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Introduction

The banking sector is the lifeline of any modern economy. It is one of the important financial pillars of the financial system which plays a vital role in the success/failure of an economy. Banks are one of the oldest financial intermediaries in the financial system. They play an important role in the mobilization of deposits and disbursement of credit to various sectors of the economy. The banking system is the fuel injection system which spurs economic efficiency by mobilizing savings and allocating them to high return investment.¹

Banks play a central role in the economy. They keep the savings of the public and finance the development of business and trade. Banks have played a critical role in the economic development of countries such as Japan and Germany and most of the emerging economies including India. Banks today are important not just from the point of view of economic growth, but also financial stability. In emerging economies, banks are special for three important reasons. First, they take a leading role in developing other financial intermediaries and markets. Second, due to the absence of well-developed equity and bond markets, the corporate sector depends heavily on banks to meet its financing needs. Finally, in emerging markets such as India, banks cater to the needs of a vast number of savers from the household sector, which prefers assured income and liquidity and safety of funds, because of their inadequate capacity to manage financial risks.

Forms of banking have changed over the years and evolved with the needs of the economy. The transformation of the banking system has been brought about by deregulation, technological innovation and globalization. While banks have been expanding into areas which were traditionally out of bounds for them, non-bank intermediaries have begun to perform many of the functions of banks. Banks thus compete not only among themselves, but also with nonbank financial intermediaries, and over the years, this competition has only grown in intensity. Globally, this has forced the banks to introduce innovative products, seek newer sources of income and diversify into non-traditional activities.

Since India secured independence, sea change has taken place and the banking concepts have undergone several improvements over the period of more than 60 years. When large and mass retirements are taking place in the banking industry and

the younger generation is occupying key positions, it may be interesting to travel through the developments in the banking industry.

Banks nationalization was done in the year 1969 by the then Prime Minister Indira Gandhi and has already completed more than 40 years and also more than 60 years since independence, knowing well that the banking sector is poised for a sea change imminently. However, the commercial banks in India have more than a two century history, with State Bank of India itself having its presence for more than 125 years.

Origin of the Word ‘Bank’:

Etymologically, the term ‘bank’ is said to have been derived from the term ‘banco’. Some attribute the origin of the word ‘bank’ to ‘bancus’ or ‘banque’ or ‘bane’. All these terms, however, mean a bench upon which the medieval European money – lenders or money – changers used to carry on their monetary transactions. These derivations, however, give one the impression that banking in Europe was started during the middle ages. But the origin of banking is much more antiquated and no define dates of its origin can be determined.²

Meaning and Definitions of Bank:

A bank is an institution which accepts deposits from the general public and extends loans to the household, the firms and the government. Banks are those institutions which operate in money. Thus, they are money-traders. With the process of development, functions of banks are also increasing and diversifying. Now, the banks are not nearly the traders of money, they also create credit. It is very hard to give a universally acceptable definition of bank. The important definitions of bank are as follows given on different bases:

In India, the definition of the business of banking has been given in the Banking Regulation Act, (BR Act), 1949. According to Section 5(c) of the BR Act, ‘a banking company is a company which transacts the business of banking in India.’ This definition points to the three primary activities of a commercial bank which distinguish it from the other financial institutions.

These are:

• Maintaining deposit accounts including current accounts
• Issue and pay cheques, and
• Collect cheques for the bank’s customers

Banking is nothing but efficiently mobilizing low cost deposits from savers, who otherwise have low return options and then efficiently allocating funds to creditworthy borrowers who have very few capital funds to be deployed on any viable project/business proposal/opportunities. Section 49(A) prohibits any institution, other than banking company, from accepting deposit money from public for withdrawal by cheque.

“Bank is an establishment for custody of money received from or on behalf of its customers. Its essential duty is to pay their drafts on it. Its profits arises from the use of the money left employed by them”

- Oxford Dictionary

“to accepting for the purpose of the landing of investment of deposits of money from public repayable on demand or other wise and withdraw able by cheques, draft, order or otherwise.”

“Banker includes group of persons, whether they are incorporated or not, who do banking business.”

- British Bills of Exchange Act, 1982

“Any bank, banking federation, trust company, saving bank (excluding mutual banks) or other institutions that engaged in the business of accepting deposits and incorporated under any state law”

- American Federal Act

“A bank is an establishment which makes to individuals such advances of money or other means of payment as may be required and safely made and to which individuals entrust money or means of payment when not required by them for use.”

- Prof. Kinely

“A Bankers is one who is the ordinary course of his business receives money which he repay by honoring cheques of persons from whom on whose account he receives it”

- Prof. H. L. Hart

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“A banker is defined as a person who carries on the business of banking, which is specified as conducting current accounts for his customers, paying cheques drawn on him, and collecting cheques for his customers.”

- English common law

“Banks are institutions, whose debts usually referred to as bank deposits are commonly accepted in final settlement of other people’s debt.” In other words, “Bankers are not merely traders in money but also in important sense manufacturers of money”

- Prof. R. S. Sayers

“Banker is a dealer in debts of his own and other people.”

- Prof. Crowther

“A Banker is a person, firm or company, having place of business where credits are opened by the deposits of collection of money or currency, subject to be paid or remitted upon draft, cheque or order when money is advanced or loaned on stock, bonds, bullion, bill of exchange and promissory note are received for discount or sale.”

- Prof. Findaly Shirras

History of Banking in India:

Ancient India

In India the ancient Hindu scriptures refer to the money lending activities in the Vedic period. During the Ramayana and Mahabharata eras, banking had become full-fledged business activity and during the Smriti period, which followed the Vedic period and Epic age the business of banking was carried on by the members of the Vaish community. Manu the great law giver of the time speaks of the earning of interest as the business of Vaishyas. “The Bankers in the Smriti period performed most of those functions of the modern banks. They accepted deposits, granted loans against pledge and personal security, as also simple loans, acted as their customers’ bailee, subscribed to public loans by granting loans to kings, acted as the treasurer and banker to the state and issued and managed currency of the country.”

Before the Buddhist period banking was practiced only by the ‘Vaishyas’ but during the Buddhist period traditional bonds loosened and Brahmins and Kshatriyas

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6 Bhargava, B.K., “Indigenous Banking in Ancient and mediaeval India”, Taraporevala, Mumbai, 1934, Page-II.
also entered into the fray. During this period, Bills of Exchange were used. There were regulations by the king to control the business. In kautilya’s Arthshastra, maximum rates of interest were fixed. The people who charged high rates were looked down upon by the society. People who did this business were known as ‘Sresthis’ or ‘Sahukar’ or ‘Mahajan’ and various other names were used for them. “Banking was known and practiced in India at a time when the rest of the world had yet to evolve a medium of exchange in the form of money”

**Mughal Period**

During the Mogul period, the indigenous bankers played a very important rule in lending money and financing of foreign trade and commerce. They were also engaged in the profitable business of money changing. Even town, big or small, had ‘Sheth’ or ‘Nagar Sheth’ who performed a number of banking functions. These sheths, besides doing money-lending business, were instrumental in transferring funds from place to place and doing collection business mainly through hundies. The hundies were an acceptable mode of transfer of monies for commercial transactions. “Hundis” –the Indian form of a bill of exchange – were most commonly used. Not only this “during Mughal rule the issue of various kinds of metallic money in different parts of the country gave the indigenous bankers great opportunities for developing the very profitable business of money changing and the most important among them were appointed mint officers, revenue collectors, bankers and money changers to government in various parts of the Empire.” A few of these indigenous bankers were quite famous and welded great political influence. The name of ‘Nagar Sheth’ is very well known in India. “Nagar Sheth of the 17th and 18th centuries, for their power and influence, are comparable with any private banking house in any other country and indeed they seem to have fulfilled many of the functions of a central bank – essentially a modern institution.” More or less, the same views were expressed by the Bombay Banking Enquiry Committee, in its report: “The indigenous banker was the trusted custodian of the deposits of people and royalty alike and financial not only the trade of the country but also requirements of the royal treasury”

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8 Panandikar, G. S., “Banking in India”, Orient Longmen, Delhi, 1975, Page-2.
Thus, it can be easily deduced that the indigenous bankers were a well established institution in the country.

**British Period**

In India, the 18th century saw the decline of indigenous bankers, fall of the Mughal Empire and continuous wars among different functions for their superiority and command, which weakened the system of indigenous banking a great deal. Another contributing factor for the decline of the system was the advent of the East India Company. In the latter half of the eighteenth century, the foreign trade of the country passed from the people into the hands of the company. This company patronized the Agency House and did not want the existence of indigenous bankers. Thus, in spite of their best efforts they could not survive. “The failure of the indigenous bankers to adjust themselves to the new circumstances must, therefore, be ascribed not to their narrowness or conservatism but to the circumstances of the time. During the latter half of the Eighteenth century when East India Company was in power without responsibility, most of the foreign trade passed out of the hands of the people. The Inland trade also was monopolized by the servants of the company for a considerable time. As a result of this, the indigenous bankers naturally lost their old predominance.”\(^{11}\) Other factors which caused the decay of the system were the development of the means of transport and communication, causing deflection of trade and commerce along new routes, changing the nature and structure of trade activities in the country.

“The British Agency Houses which combined banking with their trading activities were the fore – runners of the modern joint stock banks established on European lines. In fact they were shop – keepers, proprietors of breweries, tanneries, distilleries, cotton, and flour and saw mills.”\(^ {12}\) These agency houses received deposits from the public, advanced loans to them and discounted bills. These agency houses are known as the starting point of modern type of banking in India. In contrast to these agency houses, the indigenous bankers conducted their business mostly with their own resources. Thus in fact, utilization of public deposits for granting loans, on an organized basis, started with these agency houses.


