terms of the Reserve Bank of India Act 1934. That is why it is one of the oldest regulatory bodies which is working in the Indian financial system.

And whenever you talk about this structure all of you very much aware about this that the head of the organization is the governor and the governor and there are 4 deputy governors, who always work on behalf of the Reserve Bank, they are appointed by the central government. How the bank is managed? The banks structure is like this, the bank is managed by central board of directors and 4 local boards of directors and a committee of the central board of directors.

So, this is the way there is a central board of directors who basically looks after the different policy issues and what inside whenever we go to this system what we have seen that this hierarchy is like this. So, we have a governor we have 4 deputy governors and each department is basically aided by executive directors then the other bodies work in that particular system. But, if you see the Reserve Bank of India the final control of the bank basically always rest upon the central board which comprises the governor 4 deputy governors and 15 directors nominated by the central government.

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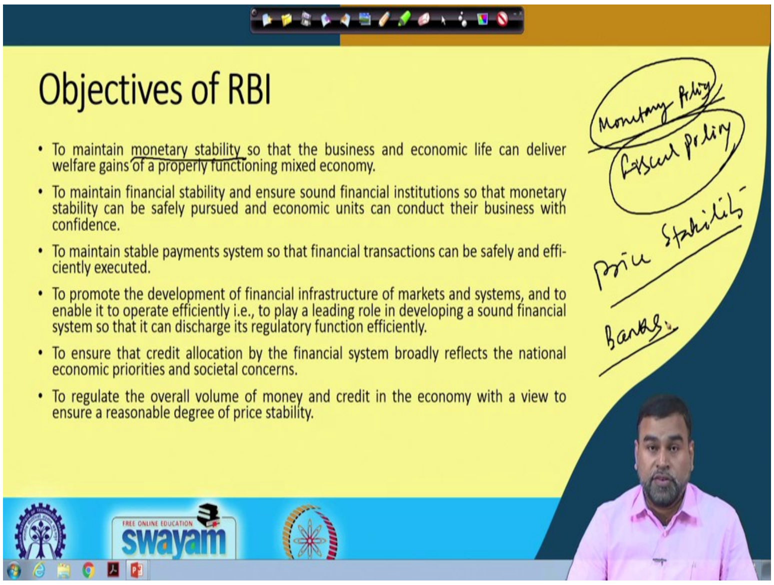

So, there are 15 directors who are not a part of this particular bank they are the specialized people or the expert people from the different areas. And the deputy governor and governor; obviously, a part of the central board and that is the way this Reserve Bank of India basically functions and inside hierarchy. If you go that after governor deputy governor we have the executive directors and directors and other people and they always work for the functioning of the Reserve Bank of India at present it is always subject to change.

But presently Reserve Bank of India has 26 departments and 28 regional offices which work to regulate the financial system or monetary system. As a whole we can say because the bank is the most important organization which always we observe in the financial system. So, this is the way the structure of the Reserve Bank of India basically looks like. So, if you see that what is objective of RBI?

RBI is established long back in 1935 so, what was the basic objective and now what is the objective, whether there is a change? And if you see overall here what really I have summarize that over the period of time what are the broad objective the Reserve Bank of India has. And how the Reserve Bank of India is working in this particular system and what is basically they are trying to do. The first and foremost thing is basically what the Reserve Bank of India does that is basically to maintain the monetary stability. So, whenever you talk about monetary stability you see that whenever you talk about monetary stability, how it comes? If you remember in economics we have the monetary policy and we have the fiscal policy.

And whenever we talk about the Reserve Bank of India, Reserve Bank of India takes care of the monetary policy and the government basically takes care of the fiscal policy the finance ministry mostly is responsible for the conduct of the fiscal policy. So, as the responsible authority for the smooth conduct of the monetary policy the Reserve Bank of India always ensures that the monetary stability of the economy can be maintained. Whenever you talk about the monetary stability; the monetary stability means we are talking about the price stability.

