

BANKING INDUSTRY IN INDIA



A guide on Banking Industry in India.



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PREFACE





The Banking Industry is the lifeline of any modern economy. It is one of the important pillars of the financial sector, which plays a vital role in the functioning of an economy by facilitating the financing requirements of trade, industry, and agriculture. The banking system reflects the economic health of the country.

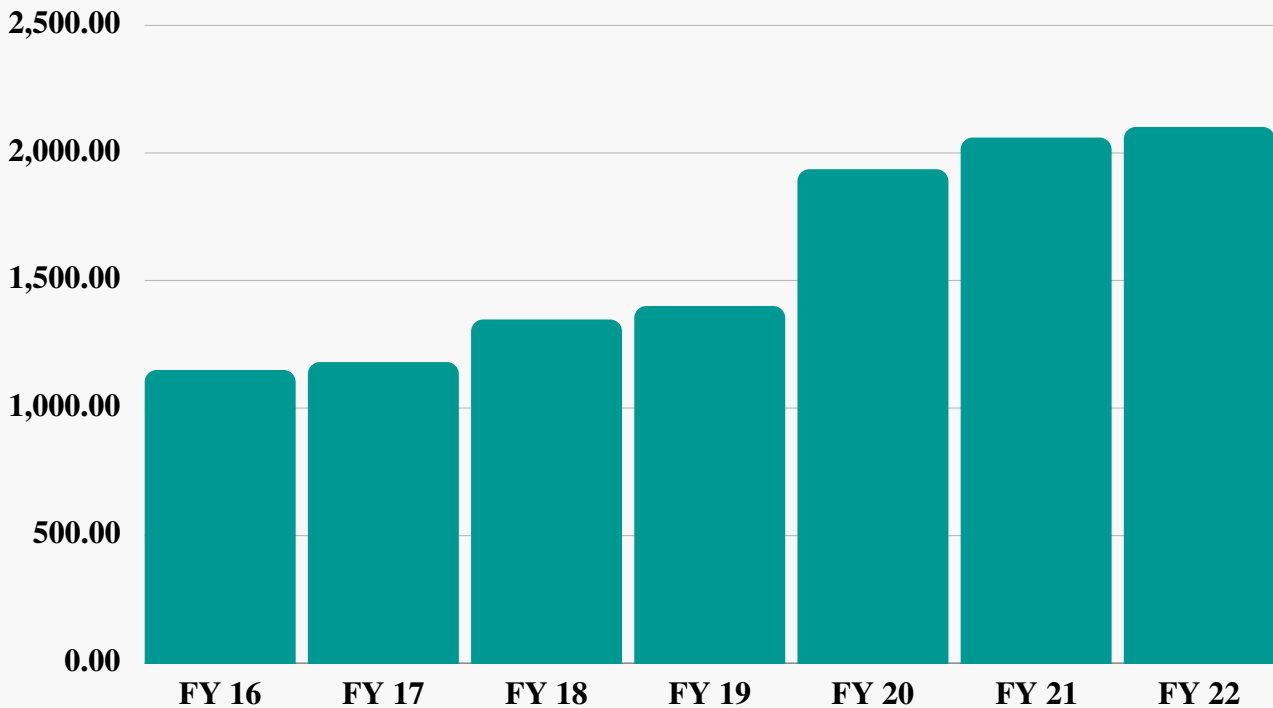
Banks have played an important role in the socio-economic progress of the country since independence. The global Banking Industry has strengthened and become stronger and more profitable in the last 10 years, and similarly, the Indian banking system has also evolved tremendously due to globalization, liberalization, and the advancement of technology to become a system that can cater efficiently to the needs of the people.

This industry is dominant in India as it accounts for more than half the assets of the financial sector. In India, the Reserve Bank of India ("RBI") has been established as the apex banking institution to regulate the monetary policy of the country.

MARKET POSITION



Growth in deposits (US \$ Billion)



The Indian Banking Industry has recently witnessed the rollout of innovative banking models like payments and small finance banks, digital banks, and neo-banking, along with supportive schemes like the Pradhan Mantri Jan Dhan Yojana. Mobile banking, internet banking, telebanking, biometric and mobile ATMs have all contributed to the physical and virtual expansion of banking over the last decade.