Evolution of Banks in India

The first joint stock bank – The Hindustan Bank – was established in 1770 by the Alexander & Co., which was one of the agency houses at Calcutta. In 1832 this bank was liquidated due to the failure of its parent firm. The Bangal Bank and the General Bank of India were established in 1785 and 1786 respectively. The latter bank was the first to be established on the basis of limited liability. But it failed in 1791 due to its inability to earn profits. The first bank also closed down after some time due to a severe run upon it by the customers. These banks were chartered by the East India Company.

Another group of banks was established not by the chartered of the East India Company, but by the Act of Indian Legislature. These banks were further divided into two groups. One group comprised three presidency Banks and the other was of Indian joint stock banks.

The Indian Government at the time established three Presidency banks, viz., the Bank of Bengal (established in 1809), the Bank of Bombay (established in 1840) and the Bank of Madras (established in 1843). In 1921, these Presidency Banks occupied a different status in Indian banking system. “The beginning of modern banking in India is traced back to early nineteenth century with the establishment of three presidency banks, but its growth till the beginning of the present century was negligible.” Besides doing commercial banking business, they maintained close link with the East India Company and the Government. They had the right to issue notes. But this right was withdrawn in 1862. Certain restrictions were imposed upon these banks to protect the interests of the Government and of the depositors. They could not deal in foreign bills and borrowing abroad as exchange business was considered to be risky. Most of the Government business was done by them. So, they enjoyed a prestige, which helped them to secure other banking business. But the restrictions imposed upon them continued even when these banks careful management. This fact made keyns to comment that “unnecessary continuation of these restrictions made the working of these banks out of date and prevented them from playing a useful part in the Indian financial system, as they would have otherwise done.”¹³

The three Presidency banks were amalgamated to form the Imperial Bank of India, which took up the role of a commercial bank, a bankers’ bank and a banker to

the Government. This step was taken to protect these banks against the competition of foreign banks. The Imperial Bank of India was established with mainly European shareholders. It was only with the establishment of Reserve Bank of India (RBI) as the central bank of the country in 1935, that the quasi-central banking role of the Imperial Bank of India came to an end.

In 1860, the concept of limited liability was introduced in Indian banking, resulting in the establishment of joint-stock banks. In 1865, the Allahabad Bank was established with purely Indian shareholders. Punjab National Bank came into being in 1895. This bank is also one of the nationalized banks at present.

The Swadeshi Movement started in 1906 led to the establishment of many banks by Indians. The period between 1906 and 1913 may be said to be a boom period for Indian banking. In 1913 the number of banks having capital and reserves of over Rs. 5 lakhs was 18, with a total paid – up capital and reserves of Rs 4 crore and total deposits of Rs. 22 crore. Between 1906 and 1913, other banks like Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up.

The period from 1913–24, more particularly the period from 1913–17 was a time of banking crisis. Many small banks which started during the Swadeish Movement failed. Neither there was strong financial base behind them, nor were they well managed. Besides, the unorganized nature of the money market pulled them in different directions. The bank of Bengal declined to lend the banks that were in difficulties in Lahore even against Government securities. This was the result of complete decentralization of the Indian banking system. From 1913–17, 78 banks failed, with a total paid – up capital of Rs. 178 lakhs.

There was a brief half to bank failures during 1918–21. The boom of after – war period gave impetus to the setting up of new banks. During this period, a few banks were established to finance industries, of which the most important was the Tata Industrial Bank. In 1923, the Alliance Bank of simla, the Tata Industrial Bank failed. The latter was merged with the Central Bank of India. There were 15, 20 and 18 banks failures in the year of 1922, 1923 and 1924 respectively.

The origins of the Reserve Bank of India can be traced to 1926, when the Royal Commission on Indian Currency and Finance – also known as the Hilton-Young Commission – recommended the creation of a central bank for India to
separate the control of currency and credit from the Government and to augment banking facilities throughout the country.

Depression of 1929 – 32 exposed the weakness of the Indian banking system. There were large numbers of bank failure. From 1921 to 1930, 143 banks failed and between 1931 and 1936, 238 banks closed working. But these were smaller banks. “With no banking legislation, no official supervision, no fluid market for short term investments which consequently leads to an over – investment in gift – edged securities, no co – ordinate policy of the different joint stock banks, no centralized banking in the way of the rate of interest, no check against the frequent happenings of swindles by directors or officers of banks and no national policy on the part of the state, the Indian joint stock banks have been unable to show any remarkable progress.”

The Reserve Bank of India Act of 1934 established the Reserve Bank and set in motion a series of actions culminating in the start of operations in 1935. Since then, the Reserve Bank’s role and functions have undergone numerous changes, as the nature of the Indian economy and financial sector changed. Starting as a private shareholders’ bank, the Reserve Bank was nationalized in 1949. It then assumed the responsibility to meet the aspirations of a newly independent country and its people. The Reserve Bank’s nationalization aimed at achieving coordination between the policies of the government and those of the central bank. The objectives outlined in the Preamble hold good even after 75 years. As evident from the multifaceted functions that the Reserve Bank performs today, its role and priorities have, in the span of 75 years, changed in tandem with changing national priorities and global developments. Essentially, the Reserve Bank has demonstrated dynamism and flexibility to meet the requirements of an evolving economy. A core function of the Reserve Bank in the last 75 years has been the formulation and implementation of monetary policy with the objectives of maintaining price stability and ensuring adequate low of credit to productive sectors of the economy. To these was added, in more recent times, the goal of maintaining financial stability. The objective of maintaining financial stability has spanned its role from external account management to oversight of banks and non-banking financial institutions as also of money, government securities and foreign exchange markets. The Reserve Bank

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designs and implements the regulatory policy framework for banking and non-
banking financial institutions with the aim of providing people access to the banking
system, protecting depositors’ interest, and maintaining the overall health of the
financial system. Its function of regulating the commercial banking sector, which
emerged with the enactment of the Banking Regulation Act, 1949, has over time,
expanded to cover other entities. Thus, amendments to the Banking Regulation Act,
1949 brought cooperative banks and regional rural banks under the Reserve Bank’s
jurisdiction, while amendments to the Reserve Bank of India Act saw development
finance institutions, non-banking financial companies and primary dealers coming
under its regulation, as these entities became important players in the financial system
and markets. Similarly, the global economic uncertainties during and after the Second
World War warranted conservation of scarce foreign exchange reserves by sovereign
intervention and allocation. Initially, the Reserve Bank carried out the regulation of
foreign exchange transactions under the Defense of India Rules, 1939 and later, under
the Foreign Exchange Regulation Act of 1947. Over the years, as the economy
matured, the role shifted from foreign exchange regulation to foreign exchange
management.

Another event in the history of Indian banking was nationalization of the
Imperial Bank of India in 1955, and giving to it new name of ‘State Bank of India’.
This was the first experience of the Government in the nationalization of a
commercial bank. Earlier in 1949 the Reserve Bank of India too was nationalized but
that was the ‘Central Bank’. The State Bank of India became a pioneer in many fields
and gave a new direction to commercial banking in the country. “Though it is the
function of the Reserve Bank of India to maintain the stability of the currency and
credit, to regulate the affairs of other banks and help in development of banking, the
leader of the banking system in the country is the State Bank of India.”\(^\text{15}\)

After independence, the Government of India started taking steps to encourage
the spread of banking in India. In order to serve the economy in general and the rural
sector in particular, the All India Rural Credit Survey Committee recommended the
creation of a state-partnered and state-sponsored bank taking over the Imperial Bank
of India and integrating with it, the former state-owned and state-associate banks.
Accordingly, State Bank of India (SBI) was constituted in 1955. Subsequently in

1959, the State Bank of India (subsidiary bank) Act was passed, enabling the SBI to take over ten major state associated banks, namely, the State Bank of Saurashtra, the Bank of Patiala, the Bank of Bikaner, the Bank of Jaipur, the Bank of Rajasthan, the Bank of Indore, the Bank of Baroda, the Bank of Mysore, the Hyderabad State Bank and the Travancore Bank and certain other small state associated banks as its subsidiaries. The main purpose was “The creation of a strong, integrated state sponsored commercial banking institution with an effective machinery of branches spread over whole of the country, which by further expansion can be put in a position to take over cash work from non – banking treasuries, provide vastly extended remittance facilities for co – operative banks and other banks, thus stimulating the further establishment of such banks.”

To better align the banking system to the needs of planning and economic policy, it was considered necessary to have social control over banks. In 1969, 14 of the major private sector banks were nationalized, namely The Central Bank of India, The Bank of India, The Punjab National Bank, The Bank of Baroda, The United Commercial Bank, The Canara Bank, The United Bank of India, The Dena Bank, Syndicate Bank, The Union Bank of India, The Allahabad Bank, The Indian Bank, The Bank of Maharashtra, and The Indian Overseas Bank. At that time these 14 banks controlled 70% of the nation’s deposits. This was an important milestone in the history of Indian banking. This was followed by a second phase of nationalization in 1980, when Government of India acquired the ownership of 6 more banks, namely The Andhra Bank, The Corporation Bank, The New Bank of India, The Oriental Bank of Commerce, The Punjab & Sind Bank, and The Vijya Bank. The private banks at that time were allowed to function side by side with nationalized banks and the foreign banks were allowed to work under strict regulation. With the nationalization of these banks, the major segment of the banking sector came under the control of the Government. The nationalization of banks imparted major impetus to branch expansion in un-banked rural and semi-urban areas, which in turn resulted in huge deposit mobilization, thereby giving boost to the overall savings rate of the economy. It also resulted in scaling up of lending to agriculture and its allied sectors. However, this arrangement also saw some weaknesses like reduced bank profitability, weak capital bases, and banks getting burdened with large non-performing assets. After the

two major phases of nationalization in India, the 80% of the banking sector came under the public sector/government ownership.

