ROLE OF RESERVE BANK OF INDIA IN REGULATING THE BANKING SECTOR IN ORDER TO SET UP GOOD GOVERNANCE

Dissertation submitted to National Law University and Judicial Academy, Assam

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MASTER OF LAWS/

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Submitted by

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July, 2022

CERTIFICATE

This is to certify that MODHU CHANDA DEY has completed his dissertation titled " ROLE OF RESERVE BANK OF INDIA IN REGULATING THE BANKING SECTOR IN ORDER TO SET UP GOOD GOVERNANCE" under my supervision for the award of the degree of MASTER OF LAWS/ ONE YEAR LL.M DEGREE PROGRAMME of National Law University and Judicial Academy, Assam.

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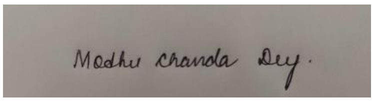
DECLARATION

I, MODHU CHANDA DEY, do hereby declare that the dissertation titled “ ROLE OF RESERVE BANK OF INDIA IN REGULATING THE BANKING SECTOR IN ORDER TO SET UP GOOD GOVERNANCE” submitted by me for the award of the degree of MASTER OF LAWS/ ONE YEAR LL.M. DEGREE PROGRAMME of National Law University and Judicial Academy, Assam is a bonafide work and has not been submitted, either in part or full anywhere else for any purpose, academic or otherwise.



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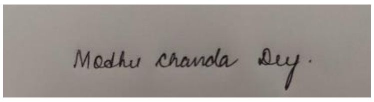
I would like to begin expressing my thanks to the almighty God.

I am forever indebted to my parents, whose blessings and strong moral support have helped me in the successful completion of the Seminar paper and would also like to thank my parents for their wise counsel and sympathetic ear.



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1881 – The Negotiable Instrument Act

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1913 – Indian Companies Act

1934 – The Reserve Bank of India Act

1949 – The Banking Regulation Act

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1956 – Securities Contracts (Regulation) Act

1969 – Acquisition and Transfer of Undertaking Act

1969 – The Monopolies and Restrictive Trade Practice Act

1976 – The Regional Rural Banks Act

1987 – The National Housing Bank Act

1999 – The Foreign Exchange Management Act

TABLE OF ABBREVIATIONS

AIR	All India Reporter.
ATM	Automated Teller Machine.
CRAFICARD	Report of the Committee to Review Arrangements for Institutional Credit for Agriculture and Rural Development.
EXIM	Export-Import Bank of India.
ICICI	Industrial Credit & Investment Corporation of India
IDBI	Industrial Development Bank of India
IFCI	Industrial Finance Corporation
NABARD	National Bank For Agriculture And Rural Development.
NEFT	National Electronic Fund Transfer
RBI	Reserve Bank of India
RTGS	Real Time Gross Settlement
SFCs	State Financial Corporation.
SIDBI	Small Industrial Development Bank of India.
SIDCs	State Industrial Development Corporation.

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CHAPTER 1

INTRODUCTION ON RESERVE BANK OF INDIA

1.1 Background

The nation's central bank is the Reserve Bank of India which regulates the banking system. Directly or Indirectly RBI holds control over the banks. RBI has the main function to maintain financial stability in the system so that each of the other banks can perform its role effectively. RBI's responsibility is to look after the Payment and Settlement System, and monetary policy which acts as a supervisor. We know that for the smooth functioning of any organization, or a system proper governance is needed. Similarly, to ensure the smooth running of the system proper policy on governance is needed. The weakness in the practice of corporate governance is the lack of risk takings. An increase in price, inadequate management of risk, inadequate policy, etc. can be regarded as the reason for failure and problems in any institution. For the entire financial set up the Reserve Bank of India acts as a regulating body and supervisory body. RBI plays a major and the most important role in the procedure of growth of the Government of India. Therefore, this research work will deal with RBI's Control over Banks in India. The work has been divided into nine chapters.

The Reserve Bank of India has the power of issuance and the supply of the Indian currency. "Originally was incorporated as a private entity in 1935, but the same was nationalized in 1949. It began its work on 1st April 1935 in conformity with the Reserve Bank of India Act,1934. After India gained its freedom on 15th August 1947, RBI became nationalized on 1st January 1949."[1]

For the entire financial set up the RBI acts as a regulating body and supervisory body. RBI plays a major and the most significant role in the procedure for the development of the Government of India. RBI associated with an Asian Clearing Union and became a member. The Reserve Bank of India has adopted initiatives such as restructuring bank scrutiny, introducing off-site inspection of bank, and giving strength to the role of auditors. It was constituted to:

1. Regulate the supply of bank notes
2. Maintaining reserves to support monetary policy

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[1] 'Reserve Bank Of India' (*Rbi.org.in*, 2022) <https://www.rbi.org.in/> accessed 9 June 2022.

3. To use the country's credit and currency system to the country's benefit

The works of RBI are controlled and ruled by a Central Board of Directors. The Government of India is authorized to appoint the board in accordance with the Reserve Bank of India. The Board consist of an Official Directors and Non-Official Director. Under official director there is a Governor and maximum of four Deputy Governors appointed and under non-official director there are ten Directors from varied parts and two government officials nominated by Government and four directors are appointed one each from four local boards.

1.2 STATEMENT OF PROBLEM

The problem of this research revolves around the role of the Reserve Bank of India in regulating the banking sector so that it can set up a good governance. There are various powers exercised by the Reserve Bank of India for the purpose of controlling the functioning of other banks.

1.3 LITERATURE REVIEW

Gopal Karkal, 'Perspective in Indian Banking',(1977)

The book throws light on the banking sector of India. In this book the author stated that some areas have done a good job of spreading banking facilities while others are still lagging behind. Since the customers are huge retailers and industrialists so they demand for higher loans and benefits in exchange for a significant amount of business.

Kulkarni (1979) explained in his study that while keeping in mind the bank expenditures and gains, social facilities arising from the bank activities cannot be overlooked as per his research on developmental responsibility and profitability of banks. When it comes to bank profitability, he claims that the profit maximization method is inappropriate. He realised that in addition to fulfilling their social responsibilities, the bank should strive to make their growing business as successful as possible, reducing costs, improving the banking system, and increasing total outcomes.

Venkatachalam (1979) explains why profits obtained from the bank have been declining nowadays. This research entirely lies upon publicly available data. They put forward ab opinion that there is a trade off between the banks' social responsibility and expanding profits.

M L Tannan in his booking “Tannan’s Banking Law” has made the most important contribution in gathering information from various sources. He discussed about the Banking Regulation Act,1949, the key role played by the Reserve Bank of India in introducing new changes in Banking system.

R.N Choudhary in his book **“Banking Laws”** discussed about the history of the banking system, the powers of the Reserve Bank of India and about its credit control policy. According to him the monetary policy is associated with the financial development of the country.

Saibal Ghosh in his article "Monetary policy and bank conduct: Empirical evidence from India," studied the impact of bank behavior on the monetary transmission mechanism. The effectiveness of monetary policy and the mechanisms via which it functions have been extensively studied in the recent years. This resurgence of interest in monetary transmission must be seen in the context of a resurgence of theories that emphasize the financial system's influence on overall economic activity.

“Tannan’s Banker’s Manual by **Rajesh Narain Gupta and Pratip Chauduri”:** This book covers Banking Laws and Allied Acts of India. There are several information mentioned in this book regarding NABARD. It mainly discusses how rural banks were established numerous numbers of recommendation forwarded regarding RRBs in India.

1.4 Research Aim and Objectives:

1. To give an overall view of historical background of the Banking Sector in India.

2. To study the role and function of RBI.

3. To analyze the contribution of the RBI in boosting the economic structure.

4. To study the Monetary Control Methods of RBI.

5. To study about Cryptocurrency, regulation of Cryptocurrency across the world and its regulation in India.

6. To study about the social control over banks and Nationalisation of Banks.

7. To study the Role of RBI in Social Development.

1.5 SCOPE AND LIMITATION

The scope of the study is limited to tracing the history of the Banking institution in India. The goal of the dissertation is to establish good governance by doing a thorough analysis of the Reserve Bank of India's involvement in banking sector regulation. Due to time and resource limitations, the researcher has limited the study of the Reserve Bank of India's role, the various functions it performs, its authority to issue and cancel licenses, in-depth analysis of the social control over banks and nationalization of banks, and monetary and credit control by RBI because the dissertation's scope and ambit were too broad to cover all the aspects in this paper.

With regard to Control over Organization of Banks, the researcher has limited its study to Powers of Reserve Bank of India to issue and cancellation of license, Opening of New Branches and Transfer of existing Branch, Appointment of chairman by the Reserve Bank of India, Control over Management.

Similarly, with regard to Monetary and Credit Control Policy, the researcher has limited its study to Meaning of Credit Control, Objectives of Credit Control, Methods of Credit Control in India, Meaning of Monetary Policy, Characteristics of Monetary Policy of the Reserve Bank of India, Limitations of Monetary Policy in India, New Monetary Policy of The Reserve Bank of India.

Due to shortage of time, there is no scope of field research in this dissertation. The paper has a limited scope due to concepts being clearly defined in terms and application by courts in many cases.

1.6 RESEARCH QUESTION

1. What is the role of RBI in regulation the banking sector in order to set up good governance?
2. How has RBI contributed for the social development of the country?
3. How RBI contributed to boosting the economic condition of the country?

1.7 Research Hypothesis

The particular paper gives the idea that the RBI plays a major role in regulating the entire banking system so as to set up good governance. For achieving the required result, it is necessary to gather a depth knowledge of RBI and to understand what are the functions that are played by RBI.

1.8 RESEARCH METHOD

This study is basically a doctrinal, analytical, and descriptive work. Primary source of data has been adopted such as statutes/bare acts, judgements etc. and secondary sources like books, article, journal, internet sources in order to complete the study. During the whole study Internet played a major role as it provided the researcher with ample amount of reliable information.

A uniform mode of citation has been adopted throughout the dissertation. The Oscola fourth edition.

1.9 CHAPTERISATION

- Chapter 1 deals with the introduction of the RBI, Statement of Problem, research aim and objective.
- Chapter 2 deals with the "Evolution of Banking System". In this chapter, Origin of the word Bank, Meaning, definition and Scope of Bank, History of Banking System, banking system in India and the types of Banks are discussed.
- Chapter 3 is about the Role of RBI in boosting the economic structure. In this chapter the topics which has been discussed are-The Reserve Bank of India Act,1934, its objective, salient features, and constitutional validity. The function and objectives of the Reserve Bank of India, the Organizational Structure of Reserve Bank of India, its framework, promotional rule, and critical issues in Reserve Bank of India are discussed.
- Chapter 4 deals with the Control over organization of the banks. In this chapter it deals with the Banking Regulation Act,1949, the powers of Reserve Bank of India to issue and cancellation of license, opening of new branch and transfer of previous one, Power of Reserve Bank of India to appoint Chairman of the Banking system and lastly the control over management.
- Chapter 5 deals with the monetary and credit control by RBI. In this part mention has been made of the meaning, objective, and the method of credit control. Also, the meaning of monetary policy, characteristics of Monetary

Policy of Reserve Bank of India, limitations, and the new monetary policy of the Reserve Bank of India.

- Chapter 6 of the work deals with "Social Control over and Nationalization of Banks". In this chapter discussion is made on the meaning of the Concept and scheme of Social Control, Nationalization of Commercial Banks, Legal mode adopted for Nationalization of Banks, Acquisition and Transfer of Undertaking Act etc.
- Chapter 7 deals with the Impact of Cryptocurrency. The topics which have been discussed under this chapter are - Introduction on Cryptocurrency, Regulation of Cryptocurrencies across the world, Arguments for banning Cryptocurrency, Arguments for regulating Cryptocurrency.
- Chapter 8 of this work deals with the role of RBI in Social Development.
- Chapter 9 Conclusion and Recommendations.

CHAPTER -2

Evolution of Banking System

2.1 ORIGIN OF THE WORD "BANK"

The financial system has evolved over many centuries rather than in a single instant to become what it is today. Banking has existed in some form or another in every country throughout the world. As far as the current system is concerned. In this case, there is a disagreement of opinion. "The word "Bank" is itself derived from the word "bancus" or "banque" that is a bench and earlier bankers, the Jews in Lombardy, transacted their business on bench in marketplace."[2] Although the practise of safe-keeping and savings started in the Babylonian temple as early as 2000 B.C., there was no such word as 'banking' before 1640. Chanakya claimed the presence of powerful guilds of merchant bankers in his Arthashastra, written around 300 B.C., who took deposits, advanced loans, etc. The two bankers who erected the famed Dilware Temples which is located at Mount Abu between 1197 and 1247 A.D. are mentioned in the Jain scriptures.

2.2 Meaning, Definition and Scope of Bank

An institution that handles deposits, advances, and other services is a bank. It receives funds in the form of deposits from people who want to save money and disburses loans to those who require them. Receiving deposits, a financial organization known as a bank uses those deposits for lending either directly or indirectly through the capital markets. Customers with capital shortages and customers with capital surpluses are connected by a bank. Organization where the population and corporations can make an investment or can borrow money in time of need is what the word "Bank" signifies.[3]

Definition of Banking under British Law

To start with Banking can be defined as an institution which deals with money, receives money from customers, collects cheques etc. According to Halsbury's Law of England, "A banker is an individual, partnership, or corporation where sole or

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[2] M.L. Tannan , Banking law and Practices in India (21st edn, Wadhwa & Co. Nagpur 2005) 7
[3] Ibid.

predominating business banking, that is receipt of money on current or deposit account and payment of cheques paid by a customer.”[4] This concept has been defined by many jurists such as-

Dr. H.L. Hart, “A banker is one who in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current accounts.”

Sir John Paget, “A bank or banker is a corporation or person (group of persons) who accept money on current account, pays cheques drawn upon such account on demand and collect cheques for the customers.”

Definition of Banking under Indian Law

Section 5(b) of Banking Regulation Act,1949 defines Banking as, “means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.”

According to Hilton Young Commission 1926, “the Bank or Banker should be interpreted as meaning every person, firm or company using in its description or title ‘Bank’ or ‘Banking’ and every company accepting deposits of money subject to withdrawal by cheque, draft or order.”

Crowther**,** “A bank collect moneys from those who have it to spare, or who are saving it out of their incomes, and it lends this money to those who requires it.”

Thus, in short, we can define bank as something which works on debit and credit. It makes a link between the person who saves and the person who deposits money.

2.3 HISTORY OF BANKING

The Babylonians had devised a financial system as early as 2000 B.C. The Greek banking institutions of Ephesus and Delphi were the most potent temples, while the Babylonian temples served as banks. However, when irreligion grew, the public lost confidence in putting money and jewels in temples, and priests ceased to operate as

[4] R.N. Chaudhary, Banking Laws (1st edn, Central Law Publication 2009) 1

financial agents. The Romans did not organize state banks in the same way that the Greeks did, but their rules governing the conduct of private banking in ancient times helped to gain confidence in it and because administrative decentralization and de-moralization were geared to ensure the highest level of confidence. For the interest of the Crown, Royal Exchangers in England during the reign of Edward III took over the essential role of money-changing, which at the time was a banker's obligation. He accepted a large number of foreign coins from travellers and merchants who were entering the kingdom and exchanged them for the British currency. He also gave foreign currency to people who were leaving the country. The first steps toward modern banking were taken during the reign of King George III.

HISTORY OF BANKING IN INDIA

During ancient times, the banker was an inseparable part of the Indian society. The idea of banking was not new or unheard of in India, and the Budhayana, Gautama, Brihaspati, and Kautilya all include several references to banking provisions. Since the deal was hazardous and failed, Occidental Banking, which was initially launched by Agency Houses, proved to be fatal.[5]

Case Law: Govind v. Ram Nath[6]

In this case the Chief Justice of Bombay High Court made a criticism about the functioning of Agency houses and passed a judgement to close the speculative transaction which falls under Section 277(G)(1) of Indian Companies Act ,1913.[7]

2.4 BANKING INSTITUITION IN INDIA

A Tremendous development has been observed after the Independence of India in the industrial sector which led to growth in industry and growth in trade which ultimately results in growth of banking institution in India.

- **Money economy-** The banker has been an integral part of the Indian civilization since the dawn of humanity. When self-sufficiency was the rule of

[5] R.N Chaudhary, *Banking Laws* (1st edn, Central Law Publication 2009) 1
[6] Govind v. Ram Nath (1930) 32 BOMLR 232.
[7] R.N Chaudhary, *Banking Laws* (1st edn, Central Law Publication 2009).

nation, the banker could have gone missing in those days. In absence of money the act of exchange was very difficult but with the advent of division of labour brought with it the use of money. Exchange of commodities with the help of money could not be done with without banking institution.

