A Study on Role of RBI in Regulating Banks

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I. INTRODUCTION

A standout amongst the most important functions of RBI is to fill in as regulator and supervisor of financial system. The financial system in India incorporates Commercial Banks, Regional Rural Banks, Local Area Banks, Cooperative Banks, Financial Institutions including Development Financial Institutions (DFIs) and Non-Banking Financial Companies. RBI infers its controlling forces for Indian Banking System from the arrangements of the Banking Regulation Act 1949. For different substances, it gets control from the RBI demonstration 1934.[1] The goals of this capacity are to secure the enthusiasm of the contributors and keep up the wellbeing and soundness of the banking and Financial System of the nation. After the progression of the Indian Economy and Banking changes in 1990s, the abundance of the supervisory functions of RBI moved toward becoming has developed massively. To stay aware of the additional significance of this capacity, the Board of Financial Supervision was comprised in 1994. From that point forward, BFS is filling in as the principle managing power behind RBI's regulatory and supervisory activities. The Banking Regulation Act, 1949 came into force on March 16, 1949. It contained various aspects related to banking in India.

Its purpose is to provide safety in the interest of depositors and prevent misuse of powers by managers of banks Act is a supplement to Companies Act, 1956. Initially it was called as Banking Companies Act, 1949 but from March 1, 1966, the name of the Act was changed to Banking Regulation Act, 1949.[2] Initially, the law was applicable only to all banking companies. But, 1965 it was amended to make it applicable to all cooperative banks and to introduce other changes. The Act gives power to the Reserve Bank of India (RBI) to license banks, have regulation on shareholding and voting rights of shareholders; supervise the rules of appointment of the boards and management; regulate the operations of the banks; lay down instructions for the audits; control moratorium, mergers and liquidation; issue directives in the best interests of public good and on banking policy, and also impose penalties. In 1965, the Act was amended to included cooperative banks under its purview by

[1]https://www.uio.no/studier/emner/sv/oekonomi/ECON4335/h16/uio_lecture_regulation.pdf
[2]https://opentextbc.ca/principlesofeconomics/chapter/introduction-to-monetary-policy-and-bank-regulation/

the addition of the Section 56. Cooperative banks, which operate only in one state and are formed and run by the state government.

II. OBJECTIVES

- To study about the role of RBI in regulating banks
- To analyse the various schemes and actions taken by RBI with respect to the regulation of the banks
- To examine the effectiveness of approach of the RBI towards commercial banks

III. LICENSING REQUIREMENTS

To complete a business of commercial banking in India, regardless of whether it is India or Foreign, a permit from RBI is required. Opening of Branches is dealt with by the Branch Authorization Policy. At present, Indian banks never again require a permit from the Reserve Bank for opening a branch at a place with populace of beneath 50,000.

Corporate Governance in Banks

One of the approach destinations of RBI is to guarantee high caliber corporate governance in banks.[3] RBI has issued guidelines for 'fit and legitimate' criteria for executive of banks. One of these guidelines is that the directors of the banks ought to have unique learning/involvement in the different banking related areas. RBI can likewise select extra directors to the board of a banking organization.

Statutory Pre-emptions

Every commercial bank is required to keep up certain segment of their Net Demand and Time Liabilities (NDTL) as cash with the Reserve Bank, called Cash Reserve Ratio (CRR) and as interest in endorsed securities, called Statutory Liquidity Ratio (SLR). These are called statutory Pre-emptions.

Interest Rates

The interest rates on the majority of the classes of deposits and lending transactions have been deregulated and are to a great extent dictated by banks.[4] Reserve Bank manages the interest rates on investment funds ledgers and deposits of non-resident Indians (NRI), little advances up to rupees two lakh, send out credits and a couple of different classes of advances.

Prudential Norms

[3] https://blog.ipleaders.in/corporate-governance-in-the-banking-sector/amp/
[4] https://www.moneycontrol.com/fixed-income/banks-deposits/

Prudential Norms alludes to perfect/dependable norms kept up by the banks. RBI issues "Prudential Norms" to be trailed by the commercial banks to reinforce the balance sheets of banks. Some of them are identified with pay acknowledgment, asset arrangement and provisioning, capital ampleness, investments portfolio and capital market exposures. RBI has issued its guidelines under the Basel II for risk management.

