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Banking regulation in private and commercial banks of India

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Abstract

The stability and expansion of the Indian economy are fundamentally dependent on the regulation of the banking industry. The major regulatory body in charge of monitoring and regulating banks' operations in the nation is the Reserve Bank of India (RBI). The RBI enforces rules on how banks do business in an effort to preserve financial stability and safeguard the interests of depositors. The banking industry in India consists of cooperative banks, public sector banks, private sector banks, foreign banks, and regional rural banks. Depending on its size, ownership, and operations, each type of bank is subject to a particular set of regulatory regulations. To make sure that banks operate in a safe and sound way, the RBI utilizes a variety of regulatory measures, including monetary policy, prudential standards, and supervisory monitoring. In response to the COVID-19 epidemic, recent legislative adjustments have prioritized helping debtors and fostering economic expansion. The RBI has taken a number of actions to lessen the pandemic's effects on the banking industry, including loan moratoria, liquidity support, and regulatory forbearance. Non-performing assets (NPAs) and fraud are two issues that the Indian banking industry must deal with. The Insolvency and Bankruptcy Code and the creation of a national fraud registry are only two of the steps the RBI has put into place to combat these problems. The RBI has also implemented a number of changes to improve the banking industry's openness, accountability, and governance. Innovations in digital banking and fintech are expected to influence how banks are regulated in India in the future. The RBI has already taken a number of actions to stimulate fintech businesses, advance digital payments, and control the usage of cryptocurrencies. The regulatory environment for fintech and digital banking is still developing, but in the future years, it is anticipated to grow stronger and more all-encompassing. In conclusion, the stability and expansion of the economy in India are greatly aided by banking regulation. The regulatory framework of the RBI strives to preserve financial stability, safeguard the interests of depositors, and advance accountability and openness in the banking industry. The RBI is expected to continue to adapt and modify its regulatory framework to keep pace with the changing environment of the banking industry. Technological advancements are likely to be the driving force behind the future of banking regulation in India.

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Keywords: RBI, cryptocurrencies, fintech, Non-performing assets

Research Objectives:

The regulatory framework of the RBI strives to preserve financial stability, safeguard the interests of depositors, and advance accountability and openness in the banking industry. The RBI is expected to continue to adapt and modify its regulatory framework to keep pace with the changing environment of the banking industry. Technological advancements are likely to be the driving force behind the future of banking regulation in India.

Research Methodology:

Research undertaken is purely doctrinal and the data collected is primary source which includes statutes, legislations, case-Laws etc. Secondary source includes books, journals, articles etc.

Research Question:

1)What is the legal foundation for regulating banking?

2) The set of rules that apply to banks

What is the legal foundation for regulating banking?

The Banking Regulation Act of 1949[1] (the "Banking Regulation Act") primarily regulates banking operations and other financial services.

The Reserve Bank of India (RBI) has the authority to establish rules, regulations, instructions, and guidelines on a variety of topics relevant to banking and the financial sector under the Reserve Bank of India Act, 1934 (the "RBI Act"). The RBI is the country's central bank and the main body in charge of banking regulation.

The Foreign Exchange Management Act of 1999 regulates international trade and associated activities. This stipulates, among other things, the licencing of specific banking and other organisations as authorised dealers in foreign exchange.

Introduction

On the basis of the Hilton Young Commission's [2]recommendations, the Reserve Bank of India (RBI) was set up as the central bank of the country in April 1935 under the provisions of the Reserve Bank of India Act 1934 (the RBI Act). Since that time, the RBI's roles and priorities have changed in response to the shifting economic landscape and now include fundamental central banking duties

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[1] https://www.indiacode.nic.in/handle/123456789/2398?sam_handle=123456789/1362

[2] Errol D'Souza. "Prudential Regulation in Indian Banking." *Economic and Political Weekly*, vol. 35, no. 5, 2000, pp. 287–98. *JSTOR*, http://www.jstor.org/stable/4408876.

such as managing the payments system, overseeing banking oversight and regulation, managing foreign exchange controls, and developing the financial markets[3].

The Banking Regulation Act of 1949 (the BR Act) is the main piece of legislation controlling banks in India, in addition to the RBI Act. Additionally, RBI publishes a variety of circulars, instructions, and suggestions on a regular basis for banks to follow.

Banks in India may be scheduled banks or non-scheduled banks depending on whether the businesses have a licence to do banking activity in India or if they are included in the Second Schedule to the RBI Act or not. Cooperative banks, whether urban or rural (UCB), and commercial banks, including public sector banks (PSBs), private sector banks (PVBs) (including domestic PVBs and foreign banks), and regional rural banks (RRBs), are additional categories for scheduled banks. Small financing banks (SFBs) and payment banks (PBs), which can be scheduled or unscheduled, are recent newcomers to the banking industry. A few development banks, such the National Bank for Agriculture and Rural Development and the National Housing Bank, have also been established under unique legislation.

12 PSBs, 22 PVBs, 45 foreign banks, 43 active RRBs, about 1,534 urban cooperative banks, and 96,508 rural cooperative credit organisations make up the Indian banking sector. In India, there were 898.2 million debit cards, 62 million credit cards, and 2,13,575 ATMs as of March 31, 2021. Furthermore, the percentage of Indian adults with bank accounts has increased from 2011 to 80%, more than doubling since then thanks to the country's current push for financial inclusion in the digital world[4].