- **Epic age** – The modern form of Banking is a concept given by the British people to India and it does not exist in its current form in India previously. What was available at that time was known as 'Rudimentary Banking.' R.C Dutt in his book refers to the use of lending practices in the vedic period which could be known as there has been a mention of 'RAN' or Debt.[8] It can be said that there is evidence which proves that the Banking system was in work during the period of Mahabharata and Ramayana.
- **Smriti Period –** Members of the Vaish community ran the banking business throughout the smriti period. Manu, the law giver stated that the business of Vaishyas was only through earning of interest. The functions performed by the banker of Smriti period is quite similar to that of banker of modern period. The functions include- acceptance of deposits, giving securities acting as a bailee for customers, giving loans to kings in times of great need, it acts as a treasurer to the state etc.
- **Buddhist Period –** Banking kept on growing during the Buddhist period and bill of exchange had become common. In Arthshastra, the renowned writer Kautilya describes the highest rate of interest that can be paid by those doing the work. Brahamans and Kshatriyas also began banking, and bankers are referred to as Sahukars, Shresthies, or Mahajans.[9]
- **Muslim Period –** The concept of Banking was more developed during the Muslim days. Various types of coins which are metallic in nature or money were issued in various sections of the country during this time, allowing local bankers to engage in the money industry. Mint officer, bankers filled revenue collectors, bankers, and other positions.
- **Mughal Period –** The industry of banking suffered a setback during the Mughal period because according to Quran one commits a sin if he charges interest on the money lent to somebody. Aurangzeb, follower of Quran did not support the concept of business of money lending. Money lending transactions

[8] Romesh Chunder Dutt, A History of Civilization in Ancient India (BiblioBazaar 2008) 39
[9] R.K. Gupta, Banking Law and Practices (Modern Law Publication 2005) 2

were likewise halted by the Imperial Treasury. However, other banking activities, such as the issuance of hundi, emerged during this time. Manakchand, the most eminent banker of the time, was given the title of Seth by Aurangzeb. Seth Manak Chand had six brothers, all of whom were bankers. Fatenchand, Seth's nephew, was given the title of Jagat Seth by Emperor Farrukshiyer.Manakchand. As he was assisting the jagatseth, he became extremely powerful. By providing help to the British in the early days during the advent to India Jagat Seth became very powerful.

- **Advent of East India Company** – The English East India company came to India and established a trading company. There flage on the other hand followed them. They established independent organizations in Bombay, Calcutta, and Madras. An agency and trade banking merger resulted in the British Agency House. The India Company collapsed, and the local bankers suffered a massive setback in 1770. Alexander and Company Agency House established the Hindustan Bank in Calcutta. The Hindustan Bank was the first European bank. During the commercial catastrophe of 1829 and 1832, the Bank of Hindustan failed due to the failure of its donations, and the bank fell bankrupt. In 1832, the company went bankrupt.

2.5 Banking Law in India

Contract law, tort law, and other aspects of commercial and civil law apply to banks and other commercial institutions. Since the British dominated India for a long time, Indian financial law is heavily influenced by English banking law. When contesting parties were Europeans, courts in India during British rule generally applied English law concerning negotiable instruments; however, when Hindus and Muslims were involved, their respective native laws and norms were made in use. However, when disputing parties are from various background, the law and rules that regulated the accused was applied, and this was referred to as the Law of Defendant.

I. The Negotiable Instrument Act,1881

The Government of India issued Act (6 of) in 1840 to govern the law relating to bills of exchange and promissory notes. Though the negotiable instrument bill was submitted in 1866 to signify the legislation on negotiable instruments, it became an Act in 1881 after various revisions were made to its predecessor. The Negotiable Instruments Act of 1881 recognised local usages and conventions common among Indian traders at the time. It was expanded to become the law of India as a whole, but it had little effect on local usages of instruments in Indian languages. The Negotiable Instruments Act of 1881 aims to "establish and reform the legislation relating to 'promissory notes,' 'bills of exchange,' and 'cheques,' whether negotiable or not."

II. The Banker's Book Evidence Act, 1891

The Banker's Books Evidence Act of 1891 was a significant piece of legislation created specifically for Indian bankers. It was a unique Act that gave bankers specific rights in terms of how they entered entries in their books and how they could produce them in court if and when they were required. The law of evidence stipulated that only the original documents might be used to prove the existence, condition, or contents of a document in court. Section 65, on the other hand, permitted for some exceptions to this norm, allowing copies of documents to be produced in court even when the original was not available.[10] The Banker's Books of Evidence Act of 1891 was one of those laws that, for the first time, authorised the production of a certified copy of records.

Section 4 laid down that: "subject to the provisions of this Act, a certified copy of any entry in a banker's books shall in all legal proceedings be received as prime facie evidence of the existence of such entry, and shall be admitted as evidence of the matters, transactions and accounts therein recorded in every case where, and to the same extent as, the original entry itself is now by law admissible, but not further or otherwise."[11]

Section 5 of The Banker's Book Evidence Act,1891, stated that "No officer of a bank shall in any legal proceeding to which the bank is not a party be compellable to produce any banker's book, the contents of which can be proved under this Act, or to appear as a witness to prove the matters,

[10] Indian Evidence Act, 1882, s.65
[11] Banker's Books Evidence Act 1891, s 4

transactions and accounts therein recorded, unless by order of the court or a judge made for a specific cause".[12]

In the Satyanarayana Case[13], the court concluded that when a 'third party' asked scrutiny of his accounts, it should be granted only in extraordinary circumstances because it entailed a substantial infringement on his regular right as a citizen engaged in some economic transaction or employment.

2.6 TYPES OF BANKS:

1. Scheduled Commercial Banks:

Section 2 (e) defines a 'scheduled bank' as one listed in the second schedule to the RBI Act of 1934. Scheduled banks are entitled to specific RBI services such as refinancing, loans, advances, and remittance facilities at competitive rates, as well as the provision of an authorised dealer's licence to handle foreign currency operations.[14] Similarly, banks have some obligations to the RBI, including as maintaining cash reserves at set levels and submitting fortnightly returns as prescribed by Section 42 of the RBI.[15]

Section 42(6)(a) requires the following conditions to be met before a bank is listed in the second schedule:

(i) It must contain a minimum of five lakh rupees in paid-up capital and reserves,

(ii) The RBI must be convinced that its affairs are not being handled in a way such that it is destructive to the depositor's willingness, and

(iii) It must be a State Cooperative Bank, a corporation as that term is defined in Section 3 of the Companies Act of 1956, or another institution that the Central Government has so notified. It may also be a corporation, or a

[12] Supra n., 8, s 5
[13] Satyanarayana v. Punjab National Bank, AIR 1977 Cal. 280.
[14] Sec. 2(e) of the RBI ACT,1934.
[15] ibid. s 42

company formed in accordance with any legislation in force in any nation other than India.[16]

"The Scheduled banks consists of the following –

- the State Bank of India and its Associate Banks (8),
- other Nationalised Banks (19).
- Foreign Banks (42).
- Private Sector Banks (92).
- Cooperative Banks (51) and
- Regional Rural Banks Local Area Banks (9)."[17]

2. Non-Scheduled Commercial Bank:

Commercial banks that are not scheduled are joint stock institutions that are not included in the second schedule of the RBI Act of 1934 since they have not satisfied the basic conditions to be scheduled. At the beginning of World War II, there were around 1500 joint stock banks functioning in India, 1400 of which were non-scheduled banks. Following the government's policy of integrating the nation's banking industry, weak and ineffective banks voluntarily merged, transferred obligations and assets, and entered into participation agreements. Over time, these policies decreased the number of the weaker banks. In the country today, there is no non-scheduled commercial bank. Into effect from June 3, 1999, the last non-scheduled bank, Bareilly Corporation Bank, was merged with the Bank of Baroda.

3. Public Sector Bank:

The Public Sector has gone through three stages to reach its current place in banking in India. The Imperial Bank of India was reorganized into the State Bank of Last India in 1955, and its seven subsidiary banks were founded soon after. In July 1969, 14 major commercial banks were nationalized as part of the second step. In 1980, six more commercial banks were nationalized as part of the stage. The New Bank of

[16] ibid., S 42(6)(a).
[17] Krishan Kumar, 'R B I S Control Over Banks In India A Study Of Legislative Provisions And Judicial Trends' (*Hdl.handle.net*, 2010) <http://hdl.handle.net/10603/129436> accessed 9 July 2022.

India, one of these banks, was eventually amalgamated into the Punjab National Bank. The public sector of Indian commercial banking is currently made up of nationalised banks.[18]

4. New Private Banks:

New private banks could not be established in India after the nationalization of banks, even though there was no legal prohibition. The formation of such banks in India was advocated by the Narasimham Committee on Financial Sector. In January 1993, rules for the establishment of new private sector banks in India was released by RBI. These banks can be divided into two categories:

- Indian Banks- Indian Banks are those banks where entrepreneurs who are Indian owns and administers such banks.
- Foreign Banks- Banks which are established outside India, but their place of business is in India.

5. Local Area Bank:

In the year 1996, the Indian government agreed to authorize new local area banks with the following goals:

(a) establishing an institutional framework to promote saving in rural and semi-urban areas; and

(b) providing loans for sustainable local economic activity.

6. Regional Rural Banks:

The Regional Rural Banks Act,1976 founded these banks. By encouraging finance and other services to small and marginal farmers, agriculturists, craftspeople, and small company owners, such banks aim to strengthen rural economies. Each Regional Rural Bank has a set approved capital and issued capital of Rs. Five crore and Rs. One crore, respectively. The Regional Rural Bank will issue capital, of which the Central Government will contribute 50%, the

[18] Avtar Singh, Law of Banking and Negotiable Instruments Act (1st edn, Eastern Book Co 2006) 6

State Government will subscribe for 15%, and the Sponsor Bank will provide 35%.[19]

7. Cooperative Banks:

A self-help, voluntary association of members who jointly satisfy their financial needs is a cooperative credit institution. Farmers in India require three sorts of credit

8. Industrial Development Bank of India (IDBI):

The IDBI is the country's tip banking institution for long-term industrial finance. In 1964, it was established as the Reserve Bank of India's wholly owned subsidiary. However, on February 16, 1976, it was delinked from the Reserve Bank of India when its whole share capital was given to the Central Government. As a result, its mission was expanded to include serving as the primary financial organisation for performing the functions and activities of providing assistance and, to a lesser extent, public sector banks throughout India.[20]

The IDBI collects its funds from the following sources-

- Market borrowing in form of bonds.
- Loans from the Reserve Bank of India's National Industrial Credit Funds.

IDBI also receives short-term advances from the RBI in exchange for the deposit of Usance bills. Several subsidiaries are there which belongs to IDBI:

Development Banks can be divided into two categories:

(A) All India Development Banks- All India Development Banks include-:

Industrial Finance Corporation of India (IFCI), Industrial Credit & Investment Corporation of India (ICICI) and Small Industrial Development Bank of India (SIDBI).[21] These banks have their area of operation over the whole country.

[19] B.R. Sharma and R.P. Nainta, *Principles Of Banking Law & Negotiable Instruments Act.* (3rd edn, Allahabad Law Agency 2006) 5
[20] Supra n., 15, p. 7
[21] Supra n., 17

(B) State level Development Banks-: It includes the following –

State Financial Corporations (SFCs) and State Industrial Development Corporations (SIDCs). The SFCs or SIDCs operates all over the State where are established.

9. Export Import Bank of India:

This was India's largest banking organization for financing overseas trade which was founded in 1982. It provides financial support to exporters and importers while also coordinates the activities of other institutions that finance exports and imports. The EXIM Bank also offers refinancing to commercial organizations for their export-import financing activities. It also funds collaborative ventures in other countries. Additionally, this bank does a few limited merchant banking tasks, like underwriting the stocks, shares, bonds, or debentures issued by businesses involved in export or import.

10. National Bank for Agriculture and Rural Development:

The Indian Government has recognised the significance of institutional credit in promoting the rural economy since its beginning. Consequently, the RBI established a centre to recheck the Arrangements for Institutional Credit for Agriculture and Rural Development (CRAFICARD) at the request of the Indian government to look into these critical issues. The Committee was constituted on March 30, 1979, with Shri B. Sivaraman as its chairman. He was formerly a member of the Planning Commission of the Government of India. On July 12, 1982, NABARD received the agricultural loan operations of RBI and the refinancing operations of the former Agricultural Refinance and Development Corporation (ARDC). "On November 5, 1982, the late Prime Minister Smt. Indira Gandhi dedicated it to the nation's service."[22] The main vision of NABARD was to work for securing prosperity, encourage participatory financial and non-financial initiatives, innovations, technology, and institutional development in agriculture and rural development.[23]

11. National Housing Bank:

[22] 'NABARD - National Bank For Agriculture And Rural Development' (*Nabard.org*, 2022) <https://www.nabard.org/content.aspx?id=2> accessed 30 May 2022.

[23] 'NABARD - National Bank For Agriculture And Rural Development' (*Nabard.org*, 2022) <https://www.nabard.org/content.aspx?id=2> accessed 30 May 2022.

The National Housing Bank Act of 1987 governs the duties of this bank, which was founded on July 9, 1988. It extends housing expenses at the municipal and regional levels, as well as providing financial and other support to institutions that mobilise resources and offer housing loans. It also gives refinancing facilities to housing expenses institutions and scheduled banks, as well as guarantee and underwriting services. It provides housing-related technical, administrative, and consultancy services on occasion.

2.7 Legal Position of Bank:

It was held in the case of Girish Chandra Saxena[24] and State Bank of India [25]that the Banks are needed to be protected in order to safeguard the interests of customers. The court continued by stating that a bank is not a "State" as defined by Article 12 of the constitution because it is neither a government agency nor an instrument of the state. It is a private banking firm that was established in England in accordance with the Royal Charter and conducts business across India, especially in Kanpur. According to the petitioner's employment contract, which was attached as Annexure-1 to the counter affidavit, the bank had the right to terminate the petitioner's employment with three months' notice or three months' salary in lieu of notice. The right to work at the bank that Petitioner asserts is derived from an agreement that he signed with the bank, and this arrangement is not a statutory agreement. The petitioner's right, which he desires to be enforced by the mans of this writ petition, is of a private nature. A writ petition under Article 226 of the constitution cannot be filed to enforce such a right since it was issued under non-statutory authority and the challenged order was issued under a non-statutory contract rather than under statutory terms.

In the case of Bank of India[26], the Supreme Court ruled that nationalised banks are covered by the word "State." In the case of Canara Bank[27], it was determined that the nationalised bank is a government entity. It has an obligation to be precise in its claim for loan recovery, both in terms of principal and interest rate.

[24] Girish Chandra Saxena v. Chief Executive, Standard Charted Bank, 11 (1994) BC 77
[25] State Bank of India v. Maharaja Saw Mill Pvt. Ltd., (2004) 1 BC 106.
[26] Bank of India v. O.P. Swarnakar, (2003), 2 SCC 721.
[27] Canara Bank v. M.D. Chikkaswamy, AIR 2002 Karn.100.

CHAPTER – 3

The Role of Reserve Bank of India in Boosting the economic structure.

3.1 Reserve Bank of India Act,1934

The RBI is the Central Bank which controls the functioning of other banking system. It acts as a supervisor and a banker of other banks. "The Reserve Bank of India was established on 1st April,1935 under the Reserve Bank of India Act, 1934."[28] The Reserve Bank of India extends to the whole of India.

3.1.1 Objective of the Act

The following are the objectives of the Reserve Bank of India Act,1934 that are understood from the Preamble of the Act.

1. Regulate the supply of bank notes
2. To keep reserve in order to ensure monetary policy
3. To use the country's credit and currency system to the country's benefit.

"At present, under section 29A of the Securities Contracts (Regulations)Act, 1956.The Central Government has delegated to the Reserve Bank of India, by notification, the powers exercisable by it under Section 16 of that Act, for regulating the transactions in money market and other instruments. Therefore, more effective regulations of the markets for interest rate contracts, including government securities and money market instrument as also derivatives, it is necessary to confer specific powers on the Reserve Bank of India, under the Reserve Bank of India Act ,1934, to lay down policy and to issue directions to agencies operating in these contracts, securities, and derivatives."[29]

3.1.2 Salient Features of the Act:

1. The Act specifies the Reserve Bank of India's activities in detail-

- Accepting deposits from the federal and state governments is one of them.

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[28] 'Reserve Bank Of India' (*Rbi.org.in,* 2022) <https://www.rbi.org.in/> accessed 9 July 2022.
[29] Krishan Kumar, 'RBI s Control over Banks In India A Study of Legislative Provisions and Judicial Trends'(Shodhganga.inflibnet.ac.in,2022) <https://shodhganga.inflibnet.ac.in/handle/10603/129436> accessed 16 May 2022

- Bills of exchange and promissory notes, purchase, sale, and rediscounting.
- Treasury bills sales and purchases.
- Financing local governments, scheduled banks, and state cooperative banks, etc.
- Providing financial assistance to the federal and state governments.

2. The Reserve Bank of India Act,1934 gives the power in the hand of Reserve Bank to control central banking. The following are the functions-

- Issue of Currency notes.
- Government's Bank
- Banker who works for Commercial Banks.
- Credit control in the economy.

3. The authority to issue new banking licenses are the duty of RBI.

4. The RBI has authority to hold commercial bank's balances related to cash.

5.Commercial Bank must give a record of weekly returns containing the following information:

- Total cash kept.
- Reserve Bank's balance.
- Money on demand and short notice.
- Government-issued securities.
- Sum total of loans, etc.

3.1.3 Constitutional Validity

"The Reserve Bank of India was established on April 1,1935 in accordance with the provisions of the Reserve Bank of India Act, 1934.Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India."[30]

3.2 Functions of Reserve Bank of India

I. **FINANCIAL SUPERVISION**:

The main objective of the Reserve Bank of India is to look after the monetary sector which comprises commercial banks, finance institutions and non-banking finance

[30] 'Reserve Bank of India' (*Rbi.org.in*, 2022) <https://www.rbi.org.in/> accessed 3 June 2022.

companies. The board of four directors are formed from the Central Board as a member for a period of two years and the Governor is the Chairman of the committee. The deputy governor is selected as the board's vice-chairman. Once in every month the board schedules its meetings. It looks after the reports and other administrative issues presented before it by the administrative departments.