So, the basic objective of Reserve Bank of India is to make this price level stable in that particular country in a particular period of time. So, this is the first objective on the basis of that Reserve Bank of India was established. Second one; to maintain the financial stability and ensures sound financial institutions. So, that monetary stability can be safely persuaded and economic unit can conducts their business with confidence. It is a very broad objective you see what do you mean by financial stability? Financial stability is a buzz word particularly after the crisis people are much more concerned about the financial stability, but already what again and again I am telling you that whenever you talk about the financial stability.

Financial stability means in Indian context that is basically stability of the banks mostly. If the banks are stable, capital base of the bank is basically adequate and enough to observe all types of risk what we are facing in the bank then automatically what we can conclude that the financial sector in Indian context is stable. So, what RBI basically is tries to ensure, the RBI try to ensure the financial sector in India should be stable, at least the banking sectors should be stable the credit risk.

The instability of the banks and failure of the banks should be minimized as bank is the payment gateway of this particular system. So, here what is happening the banker stable automatic, what will happen that the monetary stability can be maintained and people have the confidence on the market. And all of you know that the behavioral aspect is quite important for the function of the market if the consumer confidence or the people confidence on the market will be more then automatically what will happen that the functioning of the marketing will be smoother.

And, the operations and all those activities which is happening in the system that will basically work in a better way so, therefore, we have to ensure that the financial stability should be there. Financial stability mean the stability of the banks particularly the most important organization.

In the economic system then once this is stable then the monetary stability can be maintained, consumer confidence and people confidence will be higher than the market will be working in a better way. To ensure or to maintain the stable payment. So, that the financial transactions can be safely and efficiently executed, because already know that the commercial bank has the only payment gateway or the most important payment gateway in this particular system.

Then RBI ensures that the payment system should be stable; there should not be any kind of hassles in terms of the transactions. If the transactions are hassle free the people confidence on the market will be more. If the people confidence on the market will be more automatically what will happen that the safely and efficiently all kind of transaction can be executed and participation in the market also will increase.

And more the participation; obviously, will tend to the efficiency in the market because market will be more competitive and if the market will be more competitive in that sense whatever price and whatever economic output what we are determining that will be actual equilibrium output what we can get. So, therefore, the stability of the payment system is one of the major objectives of the Reserve Bank of India.

And another most important thing to promote the development of the financial infrastructure and to ensure or to enable them to operate efficiently. So, here what we can say that what do you mean by the financial infrastructure? Financial infrastructure means establishment of new banks establishment of the new branches of the commercial bank establishment of the different organizations which can help the trading. And as well as help in increasing the efficiency of the market like the example of CCIL clearing corporation of India limited which was established by RBI for the trading for the government debts.

And as well as to some extent for the foreign exchange and the derivatives instrument to some extent not derivatives mostly it is related to the government debt there are. So, that is why the RBI's basic job is mostly deal with establishment of the new infrastructure which can help for the functioning of the market in a better way also.

Another one is to ensure that credit allocation by the financial system broadly reflects the national economic priorities and the social consensus. You see whenever the commercial banks give loan to whom they are giving loans they are giving loans from where they can maximize their benefits, they give the loans they try to find out the customers to whom they can get more returns, but that may not also fulfill the social objectives there are some small units like small farmers small business units.

So, they may not be able to pay that much kind of money or that much kind of interest rate what the bigger commercial units are able to pay. So, then if there is no regulation there is no such kind of a norms which are there where this lending also, the credits also should be given to these kind of entities than those entities can be marginalized and those entities cannot grow in this particular system .

Because, the Indian economy is mostly based up on the rural economy and most of the people live in the rural areas hence also long before our maximum percentage of the share of GDP is coming from the agricultural sector. So, keeping that thing in the mind the commercial banks should provide the loans to these kind of sectors the Reserve Bank of India also make the policies which is basically related to the societal concerns.

