

Chapter 5:

Banking Regulation

Act, 1949

History

Banking in India originated in the last decades of the 18th century. The first banks were The General Bank of India, which started in 1786, and Bank of Hindustan, which started in 1790; both are now defunct. The oldest bank in existence in India is the State Bank of India, which originated in the Bank of Calcutta in June 1806, which almost immediately became the Bank of Bengal. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras, all three of which were established under charters from the British East India Company. For many years the Presidency banks acted as quasi-central banks, as did their successors. The three banks merged in 1921 to form the Imperial Bank of India, which, upon India's independence, became the State Bank of India in 1955.

During the First World War (1914–1918) through the end of the Second World War (1939–1945), and two years thereafter until the independence of India were challenging for Indian banking. The years of the First World War were turbulent, and it took its toll with banks simply collapsing despite the Indian economy gaining indirect boost due to war-related economic activities. At least 94 banks in India failed between 1913 and 1918 as indicated in the following table:

Years	Number of banks that failed	Authorised capital (Rs. Lakhs)	Paid-up Capital (Rs. Lakhs)
1913	12	274	35
1914	42	710	109
1915	11	56	5
1916	13	231	4
1917	9	76	25
1918	7	209	1

Nationalisation:

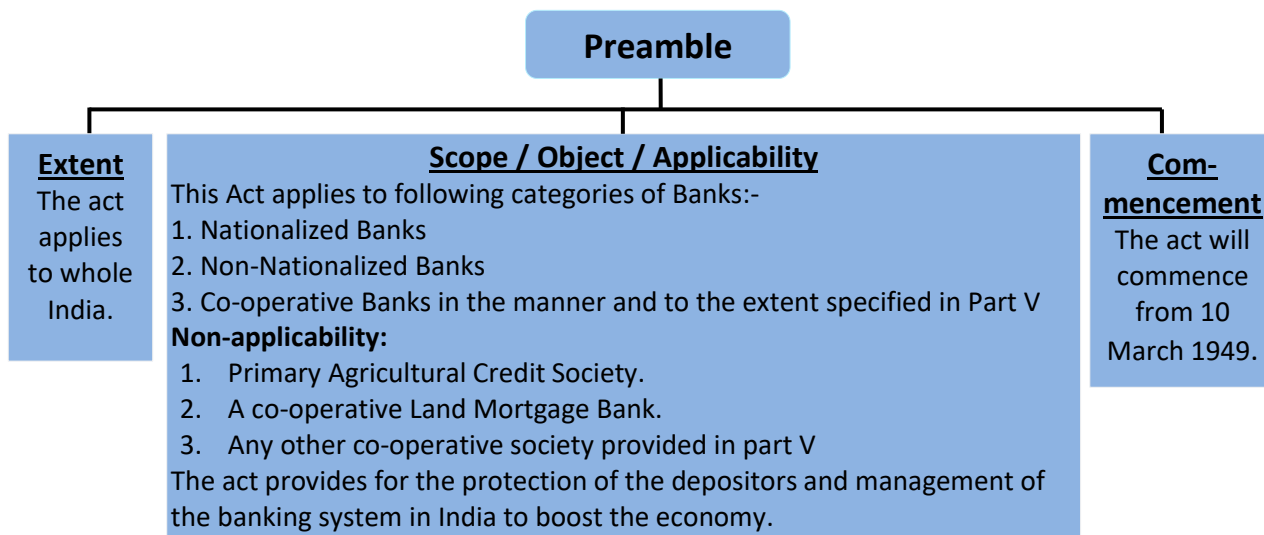
The Government of India issued an ordinance and nationalised the 14 largest commercial banks with effect from the midnight of July 19, 1969. Jayaprakash Narayan, a national leader of India, described the step as a "*masterstroke of political sagacity.*" Within two weeks of the issue of the ordinance, the Parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, and it received the presidential approval on 9 August 1969.

A second dose of nationalization of 6 more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With the second dose of nationalization, the Government of India controlled around 91% of the

banking business of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalised banks from 20 to 19. After this, until the 1990s, the nationalised banks grew at a pace of around 4%, closer to the average growth rate of the Indian economy.

On the other hand, well before nationalization, State Bank of India Act, 1955 was enacted to convert Imperial bank of India to SBI and in 1959 "State Bank of India(Subsidiary) Act was passed and eight Indian banks were made subsidiaries to State Bank of India. As a result in the Indian Banking System, the number of public sector banks figured to 29(20 nationalized & 9 banks comprising SBI & 8 subsidiaries). However, at present number of public sector banks is 27 after merging of nationalized bank "New Bank of India" with "Punjab National Bank" in 1993 and amalgamation of two subsidiaries of SBI viz. State Bank of Bikaner and State Bank of Jaipur into one as "State Bank of Bikaner & Jaipur". Besides these, in Indian banking system there are indigenous old private banks, new generation private banks and foreign banks. Moreover, Regional Rural Banks, Co-operative banks, Land Development Banks are in existence besides a few industrial or Development Banks.

