CONTROL AND REGULATIONS OF BANKS UNDER THE BANKING REGULATIONS ACT, 1949

Banking is a unique industry in the sense that the bulk of its working funds are derived from demand and time deposits. Confidence is the \textit{sine qua non} for its organic and orderly growth. It is therefore in the national interest that legislative safeguards be provided so that it gives a flavour of public service to its objective of larger profits and does not suffer from excessive competition\(^1\).

\textbf{Need for Banking Regulation}

In fact the whole process of economic life is so dependent on the banks that the maintenance of satisfactory banking discipline is indispensable to achieve the broad economic objective. Undoubtedly there is a close connection between bank behaviour and economic prosperity and stability\(^2\) and so legislative safeguards are inevitable to ensure the safety of the funds of the depositor and to encourage the development of banking on sound lines to steer

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\(^1\) S.G.Panandikar, \textit{Banking in India} (1966), p.380.

the economy along the desired direction. Bank behaviour and thus the contribution of the banking system to economic development – whether positive, negative or neutral is strongly conditioned by the structure of the banking system which in turn is shaped primarily by legislation and Government policies.

The majority of the legislations enacted by the Parliament in India since independence pertains to economic matters. The dominant features of these legislations are the gradual extension of State control over various sectors of the economy and the provision of facilities for economic development is in consonance with the Directive Principles of State Policy in the Constitution of India.

Experience over a long period of years both in the developed and under-developed countries has shown that the banking system will not function satisfactorily without some supervision by the Central Bank or the Government.

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3 History of Banking Legislation in India - Banking Report 1949, pp.3-8.


5 Ref. Article 38(1) and Article 38(2) of the Directive Principles of State Policy based on social and economic charter. Article 38 deals with the principle of policy to be followed by the State for securing economic justice.
An examination of the banking laws of the various foreign countries shows considerable variations in the nature and degree of legal control imposed upon banks. The extremes are provided by Great Britain on one hand and Germany and Italy on the other, for legal control is practically non-existent in Great Britain, it covers a wide range of commercial banks activity. In several countries in particular in a number of European countries after the economic depression of 1929-1933, legislative restrictions on banking were introduced with a view to eliminate abuses which manifested themselves during periods of emergency or crisis. In many others, statutory control was imposed with the object of extending to all banks the principles and traditions followed by well-run banks.

In India, it is not possible to refer to a single law as the Law of Banking and this has to be found out from various sources. There is not even a single book which may be termed as a book having the entire codified law on the subject. This is the position not only in India but also in England. The Indian Law has just followed the English pattern. The banking law is to be

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7 The Banking Law in England is not a codified law and only some of its facts are codified. In U.S.A. they rush to the decided particular problem (Case Study Method). See, P.W.D. Redmond, Law Relating to Banking (1966), p.18.
analysed from the various legal provisions, which have been passed relating to
the legal supervision, control and regulation of the commercial and business
activities of the individuals, traders, institutions and Government bodies
engaged in trade, commerce and industry, in so far as these activities can be
brought within the purview, control and legal supervision of the banking
institutions. It is both a judge-made law as well as statutory. Anomaly here is
whether there is any such thing termed as Banking Law, that is a law relating
to banking and bankers or is it a part of the Mercantile Law as reflected partly
in judicial decisions and partly in Statutes of the respective Country.

**Concept and Meaning of Banking Law**

The term ‘banking law’ means and includes all those branches of
law, which are connected with the banking business. Since the banker-
customer relationship springs from the law of contract, the Contract Act is of
primary importance because that relationship is that of a debtor and creditor,
agent or bailee. Other important Acts closely connected with banking are the
Negotiable Instruments Act, Transfer of Property Act, Partnership Act,
Companies Act and Insolvency Act, etc. Other important sources are the RBI
Act, Banking Regulations Act and Bank Nationalisation Act.
Banking legislation as such does not aim at the protection of the bank shareholder, which is done by the Company Law. The fundamental objective of bank legislation is to safeguard the welfare of the depositor. Banking laws contribute to public confidence in two ways. Firstly they strive to ensure if not sound management at least immunity from more flagrant abuse of place and power and secondly they aim at mitigating harm and distress when banks find themselves in difficulties or have actually to be liquidated.\(^8\)