India's Immediate Payment Service ("IMPS") is the only system at level five in the Faster Payments Innovation Index ("FPII"). With 887 active lending apps, India is the world's largest market for android-based mobile lending apps, accounting for 82% of all online lenders worldwide. Bank credit stood at US\$ 1,553.23 billion as of July 29, 2022, and credit to non-food industries stood at US\$ 1.54 trillion. Furthermore, bank assets across sectors increased to around US\$ 2.67 trillion in 2020-2022. As per India Ratings & Research, credit growth is expected to hit 10% in 2022-23, which will be a double digit growth in eight years.

The top 5 banks in India in terms of banking assets are: State Bank of India, ICICI Bank, Punjab National Bank, Bank of Baroda, and Bank of India, which account for \$1.3 trillion. Currently, Citibank (the United States of America) is the largest foreign-owned lender in India, followed by HSBC (England), Standard Chartered (England), and Deutsche Bank (Germany). Further, Singapore's DBS has shown exemplary growth in the Indian landscape in recent years.

LEGAL FRAMEWORK



1. RBI Act, 1934

This Act was enacted to establish and set out the functions of the RBI. The Act grants the RBI powers to regulate the countries' monetary policies and lays down the constitution, incorporation, capital management, business, and functions of the bank.

2. Banking Regulations Act, 1949:

This Act is deemed to be one of the most important legal frameworks for banks in the country. Along with the RBI Act, the Banking Regulations Act lays down policies and issues guidelines for the banks.

3. The Companies Act, 2013:

A bank, irrespective of whether it is a public or private sector bank, has to first be registered as a company under the 2013 Companies Act. It is a comprehensive step wherein a number of documents and registrations like the tax deduction and Tax Collection Account Number (TAN), the Permanent Account Number (PAN), etc. are required. Thereafter, the bank will need to comply with various annual, half-yearly, and quarterly compliances as defined.

4. Information Technology Act, 2000 and other related acts and rules:

The Information Technology Act has accorded legal status to the usage of electronic payment systems in the Indian Banking Industry. It provides various compliances that must be complied to safeguard the personal and sensitive information of the customers using these interfaces, especially when making online payments.

5. Interest Tax Act, 1974:

The Interest Tax Act imposes a special tax on the gross amount of interest received by scheduled banks on loans and advances made in India. The banks are expected to adjust their functioning to the tax and reimburse themselves to the extent necessary by making a proper adjustment in interest rates charged to borrowers.

6. Limitation Act, 1963:

This Act is most important in safeguarding the interests of the banks, as it gives power to the lending bank by specifying the time limits for taking legal action against the borrower in case of default.

7. The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002

The main objective of this Act is to regulate the securitization and reconstruction of financial assets and the enforcement of security interests by empowering the banks and financial institutions to recover their dues on Non-Performing Assets ("NPAs") without the intervention of courts.

8. Negotiable Instruments Act, 1881:

This Act continues to be the predominant legal basis for all cheque-based (instrument-based) payment systems in India. It defines the rules for authorised payments and the payment settlement system.

9. Foreign Exchange Management Act, 1991 (FEMA):

FEMA deals with the regulation and management of foreign exchange and cross-border banking activities. It contains various compliances, disclosures, and approvals that are required to be obtained under different rules, like the Foreign Exchange Management (Borrowing and Lending) Regulations, the External Commercial Borrowing Policy, etc.

10. The Consumer Protection Act, 1986:

This Act provides a forum for the customers to lodge a complaint in case of any subpar services rendered to them before the appropriate district, state, and national commissions. A banking company, like any other company, is also required to ensure that it takes the requisite steps for customer protection and information security.

11. Prevention of Money Laundering Act, 2002 (PMLA):

RBI has always ensured that good corporate governance practises are being followed by banking companies, and in pursuance of that, it introduced the PMLA, via which it issues guidelines in relation to mergers and acquisitions, shareholding patterns, and other restrictions. All investigations, attachment of property, proceeds of crime relating to all the scheduled offences under the act, and filing of complaints have been entrusted to the Directorate of Enforcement.

