

LEGAL FRAMEWORK OF REGULATION OF BANKS

INTRODUCTION

Banking in India is mainly governed by the Banking Regulation Act, 1949 and Reserve Bank of India Act, 1934. The RBI and the Government of India exercise control over the banks from the opening of banks to their winding up by virtue of the powers conferred under these statutes.

BUSINESS OF BANKING

"Definition of Banking:

Banking is defined in **Section 5(b)** of the Banking Regulation Act as

The acceptance of deposits of money from the public for the purpose of lending or investment. Such deposits may be repayable on demand or otherwise and withdrawable by cheque, draft otherwise.

Thus, a bank must perform two essential functions:

- (a) acceptance of deposits from public and
- (b) lending or investment of such deposits.

Deposits Withdrawable by Cheque:

- Under **Section 49A** of the Banking Regulation Act, no organisation other than a bank is authorised to accept deposits withdrawable by cheque.
- The Savings Bank Scheme run by the government, a Primary credit society and any other person or firm notified by the government are exempted from this prohibition.

Acceptance of Deposits by Non-banking Entities:

There are also non-banking companies, firms and other unincorporated associations of persons and individuals who accept deposits from the public.

LICENCE FOR BANKING:

- In India, it is necessary to have a licence from the RBI under **section 22** of the Banking Regulation Act for commencing or carrying on the business of banking.
- Every banking company must use the word "bank" as part of its name and no company other than a banking company can use the words "bank", "banker", "banking" as part of its name Further, no firm, individual or group of individuals is permitted to use the words "bank", "banking" or "banking company" as a part of the name or for the purpose of business.

Permitted Business:

- a) Borrowing, raising, or taking up of money.
- b) Lending or advancing of money either against security or without security.
- c) accepting, discounting, buying, selling, collecting, and dealing in bills of exchange, promissory notes, drafts, bills of lading, , debentures, etc
- d) Granting and issuing of letters of credit, travellers' cheques, and currency notes.
- e) Buying and selling of foreign exchange including foreign bank notes.
- f) Acting as an agent of the government, local authority or any other person and carrying on agency business.

- g) Manage, sell, and realise any property which may come into its possession in satisfaction of any of its claims.

vi. Prohibited Business:

_____ section of the Banking Regulation prohibits a banking company from engaging directly or indirectly in trading activities and undertaking trading risk.

As regards immovable properties, **Section 9 prohibits** a banking company from holding such property, howsoever acquired, except as is required for its own use, for a period exceeding seven years from the acquisition of the property. The Reserve Bank may extend this period by another five years, if it is satisfied that such extension would be in the interest of the depositors of the banking period. company. The banking company shall be required to dispose of such property within the permitted period.

CONSTITUTION OF BANKS

Banks in India fall under one of the following categories:

- (a) Body corporate constituted under a special statute.
- (b) Company registered under the Companies Act, 1956 (Companies Act 2013) or a foreign company:
- (c) Co-operative society registered under a central or state enactment on co-operative societies.

Public Sector Banks:

The public sector banks including nationalised banks, State Bank of India, and its associates (subsidiaries) and the Regional Rural Banks fall in the first category.

Banking Companies:

- All the private sector banks are banking companies.
- These banks are governed by the Companies Act, 1956 or Companies Act 2013 in respect of their constitution and by the Banking Regulation Act and the RBI Act about their business of banking.

Co-operative Banks:

- A co-operative bank is a co-operative society registered or deemed to have been registered under any Central Act for the time being in force relating to the multi-state cooperative societies,
- or any other central or state law relating to co-operative societies for the time being in force.
- If a co-operative bank is operating in more than one state, the Central Act applies. In other cases, the state laws apply.

BANKING REGULATION ACT 1949

Bank regulation is a form of government **regulation** which subjects '**banks** to certain requirements, restrictions, and guidelines, designed to create market transparency between **banking** institutions and the individuals and corporations with whom they conduct business, among other things

SEC 10: MANAGEMENT: The period of office of an MD, whole time chairman cannot exceed 5 years at a time.

SEC 11: PAID UP CAPITAL AND RESERVE: DOMESTIC BANKS Minimum Paid up Capital and Reserves Rs 5 lac.

FOREIGN BANKS Minimum Rs 15 Lac and Rs 20 Lac where bank has place of business in Bombay, or Calcutta of both).



