

Banking Regulation Act, 1949

Background:

Banking Regulation Act, 1949 aims to consolidate the law relating to banking and to provide for the nature of transactions which can be carried on by banks in India. Before 1949, the Indian Companies Act, 1913, contained special provisions relating to banking companies. These provisions were first introduced in 1936, and underwent two subsequent modifications, which proved inadequate and difficult to administer. Moreover, it was recognized that while the primary objective of company law is to safeguard the interests of the shareholder, that of banking legislation should be the protection of the interests of the depositor. It was therefore felt that a separate legislation was necessary for regulation of banking in India. With this objective in view, a Bill to amend the law relating to Banking Companies was introduced and was passed on 10th March, 1949 as the **Banking Companies Act, 1949**.

By the Banking Laws (Application to Cooperative Societies) Act, 1965, the provisions of the Banking Companies Act were extended to Co-operative Banks. Since the applicability of the Act was no longer restricted only to companies, the title of the Act was changed from Banking Companies Act to **Banking Regulation Act, 1949**.

Consequent on some banks being nationalized and becoming public sector banks, applicability of the Act had to be modified. The Act which so applied to banking companies, co-operative banks and public sector banks was further modified when the Regional Rural Banks (RRBs) were constituted by the RRB Act, 1976.

It can thus be seen that the BR Act which was originally enacted to be applicable to banking companies which are registered as companies under the applicable company law, has been modified from time to time to extend to banks having a structure other than a company under the Companies Act. A situation is thereby created where the law which originally applied to banking companies now applies to entities other than companies. This has created an anomalous situation, considering that matters such as capital, rights of shareholders, requirements of holding Annual General Meeting and number of other issues relating to the administration, management and business activities as applicable to companies are different from those as applicable to the other entities.

Public Sector Banks: The corresponding new banks constituted under the provisions of the Banking Companies (Acquisition & Transfer of Undertakings) Acts, 1970/80, the State Bank of India constituted under the State Bank of India Act, 1955 and the subsidiary banks constituted under the State Bank of India (Subsidiary Banks) Act, 1959 and the Regional Rural Banks constituted under the Regional Rural Banks Act, 1976 are all bodies corporate established by an Act of Parliament and are not companies under the Companies Act, 1956. The provisions of the Companies Act, 1956 therefore do not apply to the above categories of banks. One exception is Industrial Development Bank of India which has become a company on conversion from Development Financial Institution into a banking company. There are many provisions in the Banking Regulation Act which are enacted on the assumption that the basic law i.e. the Companies Act would apply to a bank which assumption has ceased to be valid on extending application of the Act to entities other than companies. Some such provisions may be noted as under:

- Section 9 which provides that no banking company shall hold any immovable property howsoever acquired except such, as is required for its own use, for any period exceeding 7 years from the acquisition thereof.
- Section 11 of the BR Act makes detailed provisions regarding requirement as to minimum paid-up capital and reserves. This provision applies only to the private sector banks, which are companies under the Companies Act, 1956.
- Section 12 of the BR Act contains provisions relating to regulation of paid-up capital, subscribed capital and authorized capital and voting rights of shareholders. These provisions are not applicable to public sector banks and other banking institutions which are not companies. Voting rights of a shareholder in a banking company are capped at 10% but voting rights of a shareholder of a public sector bank are restricted at 1% of total voting rights of all the shareholders of the public sector banks.
- Section 16 contains provisions prohibiting common directors on the board of directors of the bank which apply only to private sector banks.
- Provisions relating to suspension of business and winding up of banking companies contained in sections 37 to 45 are not applicable to public sector banks.

Powers and responsibilities of RBI in respect of regulation of banks:

The Reserve Bank of India has been entrusted with the responsibility under the Banking Regulation Act, 1949 to regulate and supervise banks' activities in India and their branches abroad. While the regulatory provisions of this Act prescribe the policy framework to be followed by banks, the supervisory framework provides the mechanism to ensure banks' compliance with the policy prescription.

