Statutory Liquidity Ratio

LR is the ratio of a bank's liquid assets to its net demand and time liabilities. In banking, it is the minimum amount of reserves maintained by the country's Commercial banks. The Indian Government often uses SLR.
The term "Statutory" means that the maintenance of SLR is a mandatory requirement. As of Sept 2017, the current SLR of the country is 17.9% (approx 18%). SLR is instrumental in ensuring the bank's solvency and cash flow in the economy. RBI provides specific guidelines and regular updates to all the banks for smooth classification of the liquid assets under SLR.

What is Cash Reserve Ratio (CRR)?

CRR is the portion of the bank's total deposit (mandated by RBI) to maintain them as reserves as liquid cash. The Current CRR is 4%. During inflation, RBI increases CRR, while in the case of recession, CRR is reduced. RBI introduces such changes to squeeze the money flow in the economy, bringing down inflation and reducing investments.
The lower the CRR, the higher the liquidity in the bank and vice-versa. Thus, by lowering the CRR, RBI aims to affect the economy and negatively bring down the inflation rate.

Components of SLR

The major components of SLR are as under-

- Liquid Assets: The assets that can be converted into cash are liquid assets. These include cash reserves, government bonds, govt-approved securities, treasury bills, and gold. Along with this, these assets also include securities that are considered eligible under Market Stabilization Schemes and Market Borrowing Programmes.
- Net Demand and Time Liabilities (NDTL)- It refers to the time liabilities and the demanded time of the public held by banks with each other. Banks' liabilities to pay on demand are involved in the demand deposits. These liabilities are balances in overdue fixed deposits, demand drafts, current deposits, and savings bank deposits' demand liabilities portion. On the other hand, the time liabilities comprises all the deposits that can be repaid on maturity. E.g., staff security deposits, time liabilities portion, fixed deposits.
- SLR Limit: There is a fixed limit on the SLR. The lower limit if SLR is 23%, while the upper limit is 40%.

How does SLR work?

By the end of the day, there must be a specific portion of NDTL by all the banks in the form of gold, cash, or any other type of liquid asset. The ratio for said liquid assets to time and demand liabilities is called SLR (Statutory Liquidity Ratio). The SLR is fixed for all the banks by the Reserve bank of India.
Not only that RBI has the right to fix the SLR, but it can also make changes in the fixed SLR for a bank at times of recession or inflation. It can increase the SLR up to 40%. If the SLR is increased, then it will restrict the bank's ability to inject money into the economy.

Why is the SLR fixed?

A bank's SLR is fixed for the following reasons-

- To ensure commercial banks' solvency.
- For checking the bank credit expansion.
- For compelling the banks to invest in particular government securities, e.g., bonds.
- By decreasing the SLR, there is an increase in growth and demand, which results in an increase in liquidity with all the commercial banks.

The SLR is required to fix the minimum rate for all the banks to grant money to their customers. The amount is known as the base rate. The base rate develops transparency between all the public dealing and RBI. However, the Reserve Bank of India fixes the SLR, but at times, it has the authority to increase or decrease the SLR. During the recession, SLR is reduced by the Reserve Bank of India so that the bank credits get a boost, while in case of inflation, the SLR is increased to limit the bank credits.

What if a bank fails to fulfill the required SLR?

In a case, if banks fail to maintain the required Statutory liquidity Ratio, then it has to pay the penalty to RBI. The penalty amount is equal to the deficient amount for the specific day and an amount of 3% above the bank rate.

Difference between SLR and CRR

SLR and CRR is often confused with being similar as both are the major components of monetary policy. Perhaps these two terms are different from each other. The difference between SLR and CRR is as follows-

Statutory Liquidity Ratio (SLR)	**Cash Reserve Ratio (CRR)**
Banks are asked to have plenty of reserves for cash as well as gold, i.e., liquid assets in the case of SLR.	In the case of CRR, the Reserve Bank of India demands cash reserves only.
Banks are able to earn returns on money considered as SLR.	There is no earning from the money considered as CRR.
Bank’s leverage for credit expansion is controlled by SLR.	In CRR, the liquidity in the Banks is controlled by Central Bank.
In SLR, banks keep the security to themselves. The banks require this security for the maintenance of liquid assets.	Here, RBI and banks maintain the cash reserves.