So, at a time all kind of sector should grow simultaneously, we can say that is the basic objective, the basic notion, our motto of this Reserve Bank of India and to regulate the overall volume of money. And credit in the economy with a view to ensure reasonable degree of price stability that already I have explained you because monetary stability leads to price stability. So, that is what basically the major broad objectives on which basis the Reserve Bank of India was established. So, now, we will see that how this Reserve Bank of India basically functions.

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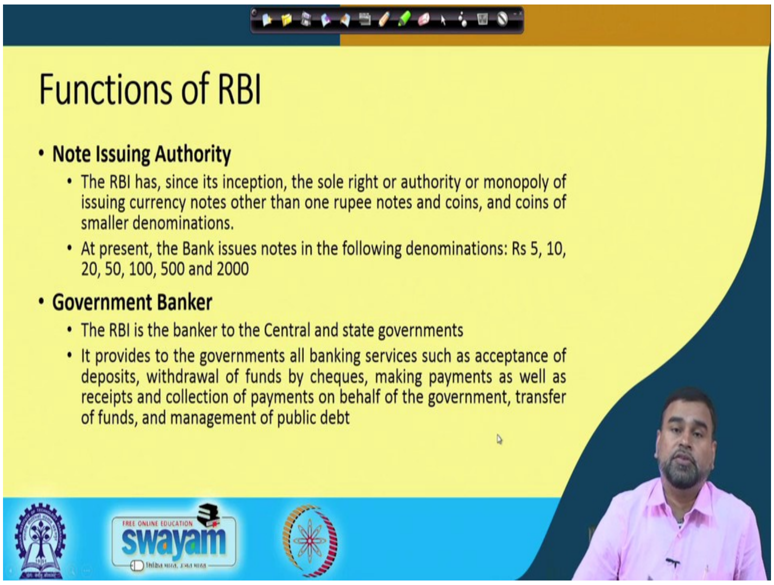

What are those basic functions of RBI? There are many functions RBI does so, I will highlight some of the major functions what RBI basically follows all of you know that; obviously, RBI is the note issuing authority. Whether RBI issues the note or not every common man and everybody able to know that after this the demonetization and all these things because everybody was watching and reading in the newspaper that RBI is trying to change this note they are going for the new 500 notes and all these things or hundred rupees notes.

So, if you see that; obviously, the basic function of RBI the first and foremost important function of RBI is note issuing authority except the 1 rupee coin. The 1 rupee note of the coin is not basically made by RBI; this is issued by this finance ministry apart from this 1 rupee note the other type of notes like 10 rupees, 5 rupees, 20 rupees to 2000 rupees, these are the denominations which are existing in the system.

Now, 50 10 20 50 100 500 and 2000 so, only RBI has the authority to issue the notes other than 1 rupees notes and the coins that is what already I have been mentioned you. So, the prime function of the RBI is to issue notes it is the note issuing authority number 1. Number 2 it is also called as the government banker because, RBI is the banker to the central and state governments.

It provides all kind of banking services to the government such as acceptance of deposits withdrawal of funds by cheques making payments as well as receipts and collection of payments on behalf of the government transfer, transfer of the funds and management of the public debt. So, all kind of banking operations what always we do with the commercial banks the same kind of banking operations the Reserve Bank of India does with the central government and as well as the state governments.

So, anytime the central government needs money they can borrow from RBI, anytime central government has some reserve money, they can keep it with the RBI any kind of foreign exchange transactions and everything anything what the central government tries to do or any state government tries to do. So, every kind of banking operations is done by the Reserve Bank of India only.

So, the Reserve Bank of India that is why popularly called as the government's banks or it is the government's banker. So, in that constant what we say that without the reserve bank the financial transactions of the central government may not be possible because, in a holistic way the countries bank is or the central governments bank is basically the Reserve Bank of India at the time of requirement. They provide the money and at the time of surplus they deposit the money and they also act as the agents on behalf of the central government whenever the foreign transactions are basically made. So, this is the way that is why they are called as the government banker.

