UNIT- 3

REGULATORY INSTITUTIONS

Regulatory Institutions refers to those institutions who monitor or regulate other institutions in the same sector. Here we will be discussing three important regulatory Institutions viz.

1. RBI – Reserve Bank of India
2. SEBI – Securities Exchange Board of India
3. IRDA- Insurance Regulation and Development Authority

Reserve Bank of India

Early 1935, the functions of Central Bank were maintained by Government & Imperial Bank of India. Government of India was maintaining the functions of note issue, management of foreign exchange reserve etc. Imperial Bank of India was acting as banker to bank, banker to Government.

In **1926 "The Commission on Indian Currency & Finance"** was appointed which was headed by Edward Hilton Young. Thus committee is also called as "Hilton Young Commission". In 1926 this committee presented their report & strongly recommended to have Central Bank & in 1927 a bill introduced in assembly but this bill had not been taken its shape.

Again in 1934, September 8 new bill was introduced in assembly & which was approved & finally "The Reserve Bank Act" was passed. RBI started its function from 1st April 1935.

Initially RBI's head quarter was in Calcutta & after it has been permanently moved to Mumbai. Now head quarter of RBI is at Mumbai.

Constitution of RBI

RBI has been constituted as a corporate body having perpetual succession & a common seal. It was established with an authorized capital of 5crore divided in shares of 100 each. The bank was nationalized in 1949. The shares held by private individuals were taken over by the Government by paying compensation at the rate of 118 for every share of 100 held by shareholders.

Zonal Office

RBI has 4 zonal offices in Mumbai, Chennai, Kolkata & New Delhi.

Regional Office

RBI has 19 Regional Offices in major capital & main cities of many states.

Sub- Offices

RBI has 9 sub offices.

Academic Institutions

Reserve Bank Staff college at Chennai.

College of Agricultural Banking at Pune.

Organization & Management

The general affairs & business of the bank is managed by the Central Board of Directors having 20 members. The members include the following

1. A Governor& not more than 4 deputy governors to be appointed by the Central Government.
2. Four directors to be nominated by the Central Government, one each from the 4 local boards

3. 10 directors to be nominated by the Central Government.
4. One Government official to be nominated by the Central Government.

Functions of RBI

1. **Banker to Government**

   RBI acts as banker to the Government. RBI maintains the account of Government & operates the same. It acts as an agent of Government of India in the dealings with IMF, World Bank & other International Financial Institutions. It maintains foreign exchange transaction on behalf of the Government.

2. **Banker's Bank**

   RBI acts as Banker's Bank which regulates all commercial & co-operative banks in India. In order to establish any banks in India it is mandatory to take permission & license from RBI as per section 22 of Banking Regulation Act & to establish new branch the bank should obtain permission under section 35 of Banking Regulation Act.

3. **Advisor to the Government**

   Like all central banks, the RBI acts as advisor to Government not only on banking & financial matters but also on wide range of economic issues including those in the field of planning & resource mobilization. It has of course a special responsibility in respect of financial policies & measures concerning new loans, agricultural finance, etc.

4. **Statutory Banker**

   The Reserve Bank of India is statutory banker to the Government of India. It is also banker to the state Government as per agreements signed with them. In this capacity

it holds their cash reserves, lends them funds for short term & provides economical & efficent central clearing & remittance facilities.

5. **Lender of last Resort**

   It is lender of the last resort for the scheduled commercial banks in India. It provides credit to these banks through rediscounting facility. It is called lender of last resort as normally the banks are expected to meet their requirements from sources other than the Reserve Bank of India.

6. **Supervision of Banks**

   The Reserve Bank's responsibilities include, in addition to the traditional central banking functions, the development of an adequate & sound banking system for catering to the needs of trade, commerce, industry & agriculture.

7. **Controller of Money Supply & Credit**

   One of the most important functions of the Reserve Bank of India is to control the money supply & credit in the economy. This becomes all the more important as India is following the managed paper currency system which has inherent inflationary tendency.