The following sequence of important events:

- Creation of Reserve Bank of India: 1935
- Nationalization of Reserve Bank of India: 1949 (January)
- Enactment of Banking Regulation Act: 1949 (March)
- Nationalization of State Bank of India: 1955
- Nationalization of SBI Subsidiaries: 1959
- Nationalization of 14 major Banks: 1969
- Creation of Credit Guarantee Corporation: 1971
- Creation of Regional Rural Banks: 1975
- Nationalization of 6 more banks with deposits over Rs 200 Crore: 1980

The result was outstanding. The public deposits in these banks increased by 800%, as the government ownership gave the public faith and trust.

But “There were some effects and achievements of nationalized banks. However, there are some problems relating to NPAs, competition, competency, overstaffing, inefficiency etc, for the nationalized bank.”

The third phase of development of banking in India started in the early 1990s when India started its economic liberalization. The aftermath of the 1991 balance of payments and foreign exchange crisis saw a paradigm shift in India’s economic and financial policies. The approach under the reform era included a thrust towards liberalization, privatization, globalization and concerted efforts at strengthening the existing and emerging institutions and market participants. The Reserve Bank adopted international best practices in areas, such as, prudential regulation, banking technology, variety of monetary policy instruments, external sector management and currency management to make the new policy framework effective.

The rapid pace of growth achieved by the financial system in the deregulated regime necessitated a deepening and widening of access to banking services. The new millennium has seen the Reserve Bank play an active role in balancing the relationship between banks and customers; focusing on financial inclusion; setting up administrative machinery to handle customer grievances; pursuing clean note policy

and ensuring development and oversight of secure and robust payment and settlement systems.

To create a strong and competitive banking system, a number of reform measures were initiated in early 1990s. The thrust of the reforms was on increasing operational efficiency, strengthening supervision over banks, creating competitive conditions and developing technological and institutional infrastructure. These measures led to the improvement in the financial health, soundness and efficiency of the banking system. One important feature of the reforms of the 1990s was that the entry of new private sector banks was permitted. Following this decision, new banks such as ICICI Bank, HDFC Bank, IDBI Bank, Yes Bank and UTI Bank were set up. Commercial banks in India have traditionally focused on meeting the short-term financial needs of industry, trade and agriculture. However, given the increasing sophistication and diversification of the Indian economy, the range of services extended by commercial banks has increased significantly, leading to an overlap with the functions performed by other financial institutions. Further, the share of long-term financing (in total bank financing) to meet capital goods and project-financing needs of industry has also increased over the years.

The last one-and-a-half decades have also seen growing integration of the national economy and financial system with the globalizing world. While rising global integration has its advantages in terms of expanding the scope and scale of growth of the Indian economy, it also exposes India to global shocks. Hence, maintaining financial stability became an important mandate for the Reserve Bank. This, in turn, has brought forth the need for effective coordination and consultation with other regulators within the country and abroad.

**Banking Sector Reforms in India**

The Indian economic development takes place in the realistic world from the 1991 “liberalization privatization globalization” policy. As per “LPG” policy all restriction on the Indian economy was totally dissolved, and the soundest phase for the Indian banking system adopt over here. This also changed the scenario of the Macroeconomic world. Banking Sector reforms were initiated to upgrade the operating standard health and financial soundness of the banks. The Government of India setup the Narasimham Committee in 1991, to examine all aspects relating to
structure, organization and functioning of the Indian banking system the recommendations of the committee aimed at creating at competitive and efficient banking system. Another committee which is Khan Committee was instituted by RBI in December, 1997 to examine the harmonization of the role and operations of development financial institutions and banks. It submitted its report in 1998. The major recommendations were a gradual more towards universal banking, exploring the possibility of gain full merger as between banks, banks and financial institutions.

Then the Verma Committee was established this committee recommended the need for greater use of IT even in the weak public sector banks, restructuring of weak banks but not merging them with strong banks, VRS for at least 25% of the staff. The Banking Sector reforms aimed at improving the policy frame work, financial health and institutional infrastructure, there two phase of the banking reforms. Narasimham Committee provided the blue print for the initial reforms in banking sector following the balance of payment crisis in 1991.18

Banking sector reforms was started in real sence from 1991 to on words. But it was conducted under the various report presented by the various committee. It may happen that the recommendation will not be the all and apply to the banks.

**Phase-I Reforms**

**Deregulation of Interest Rates:**

These banks have been given the right to decide the rate of which they are lending. No debt PLR (Prime Lending Rate) have been decided by RBI but after that authority have been given to the banks to decide the interest rates on their own self.

**Reduction in Pre Emptive Reserve:**

Under this reform the bank can reduce the reserve available to them. By reducing the reserve they can lees them in banking activity like loans deposits to other advances and in capital market.

**Branch Expansion:**

Under this reform the bank has been given authority to expand branch as the requirement but the permission of authority.

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Introducing of Prudential Norms:
Prudential norms in terms of income recognition, asset classification and capital adequacy have been well assimilated by the Indian banking system. In keeping with the international best practice, starting March 31, 2004, banks have adopted 90 days norm for classification of NPAs. Also, norms governing provisioning requirements in respect of doubtful assets have been made more stringent in a phased manner. Beginning 2005, banks will be required to set aside capital charge for market risk on their trading portfolio of government investments, which was earlier virtually exempt from market – risk requirement.\textsuperscript{19}

Permission to deal in Capital Market:
Till this reform the bank public sector as well as private sector and foreign banks are not allowed to deal in the capital market. But after this reform the banks are allowed to deal in the capital market and trade of equity, preference, debenture and other capital market instruments.

Constituting Debt Recovery Tribunals:
Special debt recovery tribunal has been established under 10 to 11 Zones in India. It is exclusively made for the NPA management. It is the main reform suggestion by the Narshimaham Committee.

Freedom to Exercise Human Resource Policy:
The freedom has been given to banks to clear with the human resource of banks. Now banks can appoint their chief executive officers and other officers as and when they require.

Change in the Constitutional Board:
Under this reform the bank can change as per need in the constitutional board of banks they can make change of board of directors. Power and duties also assign to the officers. This all the reform has been implemented in phase-I but it is not enough. So the second phase of reform has been come and it has been describe as under:

\textsuperscript{19} Dr. Muraleedharan, “Modern Banking”, PHI Learning Pvt. Ltd., New Delhi, 2009, Page-17.
Phase-II Reforms:
The second phase reforms broadly based upon the certain criteria like.

Capital Adequacy Norms:
The Basel norm of capital adequacy was introduced in India following the recommendations of the Narshimaham Committee - 1991.

- Capital adequacy ratio to be raised from 8% to 10% by 2002.
- 5% market risk weight of fixed income securities and open foreign exchange position limits.
- Market discipline of the banks
- Capital adequacy ratio is calculated on the base of risk weights on assets on the book of banks.

Assets Quality:
The problem that the banks are facing is NPA. The recommendations of Narshimaham Committee-II were:

- Bank should aim to reduce gross non-performing assets to 3% and Net NPA by 0% at the-2002.
- The income should be recognized at 90 days was reduced from 180 days.
- The credit regulation was reduced from 40% to 10%.

System and Methods:
- Banks to start recruitment of skilled and specialized manpower from the market or the better work face
- Overstaffing will be reducing by the introducing the retirement schemes of VRS
- Flexibility will be given to the public sector banks employees in remuneration structure
- The introduction of computer and technology will be rapid.

Regulation and Supervision
- Board for financial regulation and supervision to be constituted with statutory Powers.
• Greater emphasis on public disclosure as opposed to disclosure to regulators.
• Banking regulation and supervision to be progressively de-linked from monetary policy

Legal Amendments

• Broad range of legal reforms to facilitate recovery of problem loans.
• Introduction of laws governing electronic fund transfer.
• Many of the important recommendations of Narasimham Committee II have been accepted and are under implementation the second generation banking reforms concentrate on strengthening the foundation of the banking system by structure technological up graduation and human resource development.\(^{20}\)

Restructuring the Banking Industry:-

• Merger are not to be imported by re-regulators they should be market driven
• Bank to be given a better function autonomy
• Entry of new private sector banks and foreign bank will be continuing.

Capital Adequacy and Tire – I and II Capital: -

This capital adequacy was introduced for Indian commercial banks based on the Basel committee proposal (1988) which prescribes the two types of Tire Capital for banks as follows.

Tire-I Capital:

Also known as core capital the most permanent and readily available support against unexpected losses includes

• Paid up capital, statutory reserve and share premium
• Capital reserve and other disclosed free reserve
• (Less): equity investment in subsidiaries, Intangible assets, losses in the current period, forward losses.

Tire – II Capital:

It includes:

- Undisclosed reserve and fully paid up cumulative perpetual shares
- Revaluation reserve arising out of the revaluation of the assets that are undervalued in the bank’s books
- General provision and loss reserve not attributable to actual diminution in value or identifiable potential loss in any specific assets and available to meet unexpected losses
- Subordinated debt that is fully paid unsecured subordinated debt that is fully paid up.

Tire – II capital should not be more that tire – I capital 100% and subordinated debt instruments should be limited to 50% of tire – I capital.

**Banking Structure in India**

The Indian financial system comprises a large number of commercial and cooperative banks, specialized developmental banks for industry, agriculture, external trade and housing, social security institutions, collective investment institutions, etc. The banking system is at the heart of the financial system. The Indian banking system has the RBI at the apex. It is the central bank of the country under which there are the commercial banks including public sector and private sector banks, foreign banks and local area banks. It also includes regional rural banks as well as cooperative banks.\(^{21}\)

The structure of the Indian banking system is given below.

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Scheduled Banks

“At present, commercial banks in India are classified as scheduled and non-scheduled. A scheduled bank is eligible for certain central banking facilities, especially which of obtaining accommodation from the RBI, which is not available to non-scheduled bank.” 22 The second scheduled of RBI act, create a list of banks which are described as “Scheduled Banks” in the terms of section 42 (6) of RBI act, 1934, the required amount is only Rs. 5 Lakh. The Scheduled Banks enjoy several privileges. It means that scheduled banks carries safety and prestige value compared to non scheduled banks. It is entailed to receive refinance facility as applicable.