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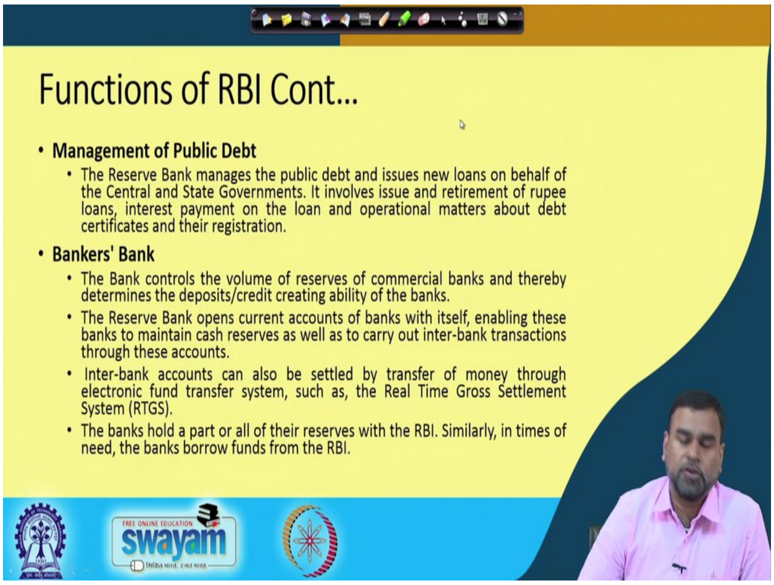

Then, another function of RBI already I told you they manage the public debt they play a very active role for management of the public debt.

How they manage? The Reserve Bank of India basically manages the public debt and issues the new loans on behalf of the central and state governments. It involves issue and retirement of rupee loans, interest payment on loans and operational matters about debt certificates and their registration what does it mean? It means that whenever any kind of loans are taken by the central government or the state government mostly it is central government.

All the loans are basically taken through the Reserve Bank of India. Number 1 and whenever they want to raise money from the public, they sell the securities through Reserve Bank of India on behalf of the government. The government securities are sold by Reserve Bank of India, whenever they try to extract or try to absorb the money from the market what they do they sell the bonds and get back the money. And whenever they try to inject the money into the system what they do they basically buy the bonds from the public and give them the money.

So, either buying and selling of the bonds either increase the money supply, decrease the money supply, management of the debt from the different agencies all these things of the government are done through the Reserve Bank of India. So, they play very active role for management of the public debt which is done by or basic job is done by the RBI. The RBI plays a vital role for the smooth functioning of the public debt management system in the country.

Then; obviously, this is also called as the banker's bank like; RBI. Whenever any commercial bank need money, from where they get the money? They get it from RBI only. So, if you see the bank basically controls the volume of reserves of commercial banks and there by determines the deposit and credit creating ability of the banks. You might have heard whenever there is a change in the policy by the Reserve Bank of India it affects the functioning of the commercial bank, why?

Because, through that commercial bank tries to cover, we will discuss more about this whenever we talk about the instruments or the policy instrument where RBI uses to control the money supply to make the price stable. So, that will come later, but here what we are trying to say RBI controls other commercial bank like State Bank of India your Punjab national bank, Syndicate bank all kind of banks which are there through different ways two different mechanism to different instruments.

Therefore, what RBI basically allowed; the Reserve Bank of India opens the current account in banks with itself and enabling the banks to maintain cash reserves as well as to carry out interbank transactions through these accounts.

Every commercial bank can transact with another banks they should maintain a certain kind of cash reserves with Reserve Bank of India that is why in our term called CRR. The basic objective of CRR is to decrease the probability of default of the liquidation of the banks in the future although that does not carry an interest, that we will discuss more afterwards. Here if you see basically every commercial bank has an account with the Reserve Bank of India.

So, whenever they need money they can borrow also from Reserve Bank of India through different ways such as through liquidity adjustment facility, through repo operation etcetera. And whenever they have any surplus money they can also park their money with the RBI and the inter bank transactions can be settled by the transfer of money through electronic fund transfer system which is basically real time gross settlement system which is operated through RBI .

