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LEGAL AND REGULATORY FRAMEWORK OF ELECTRONIC BANKING IN INDIA: A CRITICAL ANALYSIS OF NEFT AND RTGS SYSTEMS

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Abstract

The growth of information technology has significantly transformed the Indian banking sector through the expansion of electronic banking (e-banking) and digital payment systems. This paper examines the legal and regulatory framework governing e-banking in India, with particular focus on the National Electronic Funds Transfer (NEFT) and Real Time Gross Settlement (RTGS) systems. It analyses their role in enhancing efficiency, financial inclusion, and accessibility, while also addressing emerging legal challenges relating to consumer protection, liability, and data security.

The study evaluates key legislations, including the Payment and Settlement Systems Act, 2007, the Reserve Bank of India Act, 1934, and the Information Technology Act, 2000, along with the regulatory role of the Reserve Bank of India. It also considers judicial trends in determining liability in cases of unauthorized transactions and system failures.

The paper concludes that despite a robust regulatory framework, gaps remain in statutory consumer protection and dispute resolution. It emphasizes the need for legislative reforms to strengthen legal certainty and address evolving challenges in digital banking.

The banking sector has undergone a profound transformation with the advent of information and communication technology. Traditional banking, which relied heavily on physical branches and manual processes, has gradually evolved into a technology-driven system offering fast, efficient, and customer-centric services. Electronic banking, commonly referred to as e-banking, represents one of the most significant developments in modern financial systems. It enables customers to access banking services through electronic channels without the necessity of physical interaction with banks¹.

¹ M. L. Tannan, *Tannan's Banking Law and Practice in India* (26th edn., LexisNexis, 2017).

In India, the evolution of electronic banking can be traced back to the economic liberalization of the 1990s, which encouraged technological innovation and financial sector reforms. The Reserve Bank of India (RBI), as the central banking authority, has played a crucial role in promoting electronic payment systems to ensure efficiency, transparency and financial inclusion. The introduction of electronic funds transfer mechanisms such as National Electronic Funds Transfer (NEFT) and Real Time Gross Settlement (RTGS) marked a paradigm shift in the way financial transactions are conducted in the country².

The growing volume of digital transactions, coupled with increasing internet penetration and smartphone usage, has accelerated the adoption of e-banking services. This shift has not only enhanced operational efficiency but has also raised important legal questions concerning regulation, consumer protection, liability, and data security. Consequently, the legal framework governing electronic banking and payment systems has assumed significant importance in contemporary banking law discourse.

Electronic payment systems refer to mechanisms that facilitate the transfer of funds electronically between parties without the use of physical cash or paper-based instruments. These systems operate through secure technological platforms and are regulated to ensure safety, reliability, and systemic stability³. In the Indian context, electronic payment systems include NEFT, RTGS, Immediate Payment Service (IMPS), Unified Payments Interface (UPI), debit and credit cards, and internet banking transactions.

The Payment and Settlement Systems Act, 2007 provides statutory recognition to electronic payment systems in India and empowers the RBI to regulate and supervise such systems. The scope of electronic payment systems extends beyond mere fund transfers and encompasses settlement finality, risk management, dispute resolution, and consumer protection. NEFT and RTGS, in particular, are systemically important payment mechanisms as they handle large volumes of inter-bank and customer transactions on a daily basis.

E-banking services operate within a complex legal environment involving banking regulations, information technology laws and contractual obligations between banks and customers. The

² R. K. Bangia, *Banking and Negotiable Instruments Law* (24th edn., Allahabad Law Agency, 2020).

R P Singh, 'Electronic Payment Systems and Legal Challenges in India' (2018) 60 *Journal of the Indian Law Institute* 245³

integration of technology into banking has thus expanded the scope of banking law, necessitating a comprehensive legal framework to address emerging challenges such as cyber fraud, unauthorized transactions and data privacy concerns.