Non Scheduled Banks

“The commercial banks not included in the 2nd schedule of the RBI act are known as non scheduled banks. They are not entitled to facilities like refinance and rediscounting of bills etc, from RBI. They are engaged in lending money discounting and collection bills and various agency services. They insist higher security for loans.” 23

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Public Sector Banks

Public sector banks are those in which the majority stake is held by the Government of India (GoI). Public sector banks together make up the largest category in the Indian banking system. There are currently 27 public sector banks in India. They include the SBI and its 6 associate banks (such as State Bank of Indore, State Bank of Bikaner and Jaipur etc), 19 nationalized banks (such as Allahabad Bank, Canara Bank etc) and IDBI Bank Ltd. Public sector banks have taken the lead role in branch expansion, particularly in the rural areas.

“The public sector banks in India are regulated by statutes of parliament and some important provision under section 51 of the Banking Regulation Act, 1949.

Specifically, the regulations are as follows:

- Subsidiary banks of State Bank of India (Subsidiary Banks) Act, 1959.

Nationalized Banks

Nationalized banks in India are the major players in Indian banking system dominating the industry. Not only that, the nationalized banks in India also play pivotal role in the economic development of the country at the same time.

The history of nationalization of Indian banks dates back to the year 1955 when the Imperial Bank of India was nationalized and re-christened as State Bank of India (under the SBI Act, 1955). Later on July 19, 1960, the 7 subsidiaries of SBI viz. State Bank of Hyderabad (SBH), State Bank of Indore, State Bank of Saurashtra (SBS), State Bank of Mysore (SBM), State Bank of Bikaner and Jaipur (SBBJ), State Bank of Patiala (SBP), and State Bank of Travancore (SBT) were also nationalized with deposits more than 200 crores.

The banking industry in India became a major tool for the development of country's economy by the 1960. The industry also became a large employer creating a number of opportunities for the job-seekers. In order to spread banking infrastructure in rural areas, the then Prime Minister, Indira Gandhi took the initiative to nationalize some commercial banks. She submitted a paper ‘Stray thoughts on Bank

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Nationalization’ in the All India Congress Meeting, which got positive feedback. On July 19, 1969, 14 commercial banks were nationalized, which got presidential approval on August 9, 1969. In 1980, in order to provide government more power and command over credit delivery, six more commercial banks in India were nationalized. In 1993, New Bank of India merged with Punjab National Bank (PNB), which brought the number of nationalized banks in India to 19. It's also the only merger between two Indian nationalized banks. In the following years, the nationalized banks in India saw a growth rate of around 4%, which was close to average growth rate of country's economy.

**Private Sector Banks**

In this type of banks, the majority of share capital is held by private individuals and corporate. Not all private sector banks were nationalized in 1969, and 1980. The private banks which were not nationalized are collectively known as the old private sector banks and include banks such as The Jammu and Kashmir Bank Ltd., Lord Krishna Bank Ltd etc. Entry of private sector banks was however prohibited during the post-nationalization period. In July 1993, as part of the banking reform process and as a measure to induce competition in the banking sector, RBI permitted the private sector to enter into the banking system. This resulted in the creation of a new set of private sector banks, which are collectively known as the new private sector banks.

Since 1991, subsequent to economic reforms, Reserve Bank has been giving acceptance to the establishment of new banks in the private sector. Even non – resident Indians (NRIs) and foreign companies can buy shares of private sector banks. New private banks provide high level of modern customer services. As a consequence, level of customer services has improved appreciably.25

**Foreign Banks**

The RBI has allowed the entry of foreign banks as branches subject to reciprocity and other prudential considerations. Foreign banks/companies have also been permitted to invest up to 20 per cent as a technical collaborator (within overall 40 per cent ceiling) in a new private sector bank, subject to Government approval,

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provided they do not have presence in India. Foreign equity in new Indian private banks is allowed in accordance with the foreign investment policy. Since 1992, 19 new foreign banks with 47 branches have been allowed. It is mandatory for the foreign banks to achieve the minimum target of 32 per cent to priority sector lending, with two sub targets: small – scale sector, minimum 10 per cent and exports, 12 per cent. They are exempted from targeted credit in respect of agricultural advances.26

**Regional Rural Banks (RRBs)**

In considering the expanding areas of banking, it is often overlooked that a major segment of the Indian economy which will have to grow very fast, is the agricultural sector. “In order to meet the needs of the weaker sections of the rural population, namely, small and marginal farmers, agricultural laborers, artisans and small entrepreneurs such banks were set up in 1975, such banks mainly orient their operations on accordance with the declared objectives of their setting up, but may also allow financing to other categories of borrowers in exceptional circumstances which are incidental to their normal functioning. With a view to facilitating their operations in the context of their catering exclusively to the weaker sections various concessions are granted by the Central Govt. of the Country”27

On the basis of the Narasimham Committee’s recommendations, a RRBs ordinance was promulgated in September 1975, which was replaced by the RRBs Act 1976. RRBs started their development process on 2nd October 1975 with the formation of a single bank viz. Prathama Grameen Bank. So, Prathama Grameen Bank is India’s first Regional Rural Bank. The RRBs were owned by the Central Govt., State Govt, and Sponsoring Bank in the ratio of 50:15:35.

**Co – Operative Banks**

Co-operative banks in India have come a long way since the enactment of the Agricultural Credit Co-operative Societies Act in 1904. It is an important instrument of banking access to the rural masses and is a vehicle for democratization of the Indian financial system.28

Co-operative banks cater to the financing needs of agriculture, retail trade, small industry and self-employed businessmen in urban, semi-urban and rural areas of India. A distinctive feature of the co-operative credit structure in India is its heterogeneity. The structure differs across urban and rural areas, across states and loan maturities. Urban areas are served by urban cooperative banks (UCBs), whose operations are either limited to one state or stretch across states. The rural co-operative banks comprise State co-operative banks, district central cooperative banks, State Cooperative Agriculture and Rural Development Banks (SCARDBs) and Primary Cooperative Agricultural Rural Banks (PCARDBs). Owing to their widespread geographical penetration; cooperative banks have the potential to become an important instrument for large-scale financial inclusion, provided they are financially strengthened. The RBI and the National Agriculture and Rural Development Bank (NABARD) have taken a number of measures in recent years to improve financial soundness of co-operative banks.

**Non – Banking Financial Companies (NBFCs)**

Non banking financial companies (NBFCs), encompass an extremely heterogeneous group of intermediaries. NBFCs differ in various attributes, such as size, nature of incorporation and regulation, as well as the basic functionality of financial intermediaries. Notwithstanding their diversity, NBFCs are characterized by their ability to provide niche financial services in the Indian economy. Because of their relative organizational flexibility, leading to a better response mechanism, they are often able to provide tailor – made services, relatively faster than banks and financial institutions. This enables NBFCs to build up a clientele that ranges from small borrowers to establish corporate. While NBFCs have often been leaders in financial innovations, which are capable of enhancing the functional efficiency of the financial system, instances of unsustainability, often on account of high rates of interest on their deposits and periodic bankruptcies, underscore the need for reinforcing their financial viability. The regulatory framework that has been put in place by the RBI, aims at ensuring financial stability without dampening the very spirit of maneuverability and innovativeness that sustains the sector.\(^{29}\)

Reserve Bank of India

The Reserve Bank of India (RBI) is the central bank of the country. It was established on April 1, 1935 under the Reserve Bank of India Act, 1934, which provides the statutory basis for its functioning. The main objective behind the establishment of the Bank notes and keeping of reserves with a view to securing monetary stability in India and generally to operate the currency system of the country to its advantage.

Commenting on the role played by the RBI in the Indian Banking System “Over the years that it has worked, the RBI has been a fine institution of which every Indian can be proud. Working under diverse handicaps, it has kept its head high above the turmoil of the day”\(^3\) it is the apex organization in the field of banking and finance.

Objectives of the Reserve Bank

The preamble of the act states that, ‘whereas it is expedient to constitute a Reserve Bank for India to regulate the issue of bank notes and the keeping of reserve with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage’

The preamble prescribes the objectives as: (i) to secure monetary stability within the country; (ii) to operate the currency and credit system to the advantage of the country.

In other words, the objectives of the RBI are price stability and ensuring adequate credit availability to finance economic activities for the benefit of the country.\(^3\)\(^1\)

Evolution and History of Reserve Bank of India

The Reserve Bank of India (RBI) is the central bank of the country. The origins of the RBI can be traced to 1926, when the Royal Commission on Indian Currency and Finance (also known as the Hilton – Young Commission) recommended the creation of a central bank in India. It recommended that the control of currency and credit be made separate from the Government and that banking

facilities be enhanced in the country. The RBI was established on April 1, 1935 under the Reserve Bank of India Act, 1934, which provides the statutory basis for its functioning. When the RBI was established, it took over the functions of currency issue from the Government of India and the power of credit control from the then Imperial Bank of India. Since then, the Reserve Bank’s role and functions have undergone numerous changes as the nature of the Indian economy and financial sector changed. The entire evolution of RBI can be portrayed into the following seven phases:

- Phase – I (1935 – 1950)
- Phase – II (1950 – 1960)
- Phase – IV (1969 – 1985)
- Phase – VII (2000 Onwards)

Let us have a look at these phases:

**Phase – I (1935 – 1950)**

The RBI was primarily a response to the economic troubles after the First World War. The preamble of the RBI states that the basic functions of the RBI are: (I) to regulate the issue of bank notes; (II) to keep reserves with a view to securing monetary stability in India; and (III) to operate the currency and credit system in the best interests of the country. The Central Office of the Reserve Bank was initially established in Kolkata, West Bengal. Later it was permanently moved to Bombay (Now Mumbai) in 1937. The RBI, after the partition, served as the central bank for Pakistan until June 1948 when the State Bank of Pakistan commenced its operations. The RBI was originally set up as a shareholder’s bank but has been an entirely Government of India concern since its nationalization in 1949.

