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India

BANKING & FINANCE

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This country-specific Q&A provides an overview of banking & finance laws and regulations applicable in India.

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INDIA
BANKING & FINANCE

1. What are the national authorities for banking regulation, supervision and resolution in your jurisdiction?

The banking business in India is supervised and regulated by the Reserve Bank of India (RBI), the apex banking authority and banker to the Government of India. Among other things, the RBI acts as a banker and treasurer to the Government of India and is the lender of the last resort. The RBI is responsible for regulation of currency issuance and circulation, foreign exchange control management, public debt management and safeguarding the overall financial health of the country.

2. Which type of activities trigger the requirement of a banking licence?

Any entity looking to accept deposits from public, either for the purpose of lending or investment, and which deposits are repayable on demand, will need to obtain a banking license. There are certain activities that are typically undertaken by licensed banks such as borrowing and lending, trade finance, guarantee and indemnity business, financial leasing and hire purchase and securitization, buying and selling of foreign exchange including foreign bank notes, public and private loans etc. Some of these activities can be undertaken by non-banking financial companies (NBFCs) as well, however, demand deposits can only be accepted by banks.

3. Does your regulatory regime know different licenses for different banking services?

Yes, the RBI issues different banking licenses for different banking services. Historically, there have been three main categories of banks: public sector banks, private sector banks and foreign banks. Public sector banks are primarily owned and controlled by the Government. Private sector banks are typically publicly listed with diverse ownership and are not controlled by the Government. Foreign banks are either branches or wholly owned subsidiaries of foreign banks. The recent entrants in the banking space include holders of limited banking licenses known as small finance banks (banks with a focus on micro lending in underbanked areas) and payments banks (banks which can accept small value deposits but cannot lend). Then there are regional rural banks and co-operative banks, which are specialized banks with a focus on agricultural and rural lending.

4. Does a banking license automatically permit certain other activities, e.g., broker dealer activities, payment services, issuance of e-money?

Yes, a licensed banking company can conduct several ancillary businesses such as investment advisory services, portfolio management services, mutual funds, insurance or pension management, credit and prepaid cards business, forex remittance, financial leasing, securitization and other para banking activities. However, in most cases, a separate or additional permission is required from RBI or the relevant financial sector regulator, depending on the nature of regulated activity intended to be undertaken. Banks may also be required to set up separate departments or subsidiaries to offer certain kinds of regulated financial services such as broker-dealer activities, forex remittance or payment settlement system solutions.

5. Is there a “sandbox” or “license light” for specific activities?

There is a “regulatory sandbox” regime that exists for specified activities in India.

With an objective to foster responsible innovation in financial services, the RBI introduced a framework for regulatory sandbox, setting out clear principles and activities that are eligible to be tested as a part of the regulatory sandbox regime. “Innovative products/services” in the field of money transfer

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services, marketplace lending, digital KYC, financial advisory services, wealth management services, digital identification services, smart contracts, financial inclusion products and cybersecurity products whereas “Innovative technologies” such as mobile applications, data analytics, API services, applications under blockchain technology, artificial intelligence and machine learning are considered eligible for sandboxing. Products/services/technology excluded from testing are credit registry, credit information services, cryptocurrency or crypto assets, trading, investing and settling in crypto assets, initial coin offerings, chain marketing services, and any product or service that has been banned by other regulators and the Indian government.

6. Are there specific restrictions with respect to the issuance or custody of crypto currencies, such as a regulatory or voluntary moratorium?

At present, cryptocurrency is unregulated in India. There is neither any regulation nor any ban on the use of cryptocurrencies in the country. The RBI’s order banning banks from supporting crypto transactions was reversed by a Supreme Court order of March 2020. The Indian government was slated to introduce ‘The Cryptocurrency and Regulation of Official Digital Currency Bill, 2021’ during the Parliament in 2021 but that was deferred. Even though crypto currency is legally not recognized in India, the Government of India, in its Finance Bill, 2022, has proposed to introduce new provisions in the Income Tax Act, 1961, to levy tax on income from sale and purchase of virtual digital assets such as crypto assets at 30% .

7. Do crypto assets qualify as deposits and, if so, are they covered by deposit insurance and/or segregation of funds?

No. Cryptocurrency or crypto assets are not recognized legally in India.

