

# SUMMARY SHEET



## *Banking Regulation Act*





# EduTap Hall of Fame



**RBI Grade B 2020 - 21**

**198 Selections Out of 257**



Mr. Ajil



Mr. Aman Choudhary



Mr. Arun Sharma



Ms. Ila Sahu



Mr. Nishant Yadav



Ms. Ojaswi Dale



Mr. Parimal S Athale



Ms. Resmarani Sahoo



Mr. Ryan Varghese



Mr. Shubham



Mr. Somya Atr



Ms. Srishti Dabas



Ms. Twinkle Dahiya



Mr. Valbhav Nayer

**SEBI Grade A 2020**

**63 Selections Out of 80**



Mr. Gaurav



Mr. Abhishek



Mr. Abhishek



Mr. Adesh



Mr. Adil



Miss. Gopika



Mr. Harsh



Miss. Akansha



Mr. Amit Meena



Mr. Dhruv



Mr. Digant



Mr. Durga Parsad



Mr. Hitesh



Mr. Johnson

**NABARD Grade A 2020**

**65 Selections Out of 69**



Mr. Gourav Kumar



Mr. Sayed Saif



Mr. Vinay Jadhav



Mr. Ratan Singh



Mr. Vishal Singla



Mr. Mohan Das



Miss. Garima



Mr. Amandeep



Miss. Arpita



Mr. Krishan Kumar



Mr. Shivam



Mr. Karan Sharma



Miss. Shivani Bhosle



Mr. Prasad

## Banking Regulation Act

The content in the chapter majorly covers the important provisions of Banking regulation Act and other important provision related to Banking sectors that are important for our exam.

### 1 What is 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.

#### 1.1 Deposits withdrawable by cheque:

- Under **Section 49A of the Banking Regulation Act**, no organization other than a bank is authorized to accept deposits withdrawable by cheque.
- The savings bank scheme run by the government (like Post Office), a Primary credit society and any other person or firm notified by the government are **exempted from this prohibition**.

#### 1.2 Acceptance of deposits by Non-Banking Entities:

- Acceptance of deposits by non-banking financial companies is regulated by the Reserve Bank under the **Non-Banking financial companies' acceptance of Public deposits (Reserve Bank) directions, 1998** and other directions issued by it under the RBI act.

### 2 License for Banking

- In India, it is necessary to have a license from the Reserve Bank **under Section 22 of the Banking Regulation Act for commencing or carrying on the business of banking**.
- Every banking company has to **use the word "bank"** as part of its name (**Section 7 of the Act**) and no company other than a banking company can use the words **"bank", "banker", "banking"** as part of its name.
- Subsidiaries of banks and association of banks in certain cases, as also Primary Credit Societies are **exempted from this restriction**.

#### 2.1 Discretion of Reserve Bank:

- The granting of the license by the Reserve Bank may be subject to such conditions as **the RBI may think fit in each case**. (Even if the conditions are fulfilled, RBI can refuse the license)
- The refusal of license to a company will make it **ineligible to undertake banking business**, but it would still be open to the company to carry on other business-like money lending.

#### 2.2 Conditions to be satisfied:

Before granting a license under Section 22, **Reserve Bank may have to be satisfied** in respect of the following matters:



- a. **Position to pay its present and future depositors.**
- b. **Affairs of the company**
- c. **General character of proposed management.**
- d. **Adequate capital structure and earning prospects.**
- e. The fulfillment of any other condition which the Reserve bank considers relevant in public interest or in the interest of depositors.
- f. Although Section 11 of BR Act specifies the minimum capital and reserve requirements of a banking company, the **Reserve Bank can stipulate a higher requirement of capital for licensing a banking company as under Section 22.**

### 2.3 Foreign Banks

Apart from the conditions specified in the case of domestic companies, **three additional conditions** have been stipulated for consideration by the Reserve Bank, These are:

- a) Whether carrying on of banking business by the company in India will be in **public interest**.
- b) Whether the government **or the law of the country, in which the company is incorporated** discriminate in any way against banking companies registered in India.
- c) Whether the company complies with **provisions of the BR Act**, as applicable to foreign companies.

