

Study Note - 5

Law Related to Banking Sector

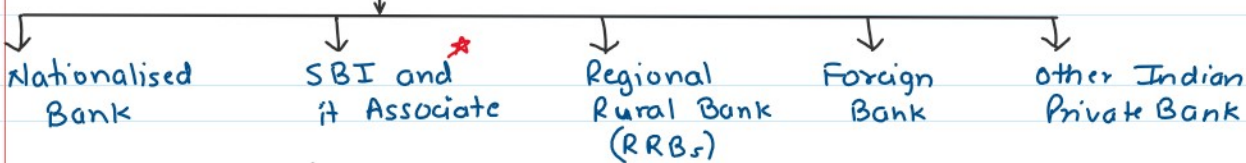
PART = A :- The Banking Regulation Act

# INTRODUCTION

- 1) The first Bank were the Bank of Hindustan which was established in 1770 and liquidated in 1829-32 and the General Bank of India established in 1786 but failed in 1791
- 2) The largest Bank and the oldest still in existence is the State Bank of India (S.B.I)
- 3) Banks in India are governed by the Banking Regulation Act, 1949 and RBI Act, 1934
- 4) Banking Company and Co-operative Societies are only the option to run a Bank in India
- 5) India has state Bank of India, Nationalised Bank, Private Sector Bank, Co-operative Bank and Regional rural Bank
- 6) The Indian Banking Sector is broadly classified into



- |   |  |
|---|--|
| 1) It refers to those Bank which are listed under the 2 <sup>nd</sup> Schedule of RBI Act, 1934 | 1) It refer to those Bank which are not listed under the 2 <sup>nd</sup> Schedule of RBI Act, 1934 |
| 2) CRR (Cash Reserve Ratio) Maintain with RBI   | 2) CRR maintain with themselves  |
| 3) It comply the Rule of RBI  | 3) It do not comply the Rule of RBI  |



## \* SBI and its Associate

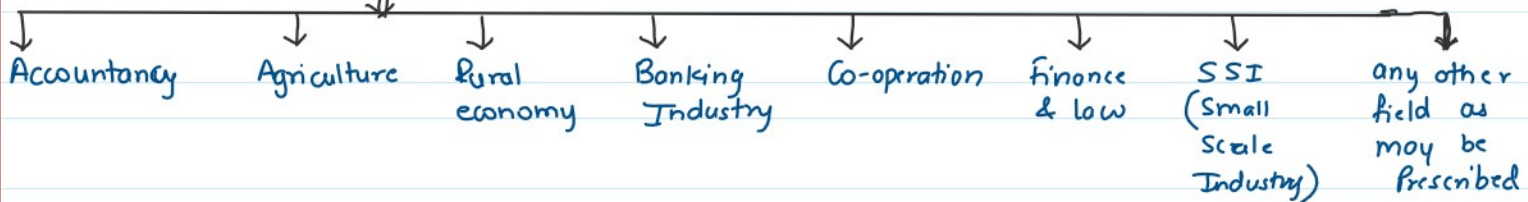
In 1960, the SBI was given control of eight state-associated Bank under the State Bank of India (Subsidiary Bank) Act, 1959. These are now called its Associate Banks.

→ The Act applies on every category of Bank so, it doesn't matter whether its a govt. sector Bank or pvt sector Bank.

## # SECTION = 10A [Board of Director of Banking Company]

1) At least 51% Board of Director should be experienced or should have knowledge in a Specified field.\*

2)\* Specified field means



3) Out of 51%, there shall be minimum **2 PERSON** with Special knowledge or Experience in

- Agriculture
- Rural economy
- Co-operation
- Small scale Industry (SSI)

4) All these persons should have no Substantial Interest or in Connection with any Commercial organisation as employee, manager and managing Agent.

5) However Such Restriction doesn't Apply on Relatives

6) Moreover, these director can have Substantial interest in or Connection with Section 8 Company [charitable concern] or Small Scale Industry.

