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# NPA A MAJOR PROBLEM IN BANKING SYSTEM & REGULATION AND MECHANISM IN BANKING SYSTEM

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## ABSTRACT

*The purpose of the study on the topic of regulation mechanism of Indian banking system is to understand the problems in banking sector and how NBFCs companies are creating problems in economy of the country. Banking sector is one of most important sector as it placed a major role in the growth of the economy by providing financial assistance to the business, MSMEs and the common person of the country. It becomes important to understand how the sector of banking is working and is contributing in the growth of the economy. Through this research work study will be done that how RBI has failed in regulating the banking system in India. Through this research role of NBFCs will be analysed and how NBFCs has affected the banking system and has lended huge amount in the hands of borrowers with no guarantee and security.*

*Through this research it will also be analyse how RBI has failed to control NBFCs which resulted high and unreasonable interest rate on advanced loan for the borrowers and how uncontrolled NBFCs has resulted huge influx of litigation in Indian Judicial System. It will also be analysed that how due to the failure of RBI towards regulation of NBFCs, resulted in increase of non-performing assets in India. It will also be analysed that how banking system is being misused by NBFCs and how banks are investing in NBFCs for better interest rates.*

**Keywords:** *Non regulation on NBFCs, Regulation by RBI on banking system, Failure of RBI on banking System, NBFCs, MSME, high interest rate by NBFCs company, RBI.*

## INTRODUCTION

RBI is the central regulatory authority of the India and place a crucial role in regulating and supervising banks either private or government, Financial institutions and NBFCs. Supervisory activities of RBI includes licencing and operation of bank, capital requirements, managements and governance structures , audit and inspection norms etc . RBI regulates interest rates, manages foreign exchange and functioning of scheduled banks. The purpose of regulation of banking

system in India is to ensure stability, transparency, protection of interest of depositors and investors, growth of economy, inflation and endeavours to ensure no excess flow of money in market. Nevertheless RBI has failed in controlling the banking systems in some respects due to no proper regulation. Due to non-regulation by RBI, country has huge borrowers with high interest rates. NBFCs and other financial institutions are taking the benefit of no proper regulation by RBI. NBFCs do not hold the banking licence but involve in proper financial system. NBFCs are performing like an alternative better option to the traditional banking systems since NBFCs are providing the loans to the borrowers within few minutes, hours and days. NBFCs are contributing a lot in economy of the country and playing a complimentary as well as rival role for banks.

### **BANKING SYSTEM IN INDIA MEANING OF BANK:**

In Indian Financial System Banks are the important segment and therefore its control and regulations become necessary. An efficient and healthy banking system helps not only in the development of nation's economic but nation can also become top financial economy in the world. The target of each nation is that how it can become financially independent. Banks are the light bearer for the development of a country. Banking system is necessary for sustainable development of a country. Sustainable development meaning thereby is, nation with good financial situation not only helps in development of own nation, its subjects, gives employment, good infrastructure, but also helps other countries and gives loan to other countries. With healthy banking system we can achieve aforementioned goals easily. A nation with mere banking system is not sufficient, it must be with healthy banking system i.e. financially strong, surplus liquidity. To obtain the goal of healthy banking system in India, there must be a central authority to regulate and govern the banking system. Regulations and control and governance by a central body helps in decreasing NPA (Non-Performing Assets) and stops fraud in the system. It also helps in misappropriation of funds by banks. It helps in giving guarantee to depositors and helps to ensure them that their money is safe in the hands of Bank. In the period before independence, the swadeshi movement led to the establishment of numerous small and local banks but later on failed due to non-regulations by any central banking system. The regulation of banking system is required to stop any internal fraud and inter connected lending and transfer of funds secretly. In the recent times it has been seen that due to big scams by banks' head huge amount has been given to big businessman against the rules and that has resulted ultimately in write-offs. Various categories of stakeholders of the Society use the banks for their different requirements. Banks are financial intermediaries between the depositors, lenders and the borrowers. Apart from accepting deposits and lending money, banks in today's changed global business environment offer many more value

added services to their clients. The Reserve Bank of India as the Central Bank of the country plays different roles like the regulator, supervisor and facilitator of the Indian Banking System.

### **NATIONALISATION OF BANKING SYSTEM IN INDIA**

Indian Banking System witnessed a major revolution in the year 1969 when government of Smt. Indira Gandhi nationalized total 14 biggest commercial banks on 19<sup>th</sup> July. The purpose of nationalization was to increase the presence of banks across the nation. After the nationalization reach of banks expanded to rural areas also. It also increase 800 % in deposits in banks and increase the faith of the public in banking system. It also helps in providing banking services to different segments of the Society and change the concept of class banking into mass banking, and to support priority sector lending and growth. After the nationalization, all banks are covered, controlled and regularized by RBI directly which has helped in controlling frauds in the banks and has given a guarantee to the depositors that their money shall be secure.

### **TYPES OF BANK IN INDIA**

#### **(a) Commercial Banks:**

- (i) Public Sector Banks: SBI and its associate banks and other nationalized banks.
- (ii) Private Sector Banks
- (iii) Foreign Banks
- (iv) Small Finance Banks
- (v) Payment Banks
- (vi) Regional Rural Banks

#### **(b) Cooperative Banks:**

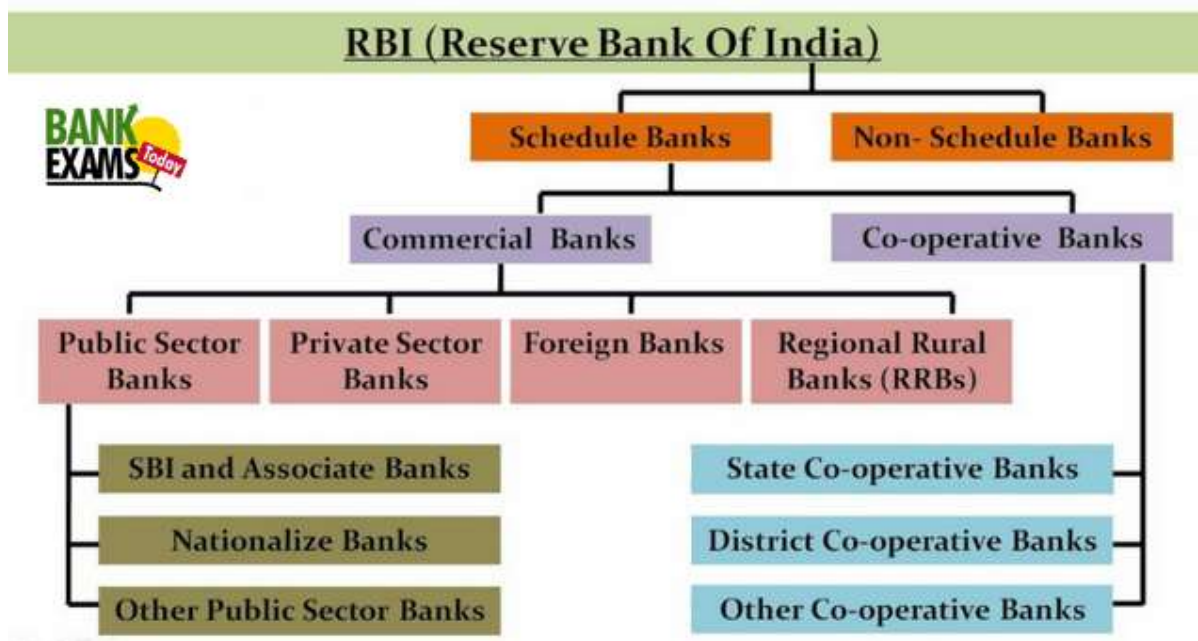
- (i) Short term agricultural institutions
- (ii) Long term agricultural credit institutions
- (iii) Non-agricultural credit institutions

#### **(c) Development Banks:**

- (i) National Bank for Agriculture and Rural Development (NABARD)
- (ii) Small Industries Development Bank of India (SIDBI)

(iii) EXIM Bank

(iv) National Housing Bank.