8. **Foreign Exchange Control & Management**

   The Reserve Bank of India is the custodian of the country's foreign exchange reserve. It manages the exchange control. Exchange control was first imposed in India in September 1939. The Reserve Bank of India acts as the agent of the Government of India in connection with membership of the International Monetary Fund.

9. **Monetary Data & Publications**

   The Reserve Bank of India is the main source of monetary data & also of the data relating to banking, the data are very important for framing the economic policies &

banking policies. The Bank collects & publishes the data regularly through weekly statements, monthly, bulletins, annual report etc.

10. Promotional Functions

In addition to the usual central banking functions, the Reserve Bank of India has been performing a variety of promotional functions.

!. Promotion of Commercial Banking

!!. Promotion Agriculture & Rural Credit

!!!. Promotion of Industrial Finance

!v. Promotion of Finance for Exports etc.

11.Currency authority/ function of note issue:

The Reserve Bank of India is the sole authority for the issue of currency in India other than on rupee coins/ notes & subsidiary coins, the magnitude of which is relatively small.

Note issue process of RBI

The note issue process of RBI is done through two departments, namely issue department & Banking department

Issue Department

Issue department issues currency notes. Currency notes are issued by backing equal value of assets. Here assets refers to gold, bullion, foreign securities, Government securities etc.

Banking Department

Banking department takes care of banking operations. It releases the currency for circulation & withdraws currency from circulation. The process of issuing new

currency for circulation is called Expansion of currency. The process of withdrawing currency from circulation is called Contraction of Currency.

Principles of Note Issue

a. Currency Principle

Under this principle RBI has to maintain 100% reserves to issue currency notes. Here each & every currency notes are to be backed by same value of gold reserve.

b. Banking Principle

Under the Banking Principle RBI has no need to maintain 100% gold reserve to issue currency notes. A certain percentage of currency notes can be backed by gold & remaining portion of currency notes can be backed by securities.

Methods of Note Issue

a. Fixed fiduciary method

Under this method RBI fixes certain limit, that limit is known as fiduciary limit. Up to this limit RBI can issue notes by reserving securities & beyond the limit of note issue must be backed by gold. This method of note issue is called Fixed fiduciary method.

b. Proportionate Reserve System

Under this method certain percentage of note issue can be backed by gold & remaining percentage of the note issue can be backed by securities. Here currency issue is being proportionated usually 25% to 40% of the note issue will be backed by gold & remaining percentage will be backed by securities.