7) Remaining 49% Board of Director do not have these Restrictions

8) The Director of a Banking Company Other than chairman and whole time Director shall hold for a period of **8 year**

9) The Tenure of chairman and wholetime Director is **5 year**.

## # Section = 10B [Banking Company to be Managed by whole time Director]

1) Every Banking Company shall have **1 of its Director**, who may be Appointed on a whole time or a part time Basis, as chairman of its Board of Director

2) And where he is appointed on a whole time Basis, as a chairman of its BOD, he shall be Entrusted with the management of the whole



- 2) And where he is appointed on a whole time Basis, as a chairman of its BOD, he shall be entrusted with the management of the whole time of the affair of the Banking Company.
- 3) He shall be responsible for absolute Management of Banking Company will answer to RBI.

# Section = 10BB [Power of RBI to appoint chairman of BOD appointed on a whole time Basis or a Managing Director of a Banking Company]

- 1) If the post of chairman or managing Director is vacant, RBI can appoint to fill this post.
- 2) RBI will do this only if such vacancy is likely to adversely affect the interest of Banking Company.
- 3) And where the person so appointed is not a Director of such Banking Company.
- 4) The chairman of BOD appointed on whole time Basis or a Managing Director is treated to be deemed Director of Banking Company.
- 5) The chairman of BOD shall hold office for a period of 5 year

# Section = 11 & 12 [Requirement Regarding minimum paid up Capital and Reserve]

Section - 11 →

Section 11 of the Banking Company Act lay down the Requirements regarding the minimum standard of paid up Capital and Reserves as a condition for the commencement of Business.

Section - 12 →

As per Section 12, the Subscribed Capital of the Company is **NOT LESS THAN** half of its Authorised Capital.

$$\text{Subscribed Capital} \geq \frac{1}{2} \times \text{Authorised Capital}$$

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Note 1 →

When Authorised Capital goes up at any time, Bank can take a sufficient time as authorised by RTI to increase subscribe and

### Note 1

When Authorised Capital goes up at any time, Bank can take a sufficient time, as authorised by RBI to increase subscribed and paid up capital.

### Note 2

The Time limit **Not Exceeding 2 year** from the Date of Increase

### # Section - 13 [Restriction on Commission, Brokerage, discount etc. on sale of share]

- 1) No Banking Company shall pay out directly or indirectly by way of Commission, Brokerage, discount or remuneration in any form in respect of any share issued by it.
- 2) Any Amount Exceeding in the aggregate 2.5% of the price which the share are issue
- 3) In simple word, Generally any discount is prohibited on sale of share but under Banking Company 2.5% Commission or Brokerage can be given on sale of share.

### # Section = 14 [Prohibition of charge on unpaid Capital]

- 1) Unpaid Capital means the Amount not yet received from the shareholder on share already allotted
- 2) No Banking Company shall create any charge upon its unpaid Capital, and any such charge if created, shall be invalid.

### # Section - 15 [Limiting the payment of Dividend]

- 1) Section 15 prohibits every Banking Company from paying any dividend on its share unless it has completely written off the Capitalized Expense specified therein.
- 2) Capitalized Expense to be written off are
  - a) preliminary Expense
  - b) Brokerage
  - c) Commission on issue of share etc.have been completely written off.
- 3) However, Banking Company may pay dividend on its share without written off the following.
  - a) The Depreciation in the value of investments in **Approved Securities** provided such Depreciation has not been actually Capitalized or accounted for loss
  - b) The Depreciation in the value of investment in share, debenture, bond etc (**Other than Approved Securities**) which adequate provision has been made for such Depreciation.



c) The Bad Debts where the Adequate provision has been made in his behalf.

## # Section - 17 [Transfer to Reserve fund] → [Most Imp]

- 1) This Reserve is Neither CRR [Cash Reserve Ratio] or SLR [Statutory Liquidity Ratio]
- 2) It is similar to General Reserve maintained by a Company
- 3) It is created out of profits. If No profit, No Reserve
- 4) At present 20% of profit must be transferred to Reserve Fund.
- 5) Such transfer may be stopped when such Reserves together with SPR (Securities premium Reserve) Account more than or equal to paid up Capital of Bank.