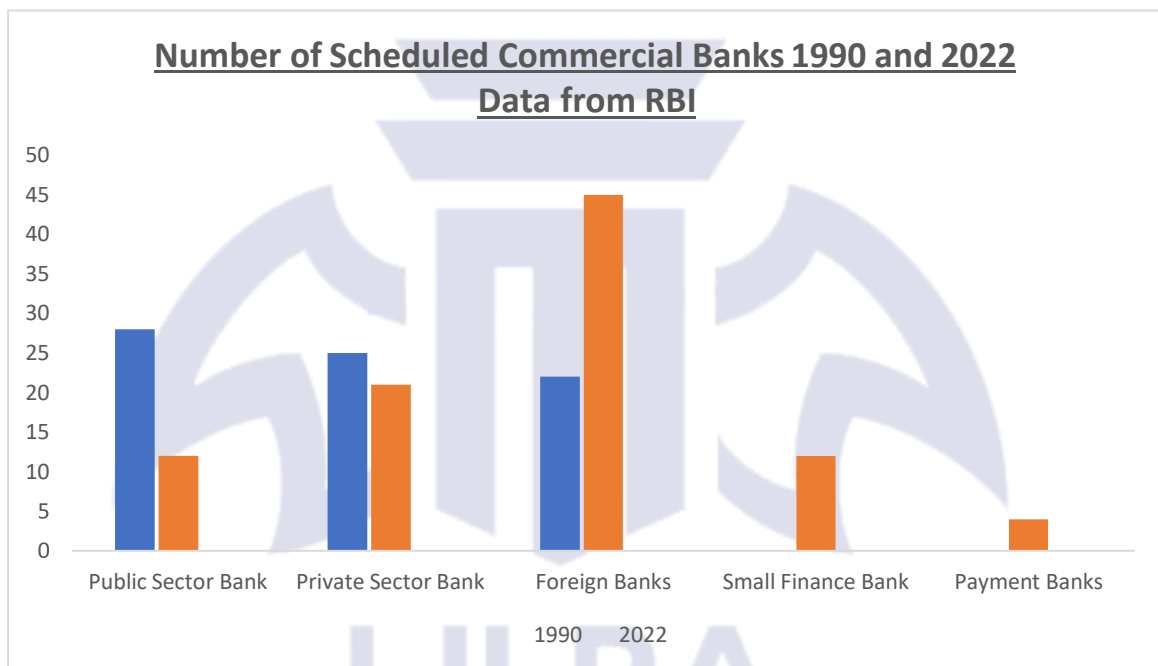


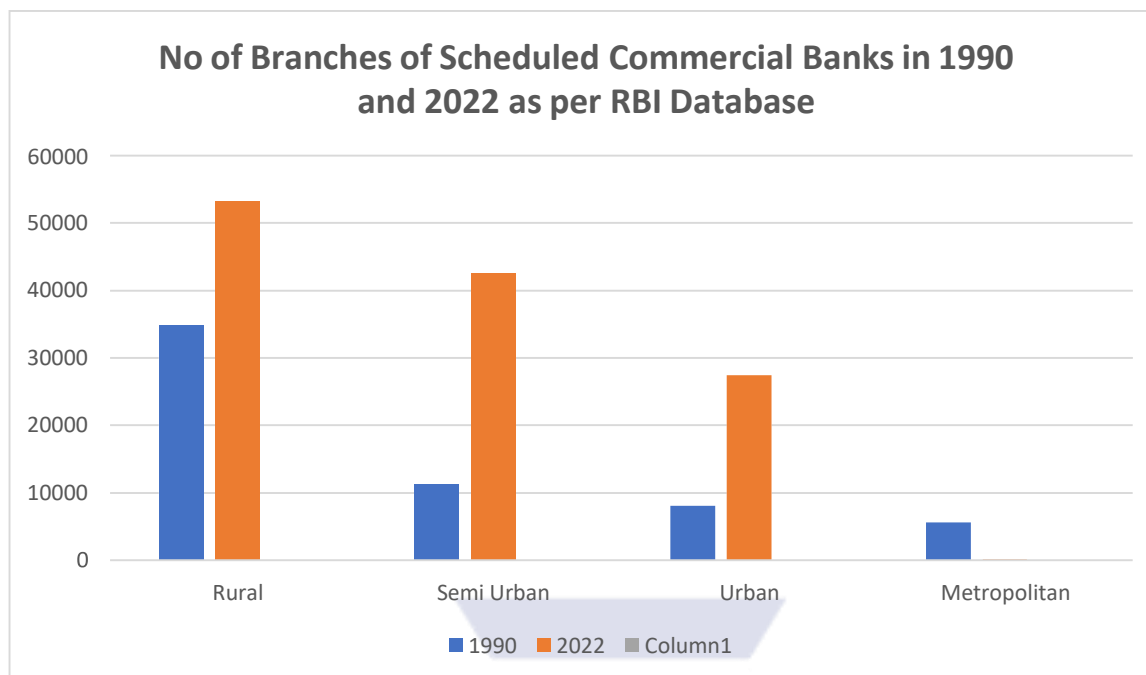
### Public Sector Banks

The term 'public sector banks' by itself connotes a situation where the major/full stake or more than 50 percent shares/ownership in the banks are held by the Government. In Public Sector banks, government takes decision towards financial activities and depositors are having the believe of security for their money. This is the reason that public sector banks are having major bank accounts and liquid. As per the government data there are total 36.2 crore and 1.3 crore beneficiaries in public sector and private sector banks respectively and public sector banks are proving more ATMs in India specially in Rural India State Bank of India is the largest Public Sector Bank of the country with the 64 percent share/ownership of the Government. It is pertinent to mention that till July, 1969, there were only 8 Public Sector Banks in India (State Bank India & its 7 associate banks). In the year 1969 after the nationalization of banks, in total 14 commercial banks (total 20 banks), 100% ownership of these banks were held by the Government of India. Thereafter, again in 1980 more banks were nationalized. However, with the changing in time and environment, these banks were allowed to raise capital through IPOs and there by the share holding pattern has changed. By default the minimum 51% shares would be kept by the Government of India, and the management control of these nationalized banks is only with

Central Government. Since all these banks have ownership of Central Government, they can be classified as public sector banks. Apart from the nationalized banks, State Bank of India, and its associate banks, IDBI Bank and Regional Rural Banks are also included in the category of Public Sector banks.

- (a) State Bank of India and its Associate Banks – 6
- (b) Nationalised Banks – 19
- (c) Regional Rural Banks – 56
- (d) IDBI Bank – 1





## **2. Private Sector Banks**

The major stakeholders in the private sector banks are individuals and corporate. When banks were nationalized under two tranches (in 1969 and in 1980), all banks were not included. Those non nationalized banks which continue operations even today are classified as Old Generation Private Sector Banks like The Jammu & Kashmir Bank Ltd, The Federal Bank, The Laxmi Vilas Bank etc. In July 1993 on account of banking sector reforms the Reserve Bank of India allowed many new banks to start banking operations. Some of the leading banks which were given licenses are: UTI bank (presently called Axis Bank) ICICI Bank, HDFC Bank, Kota Mahindra Bank, Yes Bank etc., These banks are recognized as New Generation Private Sector Banks. Ten banks were licensed on the basis of guidelines issued in January 1993. The guidelines were revised in January 2001 based on the experience gained from the functioning of these banks, and fresh applications were invited. Of the 10 licences issued in 1993, four banks merged with other lenders over a period of time. Times Bank merged with HDFC Bank, while Global Trust Bank was amalgamated with the state-owned Oriental Bank of Commerce. Centurion Bank took over Bank of Punjab to become Centurion Bank of Punjab, which merged with HDFC Bank in 2008. On account of these new generation private sector banks, a new competitive environment was created in the Indian Banking System. These banks were having competitive advantages over their counterparts (of the existing old private banks, public sector banks) in their IT support system, innovative products, and pricing of their products. Private sector banks have been rapidly increasing their presence in

the recent times and offering a variety of newer services to the customers and posing a stiff competition to the group of public sector banks. Total private sector banks as on 31st March 2013 were 22. Besides these, four Local Area Banks are also categorized as private banks. 3. Foreign Banks

The other important segment of the commercial banking is that of foreign banks. Foreign banks have their registered offices outside India, and through their branches they operate in India. Foreign banks are allowed on reciprocal basis. They are allowed to operate through branches or wholly owned subsidiaries. These foreign banks are very active in Treasury (forex) and Trade Finance and Corporate Banking activities. These banks assist their clients in raising External Commercial Borrowings through their branches outside India or foreign correspondents. They are active in loan syndication as well. Foreign banks have to adhere to all local laws as well as guidelines and directives of Indian Regulators such as Reserve Bank of India, Insurance and Regulatory Development Authority, Securities Exchange Board of India. The foreign banks have to comply with the requirements of the Reserve Bank of India in respect to Priority Sector lending, and Capital Adequacy ratio and other norms. Total foreign banks as on 31st March 2013 were 43 having 331 branches. Besides these, 46 foreign banks have their representative offices in India as on 31st March 2013.

### **CO-OPERATIVE BANKING SYSTEM**

Cooperative banks play an important role in the Indian Financial System, especially at the village level. The growth of Cooperative Movement commenced with the passing of the Act of 1904. A cooperative bank is a cooperative society registered or deemed to have been registered under any State or Central Act. If a cooperative bank is operating in more than one State, the Central Cooperative Societies Act is applicable. In other cases the State laws are applicable. Apart from various other laws like the Banking Laws (Application to Co-operative Societies) Act, 1965 and Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004, the provisions of the RBI Act, 1934 and the BR Act, 1949 would also be applicable for governing the banking activities.

