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SOCIAL CONTROL MEASURE- BANKING REGULATION ACT

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ABSTRACT

It has been felt for a long time that the banking industry has not been discharging its function in consonance with the aims of our democratic socialism, viz. to regulate our social and economic life so as to attain optimum growth rate for our social and economic life so as to attain the optimum growth rate for our economy, and to prevent at the same time any monopolistic trend, concentration of economic power and misdirection of resources.¹ The major positive side of this process is the broad social control over banks which aims at ensuring that the banks operate in a manner that aligns or goes in par with the social and economic objectives of the society. In India during the British control, people suffered a great number of losses as the landlords and the moneylenders, who performed or functioned as a bank used to lend money at exorbitant interest rates which was clearly not functioning for the welfare of the society.

Keywords: Social control, Banking Regulation Act, 1949, Important Provisions.

I. INTRODUCTION

The banking system is a key constituent of our economic life and, therefore, it is necessary that its policies are framed and implemented in a way which helps in achieving the basic social and economic objectives. There should be "an equitable and purposeful distribution" of bank credits among the different sectors such as agriculture, small scale industries and export.

¹ Extract from finance Minister's Statement to Parliament on December 14, 1967

Different types of banks, such as commercial banks, cooperative banks, rural banks, and private sector banks exist in India. The Reserve Bank of India (RBI) is the governing body for regulating and supervising the banks. Banking Regulation Act, 1949 is an Act that provides a framework for regulating the banks of India. The Act came into force on 16th March 1949. This Act gives RBI² the power to control the behaviour of banks. This Act was passed as Banking Companies Act, 1949. It did not apply to Jammu and Kashmir until 1956. This Act monitors the day-to-day operations of the bank. Under this Act, the RBI can license banks, put regulation over shareholding and voting rights of shareholders, look over the appointment of the boards and management, and lay down the instructions for audits. RBI also plays a role in mergers and liquidation.

II. STEPS TOWARDS SOCIAL CONTROL

Let us now examine the important steps taken by the government so far towards social control of bank and suggest ways and means to make them more effective.

- i. The Banking Laws (Amendment) Act 1968- The Act seeks to extend effective social control over banks. It aims at snapping the link between a few industrial houses and banks so that, “particular clients or groups of clients are not favored in the matter of distribution of bank credit and whatever the characteristic of shareholding, its influence is neutralized in the constitution of board of directors, and in the actual credit decisions taken at different levels of bank management.”³
- ii. The National Credit Council- It is high level body established by the government to assess periodically the demand for bank credit and indicate the priorities for lending and investment between all sectors of the economy that require credit, in particular the sector such as agriculture, small scale industries and export
- iii. The Banking Commission- The Government has appointed a Commission to have a comprehensive expert enquiry into the banking and the monetary structure and financial needs, policies and practice of our banking system.

III. HISTORY OF THE BANKING REGULATION ACT, 1949

The concept of banking started in India with the establishment of the Bank of Hindustan. Before nationalisation took place in India, the banking system of India was more of a private

² Reserve Bank Of India

³ Extract from finance Minister’s Statement to Parliament, op. cit.

nature. Banks were struggling to keep their branches open. Low capital and reserves and greed for obtaining high profits became a reason for the failure of the banking system. The banks were supervised under the Companies Act, 1913, but this Act was not sufficient to regulate banks. The economy was not performing well, and this started to damage the banks. Also, the concept of banks was mostly used by the upper-class people. Frauds were also one of the reasons for the decline in the usage of banks. This gave a need to regulate the banking system of India. As a result, the Banking Regulation Act was introduced in 1949. It was initially applicable to banking companies, but after the Amendment in 1965, the Act was also applicable to cooperative banks.

IV. OBJECTIVES OF THE BANKING REGULATION ACT, 1949

The objectives of the Banking Regulation Act are stated below:

- i. To meet the demand of the depositors and provide them security and guarantee.
- ii. To provide provisions that can regulate the business of banking.
- iii. To regulate the opening of branches and changing of locations of existing branches.
- iv. To prescribe minimum requirements for the capital of banks.
- v. To balance the development of banking institutions.