The problems of bank organisation and control have now come to engage the attention of bankers and economists in a manner they have never done before and the proposals for the reform of banking and for effecting its modernization have emanated from many quarters in recent years.\(^9\) The aim of legal regulation now-a-days is to bring commercial banks more and more under State control and supervision but yet preserve their private ownership, while that of nationalisation is to bring them under complete public ownership.\(^10\) Thus we find that the question today is not whether there should

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\(^8\) J.P. Jain, *Indian Banking Analysed* (1946), p.96

\(^9\) There are 5 types of control in the U.S.A. intended to presence the integrity of bank credit and provide safety: (a) Adequate bank capitalization and periodic examinations, (b) Note issues, (c) Report Reserves, (d) speculative loans, and (e) the insurance of small depositors by the Federal Deposit Insurance Corporation. See Aur Freight Hans, *Central Banking Legislation* (1965), p.33.

be regulation by law but how far and in what direction that regulation should go. An analysis of important features of banking law in U.K. and France shows that the framers of the laws have embodied in the legislative provisions, the necessary instruments of regulation and control in the hands of monetary authorities to curb unhealthy banking practices and undesirable credit expansion.

In 1931, the Indian Central Banking Committee recommended legislation of special statute for regulating the Banking Companies, but no separate legislation was made for the said purpose. Later the Indian Companies Act, 1913 was amended by the Indian Companies (Amendment) Act, 1936 to provide Part XA which provided the provisions relating to protection of depositors and included restrictions on banking companies regarding banking transactions, on the granting of loans to officers, including Directors and Auditors of the banks and the prevention of managing agency system in the banks.

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11 Ibid.
14 Directed a banking company to do only banking business. See:- D.N.Ghose, Banking Policy in India – An evaluation (1979), p.42.
The Banking Companies Act, 1949

The Banking Companies Act, 1949 was enacted for the protection of depositors of the Banking Companies. The Preamble of the Act states the Act was passed to consolidate and amend the law relating to banking. The need for the consolidation was felt owing to the absence of measures to safeguard the interests of the depositors and the abuse of power by persons who controlled the banks. The Act is regulatory, meant to regulate the functioning of the banking companies and corporations. It is not a legislation to codify the law relating to banking. This Act was subjected to several amendment\(^{15}\) and Amending Act of 1956 that came into force in 1966 was known as the Banking Regulation Act. The Act was amended by the Amending Act of 1958 to extend social control over the banks and this expression ‘social control’ was used to nationalize the 14 banks by the Act of 1969.

Bank Nationalisation Case and its Impact

In *R.C.Cooper v. Union of India*\(^ {16}\), famously known as the Bank Nationalisation case, the petitioner R.C.Cooper held shares in the Central Bank of India Ltd., Bank of Baroda, Union Bank had accounts with these banks and


\(^{16}\) 1970 (1) SCC 248.
was also a director of Central Bank. By these petitions\textsuperscript{17} he claimed a declaration that the ordinance 8 of 1969 and Banking Companies Act, 1969 which replaced the ordinance with certain modifications impaired his rights under Articles 14, 19 and 31 of the Constitution and hence invalid. The question to be decided here was whether a shareholder of a company can move a petition for infringement of rights of a company. It was held that the holder of a deposit account in a company is its creditor and is not the owner of any specific fund of the company and he is not entitled to move a petition unless his rights are also infringed.

