

RBI'S REGULATORY FRAMEWORK: BALANCING STABILITY AND GROWTH IN INDIAN BANKING

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ABSTRACT

The Reserve Bank of India (RBI), as India's central banking authority, plays a pivotal role in balancing financial stability with economic growth. Its regulatory framework is built upon a combination of microprudential, macroprudential, and developmental measures that aim to ensure a sound, resilient, and inclusive banking system. In a diverse and fast-growing economy like India's, the central challenge lies in maintaining banking sector discipline while enabling the flow of credit necessary for growth and innovation. RBI's framework includes capital adequacy norms under Basel III, the Prompt Corrective Action (PCA) mechanism, asset quality reviews, and dynamic provisioning norms to guard against systemic risks. Simultaneously, it fosters growth by encouraging financial inclusion, digital banking innovation, and calibrated deregulation. Through instruments like the Liquidity Adjustment Facility (LAF), Statutory Liquidity Ratio (SLR), and repo operations, RBI manages liquidity to support economic activity while curbing inflationary pressures. Case studies such as the resolution of Yes Bank, the IL&FS crisis, governance actions against IndusInd Bank, and regulatory tightening on NBFCs illustrate how RBI has intervened decisively to contain risk while preserving market confidence. Moreover, its recent focus on digital banking norms, climate risk disclosures, and fintech oversight shows its adaptive approach in the face of emerging challenges.

RBI's regulatory architecture has grown more proactive, data-driven, and responsive over time, incorporating stress testing, supervision technology (SupTech), and cross-sector coordination. This evolution reflects its aim to create a banking environment that is not only stable but also agile and growth-supportive. RBI's ability to balance prudence with flexibility ensures that the Indian banking system remains robust in times of crisis and responsive during economic expansion, aligning with national development goals.

Keywords: RBI, Regulatory Framework, Stability, Growth, India and Banking

1. INTRODUCTION

The Reserve Bank of India (RBI) is the central bank of India, established on April 1, 1935, under the Reserve Bank of India Act, 1934. Initially set up as a private shareholders' bank, it was nationalized in 1949 after India's independence, making it a fully government-owned institution. The RBI was conceptualized based on the recommendations of the Hilton Young Commission and was initially headquartered in Kolkata before shifting to Mumbai in 1937, where it remains today. RBI's primary mandate is to regulate the issue and supply of the Indian rupee, maintain monetary stability, supervise the banking sector, and manage foreign exchange. Over time, it has evolved into a key institution supporting the Indian economy through monetary policy, financial regulation, and developmental roles, including fostering financial inclusion and innovation.

Structurally, the RBI is governed by a Central Board of Directors appointed by the Government of India. The board includes the Governor, up to four Deputy Governors, and other directors representing various sectors and regions. The RBI functions through 27 regional offices across India and is organized into departments that manage specific functions like currency management, banking regulation, financial markets, and research. The RBI also oversees specialized subsidiaries, such as the Deposit Insurance and Credit Guarantee Corporation (DICGC) and Bharatiya Reserve Bank Note

Mudran Private Ltd. (BRBNMPL). With autonomy in monetary policy but accountability to the Parliament, the RBI plays a critical role in balancing economic growth and financial stability in India.

1.1. OBJECTIVE OF THE STUDY

This study examines how the Reserve Bank of India (RBI) balances financial stability and economic growth through its regulatory framework.

2. RESEARCH METHODOLOGY

This study is based on secondary sources of data such as articles, books, journals, research papers, websites and other sources.

2.1. RBI'S REGULATORY FRAMEWORK: BALANCING STABILITY AND GROWTH IN INDIAN BANKING

India's central banker since 1935, the RBI has long pursued twin mandates: ensuring financial stability and supporting growth by guiding credit and liquidity conditions. Over time it has added a third objective: financial stability in an increasingly complex financial system. It employs a broad array of macroprudential and microprudential tools, stress tests, supervisory frameworks, and governance rules to strike this balance. A central tension emerges: imposing measures like capital buffers or lending restrictions enhances safety but can dampen credit flow—which supports growth. The RBI calibrates these trade offs dynamically over time.

3. CAPITAL ADEQUACY AND PROACTIVE OVERSIGHT

Under Basel III norms adopted by the RBI, banks are required to maintain strong capital buffers—common equity tier 1, capital risk ratios, countercyclical reserves—to ensure resilience against shocks. The RBI's Revised Prompt Corrective Action (PCA) framework activates supervisory measures when banks breach thresholds on capital, NPAs or profitability, restricting dividends, lending, and even management actions to prevent failure and protect depositors. Yes Bank (restructured 2020), When the bank's asset quality deteriorated and liquidity evaporated, the RBI superseded the board, imposed a moratorium, capped withdrawals, and oversaw a reconstruction plan supported by SBI and other banks. This intervention prevented broader contagion while safeguarding depositors—even as loan growth was curtailed during the process.

4. LIQUIDITY RISK FRAMEWORKS AND STRESS TESTING

Given the dominance of deposit funded banking, liquidity management is critical. RBI mandates that banks maintain statutory liquidity ratio (SLR) and cash reserve ratio (CRR) buffers, and monitors liquidity coverage ratios (LCR), net stable funding ratios, and intraday liquidity positions. Banks undergo rigorous liquidity stress tests and contingency funding plans. Yes Bank again provides a lesson: RBI's liquidity stress testing identified critical vulnerabilities—heavy wholesale funding, rising NPAs, and lack of contingency planning—which precipitated urgent intervention under its liquidity and capital frameworks.