II. THE CONTROLLER AND SUPERVISOR OF THE FINANCIAL SYSTEM

The Reserve Bank of India acts as a regulator and supervisory body of the financial system and sets a parameter of banking operations. Its primary aim is to manage the confidence of the public in the system, protects the interest of the person who deposits the money and provides cost effective banking services to the people. With a view of effective lodging of complaints by the bank customers the Reserve bank of India has formulated the Banking Ombudsman Scheme.

1. Granting banks licenses to undertake banking operations (Section 22).
2. Restrictions on the opening of new branches or relocating existing branches (Section 23).
3. to review the financial records of commercial bunkhouses (Section 35).
4. to provide instructions (Section 35-A).
5. to remove executives and other officials from their positions (Section 35-AA).
6. appointing more directors (Section 36-AB)
7. in relation to the suspension (moratorium) of business (Sections 37 and 45)

III. THE REGULATOR AND SUPERVISOR OF THE PAYMENT AND SETTLEMENT SYSTEM

To improve the entire economic order, the Payment and settlement system plays an important role. The Payment and Settlement Act 2007(PSS ACT) empowers RBI with the authority to regulate and supervise the payment and settlement system in the country.

"RBI focuses on the development and functioning of safe, secure, and efficient payments and settlement mechanism. Two payment systems- National Electronic

Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS) allow the individuals, companies and firms to transfer funds from one bank to another."[31]

"NEFT operates on deferred net settlement (DNS) basis and settles transactions in batches. The settlement takes places for all transactions received until a particular cutt-off time."[32]

"The working hour are-there are twelve settlements from 8 am to 7 pm on weekdays and six between 8 am and 1 pm on Saturdays. Any transactions initiated after the designated time would have to wait until the next settlement time. While in RTGS, transactions are processed continuously all through the business hours.RBI's settlement time is 9 am to 4:30 pm on weekdays and 9am to 2 pm on Saturdays."[33]The main objective of RBI is to ensure public belief in payment and settlement system.

IV. BANKER AND DEBT MANAGER TO GOVERNMENT

RBI serves as a bank to the Government of India. Like we people require a bank to carry out our financial transaction safely, swiftly, and efficiently, the government also needs a bank to carry out their financial transactions. In this process, RBI maintains the accounts, receives the payment and also make payments out the accounts. The Government of India raises money and funds from the public with the aid of RBI through issuing bonds and government approved securities.

RBI is empowered to make a transaction of Government business of states on agreement under Section 21-(A). Section 45 states that RBI is bound to appoint the State Bank of India as its only agent in absence of any branch or office at certain places.

V. MANAGING FOREIGN EXCHANGE-

It manages The Foreign Exchange ManagementAct,1999 in order to attain different goals. The FEMA empowers the Reserve Bank of India to have a primary role in the foreign exchange management. The Foreign Exchange market

[31] 'Role Of RBI In Economic And Social Development PDF | PDF | Reserve Bank Of India | Central Banks' (*Scribd*, 2022) <https://www.scribd.com/document/438777405/Role-Of-RBI-In-Economic-And-Social-Development-Copy-pdf.> accessed 7 July 2022
[32] 'Reserve Bank Of India - Speeches' (*Rbi.org.in*, 2022) <https://rbi.org.in/scripts/BS_SpeechesView.aspx?Id=31.> accessed 7 July 2022
[33] Ibid.

has become an integral part of the Indian financial market with the amalgamation of Indian and global economy. RBI looks after gold reserves of the country. The below mentioned points are the works of FEMA:

1. The Reserve Bank of India applies its power to provide duties in regard to external trades and payment and also it looks after and manages the foreign exchange market in India.
2. RBI empowers any person to perform its work in foreign exchange or in foreign securities as an authorized dealer.
3. If anyone goes against the framework given by FEMA, then Reserve Bank of India is empowered to impose penalty.

VI. ISSUE OF THE CURRENCY

Section 22 of the RBI Act of 1934 states that the RBI has the supreme authority to issue currency in India. Section 38 of the RBI Act of 1934 states that the Central Government may only issue rupee coins and one rupee currency notes through the Reserve Bank. The signature on one-rupee notes is that of the Finance Secretary, Ministry of Finance, Government of India. The RBI is the body which has the power for printing the currency notes in the country along with the Government of India. RBI has also the power to destroy the bank notes when it is not in a position for circulation. The main objectives are-

- to print bank notes and provide a sufficient supply to the public at large.
- to keep the currency and credit system of the country in good working so that it can be used to its full potential.
- to maintain reserves.

“According to Section 23, Issue Department is responsible for issue of fresh bank notes against the security which consists of the following:

a) Gold coins and Bullion
b) Foreign Securities,
c) Rupee coins,
d) Government of India Rupee Securities, and

e) The bill of exchange and promissory notes payable in India which are eligible for purchase by the Bank."[34]

"According to section 24 of the RBI Act, 1934, banknotes shall have denominational values of Rs 2/-, Rs 5/-, Rs 10/-, Rs 20/-, Rs 50/-, Rs 100, Rs 500, Rs 1000, Rs 5000, and Rs 10000, as well as any other denominational value not exceeding Rs 10,000 that the central government may specify on the recommendation of the Central Board of RBI."[35] The Supreme Court held in the case of Jayanti Lal Rattan Shah [36] that because the high valued bank notes were demonetized for protecting the huge masses , the Act did not infringed Article 31(2) of the constitution.

Circulation of Coins and Currency Notes.

The Reserve Bank has made sufficient administrative procedures to carry out the function of distributing currency notes and coins through currency chests in order to provide remittance opportunities to banks and the general public. For this reason, the issue department has offices in ten major cities. Stocks of new or re-issuable notes are kept in currency chests, which are boxes or containers, together with rupee coins. Public sector banks also store currency chests.[37] Every bank note must be legal currency in India in order to be used as payment or credit for the amount stated on it, according to Section 26. and will have the Central Governments' guarantee. Any series of bank notes of any denomination will cease to be legal currency with effect from the date mentioned in the notification, at the Central Government's advice, by notification in the Indian Gazette.Bank notes that are extremely damaged, disfigured, or ripped are allowed to be reissued under Section 27.

VII. BANKER'S BANK

The Reserve Bank of India performs quite a similar function. It holds commercial bank deposits and acts as a lender of last resort, aiding financially in accordance with Section 17 of the Act. As per Section 17(4) the Reserve Bank has the power to provide loans and advances to the bank. The bank may act regardless of any restrictions stipulated in section 17 of the Act when, in the opinion of the RBI, a

[34] R.N Chaudhary, *Banking Laws* (1st edn, Central Law Publication 2009) 318
[35] Ibid.
[36] Jayanti Lal Rattan Shah v Reserve Bank of India, AIR 1997 SC 370: AIR 1996 SCW 3736
[37] R.N Chaudhary, *Banking Laws* (1st edn, Central Law Publication 2009) 319

specific scenario has developed that makes it necessary to act for controlling credit in the interest of Indian trade, commerce, industry, and agriculture.

a) Buy, sell, or discount any promissory note or bill of exchange, although some would not be eligible under section 17.
b) It provides loans or advances to (a) a state cooperative bank; or (b) to a Cooperative Society Registered within the State Cooperative Bank's operating area only after consultation with the State Cooperative Bank; or (c) Any other person; such loans or advances should be paid back upon request or at the conclusion of predetermined periods of time not to exceed 90 days; on such conditions as may be deemed appropriate by RBI.

VIII. THE REGULATOR OF THE BANKING SYSTEM

RBI is empowered to regulate the financial system of the nation. RBI opts the procedure such as on-site inspections, off-site surveillance etc. As a financial system regulator, the RBI has prioritized the issue of corporate governance in banks. Banks, in particular have sparked considerable attention in terms of governance, given their fiduciary responsibilities. The problem has been considered by several advisory bodies. The R H Patil committee first looked into corporate governance norms in India, as well as governance policies in public sector banks.[38]

DETECTION OF FAKE CURRENCY

RBI has the power to detect the fake currency. With a view to stop such issues, RBI has launched a website so that they can spread awareness among the people about fake banknotes.

IX. DEVELOPMENTAL ROLE

The Developmental functions of RBI are as follows -:

(i) People's dependency on local bankers and money lenders is decreased, and by motivating commercial banks to establish their branch in agrarian places people's banking habits are developed,

[38] Krishan Kumar, 'RBI s Control over Banks In India A Study of Legislative Provisions and Judicial Trends'(Shodhganga.inflibnet.ac.in,2022) <https://shodhganga.inflibnet.ac.in/handle/10603/129436> accessed 16 May 2022

(ii) By establishing the Deposit Insurance Corporation, the RBI helps to grow the country's banking sector, instills depositor trust, and prevents bank collapses.

(iii) The RBI facilitates the mobilization of savings in the country through organizations such as UTI.

(iv) In 1988, the RBI formed the Discount and Finance House of India Ltd. (DFHI) to provide protection to bank depositors.

(v) From time to time, the RBI appoints ad hoc committees and expert groups, such as the Chakravarthy Committee, to investigate banking difficulties.

X. RELATED FUNCTIONS

RBI is vested with a supervisory power in order to supervise the banking system. When a bank is set up, the license is granted by RBI. Not only to open a new bank also to open a new branch, to determine minimum reserves etc. RBI provides license. A numerous number of Developmental works are performed by the Reserve Bank of India. The following are certain Developmental works carried out by RBI:

- RBI works in place of the Government in the International Monetary Fund and also denotes the Indian membership.
- It also manages credit in order to carry out agriculture but now the power is vested on the hands of NABARD.
- RBI is envolved in purchasing and selling of precious commodities such as treasury bills etc.

3.3 Objective of the Act:

According to its preamble, the Reserve Bank of India's goal is “is to regulate the issue of bank-notes and the keeping of reserve with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage”[39].

(i)To promote growth and preserve price stability is the RBI's top priority.

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[39] Preamble of the Reserve Bank of India Act 1934

(ii)Maintaining monetary stability is necessary for the business and economic world can provide mixed economy welfare advantages only when the monetary stability is maintained.

(iii) Ensuring the good health of financial institutions and preserving financial stability so that economic entities can operate with confidence.

(iv) Ensuring the stability of the payment system so that financial transactions can be carried out effectively and safely.

(v) Ensuring that the financial system's distribution of credit adequately reflects the social and economic interests of the country.

(vi) Having control on total amount of credit and money in the economy to maintain a suitable level of price stability.

(vii) Supporting the growth of financial markets and systems to enable effective operation and regulation.

(viii) Ensure that the foreign currency market is orderly, and that excessive volatility does not affect the exchange rate.

3.4 The Organizational Structure of The RBI.

The RBI was initially set up as a shareholder's bank, following the example of the most prominent international central banks at the time The bank's fully paid-up share capital is divided into shares worth one hundred rupees each and total values Rs. Five crores. Except for shares with a nominal value of Rs. 2,20,000/- that were allocated to the Central Government for the purpose of issuing shares in accordance with instructions from the Central Board of the Bank, the entire share capital was held by private individuals, attempting to meet the required minimum share threshold. The bank's share capital has not changed since its inception. In 1982, the Reserve Bank also maintained a 150-crore rupee Reserve fund.

The Reserve Bank of India comprises of the following Boards:

(i) Central Board.

(ii) Local Board

(A) Central Board

The bank's top governing body is the Central Board of Directors. It is tasked with the role of overall oversight and management of the Reserve Bank's operations. The following twenty people make up the Central Board of Directors:

(i) Four Deputy Governors and one Governor

They are selected by the Indian government for a five-year term. The central Board of Directors decides on their pay, benefits, and other perks after consulting with the Indian government.[40]

(ii) The Local Boards Nominated Four Directors

There are four local boards of directors in addition to the Central Board of Directors. They are located in Calcutta, Bombay, Madras, and New Delhi. The Government of India selects one representative from each of these local Boards. For these Directors, the term of office is five years.

(iii)Ten additional Directors:

The Government of India also proposes the ten additional directors for the Central Board of Directors. They have a four-year contract.

(iv) One government representative:

Additionally, one government representative is invited by the Indian government to attend Central Board of Directors meetings. With the approval of the Government, this official may remain in office for an unlimited number of years, but he is not permitted to participate in voting at Central Board meetings.

All the bank's authority is exercised by the Central Board of Directors. The Central Board ought to be together once every three months and at least six times annually. The Central Board meets in New Delhi every March to discuss the finances with the ministry of finance after it is presented in Parliament. Like this, it conducts a meeting in the month of August to approve the bank's annual report and financial statements in Bombay.

The committee which comprises of the Governor, the Deputy Governors and other Directors which are formed by the Central Board that keeps a check on the bank's

[40] Reserve Bank of India Act 1934, s 8(a)

current affairs and meets once in a week. To help the Central Board committee, two subcommittees have also been appointed. One of these is the Building Subcommittee, which handles issues pertaining to construction projects. The second one is known as the Staff Sub-Committee, and it deals with employee issues along with other things. The Governor is the Reserve Bank's top representative. Four Deputy Governors are available to assist and counsel him. A certain task is assigned to each deputy governor to complete, and he is totally responsible for its proper completion.

Bombay serves as the Reserve Bank's administrative center. New Delhi, Calcutta, Chennai, Bangalore, Kanpur, Ahmedabad, Hyderabad, Patna, and Nagpur are the location where offices are made in order to carry out its duties effectively.[41] With the previous approval of the Central Government, the Bank may open an office somewhere else. When the Reserve Bank does not have its own offices, the State Bank of India serves as the latter's agent. Kanpur, Kolkata, Chennai and New Delhi are the locations of the Reserve Bank's regional offices for the exchange control division.

The Western, Eastern, Northern, and Southern regions are the four divisions in which the central bank is divided. Local Board in each of this region is located in Chennai, Bombay, Calcutta and New Delhi. Five individuals who are nominated by the Central Government for a four-year term make up each Local Board.

3.5 Framework of Reserve Bank of India

The Reserve Bank of India has a sixteen department which performs various function:

(i) Issue Department: This department handles the task of issuing paper money and also prepares plans for paper money distribution. It keeps up-to-date records of the notes printed at the Nasik Press. Bangalore, Mumbai, Kolkata etc are among the cities where it has branches.

(ii) Banking Department: The two main functions that this department of the Reserved Bank of India performs are:

First, it entails managing government business, issuing loans on behalf of the federal and state governments, and organizing the movement of government finances from one place to another.

[41] Ne. Thi Somashekhar, *Money Banking International Trade & Public Finance* (Anmol Publication pvt Ltd 2004).

Secondly involves maintaining the cash reserves of the scheduled banks, providing them with financial support when necessary, and serving as the clearing house for the scheduled banks.

(iii) Development of Banking: The main aim of this banking department is to expand or enlarge all the facilities that the bank provides to all the people of rural or semi urban areas. It also provides guidance to the scheduled banks.

(iv) Banking Operation: Inspection of the scheduled banks are carried out by this department periodically, which also analyzes their balance sheets, provides licences to open new banks, takes into account requests to open new branches, looks into requests from scheduled banks to increase their paid-up capital, considers requests to combine existing banks, and offers advice to scheduled banks on how to operate on a day-to-day basis.

(v) Agricultural Credit: This department deals with issues related to rural credit, formulates Reserve Bank policies for rural credit, awards rural credit to State Governments and State Cooperative Banks, and publishes reports on agricultural credit. It also investigates issues related to rural credit.

(vi) Exchange Control: The selling and purchase of foreign exchange is regulated and overseen by this department.

(vii) Industrial Finance: This department offers financial support to small- and medium-sized businesses as well as advise on how to operate various industrial finance corporations on a daily basis.

(viii) Non-Banking Companies: This bank provides supervision to the non-banking companies and financial institution in the country.

(ix) Legal Department: This division provides legal guidance to the Bank's many departments, drafts bank directives and communications, and counsels the Bank on how to effectively apply laws pertaining to banking in the nation.

(x) Research and Statistics: This department conducts research on issues related to money, credit, finance, production, etc. It gathers and publishes statistics about the various economic sectors; and offers advice to the government on how to address a variety of economic issues as well as how to formulate its economic and financial policies.

(xi) Department of Planning and Reorganization: In order to increase the effectiveness of existing policies, the department creates new ones and restructures old ones.

(xii) Economic Department: For the government's economic plans to be implemented more effectively, this department develops banking regulations.

(xiii) Inspection Department: The offices of Commercial banks are investigated by Inspection Department.

(xiv) Department of Accounts and Expenditure: Records of all the receipt of Reserve Bank of India are maintained by this department. It also maintains expenses of RBI.

(xv) RBI Service Board: The process of selecting fresh employees for numerous posts under RBI are the subject matter of RBI Service Board.

(xvi) Department of Supervision: This department was set up on 22 December 1993, for conducting proper supervision of commercial banks.[42]

3.6 Promotional Role of Reserve Bank of India

The RBI is the nation's central bank, and as such, it is charged with a variety of duties, including encouraging the development of financial institutions so that its policies can effectively promote economic growth in accordance with the rules and regulations set forth by the government and managing credit and currency in the economy. When the Reserve Bank of India was founded in 1935, our nation was still in the developing stage and completely lacks a well-developed money market in addition to a well-developed commercial banking system. The Reserve Bank of India actively got involved in promoting and expanding financial institutions after 1948 in order to adhere to correct credit and monetary policies for upliftment and growth in the economic sector during a period of planned economic development of the country.

As a result, the Bank has implemented the following promotional measures:

- In 1952, the Bank created the bill market system.
- The Bank has made an effort to provide industrial and agricultural sector with loans
- To provide banking services to rural areas, the Bank started Regional Rural Banks with the assistance of Commercial Banks.

[42] Preamble of the Reserve Bank of India Act 1934.

- The Bank helped establish an export-import bank in India so as to finance exporters, and it has made steps to allow Commercial Banks to open branches in overseas locations.
- The Bank promotes academic inquiry on banking-related topics.