Another question to be decided was whether the definition of 'Banking' includes other business activities that a bank may engage in effect of the legislative entry in List-I of the seventh schedule. Here the legislative entry 45 in List I is Banking and not Banker or Banks. To include within the connotation of expression 'banking' power to legislate in respect of all commercial activities which a banker by the custom of banker or authority of law engages, would result in re-writing the constitution. The expression 'undertaking' in section 4 of the Act 22 of 1969 clearly means a going concern with all its rights, liabilities and assets which from the various rights and assets

\textsuperscript{17} Writ Petition 222, 3000 and 298 of 1969.
which compose it. Power to legislate for acquisition of property in Entry 42 in List III therefore includes the power to legislate for acquisition of an undertaking. The expression 'property' in Entry 42 List III has a wide connotation and it includes not only assets but organisation, liabilities and obligations of a going concern as a unit. A law may therefore be enacted for compulsory acquisition of an undertaking as defined in section 5 of the Act 22 of 1969.

To the question whether Article 19(1)(f) and 31(2) are mutually exclusive and enquiry into reasonableness can be excluded, the constitutional scheme declares the right to property of the individual and then delimits Article 19(5) and clause (1) and (2) of Art.31. Limitations under 19(5) and Art.31 are not generally different from the law authorizing the exercise of the power to take the property of an individual for a public purpose or to ensure the well-being of the community and the law authorizing the imposition of reasonable restrictions under Article 19(5) is intended to advance that large public interest. The conclusion is inevitable that the validity of the State action must be adjudged in the light of its operation upon the right of the individual and group of individuals and are therefore not mutually exclusive.
If property is compulsorily acquired for a public purpose, and the law satisfies the requirements of Article 31(2) and 31(2A) the Court may readily presume that by the acquisition a reasonable restriction on the right to exercise of the right to hold property is imposed in the interests of the general public. Another argument was taking over by state of banking business and not non-banking business being taken over, the reasonableness of the restriction tested under Article 19(6). By virtue of this clause, the validity of a law creating a State monopoly which indirectly impinges on any other right cannot be challenged on the ground that it imposes restriction which are not reasonable restrictions in the interests of general public. Here Section 5, 6 and 15 of Act 22 of 1969, which transfer the undertaking of the named banks and prohibit those banks from carrying on business of banking and practically prohibit them from carrying on non-banking business. These rights are not absolute and they are subject to the restrictions prescribed in the appropriate clauses of Article 19.

*The Banking Companies (Acquisition and Transfer of Undertakings) Act*

The Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1970 was replaced by the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. The Banking
Companies (Acquisition and Transfer of Undertakings) Act, 1980 was enacted for nationalising 6 more banks. Section 3(5)\(^{18}\) of the above two Acts provides that every bank shall carry on and transact the business of banking as defined in clause (b) of section 5\(^{19}\) of the Banking Regulation Act, 1949. The provisions of this Act, shall be in addition to and not save as hereinafter expressly provided in derogation of the Companies Act\(^{20}\). That being so, this Act is supplemented to and a part of the Companies Act, 1956\(^{21}\). The section makes it clear that the provisions of other Statutes applicable to the banks, have to be complied with by the banks\(^{22}\). The banking company is bound to comply with the provisions of applicable law, unless there is a specific exemption in the Act or any other Statute. In *Muthain v. Syndicate Bank*\(^{23}\), the

\(^{18}\) Sec.3(5).-- Establishment of corresponding new banks and business thereof.- Every corresponding new bank shall carry on and transact the business of banking as defined in clause (b) of section 5 of the Banking Regulation Act, 1949.

\(^{19}\) Sec.5.- Unless there is anything repugnant in the subject or context,- (b) ‘banking’ means the accepting, for the purpose of lending or investment of deposits of money from the public, repayable on demand, or otherwise and withdrawable by cheque, draft, order or otherwise.

\(^{20}\) Section 2 of B.R.Act, 1949. The provisions of this Act shall be in addition to and not save as hereinafter expressly provided in derogation of the Companies Act, 1956 and any other law for the time being in force.