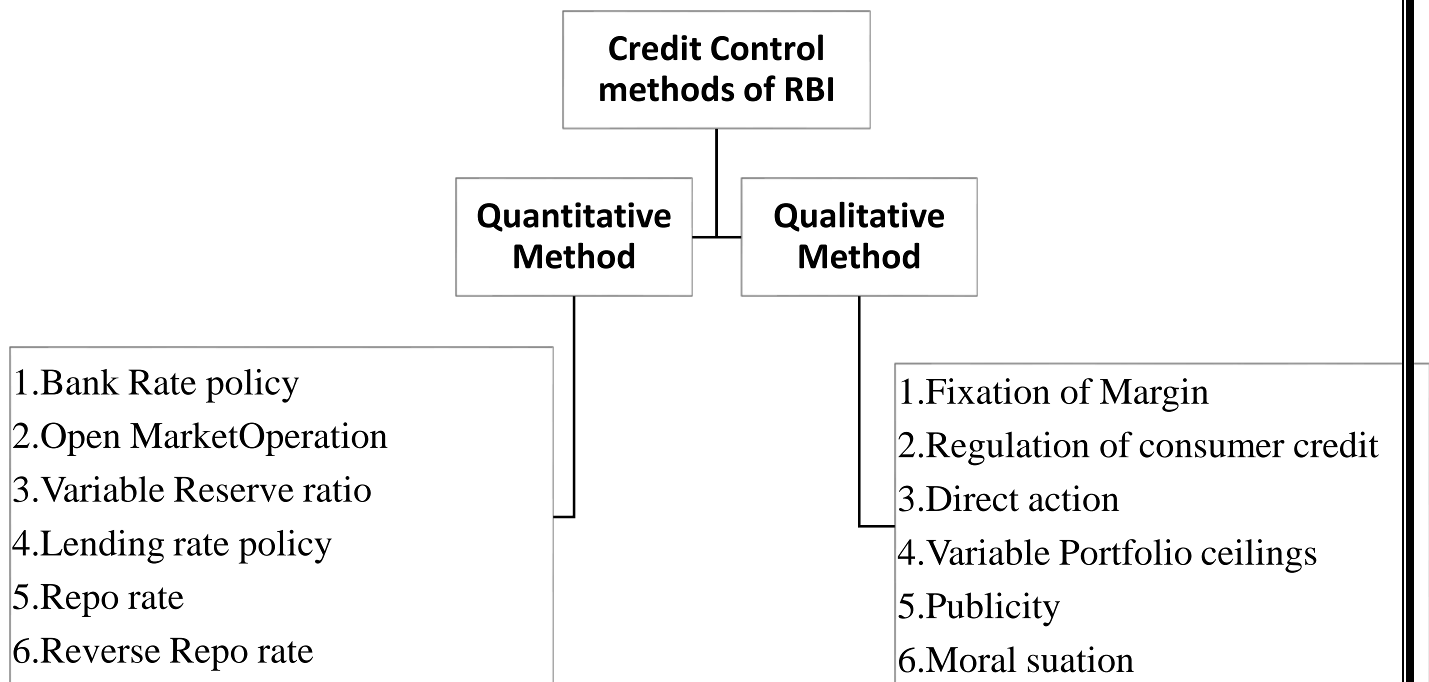
c. Minimum Reserve System

Under this system minimum amount of reserve can be maintained against all note issue. Here there is no maximum limit to issue currency notes, any quantity of note issue can be issued & irrespective of note issue only a minimum percentage of

currency will be backed by reserves usually 20% to 30% note issue will be backed by reserve.

RBI adopted this method since 1957. It maintains Gold & Foreign reserve of 200 crore to issue notes. Out of which 115 crores must be in the form of gold.

Credit Control methods of RBI:



The various methods employed by the RBI to control credit creation power of the commercial banks can be classified in two groups, viz., quantitative controls and qualitative controls. Quantitative controls are designed to regulate the volume of credit created by the banking system. Qualitative measures or selective methods are designed to regulate the flow of credit in specific uses.

➢ Quantitative Method

(i)**Bank rate policy: (5.65% -2019)**

on the loans from or rediscounts of the Central Bank. A change in bank rate affects other market rates of interest. The bank rate, also known as the discount rate, is the rate payable by commercial banks.

At the time of inflation RBI increases the bank rate, higher the bank rate reduces the amount of the commercial bank which automatically reduces the capacity to lend. At the time of deflation, RBI reduces the bank rate and facilitates banks to increase its lending capacity. An increase in bank rate leads to an increase in other rates of interest and conversely, a decrease in bank rate results in a fall in other rates of interest.

(ii) **Open Market Operations:**

Open market operations refer to the sale and purchase of securities by the Central bank to the commercial banks. If RBI wants to decrease the money supply it compel commercial bank and other institution to purchase treasury bills and other financial instrument which is there with RBI. So money in the hands of commercial bank will flow to RBI.

On the other hand to increase money supply RBI re-purchase treasury bills & other Govt. securities from commercial bank & other financial institution and increases the lending capacity. It will reduce the deflation situation.

(iii) **Variable Reserve Ratios:**

Variable reserve ratios refer to that proportion of bank deposits that the commercial banks are required to keep in the form of cash/liquid assets to ensure liquidity for the credit created by them.The Reserve Bank employs two types of reserve ratio for this purpose, viz. the Cash Reserve Ratio (CRR) and the Statutory Liquidity Ratio (SLR).

Cash Reserve Ratio:4%

The cash reserve ratio refers to that proportion of the aggregate deposits which the commercial banks are required to keep with the Reserve Bank of India. High rate of CRR enables less lending capacity and vice versa.