State Bank of India, Bank of Baroda, Punjab National Bank, Canara Bank, and Union Bank of India are the five largest PSBs in India based solely on asset size, and HDFC Bank Limited, ICICI Bank Limited, Axis Bank Limited, Kotak Mahindra Bank Limited, and IndusInd Bank Limited are the five largest PVBs in India based solely on asset size[5].

Due to constant income and decreased expenses, scheduled commercial banks (SCBs) saw an overall rise in profitability in 2020–2021. When compared to the prior years, when PSBs suffered losses and

[3] Rupa Rege Nitsure. "E-Banking: Challenges and Opportunities." *Economic and Political Weekly*, vol. 38, no. 51/52, 2003, pp. 5377–81. *JSTOR*, http://www.jstor.org/stable/4414436.

[4] Goldberg, Linda S. "Understanding Banking Sector Globalization." *IMF Staff Papers*, vol. 56, no. 1, 2009, pp. 171–97. *JSTOR*, http://www.jstor.org/stable/40377802.

[5] Rupa Rege Nitsure. "E-Banking: Challenges and Opportunities." *Economic and Political Weekly*, vol. 38, no. 51/52, 2003, pp. 5377–81. *JSTOR*, http://www.jstor.org/stable/4414436.

 ISSN: 2583-2751

PVB profitability declined, this reversal was in its own right outstanding. Additionally, despite a little reduction in interest revenue, banks' overall income remained constant.

The recent increase in non-performing assets (NPAs) has had a significant impact on banks' ability to provide loans. To support the IBC framework, the RBI also established a remedial framework through the Prudential Framework Circular of June 7, 2019, which calls for the time-bound implementation of a resolution plan, failing which disincentives in the form of additional provisions will take effect. However, the Insolvency and Bankruptcy Code 2016 (IBC) has been a game changer in the resolution of stressed assets. In addition, the RBI issued two circulars on 6 August 2020 (which were later extended by circulars on 5 May 2021) in response to the coronavirus pandemic, allowing banks to restructure stressed accounts related to COVID-19 for the borrower with a constrained window of time to implement a resolution plan with respect to eligible corporate exposures without deterioration in the asset classification. The gross NPA ratios have decreased as a consequence of these and other initiatives to enhance banking asset quality[6].

With the aim of promoting more uniformity and openness in public accounts, the RBI released the master circular on "Prudential norms on Income Recognition, Asset Classification, and Provisioning Relating to Advances" on October 1, 2021. However, the RBI issued clarifications with regard to the master circular on November 12, 2021, and the clarifications aimed to provide for customer education as well as details and steps for the classification of borrower accounts as special mention accounts and non-performing assets (NPAs), in light of the resurgence of the coronavirus pandemic in 2021 and recognising the difficulties it may pose for lenders and borrowers.

The All India Term-Lending and Refinancing Institutions, non-banking financial organisations (NBFCs), and banks were all allowed to securitize standard assets under RBI rules that were published in 2006, prior to the IBC. These recommendations clarified the definition of a "true sale," the rules for offering credit enhancement and liquidity assistance, and the accounting treatment of such transactions. However, following the global financial crisis in 2007–2008, the guidelines were updated (see the RBI Revisions to the Guidelines on Securitization Transactions) to add a minimum holding period and minimum retention requirement in order to align the interests of investors and originators, develop a well-ordered and robust securitization market, and regulate direct assignment of standard assets transactions.

The Guidelines on Sale of Financial Assets to Securitization Company (SC)/ Reconstruction

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[6] Goldberg, Linda S. "Understanding Banking Sector Globalization." *IMF Staff Papers*, vol. 56, no. 1, 2009, pp. 171–97. *JSTOR*, http://www.jstor.org/stable/40377802.

Company (RC), dated April 23, 2003, which were established under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002, controlled the sales of NPAs held by banks. The RBI Framework for Revitalising Distressed Assets in the Economy - Refinancing of Project Loans, Sale of NPA and Other Regulatory Measures, dated February 26, 2014, made changes to these regulations.The recommendations on Sale of Stressed Assets by Banks, issued 1 September 2016, further amended these recommendations on the sale of non-performing assets by banks to enhance the framework for sale of stressed assets[7].

To replace the 2012 Guidelines on direct assignment of standard assets, the Transfer of Loan Exposures Direction (the TLE Directions) was introduced in 2021[8]. It harmonised the previous guidelines on transfer of loan exposures, made them consistent with IBC mechanisms, and added the sale of assets in default.

The Securitization of Standard Assets Directions, 2021, which were also adopted by RBI, brought in a number of significant modifications, including:

1. the lifting of the restriction on the securitization of bought loans imposed by the 2012 RBI revisions to the Securitization Transactions Guidelines;
2. allowing single asset securitization, which the aforementioned 2012 Guidelines forbade; and
3. lowering the minimum holding time from three to six months for loans with terms more than two years, and from three to six months for loans with terms shorter than two years.

In addition to the 2012 Guidelines, the Reserve Bank of India (RBI) advised banks in 2016 to make sure that the pool of assets being sold does not contain any loans that were originated fraudulently or any loans that were classified as fraudulent as of the sale date when packaging and selling performing or non-performing assets to securitization companies or reconstruction companies. Loans that are in default may now be transferred to a broader variety of transferees thanks to the introduction of the TLE Directions[9]. However, the RBI has made it clear that transferors of loan exposures classified as fraud will not be released from their obligations with regard to the loan exposure and will still be required to fix staff accountability as required by the current fraud instructions.