**Phase – II (1950 – 1960)**

During this Phase, the Government of India started a centrally planned economic policy and focused on the agricultural sector. In April 1950, the Foreign Exchange Regulation Act of 1949 came into farce. In 1952 the RBI launched the
pioneering project of the All India Rural Credit Survey. In May 1955, the Imperial Bank was nationalized and re-named the State Bank of India with the RBI taking a 60 percent stake in it. Selective credit controls were introduced in 1956.


During this Phase, two commercial banks – namely the Palai Central Bank Ltd. (Kerala) and Lakshmi Bank (Maharashtra) – suffered functional failure. As a result, the RBI was requested to establish and monitor a deposit insurance system. Thus, the Deposit Insurance Corporation came into existence in 1962. The Unit Trust of India, the Industrial Development Bank of India and Co-operative banks came into existence with the RBI in 1964–66. The Government re-structured the national bank market and nationalized 14 commercial banks in 1969.


The Foreign Exchange Regulation Act, 1947 was amended in September 1973. The Foreign Exchange Regulation Act, 1973 came into force in January 1974. The Industrial Development Bank of India was de-linked from the RBI in February 1976. In April 1979, 6 more Indian scheduled commercial banks were nationalized. In July 1982, the National Bank for Agriculture and Rural Development (NABARD) was set up. The regulation of the economy, and especially that of the financial sector, was reinforced by the Gandhi administration and their successors in the 1970s and 1980s. As a result, the RBI became the central player in matters relating to interest rates, reserve ratios, etc.


The Discount and Finance House of India started its operations in the monetary market in April 1988. The National Housing Bank, established in July 1988, was forced to invest in the property market. A high-powered Committee, under the chairmanship of Shri M. Narasimham on the Financial System (CFS), was constituted by the Government of India in August 1991 for examining all aspects relating to the structure, organization, functions and procedures of the financial system.

The RBI de-regulate bank interests and some sectors of the financial market. The National Stock Exchange of India took over the trade in June 1994 and nationalized banks were allowed, in July, to interact with the capital market to strengthen their capital base. In April 1998, the framework – for a further strengthening of the banking sector – was provided by the Narasimham Committee on Banking Sector Reforms. The Bharatiya Reserve Bank Note Mudran Limited was set up – as a subsidiary company of the RBI in February 1995 – to produce bank notes. In December 1999, the Foreign Exchange Management Act (FEMA) 1999 replaced FERA 1973 and FEMA became operational in June 2000.

Phase – VII (2000 Onwards)

In April 2001, the Clearing Corporation of India was established. The RBI promoted the development of the financial market and allowed online banking in 2001. It established a new payment system (i.e., national electronic fund transfer) in 2005. The RBI, with a view to mitigating the adverse impact of the global financial crisis on the economy, pursued an accommodative monetary policy in mid-September 2008.