Preamble



Chapters

Serial No	Part	Topic	Sections covered
1.	I	Preliminary	1 to 5A
2.	II	Business of Banking Companies	6 to 36A
3.	IIA	Control over Management	36AA to 36AC
4.	IIB	Prohibition of certain activities in relation to Banking Companies	36 AD
5.	IIC	Acquisition of the undertakings of Banking Companies in certain cases	36AE to 36 AJ
6.	III	Suspension of business and winding up of Banking Companies	36B to 45
7.	IIIA	Special provision for speedy disposal of Winding up proceedings	45A to 45X

8.	III B	Provision Relating to certain operation of Banking Companies	45Y to 45 ZF
9.	IV	Miscellaneous	46 to 55A
10.	V	Application of the Act to Cooperative Banks	56

There are many sections in this act as stated above. But as per ICAI Only Overview of this act is applicable for the purpose of CA Final level. The notified content is as follows.

Sec 2: Definition

Banking [Sec 5(b)]	<p>"Banking" Means</p> <ul style="list-style-type: none"> • Accepting of Deposits; • From public; • For the purpose of lending or investment; • Which is repayable on demand or otherwise; • And allowed to withdraw by cheque, draft or any other means.
Banking Company [Sec 5(c)]	<p>"Banking company" means any company which transacts the business of banking in India.</p> <p>Explanation.—</p> <ul style="list-style-type: none"> • 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 within the meaning of this clause.
Company [Sec 5(d)]	<p>"Company" means any company as defined in Sec. 3 of the Companies Act, 1956, and includes a foreign company within the meaning of Sec. 591 of that Act.</p>
Demand Liabilities [Sec 5(f)]	<p>"Demand liabilities" means liabilities which must be met on demand, and "time liabilities" means liabilities which are not demand liabilities.</p>
Managing Director [MD] [Sec 5(h)]	<p>"Managing Director", in relation to a banking company,</p> <ul style="list-style-type: none"> • means a director who, by virtue of an agreement with the banking company or; • of a resolution passed by the banking company in general meeting or by its Board of Directors or; • by virtue of its memorandum or articles of association; • is entrusted with the management of the whole, or substantially the whole of the affairs of the company, and; • includes a director occupying the position of a managing director, by whatever name called. <p>Provided that the managing director shall exercise his powers subject to the superintendence, control and direction of the Board of Directors.</p>
Secured Loans or Advance [Sec 5(n)]	<p>"Secured loan or advance" means a</p> <ul style="list-style-type: none"> • loan or advance made on the security of assets • the market value of such asset is not at any time less than the amount of such loan or advance.

	<ul style="list-style-type: none"> and "unsecured loan or advance" means a loan or advance not so secured.
Small Scale Industrial Concern [Sec 5(na)]	<p>"small scale industrial concern" means</p> <ul style="list-style-type: none"> an industrial concern in which the investment in plant and machinery is not in excess of Rs 7 ½ lakhs or such higher amount, not exceeding Rs 20 lakhs, as the Central Government may, by notification in the Official Gazette, specify in this behalf, having regard to the trends in industrial development and other relevant factors.
Substantial Interest [Sec 5(ne)]	<p>"substantial interest",—</p> <p>a. in relation to a company means</p> <ul style="list-style-type: none"> the holding of a beneficial interest; by an individual or his spouse or minor child, whether singly or taken together, in the shares thereof, the amount paid-up capital of the company, which exceeds Rs. 5 lakhs or 10% of paid-up capital whichever is less. <p>b. in relation to a firm,</p> <ul style="list-style-type: none"> means the beneficial interest held therein by an individual or his spouse or minor child, whether singly or taken together, which represents more than 10% of the total capital subscribed by all the partners of the said firm.

Sec 6: Business of Banking Companies

It provides a list of activities which a Banking Company may engage in addition to the business of banking:-

The Main Functions:-

- Agent for any government or local authority or persons but not as a managing agent or secretary and treasurer of a company;
- May effect, insure/ guarantee/underwrite, participate in managing or carrying out of any issue of loans or any other securities made by state, local body, company, corporation, association and may also lend for the purpose;
- May carry on or transact every kind of guarantee or indemnity business
- May manage, sell and realize any property which may come its possession in satisfaction of its claims;
- May acquire , hold and deal with any property or any right, title or interest therein which forms the security for any loans or advances sanctioned;
- May undertake and execute trusts;
- May undertake the administration of estates as executor, trustee or otherwise;
- May establish and support or aid in the establishment of associations, institutions, funds , trusts and conveniences for the benefit of its present or past employees and their dependents and may grant or guarantee moneys for charitable purposes;
- May acquire, construct, maintain and alter any building or works necessary for its purposes;

- j. May sell, improve, manage, develop, exchange, lease, mortgage dispose off or otherwise deal with any of its properties and rights;
 - k. May take over and undertake the whole or any part of the business of any person or company when such business is of a nature described above;
 - l. May do all such other things as are incidental or conducive to the promotion or advancement of its business;
 - m. May engage in any other form of business which the Central Govt. specifies to be lawful
- The above list of activities is exhaustive but not comprehensive. Of the several kinds of services listed above both under main business as well as ancillary business, some are “agency services” and some are general utility services.