3.7 Critical issues in Reserve Bank of India

The following are the issues and challenges faced by the Reserve Bank of India:

i. **Rise in Inflation:**

"India has had a lifelong battle with inflation, the rise in prices of goods and services over time. Inflation eats into the value of money, making life difficult for people. The RBI, naturally, has focused on controlling this inflation. It has succeeded in the near past—retail inflation fell from double digits to 5%-levels. However, it spiked to a 19-month high of 5.76% in May this year. A delayed monsoon, as well as increase in international crude oil prices, could push inflation higher in the recent past."[43]

ii. **Clean up of Banking System:**

Bad loans are a major issue for India's banks. According to Rajan, the RBI oversaw a clean-up of the banks' balance sheets through a number of changes, such as providing banks more authority and flexibility. This is not a one-time remedy, though. It is a core challenge that there are so many non-performing assets (NPAs), particularly at state-run banks where there are so many political interventions. As a result, the next governor of the RBI must maintain stringent efforts to ease the strain on India's banks.

iii. **Crunch in Liquidity:**

The liquidity crisis has also been a persistent issue for Indian banks over the past few quarters. It occurs when banks lack sufficient money resources for immediate operations. Banks usually discover that they need to take more money from the RBI and other banks as a result. This puts a lot of pressure on both profitability and interest rates. Without sacrificing its inflation-targeted monetary policy, the RBI must

[43] '5 Problems The New RBI Governor May Have To Tackle- Meaningful Minutes' (*Kotak Securities*®, 2018) <https://www.kotaksecurities.com/ksweb/Meaningful-Minutes/5-problems-the-new-RBI-governor-may-have-to-tackle> accessed 11 July 2022.

keep working to relieve this liquidity shortage. Changes to monetary policy might not work otherwise.

iv. Committee for Monetary Policy

The administration announced the creation of a six-member Monetary Policy Committee in the budget. Three of them, including the governor and vice governor, will be from the RBI. In contrast to the existing system, which gives the RBI entire control over the country's monetary policy. A seamless transition to the new system will need to be ensured by the new RBI governor.

3.8 Board for Financial Supervision.

The Narasimham Committee advocated creating a separate organization—possibly a quasi-autonomous Banking Supervisory Board—under the supervision of the Reserve Bank to handle the Reserve Bank's supervisory activities in addition to its more typical central banking duties. The Committee also suggested that the Board should have oversight authority over development finance institutions in addition to the banking system. Financial intermediaries that are not banks as well as other non-banking financial organizations that issue bonds or take deposits from the public.

The Statutory Regulation according to Section 58 of the Reserve Bank of India Act 1934 (2 of 1934) in connection with the establishment of the Board for Financial Supervision has been approved by the Government, and notification to this effect was issued on July 28, 1994.To provide BFS (Board for financial Supervision) with operational support, a new Department of Banking Supervision (DBS) was established. The Board will supervise commercial banks, and in due order, it will also have oversight responsibilities for financial institutions and non-banking financial firms. With its Central Office in Bombay and 16 Regional Offices in different Centers, the Department of Banking Supervision has been established.

CHAPTER 4

Control over Organization of the Banks

4.1 Banking Regulation Act,1949

The administration and functioning of banking companies are regulated by the Banking Regulation Act. First, there is a barrier to entry in the form of licensing, and then creating new branches or moving existing ones requires permission. Additional rules apply to paid-up capital and reserves, shareholder rights, the appointment of the board of directors, the choice of the chairman, and the creation of subsidiaries. In addition to that, there are controls over other personnel, including the authority to remove undesirable people and hire more efficient people.[44]

4.1.1 Introduction:

For the purpose of amending and codifying the law governing banking firms, the Banking Companies Act of 1949 was passed. This was believed to be necessary because of the misuse of authority by those in charge of some banks, the lack of safeguards for protecting the interests of depositors particularly at banking businesses, and also for protecting national economic interests generally. The name of the Act has been amended to the Banking Regulation Act, 1949, with effect from 1 March 1966.

4.1.2 Objective of the Act

The following are the objectives of the Banking Regulation Act,1949:

1. To Provide specific legislation with thorough regulations, especially for India's banking industry.

2. To Establish minimum capital standards to prevent bank failures.

3. To Ensure that the banking industry develops in a balanced manner.

4. To provide the RBI with the authority to confirm the appointment, renewal, and removal of the bank chairman, directors, and officials.

5. Protect depositors' interests

6. To strengthen the country's banking system.

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[44] Indian Institute of Banking & Finance, Legal Aspects of Banking Operations (2005 ,1st Edn., Macmillon India Ltd) 20

The Act also included a procedure for quickly initiating and concluding procedures in the liquidation of banking companies. This was important to check for abuse of authority by those in charge of the banks, the absence of safeguards for bank depositors, and the general economic interest of the nation. The above stated lines are mentioned by Supreme Court in Dhirendra Chandra Pal Case[45], the Supreme Court upheld this stance.

4.1.3 Salient Features of the Act:

The Salient features of the Act are as follows:

An extensive definition of "banking" that encompasses all institutions that accept deposits for lending or investment, whether they are repayable on demand or not.

b) boycotting non-banking companies from accepting deposits repayable on demand.

c) prohibiting trading with the goal of removing non-banking danger.

d) prescribing minimum capital standards.

e) limiting dividend payments.

f) The inclusion of banks formed or registered outside the Indian provinces in the purview of the law.

j) Giving the Central Government the authority to take action against banks who are conducting their affairs in a way that is harming the interests of the depositors.

k) Making scope to put the RBI in closer contact with banking companies.

l) Providing a speedy process for requesting periodic returns.

h) prescribing a special form of balance-sheet; surveillance of the records and accounts of a bank.

4.2 Power of Reserve Bank of India to issue and cancellation of licence.

i. **Issuance of licence by Reserve Bank of India:**

In India, no corporation can conduct banking operations without a license that has been granted in that behalf by the Reserve Bank. The licence may be granted with the

[45] Dhirendra Chandra Pal v. Associated Bank of Tripura, AIR 1955 SC 213.

restrictions that the RBI may deem appropriate to impose. The banking companies that were already operating were required to apply for license within six months from the date of commencement of the Act. However, these banking organizations were allowed to keep operating up until the Reserve Bank rejected their licence applications.[46]

In order to prevent the entry of banks founded in nations that discriminate against banks founded in India, the central banking investigation committee a proposed that section 22 (1), which was born out of the desire for licensing of foreign banks conducting business in India.

ii. Conditions to be fulfilled:

The Reserve Bank of India can issue license to a company if the following condition are satisfied:

(a) The business ought to be able to make the payment of its current or potential depositors in full as soon as their payment become due.

(b) the company's works are not currently being carried out in a way that is or are likely to be harmful to the depositors.

(c) The proposed management of the corporation will not generally be harmful to the general interest, the interest of its depositors, or either of those interests.

(d) The capital structure and future earnings plans of the company are suitable.

(e) Serving the public interest by granting the company a licence to operate a banking business in India.

f) The operation of the banking system in accordance with monetary stability and economic growth would not be adversely affected by the license's issuance. This will be considered while taking into account the banking facilities that are accessible in the company's proposed primary operating region, the potential for existing banks in the area to expand, and other relevant criteria.

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[46] Indian Institute of Banking & Finance, Legal Aspects of Banking Operations (2005 ,1st Edn., Macmillon India Ltd) 20

(g) Any other requirements that should be fulfilled as per the Reserve Bank is to ensure that the company must continue its banking operations in India without compromising with the interests of the public or depositors.

iii. Issuance of Licence to Company which is placed outside India.

The Reserve Bank of India must inspect those certain conditions are fulfilled by the company laid down under sub-section 3 before issuing licence to a company which is incorporated outside India:

a) It will be in the public interest for such company to conduct banking operations in India.

b) The Indian banking businesses are not subject to any discrimination on the part of the Indian government or in which they are incorporated.

c) The business conforms with all the Banking Regulations Act, 1949 requirements that apply to foreign-incorporated banking businesses.

iv. License Cancellation:

The RBI is authorised to cancel the license under certain cases:

(a) the firm ceases to do banking practices in the nation.

(b) the company did not succeed to follow up with any of the licence conditions listed in section 22 subsection (1) at any time.

(c) the conditions mentioned in sub section (3) and (3-A) of Section (22) are not satisfied.

The Reserve Bank of India should allow the Company to take necessary steps for fulfilling the conditions required for obtaining the licence before cancellation of licence for non-compliance with any condition mentioned above. The obligation of opportunity can be waived, nonetheless, in cases when the bank believes that waiting will harm depositors' or the public's interests. Within 30 days after the date of the order denying the license, a banking company whose license has been revoked may file an appeal with the Central Government. Where no appeal has been filed, the Reserve Bank's decision becomes binding. When deciding whether to reject a license application, the flaw or improvements found during an inspection pursuant to section 35 may be considered.

In case of **Sajjan Bank (P) Ltd. Case**[47], Section 22 of the Banking Regulation Act, 1949 solely provides a licensing system with the goal of regulating the banking industry and does not infringe upon any individual's fundamental freedom to own and operate a business. Additionally, it was established that no other Reserve Bank officer may use the authority granted to the RBI.

In Case of **M. Ramchanram Member and Ex-Chairman of Vasundra Co-operative Urban Bank Ltd.**[48] The appellate authority's denial of interim orders on the grounds that there was no provision for such relief was deemed unlawful. Under section 22(5), there is a mechanism for appealing the RBI's decision to revoke an urban bank's license. The ability to issue interim orders may be considered a byproduct of the exercise of appellate authority.

In the Case of **Apex Co-operative Bank of Maharashtra and Goa Ltd.**[49] The court determined that notice under section 2 (U) of the NABARD Act was required in order to issue the applicant co-operative society a license to conduct banking activity as per the scheme of the Banking Regulation Act. Without such a notification, neither the State Government could designate it as a State Co-operative Bank, nor the RBI could provide it a license to operate as a Cooperative bank.

In the **Shivabhai Zaverbhai Patel Case**[50], it was decided that the High Court could not hear an appeal involving a Reserve Bank's judgment unless it could be demonstrated that the Reserve Bank's decision was based on irrelevant factors.

In the **Muhammed Usman Case**[51], it was determined that a cooperative society registered under the Kerala Cooperative Societies Act could only do banking activity if it were a cooperative bank with a license that allowed it to use any one of the terms "bank," "banker," or "banking." A primary credit society, a

[47] Sajjan Bank (p) Ltd. v. Reserve Bank, AIR 1961 Mad 8: 30 Comp. Cas. 146
[48] M. Ramchanram member & Ex- chairman of vasundra co-op. Urban bank Ltd., Secunderabad v. Joint Registrar Distt. Co-operative Officer, Ranga Reddi District 2004 (1) ALT 283 (A.P.)
[49] Apex Co-operative Bank of Maharashtra & Goa Ltd. v. Maharashtra State Co-operative Bank Ltd., AIR 2004 SC 141
[50] Shivabhai Zaverbhai Patel v. Reserve Bank of India, AIR 1986 Guj 19
[51] Muhammed Usman v. Registrar of Co-operative Societies, AIR 2003 Ker.299

cooperative society established to safeguard the shared interests of cooperative banks or cooperative mortgage banks, and any society established by staff members of specific financial organizations are exceptions in this regard.

Vasavi Cooperative Urban Bank Ltd., despite being registered as a financing bank under the A.P. Cooperative Societies Act and having secured a license from the R.B.I., it did not carry out any public duties, as stated by the court said in the **Mani Enterprises Case**[52]. As a result, it was not a "State" for the purposes of Article 12 of the Constitution, and no mandamus could be granted to it.

4.3 Opening of New Branches and Transfer of Existing Branch

Without the approval of the Reserve Bank of India, the banking company can neither open its new branch nor can it shift its place of business. The Reserve Bank of India is not necessary, however, if the corporation moves the location of its operations within a district, township, or village.

Temporary Branch:

For the purpose of offering financial services to the public during an exhibition, conference, mela, or any other similar event, a temporary place of business may be built at a location or its surroundings where the company maintains a place of business. Permission may only be granted for a less period of time up to one month. For installation of ATMs at branches and extension counters they are not obliged to take permission from the RBI. But they are required to inform the RBI regarding the installation of ATM at the branches.

i. **Conditions for granting permission:**

The Reserve Bank may require proof, through an inspection conducted in accordance with Section 35 or in another manner, that the company's financial situation and history, the general nature of its management, the sufficiency of its capital structure, and its earnings prospects, as well as the public interest, will be better served by the opening of the bank or its branch at a new location for business or by the transfer of its current location to another location. The Reserve Bank grants its authorization

[52] Mani Enterprises v, Vasavi co-operative urban Bank Ltd., AIR 2004 NOC 114 (299): (2004) 3 Andh. LT 349 (A.P.)

subject to any requirements that it deems appropriate to apply, either generally or in light of any specific case.

ii. Revocation of Permission

The Reserve Bank may revoke the license granted under this section by order in writing after providing a chance to the company to show cause for why the conditions that were put in place for starting a new place of business or moving an existing one were not met.[53]

iii. Permission granted to Regional Rural Bank

A Regional Rural Bank must submit its application through a Nationalized Bank in order to request the Reserve Bank's permission under this clause. The application will be sent to the Reserve Bank with this Bank's views on its merits. The Regional Rural Bank is also required to send a draft copy of the application to the Reserve Bank.

4.4 Appointment of Chairman by the RBI

If the Reserve Bank believes that a vacancy in the position of managing director or chairman on a full-time basis will negatively impact the interests of the banking firm, it may appoint an eligible individual to fill the position on a full-time basis. He will also be considered to be a director of the banking company if he is not one at the time of such appointment and is not a director of the firm. The appointment must last no longer than three years, unless otherwise specified by the Reserve Bank. He will be eligible for re-appointment. Only the Reserve Bank has the authority to dismiss him from his post.

4.5 Control Over Management

There are wide powers vested in the hands of the Reserve Bank of India to have control over management. Some of them are discussed below:

i. Authority of RBI to Remove Manager and other officials from office.

Any chairman, director, chief executive officer (or any other officer or employer of a financial firm), as well as any other officer or employer, may be dismissed by the

[53] The Banking Regulation Act 1949, s 23(4).

Reserve Bank pursuant to section 36AA. To accomplish this, the bank must be persuaded that it is necessary to act in the following ways:

a) in the public interest.

b) to prevent the banking company's affairs from being conducted in a way that is harmful to depositors' interests; or

c) to ensure good administration of the banking company.

The Reserve Bank has the authority to appoint a removal order after stating its justifications in writing. The order must include a date for removal.[54]

ii. Fair Opportunity of being heard

All officials must get a fair chance to submit their view to the RBI against the order.

iii. Appeal to Central Government

Within thirty days of the communication date, the person against whom removal order has been passed may choose to appeal to the Central government. The Central Government's choice shall be irrevocable. The Reserve Bank's order becomes final if no appeal has been filed. The Reserve Bank of India or the central government gives the judgement, which is subject to judicial review, and if the aggrieved party believes that the order violates the principles of natural justice or is perverse, unnecessary, or arbitrary, they may file a petition before the high court under Article 226 or the Supreme Court under Article 32 of the Indian Constitution.[55]

iv. Disqualification from the Management sector of the bank

A person who has been removed in accordance with this section may be prohibited, directly or indirectly, from being engaged with or participating in the management of any banking firm for a term of not more than five years as may be mentioned in the order.

v. Penalty for Disobedience of Order

Any person who violates the orders issued under this provision will be subject to a fine that might reach Rs. 250 for each day the violation persists.

[54] Banking Regulation Act 1949, s 36AA (1).

[55] R.K Gupta, *Banking Law & Practice In India* (1st edn, Modern Law Publication 2005).

vi. Appointment of appropriate person

The Reserve Bank may fill the position of the person who has been removed under this section by appointing any qualified individual from the date mentioned in the order. The appointee must serve at the Reserve Bank's pleasure for a term of not more than three years, or for additional terms of not more than three years at a time as the Reserve Bank may provide. He is not to be subject to any responsibility or liability simply because he serves as a chairman, director, chief executive officer, or other officer or employee, or for anything he does or does not do in the course of carrying out his official duties or in connection therewith.[56]

[56] Ibid, s 36AA (5).

CHAPTER 5

MONETARYAND CREDIT CONTROL BY RBI

5.1 Meaning of credit control

The control of financial expansion and contraction in the economy is referred to as credit control. It has grown to be among the most significant responsibilities of any country's central bank. The relevance of finance management has increased as a result of the gradual growth of bank credit and other sources of financing. Financial institutions use the credit expansion mechanism to raise the total level of money supply in the country. Business people also enjoy buying and selling goods and services on credit. The majority of the world's nations now run on a credit economy rather than a money economy as a result of these changes. Variations in credit volume cause variations in the purchasing power of money. This finding has important implications for society and the economy.

For instance, the Bank of Canadian Act specifies that the bank will oversee Canadian credit supervision. The RBI Act of 1934 states that the bank's mission is to "generally to operate the currency and credit system of its country to its advantages."[57] The RBI's Act grants it considerable authority for this purpose, much like all other central banks. The RBI Act of 1934 and other sections of the Financial Regulation Act of 1949 provide the bank this authority.

5.2 Objectives of credit control

1. Internal Price Level Stability

Because their primary function is borrowing and lending, a commercial bank can create credit.The build credit without increasing their cash balance. As a consequence, many individuals have more money to spend, which might drive up rates. Capital control is a tool used by the central bank to make sure that the supply of cash and the actions needed in the country are appropriately linked. This surely helps in maintaining pricing stability and management.