### 2.4 Cancellation of License:

- a) **Sub-Section (4) of Section 22 of the Banking Regulation Act** authorizes the Reserve Bank to cancel the license granted to any banking company. The cancellation of license may be on any one or more of the **following grounds**:
  - The company **ceases to carry** on banking business in India.
  - The company at any time **fails to comply with any of the conditions imposed** under section 22 of Banking Regulation Act.
- b) Before cancellation of a license for non-compliance, the company has to be **given an opportunity for taking necessary steps for complying with or fulfilling the conditions**.
- c) However, **in cases where the Reserve Bank is of the opinion that delay will be prejudicial** to the interest of depositors or the public, the requirement of opportunity can be dispensed with.

### 2.5 Branch Licensing:

This system was regulated by the Reserve bank of India under the **Section 23 of the banking regulation act, 1949**. In branch licensing, banks had referred to the guidelines of the Reserve bank of India from time to time, including change of premises, shifting from branches to other locations, etc:

- Apart from the requirement of license for commencing or carrying on banking business, banks have to obtain the **prior permission of Reserve Bank for opening a new place of business or changing location of the existing place of business.**
- Under **Section 23 of the Banking Regulation Act, Place of business for this purpose includes** any sub-office, pay office, sub-pay office or any place at which deposits are received, cheques cashed, or moneys lent.
- However, changing the location of an existing place of business **within the same city, town or village would not need such permission.**
- These restrictions also apply to **foreign branches of banking companies** incorporated in India.
- Opening of a **temporary place of business up to one month**, for purpose of affording banking facilities for any exhibition, mela, conference or like occasion, is exempt.
- However, the **temporary branch has to be within the limits** of the city, town or village where there is an existing branch or in the environs thereof.
- The present guidelines from RBI provide that **Banks should submit their request for new branches, administrative offices, ATMs once in a year**, for consideration of RBI as against the earlier practice of making individual applications for each and every branch.
- When approved, the **permission would be valid for a period of one year** before which the branches/offices should be operationalized.
- In the case of **Regional Rural Banks**, the applications for permission have to be routed **through NABARD**, and the national bank has to offer its comments on merits to the reserve bank.

### 3 Permitted Business

In addition to the business of banking, a banking company may engage in any one or more of the following forms of business.

**Section 6:** Describes **forms of business** in which banking companies may engage.

- The **borrowing**, raising, or taking up of money.
- The **lending or advancing** of money either upon or without security.
- The drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments and securities whether transferable or negotiable or not.
- The **granting and issuing of letters of credit (also called credit letter), traveler's cheques and currency notes.**
- Buying, selling and dealing in **bullion**.



**Bullion** is gold, silver, or other precious metals in the form of bars, ingots, or specialized coins that is said to maintain its worth better than conventional currencies and is therefore kept as a form of emergency currency by both governments and private citizens alike.

- The buying and selling of **foreign exchange** including foreign bank notes.
- The **acquiring, holding, issuing on commission**, underwriting, and dealing in stock, funds, shares, debentures, debenture stock, bonds, obligations, securities and investments of all kinds.
- The purchasing and selling of bonds, scrips, or other forms of securities on behalf of constituents or others.
- The providing of **safe deposit vaults** (locker services).
- Acting as **agents for any Government** or local authority or any other person and carrying on of agency business.
- 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**
- **Managing, selling, and realizing any property** which may come into the possession of the company in satisfaction or part satisfaction of any of its claims.
- **Establishing and supporting or aiding in the establishment and support of associations**, institutions, funds, trusts and conveniences calculated to benefit employees or ex-employees of the company.
- Granting **pensions and allowances** and making payments towards insurance.
- **Acquiring and undertaking the whole or any part of the business of any person or company**, when such business is of a nature enumerated or described in this sub-section.
- Any other form of business which the **Central Government may, by notification in the Official Gazette**, specify as a form of business in which it is lawful for a banking company to engage.

#### 4 Prohibited Business

- **Section 8: Prohibition of Trading:** a banking company cannot **directly or indirectly deal in buying or selling or bartering of goods**, but it may buy, sell or barter the transactions relating to bills of exchange received for collection or negotiation.
- **Section 9: Non-Banking Assets:** A banking company **cannot hold any immovable property for any period exceeding 7 years** (except such as is required for its own use) from the date of acquisition and extend it on RBI's consultation not exceeding 5 years.