Agency Services

Carrying on and transacting guarantee or indemnity business on behalf of its clients, collection of bills, pro-notes, hundies, cheques, securities etc, issuing on commission and underwriting of stocks, shares, funds etc, purchasing and selling of shares, G.P.Notes, bonds, debenture, etc. on behalf of constituents, negotiating of loans and advances, remittance of money by drafts, mail transfer, telegraphic transfer, electronic fund transfer (EFT) etc, granting and issuing letter of credit / letter of guarantee, buying and selling of foreign exchanges including foreign bank notes under Forex business, acting as an agent for any Govt. Local authority etc. contracting for private and public notes, undertaking or executing trusts, undertaking the administration of estates as executor, trustees, or otherwise. The above mentioned agency services can be grouped as under:-

1. Non-fund Business (issuing Letter of Credit/ Letter of Guarantee)
2. Collection of instruments and securities on behalf of customers
3. Portfolio Management or Merchant Banking (Acting as Issue manager, lead manager, underwriting of any issue etc)
4. Facility of remittance of funds
5. Money Exchange business as Authorized Dealer under Foreign Exchange Business
6. Other Agency Business on behalf of Govt. / Local Body etc.
7. Factoring Services (Indigenous Receivable Administration on behalf of clients)
8. Forfeiting Services (Export Receivable Administration on behalf of clients)
9. Special Purpose Vehicle (SPV) services for securitization of assets under Securitization & Reconstruction of Financial Assets and Enforcement of Security Interest Act
10. Collection of taxes on behalf of the people
11. collection of different dues/ cess/ duty of the people say, telephone/ electricity, municipal taxes etc.

General Utility Services

1. Providing Safe-custody facility to its customers for keeping their valuables
2. Providing the facility of Safe Deposit Vault (Locker) under lease agreement to its customers for keeping their valuables
3. Technology based general utility services like Tele-banking, phone-banking, on-line banking, Home Banking, Single window banking, Demat Services for securities trading, ATM services, Credit Card services etc
4. Consultancy Services
5. ECS services for payment of different dues of the people
6. Payment of pension
7. Payment of salaries of employees of schools etc.
8. Payment of salaries etc.
9. Many others

Note:- Some of the activities mentioned both under agency services & general utility services are of new generation activities particularly after reforms measures in financial sector and growing adoption of technology based banking.

Sec 7: Prohibited use of word relating to "Bank"

1. **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.
2. **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".
3. **Nothing in this section shall apply to—**
 - a. **subsidiary to a banking company** formed for one or more of the purposes mentioned in sub-section (1) of Sec. 19, whose name indicates that it is subsidiary of that banking company;
 - b. **any association of banks formed for protection of Companies Act, 1956.**

Sec 8: Disposal of Non-banking Asset

Hold the non- banking asset for 7 years only:

1. Overriding the provision of Sec 6.
2. A banking company can hold the immovable property for its own use for life time without any limitation.
3. But a banking company shall not hold the immovable property other than for own use more than 7 years.
4. The extension can be granted as per section.
5. The specified property shall be disposed of within the specified period.

Extension:

1. RBI may in any particular case.
2. As per the interest of depositors or banking company.
3. Extend the aforesaid period by 5 years.

Past Exam Questions (PE) / Practice Manual Questions (PM)

J09: (a) The promoters of a company to be registered under the Companies Act, 1956 having its main object of carrying on the business as manufacturers and stockists of Iron and Steel proposes that the name of the company is to be "ABC Steel Bank Limited". You are required to state with reference to the provisions of the Banking Regulation Act, 1949 whether the said company with the proposed name can be registered.

(b) Union Bank of India, a National Bank acquired on 1st January, 2002 a building, fully occupied by various tenants, from Mr. Rahul, the owner of the building , in discharge of a term loan advanced to Mr. Rahul, who had mortgaged the said building as security with the said Bank and failed to repay the loan. The said bank wants to keep the building permanently with it and earn the rent from tenants. You are required to state with reference to the provisions of the Banking Regulation Act, 1949 whether the said bank can do so.

Ans : 2(a)

Provision : [Relevant section 7 of Banking Regulation Act, 1949 is as follows]

1. 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.