Banking Regulation Act, 1949

I) PRELIMINARY

Section 2: Application of other laws not barred

The provisions of this Act shall be in addition to, and not, in derogation of the Companies Act, 1956, and any other law for the time being in force.

Section 4: Power to suspend operation of Act

The Central Government, on a representation made by the Reserve Bank in this behalf, may by notification suspend for such period, not exceeding 60 days, the operation of all or any of the provisions of this Act, either generally or in relation to any specified banking company.

Section 5 A: Act to override memorandum, articles, etc.

The provisions of this Act shall have effect notwithstanding anything to the contrary contained in the memorandum or articles of a banking company, or in any agreement executed by it, or in any resolution passed by the banking company in general meeting or by its Board of Directors.

Section 5: Interpretation

"**Banking**" is 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;

"**Banking Company**" is any company which transacts the business of banking.

A banking company must perform both of the essential functions, viz., (a) accepting deposits, and (b) lending or investing the same. If the purpose of acceptance of deposits is not to lend or invest, the business will not be called banking business. Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public merely for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking.

The phrase 'deposit of money from the public' is significant. The word 'public' implies that a banker accepts from **anyone** who offers his/her money for such purpose. The definition also specifies the time and mode of withdrawal of the deposits. The deposited money should be repayable to the depositor on demand. The essential feature of banking business is that the banker does not refund the money on his own accord, even if the period for which it was deposited expires. The depositor must make a demand for the same. The Act also specifies that the withdrawal should be effected through an order, cheque, draft or otherwise. It implies that the demand should be made through an instrument in writing and not merely by verbal order or a telephonic message.

The underlying principle of the business of banking is that the resources mobilized through the acceptance of deposits must constitute main stream of funds which are to be utilized for lending or investment purposes. The banker is, thus, an intermediary and deals with the money belonging to the public. A number of other institutions, which also deal with money, are not designated as banking institutions, because they do not fulfill all the above-mentioned prerequisites. The specialized financial institutions, e.g., State Finance Corporations, are not banks because they do not accept the deposits in the prescribed manner.

Section 7: Use of words "bank", "banker", "banking" or "banking company"

No company other than a banking company shall use as part of its name or in connection with its business any of the words "bank", "banker" or "banking" and no company shall carry on the business of banking in India unless it uses as part of its name at least one of such words.

No firm, individual or group of individuals shall, for the purpose of carrying on any business, use as part of its or his name any of the words "bank", "banking" or "banking company".

II) FORMS OF BUSINESS

Section 6: Forms of business in which banking companies may engage

Main business- the borrowing, raising, or taking up of money; the lending or advancing of money; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundees, promissory notes, coupons, drafts, bills of lading; the granting and issuing of letters of credit, traveller's cheques; the buying, selling and dealing in bullion and specie; the buying and selling of foreign exchange; the acquiring, holding, issuing on commission, underwriting and dealing in shares, debentures, securities and investments of all kinds;

Allied business: acting as agents for any Government or local authority or any other person or persons; contracting for public and private loans and negotiating and issuing the same; the effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, municipal or other loans or of shares, stock, debentures, or debenture stock of any company, corporation or association and the lending of money for the purpose of any such issue; carrying on and transacting every kind of guarantee and indemnity business; undertaking and executing trusts;

Section 8: Prohibition of trading.

Section 8 prohibits a banking company from engaging directly or indirectly in trading activities and undertaking trading risks. No banking company shall directly or indirectly deal in buying or selling or bartering of goods or engage in any trade or buy, sell or barter goods for others.

For the purpose of this section, 'goods' means every kind of movable property, other than actionable claims, stocks, shares, money, bullion and specie and all instruments referred to in Section 6.

Section 9: Disposal of non-banking assets.

Section 9 prohibits a banking company from holding any immovable property, howsoever acquired, except as is required for its own use.