So, every commercial bank has an account with the RBI and all the transactions which they make either through inter banking system or this access reserve whatever they have or any kind of excess money what they want to borrow from RBI everything is done basically from the RBI itself. So, therefore, whenever the commercial banks are in security of the money or whenever they have the surplus of the money they depend upon the RBI and because of that they are called the bankers bank.

So, RBI is the bank of the all those bankers that is basically another function of Reserve Bank of India. So, that is why they are the most important organization in the financial system particularly in Indian context.

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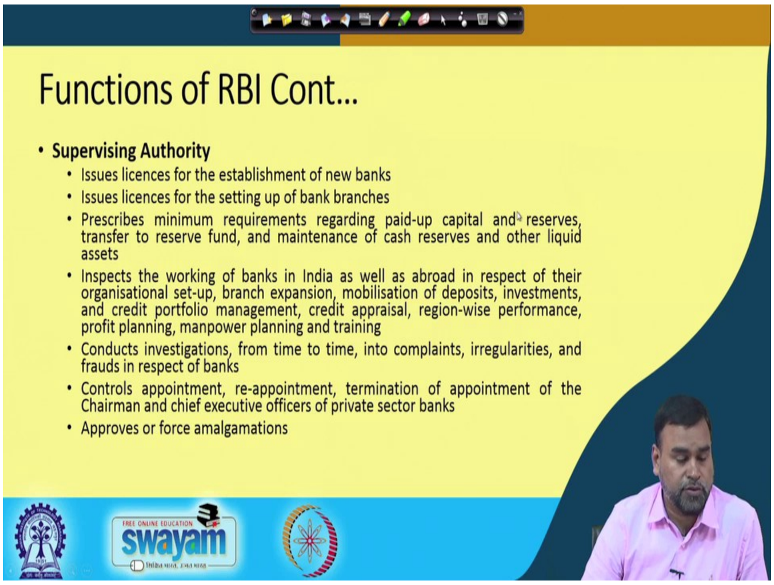

Already I told you as a regulator, they are the supervising authority. So, what kind of supervisor the whole Reserve Bank of India plays? What kind of functions they do? What kind of jobs they do to supervise this banking system first of all. It issues the license for these establishments of new banks, you might have known those 2-3 years back we have. So, many private banks got the license. So, only Reserve Bank of India has the authority to issue the licenses by going thorough process they have to see whether this particular entities are able to do the banking operations or banking business or not.

So, keeping those things in the mind what they do they can issue the licenses for the establishment of the new banks. Even any bank whenever they want to set up a new branch for that also Reserve Bank of India provide the licenses and the licenses have been given after this thorough mechanism or they are going through the actual process whether the banks are fulfilling those criteria or not.

And this RBI ensure that this particular bank is able to fulfill those requirements then only the license can be issued to them. It prescribes the minimum requirement regarding the paid up capital and reserves transferred to the fund maintenance of cash reserves and other liquid assets. You see how much loan one individual can take that regulation RBI makes, how much industrial loan can be directly given by commercial bank and if more than that then how much money should be above the limit and above which monetary limit the RBI should interfere or the commercial banks should take the permission from RBI?

This is basically done to smooth control of the operation or to make this financial system more stable. It also inspects the working of banks in India as well as Abroad in respect of their organization set up branch expansion, mobilization of deposits where the money is invested.

What is the credit portfolio management they are doing? How much loan they are giving? How much is the NPO? How much money can be recovered? What kind of credit appraisal policy the banks are following? What is the performance of the banks? What kind of credit planning, the banks are doing? What kind of manpower planning or training the banks are doing all kind of integrity issues which is responsible or which is important for the commercial banks those are all basically supervised by the RBI.

It conducts the investigation from time to time into complaints, irregularities and frauds in respect of the banks, all kind of frauds basically if any kind of irregularities which can happen. So, for all these things basically investigation is done by RBI first. So, it also controls the appointment, reappointment, termination of the chairman and chief executive officers of the private sector banks because the public sector banks CEO's and chairman are appointed by government.