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[7] Goldberg, Linda S. "Understanding Banking Sector Globalization." *IMF Staff Papers* 56, no. 1 (2009): 171–97. http://www.jstor.org/stable/40377802.

[8] D. Ajit. "Para Banking in India: Some Issues." *Economic and Political Weekly* 32, no. 42 (1997): 2677–86. http://www.jstor.org/stable/4405978.

[9] Leonard, Karen. "Indigenous Banking Firms in Mughal India: A Reply." *Comparative Studies in Society and History* 23, no. 2 (1981): 309–13. http://www.jstor.org/stable/178738.

 ISSN: 2583-2751

Another important development for the banking sector is the wave of PSB consolidation and privatisation that is now underway. The merger of 10 significant PSBs in India was announced by the Indian government in August 2019[10]. In the banking industry, this consolidation process was completed in April 2020. This major reform of the public banking system, which aimed to enhance the governance and responsibility of the impacted PSBs, was the largest since the nationalisation of 14 commercial banks in July 1969.

The set of rules that apply to banks

1.Licencing criteria for the banking industry

To conduct banking operations in India, banks are needed to get a licence from the RBI. According to Section 6 of the BR Act, "banking business" refers to accepting public deposits for lending or investment purposes that would be repayable and withdrawable[11]. It also includes guarantee and indemnity business, discounting, dealing in negotiable instruments, underwriting, participating in or managing of any issue, and other incidental activities.

2016 saw the introduction of on-tap banking licences (as opposed to banking by invitation licences), provided the bank met certain requirements, including:

(1) the capacity to pay present and future depositors in full as their claims accrue;

(2) conducting banking affairs in a manner not adverse to the interests of present or future depositors;

(3) adequate capital structure and earning prospects; and

(4) maintenance of public interests. Additionally, additional standards could be necessary depending on the nature of the banking firm. If a bank doesn't comply with the requirements or stops operating as a bank in India, the RBI has the authority to withdraw or cancel the licence.

Under a special dispensation, on 5 December 2019 RBI released rules for on-tap licensing of SFBs, after benefitting from the experience of the former SFB licensing regime implemented in 2014, with minimum paid-up voting equity capital/net worth criteria of 2 billion rupees[12]. Initial net worth requirements for main UCBs seeking to voluntarily convert to SFBs have been established at 1 billion

[1010] K. B. L. Mathur. “Public Sector Banks in India: Should They Be Privatised?” *Economic and Political Weekly* 37, no. 23 (2002): 2245–56. http://www.jstor.org/stable/4412218.

[11] S. K. Verghese. “Profits and Profitability of Indian Commercial Banks in Seventies.” *Economic and Political Weekly* 18, no. 48 (1983): M145–57. http://www.jstor.org/stable/4372724.

[12] Zeb, Shumaila, and Abdul Sattar. “Financial Regulations, Profit Efficiency, and Financial Soundness: Empirical Evidence from Commercial Banks of Pakistan.” *The Pakistan Development Review* 56, no. 2 (2017): 85–103. https://www.jstor.org/stable/26875188.

 ISSN: 2583-2751

rupees; they must be enhanced to 2 billion rupees within five years of the date on which commercial operations began.

After five years of existence, all eligble PBs are now able to submit applications to become SFBs. However, an internal working group established by the RBI in June 2020 recommended, among other things, that the initial paid-up voting equity capital/net worth requirement for setting up a new SFB be increased to 3 billion rupees and that for UCBs transitioning to SFBs, the initial paid-up voting equity capital/net worth should be 1.5 billion rupees, which should be increased to 3 billion rupees within five years. This recommendation was included in the IWG Report, which was published in November 2020. The minimum starting capital requirement for licencing new banks should be increased from 5 billion rupees to 10 billion rupees for universal banks, according to the IWG Report. This new regime is being positioned as a game changer in the small lending area to enhance the work UCBs have been doing in the past because SFBs would also target small ticket and underbanked borrowers. In a press release dated 26 November 2021, the proposals were described in full. RBI adopted 21 of the 33 recommendations presented by the IWG Report[13].

Additionally, the following suggestions were approved-

No changes to the current instructions regarding initial lock-in requirements, which may continue as a minimum of 40% of the bank's paid-up voting equity share capital for the first five years, are necessary. In addition, there are no requirements for intermediate sub-targets between five and 15 years, and for PBs planning to become SFBs, three years of experience as a PB are sufficient.

In order to harmonise the handling of various kinds of bank presence, particularly those in underserved regions, bank branches were reclassified as "banking outlets" in May 2017. A banking outlet today includes all branches, extension counters, and satellite offices as locations of service delivery by banks, whether full- or part-time. This change will help to promote financial inclusion and provide banks more freedom to choose their preferred distribution method.

No longer is authorization from the RBI needed to open banking locations in Tier 1 to Tier 6 centres. However, it has forced that banks open 25% of these locations in underserved rural areas (Tiers 5 and 6), where there isn't a physical building where a scheduled bank, local area bank, or cooperative bank might conduct core banking client activities[14]. Additionally, banks with this broad authorization may relocate, combine, or close any banking locations at their discretion; however, the relocation, merger, or closure of any rural locations, or a single semi-urban location, requires the consent of the appropriate district committee. For the purpose of building brick-and-mortar branches in Tier 1 to 4

[13] https://www.complybook.com/blog/banking-regulation-in-india

[14] https://www.lexology.com/library/detail.aspx?g=a1976e5b-288e-4dce-be91-ecd57fc575c9

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locations, RRBs must first have RBI authorisation.