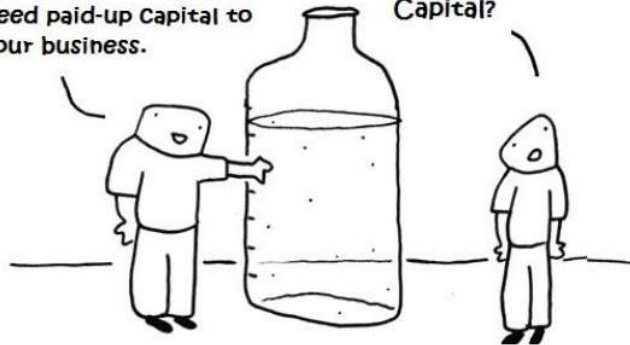
## 5 Paid Up Capital & Reserves

- **Section 11** of the Banking Regulation act provides for certain minimum requirements as to paid-up capital and reserves of banking companies.
- In case of **any dispute regarding computation of paid-up capital** and reserves of any banking company, the decision of the reserve bank shall be final.

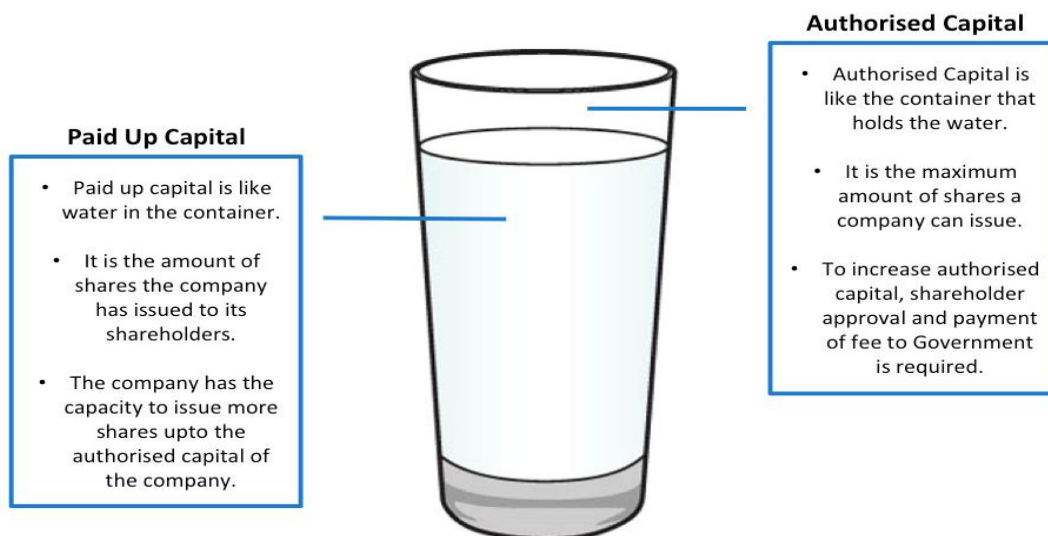
**Authorised Capital** is the water tank & **Paid-up Capital** is the water.

You need water to live like you need paid-up Capital to run your business.

What is Authorised Capital & Paid-Up Capital?



### PAID-UP CAPITAL, SUBSCRIBED CAPITAL and AUTHORISED CAPITAL:



For good companies, their Issued capital often equals subscribed capital and paid-up capital

Authorised Capital			
Issued Capital			Un-issued Capital
Subscribed Capital		Un-Subscribed	
Paid-up	Un-Paid		

- **Section 12(1) of the Banking Regulation Act** stipulates that the subscribed capital of a banking company shall not be less than half of its authorized capital; and the paid-up capital shall not be less than half of its subscribed capital.
- **If capital is increased**, this requirement has to be complied within a period not exceeding two years as allowed by the Reserve Bank.
- In terms of Section 12(1) (ii) of the **Banking Regulation Act, Banking Companies are permitted to issue** equity shares or equity shares and preference shares (whether perpetual or irredeemable or redeemable).
- However, the **issuance of preference shares** should be in accordance with the guidelines framed by the Reserve Bank.