SEC 12: CAPITAL STRUCTURE: The ratio of authorized, subscribed, and paid-up capital must be minimum 4:2:1.

SEC 13 COMMISSION/ BROKERAGE/ DISCOUNT: Bank not to pay commission, brokerage, discount, etc. more than 2.5% of the paid-up value of one share.

SEC 15 Restriction as to payment of dividend:

No banking co. shall pay dividend on its shares until all its capitalized expenses, organization expenses, share selling commission, brokerage, amount of losses incurred have been completely written off.

SEC 16 Prohibition of common director:

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

SEC 17(1): RESERVE FUND: Stipulates that a bank must create reserve fund equivalent to not less than 20% of profits out of the balance of profit of each year, before any dividend is declared (RBI has enhanced it to 25% of net profit w.e.f. 31 March 2001).

SEC 18 : Cash Reserve Ratio

Every banking co. not being a schedule bank shall maintain in India daily by way of cash reserve with itself or by way of balance in current account with RBI

SEC 20: RESTRICTION ON ADVANCES AGAINST OWN SHARES:

- No Banking Co
- Grant loans / advances on the security of its own shares.

SEC 21: Control Over Advances by RBI:

Power to reserve bank to issue directive to banks to determine policy for advances such as purpose, margin, extent, rate of interest or other conditions.



SEC 22: LICENSING: Obtain license from RBI to open a bank is essential.

SEC 23: RESTRICTION ON OPENING OF NEW AND TRANSFER OF EXISTING PLACE OF BUSINESS: Prior permission of RBI is required for opening of new branch.

SEC 24: MAINTENANCE OF SLR:

- A Banking company is required to maintain at the close of business on any day a certain percentage of its total Net demand and time liabilities in India
- In form of cash, gold, and approved securities
- Each alternate Friday during the month (fortnight basis).
- Min. Floor limit abolished, and Maximum maintained (40%).
- Report sends by banks to RBI in **Form VIII**

SEC 26: RETURN OF UNCLAIMED DEPOSITS:

Every Bank shall within 30 days after the close of each calendar year submit a return to RBI on all deposit a/cs which have not been operated upon for 10 years.

The RBI has launched the Depositor Education and Awareness Fund (the Fund) Scheme 2014 (DEAF), under which the amount to the credit of any a/c in India with any bank which has not been operated upon for a period of ten years or any deposit or any amount remaining unclaimed for more than ten years, shall be credited to the Fund, within a period of three months from the expiry of the period of ten years.

SEC 29: ACCOUNTS & BALANCE SHEET: Balance sheet and P&L a/c must be prepared as on last working day of March every year in format given in Schedule iii of the Act.

SEC 30: Audit of accounts

Balance sheet and profit and loss account shall be audited by a person duly qualified under any law for the time being in force to be an auditor of companies.

Sec 31: Submission Of Balance sheet And Auditors Report: A/cs and B/s together with the auditor's report shall be published in the prescribed manner and 3 of the same shall be furnished to RBI within 3 months from the end of the period to which the B/S pertains.

Sec 35: Inspection Of Banks: Empowers RBI to undertake inspection of banks.

Sec 35 (A): Power To Give Directions: RBI has been given powers to give directions to the banks in the public interest or in the interest of banking policy.

SEC 36 (AA): POWERS TO REMOVE MANAGERIAL OR OTHER PERSONS:

Where the RBI is satisfied that in the public interest, RBI may remove from office any Chairman, Director or other officers or employees of the banking company,

SEC 45 Z: RETURNS OF PAID INSTRUMENTS:

Guidelines for returning the paid instruments to **customer** by keeping a true copy.

SEC 45 ZA: NOMINATION: For nomination in Deposit accounts.

Form DA-1(request), DA-2(cancellation), DA-3(variation) for bank deposits

SEC 45 ZC: NOMINATION: For nomination in Safe Custody accounts.

Form SA-1, SA-2, SA-3

SEC 45 ZE: NOMINATION: For nomination in Locker accounts.

Form SL-1,SL-2,SL-3

SEC 46: PENALTIES:

Whoever in any return, B/s or other documents wilfully makes a statement which is false, or wilfully omits to make a material



statement, shall be punishable with imprisonment up to 3 years and shall also be liable to fine.