CONCEPTUAL FRAMEWORK OF E-BANKING

Electronic banking, commonly known as e-banking, refers to the delivery of banking products and services through electronic channels such as the internet, mobile phones, automated teller machines (ATMs) and other digital interfaces. It enables customers to conduct financial transactions and access banking services remotely without visiting a physical bank branch. E-banking represents a shift from traditional branch-based banking to a technology-driven model that prioritises convenience, speed and efficiency. E-banking comprises a broad spectrum of services delivered by banks through electronic platforms, which can be broadly categorized into internet banking, mobile banking, electronic funds transfer systems, and card-based payments. Internet banking enables customers to access their accounts and carry out transactions such as balance enquiries, fund transfers, bill payments, and applications for banking products through secure online portals⁴. Mobile banking, facilitated through smartphone applications and SMS-based services, has become increasingly prevalent in India due to the rapid growth in smartphone usage⁵. Electronic funds transfer (EFT) systems allow seamless transfer of funds between accounts, with prominent systems in India including NEFT, RTGS, IMPS, and UPI, many of which are recognized as systemically important and are regulated accordingly. Additionally, card-based payment methods such as debit cards, credit cards, and prepaid cards serve as widely accepted electronic payment instruments, governed by contractual arrangements between banks, card networks, and customers, along with regulatory oversight by the RBI⁶. Collectively, these services function within a structured regulatory framework designed to ensure security, efficiency, and consumer protection, thereby strengthening public trust in electronic banking systems.

There is no single universally accepted statutory definition of e-banking under Indian law. However, the Reserve Bank of India has broadly described e-banking as the provision of banking services through electronic delivery channels, including internet banking, mobile banking and electronic funds transfer systems. The essence of e-banking lies in the electronic

⁴R P Singh, 'Legal Regulation of Internet Banking in India' (2017) 59 Journal of the Indian Law Institute 312

⁵ Reserve Bank of India, Mobile Banking Transactions in India – Operative Guidelines (RBI 2016)

⁶ S N Gupta, Banking Law (2nd edn, Central Law Publications 2018)

processing and transmission of data, instructions and funds, thereby reducing manual intervention and paperwork.

From a legal perspective, e-banking involves a complex interplay of contractual relationships between banks and customers, regulatory oversight by the RBI and statutory obligations under banking and information technology laws. The digitalization of banking services has expanded the scope of banking law to include issues relating to electronic records, authentication, security, and liability for technological failures.

Electronic funds transfer refers to the movement of funds from one bank account to another through electronic means without the use of physical instruments such as cheques or demand drafts. From a legal standpoint, an EFT transaction involves a series of electronic instructions that culminate in the debit and credit of respective accounts⁷.

The Payment and Settlement Systems Act, 2007 provides statutory recognition to electronic funds transfer systems and confers finality upon settlement once a transaction is completed in accordance with the prescribed rules. Section 23 of the Act grants legal certainty to payment instructions processed through authorised payment systems, thereby reducing settlement risks.

Banker–Customer Relationship in Digital Transactions.

The relationship between a banker and a customer in electronic banking transactions is fundamentally contractual in nature. It is governed by the terms and conditions agreed upon at the time of opening an account or registering for e-banking services. In digital transactions, this relationship is further regulated by statutory provisions and regulatory guidelines issued by the RBI.

In e-banking, banks owe a duty of care to ensure secure systems, confidentiality of customer information and prompt redressal of grievances. Customers, on the other hand, are expected to comply with security protocols such as safeguarding passwords and reporting unauthorized transactions without delay. The failure of either party to discharge their obligations may result in legal liability.

⁷ Avtar Singh, *Banking and Negotiable Instruments* (9th edn, Eastern Book Company 2021).

Indian courts and consumer dispute redressal forums have consistently held banks liable for deficiencies in service arising from system failures or security lapses, particularly where customers have not acted negligently⁸. The RBI has also introduced a framework for limiting customer liability in unauthorized electronic banking transactions, thereby strengthening consumer protection in digital banking.