Disclosure Norms

One of the important apparatuses for marketing discipline is to keep up open disclosure of pertinent data. As per RBI's mandates, the banks are required to make disclosures of their yearly reports and some different records about their capital ampleness, asset quality, liquidity, income angles and penalties imposed on them by the regulator.

Anti-Money Laundering Norms

KYC norms (Know Your Customer) Anti-Money Laundering (AML) and Combating Financing of Terrorism (CFT) guidelines are a portion of the significant issues on which RBI keeps issuing its norms and guidelines.

Protection of Small Depositors

RBI has set up the Deposit Insurance and Credit Guarantee Corporation (DICGC) to secure the interest of small depositors, in the event of bank disappointment[5]. The DICGC gives insurance cover to all qualified bank depositors up to Rs.1 lakh per investor per bank.

IV. PARA – BANKING ACTIVITIES

Parabanking activities are those activities which don't go under the traditional banking activities. Instances of such activities are asset management, mutual funds business, insurance business, merchant banking activities, factoring services, venture capital, card business, equity participation in venture funds and leasing. The RBI had permitted banks to carryout these activities under the guidelines issued by it from time to time.

Annual Onsite Inspection

RBI attempts annual on-site inspection of banks to survey their financial wellbeing and to assess their performance regarding nature of management, capital ampleness, asset quality, income, liquidity position and also inner control systems. In light of the discoveries of the inspection, banks are relegated supervisory evaluations dependent on the CAMELS rating.

OSMOS

[5]https://www.imf.org/external/pubs/ft/issues9/index.htm

OSMOS alludes to Off Site Surveillance and Monitoring System. The RBI expects banks to submit itemized and organized information periodically under OSMOS. Based on OSMOS, RBI breaks down the strength of the banks.

V. Reserve Bank of India and Corporate Governance in the Banking Sector in India

In India, the Reserve Bank of India ("RBI") is the gatekeeper of Corporate Governance. RBI is the central bank of India which controls all the real issues identified with currency, foreign exchange reserves and so on. To put it plainly, RBI is the bank responsible for anchoring the monetary stability in India.

The preamble of the Reserve Bank of India Act, 1934 elucidates as "An Act to constitute a Reserve Bank of India. Whereas it is expedient to constitute a Reserve Bank for India 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 any credit system of the country to its advantage; And whereas in the present disorganisation of the monetary systems of the world it is not possible to determine what will be suitable as a permanent basis for the Indian monetary system; But whereas it is expedient to make temporary provision on the basis of the existing monetary system, and to leave the question of the monetary standard best suited to India to be considered when the international monetary position has become sufficiently clear and stable to make it possible to frame permanent measures…"[6]

There is nobody who could deny the reality banks are critical to the economic stability of any economy. In the event that a bank crashes then it doesn't crash alone, it additionally removes the lifelong venture and investment funds of its whole account holders as well. This isn't the only reason because of which corporate governance in the banking area is required. Corporate Governance is additionally required for the bank to keep a mind money laundering, financing improper and criminal acts and transaction of money to the fear mongers. The latest demonstration of RBI job in the Indian economy is demonetization, through which it has (under the decision-production limit of Indian Parliament), strike hard at the general population storing dark money or individuals printing counterfeit currency. In any case, it's a very surprising issue this could have been done in a progressively professional manner, diminishing the issues looked by the general population.

RBI plays a leading role in formulating and implementing corporate governance. The corporate governance mechanism is followed by the Reserve Bank of India is based on three categories for governing the banks.

They are as follows:

[6]https://www.legalcrystal.com/act/21198/reserve-bank-of-india-act-1934-2-of-1934-preamble-1

(i) Disclosure and transparency,

(ii) Off-site surveillance,

(iii) Prompt Corrective Action.