12. Bankers' Book Evidence Act, 1891:

As per this act, banks are required to maintain bankers' books, including all books like ledgers, day books, cash books, and all the other records used in the ordinary business of a bank. This is an important and mandatory compliance requirement for banks across the country.



ESTABLMENT OF BANKING COMPANY



A finance company or a bank serves a group of individuals by providing them with loans, accepting deposits, and engaging in other bank-related activities. In order to function as a bank (public sector, private sector, small finance bank, etc.), the applicant will have to first establish and register its business as a company under the 2013 Companies Act with the Ministry of Corporate Affairs. The process for the same has been simplified and can take as little as 7 days. It involves the following broad steps:



Reservation of
company's name
under RUN or
Spice

1

Procuring Digital
Signature Certificate

2

Applying for
Director
Identification
Number or DIN

3

Drafting of Memorandum
of Association and
Article of Association

4

Obtain
Certificate of
Incorporation

5

Additional steps to be taken
for formation of a Public
Limited Company

6

Reservation of company's name under RUN or Spice [Step-1]:

The first and foremost step in the company registration process is reserving the name of the company. There are two options: RUN or SPICe.

After the name approval, the applicant shall apply for registration of the new company by filing the required forms within sixty days of the name approval:

Form -1: Declaration of compliance by the director

Form-18: Notice of the status of the company's registered office

Form-32: Particulars of the director's, manager's, or secretary's

Once the company's name has been approved by the Ministry of Corporate Affairs and registered, the next step is to procure the digital signature certificate for the company.

A digital signature certificate is a digital key containing all the vital information about the registered signatory, like name, address, email, and phone number, as well as the authority that has provided the certificate, which can be applied for through the Ministry of Corporate Affairs Portal.

Procuring Digital Signature Certificate [Step-2]:

Applying for Director Identification Number (DIN) [Step-3]:

DIN is a unique identification number allotted to an existing or proposed director of the entity to be incorporated.

As per Section 152(3), it is mandatory to obtain this number in order to be appointed as a director. A person can apply for DIN through the combined form in SPICe or by filing DIR-3.

The newly formed company must prepare two main documents, namely the MOA and AOA, which broadly define the scope, manner of conducting business, and other information about the company's shareholdings.

Once these two documents are duly executed, they are to be submitted through forms INC-33 and INC-34, respectively, with the registrar of companies or through the application form SPICe INC-32.

Drafting of Memorandum of Association (MOA) and Article of Association (AOA) [Step-4]:

Obtain Certificate of Incorporation [Step-5]:

Upon satisfaction of the application, the respective registrar of companies shall issue the certificate of incorporation (Form INC-11) to the company. Upon receiving such a certificate, the company shall be considered duly incorporated in India.

A public company has to make the following additional compliances in order to obtain a certificate of incorporation:

- File a declaration in eForm 20 and attach the statement in lieu of the prospectus (Schedule III).

OR

- File a declaration in eForm 19 and attach the prospectus (Schedule II) to it.
- Thereafter, obtain the Certificate of Commencement of Business.

Additional steps for formation of a public limited company [Step 6]:

LICENSES REQUIRED FOR ESTABLISHING A BANK



Banking is a niche industry in India, being regulated by the RBI and thus requiring a licence to operate, which is issued by the RBI. Other than the initial banking license, a number of other licences are required to be obtained depending upon the type of bank and the target customers of these banks, which are discussed in detail below:

1. Payments bank license:

A payments bank shall be registered as a public limited company under the Companies Act 2013 and be required to obtain a licence under Section 22 of the Banking Regulations Act. The Banking Regulations (Companies) Rules, 1949, specify a number of requirements, like a requirement of a minimum paid-up equity capital of 100 crore and mandatory promoters' holdings of at least 40% for the first five years.

2. Branch licensing:

Prior approval of the RBI is required in order to establish branches of a bank in India, outside India, or change the existing location of the business within or outside the same city, town, or village. Banks should also obtain the prior approval of their board or committee of directors before applying to the RBI. This proposal is to be submitted along with the prescribed application in Form VI (Rule 12) of Banking Regulation (Companies Rules), 1949, to the RBI for approval or license.