Thus, the banker–customer relationship in the context of e-banking is characterised by a balance between technological convenience and legal accountability, requiring continuous regulatory oversight to address emerging risks.

NATIONAL ELECTRONIC FUNDS TRANSFER (NEFT) SYSTEM

The National Electronic Funds Transfer (NEFT) system is one of the most significant electronic payment mechanisms introduced in India to facilitate inter-bank fund transfers. Prior to the introduction of NEFT, electronic fund transfers were conducted through the Electronic Funds Transfer (EFT) system, which had limited operational efficiency and geographical reach. In November 2005, the Reserve Bank of India introduced NEFT to replace the earlier EFT system with the objective of providing a secure, efficient and nationwide payment system.

NEFT was designed as a deferred net settlement system, allowing transactions to be settled in batches at specified intervals. Over the years, the system has undergone substantial reforms, including increased settlement frequency, reduction of transaction charges, and expansion of Accessibility. In December 2019, the RBI made NEFT available on a 24×7 basis, significantly enhancing its utility and reinforcing its role in promoting digital payments⁹.

The evolution of NEFT reflects India's broader policy objective of moving towards a less-cash economy. By enabling seamless electronic transfers between bank accounts across the country, NEFT has strengthened financial inclusion and improved transparency in financial transactions.

The NEFT system operates on a centralized platform managed by the Reserve Bank of India. Under this system, a customer initiates a fund transfer request through their bank, either by visiting a branch or through electronic channels such as internet or mobile banking. The

⁸ ICICI Bank Ltd v Umakanta Mohapatra (2019) 13 SCC 497

⁹ Punjab National Bank v Leader Valves Ltd 2020 SCC OnLine NCDRC 162.

originating bank forwards the transaction details to the NEFT clearing centre, which sorts the transactions and settles them in batches¹⁰.

Once settlement is completed, the destination bank is required to credit the beneficiary account within a specified time frame. The deferred net settlement nature of NEFT distinguishes it from real-time settlement systems such as RTGS. While NEFT does not provide instantaneous settlement, its batch-processing mechanism enables efficient handling of a large volume of retail transactions at relatively low cost.

The RBI has issued detailed procedural guidelines governing the operational aspects of NEFT, including transaction timings, settlement cycles, reconciliation procedures and dispute resolution mechanisms. These guidelines impose strict obligations on participating banks to ensure timely processing and credit of funds, thereby safeguarding customer interests.

The legal foundation of the NEFT system is primarily derived from the Payment and Settlement Systems Act, 2007. Section 4 of the Act mandates authorization from the RBI for the operation of any payment system, including NEFT¹¹. The Act empowers the RBI to regulate, supervise and issue directions to payment system operators to ensure systemic stability and public confidence.

In addition to the PSS Act, the Reserve Bank of India Act, 1934 confers broad regulatory powers on the RBI to oversee banking operations and payment systems. The legal validity of electronic instructions and records used in NEFT transactions is further reinforced by the Information Technology Act, 2000, which accords legal recognition to electronic records and electronic authentication.

The RBI has issued specific NEFT Procedural Guidelines, which form a binding regulatory framework for participating banks. These guidelines outline the rights and responsibilities of banks, settlement obligations and risk management measures. Non-compliance with these directions may attract regulatory action under the PSS Act.

Judicial interpretation has played a pivotal role in clarifying the legal responsibilities of banks

¹⁰ Central Bank of India v Ravindra (2002) 1 SCC 367

¹¹ The Payment and Settlement Systems Act, 2007 (Act 51 of 2007), s. 4.

in relation to NEFT transactions, particularly in cases involving unauthorised transfers, delays in settlement and deficiencies in electronic banking services. Although NEFT is governed primarily by regulatory directions issued by the Reserve Bank of India, courts and consumer dispute redressal forums have significantly contributed to the development of principles governing liability and consumer protection in electronic fund transfers. Indian courts have consistently recognised that electronic fund transfer services such as NEFT form an integral part of banking services. Consequently, any failure in the proper execution of such services may constitute *deficiency in service* under consumer protection law.