Reserve transfer stopped if,

Please See below Note in Box

$$\text{Transferred Reserve} + \text{Securities premium Reserve Account} \geq \text{Paid up Capital}$$

## # Maintenance of Cash Reserve by Non-Scheduled Banks [Section 18]

- 1) Non-scheduled Bank has to maintain in India on daily Basis by the way Cash Reserve with itself or in current Account opened in RBI, SBI or any notified Bank.
- 2) Non-scheduled Bank has Option to maintain partly in Cash with itself and partly in Current Account.
- 3) Cash Reserve maintained by Non-scheduled bank is Sum Equivalent to at least 3% of total time and Demand Liabilities.

Note for Transfer to Reserve →

the following:

Notification Dated 20/9/2006, RBI has notified

All schedule Commercial Bank operating in India (including Foreign Bank) should transfer NOT LESS THAN 25% of the Net profit before Appropriation to the Reserve fund.

## # Section - 19 [Restriction on Holding of share in other Companies]

- 1) Banking Company cannot acquire even a single share in Non Banking Company

- 2) Here, Share means only equity share So, Preference share Can be acquired as they do not Carry voting power
- 3) However, Banking Company Can open subsidiary in the Specified fields Such as Insurance, Mutual funds, subject to prior approval of RBI.

## # Section = 20 & 21 [Restriction on loans and Advances]

### I Section - 20 [Restriction on Loans]

1. Bank Cannot give loan to its own director
2. This loan is not allowed even on arm length price.
3. However loan to director Can be given if it is in the Nature of perquisites Such as Home loan or Car loan
4. Loan Cannot be given to anyone upon the Security of its own shares because lender Bank Cannot trust its own performance in the open market and if loan goes into default, Bank will not have any Cash Benefit.

### II Section - 21 [Restriction on Advances]

- 1) The RBI has been empowered to determine the policy to be followed by the Bank in relation to Advance. Thus RBI Give direction to Banking Company on following matters:
  - a) Purpose of Advance may or may not be granted
  - b) The margin to be maintained in case of Secured Advances
  - c) Rate of Interest to be charged on Advances, other financial accommodation and Commission on guarantee
  - d) Maximum Amount of Advance issue for a "Single party"

## # Section 22 [Licensing of Banking Companies]

- 1) According to this Section, No Banking Company Can Commence or Carry on Banking Business in India unless it hold a licence granted to it by the RBI.
- 2) Before granting any license under this Section, RBI Can give license only if following Condition are Satisfied
  - a) Company is financially sound to Repay the present or future Deposite
  - b) Affair of the Company shall be Carried out only in the Benefit of Depositors.
  - c) There shall be Compliance of all applicable laws including Non-Banking law.
  - d) overall activity shall be in public interest
- 3) RBI Can Cancel the license in following Condition:
  - (i) If the Company has stopped Business of Banking in India
  - (ii) If the Company has failed to fulfill the Condition imposed upon it.
  - (iii) Company has violated applicable law and Regulation.