VI. DISCLOSURE AND TRANSPARENCY:

Disclosure and transparency are the most important constituent of corporate governance. In the event that the banks won't uncover their transactions to the RBI, they can operate at their impulses and likes and may vanish with the lifelong investments and reserve funds of the general population. The RBI through the necessity of routine revealing of financial transactions of the bank keeps a tab on the activities being attempted by the banks in India. Any inability to submit to the requirements set out by RBI may prompt substantial fines being imposed along with the cancellation of the permit to operate as a bank.[7]

Off-site surveillance:

RBI routinely perform an annual on-site inspection of the records of the banks yet so as to advance governance in banking division RBI in the year 1995, off-site surveillance function was started in 1995 for residential operations of banks. The primary focal point of the off-site surveillance is to monitor the financial strength of banks between two on-site inspections, distinguishing banks which demonstrate financial deterioration and would be a hotspot for supervisory concerns. The off-site surveillance gets ready RBI to make timely healing move before things gain out of power.

Prompt Corrective Action:

RBI while advancing corporate governance in banks in India has RBI has set trigger focuses based on CRAR, NPA and ROA.[8] Based on trigger focuses set by RBI, the banks need to pursue 'structured action plan likewise called mandatory action plan'. Next to mandatory action plan RBI has discretionary action plans as well. The principle reason for characterizing the standard based action focuses into Mandatory and Discretionary is that a portion of the actions are basic to reestablish the financial wellbeing of banks must be mandatorily taken by the bank while different actions will be taken at the discretion of RBI relying on the profile of each bank.

Criticisms over PCA

- Reserve Bank of India is blamed for being excessively stringent in applying the prompt corrective action (PCA) system for banks.
- This has harmed the stream of credit to the economy.

[7]https://www.researchgate.net/publication/227429688_Transparency_and_the_Disclosure_of_Risk_Information_in_the_Banking_Sector

[8]https://economictimes.indiatimes.com/markets/stocks/news/what-is-prompt-corrective-action/articleshow/58139512.cms

VII. RESTRICTIONS ON LENDING

- PCA has been imposed on 11 state-run banks, which did not meet RBI's predefined edges on either capital ampleness, asset quality or profitability.

- The thought behind this is banks preserve capital and recover their wellbeing, which implies that lending endures a shot.

Reality Check

- Analysis demonstrates that a long way from being excessively stringent, the central bank has indicated abstinence with a portion of the banks that are not effectively under PCA.
- No less than four additional banks should be rebuffed for not meeting the central bank's specified risk thresholds, if RBI pursues a strict guideline based methodology.
- These are Andhra Bank, Canara Bank, Punjab National Bank (PNB) and Union Bank of India.
- Each of these has broken the maximum permissible dimensions of 6% for net non-performing propels as a percentage of aggregate advances.
- RBI decides express that PCA can be imposed if any of the risk thresholds for capital, asset quality, profitability or use is broken.
- Anyway these banks met the minimum capital requirements expected to stay away from PCA.

Norms are Conservative

1. While recognition of NPAs has enhanced in the Indian banking system, provisioning norms are as yet conservative.
2. In jurisdictions where only capital ratios are considered in the PCA structure, NPA provisioning norms are increasingly stringent.
3. Perhaps RBI's self control has to do with an expectation that the legislature will recapitalize these banks, so that provisioning for their NPAs don't drag their capital down to low dimensions.

VIII. REGULATORY MECHANISM FOR FINANCIAL INSTITUTIONS

There is a huge bay between academic discourse on the financial regulation and real practice. The regulatory architecture for depository institutions demonstrated insufficient in the worldwide financial emergency.[9]The

[9]https://shasuncollege.edu.in/wp-content/uploads/2017/11/BANKING-THEORY-AND-REGULATORY-MECH_-05-2017-18.pdf

emergency began in non-deposit taking financial institutions, it spread to the managed deposit accepting entities with surprising deftness.

Basel II proved ineffective

- Basel-II, the international accord for managing an account direction that was formalized just before the beginning of the emergency, was a critical enhancement over its prior variant from numerous points of view
- Be that as it may, it gave inordinate circumspection to financial institutions for registering crucial parameters like hazard weights
- These parameters are imperative contributions to the computation of hazard weighted resources (RWAs), which thusly decided the dimension of required capital buffers
- In this, banks had a skewed motivator to think little of their hazard weights by utilizing complex models
- Moreover, different techniques used to process hazard weights implied that there was colossal fluctuation in revealed numbers, making any important correlation crosswise over banks for all intents and purposes unimaginable
- The hazard weight for the mortgage, the specific instrument that hastened the emergency, was lessened.