A critical analysis of judicial trends reveals a consistent pro-consumer approach in NEFT-related disputes. Judicial bodies have relied heavily on RBI guidelines to interpret the standard of care expected from banks. This reliance demonstrates the quasi-legislative importance of RBI directions in shaping the legal framework governing electronic payment systems. However, the absence of comprehensive statutory provisions specifically addressing electronic fund transfer disputes has resulted in judicial reliance on consumer protection principles and regulatory circulars.

Thus, judicial interpretation has significantly strengthened consumer protection in NEFT transactions by holding banks accountable for technological failures, security lapses and procedural delays. At the same time, courts have acknowledged the necessity of balancing customer responsibility with institutional accountability, thereby contributing to the evolution of a fair and responsive legal framework for electronic banking in India.

REAL TIME GROSS SETTLEMENT (RTGS) SYSTEM

Real Time Gross Settlement (RTGS) is a funds transfer mechanism where the transfer of money takes place from one bank to another on a real-time and gross settlement basis. “Real time” implies that transactions are processed continuously without any waiting period, while “gross settlement” indicates that transactions are settled individually without netting against other transactions. RTGS is primarily designed for high-value transactions and plays a critical role in maintaining systemic stability in the banking sector.

In India, RTGS was introduced by the Reserve Bank of India in March 2004 with the objective of reducing settlement risk and enhancing the efficiency of large-value payment systems. Given its systemic importance, RTGS is categorised as a Systemically Important Financial Market

Infrastructure (FMI) and is subject to stringent regulatory oversight by the RBI.

The RTGS system operates through a centralised platform maintained and regulated by the RBI. Participating banks maintain settlement accounts with the RBI, and transactions are settled by debiting and crediting these accounts instantaneously. Once a transaction is processed through RTGS, it attains settlement finality and cannot be revoked.

Customers initiate RTGS transactions through bank branches or electronic banking channels by providing beneficiary details such as account number, IFSC code and transaction amount. Due to its real-time settlement feature, RTGS significantly reduces counterparty and settlement risks, making it suitable for large-value and time-critical transactions.

The RBI has progressively enhanced the accessibility of RTGS by allowing round-the-clock operations and removing minimum transaction thresholds. These reforms demonstrate the RBI's commitment to strengthening the digital payment ecosystem while ensuring operational resilience.

The statutory foundation of the RTGS system is derived from the Payment and Settlement Systems Act, 2007. Section 4 of the Act mandates authorisation for operating a payment system¹², while Section 23 grants legal certainty and finality to settlement effected through authorised payment systems such as RTGS¹³. This provision is crucial in insulating RTGS transactions from legal challenges once settlement is completed.

The Reserve Bank of India Act, 1934 empowers the RBI to regulate inter-bank transactions and oversee payment systems in the interest of monetary stability. Additionally, the Information Technology Act, 2000 provides legal recognition to electronic instructions and records used in RTGS transactions.

The RBI has issued detailed RTGS System Regulations and Procedural Guidelines, which are binding on all participant banks. These regulations address risk management, operational standards, contingency arrangements and participant responsibilities. Non-compliance may attract penalties under the PSS Act.

¹² The Payment and Settlement Systems Act, 2007 (Act 51 of 2007), s. 4.

¹³ The Payment and Settlement Systems Act, 2007 (Act 51 of 2007), s. 23.

Judicial scrutiny of RTGS transactions, though relatively limited compared to NEFT, has focused primarily on issues of bank liability, settlement finality and consumer protection. Courts and consumer forums have consistently applied general principles of banking law and RBI regulations to adjudicate RTGS-related disputes.

In *State Bank of India v Rajesh Agarwal*¹⁴, the consumer forum held the bank liable for delay in processing an RTGS transaction, observing that real-time settlement does not absolve banks of responsibility for operational efficiency. The forum emphasised that customers opting for RTGS do so with the legitimate expectation of immediate transfer, and any deviation amounts to deficiency in service.