2. To Check Booms and Depressions

[57] Preamble of Reserve Bank of India Act 1934

Banking regulation should be focused on lowering the risks that these cycles generate since they increase insecurity in a nation. Trade periods increase risk in a nation, hence financial regulation should be focused on lowering the risks that these fluctuations pose.

3. Boost economical progress

In emerging and poor countries, credit control measures should aim to foster economic growth as soon as is practical. Generally speaking, these nations' economic development is delayed by a lack of funding. As a result, central banks in these countries usually work to ease financial strain by strategically increasing bank lending.

4. Promotion of Economic Growth

The rapid possible economic growth should be the goal of credit control measures in developing and least developed nations. These nations' economic development is typically constrained by a lack of funding. Because of this, central banks in these nations frequently attempt to ease financial strain by coordinating the extension of bank loans.

5. Banking Regulation and Expansion

The banking system in the country is regulated by the Reserve Bank of India (RBI). All regions of India now have access to financial services thanks to the RBI. To encourage agricultural lending through monetary policy, the RBI gives instructions to different banks about the opening of rural branches. To encourage agricultural lending through monetary policy, the RBI gives instructions to various banks about the opening of rural branches. To encourage agricultural lending through monetary policy, the RBI gives instructions to different banks about the opening of rural branches.

6. The Money Market's Stabilization

According to some economists, the Central Bank's credit control strategy should attempt to stabilise the country's money market. The Bank should minimise changes in the return for cash to achieve this goal. Extra credit, for example, should be available in times of need. In fact, the Central Bank should implement credit regulation in such a way that it always maintains an equilibrium in money demand and supply.

7. Exchange Rate Stability

Credit control has this as a primary goal as well. Credit control measures undoubtedly have an impact on the country's price level. The country's domestic rate level influences the number of exports and imports, causing swings in foreign currency rates. It should be ensured that while applying any credit control method, there will be no harmful fluctuations in trade rates.

8. Preparedness for war and other calamities

The Central Bank's goal is sometimes to make the country ready for war by expanding credit to allow the government to satisfy its financial obligations. Modern conflicts are so expensive that they cannot be funded without a significant increase in bank credit. Almost every country used large-scale credit expansion to fund escalating military expenditures throughout WWII.

5.3 Credit Control Methods in India

The RBI’s vital task is credit control. The RBI controls finance in the nation with the dual objectives of lowering inflation and promoting economic expansion. The Reserve Bank's credit control weapons can be quantitative or qualitative.

Because to the power bestowed upon it by the Banking Regulation Act of 1949 and the RBI Act of 1934 the Reserve Bank has been restricting credit by using both of these techniques. The Reserve Bank has the power to limit quantitative credit under the RBI Act. Open market exchanges, various reserve needs, and bank or discount rates are a few examples. The Reserve Bank has considerable jurisdiction under the Banking Regulation Act to supervise and manage the nation's entire banking system. These authorities give the Reserve Bank qualitative control over credit. The Reserve Bank has the authority to give instructions to banks on a wide range of topics, such as the interest rates they should make a payment of fixed deposits, the kinds of securities they can accept as collateral, the banks' branch expansion program, and several of other matters.

We will now go into greater detail regarding the various credit management strategies used by the Reserve Bank.[58]

The primary distinction between the two methods of credit management systems is that the general credit management system affects the price and overall volume of credit supplied by banks. They affect credit allowed to the entire economy, where as selective controls affect credit granted to a particular sector of the economy, where speculative tendencies and price increase has been noticed as a result of excessive bank lending.

1. **Quantitative Credit Control**:

   Quantitative techniques aim to regulate the nation's overall credit volume. They do not take into account the specific business or economic activity in which the credit is used or used; instead, they relate to the volume and cost of bank credit in general. The following are some crucial quantitative or general approaches of credit control:

i. **Bank Rate:** The bank rate policy, sometimes known as the monetary policy , was the first instrument used to regulate quantitative credit. The bank rate policy, sometimes known as the monetary policy, was the initial instrument used to regulate quantitative credit. These days, practically all central banks have access to this credit control tool.

ii. **Open Trade Operation:** The RBI has the ability to change the reserves or cash base of commercial banks by reselling government securities on the open market. When the RBI purchases government securities from commercial banks , there is a cash transfer from the RBI to the commercial banks, which increases their cash base and allows them to expand credit. On the other hand, Commercial banks buy government securities from RBI, while RBI receives funds from the commercial banks., which negatively affects their ability to expand credit.[59]The major goals of "open market operations" are to:

[58] T.N Chhabra, *Banking Theory & Practice* (Dhanpat Rai & Co(p) Ltd 2003) 185
[59] Ibid.

- To impose a restriction on capital export.
- To alleviate the money market's scarcity.
- To improve the efficiency of bank rates.
- To stop a "run on the bank".

iii. **Variable Reserve Requirement**: Traditional quantitative credit management methods, such as bank rate policy and open market operations, have flaws that make them inappropriate for serving the interests of poor nations. Due to the Federal Reserve System of the United States, a truly new and unconventional tool for quantitative credit control known as the variable reserve ratio entered the mainstream. However, Lord Keynes was the one who popularized the application of this cutting-edge method of "Monetary Management," By implementing variable reserve ratio for the first time as a tool for quantitative credit control in 1933, the Federal Reserve System set the standard and became the industry leader.

The term "variable reserve ratio" refers to the percentage of commercial banks' required deposits with the central bank, which is subject to change at the discretion of the central bank. In other terms, the term "variable reserve ratio" refers to changing the reserve requirements for commercial banks. It is popularly known for fact that all commercial banks are ordered to maintain cash reserves with the Reserve Bank of India in the amount of a specific percentage of their deposits. The minimum reserve that the bank must hold against the total deposits may be increased or decreased by the Reserve Bank of India pursuant to legal authority. Depending on the economy's needs for money and the reserve requirement, the central bank may modify this requirement.

1. **Specific or Qualitative Credit Controls**:

In order to prevent or limit inflationary pressures in these areas, the selective credit restriction is utilized to prevent speculative stockpiling of commodities like food grains. All banking firms, or the specific banking business in question, as the case may be, shall be obligated to abide by the policy once it has been so defined.[60]

[60] R.K. Gupta, Banking Law & Practice (vol. 1st, Modem Law Publication 2005) 277

i) **Purpose**: The purpose of credit-selective instruments are as follows:

a) To change the direction of financial flow so that it goes toward more urgent, desired, and economically productive goals rather than speculative and unwanted ones. To control the availability of consumer credit

b) To maintain the pricing of those items that are very susceptible to inflation.

c) The value of securities to be stabilised.

ii) Selective Credit Control Tools: In India, the following are the primary tools for selective credit control:

a) **Establishment of a Party-Wise Credit Ceiling**:

The ceilings are set while taking into account crop prospects, supply limitations, and pricing patterns. Since the credit ceiling has been set on a party-by-party basis since November 1972 for the following transactions, banks are obliged to get advance authorization from the Reserve Bank-

- loaning money to new debtors
- Or, in the case of current borrowers, raising credit limits.

b) Governing Minimum Margin:

Higher margins are required for advances against commodities subject to selective control in order to limit borrowers' ability to borrow. With a greater margin, a borrower can only finance a smaller portion of the stock through bank financing since they can obtain less credit from banks against a certain amount of stock. Additionally, different margins could be mandated for various borrower classes against the security of the same commodity.

America first regulated the margin requirement on security loans in 1934 when the Securities Exchange Act gave the Federal Reserve System the authority to engage in selective credit supervision. This tool was created to support the Federal System of Reserve efforts to restrict the amount of credit utilised for stock speculation. The Board of Governors used this strategy in 1936 to curb bearish behaviour by establishing margin requirements for 50% short sales.

c) Directives are issued:

According to Section 21 of the Banking Regulation Act of 1949, the Reserve Bank may direct banking organisations generally or a specific banking organisation or group of banking organisations as to:

i) The intended purpose of any potential or actual advance.
ii) The margin must be maintained in light of guaranteed advancements.
iii) The maximum number of advances or other financial accommodations that a banking institution may offer to a single firm, individual, group of individuals, or business while taking into consideration its paid-up capital, reserves, deposits, and other relevant variables.

The wording "caution or prohibit" in Section 36(1)(a) of the B.O.I. Finance Ltd. Case implies that when the Reserve Bank of India bans Banking Companies from engaging in any specific transaction, the order is obligatory on Banks and must be followed. While Section 36(1)(a) of the Act gives the Reserve Bank of India the authority to advise or caution banking companies with no guarantee that their actions will be followed, when the Reserve Bank forbids Banking Companies from engaging in a certain transaction or class of activities, the forbidding order must be taken as obligatory. If Section 36's prohibition authority were not intended to be binding on the Banking Companies, it would be useless. It is not possible to read the word "recommended" alone. Reading the circular in its entirety removes any question that the information provided therein was intended to be legally binding on companies and was not just "advice" or "caution" that may be disregarded.[61]

d) **Moral influence**:

"Moral influence" refers to convincing commercial banks of the need of sticking to specific policies. The effectiveness of these initiatives' rests on the cooperation of the commercial banks because there is no legal obligation on the part of the Reserve Bank or the Government of India in this respect.[62] The method is informal rather than formal using the Moral Suasion tool. The central bank in charge of managing credit uses this strategy in developed nations like

[61] Ibid.
[62] R.K. Gupta, Banking Law & Practice (vol. 1st, Modem Law Publication 2005) 277

the USA. Following the depreciation of the rupee in 1949, the Reserve Bank instructed all banks to refrain from granting accommodations for any speculative objectives and to limit loans to legitimate business needs. In June 1957, the Reserve Bank also recommended commercial banks to scale back their lending, notably against agricultural products, without affecting the size of those advances to industries. In a similar manner, in a letter dated January 8, 1971, the Governor of the Reserve Bank underlined the need for credit constraint and requested that the banks reduce the amount of time they borrow money from the Reserve Bank while stepping up their efforts to mobilize deposits. The Governor instructs the chairman in private letters to use credit control. These arguments have had a fruitful outcome.

e) Restricting Credit:

With this approach, the central bank distributes credit among different purposes to maintain control. Additionally, it aims to regulate how bank credit is distributed to the various borrower groups. The Reserve Bank has been given permission to ensure that credit is distributed in accordance with the priorities of the country. The Reserve Bank has provided instructions to the commercial banks that at least 40% of their credit must be distributed among the priority sectors of the economy, such as agriculture, small businesses, artisans, education, housing, etc., as needed by the Central Government.

Credit rationing may be very helpful in a planned economy by directing money to the most important industries. But it is undeniable that it limits the independence of commercial banks. Because the Reserve Bank predetermines the investment channels, the commercial banks are unable to pursue an autonomous policy.

f) Scheme for Authorizing Credit:

In 1965, RBI established this programme. According to this plan, the RBI had to provide its consent before the banks could grant any new loans up to Rs 1 crore or more to a single entity. This limit's size has occasionally been modified. In 1986, it was increased to Rs 6 crore. The RBI discontinued this programme in 1988.

g) **Financial Credit Arrangements:**

In accordance with these provisions, RBI oversees and carefully examines all bank loans approved for working capital needs to any one party that exceed Rs 5 crores. All such loans will be examined by the RBI after being approved by commercial banks.

5.4 Limitations of Credit Controls:

a) The selective regulations only apply to commercial banks; as a result, they do not apply to nonbanking financial institutions.
b) Controlling how borrowers ultimately use their credit is exceedingly challenging.
c) Differentiating between the profitable and wasteful uses of credit can be challenging.
d) It is very feasible that banks themselves may manipulate lending practices and grant loans for useless purposes.
e) Selective controls are limited in their application in a unit financial system.
f) The necessity of selective controls has decreased with the development of alternative company funding strategies.

The reasoning above leads us to the conclusion that quantitative and qualitative credit control procedures are not competitors but rather work in tandem to strengthen one another. The central bank should combine the two credit control strategies in the right amounts for effective monetary management. In actuality, the proper course of action for a nation's central bank to take is to combine broad and specific credit control measures in a wise and skillful manner. However, it must be made clear that due to a number of constraints and additional complications in the scenario, neither quantitative nor qualitative techniques can guarantee complete credit control in an economy.

Finally, we might assert that a nation's central bank leads the money market by monitoring, directing, and policing the operations of commercial banks and other financial institutions. It serves as a bank of issue, operates as the government's banker, agent, and counsellor, and maintains regular contact with it.

5.5 Monetary Policy: Definition-

The Reserve Bank of India attempts to guarantee price stability for the economy through the Monetary and Credit Policy, a policy statement that is customarily released twice a year. The Reserve Bank of India develops and implements the Monetary Policy of India in order to accomplish particular goals. It refers to the method through which a nation's central bank manages:

(i) the money supply and

(ii) the rate of cash or interest rate in order to accomplish specific aims. According to D.C. Rowan.

"Monetary policy is described as a discretionary government action intended to affect (a) the supply of money, (b) the cost of money or interest rate, and (c) the availability of money for attaining particular goals." Thus, the term "monetary policy of India" refers to the set of actions done to control the amount of credit generated by banks, the growth of the money supply, and the movement of money within the nation. Price stability, financial stability, and appropriate credit availability are the primary goals of monetary policy. The main components of India's monetary policy are as follows:

i. It controls the amount and rate of expansion of the suppl of wealth.
ii. It looks after the country's entire monetary sector.
iii. iii. It directs interest rates in the organized sector and deters them from rising in the unorganized sector.
iv. It chooses how loans are distributed across various industries.

5.6 Features of The Reserve Bank of India's Monetary Policy:

The major aspects of the Reserve Bank of India's monetary policy are as follows:

i. **Active Method**:

Before planning was introduced in India in 1951, the RBI's monetary policy was passive. The instruments of monetary policy were not used by the RBI to regulate credit availability. For instance, the bank rate was constant at 3 percent from 1935 to 1951. However, since 1951, the RBI has employed all available credit control tools as part of an active monetary policy.

ii. Limits on the Money Supply:

The RBI's monetary policy has been successful in accomplishing the seemingly incompatible goals of inflation control and economic development. More money is required to encourage economic growth, while less money is required to manage inflation. RBI extends credit if it determines that greater credit is necessary for economic growth. However, the RBI restricts lending if it believes that inflation is on the rise. Therefore, RBI manages the money supply to accomplish these competing goals.

iii. Seasonal Changes:

The shifting behaviour of busy and lean seasons defines monetary policy. The agricultural seasons are connected to these seasons. Due to the seasonal demands of funding production and stocking up on agricultural goods, there is a growth of finances throughout the busy season. On the other side, there is less of a need for money during the lean season. As a result, the Reserve Bank increases credit during the busy season while decreasing credit during the down season.

iv. Flexible:

In response to shifting market conditions and demands, monetary policy has shifted. If the market has a greater need for money, the RBI adopts a more lenient monetary policy by decreasing the bank rate, CRR, etc. For instance, the RBI has implemented a liberal monetary policy since the economy currently requires more funding for economic growth. Conversely, when inflation is extremely high, the RBI adopts a restrictive monetary policy to reduce the supply of money (to control inflation).

v. Investing and saving is the focus:

Loan interest rates should be minimal in order to extend investment, whereas deposit interest rates should be high in order to promote saving. The Reserve Bank's monetary policy is balanced between investment and consumption. To promote investment, sufficient cash and loans are made accessible for profitable uses at comparatively low-interest rates. To encourage saves, the Reserve Bank has also maintained a respectably high rate of interest on deposits.

vi. Numerous Credit Control Methods:

There are several credit control methods used by the Reserve Bank. According to the needs and demands of the economy, it has adopted all quantitative and selective credit management measures possible to regulate credit.

5.7 Indian monetary policy's limitations:

The Reserve Bank's monetary policy has the following primary restrictions:

i. Financial Policy's Limited Role in Economic Development:

In actuality, the function of monetary policy in the process of economic growth has been given very little weight. In this economic advancement, the RBI has not assigned any significant responsibilities. The Reserve Bank is requiring to ensure that the process of economic growth is not hampered by a lack of sufficient funding. The finance ministry directs the RBI on how much money should be printed. Therefore, the RBI has minimal influence over the money supply.

ii. Limited Impact on Pricing Control:

The Reserve Bank's monetary policy has mostly been ineffective in reducing inflationary pressure. Numerous things have an impact on prices. One of them is the availability of money. The monetary policy has no control over other variables.

iii. Bad Banking Practices:

Poor banking habits of the Indian populace are a significant constraint on monetary policy. In India, cash is preferred over checks as a form of payment. The majority of money often stays in circulation throughout the economy without being deposited at banks. This limits the banks' ability to create credit.

iv. Undesirable Financial Market:

The financial market is the place for government assets, cash equivalents, Reserve's bank securities, etc. are bought and traded. The ineffective money market hinders the effective implementation of monetary policy. The only organised money market where the monetary policy is effective. In an unorganised money market, it is unable to produce the intended effects.

v. Existence of Black Money:

The effectiveness of the monetary policy is hampered by the presence of black money in the economy. Since lenders and borrowers keep their transactions private, black money is not recorded. The goals of monetary policy cannot be met by government regulation of black money. Therefore, monetary policy's efficacy is diminished.

vi. Lack of Banking Resources:

In certain rural and distant parts of the country, banking services are not offered. Thus, credit in these industries cannot be regulated by monetary policy. These regions have native banks operating there that are not subject to monetary policy regulations.

vii. Poor Execution:

The success of monetary policy is hampered since banks do not work with the RBI to implement it. In summary, the Reserve Bank's monetary policy has a lot of drawbacks. It needs to be improved in many different ways. The availability of credit control tools is not the only factor in monetary policy implementation success. It also comes down to using your judgement when it comes to timing and determining how much restraint or relaxation is necessary. But history demonstrates that Reserve Bank credit limitations have never provided the necessary level of supervision.

