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# **AN OVERVIEW OF LAWS GOVERNING THE BANKING SECTOR IN INDIA**

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## **ABSTRACT**

The Indian Banking System is a giant tree rooted in various legislations and guidelines of the central government, which cater to the overall blooming of a well-organized banking sector. These legislations include The Banking Regulation Act of 1949, The Reserve Bank of India Act of 1934, The Foreign Exchange Management Act of 1999, The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002, and The Prevention of Money Laundering Act of 2002, etc. These are the major laws passed by the Indian parliament which play the guardian role of the banking sector. The application, objectives, relevant sections, and the major limitations of these acts are discussed in the following article. Knowing these, the legal regulatory framework of the banking sector in India can be understood well.

## **INTRODUCTION**

The banking sector in India being the backbone of the country's financial system operates under a robust legal framework designed to promote consumer inclusiveness, boost economic growth, and supply the needs of the customers. The legal system works to ensure financial stability in the Indian economy. Through the development of the banking sector over the years, numerous laws and regulations have been enacted for competent oversight and regulation of financial institutions and to cater to the rising needs of banking activities. Those legislations aimed at preventing all the possible malpractices and frauds in banking and money dealings at the time. The Reserve Bank of India, being the country's central bank, plays a lead role in implementing these laws and ensuring compliance. It also notifies certain necessary amendments and required changes through its published notifications from time to time. Post-liberalization, the concept of banks became more familiar. Formerly, it was more of a private mode. Later, banks got nationalized and the services of such nationalized banks were governed by the government which provided for the betterment of the country's financial sector. Key legislations like the Banking Regulation Act of 1949, the Reserve Bank of India Act of 1934, etc form the

foundation of banking laws in India. Later on, with the advancement of technology and electronic banking methods, newer regulations have become increasingly relevant.

### **THE BANKING REGULATION ACT, 1949**

Earlier, when the banking system was evolving gradually, the banks were supervised under the Companies Act of 1913. Later on, when banks became more prominent, the need for systematic control of the banking sector was felt. It was recognized to be made possible only with the enactment of a competent statute. Thus the Banking Companies Act of 1949 was enacted to regulate the banking companies in India. Then it was renamed to the Banking Regulation Act of 1949 from March 1966. The amendment of 1965 made the statute applicable to not only banking companies, but also to cooperative societies. The act aimed at harmonizing the banking business. The act regulated the setting up of new branches and the shift of existing branches. The Banking Regulation Act prescribed the minimum capital requirement for banks under section 11. Section 8 of the Act prohibits direct or indirect trading of any goods other than the selling of goods kept as collateral security. The act also provides for the powers and authority of the Reserve Bank of India in assisting the banks and financial institutions by providing them loans and advances in cases of financial needs. The act also confines RBI with the power to call upon meetings of the directors to discuss their administrative affairs. The act states that every banking company must keep a reserve fund which may have at least twenty percent of the profit. The act also confines the power of the central government to make an order to the RBI and to initiate liquidation procedures in case of default committed by the banks, under the insolvency and bankruptcy code of 2016. The act provides for penalties and punishments under section 46. This may include imprisonment, fines, or both for various offenses. Even though the act succeeded in organizing and mastering the overall banking sector, it held many demerits. In cases of stressed assets and non-performing assets, the act plays less scope. The act also holds less role in the case of public sector banks. Hence the act provided a proper structure to the banks in India.

### **THE RESERVE BANK OF INDIA ACT, 1934**

The act was enacted primarily to constitute the Reserve Bank of India. The act provides for the powers, functions, and responsibilities of RBI. RBI was established based on the recommendations of the Royal Commission on Indian Currency and Finance, also known as the Hilton Young Commission in 1926. The Reserve Bank of India is the central bank of the

country. It is the regulator of all the banks of the country, it is the banker to the government and it is the lender of last resort. The RBI is vested with the power to issue Indian currency that is, rupees under section 22 of the act. RBI receives and makes payments for and on behalf of the central government of India. It acts as an advisor on economic policy matters to the government. It is the overall manager and controller of foreign exchange in the country as per section 40 of the act. Section 45MC of the act states that banks are required to file winding-up petitions to the RBI. All the commercial banks of the country are required to keep with the RBI, a certain portion of their deposits. Section 58B of the act provides for penalties. RBI ensures credit smoothening of the nation and oversees the balance and stability in the monetary system of the country. Unlike the Banking Regulation Act of 1949, the RBI Act does not provide more technicalities and provisions for the development and regulation of the commercial banking sector of the country. The act is centered on the overall matters regarding the Bankers' bank, that is the RBI. The act does not cater to the needs of Non-Banking Financial institutions and it gave a predominant power to the central government on most of the matters which created inconsistencies with the powers of RBI during implementation and affected the autonomy of the RBI. These are the nominal cons of the Reserve Bank of India Act of 1934.