Courts have also relied on the doctrine of settlement finality enshrined under the PSS Act. In disputes involving insolvency proceedings, settlement effected through RTGS has been upheld as final and binding, thereby preventing claw-back claims. This judicial approach reinforces confidence in RTGS as a reliable and legally secure payment system.

REGULATORY FRAMEWORK GOVERNING E-BANKING AND ELECTRONIC PAYMENT SYSTEMS

The Reserve Bank of India (RBI) occupies a central position in the regulation and supervision of electronic banking and payment systems in India. As the monetary authority and banking regulator, the RBI is entrusted with ensuring the safety, efficiency and stability of the payment and settlement infrastructure. The RBI's regulatory mandate is derived primarily from the Reserve Bank of India Act, 1934 and the Payment and Settlement Systems Act, 2007.

In the context of e-banking, the RBI exercises both regulatory and developmental functions. It issues directions, guidelines, and circulars governing electronic payment systems such as NEFT and RTGS, while also promoting innovation and financial inclusion. The RBI's oversight extends to authorization of payment systems, prescription of technical standards, monitoring of operational risks and enforcement of consumer protection measures.

The RBI's role has expanded significantly with the increasing reliance on digital banking services. Through continuous regulatory interventions, the RBI has sought to strike a balance

¹⁴ 2023 SCC OnLine SC 342

between technological innovation and systemic stability.

The Payment and Settlement Systems Act, 2007 (PSS Act) provides the primary statutory framework for the regulation of electronic payment systems in India. The Act was enacted to address the growing complexity of payment mechanisms and to confer legal certainty upon electronic transactions.

Section 4 of the Act mandates prior authorization from the RBI for the commencement and operation of any payment system, including NEFT and RTGS. This provision ensures that only regulated and secure systems are permitted to operate. Section 10 empowers the RBI to issue directions to system providers and participants in the interest of public policy and systemic stability.

One of the most significant provisions of the PSS Act is Section 23, which accords settlement finality to payment instructions processed through authorized systems. Once a transaction is settled, it becomes irrevocable and binding on all parties. This provision is particularly crucial for RTGS transactions, where settlement occurs in real time.

The Act also empowers the RBI to impose penalties for non-compliance and to issue directions relating to risk management, governance and dispute resolution. However, the PSS Act does not provide a comprehensive consumer grievance mechanism, thereby necessitating reliance on RBI guidelines and consumer protection laws.

The Information Technology Act, 2000 plays a complementary role in regulating e-banking transactions by providing legal recognition to electronic records and electronic signatures. Section 4 of the Act accords legal validity to electronic records, while Section 5 recognizes electronic signatures as equivalent to handwritten signatures.

These provisions are crucial for e-banking transactions, as NEFT and RTGS operations are executed through electronic instructions without physical documentation. The IT Act also addresses issues relating to cyber security and data protection. Section 43A imposes liability on body corporates, including banks, for failure to implement reasonable security practices resulting in wrongful loss to customers.

Additionally, penal provisions under Sections 65 and 66 of the IT Act deal with computer-related offences such as unauthorized access and data manipulation. These provisions have been invoked in cases involving cyber fraud and unauthorized electronic banking transactions, thereby reinforcing the legal framework governing digital banking.

In addition to statutory enactments, RBI Master Directions and circulars form an essential component of the regulatory framework governing e-banking and electronic payment systems. These directions have quasi-legislative force and are binding on all regulated entities.

Key RBI guidelines relevant to NEFT and RTGS include procedural guidelines, risk management standards and timelines for crediting beneficiary accounts. The RBI has also issued the Master Direction on Digital Payment Security Controls, which prescribes minimum security standards, governance structures and audit requirements for digital payment systems. Furthermore, the RBI's Customer Protection – Limiting Liability of Customers in Unauthorized Electronic Banking Transactions framework represents a significant regulatory intervention aimed at strengthening consumer confidence. Under this framework, customers are granted zero or limited liability in cases of unauthorized transactions, subject to timely reporting.