RRBs have universal approval to operate banking branches in Tier 5 and Tier 6 locations with post facto reporting. The need that SFB branch expansion get prior RBI clearance during the initial three years of operation was lifted in March 2020. SFBs now have have universal authority to open banking locations, with the requirement that at least 25% of their locations be in rural areas without banks.

Banking establishments do not include ATMs, e-lobbies, bunch note acceptor machines, cash deposit machines, e-kiosks, and mobile branches. Banks may thus establish these in locations of their choosing.

2.Legal frameworks for financial institutions

Most banks in India are organised as corporations, including international corporations. As a result, domestic banks are also covered by the Indian Companies Act 2013 [15](CA) to the degree that it is relevant, and extra trading or listing requirements apply if such banks are listed on an Indian stock market.

The RBI now permits foreign banks to establish operations in India using either a branch model or a wholly owned subsidiary (WOS) model, depending on their eligibility. Due to the WOS structure's perceived financial stability in light of the lessons acquired from the 2007–2009 economic crisis, the WOS would get near-national treatment, including the creation of branches. Incentives provided for the subsidiarization strategy led to a growth in foreign banks' participation in India in 2018 and 2019.

The RBI and the government have recently placed a greater emphasis on consolidating, recapitalizing, and offering technical support to other actors in the banking system, including RRBs, cooperative banks, SFBs, and PBs, since these institutions hold the key to wider financial inclusion.

Under the RRB Act of 1976, RRBs were established with the purpose of giving small farmers, agricultural workers, craftsmen, and other rurally underprivileged residents access to banking services. Cooperative banks, on the other hand, through their geographic and demographic reach, play a critical role in promoting financial inclusion. The Rajya Sabha, the upper chamber of the Indian parliament, enacted the Banking Regulation Amendment Act 2020 for recalibrating the cooperative banks sector during its September 2020 session.

A number of the Act's provisions will have a long-lasting effect on the banking sector. It has expanded the BR Act's jurisdiction over cooperative bank behaviour and updated it to include provisions for RBI oversight and audits. Up until the amendment took effect, cooperative banks were

[15] https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf

governed by a dual regulatory system, with the RBI controlling the aspects of liquidity, such as licence, maintaining cash reserve, statutory liquidity and capital adequacy ratios, and inspection, and the Registrar of Cooperative Societies controlling the administrative aspects of these banks, including the control of management, elections, and audit-related matters.

After the amendment, the primary agricultural credit societies and cooperative societies whose primary business is long-term financing for agricultural development are exempt from the application of the BR Act, and the RBI will have the authority to relax the restrictions on the issuance of shares and securities to current cooperative society members as well as to take the place of the boards of directors of primary and multistate cooperative banks.

The amendment also brought in the notion of issuing several sorts of securities by UCBs, to raise capital, including special shares and preferential shares. The handling of these special shares and preference shares, as well as how RBI will handle the voting rights connected to these shares (if at all), were not made clear in the revisions. In accordance with the Banking Regulation Amendment Act 2020[16], the RBI published draught guidelines in July 2021 allowing UCBs to increase capital through the issuing of equity shares, preference shares, and debt instruments. As a result, UCBs are allowed to raise share capital by issuing equity to people registered as members within their region of operation as well as extra equity shares to current members. According to the proposed draught, the UCBs will be able to raise Tier I and Tier II capital through the issuance of perpetual non-cumulative preference shares, perpetual cumulative preference shares, redeemable non-cumulative preference shares, or redeemable cumulative preference shares. They will also be able to issue perpetual debt instruments that will be eligible for inclusion in Tier I capital as well as long-term subordinated bonds as Tier II capital. The terms and circumstances of such instruments are also outlined in the draught guidelines. It will be interesting to observe how the industry responds to these draught restrictions.

SFBs and PBs, who have entered the market more recently, have a narrower operating footprint than RRBs and cooperative banks but also face less regulatory restrictions. In order to provide basic banking services to underserved groups including small companies, marginal farmers, micro and small enterprises (MSEs), and the unorganised sector, SFBs were established in 2016. PBs were created in order to increase financial inclusion, notably by utilising mobile telephony-based technological services. PBs are not permitted to engage in lending operations, in contrast to SFBs, and their design is functionally comparable to that of suppliers of prepaid instruments (digital wallets). All qualified PBs, however, are now able to apply for conversion into SFBs after five years

[16] https://www.indiacode.nic.in/bitstream/123456789/1885/1/A194910.pdf

of operation because the RBI published "Guidelines for on "tap licencing" of Small Finance Banks in the Private Sector" in December 2019[17]. It is important to note that the industry has not embraced this conversion option because the regime is not clear enough to address issues like (1) the method by which UCBs identify promoters prior to conversion; (2) how investments in UCBs would be handled upon conversion; and (3) whether capital infusion by a group of promoters would be permitted.

A self-regulatory organisation [18](SRO) to establish and enforce norms and standards for industry players in digital payments as well as a new umbrella entity [19](NUE) to serve as a settlement agency for digital payments were also proposed by the RBI in 2020 with regard to PBs. Other SROs exist in the banking sector, such as the Indian Banks' Association, which functions very similarly to an SRO for Indian banks. Similar to this, there will be an SRO that is regarded as the industry organisation for these businesses in the digital payments sector. Currently, the Payments Council of India serves as an organisation that represents digital payment providers, while the Fintech Convergence Council additionally represents the greater fintech ecosystem.

