

Significance of RBI in India: An Analytical Study

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ABSTRACT

Banking law is the collection of legal principles which deals with almost every aspect of banking system. There are various types of banking system which are Scheduled Commercial Bank, Non Scheduled Commercial Bank, co-operative banks and development bank. At top there is Reserve Bank of India (RBI), is monetary authority of the nation and which performs the role of central banking of India. To study about the RBI it is not complete without the study of Banking law, Reserve Bank of India Act, Corporate law. RBI is regarded as the central banking authority of India which was established on 1935, under RBI Act 1934. The introduction briefly traces about the meaning of Banks, Banking system and Law of Banking. After that History of Indian Banking systems have been addressed. Then, the Regulating laws relating to Banking in India has been highlighted. This research paper also discussed about the Central Bank of India (RBI), RBI Act 1934 and the role of RBI in Indian Banking system and role of RBI in Economic development.

1. Introduction

The term bank is derived from French “banque”, from Italian word ‘banco’ meaning “desk/bench/table” used at the renaissance by Florentine bankers. In simple terms, a bank is a institution that accepts various types of deposits and then advances money in the forms of loans to people requiring it.¹ It is an old concept. It has a history from the past which developed with the civilization of humans. In past days, the word bank has limited concept which is related with money now a days, it has covered wider area and it has very wide scope. Bank is authorized body, which carry the business of banking. Banks are the financial institutions that are licensed to deal with money, deposits, providing loans and investment in securities. Business related with money is the basic nature of banking.²

Banks means a legal entity engage in the business of accepting deposits and using such funds to make extension of credit or investment for the accounts of the bank. It is a financial institution licensed to deposits and providing loan. It also provides financial services, such as management of wealth, exchange of currency and safe deposit lockers. In all countries, banks are ordered by the national government or central bank.³

Banking is the lifeline of any countries economy. The future and present of any countries economy depend upon the success and development of banking. A healthy and strong banking system is important requirement for economy growth of the country. Monetary policy of any country is directly related to economic development of the company where banks play major role. Today's Banking have become complicated with dissimilar products and services which stems from reliance on technological change which have shaped it from manual corporation into highly automated and technological

dependent.⁴ In general word, banking refers to the business transaction of taking and safeguard of the money which is owned by individual or entities, and investing out that money to earn profit. As the change of time all the work/transaction cover by banking business have grown/increased and various other services is also provided/given by banks. Banking services in recent days include safety of valuable items, issue of debit cards, lockers, ATM services and funds are online transferred around the country or world.

Regulations are the order which is designed to control the action of those to whom it applies. Regulations have to be followed and which are the official orders. Regulation can be defined as a methodical effort to affect the behavior of the people. Regulations are based on rules, which give clear and strict direction.⁵

Banking law refers to the legal aspect of the duties of the bank and legal aspect related to the various banking instruments. It impacts the banker customer relationship which is the collection of legal principles and impact on banking transaction. It regulates the founding, termination, supervision and operation of banks. It is the board word for laws which govern the business conduct of banks and financial institutions. Banks must follow all the federal, state and local regulations. Banking law is law relating to banking system and other financial institution which governs all the banking transactions. The law of banking is not a distinct area of law as like the law of contract or torts. It is set of legal principles which impact on transactions of banking and on the relationships of banker-customer. All the activities of banking system which have different range of legal rules cross each other which are called as banking law. All the legal rules are taken from various sources which are: common law, Merchant law, equity and statute. The Code of Banking Practice is a set of principles

¹Neelam C. Gulati, *Banking and Insurance Principles and Practices 4* (Excel books, New Delhi, 1st edn., 2011).

²Sanis Maharjan, *Law of Banking and Negotiable Instruments 8* (Lumbini Prakashan, Kathmandu, 2072).

³Supra Note 4, at 10.

⁴R.N. chaudhary, *Banking Laws 378* (central law publication, Allahabad, 3rd edn., 2014).

⁵Supra note 3, at 216.

which is legally enforceable and practices taken into the contract between the bank and its customers.⁶

Banking law consists of common law, rules of equity and statements. It is the law which governs the banking operations and transactions of banks and relationships between them. The law of banking emerges over the time in the commercial world which may be common law or customary law. All the statutes/rules passed by parliament which control the activities of the bank are law of banking. The operations of the banks are of great concern of all government around the world because of the role played by the banks to raise the nation's economy. For this reasons, there is provisions of legislations around the world for the monitoring and controlling all the operations of the banks.⁷

History of Indian banking system

The modern banking started in India from late 18th century. Bank of Hindustan which was the first bank was established in the year 1770. Banking systems play a vital role in the development of country and also in the monetary condition of the country. India has banking system from ancient times. For banking business separate provisions were made in companies Act 1913. In 1949 Indian Banking Act was passed which was renamed as the Banking Regulation Act in 1965. This act regulates the working of banks.⁸ As for the central banking authority Reserve Bank of India was established after 1935 after the Reserve Bank of India Act passed in 1934, the preamble of act highlights the object as to issue the notes and to take reserves for securing the monetary stability in the country and to control the currency and the system of credit of the country to the advantages. In 1949, the bank was nationalized. In India, the laws of the land governed all the banking practices. There is Reserve Bank of India guidelines and the code of conduct of the banks, which are the important aspects and which help to understand all the system of banking and the governing laws of them.⁹

Regulating laws relating to banking in India

- Banking Regulation Act 1949
- RBI Act 1934
- FEMA 1999
- Negotiable Instrument Act 1881
- Indian Partnership Act 1932
- Industrial Finance corporation of India Act 1948
- State Financial corporation Act 1951
- Companies Act 2013
- Banking Ombudsman Act 2006
- SARFAESI Act 2002
- Recovery of Debts Due to Banks and Financial Institution Act 1993
- NABARD Act 1981

⁶Elisabeth Wentworth, What is banking law?-Financial Ombudsman Scheme 1-2, available at: <http://www.fos.org.au/public/download/?id=2793> (visited on 30th Oct 2018).