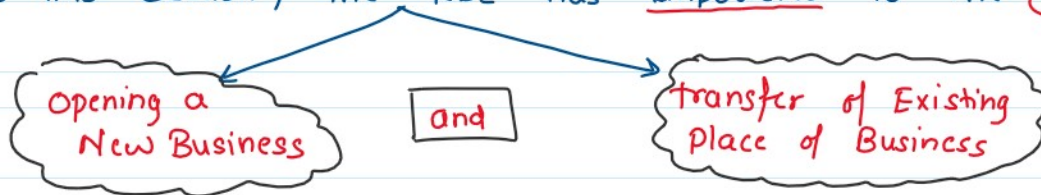


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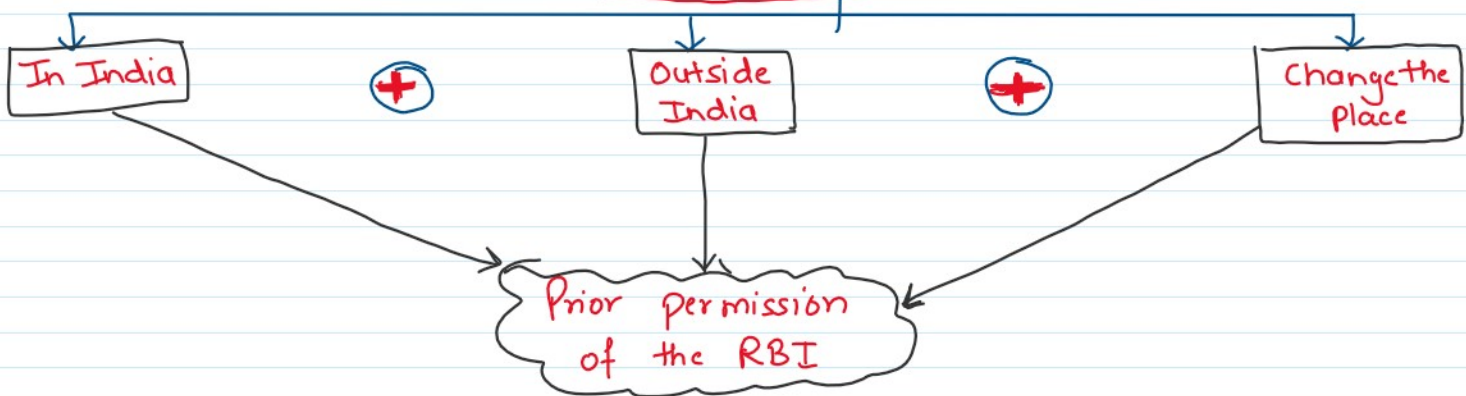
4) Thus, Banking Company whose license has been cancelled, can appeal to Central Government within **30 day** and decision of Central govt shall be final and binding.

## # Section = 23 [Control on the opening of New Business]

1) According to this Section, the RBI has empowered to the Control of



2) No Banking Company shall open a New place of Business



3) No permission is Required of RBI in following Cases.

- a) For opening a New Branch within the Same City, town or Village and
- b) For opening a Temporary place of Business for a Maximum period of **1 month** within a City,

Where the Banking Company already has a place of Business for the purpose of providing Banking facilities to the public on the occasion of an Exhibition, a Conference, a mela etc.

## # Section - 24 [Maintenance of a percentage of liquid Assets (SLR)]

1) Every Banking Company shall maintain in India in Liquid Assets for an Amount **Not less than 25%** of the total of its **Time and Demand Liabilities** at the close of Business on any day.

$$\text{Amount of Liquid Assets} \geq 25\% \text{ of Total of its Time and Demand Liabilities}$$

2) Liquid Assets include Cash, gold and unencumbered approved securities.

↓  
It refers to an asset or property that is free and clear of any liability such as creditor or claim.

### # Section-25 [Maintenance of Assets in India]

1) It requires for the maintenance of Assets equivalent to at least 75% of its Demand and Time Liabilities in India, at the close of Business of Last Friday of every quarter.

$$\text{Maintenance of Assets} \geq 75\% \text{ of Demand \& time liabilities}$$

### # Section-26 [Submission of Return of unclaimed Deposits]

- 1) Every Banking Company shall submit a Return in the prescribed form and manner to the RBI, giving particulars, regarding unoperate Account in India for 10 year.
- 2) This Return is to be submitted within 30 day after the close of each calendar year.
- 3) It is a usual affair that people deposit money in their Accounts but still many of them do not operate it for various reasons.
- 4) An Account becomes a dead Account after 36 months of non-operation.
- 5) However, Bank still anticipates arrival of Account holder.
- 6) Such unoperate accounts which have no operation for 10 year are reported to RBI.
- 7) In case of Fixed Deposit, the 10 year period is counted from the date of expiry period. In case of Regional Rural Bank, such Return shall be submitted to NARBAD.