The RBI is responsible for the private sector banks and RBI's approval is very much required. It is also approves and force the amalgamations means actually if some of the banks are not functioning well their performance is not basically good the RBI can tell them to merge or RBI can tell this from particular banks to merge together to get rid of this kind of problems and to improve their performance in the future. So, this is what basically what we are talking about the supervising roles.

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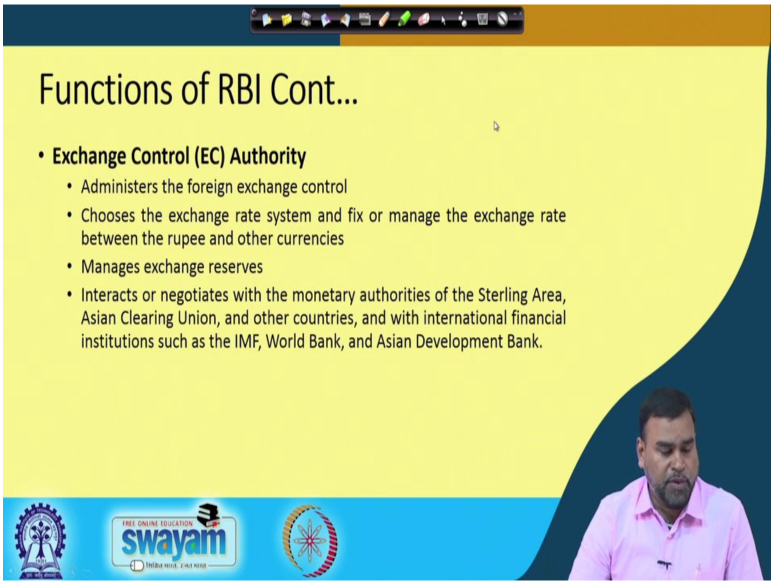

And another major function is exchange control. RBI is the exchange control authority because all foreign exchange transactions in India are done through Reserve Bank of India, only it administers the foreign exchange control. In today's exchange rate system mostly India follows a managed exchange rate system.

If there is any kind of instability in the exchange rate fluctuations then RBI can intervene into that to control that. It also manages the foreign exchange reserves, whatever we have. It has also the responsibility to interact with all those foreign bodies like a IMF, World Bank and Asian development bank etcetera for any kind of suggestion or any kind of functional relationship in time at the time of requirement.

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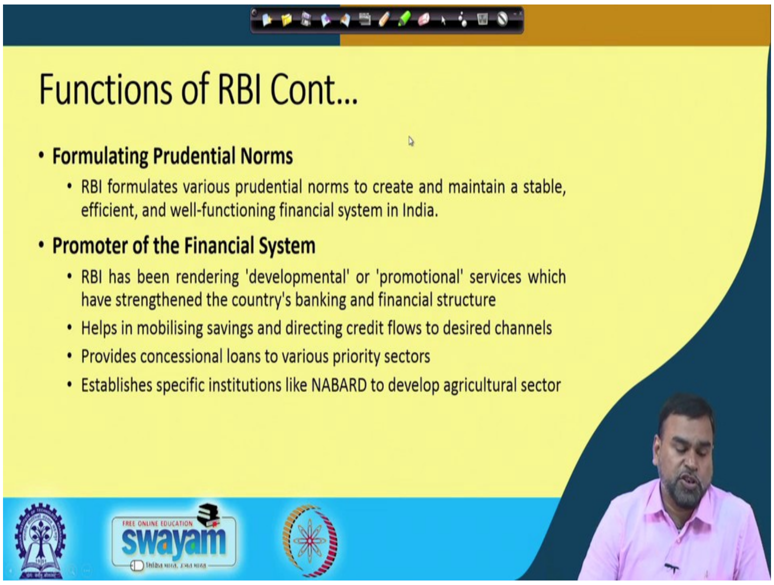

So, RBI has authority to do that; it is also responsible for formulating the prudential norms. RBI formulates various norms to create and maintain an efficient well-functioning financial system in India. So, all those kind of market disciplines all kind of regulations with respect to commercial banks are created by RBI. I can give an example for example, in terms of the market discipline the commercial banks are always directed by RBI to disclose their balance sheet in a periodical basis if they do not disclose that balance sheet then the adequate amount of fine or penalty can be imposed upon them.