Statutory Liquidity Ratio: (18.75% -2019)

The statutory liquidity ratio refers to that proportion of aggregate deposits which the commercial banks are required to keep in a liquid asset form. These liquid assets equal to 20% of their total demand deposit & time deposit. The commercial banks generally make use of this money to purchase the government securities.

Higher the SLR rate reduces the bank lending capacity due to less liquidity. Lower the SLR rate increases bank lending capacity.

(iv) Lending Rate policy:

It is standard interest rate fixed by RBI on commercial bank to lend loan. At the of inflation normally RBI increases the lending rate which reduces the money supply due to hesitation of the people to take loan.

At the time of deflation RBI decreases the lending rate, lower rate of interest attracts more borrower which results in increase in money supply.

(v) Repo rate: (5.15% - 2019)

It is a rate which RBI lends amount to commercial bank. Higher the Repo rate does not attracts the commercial banks to borrow money from RBI which reduces the capacity of

the banks to lend amount to public. On the other hand lower the Repo rate attracts commercial bank and money flow from RBI which increases the lending capacity of banks.

(vi) Reverse repo rate:(4.90% -2019)

It is a rate at which RBI borrows money from commercial bank. When RBI feels to reduce money supply in the economy it increases the reverse repo rate. Then all commercial banks would like to lend more amounts to RBI.Hence money flow from commercial bank to RBI and liquidity position with RBI reduces.

On the other hand if RBI reduces Reverse repo rate commercial bank will not lend money to RBI but they lend it to others. Hence money supply will be increased.

II. Qualitative Method/ Selective Methods

This was adopted by RBI in view of economic stabilization as part of credit management.

(i) **Fixation of margin:**

Changes in margin requirements are designed to influence the flow of credit against specific commodities. The commercial banks generally advance loans to their customers against some security or assets. More generally, the commercial banks do not lend up to the full amount of the asset value but lend an amount less than its value. Example if borrower takes 10,000 loan, he has to pledge 12,000 worth of asset document.

The margin requirements against specific securities are determined by the Central Bank(RBI). A rise in the margin results in less loans because borrower may not afford more value of the security/asset and similarly, a fall in the margin requirement results in expansion in the borrowing or more loan.

(ii) Regulation of Consumer Credit:

Regulation of consumer credit is designed to check the flow of credit for consumer durable goods. Central Bank imposes strict credit policy to restrict money supply. At the time of deflation itliberalizes loan conditions to stabilize the economy.

(iii) Direct Action:

Under Banking Regulation Act, RBI has power to take strict action on any commercial bank which is against RBI's policies. Each and every bank has to obey the rules imposed by RBI otherwise the bank will be punished severely.

(iv) Variable Portfolio ceilings:

Under this method RBI fixes maximum loan limit which can be lent by commercial banks to various sectors and commercial banks should not exceed the ceiling limit.

(v) Publicity:

RBI prints periodical bulletins and articles through which it highlights the economic conditions and advises the banks regarding their lending policy and also creates awareness among public about economic conditions.

(vi) Moral Suasion: Moral suasion and credit monitoring arrangement are other methods of credit control. The policy of moral suasion will succeed only if the Central Bank is strong enough to influence the commercial banks. Moral suasion implies persuasion and request made by RBI to follow certain policies, in this method, there is no compulsion to follow.

SECURITIES EXCHANGE BOARD OF INDIA (SEBI)

The capital market in India has witnessed tremendous growth since the beginning of 1990s when the process of liberalization initially was started. Under the impact of liberalization the industrial and financial policies were restructured. Resource mobilization in the stock markets was started increasing significantly. The liberalized investment policy of the Government, streamlining of industrial licensing policies and fiscal incentive to industry have led to the growth of the capital market significantly.

With ever expanding response of investors and growing stock exchange operations, several malpractices started taking place on the part of companies, brokers, investment consultants. Some of the undesirable practices like insider trading, delay in allotment of shares, inadequate information to investors started disturbing the smooth functioning of the market. This has started discouraging the common investor from investing into securities. Hence, there felt the need to set up an exclusive monitoring institution which would regulate the working of stock exchange.