8. What is the general application process for bank licenses and what is the average timing?

An application for a bank license must be made to the RBI. The RBI on August 1, 2016, introduced Guidelines for “On-Tap” Licensing of universal banks in the private sector (On-Tap Guidelines) which is a full-fledged banking license. This replaces the previous approach which involved a ‘”stop and go'” licensing policy by providing a limited time window for applicants to approach the RBI for a license to operate a full-fledged bank. In 2019, the RBI issued the “on-tap” guidelines for licensing of small finance banks as well.

The application format, the information and the process differ based on the type of banking license that is being sought. The applicants are required to meet RBI’s “fit and proper'” criteria for promoters, eligibility conditions and shareholding requirements, including minimum capitalization requirements. The applicants are also required to furnish detailed business plans and projections; details of the area and population proposed to be served. Extensive details on the background of the sponsors and proposed directors are required including their qualifications and experience in banking sector.

9. Is mere cross-border activity permissible? If yes, what are the requirements?

An entity holding a banking license cannot undertake mere cross-border transactions. Forex conversion and cross border remittance activities require banks to apply for an additional license to RBI called an authorised dealer license. Most banks are eligible to apply for a category 1 license which would allow them to trade in foreign currency and offer foreign currency derivative products. An entity looking to offer forex remittance services without applying for a banking license can apply for an authorised dealer – category 2 license, which is essentially like a money changer and would be able to undertake a limited business of sale and purchase of foreign exchange for specified purposes such as private and business travel abroad. Such an entity must be incorporated in India as a limited company.

10. What legal entities can operate as banks? What legal forms are generally used to operate as banks?

Private sector banks, payment banks and small finance banks are typically organized as companies limited by shares and incorporated under the (Indian) Companies Act. Certain large public sector banks such as State Bank of India have been incorporated via their own statute. Foreign banks can set up business in India either by opening a branch or setting up a wholly owned subsidiary in India depending on several conditions one of which is reciprocal treatment for Indian banks looking to set up operations in that jurisdiction. Regional rural banks and urban cooperative banks are typically registered under the Co-operative Society Act of the state concerned or under the Multi-state Co-operative

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Societies Act, 2002.

11. What are the organizational requirements for banks, including with respect to corporate governance?

All private sector banks must set-up an audit committee, a risk management committee and a nomination and remuneration committee, in each case at the board level. The audit committee and the nomination and remuneration committee can only consist of non-executive directors whereas the risk management committee must consist of a majority of executive and non-executive directors. There are specific conditions prescribed regarding age, tenure and re-election modalities for directors as well as chief executive officer of a bank. There are caps prescribed for fixed and non-fixed remuneration payable to whole time and non-executive directors. For example, the post of managing director & chief executive officer or whole-time director cannot be held by the same incumbent for more than fifteen years. However, a managing director & chief executive officer or whole-time director, who is also a promoter/ major shareholder, cannot hold such posts for more than twelve years. RBI enjoys wide discretionary powers in such matters and is known to regulate this space closely.

12. Do any restrictions on remuneration policies apply?

Yes. RBI regulates the terms of remuneration of executive directors and the chief executive officers of all banks (Indian banks as well as branches of a foreign overseas bank). In consonance with the principles of the Financial Stability Board (FSB), the RBI discourages banks in India from adopting any remuneration structures that encourage or reward an excessive risk-taking approach by the management. Generally, employees of all banks in India are not permitted to be paid remuneration in the form of commission or a share in the profits of the bank.

13. Has your jurisdiction implemented the Basel III framework with respect to regulatory capital? Are there any major deviations, e.g., with respect to certain categories of banks?

RBI had issued guidelines on the implementation of the Basel III capital regulations, which were slated to come into effect, in a phased manner, from April 1, 2013. The deadline for the implementation of Basel III capital regulations was March 31, 2019, but in the light of COVID-19 pandemic, it was postponed to April 1, 2021. To enable the banking industry to sustain the advantage of healthy financial profiles, the RBI has generally prescribed higher capital adequacy norms than those proposed under the Basel III capital regulations. For instance, banks in India are generally required to maintain common equity tier 1 capital of at least 5.5% of risk-weighted assets as opposed to the 4.5% prescribed by the Basel III capital regulations and total capital of 9% as opposed to 8% prescribed by Basel III capital regulations.

14. Are there any requirements with respect to the leverage ratio?

Keeping financial stability in mind and with a view to moving further towards harmonisation with Basel III capital regulations, RBI has prescribed a minimum leverage ratio of 4% for domestic systemically important banks and 3.5% for other banks.

15. What liquidity requirements apply? Has your jurisdiction implemented the Basel III liquidity requirements, including regarding LCR and NSFR?