## 6 Shareholding in Banking Companies:

### 6.1 Voting Rights of Shareholders:

- There is no **specified ceiling on a person's holding** of shares in a banking company under the Banking Regulation Act or any other law. However, **Section 12(2)** of the Act puts certain **restrictions on voting rights** of shareholders.
- Accordingly, **no shareholder can exercise voting rights in respect of the shares held by him/her in excess** of ten per cent. (Which may be increased up to twenty percent by Reserve Bank) of the total voting rights of all the shareholders of the banking company.
- Restriction on the transfer of shares or registration of such transfers has now been placed under Section 12 B of the Banking Regulation Act, where **prior approval of Reserve Bank would be required if the acquisition together with voting rights exceed five percent** or more of the paid-up share capital of the banking company.
- The provisions of the **Companies Act** also govern transfer of shares of banking companies.

Shareholder  
Voting Rights

❑ A voting right is the right of a shareholder of a corporation to vote on matters of corporate policy, including decisions on the makeup of the board of directors, issuing new securities, initiating corporate actions like mergers or acquisitions, approving dividends, and making substantial changes in the corporation's operations.

❑ Unlike the single vote right that individuals commonly possess in democratic governments, the number of votes a shareholder has corresponds to the number of shares he or she owns.

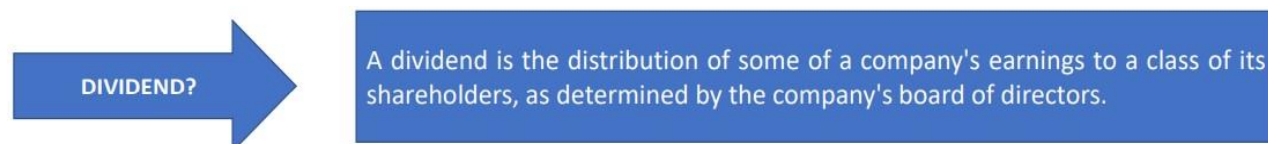
## 7 COMMISSION, BROKERAGE, DISCOUNT:

- **Section 13** of Banking regulation act imposes a ceiling on the commission, brokerage, discount or remuneration on the sale of shares of banking companies.
- Accordingly, the payment on this account in any form **should not exceed 2.5%** of the price at which the said shares are issued.

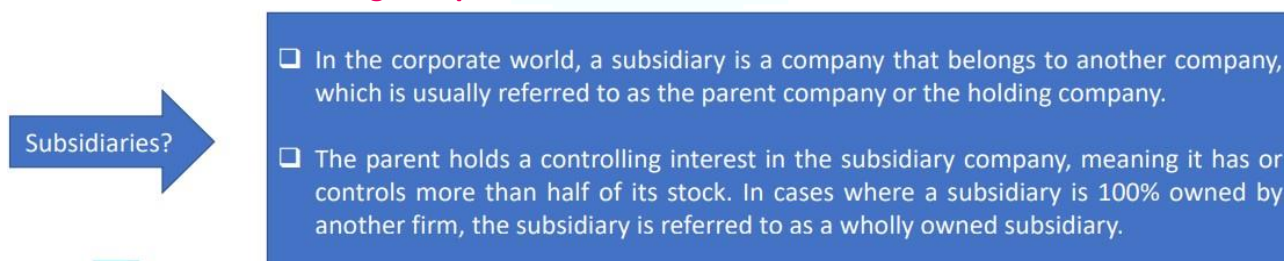


### 7.1 Dividend:

- Under section 15 of the Banking regulation act, **no dividend is payable** until all capitalized expenses are completely written off. Such expenses include preliminary expenses, organization expenses, share selling commission, brokerage, loss incurred, and any other item of expenditure not represented by tangible assets.
- However, **dividends are payable without writing off depreciation, bad debts** etc.
- The quantum of dividend that can be declared is based on the levels of Net NPAs and can be paid **out of only current year's profit**.



## 8 Subsidiaries of Banking Companies



### 8.1 Formation of Subsidiaries:

- There are certain restrictions under **Section 19 of the Banking Regulation Act** on the formation of subsidiaries by banking companies.

Accordingly, subsidiaries are permissible only for the following purposes:

- Undertaking any **business which is permissible for banking companies** under Section 6(1).
- Carrying on the **business of banking exclusively outside India**. Prior permission of the Reserve Bank is a must for this banking business.
- Undertaking any other business which **Reserve Bank with prior approval of the Central Government permits**.