Section 19: Restriction on nature of subsidiary companies:

A banking company shall not form any subsidiary company except a subsidiary company formed for one or more of the following purposes:

- the undertaking of any business which is permissible for a banking company to undertake
- with the previous permission in writing of the Reserve Bank, the carrying on of the business of banking exclusively outside India,
- the undertaking of such other business, which the Reserve Bank may, with the prior approval of the Central Government, consider to be conducive to the spread of banking in India or to be otherwise useful or necessary in the public interest

III) MINIMUM PAID-UP CAPITAL AND RESERVES

Section 11: Requirement as to minimum paid-up capital and reserves

Section 11 contains provisions to ensure adequacy of minimum paid-up capital and reserves.

Foreign Banks- In case of a banking company incorporated outside India the aggregate value of its paid-up capital and reserves shall not be less than Rs. 15 lakhs and if it has a place or places of business in the city of Mumbai or Calcutta or both, Rs. 20 lakhs. In the case of a banking company incorporated outside India- the banking company shall deposit and keep deposited with the Reserve Bank (i) the minimum paid up capital (ii) an amount calculated at 20 % of its profit for that year in respect of all business transacted through its branches in India

Indian Banks- The value of its paid-up capital shall not be less than five lakhs of rupees

NATIONALISED BANKS: These provisions apply only to the private sector banks, which are companies under the Companies Act, 1956.

Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 lays down that the authorized capital of every corresponding new bank shall be one thousand five hundred crores of rupees.

Section 12: Regulation of paid-up capital, subscribed capital and authorized capital and voting rights of shareholders

Section 12 of the BR Act contains provisions relating to regulation of paid-up capital, subscribed capital and authorized capital and voting rights of shareholders.

Section 12 provides that the subscribed capital of a banking company should not be less than one-half of its authorized capital and the paid-up capital should not be less than one-half of the subscribed capital. Banking companies are required to have capital consisting of equity shares only or of equity shares and such preference shares which were issued prior to 1st July, 1944.

Voting Rights- No person holding shares in a banking company shall, in respect of any shares held by him, exercise voting rights on poll in excess of 10% of the total voting rights of all the shareholders of the banking company.

NATIONALISED BANKS: These provisions are not applicable to public sector banks and other banking institutions which are not companies. Voting rights of a shareholder in a banking company are capped

at 10% but voting rights of a shareholder of a public sector bank are restricted at one per cent of total voting rights of all the shareholders of the corresponding new bank.

Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980 lays down that no shareholder other than the Central Government, shall be entitled to exercise voting rights in respect of any shares held by him in excess of one per cent of the total voting rights of all the shareholders

Section 13: Restriction on commission, brokerage, discount, etc. on sale of shares.

Section 13 lays down that a banking company shall not pay out directly or indirectly by way of commission, brokerage, discount or remuneration in any form in respect of any shares issued by it, any amount exceeding in the aggregate 2.5% of the paid up value of shares.

Section 15: Restrictions as to payment of dividend

No banking company shall pay any dividend on its shares until all its capitalised expenses have been completely written off.

IV) CASH RESERVE RATIO (CRR) AND STATUTORY LIQUIDITY RATIO (SLR)

Section 18: Cash Reserve (CRR)

A non-scheduled bank shall maintain in India, by way of cash reserve, a sum equivalent to at least 3 per cent of the total of its time and demand liabilities in India.

This Section does not apply to the scheduled banks as they are required to maintain similar cash reserve with the Reserve Bank of India under **Section 42** of the Reserve Bank of India Act, 1934.

Section 24: Maintenance of a percentage of assets (SLR)

Every banking company shall maintain in India in cash, gold or unencumbered approved securities, valued at a price not exceeding the current market price, an amount which shall not, at the close of business on any day, be less than twenty-five per cent or such other percentage not exceeding forty per cent, as the Reserve Bank may, from time to time, by notification in the Official Gazette, specify, of the total of its demand and time liabilities in India.

V) LICENSING

Section 22: Licensing of banking companies

No company shall carry on banking business in India, unless it holds a license issued in that behalf by Reserve Bank and any such license may be issued subject to such conditions as the Reserve Bank may think fit to impose.