### **THE FOREIGN EXCHANGE MANAGEMENT ACT, 1999**

Before the enactment of this legislation, foreign exchanges in the country were governed by the Foreign Exchange Regulation Act of 1973. The act was more complex, restrictive, and focused solely on the nation's development. Post-liberalization, the act was felt more rigid and unsuitable to meet the needs of the new globalized marketplace. Hence, the Foreign Exchange Management Act of 1999 was enacted. FEMA replaced FERA to shift towards a more market-oriented and liberalized approach. The act aimed at facilitating foreign exchange transactions and integrating India's economy into the global economy, with certain restrictions. The act aims to facilitate external trade and payments to promote the country's economy. The act provides for Foreign Direct Investment in India by making the procedural part more simple and accessible. The act aims to create a more transparent and convenient foreign exchange system. Section 3 of the act restricts unauthorized dealings in foreign exchange. Section 7 mandates the exporters to furnish details of their transactions and to file their returns at the appropriate time. Section 8 convenes the RBI and the Enforcement Directorate to enforce penalties for non-compliance with the provisions of the act. Even though FEMA made the foreign exchange system more market-friendly, the procedures can be complex and bureaucratic, especially for the sole businesses and individuals engaged in foreign investments or trade. FEMA allows for

the enforcement of penalties, but it is not desirable in cases of large corporate entities. The guidelines under FEMA are also not unambiguous. These are the notable black marks of the legislation. However, the act liberalized the overall foreign exchange sector of the country.

### **THE SARFAESI ACT, 2002**

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act of 2002 was enacted as a result of the rising number of non-performing assets and the need for expedited legal framework to address the issue was very badly felt. To give banks the power to recover secured loans by directly taking possession of and selling the collateral, the act was passed for this purpose. The act aimed at facilitating the recovery of dues and speeding up the whole procedure. The act also aimed to create a more transparent and efficient platform to enforce the rights over securities. Section 3 provides for the establishment and registration of Asset Reconstruction Companies to help banks recover the debts due. Section 13 provides for the enforcement of security interest. Section 26 provides for the right of the central registry to inspect particulars of securitization, reconstruction, and security interest transactions. Section 34 provides that the civil courts are barred from entertaining such suits for recovery. Section 27 provides for the penalties. But when going to the negatives of the act, the act is only applicable to secured creditors. The unsecured creditors had the option to apply for recovery of loans through the court system only unlike Sarfaesi. The act allows the lenders to take possession of the collateral assets but enforcing the provisions of the act was problematic, due to borrower resistance, court delays, and other inconveniences. Hence the act allows commercial banks to auction and sell securities or properties to recover defaulted payments.

### **THE PREVENTION OF MONEY LAUNDERING ACT, 2002**

The Prevention of Money Laundering Act of 2002 was enacted to prevent money laundering and to punish the offenders. Before this enactment, several other legislations like The Income Tax Act of 1961, The Conservation of Foreign Exchange and Prevention of Smuggling Activities Act of 1974, The Benami Transactions (Prohibition) Act of 1988, The Foreign Exchange Management Act of 1999, etc dealt with the issue of money laundering. To address and regulate the issue of economic crimes like money laundering, the need for a well-built statute was badly felt and this led to the enactment of this act. The act authorizes and convenes the government to enforce and seize any illegal earnings or profits of any illegal activities. The act aimed to penalize the defaulters of the provisions of the act. The act under section 12 made

the banking companies and financial institutions mandatory to preserve all necessary documents and records about their financial transactions. Section 3 of the act covers the definition of what is meant by money laundering. Section 4 of the act prescribes the punishment for the same. Section 17 of the act authorizes the officials to search and seize any illegal gain obtained through money laundering. Thus the act primarily aimed to prevent the said economic crimes and to punish the offenders. Even though the act has succeeded in its major aim, some of the provisions remain controversial, due to competing interests with many other legislations. The court had also questioned the constitutional validity of many of the provisions of the act, in several instances. The act also lacked transparency in certain provisions such as the enforcement cases under the Enforcement Department. Despite these minor criticisms of the act, the act is a prime legislation, intended to penalize economic crimes involving illegal benefits or monetary gains from illegal sources. The act also succeeded in combating the issue of money laundering and such fraudulent transactions. The act is still evolving with the changing societal needs and modern technological advancements.

## CONCLUSION

A Bank, in simple terms, is a financial institution primarily involved in accepting deposits, borrowing and lending money, and providing other financial aids to the customer. A banking company is bound to follow various legislations in the country. The banking sector of India is deeply rooted in the great legal framework involving many legislations. Despite these enactments, there are certain guidelines and regulations put forward by the central government and the Reserve Bank of India from time to time as the need arises. There are few associations and regulatory bodies, like IRDAI, SEBI, etc, who issue codes and standards of conduct for carrying out financial transactions in the country. India's legal framework on the banking sector replicates the country's economic stability and inclusiveness choice. This framework works to maintain public trust in the banking system and to protect customers from any kind of economic fraud or monetary grievances. Hence it is necessary to have a strong legal base to support India's banking sector.

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