These cooperative banks cater to the needs of agriculture, retail trade, small and medium industry and self-employed businessmen usually in urban, semi urban and rural areas. In case of cooperative banks, the shareholders should be members of the co-operative banks. The share linkage to borrowing is a distinctive feature of a co-operative bank. Rural cooperative sector in India plays a vital role in fulfilling the credit requirements of rural agricultural sector of India. At recent times,

the rural credit flow through rural cooperative sector has risen substantially in order to keep pace with the growing demand for credit in the rural parts of India. The Cooperative rural Credit Structure in our country are of following types:

### 1. **Short Term Agricultural Credit institutions.**

The short term credit structure consists of the Primary Agricultural Credit Societies at the base level, which are affiliated at the district level into the District Central Cooperative bank and further into the State Cooperative Bank at the State level. Being federal structures, the membership of the DCCB comprises all the affiliated PACS and other functional societies and for the SCB, the members are the affiliated DCCBs. The DCCB being the middle tier of the Cooperative Credit Structure, is functionally positioned to deal with the concerns of both the upper and lower tiers. This very often puts the DCCB in a position of balancing competing concerns. While the SCB may managing District Central Cooperative wish the DCCB to prioritize its task in a particular manner, the PACs may have their own demands on the DCCB. Balancing these competing concerns could often be a dilemma for the DCCBs.

There are 30 State Cooperative Banks. These banks support and guide 372 District Central Cooperative Banks (DCCBs) in India which have 13478 branches as on March, 2013. These DCCBs are providing finance to more than 35 lakhs farmers through about 1.15 lacs Primary Agricultural Cooperative Societies (PACS).

### 2. **Long Term Agricultural Credit Institutions**

The long term cooperative credit structure consists of the State Cooperative Agriculture & Rural Development Banks (SCARDBs) and Primary Cooperative Agriculture & Rural Development Banks (PCARDBs) which are affiliated to the SCARDBs. The total No. of SCARDB's are 19; of which 10 have Federal Structure, 7 have Unitary Structure and 2 have Mixed Structure (i.e. operating through PCARDBs as well as its own branches). Loans are given to members on the mortgages of their land usually up to 50% of their value in some states or up to 30 times the land revenue payable in other states, duly taking into account their need and repayment capacity. The performance of these banks as on 31st March 2012 has been as under:

No. of SCARDBs  
19

No. of Branches of PCARDBs  
1,056

No. of PCARDBs  
714

No. of Branches of Unitary SCARDBs 761

Total  
Membership  
13.65 Million

Annual Lending 17,603.42 Cr

### 3. Urban Cooperative Banks

The term Urban Cooperative Banks (UCBs), although not formally defined, refers to the primary cooperative banks located in urban and semi-urban areas. These banks, until 1996, were allowed to lend money only to non-agricultural purposes. This distinction remains today. These banks have traditionally been around communities, localities working out in essence, loans to small borrowers and businesses. Today their scope of operation has expanded considerably. The urban co-operative banks can spread operations to other States and such banks are called as multi state cooperative banks. They are governed by the Banking Regulations Act 1949 and Banking Laws (Co-operative Societies) Act, 1965. The total number of UCBs stood at 1,618 as on 31st March 2012. Scheduled UCBs are banks included in the Second Schedule of the RBI Act, 1934 and include banks that have paid-up capital and reserves of not less than ₹5 lacs and carry out their business in the interest of depositors to the satisfaction of the Reserve Bank.

#### DEVELOPMENT BANKS

History of development Banking in India can be traced to the establishment of the Industrial Finance Corporation of India in 1948. Subsequently, with the passing of State Financial Corporation Act, 1951, several SFCs came into being. With the introduction of financial sector reforms, many changes have been witnessed in the domain of development banking. There are more than 60 Development Banking Institutions at both Central and State level. We are discussing here below the major four development banks which assist in extending long term lending and Lesson 1 Overview of Banking System 9 re-finance facilities to different areas of economy for the economic development pertaining to Small Scale and Medium industries, Agricultural Sector and Housing Sector. These financial institutions play crucial role in assisting different segments including the rural economic development.

#### National Bank for Agriculture and Rural Development (NABARD)

National Bank for Agriculture and Rural Development (NABARD) was established in July 1982 by an Act of Parliament based on the recommendations of CRAFICARD. It is the apex institution concerned with the policy, planning and operations in the field of agriculture and other rural economic activities. NABARD has evolved several refinance and promotional schemes over the years and has been making constant efforts to liberalize, broad base and refine/ rationalize the schemes in response to the field level needs. The refinance provided by NABARD has two basic objectives:

- (i) Supplementing the resources of the cooperatives banks and RRBs for meeting the credit needs of its clientele, and
- (ii) Ensuring simultaneously the buildup of a sound, efficient, effective and viable cooperative credit structure and RRBs for purveying credit.

NABARD undertakes a number of inter-related activities/services which fall under three broad categories

**(a) Credit Dispensation :**

NABARD prepares for each district annually a potential linked credit plan which forms the basis for district credit plans. It participates in finalization of Annual Action Plan at block, district and state levels and monitors implementation of credit plans at above levels. It also provides guidance in evolving the credit discipline to be followed by the credit institutions in financing production, marketing and investment activities of rural farm and non- farm sectors.

**(b) Developmental & Promotional**

The developmental role of NABARD can be broadly classified as:- – Nurturing and strengthening of - the Rural Financial Institutions (RFIs) like SCBs/SCARDBs, CCBs, RRBs etc. by various institutional strengthening initiatives. – Fostering the growth of the SHG Bank linkage programme and extending essential support to SHPIs NGOs/VAs/ Development Agencies and client banks. – Development and promotional initiatives in farm and non-farm sector. – Extending assistance for Research and Development. – Acting as a catalyst for Agriculture and rural development in rural areas.

**(c) A Supervisory Activities**

As the Apex Development Bank, NABARD shares with the Central Bank of the country (Reserve Bank of India) some of the supervisory functions in respect of Cooperative Banks and RRBs.

### **Small Industries Development Bank of India (SIDBI)**

Small Industries Development Bank of India (SIDBI) was established in October 1989 and commenced its operation from April 1990 with its Head Office at Lucknow as a development

bank. It is the principal and exclusive financial institution for the promotion, financing and development of the Micro, Small and Medium Enterprise (MSME) sector and for co-ordination of the functions of the institutions engaged in similar activities. It is a central government undertaking. The prime aim of SIDBI is to support MSMEs by providing them the valuable factor of production finance. Many institutions and commercial banks supply finance, both long-term and short-term, to small entrepreneurs. SIDBI coordinates the work of all of them. SIDBI has evolved a strategy to analyze the problems faced by MSMEs and come out with tailor-made solutions. It has covered around 600 MSME clusters, through a pan-India network of 85 branches, 50 Credit Advisory Centres, and partnerships with cluster-level industry associations as on January 31, 2013. A unique scheme of the credit guarantee for Micro and Small Enterprises called CGTMSE has provided coverage to about 1 million with guarantee covers for an aggregate loan amount of over ₹ 48,000 crore.

### **RESERVE BANK OF INDIA**

The Reserve Bank, as the central bank of the country, started their operations as a private shareholder's bank. RBI replaced the Imperial Bank of India and started issuing the currency notes and acting as the banker to the government. Imperial Bank of India was allowed to act as the agent of the RBI. RBI covered all over the undivided India. In order to have close integration between policies of the Reserve Bank and those of the Government, It was decided to nationalize the Reserve Bank immediately after the independence of the country.

From 1st January 1949, the Reserve Bank began functioning as a State-owned and State-controlled Central Bank. To streamline the functioning of commercial banks, the Government of India enacted the Banking Companies Act, 1949 which was later changed as the Banking Regulation Act 1949. RBI acts as a regulator of banks, banker to the Government and banker's bank. It controls financial system in the country through various measures.

### **LEGAL FRAMEWORK FOR REGULATION OF BANKING SYSTEM**

**Reserve Bank of India Act, 1934:** The Reserve Bank of India Act, 1934 was enacted to constitute the Reserve Bank of India with an objective to (a) regulate the issue of bank notes

(b) for keeping reserves to ensure stability in the monetary system (c) to operate effectively the nation's currency and credit system. The RBI Act covers: (i) the constitution (ii) powers (iii) functions of the Reserve Bank of India. The act does not directly deal with the regulation of the banking system except for few sections like Sec 42 which relates to the maintenance of CRR by banks and Sec 18 which deals with direct discount of bills of exchange and promissory notes as part of rediscounting facilities to regulate the credit to the banking system.

The RBI Act deals with:

- (a) incorporation, capital, management and business of the RBI
  - (b) the functions of the RBI such as issue of bank notes, monetary control, banker to the Central and State Governments and banks, lender of last resort and other functions
  - (c) general provisions in respect of reserve fund, credit funds, audit and accounts
  - (d) issuing directives and imposing penalties for violation of the provisions of the Act, Banking Regulation Act, 1949
- The Banking Regulation Act, 1949 is one of the important legal frameworks. Initially the Act was passed as Banking Companies Act, 1949 and it was changed to Banking Regulation Act 1949. Along with the Reserve Bank of India Act 1935, Banking Regulation Act 1949 provides a lot of guidelines to banks covering wide range of areas. Some of the important provisions of the Banking Regulation Act 1949 are listed below. – The term banking is defined as per Sec 5(i) (b), as acceptance of deposits of money from the public for the purpose of lending and/or investment. Such deposits can be repayable on demand or otherwise and withdraw able by means of cheque, drafts, order or otherwise
- Sec 5(i)(c) defines a banking company as any company which handles the business of banking
  - Sec 5(i)(f) distinguishes between the demand and time liabilities, as the liabilities which are repayable on demand and time liabilities means which are not demand liabilities – Sec 5(i)(h) deals with the meaning of secured loans or advances. Secured loan or advance granted on the security of an asset, the market value of such an asset in not at any time less than the amount of such loan or advances. Whereas unsecured loans are recognized as a loan or advance which is not secured
  - Sec 6(1) deals with the definition of banking business – Sec 7 specifies banking companies doing banking business in India should use at least on work bank, banking, banking company in its name

– Banking Regulation Act through a number of sections restricts or prohibits certain activities for a bank.