Before granting any license, RBI may require to be satisfied that the following conditions are fulfilled:

- i) that the company is or will be in a position to pay its present or future depositors in full as their claims accrue;
- ii) that the affairs of the company are not being , or are not likely to be, conducted in a manner detrimental to the interests of its present or future depositors;
- iii) that the general character of the proposed management of the proposed bank will not be prejudicial to the public interest or the interest of its depositors;
- iv) that the company has adequate capital structure and earning prospects;
- v) that having regard to the banking facilities available in the proposed principal area of operations of the company, the potential scope for expansion of banks already in existence in the area and other

relevant factors the grant of the license would not be prejudicial to the operation and consolidation of the banking system consistent with monetary stability and economic growth;

Before granting any license under this section to a company incorporated outside India, the RBI may require to be satisfied that the conditions specified above are fulfilled and that the carrying on of banking business by such company in India will be in the public interest and that the Government or law of the country in which it is incorporated does not discriminate in any way against banking companies registered in India and that the company complies with all the provisions of this Act applicable to banking companies incorporated outside India.

Section 23: Restrictions on opening of new, and transfer of existing, places of business

Without obtaining the prior permission of the Reserve Bank –

- no banking company shall open a new place of business in India or change otherwise than within the same city, town or village, the location of an existing place of business situated in India; and
- no banking company incorporated in India shall open a new place of business outside India or change, otherwise than within the same city, town or village in any country or area outside India, the location of an existing place of business situated in that country or area.

VI) OPERATIONS & ACCOUNTS

Section 17: Reserve Fund

Every banking company incorporated in India shall, out of the balance of profit of each year as disclosed in the profit and loss account and before any dividend is declared, transfer to the reserve fund a sum equivalent to not less than 20% of such profit.

Section 20: Restrictions on loans and advances

No banking company shall

- grant any loans or advances on the security of its own shares,
- enter into any commitment for granting any loan or advance to or on behalf of—any of its directors, any firm in which any of its directors is interested as partner, manager, employee or guarantor, any company (not being a subsidiary of the banking company or a Government company) of which or the subsidiary or the holding company of which any of the directors of the banking company is a director, managing agent, manager, employee or guarantor or in which he holds substantial interest, any individual in respect of whom any of its directors is a partner or guarantor.

Section 21: Power of Reserve Bank to control advances by banking companies

Reserve Bank may determine the policy in relation to advances to be followed by banking companies generally or by any banking company in particular, and when the policy has been so determined, all banking companies or the banking company concerned, as the case may be, shall be bound to follow the policy as so determined.

Section 21 A: Rates of interest charged by banking companies not to be subject to scrutiny by courts

A transaction between a banking company and its debtor shall not be re-opened by any court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive.

Section 25: Assets in India

The assets in India of every banking company shall not be less than 75% of its demand and time liabilities in India.

Section 29: Accounts and balance-sheet

Every banking company incorporated in India, in respect of all business transacted by it, and every banking company incorporated outside India, in respect of all business transacted through its branches in India, shall prepare a balance-sheet and profit and loss account in the Forms set out in the Third Schedule or as near thereto as circumstances admit.

VII) RESERVE BANK'S POWERS OF INSPECTION AND GIVING DIRECTIONS**Section 35: Inspection**

The Reserve Bank at any time may, and on being directed so to do by the Central Government shall, cause an inspection to be made by one or more of its officers of any banking company and its books and accounts;

The Reserve Bank, at any time, may also cause a scrutiny to be made by any one or more of its officers, of the affairs of any banking company and its books and accounts;

The Reserve Bank shall, if it has been directed by the Central Government to cause an inspection to be made, and may, in any other case, report to the Central Government on any inspection [or scrutiny made under this section, and the Central Government, if it is of opinion after considering the report that the affairs of the banking company are being conducted to the detriment of the interests of its depositors, may by order in writing— (a) prohibit the banking company from receiving fresh deposits; (b) direct the Reserve Bank to apply under section 38 for the winding up of the banking company.

Section 35 A: Power of the Reserve Bank to give directions:

Where the Reserve Bank is satisfied that in the public interest or in the interest of banking policy or to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company; or to secure the proper management of any banking company generally, it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies or the banking company, as the case may be, shall be bound to comply with such directions.