Similarly, the IL&FS crisis (2018) revealed that NBFCs—outside direct RBI control—had severe asset liability mismatches. The RBI extended its stress testing to NBFCs and provided emergency liquidity windows, then tightened liquidity rules sector wide.

5. ASSET QUALITY, NPA RESOLUTION, AND GOVERNANCE

Non performing loans were a systemic challenge post 2015. RBI reinforced frameworks via PCA, increased provisioning norms, and supported the Insolvency and Bankruptcy Code (IBC). From 2018 to 2023, gross NPAs of scheduled commercial banks fell sharply (from ~11.2% to ~3.9%) due to these measures. Beyond NPAs, governance lapses trigger regulatory enforcement. In IndusInd Bank's derivatives scandal (2023), failure to mark to market foreign currency swaps concealed losses. RBI expanded forensic audits, asked executives to step down, and reaffirmed

governance oversight to prevent recurrence. Cooperative banks show regulatory vigilance too. For instance, in Dr Babasaheb Ambedkar UCB, RBI imposed penalties for lending norm violations, under its Supervisory Action Framework; while minor, it underscores preventive regulation to curb malfeasance early. Historical cooperative bank crises—like Madhavpura Mercantile Cooperative Bank (2001) and Pratibha Mahila Sahakari Bank (2003)—demonstrate RBI's decisive powers: restricting operations, revoking licenses, superseding boards when governance failures and insider connected lending triggered deposit runs and collapse.

6. MACROPRUDENTIAL TOOLS, DIGITAL BANKING, AND INNOVATION

RBI deploys sector wide instruments like counter cyclical capital buffers, risk weights, and concentration norms to contain systemic leverage. Between 2004 and today, countercyclical tools have been increasingly used to modulate credit growth in response to credit cycles. On innovation, RBI strives to foster fintech and digital banking while ensuring safety. It created a Regulatory Sandbox (2019), digital lending guidelines (2022), and cybersecurity frameworks; it has intervened when compliance lapses occurred. For instance, Paytm Payments Bank was restricted over KYC and cyber concerns, until remediation.

On July 2023, RBI issued draft norms to prohibit cross selling of third party products on digital platforms, require clear customer choice between view only and transactional modes, and mandate consent and enhanced risk checks—seeking greater consumer protection in digital banking.

7. REGULATING NBFCs AND SCALE BASED MEASURES

As NBFCs gained scale, RBI introduced a scale based regulatory structure in 2022: dividing NBFCs into base, middle and upper layers according to systemic importance. Upper layer NBFCs (like Bajaj Finance) now follow stricter governance and risk rules, including board approved policies. RBI enforces: four NBFCs were recently barred from lending due to high interest rates; others face curbs if they pursue growth at the cost of stability. This approach reflects RBI's balancing act: allowing innovation but preventing shadow banking risks that could propagate contagion.

8. MERGERS, CONSOLIDATION, AND ORDERLY RESOLUTION

To address weak banks, RBI over the years has orchestrated reorganizations. In 2019, it merged Dena Bank and Vijaya Bank into Bank of Baroda. In 2020, the Lakshmi Vilas Bank crisis led to its merger with DBS Bank India. In each case, RBI intervened under reconstruction schemes to preserve depositor interest and systemic continuity. Mergers involve coordination between RBI and the Competition Commission of India, under the Banking Regulation Act—balancing consolidation, competition, and governance norms.

9. CRITIQUES, TRADE OFFS AND ADAPTIVE REGULATION

Critics argue that excessive conservatism (tight risk weights, caps, provisioning) can stifle credit to growth sectors; yet too lenient a posture risks crises—as seen in past bank failures. RBI continually reviews regulations through its Review Authority (RRA) to streamline rules and reduce burden, while preserving oversight. There is also regulatory arbitrage: NBFCs and fintechs may escape full coverage; RBI is expanding its perimeter by extending stress testing and supervision

10. CONCLUSION

The Reserve Bank of India's regulatory framework is a dynamic balancing act between preserving financial stability and promoting economic growth. By embedding global standards like Basel III and crafting India-specific instruments such as the PCA framework, liquidity buffers, and risk-weighted lending norms, the RBI has created a resilient structure capable of absorbing shocks without stifling innovation or access to credit. Its proactive approach—evident in the resolution of distressed banks, supervision of NBFCs, and evolving guidelines on digital finance—demonstrates both foresight and adaptability. RBI's commitment to financial inclusion, sustainable banking, and governance reform further ensures that growth is equitable and robust. While the Indian banking sector has faced several challenges—from high

NPA's to digital disruption—the RBI's regulatory interventions have played a critical role in maintaining trust, insulating the system from contagion, and encouraging long-term structural reform. By continuously updating its regulatory perimeter and enhancing transparency, the RBI secures the dual objectives of monetary stability and inclusive development. As the financial ecosystem grows increasingly complex, RBI's balanced and adaptive regulatory stance will remain central to ensuring that India's banking sector continues to support the country's broader economic aspirations while maintaining public and investor confidence.

CONFLICT OF INTERESTS

None.

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