For example:

- (i) Trading activities of goods are restricted as per Section 8
- (ii) Prohibitions: Banks are prohibited to hold any immovable property subject to certain terms and conditions as per Section 9 . Further, a banking company cannot create a charge upon any unpaid capital of the company as per Section 14. Sec 14(A) stipulates that a banking company also cannot create a floating charge on the undertaking or any property of the company without the prior permission of Reserve Bank of India
- (iii) A bank cannot declare dividend unless all its capitalized expenses are fully written off as per Section 15. Other important sections of Banking Regulation Act, 1949 Sections 11 and 12 deals with the Paid up Capital, Reserves and their terms and conditions, Sec 18 specifies the Cash Reserve Ratio to be maintained by Non-scheduled banks and Sec 19 (2) clarifies about the share holding of a banking company. No banking company shall hold shares in any company, (either as pledge, or mortgagee or absolute owners of any amount exceeding 30% of its own paid up share capital plus reserves (or) 30% of the paid up share capital of that company whichever is less Section 24 specifies the requirement of maintenance of Statutory Liquidity Ratio (SLR) as a percentage (as advised by Reserve Bank of India from time to time) of the bank's demand and time liabilities in the form of cash, gold, unencumbered securities Other compliance requirements. Section 29 – Every bank needs to publish its balance sheet as on March 31st Section 30(i) – Audit of Balance sheet by qualified auditors

Section 35 gives powers to RBI to undertake inspection of banks Other various sections deal with important returns which are to be submitted by banks to Reserve Bank of India

- Return of bank's liquid assets and liabilities (Monthly) – Return of bank's assets and liabilities in India (Quarterly) – Return of unclaimed deposits of 10 years and above (Yearly)

With changing time and requirements from time to time, various other compliance issues which need to be handled by banks, have been amended/incorporated relating

### **HISTORY OF BANKING SYSTEM IN INDIA**

The History of Banking in India dates back to before India got independence in 1947. The financial system has been around for almost as long as civilization itself, and the Indian banking

system is no exception. Read here to learn about the history of banking in India.

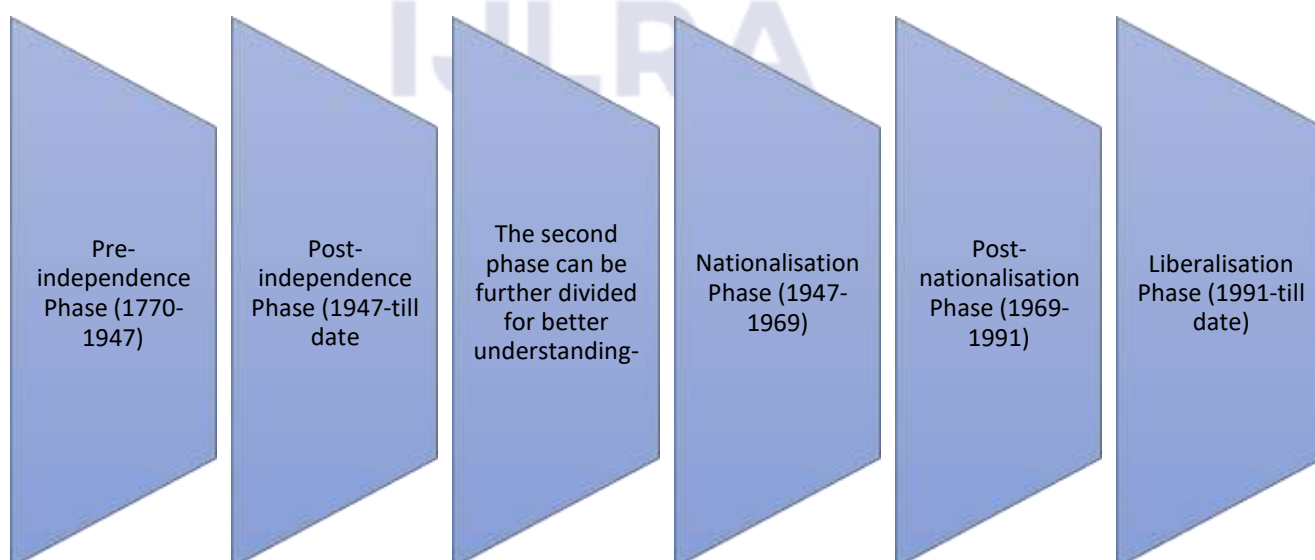
A nation’s financial system supports its economic growth. The banking industry in India has seen significant changes during the past five centuries due to the state of the economy, the need for financial services, and the subsequent advances in technology.

It appears from historical accounts from Greece, Rome, Egypt, and Babylon that temples did more than just save money; they also lent it out. One reason temples were often looted during conflicts was that they frequently served as the financial hubs of their towns.

Since the first coins were produced and wealthy individuals realized they required a secure location to put their money, banking has existed. For commerce, wealth distribution, and taxation, ancient empires also need a sound financial system.

The vedas, the ancient Indian texts mention the concept of usury, which is a practice of making unethical monetary loans which is advantageous to the lender. The Sutras (700–100 BCE) and the Jatakas (600–400 BCE) also mention usury. During the Mauryan Period (321–185 BCE), an instrument called adesha was in use, which was an order on a banker directing him to pay the sum on the note to a third person, which corresponds to the definition of a modern bill of exchange. The use of loan deeds continued into the Mughal era and was called dastawez (in Urdu/Hindi). The evolution of hundis, a type of credit instrument, also occurred during this period and remains in use.

**The history of banking in India can be broadly classified as:**



The first banking institution was the Bank of Hindustan established in 1770 and it was the first bank at Calcutta under European management. It was liquidated in 1830-32. In 1786 General Bank of India was set up but it failed in 1791. Calcutta developed as a banking hub since it was India's busiest port for trade, mostly because of the British Empire's trade. The British East India Company granted the Bank of Calcutta, Bank of Bombay, and Bank of Madras licenses to establish the three Presidency banks. For long years, they operated in India as if they were central banks. The Bank of Calcutta established in 1806 immediately became the Bank of Bengal. These three banks joined in 1921 to become the Imperial Bank of India. Later, in 1955, the Imperial Bank of India was nationalized in 1955 and was named The State Bank of India, which is currently the largest Public sector Bank. Before the Reserve Bank of India was founded in 1935 under the Reserve Bank of India Act, of 1934, the presidency banks and their successors served as quasi-central banks for a long time. Consequently, the State Bank of India is the country's oldest bank.

The History of Banking in India dates back to before India got independence in 1947. The financial system has been around for almost as long as civilization itself, and the Indian banking system is no exception. Read here to learn about the history of banking in India. A nation's financial system supports its economic growth. The banking industry in India has seen significant changes during the past five centuries due to the state of the economy, the need for financial services, and the subsequent advances in technology. It appears from historical accounts from Greece, Rome, Egypt, and Babylon that temples did more than just save money; they also lent it out. One reason temples were often looted during conflicts was that they frequently served as the financial hubs of their towns. Since the first coins were produced and wealthy individuals realized they required a secure location to put their money, banking has existed. For commerce, wealth distribution, and taxation, ancient empires also need a sound financial system. Many large banks were unable to function because of a lack of management expertise, equipment, and technology, which resulted in laborious procedures and mistakes made by humans, making Indian account holders vulnerable to fraud. A few banks have endured and are still around today like the Allahabad Bank (1865), Punjab National Bank (1894), etc.

The Government of India (GOI) chose the strategy of a mixed economy with considerable market involvement in 1948 to develop the economy, continuing the evolution of the Indian banking sector post-independence. After being established in 1935, the Reserve Bank of India was nationalized in 1949 and given the authority to oversee, govern, and inspect all banks in India. Even though the reach of banks has spread to rural areas also, the financial inclusion of the poor remains a challenge. Many initiatives like NABARD are being implemented to rectify this issue.

Indian banking is walking hand in hand with technological advancement as well.

The National Payments Corporation of India and the Government of India together unveiled the UPI (Unified Payment Interface) System and BHIM in 2016, ushering in the era of digital payments and what is commonly referred to as mobile banking.

Following technological developments, several fintech in the nation has advanced digital banking in collaboration with conventional banks to offer a wide range of financial services. Full-stack “digital banks,” which will solely rely on the Internet to provide their services and not on their physical branches, were planned to be established by Niti Aayog in 2021. Digital banking in India is anticipated to undergo a revolution as a result.

### **Merger: one of the mechanism to support and regulate small banks with less capital**

#### **MERGER OF BANK**

**What is merger:** Merger of banks is the process by which assets and liabilities enters into a one entity and subsequently works as a single in market. Merger is the best process through which two or more banks comes together and acts as a single larger bank.