2. 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".
3. Nothing in this section shall apply to—
 - a. subsidiary to a banking company formed for one or more of the purposes mentioned in sub section (1) of Sec. 19, whose name indicates that it is subsidiary of that banking company;
 - b. any association of banks formed for protection of Companies Act, 1956.

Explanation & Answer :

In the given case, the promoters of the company to be registered under the Companies Act, 1956 having its main object of carrying on the business as manufacturers and stockists of Iron and Steel cannot keep the name of the company as "ABC Steel Bank Limited" in view of the above stated provisions.

Ans : 2(b)

Provision : [Relevant section 8 of Banking Regulation Act, 1949 is as follows]

Hold the non- banking asset for 7 years only:

1. Overriding the provision of Sec 6.
2. A banking company can hold the immovable property for its own use for life time without any limitation.
3. But a banking company shall not hold the immovable property other than for own use more than 7 years.
4. The extension can be granted as per section.
5. The specified property shall be disposed of within the specified period.

Extension:

1. RBI may in any particular case.
2. As per the interest of depositors or banking company.
3. Extend the aforesaid period by 5 years.

Explanation & Answer :

In the given case, Union Bank of India, cannot keep the building permanently with it and earn the rent from tenants, in view of the above restrictions of the Banking Regulation Act, 1949.

Sec 17: Reserve Fund**Questions**

N12: Explain the provision relation to Reserve Fund under the Banking Regulation Act, 1949.

Provision

Creation: Every Banking Company shall create Reserve Fund.

Transfer of Profit: Not less than 20% of the profits as disclose in P & L before any dividend is declared, shall be transferred to reserve fund.

Exemption

- a. Based on the recommendation of the RBI the CG may grant exemption.
- b. The exemption shall be granted if-
 - CG is satisfied about giving exemption regard to asset and liabilities of the company, and

- Aggregate of reserve fund and share premium account is not less than Paid-up capital of the banking company.

Appropriation

If banking company appropriates any sum from reserve or share premium, then the banking company shall report to RBI the cause and circumstances for appropriation within 21 days from date of appropriation.

Past Exam Questions (PE) / Practice Manual Questions (PM)

Banking company transferred 15% of its net profit to its Reserve Fund – Whether valid?

N10: The Board of Directors of VDV Ltd., a banking company incorporated in India, for the accounting year ended 31-3-2010 transferred 15% of its net profit to its Reserve Fund. Certain shareholders of the company objects to the above Act of the Board of Directors on the ground that it is violative of the provisions of the Banking Regulation Act, 1949. Examine the provision of Banking Act and decide :

- Whether contention of the Shareholders is tenable.
- Would your answer be still the same in case the Board of Directors transfer 30% of the company's net profits to Reserve Fund.

Ans :

Provision : [Relevant section 17 of Banking Regulation Act, 1949 is as follows]

Creation: Every Banking Company shall create Reserve Fund.

Transfer of Profit: Not less than 20% of the profits as disclose in P & L before any dividend is declared, shall be transferred to reserve fund.

Exemption :

- Based on the recommendation of the RBI the CG may grant exemption.
- The exemption shall be granted if-
 - CG is satisfied about giving exemption regard to asset and liabilities of the company, and
 - Aggregate of reserve fund and share premium account is not less than Paid-up capital of the banking company.

Appropriation :

If banking company appropriates any sum from reserve or share premium, then the banking company shall report to RBI the cause and circumstances for appropriation within 21 days from date of appropriation.

Explanation & Answer :

Therefore, applying the above provisions:

- Contention of share holders shall be tenable since the percentage of transfer of profits to Reserve Fund is lower than statutory limits, as provided in the Act.
- In the second case the contention of shareholders shall not be tenable, since 30% is more than the minimum statutory limit of 20% of the net profits.

Sec 18: Cash Reserve

- Every banking company,
- not being a scheduled bank,
- shall maintain in India by way of cash reserve with itself or by way of balance in a current account with the Reserve Bank or by way of net balance in current accounts
- a sum equivalent, to at least 3% of the total of its demand and time liabilities in India
- as on the last Friday of the second preceding fortnight and

- submit to the Reserve Bank before the 20th day of every month a return showing the amount so held on alternate Fridays during a month with particulars of its demand and time liabilities in India on such Fridays or if any such Friday is a public holiday under the Negotiable Instruments Act, 1881, at the close of business on the preceding working day.

Explanation

1. "liabilities in India" shall not include—
 - a. the paid-up capital or the reserves or any credit balance in the profit and loss account of the banking company;
 - b. any advance taken from the Reserve Bank or from the Development Bank or from the Exim Bank or from the Reconstruction Bank or from the National Housing Bank or from the National Bank or from the Small Industries Bank] by the banking company;
 - c. in the case of a Regional Rural Bank, also any loan taken by such bank from its sponsor Bank.
2. "fortnight" shall mean the period from Saturday to the second following Friday, both days inclusive.