The liquidity coverage ratio requirement was made binding on banks by RBI from January 1, 2015. The requirement was set at minimum 60% for the calendar year 2015, and was to rise in equal steps to reach the minimum required level of 100% on January 1, 2019. From January 1, 2019, the RBI directed the liquidity coverage ratio to be minimum 100% i.e., the stock of high quality liquid assets should at least equal total net cash outflows over the next 30 calendar days.

The RBI has set the minimum ratio for net stable funding ratio at 100%. For Indian banks, the net stable funding ratio is applicable at stand-alone as well as consolidated level whereas, for foreign banks operating as branches in India, it is applicable on stand-alone basis.

16. Do banks have to publish their financial statements? Is there interim reporting and, if so, in which intervals?

All commercial banks (private sector banks, foreign banks operating through branches in India, small finance banks, payment banks, State Bank of India and rural regional banks) are required to prepare and disclose interim financial reports on half yearly basis. In addition, listed banks are required to disclose audited financial

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statements on quarterly basis with the relevant stock exchange.

17. Does consolidated supervision of a bank exist in your jurisdiction? If so, what are the consequences?

NBFCs promoted by the parent / group of a foreign bank having presence in India, which is a subsidiary of the foreign bank's parent / group or where the parent / group is having management control would be treated as part of that foreign bank's operations in India and will be covered under the ambit of consolidated supervision. Consequently, the concerned foreign banks will be required to submit the consolidated prudential returns to the RBI and also comply with the prudential regulations / norms prescribed for consolidated operations of banks in India. These foreign banks in India need not prepare 'consolidated financial statements' under accounting standard 21 – consolidated financial statements. They may consolidate the NBFCs with the bank's Indian operations on a line-by-line basis for the purposes of consolidated prudential regulations by adopting the principles of accounting standard 21 as applicable to consolidation of subsidiaries. Where a foreign bank is holding between 10% and 50% (both included) of the issued and paid-up equity of a NBFCs, it will be required to demonstrate that it does not have a management control in case the NBFCs is to be kept outside the ambit of consolidated prudential regulations.

18. What reporting and/or approval requirements apply to the acquisition of shareholdings in, or control of, banks?

Prior approval of the RBI is required for any acquisition of shareholding / voting rights of 5% or more of the paid-up capital of the bank or total voting rights of the bank by any person (including with its associate enterprises and persons acting in concert). In addition, if the acquirer is a non-resident or where the bank is a listed company then there will be additional reporting and approval requirements. Separately, every applicant will also have to ensure compliance with the anti-trust and competition law regulations while analysing any investment proposal in a bank.

19. Does your regulatory regime impose conditions for eligible owners of banks (e.g., with respect to major participations)?

Yes, the RBI undertakes a stringent due diligence to determine whether the applicant is "fit and proper" to be a major shareholder (i.e. holder of 5% or more of the equity voting capital of a bank). There are different criteria to determine the "fit and proper" status of the applicant which the RBI prefers to keep fluid. The RBI will seek detailed background information on the applicant, source of funds for the acquisition, details on existing investments in financial services sector in India while deciding on the application. RBI often seeks additional information / documents from the applicant such as shareholder agreements and makes enquiries with regulator/s, revenue authorities, investigation agencies, credit rating agencies, etc. as it considers appropriate.

20. Are there specific restrictions on foreign shareholdings in banks?

Yes; except for where a bank is set up as a wholly owned subsidiary of a foreign bank in India, the aggregate foreign investment in private sector banks cannot exceed 74% of paid-up capital of the bank.

21. Is there a special regime for domestic and/or globally systemically important banks?

The RBI framework for dealing with domestic systemically important banks is based on Basel III framework. The indicators to be used to assess domestic systemic importance of the banks are as follows: i) size; ii) interconnectedness; iii) lack of readily available substitutes or financial institution infrastructure; and iv) complexity. The domestic systemically important bank's framework requires the RBI to disclose the names of banks designated as domestic systemically important banks and place these banks in appropriate buckets depending upon their systemic importance scores. Based on the bucket in which a domestic systemically important bank is placed, an additional common equity requirement has to be applied to it. In case a foreign bank having branch presence in India is a global systemically important bank, it has to maintain additional common equity tier 1 capital surcharge in India as applicable to it as a global systemically important bank, proportionate to its risk-weighted assets in India.