**Purpose of merger:** Merger of the banks are necessary for the stability of financial condition of banks. This process and concept was initiated to support weak banks with lower liquidity and capital. Idea of merger is not new in banking system in the world and this has been floating since 1998 after the recommendation of committee. The purpose of merging of banks is to facilitate the creation of large and strong and competitive banks at international level, national level and regional level. The concept of merger and consolidation of banks is not a new idea and same has been floating from many committee’s recommendations.

#### **Committees for merger recommendations:**

- Narasimham Committee (1998),
- Indian Banking Association Report 2004,
- Planning Commission report 2008,
- Leeladhar Committee 2008 and
- PJ Nayak Committee 2014.

All these committees have recommended for the consolidation of banks for facilitating

strong financial status of the banks, greater geographical coverage of banks and maximum reach of the banks to general public etc.

### **What are Legal Framework of Merger of Banks:**

The parliament has enacted the law for the merger of banks.

Act for merger of banks is Banking Companies (Acquisition and Transfer of Undertakings) Acts 1970. The objectives of the Banking Companies (Acquisition and Transfer of Undertakings) Acts 1970 and 1980 are: *“to provide for the acquisition and transfer of the undertakings of certain banking companies, having regard to their size, resources, coverage and organization, in order further to control the heights of the economy, to meet progressively and serve better, the needs of the development of the economy and to promote the welfare of the people, in conformity with the policy of the state towards securing the principles laid down in clauses (b) and (c) or Article 39 of the Constitution and for matters connected therewith or incidental thereto.”* (underlined portions appear in the 1980 Act). Clearly, the need to re-size PSBs to enable them to become more competitive, improve their capacity for greater geographical coverage, diversify their product offerings and access resources more effectively is in line with the objectives of the nationalisation acts. The relevant provisions relating to amalgamation of these banks are given in Section 9(2)(c) and section 9(6) of the said Act, which read as follows:

*Section 9(2)(c): “The Central Government, in consultation with RBI, may make a scheme which may provide for*

- (a) The reconstitution of any corresponding new bank into two or more corporations,*
- (b) The amalgamation of any corresponding new bank with any other corresponding new bank or with another banking institution, or*
- (c) The transfer of the whole or any part of the undertaking of a corresponding new bank to any other corresponding new bank or banking institution or the transfer of the whole or any part of the undertaking of any other banking institution to a corresponding new bank”.*

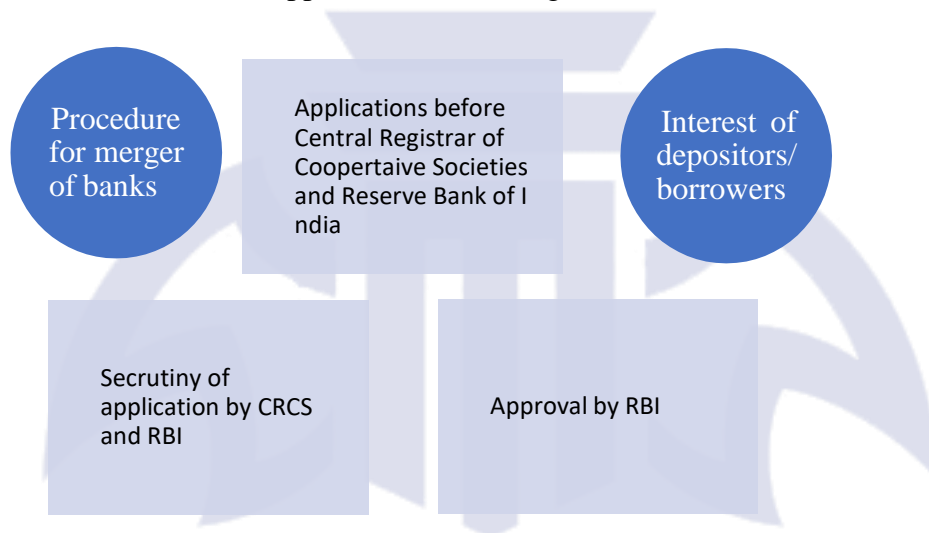
Further, as per Section 9(6) of the Act:

*“Every Scheme made by Central Government under this Act shall be laid, as soon as may be after it is made, before each House of Parliament while it is in session for a total period of 30 days, (which may be comprised in one session or in two or more successive sessions, and if before the expiry of the session immediately following the session or the successive sessions aforesaid)*

*both Houses agree in making any modification in the scheme or both Houses agree that the scheme should not be made, the scheme shall thereafter have effect only in such modified form or be of no effect, as the case may be; so, however, that any such modification or annulment shall be without prejudice to the validity of anything previously done under that scheme.*

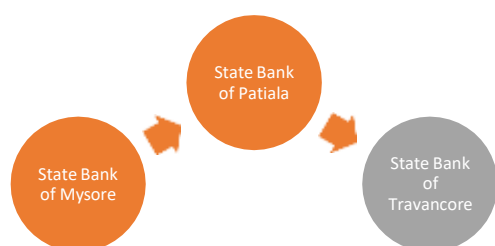
**WHAT IS THE PROCEDURE OF MERGER:**

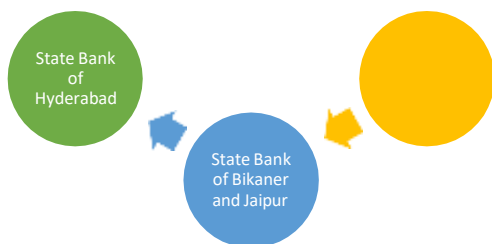
Before merger of any bank concern, it has to submit an application before the Central Registrar of Cooperative Societies (CRCS) and one application is also required to be sent before Reserve Bank of India (RBI) along with relevant information for the consideration of merger scheme. Thereafter, RBI examines the scheme keeping the interests of depositors/borrowers into consideration. This is after the approval of RBI, merger of banks are done.



In the recent time, 5 associate banks of SBI were merged with State bank of India. State bank of Patiala, State bank of Mysore, Travancore, Hyderabad, Bikaner and Jaipur were merged/consolidated. Bhartiya Mahila Bank was also merged with SBI.

**Merger of State Banks with State Bank of India**





The Government of India has also amalgamated the Regional Rural Banks. After the amalgamation of Regional Rural Banks number has been decreased from 56 to 38 only. In 2019, Government of India took the decision of amalgamation of 10 nationalised banks, that resulted in decline of Public Sector Banks to 12.

The purpose of merger of banks is to protect weak public sector banks from loss and securing the interest of customers and supporting financial system of the banks. The another purpose of banks merger is to ensure the presence of Indian Banks at International Level. As per the recent report, State Bank of India (SBI) is the only bank at the 55<sup>th</sup> position in the Global Top 100 list. On the other hand, neighbouring countries has multiple banks in top 100. China has 18 banks in global list of 100 banks and US has 12. As per the report, Finland, Denmark, Belgium, Austria, Norway like countries which is not a big country in the aspect of geographical area has good number of representation of global banks in top 100 list. The researcher is of the view that since India is a fifth largest economy in the World, then it must have at least six banks in the top 100 global list.

### Purpose of merger of banks

Protect weak public sector banks from loss.

Secure the interest of customers and support financial system of the banks

Ensure the presence of Indian Banks at International Level

### What are the Benefits of a Merger?

- **Economies of Scale:**
  - Merger of banks will result in better **scale efficiency** due to a rise in customer base, increased market reach.

- A wider bouquet of products and services for customers would result in **decreased risk in lending capital meet the credit needs of the growing Indian economy.**
- The banking entities formed after merging PSU banks will be **able to absorb financial shocks better.**
- Large banks through consolidation of PSBs will have large balance sheets which can
  - **Increased Operational Efficiency:**
    - With the number of PSBs coming down after a merger – capital allocation, performance milestones, and monitoring would become easier for the government.
    - A synergistic relationship would optimally use one another's network, customer base and access to low cost deposits.
    - Organisational restructuring would lead to better managerial efficiency and also provides scope for learning the best practices of each constituent entity.
  - **Strengthens Banks at Global Level:**
    - Stronger and globally competitive banks would provide increased choices to the stakeholders.
    - It will also build capacity in PSBs to raise resources without depending on the state exchequer.

### **What are the Challenges regarding the Merger?**

- A complex merger with a weaker and under-capitalized PSB would stall the bank's recovery efforts as **the weaknesses of one bank may get transferred** and the merged entity may become weak.
- For instance, a weak Dena Bank (under **Prompt Corrective Action**) may impact **stronger banks** like Bank of Baroda & Vijaya Bank.
- There would be a number of human resources issues such as **difficulty in adapting to new emerging culture**, discontent due to far-flung transfers etc.
- Customer retention would become problematic as there might be **a lack of comfort in banking with larger parent bank.**
- Bigger banks may follow **monopolistic behavior with increased market power** resulting in neglect of local needs.
- The amalgamation of the balance sheet of PSBs **will only impact NPA cosmetically, without actually working on NPA recovery.** This will further divert the process of NPA resolution.