Section 36: Further powers and functions of Reserve Bank

The Reserve Bank may—

- caution or prohibit banking companies or any banking company in particular against entering into any particular transaction or class of transactions, and generally give advice to any banking company;
- on a request by the companies concerned assist, as intermediary or otherwise, in proposals for the amalgamation of such banking companies
- give assistance to any banking company by means of the grant of a loan or advance to it
- require the banking company to call a meeting of its directors for the purpose of considering any matter relating to or arising out of the affairs of the banking company or require an officer of the banking company to discuss any such matter with an officer of the Reserve Bank

VIII) MANAGEMENT OF BANKING COMPANIES**Section 10A: Board of directors to include persons with professional or other experience**

Not less than **fifty-one per cent**, of the total number of members of the Board of directors of a banking company shall consist of persons, who— shall have special knowledge or practical experience in respect of one or more of the following matters, namely:— (i) accountancy, (ii) agriculture and rural economy, (iii) banking, (iv) co-operation, (v) economics, (vi) finance, (vii) law, (viii) small-scale industry, (ix) any other matter the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the banking company.

Section 10B: Banking company to be managed by whole time chairman

Every banking company shall have one of its directors, who may be appointed on a whole-time or a part-time basis, as chairman of its board of directors, and where he is appointed on a whole-time basis, as chairman of its board of directors, he shall be entrusted with the management of the whole of the affairs of the banking company

Where a chairman is appointed on a part-time basis, the management of the whole of the affairs of such banking company shall be entrusted to a **managing director**.

Section 10BB: Power of Reserve Bank to appoint Chairman

Where the office, of the chairman of the board of directors appointed on a whole-time basis or a managing director of a banking company is vacant, the Reserve Bank may, if it is of opinion that the continuation of such vacancy is likely to adversely affect the interests of the banking company, appoint a person to be the chairman of the board of directors appointed on a whole-time basis or a managing director of the banking company.

Section 16: Prohibition of common directors.

No banking company incorporated in India shall have as a director in its Board of directors any person who is a director of any other banking company.

IX) CONTROL OVER MANAGEMENT

Section 36AA: Power of Reserve Bank to remove managerial and other persons from office

Where the Reserve Bank is satisfied that in the public interest or for preventing the affairs of a banking company being conducted in a manner detrimental to the interests of the depositors or for securing the proper management of any banking company it is necessary so to do, the Reserve Bank may, for reasons to be recorded in writing, by order, remove from office, any chairman, director, chief executive officer (by whatever name called) or other officer or employee of the banking company.

Section 36AB: Power of Reserve Bank to appoint additional directors

Reserve Bank in the interest of banking policy or in the public interest or in the interests of the banking company or its depositors may, from time to time by order in writing, appoint, one or more persons to hold office as additional directors of the banking company:

X) ACQUISITION OF THE UNDERTAKINGS OF BANKING COMPANIES

Section 36AE: Power of Central Government to acquire undertakings of banking companies in certain cases

If, upon receipt of a report from the Reserve Bank, the Central Government is satisfied that a banking company (a) has, no more than one occasion, failed to comply with the directions given to it in writing

under section 21 (**Power of Reserve Bank to control advances by banking companies**) or section 35A (**Power of the Reserve Bank to give directions**), in so far as such directions relate to banking policy, or (b) is being managed in a manner detrimental to the interests of its depositors, and that— (i) in the interests of the depositors of such banking company, or (ii) in the interest of banking policy, or (iii) for the better provision of credit generally or of credit to any particular section of the community or in any particular area, it is necessary to acquire the undertaking of such banking company, the Central Government may, by notified order, acquire the undertaking of such company.

XI) RESTRUCTURING AND RESOLUTION INCLUDING WINDING UP OPERATION

Section 37: Suspension of business

The High Court may on the application of a banking company which is temporarily unable to meet its obligations make an order (a copy to be forwarded to the Reserve Bank) staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time on such terms and conditions as it shall think fit and proper, and may from time to time extend the period so however that the total period of moratorium shall not exceed six months.

