



Study Notes

# RBI Act 1934

www.ixamBee.com

## Introduction

**Reserve Bank of India Act, 1934 was enacted on 6 March, 1934 to constitute the Reserve Bank of India. This law commenced from April 1, 1935. It provides framework for the supervision of banks and other related matters.**

- ✓ The Reserve Bank of India (RBI) is India's central bank, also known as **the banker's bank**.
- ✓ The RBI controls monetary and other banking policies of the Indian government.
- ✓ The Reserve Bank of India (RBI) was established on April 1, 1935, in accordance with the Reserve Bank of India Act, 1934.
- ✓ The Reserve Bank is permanently situated in Mumbai since 1937.
- ✓ The Reserve Bank is fully owned and operated by the Government of India.

## RBI ESTABLISHMENT

- ✓ The Reserve Bank's operations are governed by a central board of directors.
- ✓ RBI is on the whole operated with a 21-member central board of directors appointed by the Government of India in accordance with the Reserve Bank of India Act.
- ✓ The Central board of directors comprise of:

**Official Directors** – The governor who is appointed/nominated for a period of four years along with four Deputy Governors

**Non-Official Directors** – Ten Directors from various fields and two government Official

## AIM and OBJECT of the ACT:

It is expedient to constitute a Reserve Bank for India-

- ✓ to regulate the issue of Bank notes,
- ✓ keeping of reserves with a view to securing monetary stability in India
- ✓ to operate the currency and credit system of the country to its advantage;
- ✓ it is essential to have a modern monetary policy framework to meet the challenge of an increasingly complex economy;
- ✓ the primary objective of the monetary policy is to maintain price stability while keeping in mind the objective of growth;
- ✓ the monetary policy framework in India shall be operated by the Reserve Bank of India;

**Note:** To determine the aim and object of the act, refer its preamble.

## Chapter 1- Preliminary

### S.1 Short title, extent and commencement.

- (1) This Act may be called the Reserve Bank of India Act, 1934.
- (2) It extends to the whole of India
- (3) This section shall come into force at once, and the remaining provisions of this Act shall come into
  - force on such date or dates as the [Central Government]
  - may, by notification in the Gazette of India, appoint.

### S.2. Definitions

In this Act, unless there is anything repugnant in the subject or context:

- (a ii) “the Bank” means the Reserve Bank of India constituted by this Act;
- (a iii) “Bank for International Settlements” means the body corporate established with the said name under the law of Switzerland in pursuance of an agreement dated the 20th January, 1930, signed at the Hague;
- (b) “the Central Board” means the Central Board of Directors of the Bank;
- (b ix) “foreign currency” and “foreign exchange” have the meanings respectively assigned to them in the Foreign Exchange Regulation Act, 1973;
- (cc) “International Monetary Fund” and “International Bank for Reconstruction and Development” mean respectively the “International Fund” and the “International Bank”, referred to in the International Monetary Fund and Bank Act, 1945;
- (ccc) “National Bank” means the National Bank for Agriculture and Rural Development established under section 3 of the National Bank for Agriculture and Rural Development Act, 1981;
- (cccc) “National Housing Bank” means the National Housing Bank established under section 3 of the National Housing Bank Act, 1987;
- (d) “rupee coin” means rupees which are legal tender in India under the provisions of the Indian Coinage Act, 1906;
- (e) “scheduled bank” means a bank included in the Second Schedule;

**Note:** *The essential condition of capital is that, such banks have paid-up capital and reserves of not less than Rs.5 lakh. Bank which are not included in the 2nd Schedule of RBI are called Non-scheduled Bank.*

(eb) “State Bank” means the State Bank of India constituted under the State Bank of India Act, 1955;

(h) “agricultural operations”, “central co-operative bank”, “co-operative society”, “crops”, “marketing of crops”, “pisciculture”, “regional rural bank” and “State co-operative bank” shall have the meanings respectively assigned to them in the National Bank for Agriculture and Rural Development Act, 1981;

(i) “co-operative bank”, “co-operative credit society”, “director”, “primary agricultural credit society”, “primary co-operative bank” and “primary credit society” shall have the meanings respectively assigned to them in Part V of the Banking Regulation Act, 1949;

## Chapter 2- Incorporation, Capital, Management And Business

### - S.3. Establishment and incorporation of Reserve Bank.

(1) A bank to be called the Reserve Bank of India shall be constituted for the purposes of ***taking over the management of the currency from the Central Government and of carrying on the business of banking*** in accordance with the provisions of this Act.