Sec 29: Maintenance of Books of accounts

Every banking company shall prepare Balance sheet and P & L as on the last working day of the year as per the requirement of Sch. III. The specified signatories to the financial statement shall be as follows.

Banking Company.	Transactions Covered	Signatories
Incorporated in India	All business transacted by it.	a. Manager or Principal officer, b. Where there are more than 3 director than at least by 3 director, if less than 3 director then by all the directors.
Incorporated outside India	All business transacted through its branches in India.	Manager or Agent of the principal officer of the company in India.

Sec 31-32: Filing of documents by Banking Company

Questions

N12: The Board of Directors of a newly incorporated Banking Company is required to file the accounts and Balance sheet. Advise the Board of Directors about the law relating to preparation, signing and filing of accounts and Balance sheet under the provisions of the Banking Regulation Act, 1949.

Provisions

1. Documents:	Balance Sheet, P & L A/c, Auditors Report and any other information as required by RBI regarding accounts.
2. To be filed with:	RBI (u/s 31), ROC (u/s 32)
3. Copies:	3 copies
4. Time Extension	RBI may extend the period of three months for furnishing the returns, and further period not exceeding 3 months.

Sec 21: To Control the Advance Made by Banking Company

Banking Policy

Where the RBI is satisfied

- in the public interest or in the interests of depositors or banking policy so to do,
- it may determine the policy in relation to advances
- to be followed by banking companies generally
- such specified banking company shall be bound to follow the policy as so determined.

Directions by RBI

RBI may give directions to banking companies, either generally or to any banking company or group of banking companies in particular:

- the *purposes for making advance*,
- the *margins to be maintained* in respect of secured advances,
- the *maximum amount of advances or other financial accommodation to be made to any one company, firm, association of persons or individual*, having regard to the paid-up capital, reserves any deposits of a banking company and relevant considerations, may be made by that banking company,.
- the *maximum amount of guarantees may be given* by a banking company *on behalf of any one company, firm, association of persons or individual*, having regard to the considerations referred to in [C.], and
- the *rate of interest and other terms* and conditions *on which advances or other financial accommodation may be made or guarantees may be given*.

The directions so issued are binding on every banking company specified.

A transaction between a banking company and its debtor shall not be reopened by any Court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive [Sec 21A].

Past Exam Questions (PE) / Practice Manual Questions (PM)

RBI's ways to regulate loans and advances

In what way does the Reserve Bank of India regulate the determination of loans and advances which can be made by a Banking Company under the Banking Regulation Act, 1949? Explain.

Ans :

Provision : [Relevant section 21 of Banking Regulation Act, 1949 is as follows]

Banking Policy

Where the RBI is satisfied

- in the public interest or in the interests of depositors or banking policy so to do,
- it may determine the policy in relation to advances
- to be followed by banking companies generally
- such specified banking company shall be bound to follow the policy as so determined.

Directions by RBI

RBI may give directions to banking companies, either generally or to any banking company or group of banking companies in particular:

- the purposes for making advance,
- the margins to be maintained in respect of secured advances,
- the maximum amount of advances or other financial accommodation to be made to any one company, firm, association of persons or individual, having regard to the paid up capital, reserves any deposits of a banking company and relevant considerations, may be made by that

banking company,.

- the maximum amount of guarantees may be given by a banking company on behalf of any one company, firm, association of persons or individual, having regard to the considerations referred to in [C.], and
- the rate of interest and other terms and conditions on which advances or other financial accommodation may be made or guarantees may be given.

The directions so issued are binding on every banking company specified.

A transaction between a banking company and its debtor shall not be reopened by any Court on the ground that the rate of interest charged by the banking company in respect of such transaction is excessive [Sec 21A].

Sec 30: Special Audit

RBI is of opinion that

1. it is necessary in the public interest or in the interests of the banking company or its depositors
2. it may at any time by order direct that a special audit
3. for any such transaction or class of transactions or
4. for such period or periods as may be specified in the order.

Auditor's Qualification and Power & Duties

1. The special audit shall be conducted by-
 - a. either appoint a person duly qualified under any law for the time being in force
 - b. Auditor of the banking company himself.
2. The auditor shall comply with direction given by RBI.
3. The Auditor shall report the matter to RBI.
4. If the Banking Company is incorporated in India the auditor shall include following points in the report:
 - a. information and explanation required by him have been found to be satisfactory or not;
 - b. transactions of the company are within the powers of the company or not;
 - c. returns received from branch offices of the company are adequate for the purposes of his audit or not;
 - d. whether the profit and loss account shows a true balance or for the period covered;
 - e. Any other matter which he considers should be brought to the notice of the shareholders of the company.
5. Special auditor has the same power & duties as that of company auditor u/s 227 of The Companies Act 1956.

The expenses regarding special audit shall be borne by banking company.