If they seek for the licence, these organisations might change into SROs with the RBI's proper permission. To lessen the concentration risk on the National Payments Corporation of India (NPCI), the RBI wishes to establish several organisations that are comparable to NUEs. However, it is important to emphasise that, unlike the NPCI, NUEs may be "for profit" entities.

Prudential control

1.Connection to the prudential regulator

The RBI directly oversees the prudential supervision of banks as a "banker to banks" and "lender of last resort," creating standards for income recognition, asset categorization, and provisioning for banks' advance portfolios, and guaranteeing consistency and transparency in published accounts.

According to the BR Act, banks must expressly maintain books and records in a specified way and submit them to the regulatory authorities on a regular basis. According to the RBI's guidelines on know your customer [20](KYC) and anti-money laundering, transactional and identification records must be kept for at least 10 years from the date of the transaction and 10 years following the end of the client relationship, respectively. Banks must comply with the CA's and its regulations' requirements for the production of documentation and the accessibility of information for shareholder scrutiny.

[17] https://uk.practicallaw.thomsonreuters.com/w-007-9424?transitionType=Default&contextData=(sc.Default)&firstPage=true
[18] https://www.rbi.org.in/scripts/bs_viewcontent.aspx?Id=3892
[19] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11954&Mode=0
[20] https://knowyourcustomer.com/about-us/industries/banking/

In order to collect, store, and disseminate information on reporting entities' exposure to the borrower (as individuals or as a group, or both) under various headings, including "special mention accounts" with aggregate debt exposure of 50 million rupees and above, the RBI has established the Central Repository of Information on Large Credits.

The BR Act gives the RBI the authority to regularly undertake on-site inspections of banks' portfolios, risk management practises, internal controls, loan allocation, and regulatory compliance. Additionally, the RBI oversees certain branches' general operations and foreign exchange transactions directly on the premises. Banks are also required to routinely report to the RBI on these and other matters in order to achieve this and to allow the RBI to monitor and supervise operations off-site.

2.Control over banks

Only with the prior consent of the RBI may a bank's chairperson, managing director, full-time director, or chief executive officer be appointed, reappointed, or have their position terminated.

Any changes to (1) the maximum number of directors, (2) the appointment, reappointment, or termination of the appointment or compensation of the chairperson, managing director, full-time director, or chief executive officer of a bank, or (3) the compensation of any other director or chief executive officer, shall not take effect unless approved by the RBI. Additionally, the RBI has the authority to remove a chairman, managing director, or full-time director from their position for reasons of public interest, depositor interests, or to ensure good administration of the bank. Such matters that need RBI approval shall not be subject to the pertinent provisions of the CA regarding the employment and compensation of managerial staff.

In the interest of the general public, banking policy, depositors, or the bank itself, the RBI may at any moment issue certain written directions, including requires the bank to address any pertinent topic with an official of the RBI and submit pertinent disclosures; calling board and general meetings to debate any matter pertaining to the bank, including the election of new directors; selecting one or more RBI personnel to act as the bank's observers; making any changes to the bank's management that it considers essential, as well as taking over for a six- to 12-month term the board of directors of a financial business.

In order to assess individuals' appropriateness for appointment or reappointment as directors on the board of directors of a bank, the RBI has instructed PVBs to conduct a process of due diligence based on qualifications, expertise, track record, integrity, and other pertinent considerations. A PVB's[21]

[21] https://www.sc.com/en/banking/banking-for-individuals/private-banking/capabilities/resources/#:~:text=This%20service%20allows%20registered%20clients,investment%20positions%20and%20transaction%20activity.

board must also consist of at least 50% independent directors. Additionally, for foreign banks that have adopted the WOS model, at least two-thirds of the directors must be non-executive, and at least 50% of the directors must be Indian residents (with at least one-third being Indian national residents).

Members of Parliament, state legislatures, local governments, statutory auditors of PSBs, and individuals serving on the board of any other bank, financial institution, or rival organisation are all ineligible to serve on the board of a PSB[22] in order to ensure minimal political interference and transparency[23].

In banks, decisions are made collaboratively and in accordance with the formal procedures outlined in the CA for board and shareholder meetings. Furthermore, it is anticipated that the RBI would release recommendations on corporate governance for regulated businesses shortly in order to harmonise the existing regulatory framework with international best practises while keeping in mind the context of the local financial system.

The RBI ordered in November 2019 that a significant portion of full-time directors, chief executive officers, material risk-takers, and control function staff compensation (i.e., at least 50%) should be variable and paid on the basis of individual, business unit, and firm-wide measures that adequately measure performance in order to prevent misaligned remuneration and incentive schemes for bank managers and employees. The entire amount of variable compensation shall not exceed 300 percent of the fixed compensation. Furthermore, if the variable pay is between 20% and 200 percent of the fixed pay, at least 50% of the variable pay must be made up of non-cash assets, and at least 67% of the variable pay must be made up of non-cash assets if the variable pay is over 200 percent.

No matter the amount of compensation, top executives must always have deferral plans for at least 60% of their total variable pay. These agreements must also be susceptible to clawbacks in the event that the bank's financial performance is weak or poor. For pay cycles starting on or after April 1, 2020, these standards apply to PVBs, including local area banks, SFBs, and PBs, as well as international banks operating in a WOS framework.