(2) The Bank ***shall be a body corporate*** by the name of the Reserve Bank of India, having perpetual succession and a common seal, and shall by the said name sue and be sued.

### S.4. Capital of the Bank.

The capital of the Bank shall be ***five crores*** of rupees.

### S. 7. Management

(1) The ***Central Government may from time to time give such directions to the Bank*** as it may, after consultation with the Governor of the Bank, consider necessary in the public interest.

(2) ***Subject to any such directions, the general superintendence and direction of the affairs and business of the Bank shall be entrusted to a Central Board of Directors*** which may exercise all powers and do all acts and things which may be exercised or done by the Bank.

(3) Save as otherwise provided in regulations made by the Central Board, the Governor and in his absence the Deputy Governor nominated by him in this behalf, shall also have powers of general superintendence and direction of the affairs and the business of the Bank, and may exercise all powers and do all acts and things which may be exercised or done by the Bank.

### S. 8. Composition of the Central Board, and term of office of Directors.

- (1) The Central Board shall consist of the following Directors, namely:-
- (a) a **Governor and [not more than four] Deputy** Governors to be appointed by the Central Government;
  - (b) **four Directors** to be nominated by the Central Government, one from each of the four Local Boards as constituted by section 9;
  - (c) **[ten] Directors** to be nominated by the Central Government; and
  - (d) **[two Government officials]** to be nominated by the Central Government;
- (2) The Governor and Deputy Governors shall devote their whole time to the affairs of the Bank, and shall receive such salaries and allowances as may be determined by the Central Board, with the approval of the [Central Government]:
- Provided that the Central Board may, if in its opinion it is necessary in the public interest so to do, permit the Governor or a Deputy Governor to undertake, at the request of the Central Government or any State Government, such part-time honorary work, whether related to the purposes of this Act or not, as is not likely to interfere with his duties as Governor or Deputy Governor, as the case may be.
  - Provided further that the Central Government may, in consultation with the Bank, appoint a Deputy Governor as the Chairman of the National Bank, on such terms and conditions as that Government may specify.
- (3) A Deputy Governor and the Director nominated under clause (d) of subsection (1) may attend any meeting of the Central Board and take part in its deliberations but shall not be entitled to vote:
- Provided that when the Governor is, for any reason, unable to attend any such meeting, a Deputy Governor authorised by him in this behalf in writing may vote for him at that meeting.
- (4) The Governor and a Deputy Governor shall hold office for such term not exceeding five years as the [Central Government] may fix when appointing them and shall be eligible for re-appointment. A Director nominated under clause (c) of sub-section (1) shall hold office for a period of four years [and] [shall be eligible for reappointment]:
- Provided that any such Director shall not be appointed for more than two terms, that is, for a maximum period of eight years either continuously or intermittently.
- A Director nominated under clause (d) of sub-section (1) shall hold office during the pleasure of the [Central Government].
- (5) No act or proceeding of the Board shall be questioned on the ground merely of the existence of any vacancy in, or any defect in the constitution of, the Board.
- (7) A retiring Director shall be eligible for re-nomination.

### S.17. Business which the Bank may transact. (IMP)

- ✓ This section defines various types of business which RBI may transact, which include acceptance of deposit without interest from Central / State govt. purchase sale of forex, securities, rediscounting the bills, P/N, grant loans etc.
- ✓ It defines the manner in which the RBI (the central bank of India) can conduct business.
- ✓ The RBI can accept deposits from the central and state governments without interest.
- ✓ It can purchase and discount bills of exchange from commercial banks. It can purchase foreign exchange from banks and sell it to them.
- ✓ It can provide loans to banks and state financial corporations.
- ✓ It can provide advances to the central government and state governments.
- ✓ It can buy or sell government securities. It can deal in derivative, repo and reverse repo.