3. Specialized branch license:

Banks can open industrial finance branches, overseas branches, SIB/SSI branches, Treasury branches, and NRI branches without prior approval but only after obtaining a licence from the concerned regional office of the RBI prior to the opening of these branches. Further, merchant banking branches, asset recovery branches, etc., are required to seek the prior approval of the central office of the Department of Banking Operations and Development.

4. Banking license for private and public sectors and non-banking financial companies:

As per the New Banking Licensing Policy, 2013, eligible companies in the private and public sectors and Non-Banking Financial Company ("NBFCs") are eligible to set up a bank through a wholly-owned Non-Operative Financial Holding Company ("NOFHC"). The applicants shall meet the RBI's criteria and have a successful track record for 10 years. There are various eligibility criteria for the promoter groups of such NOFHCs based on their contribution, minimum paid-up equity capital requirements, and restrictions on foreign shareholding.

5. License for small finance banks:

Resident individuals or professionals with 10 years of experience in banking and finance, companies and societies owned and controlled by residents, existing NBFCs, microfinance institutions, and local area banks can apply for a small finance bank license. Such entities shall be owned and controlled by Indian residents and should be able to meet the "fit and proper" criteria as stated by the RBI with a minimum paid-up equity capital of Rs 100 crore.



MAJOR COMPLAINCES



Major compliances for a banking company would be as follows:

S.No.	License required	Description
1.	Compliance with the guidelines on digital lending	RBI recently issued guidelines to all lenders, including banks, to protect the data of borrowers using digital lending apps from being misused. As per the guidelines, the entities cannot store borrowers' data except for important information required to process and disburse the loan and manage its repayment. Further, banks cannot store the biometrics of the borrower in any case.
2.	Policies for safeguarding the interest of customers	Banks are required to establish various policies, like <ul style="list-style-type: none"> • Protected Disclosures Scheme • Code of Conduct for the prohibition of insider trading • Whistle-blowing System; • Basic anti-social organisation policy; • Anti-Money Laundering and Countering the Financing of Terrorism Policy
3.	Data privacy compliances	As the banks are collecting sensitive and personal data, they shall comply with the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011 and the Information Technology (Intermediaries Guidelines) Rules, 2011, which lay down that anyone collecting personal data should ensure to have a privacy policy on their website, obtain written consent from the data providers, and appoint a grievance officer.
4.	Corporate governance	Effective corporate governance is critical to the proper functioning of the banking sector and the economy as a whole. Banks are required by the RBI to observe corporate governance and are also required to publish their corporate governance report at the end of the year.
5.	Compliances for a listed bank	In case the bank is listed on a stock exchange, the following disclosures shall be made by it as per the SEBI (LODR) Amendment Regulations 2018 (Listing Regulations): <ul style="list-style-type: none"> • disclose meetings of all committees; • Annex a secretarial audit report to the annual report; • disclose a revision in credit ratings, preferential allotment, or qualified institutional placement; • Details of familiarisation programmes imparted to independent directors shall be disclosed on the bank's website. • Maintain a dividend distribution policy and disclose all its details.

<p>6.</p>	<p>Compliance as a company</p>	<p>Being a company incorporated under the Companies Act, 2013, a bank is required to comply with all the various guidelines issued. Some of the major ones are-</p> <ul style="list-style-type: none"> • Comply with the bank’s code of conduct; • Form a board of directors with the requisite number of directors; • Disclose the shareholding pattern on the website; • Establish the Audit Committee, Stakeholder Relationship Committee, Corporate Social Responsibility Committee, and Nomination and Remuneration Committee. Other committees like the IT Strategy Committee, the Customer Service Committee, the Risk Management Committee, etc. may also be formed; • Properly convene the annual general meeting, the extraordinary general meeting, and all other meetings of the committees; • Disclose all materially significant related party transactions; • Publish their annual reports; • Make all the necessary filings with the Ministry of Corporate Affairs; • Publish the yearly reports like the "Annual Report," "Corporate Social Responsibility Report," "Financial Balance Sheet," etc.; • Obtain all necessary registrations, like the Goods and Services Tax Identification Number (GSTIN).
<p>7.</p>	<p>Compliances for payment systems</p>	<p>As per the Payment and Settlement Systems Act, 2007, an authorization from RBI is required before commencing or operating as a payment system, and it mandates the storage of all data collected in India. The Act empowers RBI to prescribe the format and size of payments, the manner of transfer of funds, and other standards to be complied with in general.</p>