Additionally, the RBI has added another level of management for UCBs. In order to help the boards of directors of UCBs in directing the UCBs, the RBI has released recommendations on how to form boards of management (BOMs). The BOMs' duties and obligations are similar to those of UCB directors, but in an advising position.

3.Liquidity, capital, and regulations

Based on the recommendations of the Basel Committee on Banking Supervision, the RBI has

[22] https://financialservices.gov.in/banking-divisions/public-sector-banks
[23] https://unacademy.com/content/railway-exam/study-material/general-awareness/what-are-public-sector-banks/

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established the minimal capital adequacy rules for banks. The RBI Basel III Capital Regulations went into effect on April 1, 2013, and they were gradually implemented until March 2020. The minimum total capital to risk-weighted assets ratios that must be maintained for three years from the start of operations are as follows, according to RBI guidelines.

Common Equity Tier[24] 1 (CET1) and Common Equity Tier 2[25] (CET2) capital are currently the two components of a bank's capital, with CET2 capital having a maximum ratio of 100% of CET1 capital. Ordinary equity shares, with or without voting rights, and innovative instruments up to 15% of such capital make up CET1 capital in most cases. As long as these instruments have certain loss absorption properties, CET2 capital may be in the form of loan capital instruments or preference share capital instruments.

The net stable funding ratio (NSFR) and the liquidity coverage ratio (LCR) are the two minimum liquidity ratios outlined under the Basel III framework. While the LCR encourages banks to be short-term resilient to anticipated 30-day liquidity shocks, the NSFR mandates that banks support their operations with steady sources of funding over a one-year time horizon. The first has been in place in India since 1 January 2015, while the second—defined as the ratio of available to necessary steady funding—has been in force from 1 April 2020.

The cash reserve ratio, which is a percentage of banks' demand and time liabilities (DTL), must be maintained by a balance in an interest-free current account with the RBI, as well as the statutory liquidity ratio (SLR), which is a percentage of DTL that must be maintained by liquid assets like cash, gold, or approved unencumbered securities, against which banks may obtain funds from the RBI on an overnight basis under the margina agreement. Foreign banks using the WOS model are likewise subject to comparable capital adequacy standards or buffers.

4.Restoration and resolving

In India, there is no distinct resolution structure for bankrupt banks. Even the IBC, a thorough overhaul of the legal framework for insolvency and bankruptcy, does not specifically address the bankruptcy of "financial firms" like banks, insurance companies, and stock exchanges, but instead gives the central government the authority to notice such events. Additionally, RBI clearance would be necessary for any petition seeking to wind up a bank. More specifically, the RBI's authority is further constrained when it comes to resolving cooperative or development banks.

Having said that, the BR Act gives the RBI substantial authority to exert control over or alter the administration of the board of a failing bank (with or without consulting the national government).

[24] https://www.bis.org/fsi/fsisummaries/defcap_b3.pdf
[25] https://www.wallstreetmojo.com/tier-2-capital/

The RBI may also be asked to serve as the bank's liquidator or make a court application to have a mismanaged bank's operations suspended. Based on capital, asset quality, profitability, and leverage ratios, RBI places the scheduled commercial banks under a prompt corrective action [26](PCA) framework (last updated on 2 November 2021)

The Deposit Insurance and Credit Guarantee Corporation Act of 1961 allowed for the introduction of bank deposit insurance in India in 1962. All commercial banks in India, including foreign banks, local area banks, RRBs, and the majority cooperative banks, have deposits up to 100,000 rupees insured by the Deposit Insurance and Credit Guarantee Corporation [27](DICG), a WOS of the RBI. With the permission of the Government of India, the DICG increased the insurance cover maximum for depositors in insured banks to 500,000 rupees per depositor with effect from 4 February 2020 in order to give bank depositors more security.

The 2020 amendments to the BR Act amended Section 45 of the BR Act, enabling the RBI to enact a scheme for the reconstruction or amalgamation of entities without imposing a moratorium on the bank in order to safeguard the interests of depositors and the general public or to ensure proper management. The change might prevent the financial system as a whole from being disrupted by placing troubled banks under moratorium while allowing banks under moratorium to meet their obligations and make payments under the plan.

Operation of business

The Information Technology Act of 2000, read with the Information Technology (Reasonable Security Practises and Procedures and Sensitive Personal Data or Information) Rules 2011[28], or the general harmonisation mandated by the General Data Protection Regulation of the European Union, have both increased banks' obligation to protect customer data in recent years. In a circular dated April 6, 2018, the RBI instructed banks to make sure that any information pertaining to the payment systems they manage is maintained solely in India. Furthermore, the Joint Parliamentary Committee [29](JPC) was tasked with further reviewing the Personal Data Protection Bill 2019[30] (the PDP Bill), which was initially presented to Parliament for comment. The Data Protection Bill, now known as the PDP Bill, and the JPC's report on it were both released on December 16, 2021. The bill's updated draught now includes protection for both personally identifiable information and non-personal data under its purview. In addition, a framework for regulating non-personal data has been developed by