### 8.2 Shareholding in Other Companies:

- Apart from the restriction on subsidiaries, **there is also a ceiling [Section 19(2)] on shareholding** in companies other than subsidiaries.
- Thus, the holding of shares by a banking company in any company as pledgee, mortgagee or absolute owner shall **not be exceeding thirty per cent of the paid-up share capital of that company** or the paid-up share capital and reserves of the banking company.

- Further, holding of shares in any company in which the managing **director or manager of a banking company is interested in or concerned with in any manner**, is prohibited except in the case of subsidiaries.

## 9 Board of Directors:

The board of directors is **responsible to the bank's depositors, other creditors, and shareholders for safeguarding their interests through the lawful, informed, efficient, and able administration.**

### 9.1 Qualification of Directors:

- **Section 10A of the Banking Regulation Act** stipulates certain qualifications for directors of banking companies.
- Accordingly, **at least fifty-one per cent of the total number of directors shall be** persons, who have special knowledge or practical experience, with respect of accountancy, agriculture and rural economy, banking, cooperation, economics, finance, law, small scale industry or any other matter, the special knowledge or practical experience which is useful to the banking company, in the opinion of the Reserve Bank.
- Further, **at least two of the directors should have** special knowledge or practical experience in agriculture and rural economy or cooperation or small-scale industry.

### 9.2 Substantial Interest:

**Substantial interest for this purpose is defined in Section 2 of the Banking regulation act.** Accordingly, holding of beneficial interest by any individual or his spouse or minor child, whether singly or taken together in the shares of a company exceeding 5 lac rupees or 10% of the paid-up capital of the company amounts to substantial interest.

- **The directors of a banking company shall not have** a substantial interest in or be connected with as employee, manager or managing agent in a company or firm which carries on trade, commerce or industry as per Section 10A (2)(b) of the BR Act.
- However, **companies registered under section 8 of the companies act 2013 and small-scale concerns** are not included for the purpose.

Section 8

- ☐ A company is referred to as **Section 8 Company** when it registered as a Non-Profit Organization (NPO) i.e. when it has motive of promoting arts, commerce, education, charity, protection of environment, sports, science, research, social welfare, religion and intends to use its profits (if any) or other income for promoting these objectives.
- ☐ The income of NPO can not be used for paying out dividends to the company's members and has to be for the promotion of charitable objectives.

### 9.3 Period of Office

- The **directors of a banking company** shall not hold office for more than eight years continuously. However, this provision is not **applicable to the chairman** or a whole-time director.
- When the chairman or a whole-time director of a bank is removed from office, he/she ceases to be a director of the bank and **shall not be eligible for further appointment** as director of that banking company for a period of four years.

### 9.4 Reconstitution of Board

- When **the board of a banking company is not constituted in accordance** with the requirements of Section 10A of the BR Act, the board has to be reconstituted, to comply with the provisions.
- If **the Reserve Bank is of the opinion** that the board of any banking company does not fulfill the requirements, it may order such a bank to reconstitute the board after giving reasonable opportunity of being heard.
- If, within two months' time, the bank **does not fulfill the order of the Reserve Bank**, the Bank may then remove any director and such a person shall cease to hold office.
- The **Reserve Bank may also appoint a new director** in the place of the person removed and he/she shall continue in office until the date up to which his predecessor would have held office.
- However, **any proceedings of a banking company will not be invalid** only because of any defect in the composition of the board.

## 10 Whole-time Chairman/Managing Director:

- **Section 10B of the Banking Regulation Act** provides that every banking company should have a full-time or part-time chairman, appointed from among its directors.
- The **chairman on a part-time basis has to be appointed with the prior approval of the Reserve Bank**
- The whole-time chairman and a managing director **shall hold office for a period not exceeding five years** as the board may fix and is also **eligible for re-election or re-appointment**.

### 10.1 Qualification Of Whole-time Chairman/Managing Director:

- Should have **special knowledge or practical experience** of the working of a banking company or the State Bank or a subsidiary bank or a financial institution or financial, economic or business administration.
- The whole-time chairman or the managing director will be **disqualified under the following circumstances**:

- (a) if he/she is director of a company other than a subsidiary of the banking company or a charitable company (registered under Section 8 of the Companies Act 2013);
  - (b) if he/she is a partner of any firm which carries on trade, business or industry.
  - (c) if he/she has substantial interest in any other company or firm or is director, manager, managing agent, partner or proprietor of any trading, commercial or industrial concern; or
  - (d) if he/she is engaged in any other business or vocation.
- The Reserve Bank may also permit the whole-time chairman or the managing director to undertake part-time **honorary work** not likely to interfere with the duties of the chairman or the managing director.