Now, the important highlights of the evolution of the RBI are depicted as under.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>EVENTS</th>
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<tbody>
<tr>
<td>1913</td>
<td>The Royal Commission on Indian Finance and Currency (Chamberlain Commission) underlined the need for a central bank for India.</td>
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<tr>
<td>1926</td>
<td>Hilton Young Commission recommended the establishment of a central bank in India, to be named as Reserve Bank of India.</td>
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<tr>
<td>Jan 1927</td>
<td>The government introduced “The Gold Standard and Reserve Bank of India” in the legislature.</td>
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<td>March 1927</td>
<td>The Bill was referred to a Joint Committee to resolve some of the controversial clauses.</td>
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<tr>
<td>Jan 1928</td>
<td>Government of India published the “New Gold Standard and Reserve Bank Bill”, as amended by the Joint Committee.</td>
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<tr>
<td>Year</td>
<td>Event</td>
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<tr>
<td>Feb 1929</td>
<td>Government clarified that it did not intend to bring the Reserve Bank Bill before the legislature in the near future.</td>
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<tr>
<td>1931</td>
<td>Report of the Indian Central Banking Enquiry Committee released, strongly recommending the establishment of the Reserve Bank.</td>
</tr>
<tr>
<td>March 1933</td>
<td>Report of the India Office Committee released, recommending establishment of Reserve Bank of India as a private shareholders’ bank.</td>
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<tr>
<td>July 1933</td>
<td>London Committee, which was set up after the India Office Committee, adopted the 1928 Reserve Bank Bill as the basis and proposed certain amendments to the Bill.</td>
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<tr>
<td>Sep 1933</td>
<td>Reserve Bank of India Bill, drafted on the basis of London Committee recommendations, introduced in the Legislative Assembly.</td>
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<tr>
<td>Dec 1933</td>
<td>Reserve Bank of India Bill passed by the Assembly.</td>
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<tr>
<td>Feb 1934</td>
<td>Reserve Bank of India Bill was passed by the Council of States.</td>
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<tr>
<td>March 1934</td>
<td>Reserve Bank of India Bill received the assent of the Governor-General.</td>
</tr>
<tr>
<td>April 1935</td>
<td>The Reserve Bank of India was created as a private share holders’ bank. Sir Osborne Smith was appointed the first Governor of the Reserve Bank of India.</td>
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<tr>
<td>July 1937</td>
<td>Sir James Braid Taylor assumed office of the Governor.</td>
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<tr>
<td>March 1937</td>
<td>The Reserve Bank acted as banker to the Government of Burma and was also responsible for note issue in Burma as per the Burma Monetary Arrangements Order.</td>
</tr>
<tr>
<td>Jan 1938</td>
<td>The Reserve Bank issued its own bank notes.</td>
</tr>
<tr>
<td>Sep 1939</td>
<td>Introduction of Exchange Controls in India under Defense of India Rules</td>
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<tr>
<td>1939</td>
<td>Indian Bank Act to bring banks within the ambit of the Reserve Bank.</td>
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<tr>
<td>March 1940</td>
<td>The Reserve Bank’s accounting year changed from January -December to July- June.</td>
</tr>
<tr>
<td>1940</td>
<td>The silver rupee replaced by the quaternary alloy rupee. One Rupee note reintroduced. This note had the status of a rupee coin and represented the introduction of official fiat money in India.</td>
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<td>Year</td>
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<tr>
<td>1944</td>
<td>The Public Debt Act passed by the Government enabled the consolidation of laws relating to Government securities and management of public debt by the Reserve Bank.</td>
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<tr>
<td>Feb 1945</td>
<td>Non-scheduled banks were allowed to open accounts with the Reserve Bank.</td>
</tr>
<tr>
<td>1945</td>
<td>Establishment of Department of Banking Operations and Development and Research and Statistics Department in the Reserve Bank.</td>
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<tr>
<td>Jan 1946</td>
<td>High Denomination Bank Notes of Rs 500, Rs 1,000 and Rs 10,000 were demonetized to curb unaccounted money.</td>
</tr>
<tr>
<td>1946</td>
<td>Interim arrangements for bank supervision were put in place by an ordinance.</td>
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<tr>
<td>March 1947</td>
<td>The Reserve Bank ceased to function as Central Bank of Burma.</td>
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<tr>
<td>1947</td>
<td>Foreign Exchange Regulation Act was passed.</td>
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<tr>
<td>1948</td>
<td>Foreign Finance Corporation of India was established on the recommendation of the Central Board of the Reserve Bank.</td>
</tr>
<tr>
<td>June 1948</td>
<td>The Reserve Bank ceased to function as Central Bank of Pakistan.</td>
</tr>
<tr>
<td>Jan 1949</td>
<td>The Reserve Bank was nationalized.</td>
</tr>
<tr>
<td>March 1949</td>
<td>Banking Companies Act, 1949 came into force, replacing the earlier interim arrangements. This formed the statutory basis of bank regulation and supervision in India.</td>
</tr>
<tr>
<td>July 1949</td>
<td>Sir Benegal Rama Rau assumed office as Governor.</td>
</tr>
<tr>
<td>April 1950</td>
<td>Foreign Exchange Regulation Act, 1949 came into force.</td>
</tr>
<tr>
<td>1952</td>
<td>The Reserve Bank launched a pioneering project of All India Rural Credit Survey.</td>
</tr>
<tr>
<td>Sep 1954</td>
<td>The Reserve Bank set up Bankers’ Training College at Mumbai (earlier Bombay).</td>
</tr>
<tr>
<td>May 1955</td>
<td>The Imperial Bank was nationalized and renamed as State Bank of India with the Reserve Bank taking a 60 per cent stake in it.</td>
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<tr>
<td>1956</td>
<td>Introduction of selective credit controls.</td>
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<tr>
<td>Oct 1956</td>
<td>Introduction of decimal coinage</td>
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<tr>
<td>Year</td>
<td>Event</td>
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<tr>
<td>1956</td>
<td>System of note issue was changed from proportional reserve system to minimum reserve system.</td>
</tr>
<tr>
<td>Jan 1957</td>
<td>Shri K. G. Ambegoankar was appointed as Governor.</td>
</tr>
<tr>
<td>March 1957</td>
<td>Shri HVR Lyengar appointed as Governor.</td>
</tr>
<tr>
<td>1961</td>
<td>Failure of two commercial banks, namely, Palai Central Bank Ltd (Kerala) and Lakshmi Bank (Maharashtra). This led to deliberations of the need for deposit insurance in India.</td>
</tr>
<tr>
<td>1962</td>
<td>Deposit Insurance Corporation came into existence.</td>
</tr>
<tr>
<td>March 1962</td>
<td>Shri P. C. Bhattacharya appointed as Governor.</td>
</tr>
<tr>
<td>July 1963</td>
<td>Agricultural Refinance Corporation was set up as a subsidiary of the Reserve Bank.</td>
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<tr>
<td>Feb 1964</td>
<td>Unit Trust of India came into existence with 50 per cent shareholding by the Reserve Bank.</td>
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<tr>
<td>June 1964</td>
<td>Industrial Development Bank of India came into existence with the Reserve Bank wholly contributing the capital of Rs. 10 crore.</td>
</tr>
<tr>
<td>1966</td>
<td>Cooperative banks brought under the ambit of regulation of the Reserve Bank.</td>
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<tr>
<td>March 1966</td>
<td>Department of Financial Companies was established.</td>
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<tr>
<td>June 1966</td>
<td>Indian rupee was devalued by 36.5 per cent.</td>
</tr>
<tr>
<td>April 1967</td>
<td>The size of the bank notes was reduced.</td>
</tr>
<tr>
<td>July 1967</td>
<td>Shri L. K. Jha appointed as Governor.</td>
</tr>
<tr>
<td>April 1968</td>
<td>Demonetization of quaternary coins</td>
</tr>
<tr>
<td>May 1968</td>
<td>The Bill for setting up of the Agricultural Credit Corporation passed in Parliament.</td>
</tr>
<tr>
<td>Dec 1968</td>
<td>The Deposit Insurance Corporation (Amendment) Bill, 1968 came into force. All central, state and urban cooperative banks with paid-up capital of Rs 1 lakh or more were covered under the scheme.</td>
</tr>
<tr>
<td>1969</td>
<td>The government propounded the tenet of “Social Banking”. This led to nationalization of 14 commercial banks.</td>
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<tr>
<td>Date</td>
<td>Event</td>
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<tr>
<td>Sep 1969</td>
<td>National Institute of Bank Management (NIBM) established at Mumbai which was subsequently shifted to Pune.</td>
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<tr>
<td>Sep 1969</td>
<td>Cooperative Bankers Training College was established at Pune.</td>
</tr>
<tr>
<td>May 1970</td>
<td>Shri B. N. Adarkar appointed as Governor.</td>
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<tr>
<td>June 1970</td>
<td>Shri S. Jagannathan appointed as Governor.</td>
</tr>
<tr>
<td>Jan 1971</td>
<td>Credit Guarantee Corporation of India was established.</td>
</tr>
<tr>
<td>Dec 1972</td>
<td>Basic Statistical Returns (BSR) Scheme introduced to collect banking statistics.</td>
</tr>
<tr>
<td>Sep 1973</td>
<td>The Foreign Exchange Regulation Act, 1947 was amended.</td>
</tr>
<tr>
<td>Jan 1974</td>
<td>Foreign Exchange Regulation Act, 1973 came into force. The Cooperative Bankers Training College was renamed as College of Agricultural of Banking</td>
</tr>
<tr>
<td>1975</td>
<td>Exchange rate of Rupee was linked to the basket of currencies of major trading partners.</td>
</tr>
<tr>
<td>May 1975</td>
<td>Shri N. C. Sengupta was appointed as Governor.</td>
</tr>
<tr>
<td>Aug 1975</td>
<td>Shri K. R. Puri was appointed as Governor.</td>
</tr>
<tr>
<td>Nov 1975</td>
<td>Agricultural Refinance Corporation (ARC) was renamed as Agricultural Refinance and Development Corporation (ARDC).</td>
</tr>
<tr>
<td>Feb 1976</td>
<td>Regional Rural Banks Act, 1976 received assent of the President.</td>
</tr>
<tr>
<td>Feb 1976</td>
<td>Industrial Development Bank of India delinked from the Reserve Bank of India.</td>
</tr>
<tr>
<td>May 1977</td>
<td>Shri M. Narasimham was appointed as Governor.</td>
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<tr>
<td>Dec 1977</td>
<td>Dr. I. G. Patel was appointed as Governor.</td>
</tr>
<tr>
<td>Jan 1978</td>
<td>Demonetization of high denomination notes (Rs 1,000, Rs 5,000 and Rs 10,000) effected.</td>
</tr>
<tr>
<td>July 1978</td>
<td>Deposit Insurance Corporation and Credit Guarantee Corporation of India Ltd. were merged and renamed as Deposit Insurance and Credit Guarantee Corporation (DICGC).</td>
</tr>
<tr>
<td>April 1979</td>
<td>Six more Indian scheduled commercial banks were nationalized.</td>
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<tr>
<td>July 1982</td>
<td>National Bank for Agriculture and Rural Development (NABARD) was set up.</td>
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<td>Year</td>
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<tr>
<td>Sep 1982</td>
<td>Dr. Manmohan Singh was appointed as Governor.</td>
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<tr>
<td>1984</td>
<td>MICR Clearing was introduced. Release of Sukhomoy Chakravarty</td>
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<tr>
<td></td>
<td>Report on monetary measurement: Dr. C. Rangarajan (Deputy Governor)</td>
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<td></td>
<td>Committee Report on computerization in banking system.</td>
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<tr>
<td>1985</td>
<td>The Reserve Bank celebrates its Golden Jubilee Year. The Honorable</td>
</tr>
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<td></td>
<td>Prime Minister Rajiv Gandhi graced the inaugural function.</td>
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<td>Jan 1985</td>
<td>Shri A. Ghosh was appointed as Governor.</td>
</tr>
<tr>
<td>Feb 1985</td>
<td>Shri R. N. Malhotra was appointed as Governor.</td>
</tr>
<tr>
<td>Dec 1987</td>
<td>Indira Gandhi Institute of Development and Research was set up.</td>
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<tr>
<td>April 1988</td>
<td>Discount and Finance House of India Ltd. was set up, marking the</td>
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<tr>
<td></td>
<td>beginning of RBI’s role in financial markets.</td>
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<tr>
<td>July 1988</td>
<td>National Housing Bank was set up under the National Housing Bank</td>
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<tr>
<td>1990</td>
<td>Small Industries Development Bank of India was set up.</td>
</tr>
<tr>
<td>Dec 1990</td>
<td>Shri S. Venkitaramanan was appointed as Governor.</td>
</tr>
<tr>
<td>1991</td>
<td>Paradigm shift in economic management and the Reserve Bank steps in</td>
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<td></td>
<td>as the facilitator. Support to economic reforms, liberalisation,</td>
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<td></td>
<td>privatisation, and globalization and contributory presence in world</td>
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<td>bodies.</td>
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<tr>
<td>July 1991</td>
<td>The value of the rupee was adjustment downwards in two stages, on</td>
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<td></td>
<td>July 1 and 3, 1991. Two – step downward adjustment of the rupee in</td>
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<td>terms of the intervention currency, pound sterling, worked out to</td>
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<td>17.38 percent. Thereafter, the rupee exchange rate was anchored on a</td>
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<tr>
<td></td>
<td>rupee – US dollar rate close to Rs. 26 a dollar.</td>
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<tr>
<td>Aug 1991</td>
<td>A high – powered Committee on the Financial System (CFS) was</td>
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<tr>
<td></td>
<td>constituted by the Government of India in August 1991 to examine all</td>
</tr>
<tr>
<td></td>
<td>aspects relating to the structure, organization, functions and</td>
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<tr>
<td></td>
<td>procedures of the financial system (Chairman: Shri M. Narasimham).</td>
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<tr>
<td>Nov 1991</td>
<td>Committee on the Financial System submitted its report in November</td>
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<tr>
<td></td>
<td>1991, made wide-ranging recommendations, which formed the basis of</td>
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<td></td>
<td>financial sector reforms relating to banks, development financial</td>
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<tr>
<td></td>
<td>institutions (DFIs) and the capital market in the years to come.</td>
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<tr>
<td>Date</td>
<td>Event</td>
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<tr>
<td>March 1992</td>
<td>A dual exchange rate system called Liberalized Exchange Rate Management System (LERMS) introduced. Forex management under deregulated regime led to a series of measures culminating in FEMA 1999.</td>
</tr>
<tr>
<td>Dec 1992</td>
<td>Dr. C. Rangarajan was appointed as Governor.</td>
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<tr>
<td>1993</td>
<td>Unified Exchange Rate was introduced.</td>
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<tr>
<td>Aug 1994</td>
<td>Rupee made convertible on the Current Account. India attained the status of Article VIII of the Articles of Agreement of the IMF.</td>
</tr>
<tr>
<td>Sep 1994</td>
<td>The Reserve Bank and the Government of India signed an agreement as per which automatic monetization of the budget deficit through the issue of ad – hoc treasury bills would phase out over a period of three years.</td>
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<tr>
<td>Nov 1994</td>
<td>Board for Financial Supervision constituted as a Committee of the Central Board of Directors.</td>
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<tr>
<td>Feb 1995</td>
<td>Bharatiya Reserve Bank Note Mudran Limited established as a fully owned subsidiary of the Reserve Bank. It commenced printing of notes on June 1 and December 11, at Mysore and Salboni, respectively.</td>
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<tr>
<td>June 1995</td>
<td>Banking Ombudsman scheme for redressed of customer grievance against the banking sector introduced.</td>
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<tr>
<td>1996</td>
<td>The Reserve Bank becomes a member of the Bank for International Settlements.</td>
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<tr>
<td>July 1996</td>
<td>Institute for Development and Research in Banking Technology, Hyderabad was established by the Reserve Bank as an autonomous entity.</td>
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<tr>
<td>Sep 1996</td>
<td>The Reserve Bank’s Website became operational.</td>
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<tr>
<td>April 1997</td>
<td>The Reserve Bank and the Government of India agreed to replace the system of ad – hoc treasury bills by ways and means advances, ending automatic monetization of fiscal deficits.</td>
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<tr>
<td>Nov 1997</td>
<td>Dr Bimal Jalan was appointed as Governor.</td>
</tr>
<tr>
<td>April 1998</td>
<td>The framework for further strengthening the banking sector was provided by the Committee on Banking Sector Reforms (Chairman: Shri M. Narasimham).</td>
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<tr>
<td>Year</td>
<td>Event</td>
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<tr>
<td>Dec 1998</td>
<td>The Monetary Museum website launched.</td>
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<tr>
<td>1999</td>
<td>“Clean Note Policy” introduced for better currency management.</td>
</tr>
<tr>
<td>June 2000</td>
<td>FEMA became operational.</td>
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<tr>
<td>April 2001</td>
<td>Clearing Corporation of India was established.</td>
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<tr>
<td>March 2002</td>
<td>Bharatiya Reserve Bank Note Mudran became private limited company.</td>
</tr>
<tr>
<td>Sep 2003</td>
<td>Dr. Y. V. Reddy was appointed as Governor.</td>
</tr>
<tr>
<td>Feb 2004</td>
<td>Market Stabilization Scheme was launched.</td>
</tr>
<tr>
<td>Nov 2004</td>
<td>The Reserve Bank Monetary Museum was set up in Mumbai.</td>
</tr>
<tr>
<td>Jan 2006</td>
<td>Revamped Banking Ombudsman Scheme came into effect.</td>
</tr>
<tr>
<td>March 2006</td>
<td>Banking Codes and Standards Board of India constituted.</td>
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<tr>
<td>July 2006</td>
<td>Customer Service Department was set up at the Reserve Bank.</td>
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<tr>
<td>2008</td>
<td>Payment and Settlements System Act, 2007 came into force with effect from August 12, 2008. Cheque truncation was introduced in Delhi region as a pilot project.</td>
</tr>
<tr>
<td>Sep 2008</td>
<td>Dr. D. Subbarao was appointed as Governor.</td>
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<tr>
<td>Dec 2008</td>
<td>Incorporation of National Payment Corporation of India</td>
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<tr>
<td>2008/9</td>
<td>RBI pursued an accommodative monetary policy beginning mid-September 2008 to mitigate the adverse impact of the global financial crisis on the economy.</td>
</tr>
<tr>
<td>April 2009</td>
<td>The Reserve Bank enters its Platinum Jubilee Year.</td>
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<tr>
<td>July 2009</td>
<td>The Reserve Bank establishes a new department – Financial Stability Unit.</td>
</tr>
<tr>
<td>Nov 2009</td>
<td>The Reserve Bank purchased 200 mts of gold under IMF’s limited gold sales programme.</td>
</tr>
<tr>
<td>2009/10</td>
<td>From October 2009, the RBI began the process of exit from the expansionary monetary policy.</td>
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</table>
Functions of Reserve Bank of India