5.8 New Monetary Policy of the RBI:

With the economy developing at a faster rate, a new monetary strategy has been established to accommodate the rising demand for credit. In 2009–10, the GDP is anticipated to increase at a pace of 6.5 percent. The important objective of this new policy is to gain rate stable momentum, monetary stability, and appropriate credit scope for growth. The following are some of the significant changes to this policy:

i. Lowering the Cash Reserve Ratio (CRR):

To boost market liquidity, the RBI has decreased the cash reserve ratio. In order to keep the economy's growth rate steady, CRR has been decreased. CRR was remained at 5% as of April 2009.

ii. Rate of bank:

The decision to maintain the bank rate at 6% is deemed preferable. However, the situation will be continually examined. The bank rate in the monetary policy year 2009–10 is maintained at 6%.

iii. Reverse-Repo Rates and Repo Rates:

The RBI regularly reviews the rates for repo and reverse repo. For the 2009–2010 fiscal year, the RBI lowered the "Repo" and "Reverse-Repo" rates. Currently, the repo rate is 4.75 percent, while the reverse-repo rate is 3.25 percent. This will cause the economy's interest rates to decline.

iv. Flexible Interest Rate Policy:

The following actions should be taken as soon as feasible in order to provide flexibility in the interest rate structure:

a) Banks should have some latitude in setting interest rates.

b) All new deposits will now be subject to a variable interest rate structure that will be revaluated every six months. It implies that interest rates may change after six months. The interest rate on the current term deposits, however, will remain the same.

c) Banks should come up with strategies to entice depositors to make short-term deposits as opposed to long-term ones. This calls for a narrowing of the interest rate spread between long-term and short-term deposits.

v. Visibility of Interest Rate Information:

Greater openness on the actual interest rates charged to depositors and borrowers is required in the interest of the customer and to foster fair competition. The following actions are suggested to go in this direction:

a) The depositors should be informed by banks about the various deposit rates and the effective annualised return. The RBI should also have access to this data so that it may compile and compare a comprehensive overview of all banks on its website. The depositors will be able to compare the interest rates offered by other banks.

b) The maximum and minimum interest rates that banks may charge their borrowers should be disclosed to RBI. By using the media or its website, RBI will make this information available to the general public. The borrowers would be able to compare interest rates offered by other institutions.

c) Banks are recommended to adopt the "full cost" idea for borrowers by outlining the processing fees, service fees, and other fees collected from borrowers in unambiguous terms. It implies banks should be transparent with prospective customers about additional service fees and processing costs (in addition to interest), and they shouldn't keep them in the dark.

vii. Low Rate of Interest for Export Credit:

There is a decrease in the interest rate for export loans. The new monetary strategy will result in lower interest costs for exporters. Banks will need to let the RBI know the maximum and lowest interest rates they charge exporters for their loans. For creditworthy exporters, the Gold Card Scheme was introduced in April 2004

viii. Kisan Credit Cards (KCCs):

Banks provide farmers with KCCs a type of credit card, which may be used to get the necessary finance. All banks have been instructed by the Reserve Bank to provide farmers with Kisan Credit Cards. Banks have distributed 7.57 billion Kisan Credit Cards as of August 2008.

ix. Urban Cooperative Banks:

It has been determined under the new monetary policy that cooperative banks shall be subject to a separate supervisory authority. Representatives of the federal, state, and municipal governments ought to be on this authority. The effective operation of cooperative institutions may thereafter be solely the responsibility of this body, which will also be in charge of safeguarding the security of public deposits in cooperative institutions.

x. Credit provided to Women:

Banks in the public sector are required to lend to women at least 5% of the time.

xi. Automated Teller Machines (ATMs):

The network of automated teller machines (ATMs) and the services offered by banks via ATMs are expanding. Currently, there are over 28,000 ATMs spread across the nation.

With effect from April 1, 2009, all banks must permit customers to use their ATM cards on their own ATMs or at any other ATMs without incurring any additional fees. Accordingly, beginning on April 1st, 2009, any bank's ATM cardholder may use his ATM card at any ATM without incurring any additional fees.

xii. Interest on Saving Bank Accounts:

Beginning on April 1, 2010, a new method of calculating interest rates on savings bank accounts will be in force. Instead of the current method, which computes interest on the lowest balance between the 10th and 30th of the month, this system will pay depositors interest on a daily product basis. Owners of savings accounts will gain from this adjustment.

The Reserve Bank's primary responsibility, like that of all other central banks, is to create and implement monetary policy. By regulating the entire money supply and credit, monetary policy refers to the use of tools under the Central Bank's authority to affect the level of overall demand for goods and services. The production of powerful money (the reserve base) and the multiplier that acts on it are key factors in the overall expansion of the money supply. The Reserve Bank aims to regulate both aspects of change in the money supply using the different tools at its disposal. The Reserve Bank of India Act of 1934 and the Banking Regulation Act of 1949 both codify the Reserve Bank of India's power to regulate the credit system. While the later Act grants the Reserve Bank unique authority to directly regulate the activities of commercial banks and cooperative banks, the older Act grants the Reserve Bank the conventional general credit control authorities. Controlling the credit given by commercial banks is one of the Reserve Bank of India's primary responsibilities as the nation's central bank. Like all other central banks, the Reserve Bank of India has broad authority for this. The general or quantitative credit control measures have been utilized by the Reserve Bank of India in combination with selective credit control measures.

CHAPTER 6

Social Control over and Nationalization of Banks

6.1 Meaning of Social Control

Commercial banks, which are the most significant component of the nation's economy, should fuse the money market into efforts to achieve the best growth rate, avoid autocratic trends, the accumulation of financial power, and improper resource allocation. It is stated that it had neglected agricultural and small and medium-sized industrial firms while encouraging hoarding and speculation. The goal of social control as it is understood is to accomplish these social aims without the government taking control of the banks. Due to significant structural and operational flaws, the Indian banking sector required some drastic reforms, with social control over the banks being the first to be implemented.

According to the definition, social control means two things:

i. Nationalization is a form of social control.
ii. Social control only helps banks contribute funds to top-priority companies. However, a lot of people generally took it to signify controlling commercial banks in order to realize or advance socialism or controlling financial organisation in order to remember a socialistic structure of society, specifically to give opportunities for the socially backward to get to the top.

In contrast to nationalization, which places both ownership and control of commercial banks in the government's hands, social control does not entail giving the Indian government ownership of the banks. In Social Control, the government may more efficiently distribute credit for social benefit while the bankers only have limited freedom to control the banking industry. Before banks were nationalized in 1969, a social scheme to control credit was implemented to remove the disregard for the credit requirements of agriculture, weaker sectors, and small-scale businesses.

The main goals were:

1. Lessening the managing committee members' influence because they served as the industrialists' spokesmen.

2. Controlling the massive loan flow into the priority industry

3. The weaker sectors are receiving more loans than other sectors.

However, despite the efforts made, the plan did not significantly alter the situation; it stayed the same. The majority of banks were unaware of the implications of the aforementioned system, and those in charge at the time controlled the policies. The government considered nationalization as a backup plan since it thinks the social control plan alone won't be sufficient.

6.2 The Scheme of Social Control

On December 14, 1967, the Indian government announced its plan to impose social control over the country's commercial banks. The statement was made in the Lok Sabha by the Deputy Prime Minister and Minister of Finance, outlining the government's stance and the method by which social control would be implemented. The National Credit Council was established, and the Banking Regulation Act was amended to introduce legislative regulations. These were the two key actions that were taken:

i. Establishing a National Credit Council [63](also referred to as the N.C.C.)
ii. passing new laws by amending the Banking Regulation Act.

1. **National Credit Control:**
   National Credit Council started under the Government's initiative and its role were classified into following categories:
1. to determine the need for bank loans across different industries
2. to prioritize the allocation of loans, advances, and investments based on the needs of key sectors, particularly exports, small-scale industries, and agriculture, as well as the availability of resources.
3. To make the most effective and efficient use of all available resources, commercial banks, cooperative banks, and other specialized organizations should coordinate their lending and investment strategies.

"The N.C.C. had 25 members, five of whom were permanent members. The five permanent members were the Chairman of the Finance Ministry, Vice Chairman of the Reserve Bank, Vice Chairman of the Planning Commission, Secretary of the Finance Ministry (Department of Economic Affairs), and Chairman of the

[63] R.N. Chaudhary, Banking Laws (1st edn, Central Law Publication 2009)

Agricultural Refinance Corporation. The remaining twenty were chosen by the government to provide enough representation from various industries, including export commerce, large and medium-sized businesses, cooperatives, agriculture, and other professional groups, including economists and other experts."[64]

2. **Amendment of the Banking Regulation Act, 1949:**

Through an amendment in the Banking Regulation Act, 1949, the concept of Social Control was incorporated in the banking system. The Preamble of the Amending Act 58 of 1968 reads as under: - "An Act further to amend the Banking Regulation Act, 1949, so as to provide for the extension of social control over banks and for matters connected therewith, or incidental thereto, and also to further amend the Reserve Bank of India Act, 1934 and the State Bank of India Act, 1955".[65]

6.3 Nationalisation of Commercial Banks

In India, nationalizing commercial banks is a novel attempt to merge the operations of commercial banks with the deliberate process of financial development. The Scheme of Social Control, which was first implemented on February 1st, 1969, was determined to be insufficient and unsatisfactory in achieving this goal. The commercial banking sector in India persisted in promoting hoarding and speculation while failing to aid in the growth of tiny and medium-sized businesses and agriculture. It promoted the development of monopolies by making loans available to major business organizations on comparatively lenient terms.

India's goal after gaining independence was to create a socialist social structure. In layman's terms, this refers to a society where income is shared as fairly without turning the nation into an autocratic State. The goal is said to be accomplished by democratic means. A mixed style of planning is used with this goal in mind. Private and governmental sectors are permitted to operate separately. The government owns and controls the public sector in its entirety. The Monopolies and Restrictive Trade Practices Act, 1969, is the most recent of a system of laws,

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[64] M.L. Tannan, Banking law and Practices in India (21st edn,Wadhwa & Co. Nagpur 2005)

[65] R.K Bangia, *Banking Law & Negotiable Instruments Act* (1st edn, Allahabad Law Agency 2002).

licenses, rules, and regulations that govern the private sector. The nationalization of businesses and organizations promotes the expansion of the public sector. The financial institutions are both the guardians of individual savings and a strong tool for extending credit. By collecting deposits, they mobilize the nation's resources, and by distributing advances, they direct those resources toward economic and national development. The State Bank of India acquired the Imperial Bank of India's operations after it was nationalized in 1955. Regarding the scheduled banks, there have been accusations that the larger corporate houses and large and medium-sized industries were obtaining the majority of the advances, at the expense of smaller businesses, agriculture, and exports, which deserve importance. The modification of Banking Regulation Act with effect from 1-02-1969 was one of the main justifications for imposing social control.

Nationalized banks are expected to prioritize plans for neglected industries and sell abroad, to fulfill some of the needs of public sector organizations, and to make use of the remaining resources for organized industries on the theory that smaller businesses and those in underdeveloped regions will be preferred over large conglomerates. To accomplish those goals, exporting enterprises and sectors representing weak and backward regions may be subject to borrowing rates that are lower than those applied to established companies, effectively subsidizing these sectors. It is also planned to take a further action in the form of credit guarantee insurance, which would be paid for by the stronger sectors of the community and would cover the risk associated with the weaker sector.

Objectives of Nationalisation:

- Industrialists losing influence over commercial banks
- Disallowing the use of bank credit for ineffective purposes
- The expansion of credit to previously underserved segments (Weaker sectors, small-scale sectors and agricultural sectors)
- Transforming it into a more competent professional stream
- Improved training for banking staff
- Greater regional harmony.
- Improving financial practices

6.4 Acquisition and Transfer of Undertakings Act,1969

In accordance with his authority under Article 123(I) of the Constitution, the Vice-President of India (acting in the capacity of the President) promulgated an Ordinance No. 8 of 1969 late on Saturday, July 19, 1969. The Banking Companies (acquisitions and transfer of undertaking) Ordinance of 1969 was its official name.[66] The 14 banking organizations' obligations, each of which had a deposit of at least Rs. 50 crores, were allegedly transferred to 14 new legal entities known as "corresponding new banks." The ordinance outlined the management structure for the 14 new banks as well as the distribution of compensation to the owners of the respective banking businesses that were acquired. On July 21, 1969, a petition was filed with the Supreme Court of India contesting the authority of the Ordinance. But on August 9, 1969, the Banking Companies (Acquisition and Transfer of Undertakings Act, 1969, was approved and signed into law by the Parliament before they could be heard (Act 22 of 1969).[67] By virtue of this Act, Ordinance 8 of 1969 was repealed. The Supreme Court heard arguments against the Act as well. The Supreme Court issued an injunction against the Act's implementation in the interim.[68]

The Supreme Court's 11-judge panel heard the petitions on February 10 and ruled 10-1 that, despite Act 22 of 1969 falling under the purview of Parliament's legislative authority, it was completely unconstitutional for the following principal reasons:

1. Fourteen banking institutions were restricted by the Act from conducting banking operations, while allowing other banks both Indian and foreign to do so. This constituted hostile discrimination.
2. The 14 banking businesses would have been able to do any other business, but because they had lost all of their assets, employees, locations, and even names, they were unable to do so due to this unjust restriction
3. The 14 banking businesses would have been able to do any other business, but because they had lost all of their assets, employees, locations, and even names, they were unable to do so due to this unjust restriction In the Rustom Cowasji

[66] S.R Myneni, "Law of Bantam," (2006) p.43,1st Edn., Asia Law House Hyderabad.
[67] Ibid.
[68] Ibid.

Cooper case[69], it was determined that the criteria used to calculate the compensation for the 14 banking entities were illusory and immaterial.

6.5 Management of Nationalized Bank.

1. The head office of the takeover bank shall be similar as that of the relevant bank if the Central Government doesn't mention otherwise by notification.
2. Board of Directors shall have overall supervision, direction, and control of the nationalized bank's affairs.
3. Each member of the Board of Directors is entitled to compensation that is similar to the compensation that a member of the Board of Directors of the prior bank would have been eligible to receive immediately prior to the Act's implementation.
4. The custodian of the nationalized bank shall be the chairman of the existing bank. until the Board of Directors is established, the Custodian shall have broad supervision, direction, and control of the business of the nationalized bank.[70]
5. Each related new bank must follow the Central Government's instructions in consultation with the Governor of the RBI with regard to policy concerning the public interest in carrying out its duties.

6.6 Intention behind Nationalization of Banks.

To provide customers with better service, and through them, the Nation, was one of the driving forces behind nationalization. It was believed that after a short period of time, the operation of such a nationalized bank would significantly improve. The Reserve Bank of India now has authority over these nationalized banks. Everyone who has made a deposit has received a guarantee of safety and security. Though these nationalized banks must turn a profit to stay afloat, in theory, profit-making was not the primary goal. The primary goals of bank nationalization were to give the bank administration a professional bent, remove the power to control, provide appropriate credit for exports, small-scale businesses, and agriculture, as well as to foster new classes of entrepreneurs.

The various reasons which led to the nationalization of the Banks are:

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[69] Rustom Cowasji Cooper v. Union of India, (1970) 40 Comp Cas 325: AIR 1970 SC 564: (1970) 1 SCC 248].

[70] . Sec. 7(1) The Banking Companies (Acquisition & Transfer) Act, 1970

1. **Accumulation of financial and industrial power:**

The main justification for taking over the banks was the accusation that private banking organizations, which were managed and controlled by powerful businessmen and industrialists, played an important role in the concentration of wealth and economic power through their lending practices. The majority of the loans given out by these organizations in the past went to large firms. Big business has an advantage over small business in obtaining assistance from banks, according to the Monopolies Enquiry Commission, which was chaired by Justice K.C. Das Gupta in 1965. This is due to the necessary result of the care that financial institutions were expected to exercise in the interests of their shareholders and depositors when selecting the parties to whom advances should be made.

The Commission also noted that the larger companies' nature made them better risk candidates, which gave them an advantage when applying for loans and, in part, aided in the expansion of economic power concentration. The aforementioned observations clearly demonstrate how banks' evaluation of security in terms of tangible assets was the basic aspect of credit granting, which contributed to the expansion of economic power concentration. It was crucial that the lending institutions' view of security be substantially altered if this trend was to be reversed in order to create a socialist society.

2. **Branch expansion:**

Private banking firms placed their branch locations mostly on urban areas, keeping rural areas outside of their sphere of influence. In the early years, opening branches in small towns and villages has not been a financially successful venture. Therefore, the private sector banks were not eager to open more and more branches in the countryside, despite the fact that doing so was urgently required for the effective mobilisation of deposits.

3. **Neglect of the agricultural sector, small businesses, and other deserving industries**.

Because of the risk associated with financing these industries, the commercial banks completely ignored agriculture and small business for a long time. Industry and commerce received a larger portion of bank financing. Due to these disparities and credit gaps, credit planning has to be implemented in order to distribute bank resources fairly and further a greater social goal. To make significant adjustments to these banks' credit policies, public ownership of banks was deemed to be necessary.