So, like that what are those disclosure, what are the thing they should disclose and which are the things is beneficial for shareholders and all kinds of others stakeholders of that particular bank. For everything the rules and regulations or norms are basically maintained by RBI and RBI also ensures that they should follow this; the CRR should be maintained. And as well as they should maintain this capital adequacy ratio norms which is given by the Basel. So, all kind of things norms basically always monitored and regulated by RBI. And already I told you these are the promoter of the financial system, they help in mobilizing the savings, they also render the developmental in promotional services.

And establishes also already I told you they gives this guidelines to provide these loans to the different priority sectors and also RBI can establish the different specific organizations to develop the particular sector like NABARD. NABARD was established in 1964 by the Reserve Bank of India to promote the agricultural sector because, the agricultural sector was not that developed. So, specific organization has been established to develop that particular sector. So, like that there are different kind of organization can be all set up by RBI to promote this particular entities which are not developed in that particular system .

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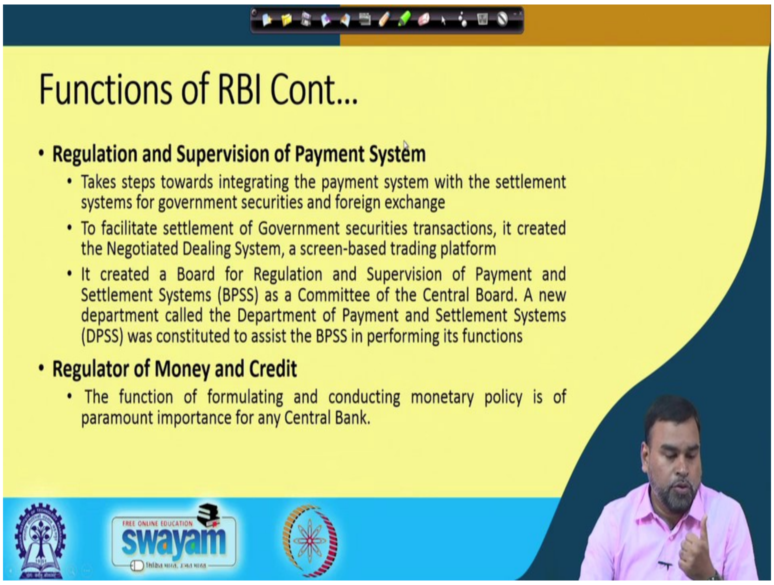

Already I told you it regulates the supervision by the payment system; it created a board of regulation and supervision of payment in settlement system as a committee of the central board, your new department called department of payment in settlement system was constituted to assist this particular committee in performing. These functions and; obviously, it conducts the monetary policy which is the most important or vital thing what the central bank does because from the beginning we said that the monetary stability is the prime objective of the financial stability of the Reserve Bank of India.

So, that is how the Reserve Bank of India conducts the monetary policy. How they will ensure that price can be stable? How they can ensure that the bank should run in an efficient manner? So, this is the way basically that is why the RBI basically is the regulator of both money and credit.

So, the most important job RBI if you see overall three things they do they create the rules for the banks, they monitor the exchange rate and control that and control, they are the exchange rate controlling authority. And as well as the all kind of transaction foreign exchange transactions basically drawn through them and the most vital thing is they are the government bank and also banker's bank.

And the most important thing is they are the implementer of the monetary policy in the system and they conduct the monetary policy in such a way by that monetary stability and financial stability can be enforced. So, in the fourth coming classes we will be discussing about the instrument of monetary policy and how the RBI basically conducts the monetary policy to make this price level stable and to increase the output of the economy.

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Please go through these particular references for this particular session.

Thank you.