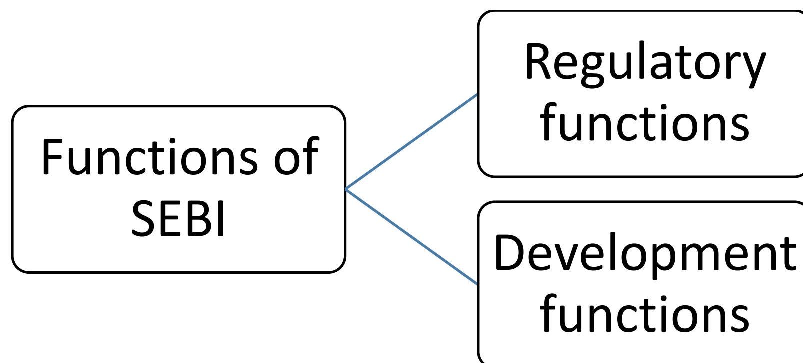
The Government of India established the market watchdog SEBI i.e. Securities and Exchange Board of India (SEBI) **in April 1988**. SEBI as security exchange board of India became a statutory body under SEBI Act 1992, and its head office is located at Mumbai. At present SEBI has offices in Mumbai, Calcutta, New Delhi and Chennai.

Objectives of SEBI:

- To provide protection to the investors and protect their rights and interests so that there is a steady flow of savings into the market.
- To promote fair dealing by the issuers of securities and to ensure a market place where companies or institutions can raise funds at a relatively low cost.

- To regulate and develop a code of conduct and fair practice by intermediaries like brokers etc. with a view to make them competitive and professional.
- To promote efficient services by brokers, merchant bankers & other intermediaries.
- To promote orderly & healthy growth of the securities market in India.
- To provide suitable education & guidance to investors so as to enable them to protect their interest.

Functions of SEBI:



Regulatory functions:

- Regulating the business in stock exchanges and any other securities market.
- Registering and regulating the working of stock brokers, share transfer agents, sub brokers, bankers to an 'issue, etc.
- Promoting and regulating self-regulatory organizations.
- Prohibiting fraudulent and unfair trade practices relating to securities market.
- Registering and regulating the working of venture capital funds and collective investment schemes including mutual funds.
- Prohibiting insider trading in securities.

Development Functions

- Promoting investors education and training of intermediaries of securities market.
- Conducting research and carrying out publications.
- Calling for information from undertaking inspection, conducting inquiries and audits of stock exchanges and market intermediaries.

Powers of SEBI

SEBI has been given wide powers. Some of them are as follows.

- SEBI can ask stock exchanges to maintain the prescribed documents and records.
- SEBI may ask a stock exchange or any member to furnish information and explanation concerning its affairs.
- SEBI can approve and amend bye-laws of stock exchanges. It can call periodical returns from stock exchanges.
- SEBI can license dealers in securities in some areas.
- It can ask a public limited company to list its shares and play supportive role when share market -is bearish. When an individual investor and even speculators hesitate to transact in stock market, it is the institutional investor who often accounts for bulk of trade. This helps sustaining for stock exchanges.

Insurance Regulation and Development Authority (IRDA)

IRDA is an autonomous apex statutory body which regulates and develops the insurance industry in India. The IRDA Act 1999 was passed as per the major **recommendation of the**

Malhotra Committee report-1994. Later IRDA was incorporated as an independent statutory body in **April,2000.**

It serves as an authority to protect the interests of holders of insurance policies, to regulate, promote and ensure orderly growth of the insurance industry. Its Headquarters located at Hyderabad and Andra Pradesh.

Objective: To protect the interest of the policy holder and governing insurance industry across India.

The functions/Duties and powers of the Authority:

- Protecting the interests of the policyholders in matters concerning assigning of insurance policy, nomination by policyholders, settlement of insurance claim, insurable interest, surrender value of policy and other terms and conditions based on contracts of insurance.
- Promotion of efficiency in the conduct of insurance business.
- Controlling and regulation of the insurers/Insurance Companies and Intermediaries.
- Calling for data or information from, undertaking inspection of, conducting enquiries and investigations, conducting audit of the insurers, intermediaries