6.7 Nationalization of Banks and Judiciary.

It is regrettable that a rivalry between the Supreme Court and Parliament is being attempted in comments made about the Bank Nationalization case[71], and that it is implied that the court has supported upon the privileges and powers of parliament. But in reality, the court hasn't taken any action of the sort. These concepts are simply the work of a small group of individuals who want to utilize this to stir up the emotions of the uninformed masses. The decision itself serves as evidence that the Apex Court has recognised Parliament's right to make such laws. The Supreme Court has not questioned Parliament's ability to pass legislation in connection to the Act. Therefore, it is incorrect to imply that the Supreme Court has disagreed with Parliament in any way or questioned its right to pass laws. We should keep in mind that under any democratic constitution, the court has the authority to interpret the Constitution. The judiciary was not successful in its duty as it did not diligently fulfill this obligation without fear or favor, without affection or malice. The Supreme Court has indeed acted in this manner.

The Court's judges are not political individuals. Furthermore, it is untrue to claim that they reside in an ivory tower. Although they are aware of current political trends since they are citizens of the country, judges have no power to be controlled or influenced by political, social, or economic factors, regardless of their individual backgrounds. One must keep in mind that the judges' primary interest is determining whether the law at issue meets constitutional criteria.

The Bank Nationalization Act has been invalidated for the following reasons:

(i) Breaking the Constitution's Article 14.

(ii) Failure to comply with Articles 31(2) and 19(5) of the Constitution.

There were numerous further arguments made before the apex Court. For instance, it was debated—and there was probably some merit to the debate—that the law was passed as a political tool to punish particular businesses that had spent decades

[71] R. C. Coopery v. Union of India, 1970 (1) S.C.C. 248

developing these institutions. The Court, however, rejected the argument because there was insufficient evidence to back it up. This proves beyond a doubt that the Court viewed the matter objectively and without bias. The Court was making an impartial decision that it believed was supported by the law and the evidence in the case.

Then, a different argument was made that social control was doing admirably and that, as a result, legislation nationalizing the banks wasn't necessary. Having spent an ample amount of time working on the Directorate of a certain bank, I could attest to the fact that this social control was doing the best it could. Some people have argued that the bank funds could not be used for the objectives for which the government intended them to be used. While it's true that bank funds couldn't be invested whatever one wanted, Reserve Bank of India circulars puts a pressure on banks to make investments so as to boost the rural sector.

But one must also keep in mind that it is the duty of the bank to protect the depositors' interests as well. The majority of these depositors are neither wealthy nor resourceful in the way that some may believe instead, they have modest savings that they decide to invest as a form of insurance against bad times. Normally, the banks desired that their investments have sufficient security. Therefore, each bank had to determine how much of whatever investment it could make without adversely affecting the interests of the depositors. That was and still is the main challenge. We are all aware of the ultimate fate of our cooperative banks, which mostly served the agrarian economy and contributed to the destruction of many farmers due to the schemes of malicious officials and deeply rooted social and economic norms. Therefore, it was necessary to proceed cautiously before any benefits from nationalization could be realized; otherwise, any rash action could cause the economic system to collapse. We have no intent to criticize anyone, but it strikes us as somewhat odd that "stray thoughts" may overnight reach the dimensions of a mature strategy that would serve as the foundation for the future superstructure of the national economy. To the Supreme Court's credit, it must be noted that none of these factors played a role in its decision-making process because they were to an issue of policy that the Court was unable to address.

Let's now discuss how Article 14 of the Constitution is put into practice. The Supreme Court primarily cited two reasons while discussing the implementation of this Article. It was noted that nationalized banks were completely forbidden from conducting any banking business, in contrast to other banks that were already operating but weren't nationalized as well as any future institutions that may emerge. Therefore, it was extremely discriminatory to forbid nationalized banks from operating at all while allowing others in the same classification to do so. The Supreme Court believed that the Act ought to be invalidated for this reason, among others. We acknowledge that the Constitution gave the government the authority to nationalize the whole banking industry, but the way the Act in question envisioned nationalization would have violated Article 14 of the Constitution. The comparison of nationalizing some transportation lines while forcing the impacted parties to operate on other routes was inapplicable in defending the disputed Act under Article 19 of the Constitution.

The Court's decision is also criticized for giving new meaning and implications to Article 31(2) of the Constitution. In this decision it gives importance to what the Court had stated in previous decisions. In **Gopalan's case**[72], decision was made that Article 19 must be read independently of the other Constitutional Articles addressing fundamental rights; however, it is now decided that there is a combination of all articles. If they make reference to the same right, they must be read together. We must admit that it has never been easy for us to understand the distinction brought up in this case. We held that all the fundamental rights set forth in Article 19 should be interpreted in the context of the other provisions of the same part of the Constitution that immediately follow them. We were unable to realise the distinction between the Constitution's Article 19(1)(f) and Article 31(2), as well as the underlying ideas that sought to do so. In the Bank Nationalization case, the majority of the 10 judges were forced to reevaluate the previous decision and conclude that those clauses had to be read simultaneously due to the sheer weight of logic. They draw attention to the similarities between the limitations set forth in article 19(1)(f) and article 31(2). As a result, the constraints in Article 31 are supplemented by the reasonableness test established in Article 19(1) (f) (2).

[72] A.K. Gopalan v. State of Madras, A.I.R. 1950 S.C. 27

6.8 Advantages of Nationalization:

1. Large Profits:

By nationalizing banks, the government would be able to collect all of their significant earnings as tax money, opening up a new source of funding for the plans.

2. To Promote Interest:

A swift and significant growth in deposits would result from nationalizing banks since it would protect and advance the interests of deposits and boost public confidence in banks. By doing so, nationalization would strengthen the banking sector and prevent bank failures.

3. Increasing Economic Power Decentralization

The nationalization of banks would undoubtedly disperse the concentration of economic power currently held by a small number of businessmen, who run the joint-stock banks in their own self-interest and via them, achieve a significant hold over the country's economy

4. Keeping the Price Stable

The nationalization of banks would aid in rate stabilization by eradicating the man -made crisis of basic needs, preventing advances in stockpiling and hoarding, along withother activities and the creation of manmade crisis, and by promoting the use of bank credit.

5. Banks' Favorable Attitude

By offering credit at low rates to advance the interests of the directors, nationalization of banks would inhibit the banks' favorable attitude toward the directors.

6. Nationalization Adopted by Various Nations

Just as France, Italy, the United Arab Emirates, Indonesia, Burma, Libya, the USSR, and the GDR all benefitted by nationalizing their banks, India should likewise gain from doing the same for its banking sector.

7. Check for Tax Evasion

Black money and tax evasion would be reduced if banks were nationalized.

8. Socialism's objective

The goal of socialism would be substantially advanced if banks were nationalized because the service motivation would take the place of the profit motive in their operations.

9. The Sharing of Credit

Since money would flow into socially acceptable and productive routes, the nationalized banks' distribution of credit would be significantly more effective and relatively less expensive.

10. 10. Due to custom and vested interests, priority sectors like agriculture, small-scale industries, transit operators, retail commerce, small enterprises, professionals and self-employed individuals, and education were historically denied adequate access to the financial system. In essence, nationalizing banks would allow the banking sector to diversify its resources as needed for the country's planned economic development and for the benefit of the priority sector.

11. The RBI would be better able to carry out its monetary policy if all commercial banks were nationalized.

12. Since money would flow into socially acceptable and productive routes, the nationalized banks' distribution of credit would be significantly more effective and relatively less expensive. Standardization of banking services would be ensured by nationalization.

13. A prerequisite for effective planning, overall advancement of the national economy, societal welfare, and community development might be considered as state ownership of the banking system. Banks serve the requirements of the common man in terms of finances because they are owned and controlled by the people.

6.9 Disadvantages of Nationalization:

The Following are the disadvantages of Nationalization:

1. Amount of Debt

Huge sum of wealth must be given in return to the shareholders during nationalization. This increases the government's financial burden.

2. Dangerous and Less Valuable Loans

Loans to small businesses and farms are hazardous and unprofitable and goes against the principles of a healthy banking system and may threaten the institutions' capacity to survive financially.

3. Malpractices

Bank nationalization is not necessary to stop the wrongdoing of privately owned banks since the Reserve Bank of India can effectively supervise them by implementing the right monetary and fiscal policies.

4. Reduction in effectiveness

The efficiency of these banks will decrease as a result of political intervention, according to the experience of previous nationalized institutions, which will also limit their effectiveness.

5. Wealth Concentration

The primary cause of monopoly growth and power concentration is the current economic system; hence nationalization is not the solution.

6. Depositors receive no security

Some Institutions cannot offer extra security to depositors in India while still giving them enough relief.

7. The privatization era

Regarding the mention of other nations, banks in Norway, Sweden, Finland, and Denmark are privately owned and successfully run.

8. Slowed the services down

Because of the control the RBI has had since the banks were nationalized, government executives and other bank officials are hesitant to make judgments, which inevitably has a negative impact and slows down client services.

9. Biasness and Corruption

Through nationalization, public control keeps banks prone to corruption. Additionally, the average man has experienced that public sector organizations do not respect individuals, and that their work and services are plagued by delays and sluggishness.

10. Since State capitalism is not socialism, nationalization may not result in it. Additionally, there is a scope to treat public property owners' property rather than as sacred national property. It is therefore abused and destroyed just like anything else.

11. When we look at the data provided by the RBI Bulletins of loans made by scheduled banks according to purpose, we can see that the claim that joint-stock banks in their lending operation disregarded industry and supported speculative activity was untrue.

12. It was incorrect to claim that the directors of the private banks received unfair favors. In reality,bank credit was granted based on the applicant's creditworthiness, ability to repay, and presented collateral security rather than on a personal basis. Furthermore, the majority of the private bank borrowers had such excellent credit standing that even nationalized banks did not want to lose them.

13. Since there is no actual differentiation between branches in urban and rural areas, the rapid branch expansion has resulted in higher establishment expenses. The quality of the employees has also been diminished by the rapid increase in employee numbers and hasty promotions. As a result, there has been a noticeable drop in the standard of management and supervisory employees in banks.
14. Even if joint-stock banks were nationalized, credit availability to millions of individual peasants would not significantly improve, and bank credit would still be negligible.

CHAPTER 7

Impact of Cryptocurrency

7.1 INTRODUCTION ON CRYPTOCURRENCY

A cryptocurrency is a means of creating virtual "money" and ensuring their secure ownership and transaction through the use of a cryptographic problem. It is a system that has the digital payment which doesn't depend on banks for verification. Crypto and Cryptocurrency are abbreviations for cryptography, which is a way of securing data in the presence of a third party with ulterior interests by utilizing encryption and decryption. [73]

This challenge is designed to be simple to verify but extremely difficult to solve. Various cryptocurrencies adopt various functions for this purpose, the most popular being a hash target, which calculates hashes so that they are less than a specified value. The hash goal (i.e., the difficulty of the problem) is modified on a regular basis based on the total processing power on the network, which has the advantage of maintaining a consistent time between solutions.[74] Other protocols, like as Primecoin, solve the problem by computing big prime numbers.

When it comes to the reasons why cryptocurrencies could be used as money, it is easy to see how they fulfil the characteristics of a valuable commodity for indirect exchange:

1. Adaptability. Cryptocurrencies succeed in this area because they have no physical extension. They may be swapped using any device that has your "wallet file," and sending money across the world is no more difficult than sending money across the street.

2. Longevity- Coins can be "lost," but they will not wear out or devalue.

3. Flexibility. Bitcoins can be divided to the eighth decimal place. In theory, there is no technical limit to the divisibility of a protocol.

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[73] Cameron Harwick, 'Cryptocurrency And The Problem Of Intermediation' (2016) 20 The Independent Review.
[74] Ibid.

4. Safety- As previously stated, protocol-level theft and forgery are extremely difficult, but the protocol has no unique means of preventing more traditional sorts of theft and fraud, such as social engineering.[75]

The RBI issued a notification on May 31, 2021, making it clear that the 2018 circular they had published was no longer valid because the Supreme Court had overturned it in 2020.

Many bitcoin investors were relieved that the RBI had cleared this situation. It was noted that the RBI has a restrictive attitude regarding cryptocurrencies in 2018. Even after 2018, RBI continued to express reluctance toward cryptocurrencies and issued announcements cautioning people not to use them.

The RBI's strategy has changed in light of the current circumstance. If we pay close attention, RBI has made it clear that it intends to participate actively in the market by teasing the launch of its own digital currency in The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021. It indicates that the RBI will issue a specified quantity of money in digit form. As a result, some currency may exist in physical form, while other currency may exist only in digital form.

Shaktikant Das, the governor of the RBI, stated that the central bank has concerns about cryptocurrencies and is developing its own digital currency. He claimed that this will be different from Cryptocurrency. He declared that the advantages of blockchain technology must be fully utilized if the RBI does not want to be left behind in the era of technical development. In terms of cryptocurrencies, the RBI and the government are currently ambiguous. RBI has repeatedly said that they do have significant concerns about cryptocurrencies, which have been addressed to the government, and that the government may soon come up with a transparent picture, even though they were forced to authorize cryptocurrency after the Supreme Courts' intervention.

7.2 Rise of Cryptocurrency

i. **Failed Government Policy**:

   The covid 19 pandemic epidemic caused significant financial losses for many people, and somehow the government's actions failed to significantly relieve

[75] Ibid.

investor's stress. Therefore, investors seek out opportunities where they may anticipate better returns, and bitcoin and other cryptocurrencies offer significant yields relative to the interest offered by Indian financial institutions.

ii. **A lack of faith in the financial industry:**

Lower interest rates, debt relief, and public sector banks being bailed out with taxpayer money raise concerns about how well these institutions operate. On the other hand, cryptocurrency banks do offer loans with lower interest rates.

iii. **Cryptocurrency is increasingly seen as a form of digital gold.**

The return on investment in cryptocurrencies is quite high. Bitcoin has grown rapidly. Bitcoin's exchange rate fluctuates from 123$ on October 1, 2013, to 34000$ in January 2021. Gold is valuable in India. India's gold price is currently between $25,000 to $50,000. When money is invested in gold, it doubles in value, but bitcoin returned 340 times more and is therefore regarded as digital gold.

7.3 Regulation of Cryptocurrencies across India.

The Reserve Bank of India (RBI) gave a notification titled "Prohibition on Dealing with Virtual Currency" that, when read with sections 35A of the Banking Regulation Act and sections 45JA and 45L of the Reserve Bank of India Act 1934[76], places a ban on all financial institutions and asks them to refrain from offering services related to cryptocurrency transactions as well as to end any relationships that are heavily involved in those transactions. Because banking services entail the exchange of money, this cycle caused the crypto market to become severely crippled. As a result, many crypto users were forced to withdraw cash, which caused losses for both the banking and crypto industries. The RBI circular was the subject of a petition brought in the Supreme Court by IMAI, the organization that represents digital and internet businesses in India. The Supreme Court decided in favor of cryptocurrencies by using the doctrine of proportionality.

The Supreme Court was unable to rule on the legality of the Banning of Cryptocurrency and Regulation of Official Digital Currency Bill, 2019 which has not yet been passed. The apex court stated that on the one hand, crypto users are subject

[76] 'Legality Of Cryptocurrency In India - Ipleaders' (*iPleaders*, 2022) <https://blog.ipleaders.in/cryptocurrency-2/#:~:text=Regulation%20of%20cryptocurrency%20in%20India,-India%20is%20a&text=On%206th%20of%20April,and%20money%20laundering%2C%20among%20others.> accessed 10 July 2022.

to criminal penalties, and there are other activities related to mining, etc., which are prohibited by this bill. On the other hand, this bill also anticipated and paved the way for the government to introduce its own digital currency, which it has not yet done.

7.4 Regulation of Cryptocurrency across the world.

1. European Union:

A definition of virtual or crypto currency has been proposed by the union. It describes virtual currencies as a type of digital representation of value that is accepted as payment by both natural and legal entities and that can be transferred, stored, and traded electronically but is not issued by a central bank, a public authority, or necessarily linked to a fiat currency. In the Hedvist judgement, the European Court of Justice had ruled that exchanges of traditional currencies for virtual currencies and vice versa constitute the provision of a service in exchange for payment. This made it possible for transactions to be exempt from Value Added Tax, which means that in EU member states, cryptocurrency transactions are not subject to VAT. The verdict acknowledged the worth and nature of the currency.

Even though these currencies are accepted throughout Europe, there is still some confusion around these transactions. The European Supervisory Authorities for Securities (ESMA), Banking (EBA), and Insurance and Pensions (EIOPA) jointly released a statement at the beginning of February warning consumers about virtual currencies.[77] Virtual currencies are unsuitable for investment, savings, or retirement planning because they are high risk, unregulated goods. A legislative proposal by the European Commission to change the Fourth Anti-Money Laundering Directive has also been made (AMLD). It aims to bring trading platforms for virtual currencies as well as custodian wallet providers under the AMLD. This would assist in meeting the requirements for due diligence and having regulations that can stop money laundering, terrorist financing, etc. It is obvious that virtual currencies have not yet gained acceptance in European nations since the market is regarded as unstable.

2. United Kingdom:

Although the United Kingdom does not currently have any explicit regulations governing the crypto industry, it believes that virtual currencies should be regulated. It

[77] Ibid.

claims that regulation is essential to preventing illegal activity, promoting market integrity, and preserving the stability of the financial system. To protect the stability of the financial systems in the United Kingdom, according to Section 2A of the Bank of England Act of 1988 is the task of Bank of England.

The Bank considered the risk created by the use of cryptocurrencies in the UK when deciding whether to include the provision. After careful consideration, it was determined that the crypto market is currently too small to pose a significant risk to the nation's monetary or financial stability. Additionally, it is essential to protect customers using payment methods from money laundering, taxation, and the exploitation of these systems to fund terrorism or any other crime.