### **What can be the Way Forward?**

- **Dual regulation** by the Ministry of Finance and RBI on PSBs often results **in paralysis in decision making** which makes consolidation of banks a redundant measure if they are not given power to act swiftly, as pointed by PJ Nayak Committee.
- **The governance of public banks needs to be improved** before making any significant change in any emerging architecture.
- Bigger banks offer more resilience to the banking sector but overlooking **bigger red flags like strong credit appraisal and risk control system** would do little help in creating robust banks.
- Therefore, due focus on ensuring a strong foundation of PSBs is important.

### **Regulation through Repo Rate, SLR and CRR by RBI**

CRR is an important tool of the Monetary Policy. Monetary Policy is the process of regulating the supply of money in an economy by the monetary authority of the country. A specific CRR is provided to each commercial bank in India by the RBI. The Reserve Bank of India is authorised to make monetary policy under the Reserve Bank of India Act, 1934 and can set the cash reserve ratio between 3% and 15%.

### **What is a Cash Reserve Ratio? What is liquidity:**

Liquidity refers to the availability of cash or other highly liquid assets that can be easily converted into cash to meet short term funding needs.

### **Repo rate and reverse repo rates are determined by the RBI.**

Reserve bank of India is a bankers of banks, who gives loan to banks in two ways long term and short term. Banks can take loan from RBI. Long term interest rate is known as bank rates and short term bank loan is known as Repo rate. Loan interest to the customers depends on the repo rate. If repo rate is high then obviously loan interest to the customers will be high. It is pertinent to mention that if banks get loan from RBI at lesser repo rates then people will get more and more loan at lesser interest rates. However, if banks get loan from RBI at higher repo rate then people will get less loan even at high interest.

In case of decrease of CRR and Repo rate, liquidity of bank will increase and banks will be in the position to give more loan to the customers. In case of increase of CRR and Repo Rate, liquidity

of Bank will decrease and banks will be in the position to give less loan to the customers. Repo rate term loan: Banks has to place with RBI some Government Security. There is repurchase agreement.

Cash Reserve Ratio (CRR) is a specific part of the total deposit that is held as a reserve by the commercial banks and is mandated by the Reserve Bank of India (RBI). This specific amount is held as a reserve in the form of cash or cash equivalent which is stored in the bank's vault or is sent to the RBI. CRR ensures that the banks do not run out of money.

Cash Reserve Ratio in India is decided by the Monetary Policy Committee (MPC) under the periodic Monetary and Credit Policy. If the CRR is low, the liquidity with the bank increases, which in turn goes into investment and lending and vice-versa. Higher CRR creates a negative impact on the economy and also lowers the availability of loanable funds. As a result, it slows down the investment and reduces the supply of money in the economy.

### **Significance of CRR**

- CRR is an important tool of the Monetary Policy which provides the following benefits:
- CRR regulates the money supply and the level of inflation in the country.
- CRR ensures the security of the reserved amount as the specific amount of the bank's deposit is stored with the Reserve Bank of India which can be readily available as per the need of the customers.
- CRR also has a major role to play during high inflation. During high inflation, the Reserve Bank of India increases the CRR rate to reduce the amount of money that is available with the banks. This reduces the excess flow of money in the economy.
- During the need of funds, the government can lower the rate of the CRR to help the banks in providing loans to various businesses and industries for investment. A low rate of CRR also increases the growth rate of the economy.

### **Repo Rate and Reverse Repo Rate**

- Repo rate can be defined as an amount of interest that is charged by the Reserve Bank of India while lending funds to the commercial banks. The word 'Repo' technically stands for 'Repurchasing Option' or 'Repurchase Agreement'. Both the parties are required to sign an agreement of repurchasing which will state the repurchasing of these securities on a specific date at a predetermined price. The repo rate in India is controlled by the Reserve Bank of India.
- Any changes in the repo rates can directly impact the economy. A decrease in the repo

rates helps in improving the growth and economic development of the country. A decline in the repo rate can lead to the banks bringing down their lending rate which is beneficial for retail loan borrowers.

### **Reverse Repo Rate**

▪ The reverse repo rate is the rate of interest that is provided by the Reserve bank of India while borrowing money from the commercial banks. In other words, we can say that the reverse repo is the rate charged by the commercial banks in India to park their excess money with RBI for a short-term period. The current reverse repo rate in India as of May 2022 is 3.35%. Reverse repo rate is an important instrument of the monetary policy which control the money supply in the country.

### **components of Repo Transaction**

▪ Some of the major components of the Repo Transaction which is important for the agreement of the RBI for executing any transaction with the banks are as follows:

**Preventing economy squeezes:** The Reserve Bank of India can increase or decrease the repo rate depending on the inflation and thus, it can control the economy of the country.

**Short-Term Borrowing:** RBI can lend money to the commercial banks for a short period of time provided that the banks must buy back their deposited securities at a predetermined price.

**Collaterals & Securities:** Collaterals in the form of gold and bonds are also accepted by the RBI.

**Liquidity:** The funds borrowed by the banks from the RBI are kept as a precautionary measure to maintain liquidity.

### **What is financial reform and Why there is need of Financial reforms**

In any country financial reform is necessary for the development of economy. Regular financial reform results in growing the economy at very swiftly. With financial reforms when can achieve following goals:

- Initiate deregulation, due to heavy regulation in the financial industry.
- Make the financial sector more efficient, productive, and profitable. With efficient and profitable finance sector more and more steps for the development of country in education, health, infrastructure and market etc can be taken strongly.

- Promotion of market determination of interest rates, for efficient resource allocation.
- Autonomy to be provided to institutions, to promote both operational and functional independence Establishment of financial stability to protect against internal and external shocks.
- Preparation of the financial sector for exposure to international competition.
- Opening of the external sector in a staggered manner.
- Merger small financial body and create a larger one with capital value.
- To create largest bank with international footprints.
- To bring Indian banks in the top list of world.
- To give financial assistance to under developing country.
- To give maximum contributions in international financial body.

### **Committee for Financial sector reforms:**

#### **The Narasimhan Committee-I Report (1991)**

The Narasimhan committee has time to time recommended various reforms in Banking system for its sustainable development and progress financially. Narasimhan committee -I report has recommended following reforms: Key recommendations given by the Narasimhan Committee on Financial Sector reforms were:

- Phased reduction in Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) for banks. CRR is an important tool of the Monetary Policy. Monetary Policy is the process of regulating the supply of money in an economy by the monetary authority of the country. Therefore, it becomes necessary to have continuous recommendations on CRR. Statutory Liquidity Ratio (SLR) is also a monetary policy mechanism framed by RBI. The purpose of SLR is to maintain minimum percentage of deposits that a commercial bank has to maintain either in the form of Gold, Cash or other securities. SLR is a fixed form of control over the credit growth in India. Government of India uses the SLR mechanism to control the inflation in India. Whenever SLR rate increases, it decreases the flow of liquidity in the market and secure the general public from any kind of risks and fraud in future. The purpose of SLR and CRR monetary mechanism is to check the expansion of bank credit and to ensure the solvency of banks in Indian Banking System and it also compels the banks for the investment in government securities. The SLR has been prescribed under section 24 (2A) of Banking regulation Act, 1949.
- Directed credit program to be phased out;
- Priority sector to be redefined to comprise weaker sections.

- Interest rates to be deregulated according to the emerging market conditions Capital adequacy to risk weighted assets to be a minimum of 4 per cent for Banks by March 1993.
- The BIS standard of 8 per cent to be achieved in the following three years i.e., March 1996. Bank for International Settlement (BIS) is a world's oldest financial institution in the world to regulate and maintain the financial activities of banks in the membercountries.

In the case of NPAs (Non-Performing Assets), no income to be recognized in accounts. Assets to be segregated in four categories as standard, sub-standard, doubtful and loss. Provisions had to be made accordingly for those assets that fell in the last three categories. Provisions for Sub-standard assets to be 10 per cent of total assets in this category, while Doubtful category attracts 100 per cent of the security shortfall plus 20 to 50 per cent of further provision, depending on the period these assets remain in this category. Assets falling in the Loss category to be provided up to 100 per cent or fully written off. Transparency to be brought in the balance sheets of Banks and Financial Institutions to ensure adherence to the provisioning requirements. The processes to be aligned with tax authorities giving due cognizance to the NPA and provisioning requirements. Special tribunals to be set up for recovery. Asset Reconstruction fund to be created to take over all bad and doubtful debts in a phased manner. Private sector banks to be treated at par with public sector banks. Rural banking subsidiaries to be set up by public sector banks. Branch licensing to be abolished; individual banks can make the decision of opening and closing of branches (except branches in the rural areas) depending on the commercial viability. Foreign banks to be treated at par with domestic banks. Proposed structure of banking system: o 3 to 4 Large Banks (including SBI) with international operations o 8 to 10 National Banks with branches across the country, providing universal banking. o Local banks operational in specific regions o Rural banks operational in rural areas, engaged in mostly agricultural and allied areas. Computerisation to play a vital role in improving customer service, systems, and processes. Banks to be given more say in the internal administration of banks Supervision in banks to be based on prudential norms and regulations. More focus on internal audit and inspection.