⁷ Jemengick, Banking Law 1, available at: <https://www.scribd.com/doc/79242553/Banking-Law-20th-Sept-2011-Doc-Revised-3> (visited on 22nd Oct 2018).

⁸Banking Regulation Act 1949, available at: https://en.wikipedia.org/wiki/Banking_Regulation_Act,_1949 (visited on 27th Oct 2018).

⁹Supra note 3, at 418.

- The Nationalized Banks Scheme 1970

Central bank of India (RBI)

There are various types of banking system which are Scheduled Commercial Bank (SCBs), Non Scheduled Commercial Bank (NCBs), co-operative banks and development bank. At top there is Reserve Bank of India (RBI), is monetary authority of the nation and which performs the role of central bank of India. Central Bank (RBI) was established on April 1, 1935 under RBI Act 1934. On the recommendation of Royal commission on India currency and finance, this is known as John Hilton young commission 1926, RBI was established in 1935, under the RBI Act 1934. All the central banking functions were conducted by Imperial bank of India at that time. As the central bank of the nation RBI performs all the traditional functions of central bank as well as all the promotional and developmental functions.

At first, RBI was established as a private ownership bank having paid up capital of Rs 5 crores. Government of India transfer RBI from private ownership after the independence of the nation by passing the public ownership act 1948. The RBI started working as a nation owned central banking institutions from 1949, January 1, where the central office was established in Mumbai.¹⁰

The Reserve Bank of India Act, 1934

Reserve Bank of India (RBI) as the central bank of our country was established on 1st April, 1935 under the RBI Act, 1934. The RBI (central Bank) was settled by the recommendations of the Hilton young commission. All the statutory provisions of functions of bank are provided by RBI Act, 1934, which come in operation on 1st April, 1934. The three presidency banks were merged into the central bank by the recommendation of Chamberlain commission report of 1914. The legislation was introduced in January 1927, as the conduct of the commission report which set up the RBI; however, the enactment was come only after seven years in March 1934.¹¹

The preamble of the Act says that the central bank was create in India for the regulations of the issuance of the notes and to secure the monetary stability in the nation there was keeping of reserve and for the advantage to the credit system and to handle the currency of the nation, and in present about the disorganization of the monetary system around the world for the Indian monetary system what will be suitable as a permanent basis is not possible to determine, but it is fit for the existing monetary system to make temporary provision, and there is possibility to frame all the permanent measures as the international monetary position is becoming stable and clear where there is question relating to the monetary standard best suited to India. It extends to the whole of India.

The following objects manifest from the preamble of the act:

1. To issue bank notes
2. To strengthen the monetary condition of the country

¹⁰Supra note 3, at 418.

¹¹ Vinod Kothari, *Tanna's Banking Law and Practice in India* 162 (Lexis Nexis, Haryana, 26th edn., 2017).

3. To control the deposit fund and
4. To carry on the system of credit and currency for the benefit of the country.¹²

Role of central Bank in India

Reserve bank of India is India's central bank and apex bank in Indian banking system. For the development and assorting of the nation's economic conditions, for the durability of financial structure it plays a very important role.¹³ It not only performs the regulative role of credit controlling and management of currency in the nation's economy which maintain the value of the rupee which ensure the stability of price stability in the economy of the nation's. It also performs the functions of promoter of all the financial institutions over the nations all the related policies are formulated by the government of nations. At the time of establishment of RBI in 1935, India lacks all the developed commercial banking systems separately from the need of well developed money market in the nations. India takes an active pace for the development and promotion of all the financial institutions, after 1948 through which RBI can chase proper monetary policies and credit policies for economical expansion, developments and growths at the time of designed development of the economy of the nation.¹⁴ The various role of central bank (RBI) in India are as follows:

1. Role of RBI in Indian banking system
 - Monetary authority
 - Issuer of currency
 - Issuer of banking license
 - Banker's bank
 - Lender of last resort
 - Banker and debt manager of government
 - Controller of credit
 - Acts as clearing house
 - Manager of forex¹⁵
2. Role of RBI in development of economy
 - Advancement of banking system
 - Enlargement of financial institution
 - Development of backward areas
 - Stability of the Economy
 - Growth of Economy
 - Structure of the proper rate of interest¹⁶

2. Conclusion

It concludes that, RBI is India's central bank. It plays an important role to increase and improve the economy of the nation economic and all the financial structure of the nation. A central bank (RBI) is institution which manages the currencies, supply of money and rate of interest. RBI also oversees the commercial banking system of India. The primary role of RBI is to control the nation supply of money by setting the requirements of reserves, managing the rate of interest and to

act as a lender of last resort to the entire banking sector during time of bank insolvency or financial crisis. So, RBI performs both the role in Indian Banking system and role in Economic development of India.

¹² *Supra* Note 3, at 5.

¹³ Kunal Motwani, *Role of RBI in Indian Banking System* 22, available at: <https://www.slideshare.net/kunalmotwani1996/role-of-rbi-in-indian-banking-system-itt-presentation> (visited on 27th Oct 2018).

¹⁴ *Supra* note 3, at 437.

¹⁵ *Supra* note 13, at 23.

¹⁶ Ravi Teja, *Role of RBI in Indian Economy* 19, available at: <http://www.slideshare.net/raviteja1926/role-of-rbi-in-indian-economy-14920113> (visited on 27th Oct 2018).