### 10.2 Removal Of Whole-time Chairman/Managing Director:

- If the **Reserve Bank is of the opinion** that the person elected to be the chairman or the managing director is not a fit and proper person to hold such office, the Reserve Bank may require the banking company to remove such a chairman or the managing director and appoint a suitable person.
- The banking company or the person affected by the Reserve Bank's order **may appeal to the Central Government within thirty days.**

### 10.3 Temporary Vacancies:

- In cases where the whole-time chairman or the managing director dies or he/ she resigns or is not capable of discharging his/her functions due to illness, temporary arrangements can be made to carry out the duties of the chairman or the managing director for a period not exceeding four months. However, this has to be done with the approval of the Reserve Bank.

### 10.4 Power of Reserve Bank to Appoint Chairman:

- In certain cases, the **office of the whole-time chairman or the managing director of a banking company may fall vacant** and may not be filled up by the bank immediately.
- If the Reserve Bank is of the opinion that **continuation of such vacancy is likely to be against the interests of the banking company**, it may appoint an eligible person to fill such vacancy under Section 10BB of the Banking Regulation Act.
- Such appointment may be for a **period not exceeding three years**. There is also a provision for reappointment after the initial period.
- The chairman or the **managing director so appointed may be removed from office only by the Reserve Bank** and shall draw pay and allowances from the banking company, as determined by the Reserve Bank.



### 10.5 Qualification Shares:

The shares in a company which a person must hold in order to qualify for directorship:

- The **whole-time chairman or the managing director of a banking company is exempted** under section 10C of the banking regulation act from the requirement of holding qualification shares.
- Similar exemption is also available to a **director of a banking company appointed by reserve bank** under section 10A of the act.

### 10.6 Overriding Provisions:

- The provisions of section 10A, section 10B and section 10BB of the banking regulation act regarding the appointment and removal of a director, managing director or the chairman shall have **overriding effect over all other laws, contracts, etc.**
- Any person affected by any action taken under these provisions is not entitled to any compensation.

### 11 Appointment of Additional Directors:

- The **Reserve Bank has the power to appoint additional directors on the boards of banking companies under Section 36AB of the Banking Regulation Act.** One or more additional directors may be so appointed when the bank is of the opinion that it is necessary to do so in the interest of: banking policy, public, banking company, depositors of the banking company
- The **directors so appointed shall not require any qualification shares.** They hold office during the pleasure of the Reserve Bank.
- Subject to this, **appointment may be for a period not exceeding three years** or further extended periods not exceeding three years at a time as specified by the Reserve Bank.
- The additional directors are protected from any liability or obligation for executing their functions in good faith.
- The provisions of section **36AB have overriding effect over other laws.**

### 12 Restriction on Employment:

- The **Banking Regulation Act (Section 10)** prohibits employment of managing agents and **imposes restrictions on employment of certain type of persons**, namely –
  - a) a person who is or has been **adjudicated insolvent** or has suspended payment or has compounded with his/her creditors;
  - b) a person who is or has been **convicted by a criminal court** of an offence involving moral turpitude.

- c) a person whose remuneration or part thereof is by way of **commission or share in the profits** of the company.
- d) a person whose **remuneration is excessive** in the opinion of the Reserve Bank.
- The above restrictions are applicable to workmen as well as management personnel.

### 13 Controls Over Management

Supersession of Board of Directors of Banking Company:

- Section 36 ACA of Banking Regulation Act **empowers Reserve Bank to supersede Board of Banking Company for a period of six months which may be extended upto twelve months.**
- During the interim period, an **Administrator appointed** who shall act as per directions of Reserve Bank.

### 14 Power to Issue Directors

#### 14.1 The Banking Regulation:

- The Act authorizes **the Reserve Bank to issue directions** to banks under Sections 21 and 35A of the Act.
- While **Section 21** gives the power to regulate advances by banking companies. **Section 35A** gives wide powers generally to regulate banking companies.