### **BASEL COMMITTEE.**

In the year 1974, the central governors of the G10 countries has constituted the Basel Committee on Banking Supervision for the supervision on banking system in G10 countries. The committee was established in the year 1974 for the world's economy. Initially this was covering only group of 10 countries but now it has covered major part of world's countries. BCBS is the committee of Bank for International settlements (BIS). The headquarter of BIS is at Basel Switzerland. BIS is a world's oldest financial institution in the world to regulate and maintain the financial activities

of banks in the member countries.

The membership of BIS is not mandatory and this is only a voluntary in nature. BIS was established in 1930. This is presently covers around 62 central banks of the countries. This covers the 99.5 percent GDP of the world's economy. BIS acts as a hub for central banks of the countries to exchange information, collaborate, and promote monetary and financial stability worldwide.

The purpose of committee of BIS namely BCBS (supra) was to ensure financial stability in banking system. The Basel Committee on Banking Supervision (BCBS) reports to Group of Central Bank Governors and Head of Supervision in Basel, Switzerland. The committee has framed Basel I, II and III norms for the banks.

As per the norms of Basel III, banks are required to maintain higher capital adequacy ratios (like keeping money in secrecy for future problems) and quality of capital to withstand the situation of Financial Stress in Banking System and tackle sudden economic downturns. The capital ratio can be classified in Tier 1 and 2 capitals. Basel III has given concept of CAR (Capital Adequacy Ratio), CRWA (Capital to Risk weighted asset ratio) and RWA (Risk Weighted assets).

Basel III norms has been sustained on three pillars. First pillar of the norms is Minimum Capital requirements meaning thereby is that banks are required to maintain minimum liquidity in banks. Not only banks have to maintain minimum capital but also keep buffer of liquidity for additional capital requirement. The purpose of Basel norms is to ensure sound and stable global banking system in the world.

The second pillar of the norm is supervisory review of banks financial activities regularly to identify and manage all the future risks, to mitigate risks, possible loss of depositors' savings, loss of confidence of general public in the banking system and credit crunch.

The third pillar of Basel III norm is Market Discipline.

Basel I guidelines focus only on the minimum capital requirements for the banks, whereas Basel II framework has broadened the scope of this approach. Basel II not only targets the additional risks to be covered in the capital adequacy ratios, but also includes two key areas of the Supervisory Review Process (SRP) and market discipline, incorporating enhanced disclosure requirements. Subsequently, Basel III regulations further reinforces these measures with requirements for added buffers for the creation of robust processes.

According to the Basel II & III guidelines, Pillar 2 (SRP) requires banks to implement an internal process, called the Internal Capital Adequacy Assessment Process (ICAAP), for assessing their

capital adequacy with respect to their risk profiles, as well as a strategy for maintaining their capital levels. Risk management systems must be established in banks and the presence of a review mechanism by the supervisory authority is mandated by RBI.

### **The advantages of Basel Norms**

1. High stability, banks with high capital backup is essential for the development of the country.
2. Less credit, market and operational risks, these risks are not good for any banking system. Due to these risks, banks may suffer huge financial loss of depositors.
3. It improves capital in banks,
4. Enhance the confidence of public in banking system,

### **Disadvantages of Basel Norms.**

1. In this world of non-banking financial system, where NBFCs are earning a lot from lended money at high risk, banks has restrictions. The banks has to keep minimum capital backup compulsorily.

Basel norms are not mandatorily applicable on Indian Banks unless rules under the authority of RBI. This is the RBI who has to frame the rules and regulations for the Indian Banking System.

### **Risk faced by Banks:**

**Credit Risk:** The loan risk is a very big risk of any banking system in the world. Banks has arranged the money from the deposits of general public, markets through equity and debts. Then at the time of giving loan, banks have to check and ensure the no default is done if loan is granted to customer, businesses and others. On the failure of banks loan repayment, this is the ultimately depositors who had to suffer a lot.

**Market Risk:** Banks also have surplus liquidity and funds after the loan, in such situation banks used to do investment in market as Gold, securities and bonds, shares and real estates etc. some of these investments are very risky as their prices used to fluctuate.

**Operational Risk:** After the credit and market risks in banking system, banks also have some operational risks also. Sometime due to fraud, scams, theft, cyber attacks, infrastructural issues and data loss banks has to suffer a big loss in terms of money.

To tackle these kind of risks, basel committee on banking system has formulated the Basel I

norms in 1988 and in 2004 Basel II norms. In 2010 Basel III norms were formulated. The central bank of countries can adopt these norms. Currently central banks of countries are following the norms of Basel III.

### **What is NPA and HOW MSME ARE ONE OF THE CAUSE OF HUGE NPA**

Non-Performing Assets as the name suggests the meaning of NPA is that when there is no profit for the banks from borrowers and neither principal nor interest are being paid by the borrowers. Basically a loan becomes NPA when same remains unpaid for 90 days in normal cases and 2 cropping seasons in agriculture.

There are various reasons for NPA. Banks has classified NPAs further into three categories i.e. Sub-standard assets( assets which is NPA for a period of less than or equal to twelve months), Doubtful assets (NPA for more than twelve months) and loan assets (which is uncollectable, no hope for recovery, recovery has been done for little part). There is also one another category of write-offs loan. Write-offs refer to the removal of a NPA loan from the bank's record. Write-offs is a procedure where banks acknowledge that there is no possibility of recovery and it will reflect as NPA on banks and therefore for time been same is strike of from the records. The write-offs is not a solution of the problems of NPA. This process does not absolve the borrowers from his obligation to pay loan. It just acknowledgment from the bank that loan is highly unlikely to recover. There are various reasons for NPA. NBFCs has contributed in this.

Rules and Regulations to deal with NPAs in India

1. The Recovery of Debts due to banks and Financial Institutions Act (RDB Act), 1993
2. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI Act), 2002: with the help of this act banks are given power to take possession and sell secured assets of the borrowers who failed to repay the loan.
3. The Insolvency and Bankruptcy Code (IBC), 2016.

It is pertinent to mention that as per the recent report of RBI, the gross non-performing assets (GNPA) ratio for Scheduled Commercial Banks has witnessed a decline in NPA. SCBs has a significant falling in NPA from 3.9% at the end of March 2023 to 3.2% by the end of September, 2023. There are various reasons of NPA increase in India. It has been seen that firms, company and individually are taking loans very aggressively and there has been flexibility in rules for taking loans for starting new businesses in India. Most of the investment from the loans has been done in the sector like roads, aviation, power and steel etc. Due to the increase in NPA,

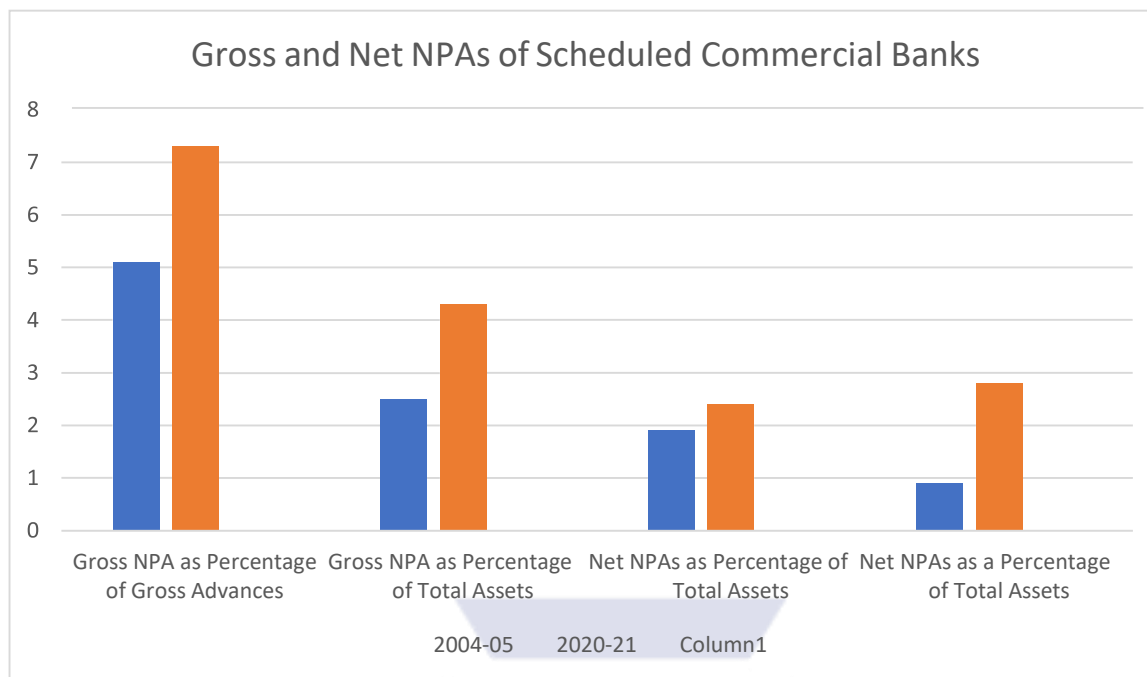
government and RBI has taken measures to check and control in NPA increase and as per the rules now every banks have to report the figures of NPAs to the regional office of the RBI at the end of each year within two years from the close of year. Due to NPA, banks economy has been suffered and has resulted in non availability of surplus funds. In the recent data released by government, MSMEs has suffered a lot during the Covid Period which has resulted in Increase of NPA. As per Data, NPA for MSMEs has arisen by 20000 Crore to Rs. 1,65,732 crore as of September 2021. Earlier it was 1,45,673 Crore in September 2020. To revive the MSMEs RBI and Government has started the scheme of Emergency Credit Line Guarantee Scheme. The purpose of this scheme was not only to revive the MSMEs but also to secure earlier loan of MSMEs from becoming NPA. As per the aforementioned scheme, MSMEs can get unsecured loan of Rs. 3,00,0000/- from the bank. As per the data, by 28 February 2023, a total of 1.13 crore MSMEs are supported with this scheme with the funds of Rs. 2.40 lakh crore. But it is pertinent to mention that this scheme has also resulted in NPA by MSMEs. As per the data presented before parliament, around 18.65 lakh accounts amounting to Rs. 11,341 crore were classified as NPAs due to non payment of loan. Due to high NPAs in Banks, lenders suffer lowering of profits in margins and financial distress is increasing and ultimately it is causing higher interest rates by banks and huge investments by large banks in NBFCs.