### S.18. Power of direct discount.

#### *s.18 deals with emergency loans to banks.*

When, ***in the opinion of the [Bank] a special occasion has arisen*** making it necessary or expedient that action should be taken [under this section] ***for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture***, the Bank may, notwithstanding any limitation contained in section 17, –

- (1) ***purchase, sell or discount any bill of exchange or promissory note*** though such bill or promissory note is not eligible for purchase or discount by the Bank under that section; or
- (3) ***make loans or advances to –***
  - (a) a ***State co-operative bank***, or
  - (b) on the recommendation of a State co-operative bank, ***to a co-operative society*** registered within the area in which the State co-operative bank operates, or
  - (c) ***any other person***, repayable on demand or on the expiry of fixed periods, ***not exceeding ninety days***, on such terms and conditions as the Bank may consider to be sufficient.

## Chapter 3- Central Banking Functions

### S. 21 – RIGHT TO TRANSACT GOVT. BUSINESS:

RBI to transact Govt. business in India is. ***Remittance, exchange, keeping deposit free of interest etc.***

(1) The [Central Government] shall entrust the Bank, on such conditions as may be agreed upon, with all [its] money, remittance, exchange and banking transactions in India, and, in particular, shall deposit free of interest all [its] cash balances with the Bank:

Provided that nothing in this sub-section shall prevent the [Central Government] from carrying on money transactions at places where the Bank has no branches or agencies, and they may hold at such places such balances as [it] may require.

(2) The [Central Government] shall entrust the Bank, on such conditions as may be agreed upon, with the management of the public debt and with the issue of any new loans.

(3) In the event of any failure to reach agreement on the conditions referred to in this section the [Central Government] shall decide what the conditions shall be.

[(4) Any agreement made under this section shall be laid, as soon as may be after it is made, before Parliament.]

## S. 22. BANK NOTES:

### ***Sole right to issue bank notes***

(1) The Bank shall have the sole right to issue bank notes in [India], and may, for a period which shall be fixed by the [Central Government] on the recommendation of the Central Board, issue currency notes of the Government of India supplied to it by the [Central Government], and the provisions of this Act applicable to bank notes shall, unless a contrary intention appears, apply to all currency notes of the Government of India issued either by the [Central Government] or by the Bank in like manner as if such currency notes were bank notes, and references in this Act to bank notes shall be construed accordingly.

(2) On and from the date on which this Chapter comes into force the [Central Government] shall not issue any currency notes.

## S. 23 ISSUE DEPARTMENT

Bank notes shall be issued by Issue Dept. against security of gold coins, bullion, rupee coins, foreign securities & other approved securities up to Rs. 200 cr.

(1) The issue of bank notes shall be conducted by the Bank in an Issue Department which shall be separated and kept wholly distinct from the Banking Department, and the assets of the Issue Department shall not be subject to any liability other than the liabilities of the Issue Department as hereinafter defined in section 34.

(2) The Issue Department shall not issue bank notes to the Banking Department or to any other person except in exchange for other bank notes or for such coin, bullion or securities as are permitted by this Act to form part of the Reserve.

## **S. 24 DENOMINATION OF NOTES**

RBI issues all currency notes for denomination of 2, 5,10,20,50,100, 200, 500, 1000, 2000, 5000,10000.

(1) Subject to the provisions of sub-section (2), bank notes shall be of the denominational values of two rupees, five rupees, ten rupees, twenty rupees, fifty rupees, one hundred rupees, five hundred rupees, one thousand rupees, five thousand rupees and ten thousand rupees or of such other denominational values, not exceeding ten thousand rupees, as the Central Government may, on the recommendation of the Central Board, specify in this behalf.

(2) The Central Government may, on the recommendation of the Central Board, direct the non-issue or the discontinuance of issue of bank notes of such denominational values as it may specify in this behalf.]