[26] https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=12208&Mode=0
[27] https://www.dicgc.org.in/FD_A-GuideToDepositInsurance.html#q1
[28] https://www.meity.gov.in/writereaddata/files/GSR313E_10511%281%29_0.pdf
[29] https://prsindia.org/theprsblog/jpc-vs-pac
[30]http://164.100.47.4/BillsTexts/LSBillTexts/Asintroduced/373_2019_LS_Eng.pdf

the Ministry of Electronics and Information Technology. Additional rules established by the Unique Identification Authority of India, the NPCI, and recurring RBI instructions also apply to data that pertains to consumers' identification. The disclosures and periodic reporting that banks are required to submit to the RBI include information about any borrowers and promoters who are willful defaulters as well as the reporting of any NPAs, fraud, suspicious transactions, and cybersecurity breaches. All scheduled banks must lend to the following priority sectors: agribusiness, MSE, education, housing, social infrastructure, export credit, and renewable energy. At present, domestic banks must lend to the priority sectors at a rate of 40% of adjusted net bank credit (ANBC) or the credit equivalent of off-balance sheet exposure, whichever is higher. ANBC is determined by subtracting rediscounted bills with the RBI and other recognised financial institutions from the existing bank credit and adding permissible non-SLR bonds or debentures in the category of holdings to maturity together with other suitable investments.

If banks violate any of the statutory terms of the RBI Act or the BR Act, as well as any periodic circulars and instructions issued by the RBI, they may be subject to a variety of penalties. Such banks would also be subject to criminal responsibility under the relevant sections of the Indian Penal Code 1860, for example, on the basis of fraud, misappropriation of money, cheating, forgery, and criminal breach of trust. The RBI also has the authority to impose further supervisory restrictions and constraints on the offending bank as well as to suspend, revoke, or cancel banking licences.

Funding

The RBI allows SCBs (other than RRBs) to conduct certain financial activities outside of banking, such as the provision of credit information, management of payment systems, operation of stock exchanges or depositories, securitization or asset reconstruction, merchant banking, portfolio management, stock broking, investment advisory, operation of credit rating agencies, collective investment schemes, pension fund management, and authorised dealing in foreign exchange. Such banks may also invest stock in their own subsidiaries or in other businesses providing similar financial services.

Banks are required to hold Basel III-compliant tiers of capital. The Reserve Bank of India (Call, Notice and Term Money Markets) Directions, 2021, which were released by the RBI in April 2021, also permit SCBs (with the exception of local area banks), payment banks, small finance banks, regional rural banks, cooperative banks, and primary dealers to participate in call, notice, and term money markets as both borrowers and lenders. Within the regulatory framework outlined by the RBI, a participant may impose prudential restrictions on borrowing and lending transactions with the permission of its board of directors.

The liquidity adjustment facility [31](LAF) is a service provided by the RBI to SCBs and authorised foreign exchange dealers to allow them to park excess funds with the RBI or to access liquidity as needed. All transactions involving the LAF are conducted through repurchase agreements, with the RBI serving as the counterparty in each one. The LAF and Marginal Standing Facility were made available to RRBs by the RBI in 2020 in order to provide them new options for managing their liquidity.

Transfers of banking operations and bank control

1.Control system

The RBI published regulations in November 2015 requiring prior authorisation for the purchase of shares or voting rights in PVBs, with the exception of urban cooperative banks, foreign banks, and banks with particular statutory licences. Any person seeking to directly or indirectly acquire shares or voting rights of a bank, either alone or in concert with others, must obtain prior RBI approval if the acquisition would result in an aggregate shareholding or voting rights of that person (along with holdings of relatives, associate entities, and persons acting in concert) of 5% or more. The total maximum may be raised to 10% in some circumstances of new purchase by an existing substantial shareholder (i.e., with holdings exceeding 5%). According to RBI guidelines, the potential buyer must also be a "fit and proper" person. Further, the CA now permits greater corporate veil piercing to many levels beyond the present capital structure of banks (including their holding companies), allowing for increased examination of beneficial ownership of shareholders.

The bank ownership restrictions are generally as follows:

1. the restriction is 10% of the paid-up capital for people and non-financial companies (apart from promoters or promoter groups); however, if the promoters are individuals or non-financial organisations in already-existing banks, the shareholding limit is 15% of the paid-up capital;
2. The ceiling is 15% of paid-up capital for firms in the financial industry that are not regulated, diversified, or listed;
3. 'Regulated, highly diversified, listed enterprises from the financial sector' and shareholdings by supranational institutions, public sector undertakings, or government are restricted to no more than 40% of the paid-up capital; and
4. On a case-by-case basis, a larger stake or strategic investment by promoters or non-promoters through capital infusion by domestic or foreign entities or institutions shall be allowed in situations like relinquishment by existing promoters, rehabilitation or restructuring of problematic or weak

[31] https://www.rbi.org.in/scripts/LAFUserView.aspx

banks, entrenchment of existing promoters, or in the interest of the bank or consolidation in the banking sector.