V. SCOPE AND APPLICABILITY OF THE BANKING REGULATION ACT, 1949

The sections under this Act are to be interpreted along with the sections of the Companies Act, 1956, *or* any other laws prevalent in the banking system. This Act applies to banking companies and cooperative banks. It will not apply to a primary agricultural credit society or a cooperative land mortgage bank, or any other co-operative society, except mentioned in Part V of the Act.

VI. FEATURES OF THE BANKING REGULATION ACT, 1949

The Act has been divided into five parts comprising 56 sections.

The main features of the Act are mentioned below:

- i. Non-banking companies are forbidden to receive money deposits that are payable on demand.
- ii. Non-banking risks are reduced by prohibiting trading by banking companies.
- iii. Maintaining minimum capital standards.

- iv. Regulation on the acquisition of shares of banking companies.
- v. Power of the Central Government to make schemes for the banks.
- vi. Provisions regarding liquidation proceedings for banking companies.

VII. IMPORTANT PROVISIONS OF THE BANKING REGULATION ACT,1949

Some important provisions of the Act are stated below:

1. Definitions

The Act has defined some terms such as banking⁴, banking company⁵, branch office, etc. A banking company means a company that conducts banking business in India. Banking means to accept for lending or investment of deposits of money from the public which can be repaid on demand. Subsidiary banks have the same meaning as given under the State Bank of India (Subsidiary Banks) Act, 1959. A secured loan or advance means an advance or a loan secured against the security of assets.

2. Business which can be undertaken by the banking companies

Under [Section 6\(1\)](#), a banking company may be involved in the business of borrowing or lending money; buying or selling bills of exchange, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures; buying or selling of foreign exchange; dealing stock, funds, shares, debentures, bonds; carrying on agency business such as clearing and forwarding of goods; conducting the business of guarantee and indemnity, etc.⁶

3. Prohibition of trading

Trading is prohibited under [Section 8](#) of this Act. No banking company shall directly or indirectly deal in the buying or selling, or bartering of goods except when it is selling the goods kept in its security. The bank should also not engage in any trade or buy, sell or barter goods except for bills of exchange received due to collection or negotiation.⁷

4. Management of bank

The bank should not employ or be employed by the managing partner as stated under [Section](#)

⁴ Section 2(a) of Banking Regulation Act, 1949

⁵ Section 2(b) of Banking Regulation Act, 1949

⁶ Section 6(1) of Banking Regulation Act, 1949

⁷ Section 8 of Banking Regulation Act, 1949

[10](#) of the Act. The bank should also not employ a person who has been adjudicated insolvent or whose remunerations depend on the profits of the company. At least 51% of the total members of the board must have professional experience in matters such as accountancy, agriculture, rural economy, banking, cooperation, economics, finance, law, small-scale industry, etc. The term of the office of the director should not be more than eight years.⁸

5. Minimum paid-up capital and reserves

[Section 11](#) states that if a banking company is incorporated outside India then the total value of its paid-up capital should be more than fifteen lakhs and if it has a place of business in Calcutta or Bombay or both, then it should be more than twenty lakhs.⁹

The banking company must deposit twenty percent of its profit for the year. If the company is incorporated in India and if it has branches in different states, then the paid-up capital is five lakhs of rupees, and if the place of business is situated in the city of Bombay or Calcutta or both, then ten lakhs of rupees must be the minimum paid-up capital. If the company has all its branches in the same state none of which is situated in the city of Bombay or Calcutta, then the paid-up capital must be one lakh rupees concerning its principal place of business, plus ten thousand rupees in respect of each of its other branches situated in the same district in which it has its principal place of business, plus twenty-five thousand rupees in respect of each branch situated elsewhere in the state otherwise than in the same district.

