All you need to know about Banking Law and Practice in India

Introduction

As per the reports of the Reserve Bank of India (“RBI”), India’s banking sector is sufficiently capitalised and well-regulated. The financial conditions and the economy in the present moment are far better than any country in the world. Be it credit, market or liquidity risk studies and surveys, they all suggest Indian banks have withstood the global downturn efficiently and can recover quickly from difficult conditions. India is said to be one of the fastest growing economies in the world.

The digital payment evolved overnight after the Prime Minister’s measure of Demonetisation in 2016. According to FSI reports, India developed the most in the 25 countries with India’s Immediate Payment Services (“IMPS”) being the only one which is placed at Level 5 in the Faster Payments Innovation Index (“FPII”). Also, RBI has allowed more features such as unlimited fund transfers between wallets and bank accounts, these wallets are expected to become really strong players in the financial ecosystem. The unorganised retail sector has a huge untapped potential of adopting digital mobile wallets for payments, as per a report by the Centre for Digital Financial Inclusion. Around 63 per cent of retailers are interested in using digital modes of payment.

In 2017, Global rating agency Moody’s announced that the Indian Banking system was stable. They also upgraded four Indian banks from Baa3 to Baa2. Under the union budget 2018, the government has allocated Rs 3 trillion towards Mudra scheme, which provides financial assistance to small businessmen who want to grow their business. The government has also invested Rs 3,794 crores towards credit support, capital and interest subsidy to MSMEs.

The government and regulator have undertaken several measures to strengthen the Indian Banking sector. Such as a two-year plan to strengthen the public sector banks through reforms and capital infusion of Rs 2.11 lakh crore that will let the banks play a large role in the financial system by giving a boost to the MSME sector. Lok Sabha has also approved Rs 80,000 crores of recapitalisation bonds for public sector banks.

Looking at the Statistics, Banking sector for lawyers will grow to be a booming sector in the Indian Economy in the coming year. It is a lucrative and attractive career option for all the law students. It is said to be a top sector and attractive for lawyers even when it is not doing so well. When banks do well, they need many lawyers. When they are not doing so well, they need more lawyers! It is a proven fact, that firms do well when banks do not do well, assets are said to be distressed and clients default on payments. It can be said that the banking sector for lawyers is recession proof and is here to stay.

History of Banking in India

The history of banking goes back to the vedic age where practices like usury and loan deeds were prevalent. The vedic era and the maurya era also witnessed banking activities. The first bank to be set up in India was the Bank of Hindustan in the year 1770 at Calcutta and it was wound up in 1830-32. By 1843, there were 3 main banks under the British East India company which were Bank of Calcutta, Bank of Bombay and the Bank of Madras. In 1921, the three banks were merged to form the Imperial Bank of India. In 1955, the Imperial Bank of India was no longer a private entity as it was nationalised and renamed as State Bank of India. The State Bank of India is the oldest bank in India.

Evolution of Banking Law in India

The Indian banking system has evolved from a caterpillar to a butterfly in the last two centuries. In the ancient times, banking was mainly handled by businessmen such as the Sharoffs, Mahajans, Seths, Sahukars, etc. They performed the usual function of lending money to traders and craftsmen and sometimes placed their funds at disposal for the war chest of the kings.

Modern-day banking started around the last decades of the 18th century, with the General Bank of India and Hindustan Bank coming into existence. Then the three presidency banks were made which were – Bank of Madras, Bombay and Calcutta. The presidency banks acted as quasi-central banks for quite a while. They merged into what was called as Imperial Bank of India in 1925. The swadeshi movement inspired the Indian business community to form banks of their own from 1906 to 1911. A number of banks established then have still managed to survive till date, which includes Canara Bank, Indian Bank, Bank of Baroda and the Central Bank of India etc.

A landmark event which marks the evolution of banking happened in 1934 when a decision to set up Reserve Bank of India was taken. It started functioning in

1935. RBI has since been the central bank of the country and the regulator of the banking sector. It derives its powers from the RBI Act, 1934.

The two other major events in the modern banking era are the nationalisation of 14 largest commercial banks in 1969, through the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969. Later another set of 4 banks were merged, taking this count to 20. At this point, more than 90% of all banking business in India was controlled by Government of India.

Post the government's liberalisation policies, a host of private players entered into the India banking market where RBI made sure that they were being closely watched and strictly regulated. Further, there were regular checks on the compliance of various guidelines and any irregularities would have lead to the disqualification of their licences.

RBI as the Central Bank of the Country

RBI started its operations as a private shareholders bank. It replaced the Imperial Bank of India and started issuing currency notes and acting as a banker to the government. RBI covered all the undivided India. In order to make policies that were consistent with both the RBI and the government's agenda. The government nationalised RBI immediately after the Independence of the country. From 1st January 1949, RBI started functioning as a state-owned and controlled, Central Bank. India also enacted the *Banking Regulation Act* in 1949 to streamline the functioning of commercial banks. RBI has mainly three functions:

1. It is the regulator of banks.
2. Banker to the government.
3. Banker's Bank.

Functions of the Reserve Bank of India

The Reserve Bank is the apex bank and has multifarious functions. It derives its power from the Reserve Bank of India Act, 1934. Functions of the Reserve Bank of India are-

- Issuer of currency– Currency notes can only be issued by the Reserve bank of India. However, 1-rupee notes are issued by the Ministry of

Finance. The currency notes have a character of legal tender i.e. they have to be accepted as a mode of payment of debt.

- Banker and advisor to the government– The Reserve Bank of India functions as a banker to the government. It collects funds and makes payments on behalf of the government. It also gives loans to the government. It also acts as an advisor to the government as it advises the government regarding money market, loans, economic policy matters etc.
- Manager of foreign exchange– The Reserve bank manages foreign exchange. It aims to facilitate foreign trade and payment and establish a well-developed foreign exchange market in India.
- Controller of money supply and credit – The Reserve Bank is also the controller of money supply and credit. It uses different methods of control like repo rate and bank rate.

1. Repo rate– The repo rate is the rate at which the Reserve Bank lends money to the commercial banks for their short-term needs. An increase in the repo rate makes borrowing expensive for the commercial banks. The commercial banks are thus forced to increase their lending rates which in turn discourages the borrowers from taking loans. The effect of decreasing the repo rate is the vice versa.
2. Bank Rate– The Bank rate is the rate at which the Reserve Bank lends money to the commercial banks for their long-term needs. An increase in the bank rate makes borrowing expensive for the commercial banks. The commercial banks are thus forced to increase their lending rates which in turn discourages the borrowers from taking loans. The effect of decreasing the bank rate is the vice versa.

- Banker's bank and supervisor– The Reserve Bank supervises the functioning of all the banks. It controls and regulates the commercial banks. Regulations may be related to licensing, expansion, winding up etc. The Reserve Bank is also a banker to the banks.

1. Custodian of Cash Reserves– The Reserve Bank is a custodian of cash reserves of the commercial banks as the commercial banks are required to keep a certain proportion of their deposits with the Reserve Bank. This makes the Reserve Bank a custodian of cash reserves.
2. Lender of last resort- When the commercial banks are not liquid enough to fulfill the obligation of their depositors, at such a time, the Reserve Bank steps up and provides loan to the commercial banks. It guarantees solvency to the bank and this makes the Reserve Bank, the lender of last resort.