## **S. 28 – RULES FOR REFUNDING VALUE:**

RBI can frame rules for refunding value of mutilated, soiled or imperfect notes as a matter of grace.

Notwithstanding anything contained in any enactment or rule of law to the contrary, no person shall of right be entitled to recover from the [Central Government] or the Bank, the value of any lost, stolen, mutilated or imperfect currency note of the Government of India or bank note.

Provided that the Bank may, with the previous sanction of the [Central Government], prescribe the circumstances in and the conditions and limitations subject to which the value of such currency notes or bank notes may be refunded as of grace and the rules made under this proviso shall be laid on the table [Parliament].

## **S. 29 – Bank Notes Exempted from Stamp Duty under Indian Stamp Act.**

## **S. 31 – PROHIBITS ISSUE OF BEARER B/E, P/N PAYABLE TO BEARER:**

No person in India other than RBI or the Central Govt. is authorized to draw, accept make or issue any bill of exchange, hundi, Promissory note, drafts payable to bearer.

[(1)] No person in [India] other than the Bank or, as expressly authorized by this Act, the [Central Government] shall draw, accept, make or issue any bill of exchange, hundi, promissory note or engagement for the payment of money payable to bearer on demand, or borrow, owe or take up any sum or sums of money on the bills, hundis or notes payable to bearer on demand of any such person: Provided that cheques or drafts, including hundis, payable to bearer on demand or otherwise may be drawn on a person's account with a banker, shroff or agent.



[(2) notwithstanding anything contained in the Negotiable Instruments Act, 1881, no person in [India] other than the Bank or, as expressly authorised by this Act, the Central Government shall make or issue any promissory note expressed to be payable to the bearer of the instrument.]

[(3) notwithstanding anything contained in this section, the Central Government may authorize any scheduled bank to issue electoral bond.

**Explanation** - For the purposes of this sub-section, “electoral bond” means a bond issued by any scheduled bank under the scheme as may be notified by the Central Government.]

### SEC 33 ASSETS OF THE ISSUE DEPARTMENT:

The assets of issue dept. consist of gold coins, gold bullion, foreign securities etc. The aggregate value of gold coins, gold bullion, and foreign securities held as assets and the aggregate value of the gold coins, and gold bullion shall not at any time be less than Rs 200 cr. and Rs.115 crore respectively.

(1) The assets of the Issue Department shall consist of gold coin, gold bullion, [foreign securities], rupee coin and rupee securities to such aggregate amount as is not less than the total of the liabilities of the Issue Department as hereinafter defined.

[(2) The aggregate value of the gold coin, gold bullion and foreign securities held as assets and the aggregate value of the gold coin and gold bullion so held shall not at any time be less than two hundred crores of rupees and one hundred and fifteen crores of rupees, respectively.]

[(3) The remainder of the assets shall be held in rupee coin, Government of India rupee securities of any maturity, promissory notes drawn by the National Bank for any loans or advances under clause (4E) of section 17 and such bills of exchange and promissory notes payable in India as are eligible for purchase by the Bank under sub-clause (a) or sub-clause (b) or sub-clause (bb) of clause (2) of section 17 or under clause (1) of section 18.]

(4) For the purposes of this section, gold coin and gold bullion shall be valued at [a price not exceeding the international market price for the time being obtaining], rupee coin shall be valued at its face value, and securities shall be valued [at rates not exceeding the market rates] for the time being obtaining.

(5) Of the gold coin and gold bullion held as assets, not less than seventeen twentieths shall be held in [India], and all gold coin and gold bullion held as assets shall be held in the custody of the Bank or its agencies;

Provided that gold belonging to the Bank which is in any other bank or in any mint or treasury or in transit may be reckoned as part of the assets.