3. United States of America:

This nation is one of the few that has really begun the process of drafting legislation governing virtual currency. The Financial Crimes Enforcement Network (FinCEN) views cryptocurrency exchanges as money transmitters even if it does not generally view cryptocurrencies as legal cash. It accepts these currencies as a replacement for the actual money. In a similar vein, the IRS views cryptocurrency as a digital representation of value that acts as a path of trade but does not recognize it as legal tender. Additionally, it has published tax advice pertaining to the same. The IRS by the circular of 2018 has also approved the same

7.5 Arguments for banning Cryptocurrency.

1. **Protection from inflation**: Because of inflation, many currencies have seen a gradual fall in value. Almost all cryptocurrencies are introduced with a hard and fast amount at the time of their inception. There are only 21 million Bitcoins that have been released worldwide, according to the ASCII computer file, which lists the quantity of each coin. Asa result, as demand rises, its value will rise as well, helping to keep the market stable and, in the long run, preventing inflation.

2. **Capital**

   A decade ago, the cryptocurrency market was not even on the spotlight, but it quickly grew and is now a trillion-dollar industry. With a net worth of $600 billion, Bitcoin takes up a big portion of the market. India runs the risk of cutting itself off from this quickly growing business by banning cryptocurrencies, which are hailed as a "civilizational development" compared to the internet itself. Additionally, this would unintentionally prevent foreign investment from flowing into India.

In addition, assuming the amount of the investment Indians have already made in cryptocurrencies, a prohibition would make innocent Indians' ownership illegal and cause them to move their money from India to safe havens in nations with more lenient regulations.

3. Sovereignty

Cryptocurrencies are a form of decentralized money that are not governed by any supranational or governmental organization. Early in 2019, The New York Times published an article asserting that cryptocurrencies will undercut US sanctions against Iran. US Congressman Brad Sherman later asserted that bitcoin posed a threat to the US Dollar's dominance. In fact, due to its dependability and autonomy from centralized authority, Bitcoin has frequently been referred to as "Digital Gold." Thus, by reducing the possibility of US sanctions against India, India's dominance in the Bitcoin market would enable it to protect its sovereignty.

4. Genuineness of transactions

The widespread misconception is that cryptocurrencies are not trustworthy and promote financial fraud. This ignores the fact that the blockchain technology used by cryptocurrencies is regarded as being extremely dependable since it generates an irrevocable record of each transaction involving Bitcoin and distributes it to users throughout the network. By reducing fabrication and forgery, this may contribute to the complete automation or robotization of accounting. This has the potential to transform the game in India by lowering corruption and boosting confidence in our financial institutions.

5. Independent thought, creativity, and exclusion

Blockchain technology is designed primarily to have open-source protocols, even allowing consumers root access to the entire database and the ability to replay any operations carried out by that Blockchain. Digital technology has significantly progressed and several Blockchain developers are currently working on solutions that would let users manage their login identities, notification systems that don't need Big Tech, and much more.

7.6 Arguments for regulating Cryptocurrency.

a. Fear of Uncertainty

As we've already determined, cryptocurrency is a type of digital money. Thus, their operation and trade are not governed by a central authority. Consequently, since there are no controls or regulating systems in place on this platform, this could create an environment where criminal activity is promoted and propagated.

b. Terror financing

Izz ad-Din al-Qassam Brigades, the military arm of the terrorist group Hamas, was able to raise money in 2019 by using a website that created a unique Bitcoin address for each contributor to deposit their gifts to. They also created a campaign that showed individuals how to make anonymous donations. This is a classic illustration of how technically inclined criminals and terrorists may use cryptocurrencies and this platform to their advantage.

c. High Risk for Investors

The majority of cryptocurrencies are susceptible to changes in both market and value. For instance, a period of rapid value growth may be followed by a period in which value declines. Due to the significant potential investment risks, the fluctuating nature of cryptocurrencies makes it a risky front for investments by individuals, businesses, or banks.

Thus, if we were to ban cryptocurrencies, other nations would continue to advance while we would be left behind. Instead, controlling and utilizing this new technology would help India accomplish its goals while influencing the emerging global order. Effective regulation would also aid in reducing fraud and unauthorized use of cryptocurrencies. Only after the bill is presented and its content is made available to the public, they may clearly understand what the bill can offer.

CHAPTER 8

ROLE OF RESERVE BANK OF INDIA IN SOCIAL DEVELOPMENT

Social responsibilities of RBI are not mentioned under the RBI Act. But RBI has put forwarded certain initiatives for sustainable development and has directed the banks to undertake such social responsibility.

Agricultural credit Department was created in order to promote development in agricultural sector which later came to be known as NABARD.

1. It established the first mutual fund unit trust of India to promote savings.
2. As a subsidiary, the Deposit Insurance Corporation protects small bank depositors. India was the second country after the United States to offer deposit insurance.
3. To give housing loans, the National Housing Bank was established.
4. Encouraged the formation of State Finance Corporation and provide refinancing opportunities.
5. To train bank staff, including those from other banks, the bank has set up the Agricultural Banking and Bankers Training College.
6. Incorporated MICR mechanized clearing houses at many locations in order to increase the speed of the clearing.
7. Incorporated IBRDT at Hyderabad so that the research Banking Technology can be improved.
8. It has started RTGS.
9. In order to expand the branches throughout India, the bank implemented branch expansion policy.
10. The Bank began lending to small borrowers in the priority sector.
11. The Bank played a key role in promoting banking literacy.
12. The Bank established its own printing press for banknotes.
13. The Bank aided in the creation of CBS and the installation of ATMS.
14. The Bank established the Lead Bank Scheme for District Development.
15. Cooperative Banks have been regulated.
16. RuPAY, an Indian Debit card was introduced.

CHAPTER 9

CONCLUSION AND RECOMMENDATIONS.

A strong banking system is a requirement for rapid economic growth. Banks serve two purposes: first, by supply of facilities for the keeping of savings into fruitful realms in accordance with predefined plan priorities, they promote the habit of thrift in the community. Economic expansion raises the need for both short-term and long-term capital, and the banking sector in both developed and developing nations has provided both of these types of capital resources. Even while a lack of money is one of the causes of underdevelopment, this is not always the case. In some cases, underdevelopment is the result of insufficient efforts to mobilize resources. It is true that having a strong banking system becomes essential**.**

It is true that having a strong banking system becomes essential. Banks are not just businesses that receive and distribute money; it is crucial that they adhere to the laws and regulations that regulate their operations. Certain precautions, such as good banking procedures and protective rules, are necessary for investors and savers. Therefore, a strong banking system is needed to create financial chances for an increasing level of income. During the Industrial Revolution, Great Britain had a strong banking system that provided the working capital needed for an increasing level of economic activity. The issue in developing nations is not just a lack of adequate resources in comparison to investment needs, but also a lack of infrastructure for institutionalizing available funds. The absence of a widespread banking habit can be seen in the generally insufficient or uneven growth of banking as well as other financial intermediaries. The situation in India therefore requires a significant change in the central bank's function, with a focus on encouraging and developing policies; Institutionally sound advancement in the banking system must be ensured, and the credit system's functionality must be modified to suit the demands of a developing economy. More specifically, the banking system's policies and practices should be geared toward achieving fundamental social and economic goals, such as the economy's optimal growth rate and the avoidance of any monopolistic trends, the accumulation of economic power, and the misallocation of resources. The establishment of a suitable framework for medium- and long-term financial institutions must be supported by the central bank if it is to meet the expanding need for industrial investment, which the banking system is unable to handle. Another one of the Reserve Bank's unique roles is the provision of agricultural finance.

The Reserve Bank of India, the State Bank of India, the Indian commercial banks, the industrial banks, the indigenous bankers, the cooperative banks, and the land development banks make up the Indian banking system. Since there was no central bank when the Reserve Bank of India was founded in 1935, organized banking in this nation was a latecomer. In the first half of the 19th century, the three Presidency Banks in Calcutta, Bombay, and Madras operated and served as early counterparts to modern banks. These banks enjoyed a partial monopoly on note issuance as well as the country's banking monopoly. In the presidency towns, they had unlimited access to government balances.

As it is well known, India has had an indigenous financial system since very early times. Moneylenders known as bankers, seths, mahajans, or shroffs are known to have existed and conducted the business of money lending and banking on a significant scale throughout almost all of the regions of the country during the time of Indian history.

To safeguard the interests of depositors and the public, a good banking system should have three fundamental qualities. These include:

- a fraud-free culture,
- a tried-and-true Best Practice Code, and
- an internal method for quickly resolving grievances.

In India, all of these requirements are either nonexistent or very weak. A bank fraud is a deliberate act of omission or commission committed by a person during a banking transaction or in the books of accounts kept manually or electronically in a bank, which results in wrongful gain to a person for a temporary period or otherwise, with or without any monetary loss to the bank.

According to the rules of the Indian Penal Code, bank frauds have been categorized as follows by the RBI in order to ensure consistency in reporting occurrences of fraud:

- Cheating,
- Property Misappropriation Committed Criminally,

- Criminal Breach of Trust,
- Forgery,
- Falsification of Accounts,
- Theft,
- Extortion,
- (House Breaking),
- Robbery and Dacoity,
- Criminal Conspiracy,
- Bribery and Corruption,
- Offenses Relating to Currency Notes and Bank Notes.[78]

Mahatma Gandhi once said that there is enough in the world to meet everyone's needs except for one person's greed. Corruption and fraud cannot be completely stopped by the law alone. As per prevailing guidelines, Cases of fraud with a value less than Rs 1.00 crore will be reported to the local police, under the current guidelines. But if a bank official is suspected of being involved it will be necessary to refer such cases to the Central Bureau of Investigation (CBI). The information and compliance for alleged bank frauds which worth more than Rs. 5 crores would be handled by the Banking Securities and Fraud Cell in Delhi, Mumbai, Bangalore, and Kolkata.

Additionally, the bank cannot fight the scam on its own. The bank, the government, labor unions, customers, law enforcement agencies, international agencies, and other parties must all work together to combat it. The government ought to place more emphasis on preventing fraud, especially scams involving organized crime. "Prevention is better than cure," they say. The proverbs "A stitch in time saves nine," "Honesty is the best policy," and "Justice delayed is justice denied" are all helpful and should serve as practical guidelines for preventing scams.[79]

[78] B. Manoharan, 'Prevention Of Frauds In Public Sector Banks' [2007] Journal of Professional Banker.
[79] B. Manoharan, 'Prevention Of Frauds In Public Sector Banks' [2007] Journal of Professional Banker.

Loopholes of Indian Banking System:

The Indian commercial banks have without a doubt achieved considerable growth in recent decades. They are still dealing with a number of issues. They are:

1. Non-performing Assets (NPAs)

   First, the high level of NPAs in the banking industry today is one of its concerns. There are several strategies available to address this pressing issue, some of which include: reducing current NPAs and preventing their continued accumulation; investigating options for recouping NPAs, such as using Lok Adalats to retrieve lesser loans; applying and enforcing the Revenue Recovery Act, which has a quick claim-review procedure; strengthening the Debt Recovery Act's provisions for collecting debts owed by banks and Developmental Financial Institutions (DFIs).

2. Insufficient Capital

   The Indian commercial banks' capital requirements were neither standardized nor sufficient. Since nationalization, the capital bases of 28 public sector banks have not increased.

3. Balance Sheets That Aren't Transparent

   Many banks continue to manipulate their balance sheets by fraudulently raising their deposits in the final week of the fiscal year, despite banks being required to undergo audits.

4. Investing in Shares

   Numerous banks have also been misusing public deposits by engaging in share speculation. Security scams have been the result of this.

5. Reduced Profitability

   The profitability of commercial banks has significantly declined as a result of irregularities in account maintenance, fraud, misappropriation, and corruption in lending operations.

6. Not enough social banking

The requirements of the corporate sector have been mostly met by commercial banks, despite a clearly established policy favoring the weakest segments of society. This is demonstrated by the fact that, while bank credit to medium and large-scale industries expanded by 44.4% over 1993-1994, bank credit to small-scale industries increased by 6.8%, while bank credit to agriculture and trade increased by 26.1% and 6.1%, respectively.

- Improvements to the Banking System

Following the Narasimham Committee's recommendations, the following actions have been taken to reform the Indian banking system.

- Payback of Debts

The Collection of Debt owing to Banks and Financial Institutions Act, 1993 was passed to create debt recovery tribunals for the recovery of delinquent debts. At important centers, these tribunals have been established.

- Being able to open branches

After meeting the required capital adequacy standards, banks are free to update extension counters and open additional branches. Except in rural and semi-urban areas, they are also allowed to close non-viable branches.

- Board of Central Bank Frauds

This Board was established in January 1997 by the Finance Ministry of the Government of India to provide advise on cases being investigated by the CBI involving bank employees up to the level of general manager.

- Relaxation of Lending Standards

Bank lending standards have also been loosened. They can now choose the quantities and lengths of ad hoc credit limits without adding more interest, as well as the holding levels of certain inventories and receivables that can be granted to borrowers.

7. New Private Banks:

The RBI released amended rules in 2001 to facilitate expanded participation by private sector banks. These criteria are as follows:

(A) Within three years of opening for operation, the bank should have a minimum paid-up capital of Rs. 200 crores, which will be increased to Rs. 300 crores.

(a) 40% promoter stake is appropriate.

(c) A primary equity contribution by NRIs should not be more than 40%.

(d) No major corporation may promote the new bank, although private businesses may provide up to 10% of the shares.

(e) NBFCs with a AAA rating and adequate capital of 12% can operate as banks.

(f) The new bank is required to keep its capital adequacy ratio at 10%.

Results achieved by the Reserve Bank of India:

The Reserve Bank of India's key accomplishments include the following:

a. It has done an excellent job of regulating credit to fulfill the needs of commerce, industry, and agriculture.
b. It has been managing the public debt admirably as a partner to the government.
c. It has created and encouraged ethical banking practices throughout the nation. The public now has more faith in the banking sector because of this.
d. The Reserve Bank has successfully encouraged the institutionalization of savings through the establishment of specialized financial agencies, and the enlargement of banking services throughout the nation.
e. It has been successful in developing rural credit and cooperative credit.
f. By encouraging a number of banks to offer medium- and long-term credit, it has had considerable success in the sphere of industrial lending.
g. The Reserve Bank has been successful in supplying exporters with credit facilities by offering commercial banks concessional lending, refinancing options, and guarantees. It was crucial in establishing the Export-Import Bank, which offers exporters loans and other facilities.
h. The Reserve Bank, acting as the system's watchdog, has been offering banks through DICGC deposit insurance and credit guarantee facilities.
i. The Reserve Bank has been instrumental in the nation's push to encourage social banking.
j. The Reserve Bank has also been largely effective in fostering a culture of using bills across the nation.
k. With the assistance of the State Bank of India, the Reserve Bank's 15 branches, 2 offices, and clearing house services have been effectively provided.

l. The Reserve Bank has done a commendable job managing and controlling foreign currencies.

m. The Reserve Bank is making a significant contribution to the growth of human resources in the banking industry by establishing a number of training centers and colleges to provide training to the employees of cooperative banks, commercial banks, regional rural banks, NABARD, etc.

n. The Reserve Bank has modernized its operations through its information technology department by implementing cutting-edge computer technology for inter-office communication and Internet technology for information gathering and dissemination. Additionally, it has promoted computerization of the branches of commercial banks.

Shortcomings of Reserve Bank of India

The Reserve Bank has not been successful in the following areas:

a. It has not been able to manage the unorganized money market, which means that local bankers continue to operate on their own.

b. The Reserve Bank has not been successful in achieving parity between the bank rate and other money market rates.

c. The Reserve Bank has been unable to keep the economy's inflation under control.

d. The reserve bank's credit-squeezing strategy has contributed to a deterioration in the profitability of commercial banks. Only 46% of the total deposits held by banks are available for lending since around 54% are blocked into reserves. A minimum of 40% of this must go to the priority sector. Therefore, it implies that the commercial banks are not successful to make huge gain.

e. The Reserve Bank has not entirely succeeded in creating an organized bill market, despite its best efforts. Additionally, it has not taken any action to formalize and accept hundis as legal tender.

f. Despite the increase of credit options in rural areas, there aren't enough resources to cover the credit needs of the rural inhabitants. Additionally, the Reserve Bank has failed to promote Indian exchange banks. Due to a lack of clear directions from the Reserve Bank, the State Bank of India and a few other public sector banks have not been able to make progress in this regard.

g. The customer service at public sector banks continues to be of a very low grade notwithstanding the Reserve Bank's measures.
h. Lastly, the Reserve Bank has failed to stop the growth of black money in the nation. In fact, their strategy of restricting credit has aided in the creation of black money.

RECOMMENDATION:

As per my point of view, following are the certain suggestion to deal with the control mechanism of the Reserve Bank of India:

a. The legal system should conform to evolving business practices.
b. Bank employees should receive formal training to focus on clients.
c. It is necessary to eliminate the "System of Branch Licencing of Banks."
d. Weak banks need to be strictly regulated, watched upon, and controlled.
e. Foreign banks operating in India ought to be bound by the same rules as domestic banks.
f. Examining the rules and regulations that the government and RBI have set.
g. The removal of the SBI board's RBI nominee.
h. Both the banks and the customers should find the system easy to use.
i. Banks should reduce their non-performing assets.
j. The best possible use of human resources should be made.
k. The RBI should stop acting as the government's extra arm.
l. The RBI needs to regularly disclose both its direct and indirect intervention programs in the foreign exchange market. The effectiveness of the forex market will increase as a result.
m. The government's operations ought to be transparent. The amount of money required specifically for the purchase of oil and military equipment, among other things, should periodically be made public by the government.

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