RBI ACT -1934

SEC-2 (e) SCHEDULED BANK:

- As per this section, a Scheduled bank means a bank whose name is included in the 2nd schedule of RBI Act 1934.
- The essential condition of capital is that such banks have **paid-up capital and reserves of not less than Rs. 5 Lacs.**
- Bank which are not included in the 2nd Schedule of RBI are called Non-scheduled Bank.

SEC 17: VARIOUS TYPES OF BUSINESS WHICH RBI CAN TRANSACT:

Defines various types of business which RBI may transact, which include acceptance of deposit without interest from Central / State govt. purchase sale of forex, securities, rediscounting the bills, P/N, grant loans etc.

SEC 18: RBI provides emergency loans to banks on liberal terms.

SEC 20: BANKER TO GOVT: It performs various functions for the Govt. It transacts Govt. business and manages public debt of the central Govt.

SEC. 21 - RIGHT TO TRANSACT GOVT. BUSINESS: RBI to transact Govt. business in India is. Remittance, exchange, keeping deposit free of interest etc.

SEC. 22. BANK NOTES: Sole right to issue bank notes

SEC. 23 ISSUE DEPARTMENT Bank notes shall be issued by Issue Dept. against security of gold coins, bullion, rupee coins, foreign securities & other approved securities up to Rs. 200 cr.

SEC. 24 DENOMINATION OF NOTES: RBI issues all currency notes for denomination of 2, 5, 10, 20, 50, 100, 200, 500, 1000, 2000, 5000, 10000 (Denomination of 2 & 5 have already been discontinued)

SEC 26: Bank notes issued by RBI shall be legal tender and shall be guaranteed by Central Govt.

SEC 28 - RULES FOR REFUNDING VALUE: RBI can frame rules for refunding value of mutilated, soiled, or imperfect notes as a matter of grace.

SEC 33 ASSETS OF THE ISSUE DEPARTMENT: The assets of issue dept. Consists of gold coins, gold bullion, foreign securities etc. The aggregate value of gold coins, gold bullion, and foreign securities held as assets and the aggregate value of the gold coins, and gold bullion shall not at any time be less than Rs 200 cr. and Rs 115 cr. Respectively

SEC 42(1) - CASH RESERVE RATIO (CRR): Consequent to GOI's notification of Sec. of RBI (Amendment) Act 2006 minimum statutory floor and ceiling limit no longer exists.

SEC. 45-H-T: Regulations relating NBFC

Q1. Banking in India is governed by the Banking Regulation Act 1949 and Reserve Bank of India Act 1935. (true/ false)

ANS: False

Q2. The act regulates entry into banking business licensing as provided in section _____ of the banking Regulation act 1949.

ANS: Section 22



Q3. Section 6 of Banking Regulation Act deals with forms of business permissible apart from banking business include trading activities. (true/ false)

ANS: False

Q4. Section 49A of Banking Regulation Act deals with _____?

ANS: Deposits withdrawable by cheque

Q5. The ratio of authorized, subscribed, and paid-up capital must be minimum _____.

ANS: 4:2:1, SECTION 12

Q6. Under banking Regulation Act Reserve Bank was constituted. (true/ false)

ANS: False

Q7. The Central govt. has launched the Depositor Education and Awareness Fund (the Fund) Scheme in 2014. (true/ false)

ANS: RBI

Q8. RRBs have been created as a company under Companies Act. (true/false)

ANS: False, as a body corporate under a special statute

Q9. Return prescribed by RBI for SLR under section 24 of RBI Act? (true/false)

ANS: false



Q10. Nonbanking assets are required to be disposed of within 10 years. (true/false)

ANS: False 7 years, section 9

Q11. Section 45(ZA) of BR Act covers _____ ?

ANS: Nomination facility has been granted for bank deposit

Q12. What is the minimum value of stock of gold coins and gold bullion, which RBI must maintain at any point of time?

ANS: 115 CRORE, SEC 33 ASSETS OF THE ISSUE DEPARTMENT

Q13. Central government is the primary regulator of a bank. (true/false)

ANS: False

Q14. Which section of the RBI Act allows the RBI to form rules regarding the exchange of damaged and imperfect notes?

ANS: Section 28

Q15. Which section of RBI Act states that the RBI has the exclusive rights to issue currency notes in India?

ANS: Section 22



**LEARNING
SESSIONS**

Mail: banishagupta2099@gmail.com

Website: <https://iibf.info>

