The Banking Laws (Amendment) Act, 2012

The Banking Laws (Amendment) Bill, 2012 was approved by both the houses of Parliament in December 2012. It received presidential assent and was notified as the Banking Laws (Amendment Act) Act, 2012 in January 2013. The Banking Laws (Amendment) Act, 2012 (the "**Act**") amends the Banking Regulation Act, 1949, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980 and also makes consequential amendments to certain other enactments including the Indian Stamp Act, 1899 and the Indian Contract Act, 1972 ("**Contract Act**").

The Banking Laws (Amendment) Act, 2012 seeks to strengthen the regulatory and supervisory powers of Reserve Bank of India (RBI) more effective and it would increase the access of the banks to capital market to raise capital required for expansion of banking business.

This Act is expected to pave the way for issuing new banking licenses by giving the Reserve Bank of India ("**RBI**") greater regulatory power over the banking sector before it issues new licenses to various private players. Increased competition in the banking sector will be beneficial to banking customers giving them more choice at competitive prices. This would increase the level of financial inclusion and also provide financing for the productive sectors of the economy so that the growth momentum is sustained

The amendments introduced by the Act can be categorized under two broad heads, (a) those intended to attract private sector investment and build investor confidence in the banking sector; and (b) those intended to strengthen the RBI‟s regulatory powers over banks.

1 Reforms to attract investment

1.1 Banks may now issue preference shares

The Act allows banks to issue preference shares in accordance with guidelines issued by the RBI. The RBI is yet to frame these guidelines which are expected to, amongst others, specify the class of preference shares (whether perpetual, irredeemable or redeemable) and the terms and conditions for each class of preference shares that a bank may issue. Internationally, preference shares have been used by banks as a means to raise Tier 1 capital. Banks in India have to comply with Basel III norms from April 2013, which requires banks to meet higher capital requirements. The permission given to private sector banks to issue preference shares provides banks with an additional avenue to raise finance without ceding any voting control to the holders of those instruments.

1.2 Increase in the ceiling on voting rights

Earlier, any shareholder of a private bank was, regardless of the extent of its shareholding, entitled to exercise only 10% of the total voting rights of all shareholders of the company on a poll. The Act enables the RBI to increase, in a phased manner, the voting rights of shareholders of private sector banks from the current limit of 10% to 26%. Similarly, in case of public sector banks, the voting right that may be exercised by a shareholder has been increased from 1% to 10%. The increase in voting rights would bridge the gap between the legal and economic ownership of banks and would enable the investors to exercise more control over the working of the banks. This could make banks more attractive to investors thereby facilitating raising of additional capital by the banks.

1.3 Increase in the authorized capital of nationalized banks

In order to enable nationalized banks to attract investors, the authorized share capital of nationalized banks has been increased to INR thirty billion (3000 crores) from INR fifteen billion
(1500 crores). Nationalized banks have also been permitted to increase or decrease their authorized capital with the permission of the RBI and the Central Government, and raise capital through rights issues and the issue of bonus shares. The ability to issue bonus shares is likely to be appreciated by investors since, earlier, even nationalized banks with significant amounts of free reserves could not issue any bonus shares in the absence of an enabling legislation.

1.4 Brokerage, Commission or Remuneration

The brokerage, commission or remuneration that a banking company can pay in respect of any shares issued by it has been increased from 2.5% of the paid up value of the shares to 2.5% of the price at which shares are issued. It has been clarified that the "price of shares" includes the amount of premium on the shares. Under the Companies Act, 1956, a company is allowed to pay commission extending to 5% of the price at which the shares are issued in respect of shares issued by it.

2 Regulatory powers of RBI

2.1 Acquisition of substantial shareholdings

The Act provides that approval of the RBI must be procured for any direct or indirect acquisition of shares or voting rights in an Indian bank which is in excess of 5% of the paid-up capital of the bank. The RBI may grant its approval if it is satisfied that the acquirer is a fit and proper person after considering criteria such as public interest, banking policy and the banking and financial system in India, as well as the interests of the bank in question.

2.2 Power to seek information in respect of Associate Enterprises

The RBI can direct a banking company to provide information relating to the business or affairs of any Associate Enterprise of such banking company. The RBI can also inspect the books of any Associate Enterprise of the banking company along with the authority regulating such Associate Enterprise. This right to require information further empowers the RBI to oversee the affairs of a banking company and entities who are affiliates of such banking entity. This power becomes more important in the context of the Draft Guidelines for Licensing of New Banks in the Private Sector issued by the RBI which provides that new banks must be set up by promoter groups through a wholly-owned non-operating holding company ("NOHC") and the RBI should be able to obtain required information from the promoter group to supervise the NOHC and the bank on a consolidated basis.

2.3 Right of the RBI to supersede the board of directors of a banking company

A significant power conferred on the RBI by the Act is the right to supersede the board of directors of a banking company if the RBI believes, in consultation with the Central Government, that it is necessary to do so in the public interest, or for preventing the affairs of any banking company from being conducted in a manner detrimental to the interest of the depositors or any banking company, or for securing the proper management of any banking company. This is in addition to the power granted to the RBI under the Banking Regulation Act, 1949 to remove the chairman, a director or other officers or employees of a banking company. The period of such supersession of the board of directors may not exceed 12 months.
During this period, the chairman, the managing director and the directors of the banking company will vacate their office and their power, functions or duties will be exercised by the administrator appointed by the RBI.