As the central bank of the country, the RBI performs a wide range of functions. The functions of the Reserve Bank today can be categorized as follows:

- Monetary policy
- Regulation and supervision of the banking and non-banking financial institutions, including credit information companies
- Regulation of money, forex and government securities markets as also certain financial derivatives
- Debt and cash management for Central and State Governments
- Management of foreign exchange reserves
- Foreign exchange management—current and capital account management
- Banker to banks
- Banker to the Central and State Governments
- Oversight of the payment and settlement systems
- Currency management
- Developmental role
- Research and statistics

As regards the commercial banks, the RBI’s role mainly can be differentiated with below mentioned functions:

- **Monetary Management**: One of the most important functions of central banks is formulation and execution of monetary policy. In the Indian context, the basic functions of the Reserve Bank of India as enunciated in the Preamble to the RBI Act, 1934 are:
  “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.”

Thus, the Reserve Bank’s mandate for monetary policy lows from its monetary stability objective. Essentially, monetary policy deals with the use of various policy instruments for influencing the cost and availability of money in the economy. As macroeconomic conditions change, a central bank may change the choice of instruments in its monetary policy. The overall goal is to promote economic growth and ensure price stability.
The Governor of the Reserve Bank announces the Monetary Policy in April every year for the financial year that ends in the following March. This is followed by three quarterly reviews in July, October and January. However, depending on the evolving situation, the Reserve Bank may announce monetary measures at any point of time. The Monetary Policy in April and its Second Quarter Review in October consist of two parts:

Part A provides a review of the macroeconomic and monetary developments and sets the stance of the monetary policy and the monetary measures.

Part B provides a synopsis of the action taken and the status of past policy announcements together with fresh policy measures. It also deals with important topics, such as, financial stability, financial markets, interest rates, credit delivery, regulatory norms, financial inclusion and institutional developments.

- **Issuer of Currency:** Reserve Bank of India has the monopoly right of Note – Issue. If issue notes of the denomination of Rs. 2, 5, 10, 20, 50, 100, 500 and 1000. The bank has its separate department for note issuing. This is known as Issue Department. In accordance with the Reserve Bank of India Act, this bank is required to maintain Reserve Fund for note issuing. This is to maintain confidence of the people in the country’s currency. Since 1956, note issuing is based on minimum Reserve System.\(^{32}\)

Management of currency is one of the core central banking functions of the Reserve Bank for which it derives the necessary statutory powers from Section 22 of the RBI Act, 1934. Along with the Government of India, the Reserve Bank is responsible for the design, production and overall management of the nation’s currency, with the goal of ensuring an adequate supply of clean and genuine notes. In consultation with the Government, the Reserve Bank routinely addresses security issues and targets ways to enhance security features to reduce the risk of counterfeiting or forgery of currency notes.

The Paper Currency Act of 1861 conferred upon the Government of India the monopoly of note issues, thus ending the practice of private and presidency banks issuing currency. Between 1861 and 1935, the Government of India

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managed the issue of paper currency. In 1935, when the Reserve Bank began operations, it took over the function of note issue from the Office of the Controller of Currency, Government of India.

The Reserve Bank carries out the currency management function through its Department of Currency Management located at its Central Office in Mumbai, 19 Issue Offices located across the country and a currency chest at its Kochi branch. To facilitate the distribution of notes and rupee coins across the country, the Reserve Bank has authorized selected branches of banks to establish currency chests. There is a network of 4,281 Currency Chests and 4,044 Small Coin Depots with other banks. Currency chests are storehouses where bank notes and rupee coins are stocked on behalf of the Reserve Bank. The currency chests have been established with State Bank of India, five associate banks, nationalized banks, private sector banks, a foreign bank, a state cooperative bank and a regional rural bank. Deposits into the currency chest are treated as reserves with the Reserve Bank and are included in the CRR. The reverse is applicable for withdrawals from chests. Like currency chests, there are also small coin depots which have been established by the authorized bank branches to stock small coins. The small coin depots distribute small coins to other bank branches in their area of operation.

- **Banker to Government:** “Like other central banks of the world, the RBI also acts as the banker, agent and advisor to the Government. It acts as the agent of both Central and State Government except Jammu and Kashmir. As per provisions of Sections 20, 21 and 21A of the RBI Act, the Banks has the legal right and obligation to transact the business of both Central and State Governments. As banker to the Government, the Bank discharges the following functions:
  1. Keeping the cash balances of the Government as deposits free of interest.
  2. Receiving and making payments on behalf of the Government.
  3. Carrying out the Governments’ exchange remittances and other banking operations.
  4. Helping both Central and State Governments float new loans and manages public debt.
  5. Making ways and means advances to the states and local authorities.
6. Acting as advisor to the Government on all monetary and banking matters.”

- **Banker to Banks**: “As a banker to banks, the Reserve bank focuses on establishing smooth, swift and seamless clearing and settlement of inter-bank obligations; providing an efficient means of funds transfer for banks; enabling banks to maintain their accounts with the Reserve Bank for statutory requirements; maintaining transaction balances and acting as a lender of last resort.”

Banks are required to maintain a portion of their demand and time liabilities as cash reserves with the Reserve Bank, thus necessitating a need for maintaining accounts with the Bank. Further, banks are in the business of accepting deposits and giving loans. Since different persons deal with different banks, in order to settle transactions between various customers maintaining accounts with different banks, these banks have to settle transactions among each other. Settlement of inter-bank obligations thus assumes importance.

To facilitate smooth operation of this function of banks, an arrangement has to be made to transfer money from one bank to another. This is usually done through the mechanism of a clearing house where banks present cheques and other such instruments for clearing. Many banks also engage in other financial activities, such as, buying and selling securities and foreign currencies. Here too, they need to exchange funds between themselves. In order to facilitate a smooth inter-bank transfer of funds, or to make payments and to receive funds on their behalf, banks need a common banker.

In order to meet the above objectives, in India, the Reserve Bank provides banks with the facility of opening accounts with itself. This is the ‘Banker to Banks’ function of the Reserve Bank, which is delivered through the Deposit Accounts Department (DAD) at the Regional offices. The Department of Government and Bank Accounts oversees this function and formulates policy and issues operational instructions to DAD.

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Financial Regulation and Supervision: “Banking is based on public confidence and confidence emerges out of effective financial system well monitored and guided. It is where Reserve Bank comes as regulator and supervisor of the financial system.”

The Reserve Bank’s regulatory and supervisory domain extends not only to the Indian banking system but also to the development financial institutions (DFIs), non-banking financial companies (NBFCs), primary dealers, credit information companies and select segments of the financial markets. In respect of banks, the Reserve Bank derives its powers from the provisions of the Banking Regulation Act, 1949, while the other entities and markets are regulated and supervised under the provisions of the Reserve Bank of India Act, 1934. The credit information companies are regulated under the provisions of Credit Information Companies (Regulation) Act, 2005. To ensure a sound banking system in the country, the RBI exercises powers of supervision, regulation and control over commercial banks. The bank’s regulatory functions relating to banks cover their establishment (i.e. licensing), branch expansion, liquidity of their assets, management and methods of working, amalgamation, reconstruction and liquidation. RBI controls the commercial banks through periodic inspection of banks and follow-up action and by calling for returns and other information from them, besides holding periodic meetings with the top management of the banks. While RBI is directly involved with commercial banks in carrying out these two roles, the commercial banks help RBI indirectly to carry out some of its other roles as well. For example, commercial banks are required by law to invest a prescribed minimum percentage of their respective net demand and time liabilities (NDTL) in prescribed securities, which are mostly government securities. This helps the RBI to perform its role as the banker to the government, under which the RBI conducts the Government’s market borrowing program.