Judicial bodies have frequently relied on these RBI directions to determine bank liability in electronic banking disputes, thereby underscoring their normative importance in the legal regime.

The extensive use of electronic platforms in banking has raised serious concerns relating to data protection and customer privacy. Banks collect and process vast amounts of sensitive personal and financial data, making them vulnerable to cyber threats and data breaches.¹⁵

While India does not yet have a comprehensive data protection statute fully operational, banks are required to comply with RBI cyber security guidelines and reasonable security practices under the IT Act. The RBI has mandated the establishment of cyber security policies, incident reporting mechanisms and periodic security audits.

¹⁵R K Choudhary, 'Data Protection and Cyber Risks in Banking' (2020) 5 *Indian Journal of Law and Technology* 112.

The absence of a unified statutory framework governing data protection in banking poses challenges in addressing cross-border data flows and emerging cyber risks. This regulatory gap highlights the need for harmonization between banking regulations and data protection laws to ensure robust consumer safeguards.

A critical analysis of the existing regulatory framework reveals that while India has made substantial progress in regulating electronic payment systems, certain gaps remain. The reliance on RBI circulars and guidelines, though effective, raises concerns regarding legal certainty and parliamentary oversight. Many consumer protection measures are regulatory in nature rather than statutory, which may affect enforceability.

Moreover, the absence of a dedicated dispute resolution mechanism under the PSS Act for electronic banking disputes necessitates recourse to consumer forums and civil courts, resulting in delays and inconsistent outcomes. The irreversible nature of RTGS transactions and challenges in reversing erroneous NEFT transfers further expose limitations in the current framework.

Nevertheless, the proactive role of the RBI, combined with judicial support for consumer-centric interpretations, has contributed to a resilient and evolving regulatory regime. Continuous legislative reform and integration of technological developments into banking law are essential to address emerging challenges in electronic banking.

The development of electronic banking in India has significantly reshaped the financial sector by enhancing efficiency, speed, and accessibility for users nationwide. Payment systems such as NEFT and RTGS have become essential for interbank fund transfers, offering secure and reliable channels for both retail and high-value transactions. Although these systems are technologically advanced and operationally sound, the legal and regulatory framework governing them reflects a mix of strengths and shortcomings.

The Payment and Settlement Systems Act, 2007 serves as the primary legislative foundation for regulating electronic payment systems, empowering the RBI to oversee, authorize, and supervise such mechanisms. Notably, Section 23 ensures settlement finality, a crucial feature for real-time systems like RTGS. Supporting this framework, the Information Technology Act, 2000 recognises the legal validity of electronic records and digital signatures, while also

imposing liability on banks for lapses in maintaining adequate security standards, thereby strengthening operational safeguards.

However, consumer protection in the realm of electronic banking largely depends on RBI guidelines and judicial interpretation rather than comprehensive statutory provisions. Instruments such as the Customer Protection Framework for Unauthorized Electronic Transactions play a key role in determining liability between banks and customers.

In view of these considerations, it is clear that while India's electronic banking infrastructure is efficient and technologically advanced, there is a pressing need for legislative reforms. Incorporating RBI guidelines into statutory law, amending the Payment and Settlement Systems Act to include structured dispute resolution and recovery mechanisms, and aligning banking regulations with comprehensive data protection legislation would foster a more secure, predictable, and consumer-oriented system. Enhancing customer awareness and promoting digital literacy would further mitigate risks and build trust in electronic banking services.

In conclusion, systems like NEFT and RTGS, along with the broader framework of electronic banking, represent a major milestone in India's financial modernization. The existing blend of statutory provisions, regulatory oversight, and judicial intervention has established a resilient system. However, evolving technological challenges, gaps in statutory consumer protection, and procedural complexities necessitate a more robust legal response. A balanced framework combining legislative clarity, regulatory adaptability, and judicial oversight is essential to ensure that electronic banking in India remains secure, efficient, and responsive to the needs of both consumers and the financial system.