### **STEPS BY GOVERNMENT TO STOP NPA**

For decline in the NPA, Government took many steps. The big steps being taken by the government to bring decline in NPA is merger of banks. The purpose to merge the banks was to bring decline in the financial loss in banking system and to protect less performing or weak banks from loss and ensure financial securities of depositors of these banks. The idea of bank mergers has been floated since 1998 from 2<sup>nd</sup> M. Narasimham Committee recommendations. By this committee recommendations were given to merge the banks into three tiered structure i.e. 3 large banks with an international presence at top, 8 to 10 national banks and a large number of banks from regional and local. Thereafter, in the year 2014 P.J. Nayak Committee has also recommended government either merge or privatise state banks.

### **NBFCs in India**

Non-Banking Financial companies cannot accept demand deposits. NBFCs cannot issue cheques to the depositors. NBFCs has liberty for time deposits.



### **What are the advantages and disadvantages of NBFCs**

**Minimum Documentations:** The process of the sanction of loan and thereafter the disbursement has been smoothed by the NBFCs. The process of sanctioning and loan disbursement of the NBFCs are paperless, this has minimized the documentations and verification of the customer or borrower is through OTP and Aadhar. After the NBFCs smooth process for loan, it has become very easy to get loan within few minutes. The researcher is of the view that due to this online verification of customers or borrowers the chances of non-payment has been increased. It has been seen that most of the customers have not get their documents updated and resulted in non-availability of the borrowers at the address when dispute arise. This ultimately causes huge financial loss to the NBFCs and companies who have invested in the NBFCs for better profits. This non-verification of address physically has resulted in frauds with the bank and has increased the litigations. It has also been seen in courts that due to non-availability of fresh address of the defaulters, numbers of matters has been marked as sine-die or dismissed.

**2. Competitive Interest Rates:** One of the advantages of NBFCs is that businessmen are getting loans for their business at very lower interest rates in some conditions, the competitive rates for business loan from normal banks are very high. It has also been seen that the loan processing fees including file charges are very low and sometimes same have been waived off by NBFCs on the criteria of good financial condition of the business.

**Easy Eligibility Criteria:** The process of loan sanction and disbursement by Banks is very time taking process, sometime it results in failure. Banks usually follow very long and tough verification and lending rules. On the other side, in NBFCs, process for granting the loan is very smooth and cordial to the customers/business. It takes very less time in verification and disbursement of money in the account. It is pertinent to mention that NACH facility has been created for verification of banks and creating the e-mandate in the borrower's account. This e-mandate concept has also accelerated the process of loan sanction and disbursement. NBFCs are following less stringent lending rules and terms.

**Pre-Approved Loan Limit:** It is pertinent to mention that in today's world, not only NBFCs but banks also have been providing the loan to the customers/borrowers through the process of pre-approved loan limits. Through this process, individuals, businessmen and individuals can withdraw fund from pre-approved limits of loan. The researcher is of the view that through this process, huge liquidity is being given in the hands of the borrowers which is causing financial imbalance in the society and ultimately resulting in increase of inflation and also increase in defaulters. The NBFCs are providing pre-approved loan to customers who are not interested in loan. The agents of the NBFCs are luring the customers/borrowers to take loans with huge amount offer. In pre-approved loan limits, NBFCs and banks are charging the interest on used or withdrawn amount of the limits only. The researcher is of the view that due to unwanted offers either in the form of pre-approved limits or overdraft limits or pre-approved loans or loans after verification has caused low-income persons excessively indebted. The lower and middle class persons are nowadays under the burden of huge financial debts. Due to the attractive offers to the customers/borrowers to whom banks are not inclined to give loans, they are being trapped in debt, ultimately they are not in the position to repay the same as per the agreement. It is pertinent to mention that most of the customers/borrowers on NBFCs are uneducated and in the urgent need of loan for their desires. They are not able to understand the terms and conditions of the already designed complicated commercial/corporate contracts of the company. It has been seen that on failure to repay loans, NBFCs use to deal with the borrowers in a very harsh manner. The agents of NBFCs used to deal with customers/borrowers in a very abusive manner. The process of NBFCs for recovering the loan is very harsh. It has been seen that NBFCs are charging the interest as high as 30 percent or more annually.

### **How NBFCs are also one of the cause of NPA**

An asset is classified as a non-performing asset (NPA) if dues in the form of principal and

interest are not paid by the borrower for a period of 180 days. However with effect from March 2004, default status would be given to borrower if dues are not paid for 90 days. If any advance or credit facilities granted by bank to a borrower become non-performing, then the bank will have to treat all the advances/credit facilities granted to that borrower as non-performing without having any regard to the fact that there may still exist certain advances/credit facilities having performing status.

RBI guidelines on income recognition (Interest income on NPAs).

Bank recognizes income including interest income on advances on accrual basis. That is, income is accounted for as and when it is earned. The prima-facie condition for accrual of income is that it should not be unreasonable to expect its ultimate collection however, NPAs involves significant uncertainties with respect to its ultimate collection. Considering this fact, in

### **Factors of NPAs**

In the last two decade or so, recovery of loan has become a major problem for banking industry. More and more borrows are twining useful defaults taking the benefit of mainly inherent deficiencies in our legal system. The problem of recovery has been further aggravated by the external factor like the Government loan worker scheme other reasons are:

1. Non availability of proper, sufficient and valid securities.
2. Weak monitoring appropriate lending policies.
3. Improper execution of documents.
4. Lack of constant efforts towards recovery.
5. Cumbersome time consuming and costly legal process.
6. Lack of technical and marketing skill expertise. Commercial policy of government
8. Personal reason of Borrower Company.
9. Target oriented approach to lending
10. Slow disposal of recovery cases under the public debt recovery act.
11. Wrong identification of beneficiaries.
12. Genuine viability problem of borrowing unit.
13. Willful default induced by officially announced loan waiver scheme.

14. Lack of due diligence on the part of staff and loans proposal are approved by the board as the matter of routine.
15. Systematic failure and corruption.

### **Merger and take over**

The term merger, amalgamation, take-over, consolidation, acquisition etc. are often used interchangeably. In technical jargon; A merger is the absorption of one or more corporation by another with the acquiring firm retaining its corporate entity and other firm disappearing from the corporate entity.

In acquisition, one survives and other loses its existence and the survivor acquires the assets. A consolidation means all the combining firms disappear as distinct and separate corporate entities and a new consolidated entity comes into being. Merger/acquisition is a process under which a sick unit is merged with a healthy unit or sometimes, a healthy unit acquires the sick unit. A part of the consideration is paid to the sick unit by the healthy unit is used to liquidate the NPAs, wholly or partly. The merger/acquisitions are especially beneficial to the healthy unit because u/s 72 of the IT Act, it is allowed to carry-forward and set-off accumulated losses and absorbed depreciation of the sick unit.

In the case of the merger, the NPAs (sick unit) will get immediately converted into performing assets because it will acquire the status of the healthy unit – in fact, the sick unit will be wiped out from the books of the bank and the healthy unit will show increased outstanding under different account – heads:

### **Conclusion:**

With this research paper the researcher has found that though NBFCs has contributed a lot in the financial/economical condition of the country, but on the other side it has also one of the cause of unnecessary and unreasonable interest rate on loans and NPA and default in payment of loan by borrowers. It is pertinent to mention that most of the customers/borrowers on NBFCs are uneducated and in the urgent need of loan for their desires. They are not able to understand the terms and conditions of the already designed complicated commercial/corporate contracts of the company. It has been seen that on failure to repay loans, NBFCs use to deal with the borrowers in a very harsh manner. The agents of NBFCs used to deal with customers/borrowers in a very abusive manner. The process of NBFCs for recovering the loan is very harsh. It has been seen that NBFCs are charging the interest as high as 30 percent or more annually.

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