The subscribed capital of the company should not be less than one-half of the authorised capital, and the paid-up capital should not be less than one-half of the subscribed capital. The banking company cannot create any charge on unpaid capital. The company shall transfer every year at least twenty percent of its profits to the Reserve Fund. The banking company must inform RBI of the appropriation of the Reserve Fund within twenty-one days from the date of appropriation.

6. Limitations on nature of subsidiary companies

A banking company should not form a subsidiary company unless the formed company is for an undertaking of a business or written permission was obtained from the Reserve Bank of India. The banking company can hold shares of an amount of more than thirty percent of the paid-up

⁸ Section 10 of Banking Regulation Act, 1949

⁹ Section 11 of Banking Regulation Act, 1949

share capital of the company or its own paid-up capital.¹⁰

7. Licensing of banking companies

No banking company can carry out business in India unless it has obtained a license from the RBI. RBI can hold the inspection of books before granting the license. RBI can also cancel the license if the company stops carrying on banking business in India.¹¹

8. Opening of new and transfer of existing branches

Every banking company must obtain the permission of RBI before opening a new branch or transferring the existing branch to a different city, town, or state. No banking company incorporated in India shall open a new branch outside India without the prior permission of RBI. However, a new branch can be opened for a temporary period not exceeding one month.¹²

9. Accounts and balance-sheet

The banking companies shall prepare a balance sheet and profit and loss account on the last working day.¹³

10. Inspection

RBI can cause the inspection of the banking company and must state its report to the company. The directors of the banking company must submit all books, accounts, or documents for inspection.¹⁴

11. Power of RBI to issue directions

RBI may frequently issue directions to the banking company if it is satisfied that the directions are in the interest of the public or to prevent the banking company from detrimentally conducting business.¹⁵

12. Restriction of certain activities by the banking company

The banking company cannot obstruct any person from entering its place of business. It cannot

¹⁰ Section 19 of Banking Regulation Act, 1949

¹¹ Section 22 of Banking Regulation Act, 1949

¹² Section 23 of Banking Regulation Act, 1949

¹³ Section 29 of Banking Regulation Act, 1949

¹⁴ Section 35(A)(1) of Banking Regulation Act, 1949

¹⁵ Section 35(A) of Banking Regulation Act, 1949

hold anything violent in the place of business. The banking is liable under [Section 36AD](#) for violation of the above-mentioned activities.¹⁶

13. Powers and functions of RBI

Section 36 mentions the powers of RBI. The Reserve Bank may prohibit banking companies from entering into a particular transaction and can advise the banking company. It can also assist the banking company by granting loans or advances under [Section 18](#). It can direct the banking company to call for a meeting of its directors to discuss the matters of the company. It can also appoint officers to observe how the affairs of the banking company are conducted.

14. Suspension of business

If the banking company for a temporary period is unable to meet its obligation, it can apply for a moratorium to the High court. The High court can grant the moratorium and stop the proceedings for a temporary period as it deems proper. The period of the moratorium shall not exceed six months. The banking company is only considered valid if it has attached the report of the RBI stating that the banking company will be able to pay its debts if the application is granted.¹⁷

15. Acquisition of the undertakings of banking companies

The undertaking of banking companies must be done by the Central Government after consulting with the Reserve Bank of India. The undertaking must be done only after the banking companies have been provided with an opportunity for showing cause for care.¹⁸

16. Payment of dividends

The banking companies should only pay dividends after all the capital expenses are paid up. It shall not pay the dividends until the depreciation in the value of investments in approved securities or investments in shares, debentures, or bonds are written off.¹⁹

17. Reserve fund

Every banking company must form a reserve fund and must transfer at least twenty percent of its profit to the reserve fund. Each banking company must report to the Reserve Bank if it has

¹⁶ Section 36(AD) of Banking Regulation Act, 1949

¹⁷ Section 37 of Banking Regulation Act, 1949

¹⁸ Section 36AE of Banking Regulation Act, 1949

¹⁹ Section 46 of Banking Regulation Act, 1949

appropriated any funds from the reserve fund.²⁰

18. Power of Central Government in respect of liquidation of companies

The Central Government may order the RBI to initiate insolvency proceedings if the banking companies have committed a default under the [Insolvency and Bankruptcy Code, 2016](#).