### # Section-27 [Submission of Return, form etc]

1) Every Banking Company shall submit regular return to RBI showing its Asset and Liabilities in India as on the Last Friday of every month.



- 2) If Such Friday is a declared holiday, it shall be Submitted before Friday if suddenly Holiday on Such Friday, it shall be Submitted Next working day.
- 3) RBI Can also issue instruction to Banking Companies to furnish any other information as and when Required.
- 4) RBI Can also Demand any information at any time in any format.

### # Section - 28 [Power to Publish Information]

- 1) Information Submitted by Banking Company is actually Submitted in Public Interest.
- 2) RBI Can publish it in public Interest, It directly related with future depositors
- 3) RBI Can publish Such information in Consolidated form as the RBI may think fit.

### # Section - 29 [Maintenance of Account & Balance sheet]

- 1) This Section provides for the preparation of Balance sheet and Profit & loss Account as on the last working day of the year
- 2) Financial statement shall be prepared as per **III Schedule** of Banking Regulation Act 1949
- 3) Such **III Schedule** Can be altered by Central govt. any No. of time Subject to 3 month advance Notice.

### # Section - 30 [Audit of Balance sheet and P&L Account]

- 1) As per this Section, the Balance sheet and P&L A/c prepare in accordance with Section 29 **SHALL** be audited by a person duly qualified under Any Law.
- 2) Auditor of the Bank will have to write following five additional points in Audit report:-
  - a) Whether information and Explanation Received by him was Satisfactory or NOT
  - b) Whether transaction undertaken by officers were within power or NOT
  - c) Whether Return Received from Branches were adequate or not
  - d) Whether P&L A/c was true and fair or not
  - e) Any other matter which he Considers necessary for the knowledge of Shareholder

## # Section-31 [Submission of Return to RBI]

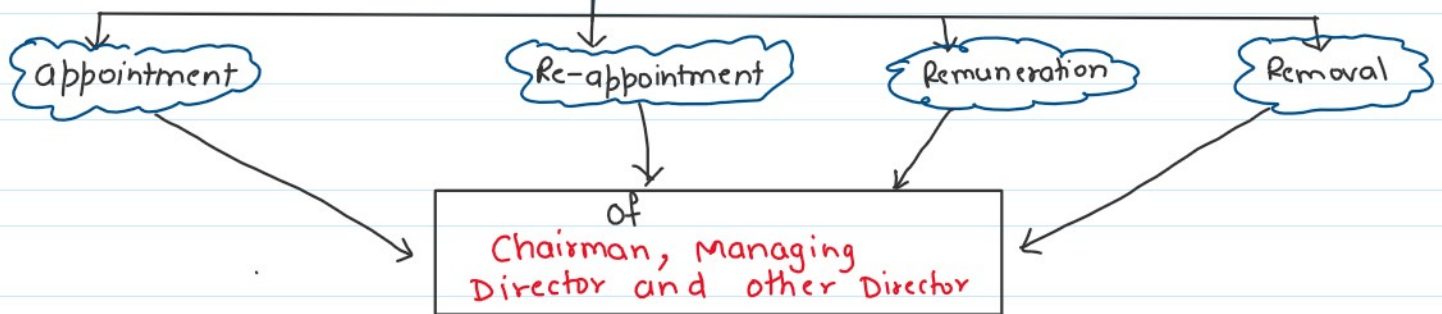
- 1) Bank must publish Summarised form of P&L A/c and Balance sheet and audit Report in prescribed manner
- 2) Financial statement together with Audit Report shall also be submitted of 3 Copies of Return to RBI as well as ROC within 3month from the end of financial year.
- 3) RBI Can provide Maximum extension of 6 month.

