



# RBI to Review Framework on Liquidity Coverage Ratio

[Source: LM](#)

## Why in News?

The [Reserve Bank of India \(RBI\)](#) is likely to review the framework on [Liquidity Coverage Ratio](#) for better management of liquidity risk by banks.

- Recent incidents in certain jurisdictions, like **Silicon Valley** and Signature Bank in the US, have shown the **potential for quick fund withdrawals through digital banking channels during stressful times**.
- The RBI Governor highlighted the need to reevaluate the LCR framework in response to these emerging risks.

## What is the Liquidity Coverage Ratio (LCR)?

- The LCR was introduced as part of the [Basel III reforms](#) following the 2008 global financial crisis.
- The LCR is a ratio that measures the proportion of [high-quality liquid assets \(HOLA\)](#) that financial institutions hold.
- Banks covered under the LCR framework **must maintain a stock of HOLA to cover 30 days' net outflow under stressed conditions**, with a minimum LCR of 100% since 1<sup>st</sup> January 2019.
  - HOLA are liquid assets that can be **sold immediately or converted to cash at little or no loss of value**. HOLA can also be used as collateral for borrowing purposes.
  - HQLAs include cash, short-term bonds, and other cash equivalents, as well as excess [Statutory Liquidity Ratio \(SLR\)](#), [Marginal Standing Facility \(MSF\)](#) assets and the **Facility to Avail Liquidity for Liquidity Coverage Ratio (FALLCR)** (set at 15% of the bank's deposits since 1st April 2020).
- The LCR is a **preventive measure** that can be beneficial for a bank during a financial crisis.
- **Limitation:** The LCR may lead to banks holding more cash and issuing fewer loans, potentially slowing economic growth.
- **Status of LCR:** [Scheduled Commercial Banks](#) currently maintain an LCR of 131.4%, significantly above the minimum requirement of 100%.

**LCR = High-Quality Liquid Asset Amount (HQLA) / Total Net Cash Flow Amount**

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# QUANTITATIVE INSTRUMENTS OF MONETARY POLICY



## LIQUIDITY ADJUSTMENT FACILITY (LAF)

- € **Repo Rate (RR):** The rate at which the RBI lends money to commercial banks. Here, RBI **purchases securities**.
- € **Reverse Repo Rate:** The rate at which the RBI borrows money from commercial banks within the country. **Opposite of Repo.**
- € If RBI wants to signal **tight monetary policy**, it will **increase the repo rate**; banks will **increase their lending rates**.



## BANK RATE

- € It is a **long-term rate (RR is short-term)** at which the central bank lends money to other banks.
- € **Increase in Bank rate** will increase the **interest rates on the Loans /Deposits** and vice versa.



## STATUTORY LIQUIDITY RATIO (SLR)

- € SLR is the minimum percentage of deposits that a commercial bank has to **maintain in the form of liquid cash, gold or other securities**.
- € If RBI wants to **tighten the monetary policy**, it will **raise the SLR**.



## CASH RESERVE RATIO (CRR)

- € Banks are required to hold a certain proportion of their deposits in the form of **cash with RBI**.
- € With the **increase in CRR**, banks **increase the lending rates**.



## OPEN MARKET OPERATIONS (OMOS)

- € These include **purchase/sale of government securities** by the Central Bank for **injection/absorption of durable liquidity** in the banking system.



## UPSC Civil Services Examination, Previous Year Questions (PYQs)

### Prelims

**Q. Which of the following statements is/are correct regarding the Monetary Policy Committee (MPC)? (2017)**

1. It decides the RBI's benchmark interest rates.

2. It is a 12-member body including the Governor of RBI and is reconstituted every year.
3. It functions under the chairmanship of the Union Finance Minister.

**Select the correct answer using the code given below:**

- (a) 1 only
- (b) 1 and 2 only
- (c) 3 only
- (d) 2 and 3 only

**Ans: (a)**

**Q. If the RBI decides to adopt an expansionist monetary policy, which of the following would it not do? (2020)**

1. Cut and optimize the Statutory Liquidity Ratio
2. Increase the Marginal Standing Facility Rate
3. Cut the Bank Rate and Repo Rate

**Select the correct answer using the code given below:**

- (a) 1 and 2 only
- (b) 2 only
- (c) 1 and 3 only
- (d) 1, 2 and 3

**Ans: (b)**

PDF Reference URL: <https://www.drishtiias.com/printpdf/rbi-to-review-framework-on-liquidity-coverage-ratio>