DISPUTE RESOLUTION



Disputes in the Banking Industry can arise from card or loan-related issues. Card-related payment disputes between customer and merchant occur in fewer than 1% of transactions, but these disputes, if taken to court, can result in a hefty cost to the banks. If banks treat disputes simply as issues to be minimized, they can miss the silver lining, i.e., the opportunity to strengthen their relationships with customers, and the best way to do the same is to opt for appropriate dispute resolution mechanisms. A convenient approach would be to further digitise the dispute resolution process, as it simplifies and eases the process for both banks and customers.

In terms of banking disputes, the depositors (consumers) must approach the defaulting bank or non-bank entity first before complaining to the Ombudsman as per the RBI Integrated Ombudsman Scheme, 2021.

The Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act), and the Recovery of Debts and Bankruptcy Act, 1993 ("RDB Act") envisage debt recovery for banks and financial institutions through the mechanisms of Asset Reconstruction Companies (ARCs) and Debt Recovery Tribunals ("DRTs").



In the context of digital payments, RBI also prescribed an in-house online dispute resolution ("ODR") mechanism for all licenced payment system operators. The ODR mechanism only addresses disputes arising from failed transactions and their compensation, leaving out a wide range of disputes in the payments and non-payments ecosystem.

Additionally, in the event of non-resolution of the dispute, the consumer must approach the Integrated Ombudsman, leaving no scope for centralised resolution of the dispute. The RBI Integrated Ombudsman Mechanism is a lengthy mode of dispute resolution as there is no direct recourse to the centralised institution for resolution, and the limitation for filing a case is merely one year from the cause of action.

On the other hand, arbitration of such disputes offers flexibility to the consumer with a limitation period of three years and direct recourse to the arbitrator where an arbitration agreement is made between the service provider and the customer. It also reduces the time spent in litigating these disputes, thereby minimising losses for both consumers and service providers.





How we can help?

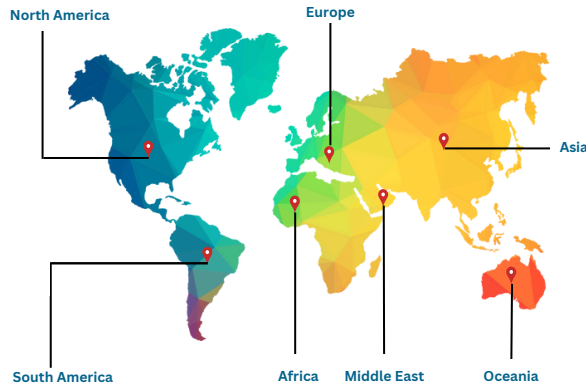
Our services for our clients who want to establish a banking company include the following:

- preliminary market research relating to the registrations, compliances, and authorizations that would be required for establishing any form of a bank in India;
- in obtaining the abovementioned licenses, authorizations, and clearances,
- in the formation and registration of your banking company under the Companies Act, 2013, with the Ministry of Corporate Affairs,
- in filling out the returns and reports that are to be filed with various government departments mandatorily at different times during the year,
- we can assist you with the drafting and registration of loan agreements that you may enter into with prospective clients after you start your business.

We can assist our clients with the following services:

- legal documentation regarding policies, transactions, etc.;
- in filling out the returns and reports that are to be filed with various government departments mandatorily at different times during the year,
- ensuring compliance with RBI norms;
- legal counsel on banking services and loans that may arise between the bank and its customers;
- suggest you in restructuring of the loans granted to your clients;
- preparing initial drafts of legislation administered/to be administered by the bank;
- replying to the candidate's queries on legal and administrative matters;
- handling all court cases, representations, and filings before the court of law.

SERVING CLIENTS WORLDWIDE



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