Court held that the rate of interest claimed by the Syndicate Bank can be a subject matter of judicial scrutiny under the provisions of the Usurious Loans Act, as there is no prohibition in the B.R.Act, 1949 precluding the Court from scrutinising the rate of interest under the Usurious Loans Act. In Indian Bank v. K. Usha\textsuperscript{24}, it was held that section 19(d) of Specific Relief Act provides that specific performance of a contract entered into by a company, which subsequently becomes amalgamated with another company can be enforced against the new company. The Central Government may on a representation made by the Reserve Bank and if it is satisfied that it is expedient to do so, by a notification in the official gazette for such period not exceeding 60 days, suspend the operation of all or any of the provisions in the B.R.Act either generally or in relation to any specific Banking Company\textsuperscript{25}. The legislature has delegated the power to suspend the operation of the Act to the government and to the Governor or in his absence the Deputy Governor of the RBI. The copy of the notification is required to be placed before the Parliament.

\textsuperscript{24} 1993 (2) Bank CLR 508.

\textsuperscript{25} Section 4 of the B.R.Act, 1949.
**Definition of banking under the Banking Regulations Act**

The banks are regulated and controlled by the R.B.I. and the Central Government. The powers and functions are derived from the R.B.I.Act, 1934 and B.R.Act, 1949. The former Act constitutes the Central Banking Legislation and the latter Act contains legislation for regulating the activities of commercial and co-operative banks. The expression ‘banking’ has been defined in section 5(b) of the B.R.Act 1949 as the acceptance of money from the public repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise. The recovery of money or deposit from the customers and honouring their cheques is the essential characteristic of banking. If the company is authorised only to grant loans, it will not be banking company, as lending of money may be a phase of banking business but it is not the main phase or the distinguishing phase of banking. But if the bank acts as an authorised dealer in foreign exchange to receive foreign contribution through anyone of its branches, it transacts the banking business. This is clear from the definition of banking under the B.R.Act, where banking means the

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acceptance of deposits of money from the public repayable on demand or otherwise\textsuperscript{29}.

The earliest attempt in India in the direction of formulating a definition was that of the Hilton Young Commission, which recommended that the term 'bank' or 'banker' should be interpreted as meaning every person, firm or company using in its description or its title bank or banker or banking and every company accepting deposits of money, subject to withdrawal by cheque, draft or order. The Indian Companies (Amendment) Act, 1936, though rejected the former part of the above definition, rightly so and substantially accepted its latter part\textsuperscript{30}. The essence of banking is the acceptance of withdrawable deposits of money for the purpose of lending or investment\textsuperscript{31}.

In France, persons accepting funds from the public for use on their own account for discounting of bill or granting of credit or rendering financial assistance to others generally come under the banking legislations. But it has

\textsuperscript{29} Sir Mohammed Akharkhar v. Allar Singh, 63 I.A. 279.

\textsuperscript{30} K.L.Pande, Development of Banking in India Since 1949 (1968), pp.5, 6.

\textsuperscript{31} Strictly speaking, the term 'Bank' implies a place for deposit of money. In its more enlarged sense, a Bank may be defined as an institution, generally incorporated, authorized to receive deposits of money, to lend money and issue promissory notes, usually known by the name of Bank notes or to performs some one or more of these function. Refer, American Jurisprudence, Sec.2.
been accepted universally that accepting of deposits in current account for 
customers and paying, as well as collecting cheques for them, are the essential 
requisites of banking. In France, the Privy Council pointed out that the words 
'banking' and 'banker' may bear different shades of meaning at different 
periods of history and that their meaning may not be uniform today in 
countries of different habits and different degrees of civilization. In U.K., 
banking has generally been identified with the acceptance of deposits, 
withdrawable by cheques by customers. In U.S.A. the Federal Banking 
legislation lays emphasis on discounting of bills and accepting of deposits.

**Definition of Banking Company under the Banking Regulation Act**

The expression ‘banking company’ means any company, which 
transacts the business of banking in India. The Banking Company is one 
which is formed and registered under Section 3 of the Companies Act, 1956.

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33 Commissioners of Taxation v. English, Scottish and Australian Bank Ltd., (1920) AC 683.