Sec 35: Inspection of Banks

Questions

N11: Various complaints have been made against the activities of a Co-operative Banking Company to the effect that if unchecked, the shareholders, depositors and others will suffer heavily and the complainants requested for the appointment of directors by Reserve Bank of India. Discuss whether the Reserve bank has any powers to inspect the records of the Co-

operative Bank to ascertain the truth or otherwise in the complaints and to appoint directors in the Co-operative Bank under the Banking Regulation Act, 1949.

N12: Due to financial irregularities, the affairs of MNP Bank Limited have gone from bad to worse and this fact has come to the notice of the Reserve Bank of India as well as Central Government. Examining the provisions of the Banking Regulation Act, 1949, answer the following:

(a) Powers of RBI to inspect the Bank.

(b) Powers of Central Government to give directions in this matter.

Inspection

The banking company shall be liable to inspection:

1. As directed by CG to RBI, or
2. By RBI itself

The RBI shall provide the copy of inspection report to Banking Company.

Scrutiny

1. RBI at any time, can scrutinise one or more of its officers, or the affairs of any banking company and its books and accounts; and
2. a copy of the report of the scrutiny shall be furnished to the banking company if
 - the banking company makes a request for the same or
 - any adverse action is contemplated against the banking company on the basis of the scrutiny.

Duties of the banking company

It shall be the duty of every director or other officer or employee of the banking company

1. to produce to any officer making an inspection under sub-section (1) or a scrutiny under sub-section (1-A)
2. all such books, accounts and other documents in his custody or power and
3. to furnish him with any statements and information relating to the affairs of the banking company
4. as the said officer may require of him within such time as the said officer may specify.

Power of Inspecting Officer

An inspecting officer can examine any director or officer or the employee of the Banking Company in relation to business on oath.

Reporting to CG

If RBI has been directed by the Central Government to inspect, 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 after giving such opportunity to the banking company to make a representation in connection with the report as, in the opinion of the Central Government, seems reasonable by order in writing—

- a. prohibit the banking company from receiving fresh deposits;
- b. direct the Reserve Bank to apply under Sec. 38 for the winding up of the banking company:

Provided that the Central Government may defer, for such period as it may think fit, the passing of an order under this sub-section, or cancel or modify any such order, upon such terms and conditions as it may think fit to impose.

Sec 35A: Issue General Directions to Banking Company

Where the Reserve Bank is satisfied that 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 —

- a. In the public interest; or
- b. In the interest of banking policy; or
- c. 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
- d. to secure the proper management of any banking company generally;

Modification of the Direction: The RBI may:

- a. on representation made to it or on its own motion,
- b. modify or cancel any directions issued and
- c. Impose such conditions as it thinks fit, subject to which the modification or cancellation shall have effect.

Sec 36: General Powers and Functions of RBI

1. The RBI may:

- a. Caution or **prohibit banking company** or generally **from entering into any particular transaction** or class of transactions.
- b. On a request by the companies concerned, **assist as intermediary** or otherwise in proposals **for the amalgamation** of such banking companies;
- c. Give assistance to any banking company means of the **grant of a loan or advance** under required law.
- d. At any time, if it is satisfied that in the public interest or in the interest of banking policy or for **preventing the affairs of the banking company being conducted in a manner detrimental to the interests** of the banking company or its depositors it is necessary so to do by order in writing and on such terms and conditions as may be specified therein—
 - i. **require the banking company to call a meeting** of its directors for the purpose of **considering any detrimental 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.
 - ii. **depute one or more of its officers to watch the proceedings** at any meeting of the Board of Directors of the banking company or of any committee or of any other body constituted by it;
 - iii. require the banking company to give an opportunity to the officers so deputed to be heard at such meetings and also require such officers to send a report of such proceedings to Reserve Bank
 - iv. require the Board of Directors of the banking company or any committee or any other body constituted **give written notice to the officers of the RBI appointed for the meetings.**
 - v. **appoint one or more of its officers to observe the manner in which the affairs** of the banking company or of its officers or branches are being conducted and make a report thereon;

- vi. require the banking company to make, within such time as may be specified in the order, such changes in the management as the Reserve Bank may consider necessary.
2. The **RBI shall make an annual report to the Central Government** on the trend and progress of banking in the country.
 3. The **RBI may appoint such staff at such places** as it considers necessary for the **scrutiny of the returns, statements and information** furnished.

Sec 35B, 36AA, 36AB: Appointment or Removal of Managerial Personnel

Amendment to Terms of Appointment [Sec 35B]

In case of Banking Company, any **amendment** relating to following matters **shall have effect only if approved by RBI** –

- a. maximum permissible directors, or
- b. appointment/ re-appointment/ termination of the appointment/ remuneration.

Removal of the Managerial Personnel [Sec 36AA]

Grounds / Reasons: If RBI is satisfied –

- (a) In the public interest.
- (b) for preventing the affairs detrimental to the interest of company or depositors.
- (c) For securing the proper management.