Improvements in Basel III

- It has ordered a higher capital adequacy ratio to ingest potential misfortunes beginning in both exchanging and saving money books, including extra capital conservation buffers
- The thought is that once this buffer is exhausted, regulators ought to be concerned
- The financial establishment must form its reserves previously it is permitted to appropriate its benefits by method for profits, share buybacks and worker rewards
- It has found a way to lessen the inconstancy of the risk-weighted assets by compelling the carefulness of banks
- For some, benefit classes, utilization of increasingly refined and complex models (purported "propelled approach") is prohibited
- In addition, numerous crucial parameters used to figure risk weights
- The acknowledgment that financial institutions can construct use while obviously conforming to capital adequacy standards has prompted the selection of new risk measurements, for example, use ratio which is coldhearted to exact risk weights

- Much of the time, banks developed unnecessary use while obviously keeping up solid risk-based capital ratios
- At the tallness of the emergency, financial markets constrained the saving money area to decrease its use in a way that intensified descending weights on resource costs
- This deleveraging procedure exacerbated the input circle between misfortunes, falling bank capital and contracting credit accessibility
- The requirement for an incorporated and undertaking level risk the executives approach is stressed
- Other than the capital necessity and new liquidity/use ratios, Basel-III imagines forward-looking supervisory control that incorporates occasional pressure testing
- It is trusted that these measures, together with compulsory divulgence prerequisites and related market discipline, will decrease the recurrence and seriousness of financial emergencies.

Banking Ombudsman Scheme

- Banking Ombudsman Scheme is a mechanism created by the RBI to address the complaints filed by the bank customers.[10]
- It is run directly by the RBI to ensure customer protection in the banking industry.
- The scheme was established under Section 35 A of the Banking Regulation Act, 1949 by RBI with effect from 1995. The present Ombudsman scheme was established in 2006.
- The Banking Ombudsman is a senior official appointed by the Reserve Bank of India to check the system.
- He also has the responsibility to redress customer complaints against deficiency in certain banking services.
- All Scheduled Commercial Banks, Regional Rural Banks and Scheduled Primary Co-operative Banks are includes under the Scheme.
- The Banking Ombudsman can either receive or consider any complaint relating to a number of deficiencies related to the banking operations including internet banking.

IX. CONCLUSION

The financial systems of the greater part of the developing countries are portrayed by conjunction and participation between the formal and informal financial sectors. The Indian financial system can likewise be extensively ordered into the formal (composed) financial system and the informal (disorderly) financial system.

[10]https://www.indianeconomy.net/splclassroom/banking-ombudsman-scheme/

In India, the financial part involves banking and non-banking financial foundations. There is no rigid standard to recognize banking and non-banking organizations. The banking system is at the core of the financial system. The Indian financial system involves an expansive number of commercial and cooperative banks specific formative banks for industry, agriculture and so forth. The Indian banking system has the Reserve Bank of India at the zenith. It is the operational hub of the Indian money related system. Since beginning, the RBI has been directing, observing, managing, controlling and advancing the predetermination of the financial system in India. The commercial banks encourage the financial improvement of a nation by steadfastly following the money related arrangement of the national bank i.e. RBI. Each specialist worried about Co-agent segment should have its impact in guaranteeing that the goals of the Urban Co-agent Banking segment are sustained in a way that investor premium and general society enthusiasm everywhere is ensured. The job of RBI could, in this manner, be to outline an administrative and supervisory routine that is multi-layered to catch the heterogeneity of the part and execute arrangements that would give sufficient breathing room to the area to develop in a non-disruptive way. The State and Central Governments could perceive that the UCBs are co-agent societies as well as they are basically banking substances whose administration structure is that of a co-agent. They ought to perceive the systemic effect that wasteful working of the elements in the division could have. Thus, it would be in light of a legitimate concern for the division in the event that they bolster, encourage and enable the RBI to set up components and systems that would empower these UCBs to play out their banking functions in a way that is in the general enthusiasm of the investor and the general population on the loose.

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