Where the Reserve Bank is satisfied that the affairs of a banking company in respect of which an order under has been made, are being conducted in a manner detrimental to the interests of the depositors, it may make an application to the High Court for the winding up of the company, and where any such application is made, the High Court shall not make any order extending the period for which the commencement or continuance of all actions and proceedings against the company were stayed.

Section 38: Winding up by High Court:

The High Court shall order the winding up of a banking company— (a) if the banking company is unable to pay its debts; or (b) if an application for its winding up has been made by the Reserve Bank under section 37 (**Suspension of business**) or this section.

The Reserve Bank shall make an application under this section for the winding up of a banking company if it is directed so to do by an order of the Central Government under Section 35 (**Inspection**).

The Reserve Bank may make an application under this section for the winding up of a banking company—

(a) if the banking company— (i) has failed to comply with the requirements specified in section 11 (**Requirement as to minimum paid-up capital and reserves**); or (ii) has by reason of the provisions of section 22 (**Licensing**) become disentitled to carry on banking business in India; or (iii) has been prohibited from receiving fresh deposits by an order under section 35 (**Inspection**) or under section 42 of the Reserve Bank of India Act (**Cash reserves of scheduled banks to be kept with the Bank.**); or (iv) having failed to comply with any requirement of this Act other than the requirements laid in section 11, has continued such failure, or, having contravened any provision of this Act continued such contravention beyond such period or periods as may be specified in that behalf by the Reserve Bank from time to time, after notice in writing of such failure or contravention has been conveyed to the banking company; or

(b) if in the opinion of the Reserve Bank— (i) a compromise or arrangement sanctioned by a court in respect of the banking company cannot be worked satisfactorily with or without modifications; or (ii) the returns, statements or information furnished to it under or in pursuance of the provisions of this Act disclose that the banking company is unable to pay its debts; or (iii) the continuance of the banking company is prejudicial to the interests of its depositors.

Section 39: Reserve Bank to be official liquidator

Where in any proceeding for the winding up by the High Court of a banking company, an application is made by the Reserve Bank in this behalf, the Reserve Bank, the State Bank of India or any other bank notified by the Central Government in this behalf or any individual, as stated in such application shall be appointed as the official liquidator of the banking company.

Section 40: Stay of proceedings

The High Court shall not make any order staying the proceedings in relation to the winding up of a banking company, unless the High Court is satisfied that an arrangement has been made whereby the company can pay its depositors in full as their claims accrue.

Section 44: Powers of High Court in voluntary winding up

No banking company may be voluntarily wound up unless the Reserve Bank certifies in writing that the company is able to pay in full all its debts to its creditors as they accrue.

Section 44A: Procedure for amalgamation of banking companies

No banking company shall be amalgamated with another banking company, unless a scheme containing the terms of such amalgamation has been placed in draft before the shareholders of each of the banking companies concerned separately, and approved by a resolution passed by a majority in number representing **two-thirds** in value of the shareholders of each of the said companies, present either in person or by proxy at a meeting called for the purpose.

If the scheme of amalgamation is approved by the requisite majority of shareholders, it shall be submitted to the Reserve Bank for sanction and shall, if sanctioned by the Reserve Bank, be binding on the banking companies concerned and also on all the shareholders.

Section 45: Power of Reserve Bank to apply to Central Government for suspension of business by a banking company and to prepare scheme of reconstitution of amalgamation.

The Reserve Bank may apply to the Central Government for an order of moratorium in respect of a banking company.

The Central Government may make an order of moratorium staying the commencement or continuance of all actions and proceedings against the company for a fixed period of time

During the period of moratorium, the Reserve Bank may prepare a scheme (i) for the reconstruction of the banking company, or (ii) for the amalgamation of the banking company with any other banking institution

XII) APPLICATION OF THE ACT TO CO-OPERATIVE BANKS:**Section 56: Act to apply to co-operative societies subject to modifications.**

The provisions of this Act, shall apply to, or in relation to, cooperative societies as they apply to, or in relation to banking companies.