[(6) For the purposes of this section, the foreign securities which may be held as part of the assets shall be –

(i) securities of the following kinds payable in the currency of any foreign country which is a member of the International Monetary Fund, namely: –

(a) balances with the bank which is the principal currency authority of that foreign country and any other balances or securities in foreign currency maintained with or issued by the International Monetary Fund, the International Bank for Reconstruction and Development, the International Development Association or the International Finance Corporation [or Asian Development Bank] or the Bank for International Settlements or [any banking or financial institution [approved] by the Central Government] in this behalf, provided that they are repayable within a [period of ten years];

(b) bills of exchange bearing two or more good signatures and drawn on and payable at any place in that foreign country and having a maturity not exceeding ninety days; and

(c) Government securities of that foreign country maturing [within ten years];

(ii) any drawing rights representing a liability of the International Monetary Fund.]

### Short Notes on some important topics

- **Collection and furnishing of credit information.**

- ✓ The Reserve Bank is empowered to collect credit information from banking companies and to furnish such information in consolidated form to any banking company applying for the same along with the prescribed fee.
- ✓ The term credit information means any formation relating to –
  - (1) the amounts and the nature of loans or advances and other credit facilities granted by a banking company to any borrower or class of borrowers;
  - (2) the nature of security taken from any borrower or class of borrowers or credit facilities granted to him or to such class;
  - (3) the guarantee furnished by a banking company for any of its customers or any class of its customers;
  - (4) the means, antecedents, history of financial transactions and the creditworthiness of any borrower or class of borrowers; and
  - (5) any other information which the bank may consider to be relevant for the more orderly regulation of credit or credit policy.

- ✓ **Section 45-C** empowers the Reserve Bank to direct any banking company to submit to it statements relating to credit information in the specified time and form. Every banking company shall be bound to comply with such direction.
- ✓ **Under Section 45-D** a banking company may make an application to the Reserve Bank to furnish the applicant with such credit information as may be specified in the applications in connection with any person. The Reserve Bank shall furnish the credit information in its
  - ✓ possession but it shall not disclose the names of the banking companies which have submitted such formation to the Bank.
  - ✓ Any credit information submitted by a banking company to the Reserve Bank or by the Reserve Bank to any banking company shall be treated as confidential and shall not be published or disclosed except for the following purposes specified in the Act:
- **Publication (Declaration of Bank Rate)**
  - ✓ The Bank shall make public from time to time the standard rate at which it is prepared to buy or re-discount bills of exchange or other commercial paper eligible for purchase under this Act.
  - ✓ It is discussed under s.49 of the Act.
- **Cash Reserve Ratio-**
  - ✓ Consequent to GOI's notification of Sec. of RBI (Amendment) Act 2006 minimum statutory floor and ceiling limit no longer exists.
  - ✓ Further, no interest will be payable on CRR balances w.e.f. fortnight beginning 31 March 2007.
  - ✓ It is discussed under s.42(1) of the Act.
- **Independence of RBI**
  - ✓ Under **section 7 of the RBI Act**,
    - the central government may from time to time give such directions to the RBI as it may, after consultation with the Governor of the Bank, consider necessary in the public interest. Moreover, there is no legal act mandating autonomy of the RBI.
  - ✓ Yet, RBI has always been looked upon as an autonomous body which has under its umbrella all commercial banks, be it PSBs or private banks or foreign banks.
  - ✓ It is not only vested with the powers to formulate the monetary policy but also to monitor the functioning of all banks.
  - ✓ To play its role effectively, autonomy in its functioning is sine qua non for RBI.
  - ✓ However, the independence of RBI has been challenged many times due to a continued tug of war for wresting more power between the bank and the govt.

✓ **The main reasons for this have been:**

- RBI's failure to check the growth of Non-Performing Assets.
- Reduced liquidity in the economy due to tight monetary policy followed by RBI.
- Corrective measures taken by RBI to clean up the banking system which are not seen very positively by the government
- Clash between short term populist agenda of the government and long-term view for price stability taken by RBI.
- Regulation of Public Sector Banks: One important limitation is that the Reserve Bank is statutorily limited in undertaking the full scope of actions against public sector banks (PSBs) – such as asset divestiture, replacement of management and Board, license
- revocation, and resolution actions such as mergers or sales — all of which it can and does deploy effectively in case of private banks.
- Erosion of statutory powers of the central bank through piece-meal legislative amendments that directly or indirectly eat at separation of the central bank from the government.