22. What are the sanctions the regulator(s) can order in the case of a violation of banking regulations?

The RBI may impose stringent penalties on banks in India (including foreign banks operating through branches in India) for violation of the Banking Regulation

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Act, 1949 (BR Act), the Payment Settlements Systems Act, 2008 or any regulations or instructions of the RBI. The provisions of the Indian Penal Code, 1860 are also applicable to the full-time chairman, managing director, auditor, liquidator, manager and other employees of banks in India (including foreign banks operating through branches in India) and, in certain cases, the officers-in-charge are even liable to imprisonment.

In several instances, the RBI has levied stringent monetary penalties on banks for violating KYC or AML norms and disclosure requirements prescribed under the extant foreign exchange laws and instructions of the RBI.

The RBI is also empowered to cancel the licences of banks (including foreign banks undertaking banking activities in India) in certain instances, such as non-compliance with licensing guidelines issued by the RBI as applicable to that bank.

23. What is the resolution regime for banks?

Under Indian law, no separate guidelines or procedures have been prescribed on the bankruptcy of a bank or financial institution. Often, a weaker bank facing bankruptcy may be merged with a stronger and financially sound bank.

Under the BR Act, the RBI has wide powers to manage the financial health of a bank, including the power to supersede the board of directors, impose a moratorium on its functions, prepare a scheme for amalgamation or restructuring, and apply for winding-up. No court in India can approve a winding-up petition against a bank unless the RBI certifies its inability to pay its debt in writing. The RBI can also apply to the courts to suspend an entity's banking business if the bank's business is being conducted in a manner detrimental to the interests of depositors. In the case of a bank being wound up, the RBI may even be appointed as the liquidator.

The Insolvency and Bankruptcy Code, 2016, seeks to consolidate the laws relating to the reorganisation and insolvency of companies. However, the Insolvency and Bankruptcy Code, 2016, is not applicable to reorganisation or insolvency, or both, of any bank in India (including foreign banks operating through branches).

24. How are client's assets and cash deposits protected?

All commercial banks including branches of foreign banks functioning in India, local area banks and regional rural banks as well as all co-operative banks are insured by the Deposit Insurance and Credit Guarantee Corporation, a wholly-owned subsidiary of the RBI. The Deposit Insurance and Credit Guarantee Corporation insures every customer deposit upto a maximum of ₹ 5,00,000 (Rupees Five Lakhs) for both principal and interest amount held by the customer.

25. Does your jurisdiction know a bail-in tool in bank resolution and which liabilities are covered?

Following the global financial crisis and recommendations of the FSB, the RBI has also adopted a framework for designating certain domestic and foreign banks in India that are 'too big to fail' as domestic systemically important banks and global systematically important banks respectively. In addition to ICICI Bank Ltd and State Bank of India, the Government of India has identified HDFC Bank Limited as a domestic systemically important bank, as the continued functioning of these banks is critical for the uninterrupted availability of essential banking services to the Indian economy. The RBI has prescribed additional capital requirements and increased supervision for these banks.

26. Is there a requirement for banks to hold gone concern capital ("TLAC")?

Total loss absorbing capacity requirements are not applicable to any Indian bank under any scenario. However, DSIBs are required to maintain additional capital in certain cases.

27. In your view, what are the recent trends in bank regulation in your jurisdiction?

With the evolution of financial services, digital lending has gained a lot of prominence in India. Banks as well as NBFCs have been at the forefront of partnered digital lending. India's objective to increase financial inclusion and digitisation coupled with lockdowns and restrictions imposed by COVID-19 has driven consumers and businesses to take their transactions online. In fact, the Government of India backed policy think tank – Niti Ayog has recently issued a road map for setting up of full stack digital only banks called 'Neo Banks' to propel digital banking and digital lending to a mainstream forum.

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28. What do you believe to be the biggest threat to the success of the financial sector in your jurisdiction?

With the move towards digitization of banking and lending activities, cyber security and cyber terrorism related issues remain the biggest threat to the stability and security of financial sector. Indian banks and digital payment systems providers routinely face cyber threats resulting in sensitive and confidential customer data being leaked and resulting in interruptions in business continuity and system downtime. The RBI has been dynamic in providing guidelines and framework on cyber security to banks to keep enhancing their resilience by improving their current defences in addressing cyber risks. Apart from directing the banks to put in place a cyber security policy containing an appropriate strategy to combat cyber threats, the RBI has also directed all the banks to ensure periodic testing for vulnerabilities so as to remain regularly updated on the latest nature of emerging cyber threats.

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