#### 14.2 Nature of Directions:

- The **directions issued by the Reserve Bank** in exercise of powers under Section 21 and 35A of the BR Act, being statutory directions, are binding on the banks. **The directions are addressed to banks only and not to customers or the public.**

#### 14.3 Caution and Advice:

- **Section 36** of the Banking Regulation Act provides that the Reserve Bank may caution or prohibit banking companies generally or any banking company in particular against any transaction or class of transactions.

### 15 Deposit Regulation:

#### 15.1 Regulation of Acceptance of Deposits:

- The **Banking Regulation Act does not contain any specific provisions** for regulation of acceptance of deposits of banks. However, **Section 35A** which authorizes the Reserve Bank to give directions is wide enough to cover acceptance of deposits.
- The **Reserve Bank issues directions from time to time regulating the rates of interest** applicable to deposits.

- The **directions issued by the Reserve Bank may also stipulate conditions regarding minimum or maximum periods** for which deposits may be accepted

### 15.2 Return on Unclaimed Deposits:

- Banks have to **file a return** every year on their unclaimed deposits **under Section 26** of the Banking Regulation Act.
- The return has to be filed within thirty days of the end of each calendar year and **should cover all deposits not operated for 10 years.**
- In the **case of fixed deposits**, the period of 10 years from the expiry of the period of the deposit.
- The act also provides for setting up of a **depositor education and awareness fund** to take over inoperative deposit accounts which have not been claimed or operated for a period of 10 years or more, **within a period of 3 months from the expiry of the said period of 10 years.**

## 16 Nomination:

### 16.1 Repayment of Deposits:

- **Section 45ZA of the Banking Regulation Act** provides that a depositor of a banking company (including co-operative banks) may nominate one person in the prescribed manner as nominee to whom the deposit may be returned in the **event of death of the sole depositor.**

### 16.2 Articles in Safe Custody and Safety Lockers:

- **Sections 45ZC and 45ZE** provides that any person, who leaves any article in safe custody and in safety lockers respectively with a banking company, may nominate one person as nominee to receive the article in the event of death of that person.

## 17 Loans and Advances

- The **definition of 'banking' in section 5(b) of the banking regulation act** indicates that acceptance of deposits may be for lending or investment.
- Thus, lending or making of loans and advances is a **core business** of a banking company.

### 17.1 Regulation of Loans and Advance:

- The **reserve bank is empowered under section 21** of the banking regulation act to issue directions to control advances by companies. RBI may issue directions when it is satisfied that it is necessary to give directions: In public interest, interest of depositors, In the interests of banking policy.
- Apart from this, the **general powers to give directions under section 35A** are also available for regulation of loans and advance.

### 17.2 Restrictions on Loans and Advances:

- **Section 20 of the Banking Regulation Act** imposes certain restrictions on loans and advances. Accordingly, **no banking company shall grant loans or advances on the security of its own shares.**
- Further, a **banking company is prohibited from entering into any commitment** for granting any loans or advances to or on behalf of any of its directors. The prohibition also applies to loans and advances to:
  - a) firms in which any director is interested as a partner, manager, employee or guarantor, and
  - b) any company (other than a company registered under Section 8 of the Companies Act) in which a director of the banking company holds substantial interest.

### 17.3 Restrictions on power to remit debt:

For **remitting any debt** to its directors, a banking company **requires prior permission of the Reserve Bank** under Section 20A of the Banking Regulation Act.

### 17.4 Some other regulatory restrictions on lending by banks in terms of RBI directives or the Banking regulation act, 1949:

1. Bank's **aggregate investment** in shares, certificate of deposits, bonds etc should not exceed the limit of 40% of the bank's net owned funds as at the end of the previous year.
2. **No bank should grant Loans against:** Certificate of Deposits, Indian depository receipts.
3. **No additional facilities should be granted by any bank/FI to the listed willful defaulters.**
4. As a prudential measure aimed at **better risk management and avoidance of concentration of credit risks**, The exposure ceiling limits would be 15 percent of capital funds in case of a single borrower and 40 percent of capital funds in the case of a borrower group.

## 18 Regulation of Interest Rates

- The **Reserve Bank is authorized to regulate interest rates under Section 21** (read with Section 35A) of the Banking Regulation Act.

### 18.1 Interest on Deposits:

- Now **liberalization of interest rates regime** has given freedom to banks to decide the rates themselves.