19. Offences and punishment under the Banking Regulation Act, 1949

Various provisions are mentioned in the Act which states that a person will be liable for imprisonment and fine if he does any act which is in contravention with the Act. It is stated under [Section 46](#) as below:

A person will be liable for imprisonment of up to three years and a fine which may extend up to one crore rupees if he has misrepresented any facts or presented the wrong acts intentionally.²¹

A person will be liable to a fine of up to twenty lakh rupees and up to fifty thousand rupees in case of a continuing offence if he fails to produce the documents or books or refuses to answer the questions asked by the inspection officer.²²

All the directors of the banking company will be held liable and will be imposed a fine of twice the amount of the deposits made with the banking company if the banking company has illegally received any deposit.²³

The directors or the secretary will be punished if the company has caused a default or the default occurred due to the negligence of the director.

20. Shortcomings of the Banking Regulation Act, 1949

The Banking Regulation Act has less scope on public sector banks. The amendments in the Act are not enough to leverage the stressed assets in the financial system. There are no strict provisions for non-performing assets (NPA), and this gives a chance to the defaulters to escape from the situation. Some provisions of this act can hamper the working of the banks.

²⁰ Section 17 of Banking Regulation Act, 1949

²¹ Section 46(1) of Banking Regulation Act, 1949

²² Section 46(2) of Banking Regulation Act, 1949

²³ Section 46(3) of Banking Regulation Act, 1949

21. Amendments to the Banking Regulation Act, 1949

i. Banking Laws (Application To Co-operative Societies) Act, 1965

Initially, the Banking Regulation Act was passed as Banking Companies Act, 1949. But with the introduction of the [Banking Laws \(Application To Co-operative Societies\) Act](#), the word Companies was omitted and the word Regulation was added to the title of the Banking Regulation Act, 1949. The Act also added a new Section called [Section 56](#) as [Part V](#) after [Part IV](#) in the Banking Regulation Act. This section will apply to co-operative societies subjected to some modifications.²⁴

ii. Banking Regulation (Amendment) Act, 2020 (Act 39 of 2020)

This [Act](#) came into force on September 29, 2020. The Banking Regulation Act will not be applied to a cooperative society whose main business is providing long-term financial support for agricultural development. The amendment also mentioned that the societies should not use the words 'bank', 'banker', or 'banking' in their name or connection with their business. A cooperative bank may issue equity shares, preference shares, or special shares on face value or at a premium to its members or to any other person residing within its area of operation after obtaining prior approval from the Reserve Bank of India.

After the amendment, RBI may suspend the Board of Directors of a multi-cooperative bank for five years to protect the depositors. This amendment omitted some provisions like granting of unsecured loans or advances to its directors, and to private companies where the bank's directors or chairman is an interested party, opening a new place of business, or changing the location of the cooperative bank outside of the city, town or village in which it is currently located without permission from RBI, etc.

Key Functions of the Board:

- i) Estimating the amount of debt needed for the general economy.
- ii) Give pointers for disbursement of credit to the priority sector.
- iii) Making certain that debt is equally distributed within the economy.

²⁴ <https://www.adda247.com/upsc-exam/the-banking-regulation-act-of-1949-provisions-and-amendment/>

VIII. CONCLUSION

All the banking companies will be controlled under the Banking Regulation Act, 1949. This Act provides a proper structure to the banking system in India. The Act puts restrictions on the banks to avoid fraud and protect the interests of the depositors. It also states the procedure for winding up the banking company. The Act also states the acquisition and mergers of the banking companies. Thus, this Act led to the proper growth of the banking companies which was lacking before 1949.