Order/ Direct: RBI may remove any officer or employee from specified date through order.

Procedure:

1. A reasonable opportunity to person to make representation against removal.
2. the reason for removal shall be recorded in writing.

Appeal:

1. To CG within 30 days of receipt of order.
2. The decision of the CG shall be final and not questionable.

Disqualification:

The person removed shall not take part in the affairs of the company for maximum up to 5 years as may be specified in order.

Contravention: Contravention of above provision shall be punishable with the fine upto Rs. 250 per day.

Validity Any such order shall be valid for the period upto 3 year and further for 3 years if extended by RBI.

Past Exam Questions (PE) / Practice Manual Questions (PM)

Reserve Bank of India terminates director on the ground that his conduct is detrimental to the interest of the depositors

M10: Mr. Gopal is a director in a Bank. The Reserve Bank of India terminates him on the ground that his conduct is detrimental to the interest of the depositors. Decide, whether the Reserve Bank of India can do so under the Banking Regulation Act, 1949. Can the Reserve Bank of India appoint Additional Director in a Bank under the said Act.

Ans :

Provision : [Relevant section 36AA & 36AB of Banking Regulation Act, 1949 is as follows]

Grounds / Reasons: If RBI is satisfied –

- (a) In the public interest.
- (b) for preventing the affairs detrimental to the interest of company or depositors.
- (c) For securing the proper management.

Order/ Direct: RBI may remove any officer or employee from specified date through order.

Procedure:

1. A reasonable opportunity to person to make representation against removal.
2. the reason for removal shall be recorded in writing.

Appeal:

1. To CG within 30 days of receipt of order.
2. The decision of the CG shall be final and not questionable.

Disqualification:

The person removed shall not take part in the affairs of the company for maximum up to 5 years as may be specified in order.

Contravention: Contravention of above provision shall be punishable with the fine upto Rs. 250 per day.

Validity : Any such order shall be valid for the period upto 3 year and further for 3 years if extended by RBI.

Sec 36AB: Appointment of the Additional Director

The RBI is of the opinion-

1. In the public interest
2. In the interest of the banking policy
3. In the interest of the banking company or its depositors.

RBI by order in writing can appoint the additional director for the banking company.

Such additional director shall hold office maximum up to 3 years or such further periods not exceeding 3 years at a time.

N12: Mr. Jhameshwar was working as Manager in a banking company. The Reserve Bank of India removed Mr. Jhameshwar on the ground that his conduct was detrimental to the interests of the depositors. Decide, whether the Reserve Bank of India has power to remove the said Manager under the provisions of the Banking Regulation Act, 1949. What remedies are available to Mr. Jhameshwar against his removal under the provisions of the said Act?

Ans :

Provision : [Relevant section 36AA of Banking Regulation Act, 1949 is as follows]

Grounds / Reasons: If RBI is satisfied –

- (a) In the public interest.
- (b) for preventing the affairs detrimental to the interest of company or depositors.
- (c) For securing the proper management.

Order/ Direct: RBI may remove any officer or employee from specified date through order.

Procedure:

1. A reasonable opportunity to person to make representation against removal.
2. the reason for removal shall be recorded in writing.

Appeal:

1. To CG within 30 days of receipt of order.
2. The decision of the CG shall be final and not questionable.

Disqualification:

The person removed shall not take part in the affairs of the company for maximum up to 5 years as may be specified in order.

Contravention: Contravention of above provision shall be punishable with the fine upto Rs.

250 per day.

Validity : Any such order shall be valid for the period upto 3 year and further for 3 years if extended by RBI.

Explanation & Answer :

In the given case, the Reserve Bank of India has power to remove the said Manager under the provisions of the Banking Regulation Act, 1949 as mentioned above & further above stated remedies are available to Mr. Jhameshwar against his removal under the provisions of the said Act.

Sec 36AB: Appointment of the Additional Director

The RBI is of the opinion-

1. in the public interest
2. In the interest of the banking policy
3. In the interest of the banking company or its depositors.

RBI by order in writing appoints the additional director for the banking company.

Such additional director shall hold office maximum up to 3 years.

Sec 36AE-AG: Acquisition of Undertaking

Questions

M12: The Reserve Bank of India issued certain directives to a Banking Company. The company does not care to act as per the directives. This fact comes to the notice of the officials of the Government of India. The officials, therefore desire to exercise the Central Government's powers to acquire the said Banking Company. Examining the provisions of the Banking Regulation Act, 1949, state the manner, if any, such powers can be exercised. Also, state the matters that may be incorporated in the scheme of acquisition.

Grounds for Acquisition [Sec 36AE]

On basis of the following two grounds CG can order acquisition of the concerned banking company.