### 18.2 Usurious Loans Act,1918:

Usury is **the act of lending money at an interest rate that is considered unreasonably high or that is higher than the rate permitted by law**



- The Usurious Loans Act, 1918 **prohibits lending at exorbitant rates.**
- Accordingly, **Section 21A** was inserted in the Banking Regulation Act to make **the rates of interest charged by banking companies beyond the scrutiny of courts.**

## 19 Reserve Funds:

### 19.1 Creation of Reserve Funds:

- Every banking company incorporated in India has to create a reserve fund **under Section 17(1) of the BR Act** out of the profits as shown in the **profits and loss account prepared under Section 29 of the Act.**
- Every year, a sum equivalent to **not less than twenty per cent of such profits** has to be transferred to the reserve fund.
- Such transfer of profits to reserve fund has to be made **before any dividend is declared.**
- According to **Section 29A of the BR Act**, RBI may direct at any time, a banking company to annex to its **financial statements information relating to the business and affairs of any associate enterprise** of the banking company as the RBI may consider necessary.

### 19.2 Exemption from Contribution:

- If any banking company has an **adequate paid-up capital and reserves in relation to its deposit liabilities**, the Reserve Bank may recommend to the Government of India for exemption from the requirement of transfer of profits to reserve fund.

### 19.3 Appropriation from Reserve Fund/Share Premium Account:

- **Appropriation of any amount from the reserve fund** or the share premium account has to be reported to the Reserve Bank within twenty-one days of such appropriation. The banking company has to **explain the circumstances in which such appropriation was made.**

### 19.4 Foreign Banks:

- The provisions of Section 17(1) of the Banking Regulation Act for creating a reserve fund **do not apply to foreign banks operating in India.**
- In their case, instead of creating a reserve under Section 17(1), **Section 11(2) of the Act requires them to deposit and keep deposited with the Reserve Bank an amount** calculated at twenty per cent of the profit for each year in respect of all the business transacted through their branches in India.
- The amount may be deposited **in cash or unencumbered approved securities** or partly in cash and partly in unencumbered approved securities.

## 20 Maintenance of Liquid Assets:

- Every banking company has a duty to maintain a **certain percentage of their assets in India under Section 24 of the Banking Regulation Act** in the form and manner specified by the Reserve Bank by notification in the official gazette.
- A scheduled bank, **in addition to the average daily balance which it is or may be required to maintain under Section 42 of the Reserve Bank of India Act, 1934** shall maintain in India, assets, the value of which shall not be less than such percentage not exceeding 40 per cent of the total of its demand and time liabilities in India as on the last Friday of the second preceding fortnight.
- Banking companies, other than scheduled banks, have also to maintain such assets **in addition to the cash reserve, which they are Required to maintain under Section 18 of the BR Act.**

### 20.1 Returns filed to RBI:

- For ensuring compliance with the above provisions, **a monthly return has to be submitted** to the Reserve Bank by every banking company.

### 20.2 Penalty for Default:

- If the **balance on any alternate Friday falls below the minimum requirement**, the banking company is liable to pay to the Reserve Bank **penal interest at the rate of three per cent above bank rate** on the short shortfall for the day.
- **If the default recurs** on the succeeding alternate Friday, the penal interest is raised to 5 per cent above the bank rate on the shortfall.
- If the **default occurs on the next succeeding Friday**, then every director, manager and secretary of the banking company is punishable with a fine.
- If the Reserve Bank is satisfied on the application of a banking company that it had sufficient cause not to comply with the provisions as to maintenance of assets, **penal interest may be waived.**

## 21 Assets of Banking Company in India:

### 21.1 Quarterly position of Assets:

- Every banking company has to maintain in India **certain amount of assets as required under Section 25 of the Banking Regulation Act**. Accordingly, at the close of business on the last Friday of every quarter, **such assets shall not be less than seventy-five per cent of the demand and time liabilities of the banking company in India.**
- The assets may be in cash, gold or unencumbered approved securities.
- **"Assets in India' also include** export bills drawn in and import bills drawn on and payable in India and expressed in currencies approved by the Reserve Bank for this purpose.

- The **paid-up capital reserves and any credit balance in the profit and loss account of a banking company shall not be treated as 'liabilities in India' for this purpose.**

### **21.2 Returns filed to RBI:**

A return regarding the assets maintained in India under Section 25(1) of the Banking Regulation Act has to be **submitted to the Reserve Bank within one month from the end of every quarter.**