## # Section-35 [Inspection]

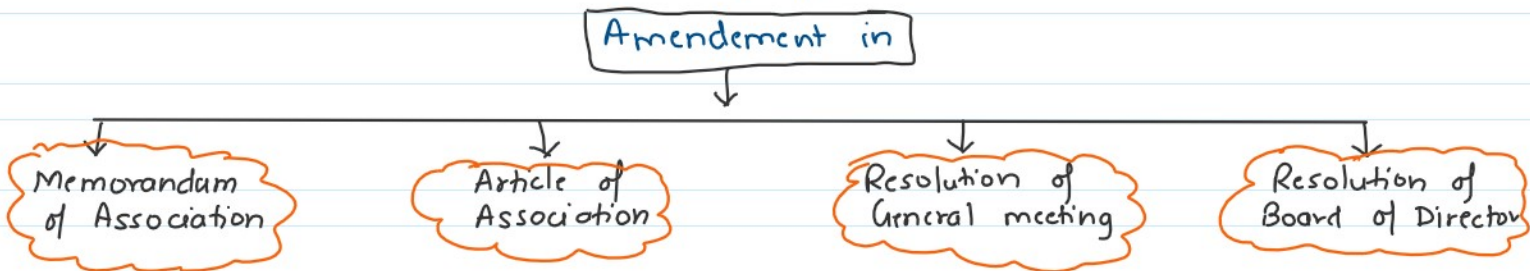
- 1) RBI Can perform inspection of any Banking Company at any point of time
- 2) To safeguard the interest of shareholders and depositors of Banking Companies

## # Section-35B [Prior approval from RBI for appointment of Managing Director etc]

- 1) RBI approval is Compulsory for



- 2) Such Approval is also Necessary for



## # Section-36AA & 36AB [Removal of managerial and any other person from office]

under this Section, the RBI has power to remove managerial and other persons from office and to appoint additional director.



## # Section-37 [Suspension of Business]

- 1) When a Banking Company is temporarily unable to meet its obligation it may apply to High Court Requesting an order for staying the Commencement or Continuance of all legal action
- 2) And proceedings against it for a period of not Exceeding 6 month
- 3) Such Stay order is generally Called a **MORATORIUM**
- 4) For Such Requisition, the Banking Company should Submit an application along with a Report of the RBI.
- 5) In that Report the RBI indicates that the Banking Company is able to pay its debt if the application is granted.
- 6) If Such Report is not obtained from the RBI, the Banking Company Cannot get the grant of Moratorium.

## # Section 38 to 44 [Winding up of Banking Companies]

- 1) Section 38 to 44 of the Act lay down the provisions for winding up of a Banking Company. The RBI may apply for the winding up of a Banking Company if.
  - a) It fails to Comply with the Requirement as to minimum paid-up Capital and Reserve as laid Down in SECTION 11
  - b) Expiry of License
  - c) Failure to follow RBI guidelines
  - d) The RBI think that according to Returns furnished by the Company it is unable to pay its debt or its Continuance is prejudicial to the interest of the Depositors.
  - e) Prohibited by Central Govt.

### Note →

The Banking Company Cannot be Voluntarily wound up unless the RBI Certifies that it is able to pay its debts in full

## # Section 44A [Amalgamation of Banking Companies]

- 1) It Can be Voluntary Amalgamation or Compulsory amalgamation
- 2) In Both Cases, it needs approval of Shareholder by  $\frac{2}{3}$ rd majority

- 3) unwilling shareholder can take their money back if they do not agree
- 4) After the approval of shareholder, RBI approval is also taken
- 5) After approval of RBI, RBI issues order for dissolution of the first bank on a specified date.

#### # Miscellaneous point

- 1) The rate of Cash Reserve Ratio (CRR) at present is 4%.
- 2) SLR present rate is 19.5%. as per study material it is 21%.
- 3) Bank Rate is 6.5%.
- 4) Minimum paid-up share capital is ₹ 5 billion = 500 Crore
- 5) Minimum Net worth is 5 Billion
- 6) At present FDI is 74%.