- A. On basis of the report made by the RBI the CG is satisfied that-
 1. The banking company concerned has failed for more than 1 occasion to comply the directions given under section 21 & 35A.
 2. And acting in the manner which is detrimental to interest of the depositors.
- B. And in the interest of following, it is necessary to acquire the banking company -
 1. Depositors,
 2. Banking policies,
 3. For better provision of credit in general or in particular area.

Procedure:

Reasonable opportunity of being heard shall be provided to the banking company.

Effects of Order:

The undertaking and all assets & liabilities of concerned bank stand transferred to and vest in the CG.

Acquisition Scheme [Sec 36AF]

After consultation with the Reserve Bank, make a scheme for carrying out the purposes of this Part in relation to any acquired bank. The said scheme may provide for all or any of the following matters.

1. Capital, constitution, name and office of the company or corporation incorporated for transfer of undertaking of the acquired bank.

2. Constitution of Management Board of the transferee bank.
3. Continue the service of all the employees of the acquired bank.
4. The manner of payment of the compensation to the shareholder of the acquired bank.
5. Incidental, ancillary and supplementary matters as may be necessary to transfer the property to CG

Compensation to Shareholders for Acquisition [Sec 36AG]**Reference to Tribunal:**

If the amount of compensation offered is not acceptable to acquired bank, such bank request the Central Government in writing, to have the matter referred to the Tribunal constituted. The application shall be made before the date notified by the Central Government in the Official Gazette.

Person to application:

If, before the date notified, the Central Government receives requests-

- From not less than $\frac{1}{4}$ of the shareholders holding not less than $\frac{1}{4}$ of the paid-up share capital of the acquired bank.
- From acquired bank if such banking company incorporated outside India.

Finalisation of Compensation:

If before the date notified, the Central Government does not receive requests, the amount of compensation offered and where a reference has been made to the Tribunal, the amount determined by it shall be the compensation payable and shall be final and binding on all parties concerned.

Past Exam Questions (PE) / Practice Manual Questions (PM)

N09: XLR Bank Limited is not managing its affairs properly. Employees as well as depositors of the bank have complained to the Central Government from time to time about such mismanagement and requested the Central Government to acquire the undertaking of the Banking Company. Explain the powers of the Central Government in this regard under the Banking Regulation Act, 1949.

Ans :

Provision : [Relevant section 36AE of Banking Regulation Act, 1949 is as follows]

On basis of the following two grounds CG can order acquisition of the concerned banking company.

A. On basis of the report made by the RBI the CG is satisfied that-

1. The banking company concerned has failed for more than 1 occasion to comply the directions given under section 21 & 35A.
2. And acting in the manner which is detrimental to interest of the depositors.

B. And in the interest of following, it is necessary to acquire the banking company -

1. Depositors,
2. Banking policies,
3. For better provision of credit in general or in particular area.

Procedure:

Reasonable opportunity of being heard shall be provided to the banking company.

Effects of Order:

The undertaking and all assets & liabilities of concerned bank stand transferred to and vest in the CG.

Some shareholders are not satisfied with the amount of compensation fixed under the

scheme of acquisition – Options Available?

M11: The Central Government acquired a Banking Company. The scheme of acquisition, apart from other matters, provided for the quantum of compensation payable to the shareholders of acquired bank. Some shareholders are not satisfied with the amount of compensation fixed under the scheme of acquisition.

Is there any remedy available to the share holders under the provisions of the Banking Regulation Act, 1949?

Ans :

Provision : [Relevant section 36AF & 36AG of Banking Regulation Act, 1949 is as follows]

Acquisition Scheme :

After consultation with the Reserve Bank, CG shall make a scheme for carrying out the purposes of this Part in relation to any acquired bank. The said scheme may provide for all or any of the following matters.

1. Capital, constitution, name and office of the company or corporation incorporated for transfer of undertaking of the acquired bank.
2. Constitution of Management Board of the transferee bank.
3. Continue the service of all the employees of the acquired bank.
4. The manner of payment of the compensation to the shareholder of the acquired bank.
5. Incidental, ancillary and supplementary matters as may be necessary to transfer the property to CG.

Compensation to Shareholders for Acquisition [Sec 36AG] :**Reference to Tribunal:**

If the amount of compensation offered is not acceptable to acquired bank, such bank shall request the Central Government in writing, to have the matter referred to the Tribunal constituted. The application shall be made before the date notified by the Central Government in the Official Gazette.

Person to application:

If, before the date notified, the Central Government receives requests-

- From not less than $\frac{1}{4}$ th of the shareholders holding not less than $\frac{1}{4}$ th of the paid-up share capital of the acquired bank.
- From acquired bank if such banking company incorporated outside India.

Finalisation of Compensation:

If before the date notified, the Central Government does not receive requests, the amount of compensation offered and where a reference has been made to the Tribunal, the amount determined by it shall be the compensation payable and shall be final and binding on all parties concerned.