The internal working group, established by the RBI in June 2020 to review the current ownership and corporate structure guidelines for Indian private sector banks, made several recommendations in the IWG Report[32], including increasing the promoter shareholding cap in the long run (15 years) from the current 15% to 26% of paid-up voting equity capital. The IWG has also suggested capping non-promoter ownership at 15% of all shareholders' paid-up voting equity capital. The suggestions made by the IWG Report regarding promoter shareholding have been adopted by RBI in its current form. However, with regard to non-promoter shareholding, RBI modified its recommendations in a press release dated November 26, 2021. It stated that non-promoter shareholding for natural persons and non-financial institutions will be limited to 10% of the paid-up voting equity share capital of the bank entities, and for all categories of financial institutions or entities, supranational institutions, public sector undertakings, or government. Last but not least, no shareholder in a bank may exercise voting rights in a poll that exceeds 26% of the combined voting rights of all bank shareholders in accordance with Section 12(2) of the BR Act. Except in the case of WOS-model foreign banks, at least 26% of the paid-up capital must always be owned by locals. The application of Section 12 of the Act was expanded to apply to cooperative banks with adjustments in the 2020 amendments to the BR Act. With the RBI's prior approval, cooperative banks may now issue equity, preference, or special shares, at face value or at a premium, as well as unsecured debentures, bonds, or similar securities (with an initial or original maturity of not less than 10 years), to any bank member or other person residing in the bank's service area, subject to conditions and any ceiling, limit, or restriction on the issue, subscription, or transfer that the RBI may specify.

These might be sold through a private placement or a public offering. Given the unique membership and control structure of cooperative societies, the operation of these approvals and the ensuing issue of the securities is still to be seen. Both non-resident and resident Indian firms are permitted to invest in Indian enterprises. The total foreign ownership in an Indian PVB cannot exceed 74% of paid-up capital via the approved method or 49% of paid-up capital under the automatic route, according to the Foreign Direct Investment Policy 2020[33]. Additional foreign ownership above 24% of paid-up capital will also need shareholder approval. Similar to this, a non-resident Indian individual's total ownership cannot exceed 10% of a bank's paid-up capital without the shareholders' consent.

2.Transferring banking operations

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[32] https://www.rbi.org.in/Scripts/BS_PressReleaseDisplay.aspx?prid=52618

[33] https://dpiit.gov.in/sites/default/files/FDI-PolicyCircular-2020-29October2020.pdf

The RBI published its initial recommendations on mergers and amalgamations of two PVBs, a bank, and a non-banking financial institution in 2005. In all cases, merger must first have RBI clearance before the company law tribunal gives its final sanction. From an antitrust standpoint, the Competition Commission of India must also approve the merger. There is no legal requirement for banks to ask consumers for permission before merging; but, as best practise, notices are delivered to all customers well in advance, and corporate and regulatory clearances are also made public. Customer service continuity is another factor that is taken into account when deciding whether to approve the merger plan.

Banks and other financial institutions are allowed to sell or assign financial assets to asset reconstruction or securitization businesses under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002 [34]and associated RBI guidelines, which are published on a regular basis. Banks are not permitted to sell financial assets at a contingent price with a commitment to cover a portion of the difference upon realisation, and the transaction is non-recourse following rigorous due diligence by the assignee or purchaser. Banks may, however, sell particular financial assets with a promise to split any future profits made by the asset reconstruction firm. Cash, bonds, debentures, security receipts, or pass-through certificates issued by the asset reconstruction business are all possible forms of consideration for the sale.

if consumers just need to be informed of changes in lenders or service providers or if customer consent is also required depends on the contractual clauses of the agreement with customers.

A recap of the year

1.Online banking

Digital banking has replaced traditional brick-and-mortar banking as a result of legal changes and technical advancements that have paved the way for more affordable alternatives to traditional capital raising and extensive lending methods. The most important recent advancements in the market in this respect are real-time payment systems, digital wallets, mobile banking, invoice financing (also known as the trade receivables discounting system), and digital lending.

Customer protection has also received a lot of attention, with the addition of two-factor authentication, stricter regulations for electronic signatures, and the prevention of personal data leaks. A digital ombudsman programme was also created as an improved complaint redressal procedure. The One Nation One Ombudsman concept, also known as the Integrated Ombudsman Scheme, was

[34] https://www.indiacode.nic.in/handle/123456789/2006

launched by the RBI in order to enhance and streamline the current three ombudsman schemes. This approach is jurisdiction-neutral.The new programme intends to improve the process for customers who file complaints against organisations that are under RBI regulation, such banks and NBFCs. For the purpose of receiving and processing complaints both in person and by email, a centralised facility has been established in Chandigarh.

Three pillars—blockchain, artificial intelligence, and the internet of things—are expected to support digital transformation in Indian banking during the next several years. The RBI activated a regulatory sandbox (RS) system in August 2019 to let banks to test new products live using these technologies. The RS enables the regulator, innovators, banks, and clients to carry out field tests on technological applications in various banking segments (such as retail payments, digital KYC, and wealth management), to gather evidence on the advantages and risks of new financial innovations, while carefully monitoring and containing their risks or offering restricted relaxations.

Perspective and conclusions

Modernising payment and settlement systems, improving stressed asset resolution, and adjusting macroprudential laws to the highest international standards have been the RBI's recent banking policy key areas. The vision, major goals, and methodology for enhancing access to widespread, formal, and cheap financial services as well as fostering financial literacy and consumer protection have all been outlined in the RBI's most current National Strategy for Financial Inclusion (2019-2024).

Additionally, the RBI has identified financial stability as a top goal in the wake of the global financial crisis. It has recently implemented a number of policy changes, including macroprudential, monetary, and liquidity policies, in an effort to boost domestic demand and quicken the rate of economic development.

In the upcoming years, it is also anticipated that the RBI would continue to implement structural reforms for inflation control through preserving price stability, reducing capital costs, raising responsibility within and among banks and non-banking financial enterprises, and harmonising regulatory frameworks.