As the regulator and the supervisor of the banking system, the Reserve Bank has a critical role to play in ensuring the system’s safety and soundness on an ongoing basis. The objective of this function is to protect the interest of depositors through an effective prudential regulatory framework for orderly

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development and conduct of banking operations, and to maintain overall financial stability through various policy measures.

- **Foreign Exchange Reserves Management**: The Reserve Bank, as the custodian of the country’s foreign exchange reserves, is vested with the responsibility of managing their investment. The legal provisions governing management of foreign exchange reserves are laid down in the Reserve Bank of India Act, 1934. The Reserve Bank’s reserves management function has in recent years grown both in terms of importance and sophistication for two main reasons. First, the share of foreign currency assets in the balance sheet of the Reserve Bank has substantially increased. Second, with the increased volatility in exchange and interest rates in the global market, the task of preserving the value of reserves and obtaining a reasonable return on them has become challenging. The basic parameters of the Reserve Bank’s policies for foreign exchange reserves management are safety, liquidity and returns.

- **Foreign Exchange Management**: For a long time, foreign exchange in India was treated as a controlled commodity because of its limited availability. The early stages of foreign exchange management in the country focused on control of foreign exchange by regulating the demand due to limited supply. Exchange control was introduced in India under the Defense of India Rules on September 3, 1939 on a temporary basis. The statutory power for exchange control was provided by the Foreign Exchange Regulation Act (FERA) of 1947, which was subsequently replaced by a more comprehensive Foreign Exchange Regulation Act, 1973. This Act empowered the Reserve Bank, and in certain cases the Central Government, to control and regulate dealings in foreign exchange payments outside India, export and import of currency notes and bullion, transfer of securities between residents and non-residents, acquisition of foreign securities, and acquisition of immovable property in and outside India, among other transactions. Extensive relaxations in the rules governing foreign exchange were initiated, prompted by the liberalization measures introduced since 1991 and the Act was amended as a new Foreign Exchange Regulation (Amendment) Act 1993.
Significant developments in the external sector, such as, substantial increase in foreign exchange reserves, growth in foreign trade, rationalization of tariffs, current account convertibility, and liberalization of Indian investments abroad, increased access to external commercial borrowings by Indian corporate and participation of foreign institutional investors in Indian stock market, resulted in a changed environment. Keeping in view the changed environment, the Foreign Exchange Management Act (FEMA) was enacted in 1999 to replace FERA with effect from June 1, 2000.

FEMA aimed at consolidating and amending the laws relating to foreign exchange with the objective of facilitating external trade and payments and for promoting the orderly development and maintenance of foreign exchange markets in India. Emphasizing the shift in focus, the Reserve Bank in due course also amended (since January 31, 2004) the name of its department dealing with the foreign exchange transactions to Foreign Exchange Department from Exchange Control Department.

- **Market Operations**: The Reserve Bank operationalizes its monetary policy through its operations in government securities, foreign exchange and money markets.

  - Open Market Operations –“The term ‘Open Market Operations’ in the wider sense means purchase or sale by a Central bank of any kind of paper in which it deals, like government securities or any other public securities or trade bills etc.” Open Market Operations in the form of outright purchase/sale of Government securities are an important tool of the Reserve Bank’s monetary management.

  - Liquidity Adjustment Facility (LAF) – “Liquidity Adjustment Facility was introduced in 2000. With the help of LAF, the RBI can manage market liquidity on a daily basis and also transmit interest rate signals to markets. It consists of the daily infusion or absorption of liquidity on a repurchase basis. LAF is used through repo (liquidity injection) and reverse repo

(liquidity absorption) auction operations by using Government collateral securities.”37

- Market Stabilization Scheme – The Market Stabilization Scheme (MSS) was introduced in April 2004 under which Government of India dated securities / treasury bills could be issued to absorb surplus structural / durable liquidity created by the Reserve Bank’s foreign exchange operations. MSS operations are a sterilization tool used for offsetting the liquidity impact created by intervention in the foreign exchange markets.

- Domestic Foreign Exchange Market Operations – Operations in the domestic foreign exchange markets are conducted within the Reserve Bank’s framework of exchange rate management policy. The exchange rate management policy in recent years has been guided by the broad principles of careful monitoring and management of exchange rates with flexibility, without a fixed target or a pre-announced target or a band coupled with the ability to intervene if and when necessary. It also allows underlying demand and supply conditions to determine the exchange rate movements over a period in an orderly way.

- Money Market – The Reserve Bank also carries out regulation and development of money market instruments such as call / notice / term money market, repo market, certificate of deposit, commercial paper and Collateralized Borrowing and Lending Obligations (CBLO). The call / notice / term money market operations are transacted / reported on the Negotiated Dealing System – Call (NDS Call) platform.

- **Payment and Settlement Systems:** “The smooth functioning of the payment and settlement systems is a prerequisite for the stability of the financial system. The legal framework for the oversight role of RBI is provided by the Payment and Settlement Systems (PSS) Act, 2007 and the Payment and Settlement System Regulations. Following this ACT, RBI has been provided a

sound and well-founded legal basis for regulation and oversight of payment and settlement systems. The ACT clearly defines settlement finality and provides an explicit legal basis for multilateral netting. The findings of the 2009 CPSS Core Principles self-assessment are that the existing payment system operates cheaply and efficiently, with minimal systemic risk.”

**Guidelines on the Base Rate**

The RBI had full control on determination interest rates on different types of loans and advances are determined by individual banks at their own discretion. The RBI provides overall guidelines about the interest rates to the banks and the criteria based on which the interest rates will be decided by the individual banks. The criteria decided by the RBI included prime lending rates and presently the base rate. At times the RBI may also decide certain ceilings on interest rates according priority to the types of advances. For example, there is cap on interest for export finance. Interest is also subsidized by way of re-finance to the banks by the RBI or the other apex level institutions. There are some important developments regarding interest on loan and advances which are explained below:

- The RBI controlled interest rates till October 1994 but it freed lending rates to be decided by individual banks w.e.f. October 18, 1994. RBI advised banks to decide prime lending rate (PLR) and accordingly fix interest on loans and advances. However from July 1st 2010, the RBI introduced ‘Base Rate System’ which replaced prime lending rate system.

- The individual banks decide the base rate depending on the cost of fund position. The individual banks inform to the RBI the base rate, minimum, and maximum lending rates. The base rate is also made transparent to the customers.

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- Banks are free to use any methodology as considered appropriate to fix base rate, provided it is consistent and made available for supervisory review/scrutiny, as and when required.

- Banks may determine their actual lending rates on loans and advances with reference to the Base Rate and by including such other customer specific charges as considered appropriate.

- All categories of loans are priced only with reference to the Base Rate. However, the following categories of loans have been exempted from the purview of Base Rate:
  
  I. Advances under differential rate of interest (DRI)
  II. Loans to banks’ own employees
  III. Loans to banks depositors against their own deposits

- The Base Rate could also serve as the reference benchmark rate for floating rate loan products, apart from external market benchmark rates. The floating interest rate based on external benchmark should, however, be equal to or above the Base Rate at the time of sanction or renewal.

- Base Rate is reviewed by the banks once in a quarter.\(^\text{39}\)

**Financial Inclusion**

The Indian banking industry has been able to penetrate to less than half of the population. In recent past, Reserve Bank of India (the regulator) has taken a number of steps to further expedite the process of financial inclusion. Its efforts in adapting to the changing needs of the economy and enabling greater access to financial services to the unreached and under – reached segments are praiseworthy. Broad based financial inclusion is must, as there is hardly any instance where transition from an

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agrarian system to a post industrial modern society has happened in any economy without robust financial system.\(^{40}\)

Financial Inclusion rests on three pillars – access to financial services, affordability of such services and actual utilization of such services. Financial Inclusion can be achieved only if all the three pillars show affirmative results. Thus, the ABC of Financial Inclusion is Advice, Banking and Credit. It must also be focused that while for developing countries like India, generally the process of financial inclusion starts with opening of saving bank accounts. The process, at a later stage, must also incorporate credit facilities and other financial services such as insurance. Thus promotion of financial inclusion would require holistic and coherent approach on the part of the banking industry as also the regulator RBI (Reserve Bank of India) and the GOI (Government of India).\(^{41}\)

**Definition of Financial Inclusion**

The Asian Development Bank has defined financial inclusion as ‘provision of a broad range of financial services such as deposits, loans, payment services, money transfers, and insurance to poor and low income households and their micro – enterprises.’

The Committee on Financial Inclusion has defined financial inclusion as ‘the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.’

**Benefits of Financial Inclusion**

1. Financial inclusion is an avenue for bringing the saving of the poor into the formal financial intermediation system.
2. Large number of low – cost deposits helps banks manage both liquidity risks and asset – liability mismatches.
3. Financial inclusion helps transfer payments such as social security, national rural employment guarantee programme (NREGA) wages into the bank

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accounts of beneficiaries through the ‘electronic benefit transfer’ (EBT) method.

4. It provides opportunities to the poor to build savings, make investments, and avail credit.

5. It helps the poor insure themselves against income shocks and equip them to meet emergencies such as illness or loss of employment.

**Process of Financial Inclusion**

Financial inclusion is to be undertaken in three steps:

1. Providing access to financial products and services.
2. Availability of financial products and services in a fair and equitable manner.
3. Credit counseling which includes providing sound services to arrest deterioration of incomes, restructuring of debt solution to overcome debt burden and improve money – management skill.\(^\text{42}\)

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