35 Section 3.- (1) in this Act, unless the context otherwise requires, the expression 'company', 'existing 
company', 'private company' and 'public company' shall subject to the provisions of sub-section 92) 
have the meanings specified below:-

(i) ‘company’ means a company formed and registered under this Act or an existing 
company as defined in clause (ii).
The SBI is not a banking company as it is not a company. But it is a subsidiary bank which falls within the definition of section 2(k) of the SBI (Subsidiary Banks) Act, 1959 and established by the Government of India.

The SBI and other banks in public sector are establishments under the Central Government and are exempt from the provisions of State Shops and Establishments Act. The different branches of a banking company cannot be considered as the separate entity and the banking company invests its officers...

(ii) 'existing company' means a company formed and registered under any of the previous companies law specified below:-

(a) any Act or Acts relating to companies in force before the Indian Companies Act, 1866 (10 of 1866) and repealed by that Act.
(b) the Indian Companies Act, 1866 (10 of 1866).
(c) the Indian Companies Act, 1882 (6 of 1882)
(d) the Indian Companies Act, 1913 (7 of 1913)
(e) the Registration of Transferred Companies Ordinance, 1942 (54 of 1942) and
(f) any law corresponding to any of the Act or the ordinance aforesaid and in force.

(iii) 'private company' means a company which by its articles,-

(a) restricts the right to transfer its shares, if any,
(b) limits the number of its members to fifty not including,-
   (i) persons who are in the employment of the company, and
   (ii) persons who have been formerly in the employment of the company.
(c) prohibits any invitation to public to subscribe any shares in or debentures of the company.

(iv) 'public company' means a company which is not a private company.

with requisite powers and authorities and accordingly the officers of the banking company transact business on behalf of the banking company\textsuperscript{39}. But the sole repository of these powers and authorities is the banking company.

*Meaning of Banking Policy under the Banking Regulation Act*

The banking policy is specified from time to time by the RBI taking into consideration various factors, i.e., interest of the banking system, the monetary stability, sound economic growth, etc.\textsuperscript{40}. The policy may be declared in the form of the directive or instructions issued to the banks. The powers have been given to the RBI to give directions in various fields, namely, (i) under section 21 to control advances by banking companies; (ii) under section 35A to give directions to banking companies in public interest or in the interest of the banking policy or to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or to secure the proper management of any banking company generally\textsuperscript{41} and (iii) under section 36 to exercise general powers on the banking companies.


\textsuperscript{40} Mohd.Nachigar v. Deputy Director, 1976 (46) Comp.Case 653 (Mad).

In India, banking business is conducted by the following types of organisations.-

i) **Statutory Corporations**: All the public sector banks, i.e., SBI and its associates, the nationalised banks, fall under this category. The SBI has been constituted under the SBI Act, 1955 and the six subsidiary/associate banks of State Bank have been constituted under the SBI (Subsidiaries Bank) Act, 1959. The nationalised banks constituted under the Banking Companies (Acquisition & Transfer of Undertakings) Act, 1970 & 1980.

ii) **Companies registered under the Companies Act, 1956**: All the banks in the private sector are registered under the Companies Act, 1956 and are governed by the Companies Act relating to their constitution and their banking business is governed by the B.R.Act 1949 and RBI Act 1934.

iii) **Co-operative societies registered under the Co-operative Societies Act**: They transact the banking business by obtaining licence from R.B.I. under B.R.Act, 1947.

Section 36 provides for further powers and functions of Reserve Bank under it, the Reserve Bank may.-
(a) Caution or prohibit banking companies generally or any banking company in particular against entering any particular transaction or class or transaction and generally give advice to a banking company.

(b) on a request in by the companies concerned and subject to the provisions of section 44A assist, as intermediary or otherwise in proposals for the amalgamation of such banking companies.

(c) give assistance to any banking company by means of the grant of a loan or advance to it under clause (3) of sub-section (1) of section 18 of the RBI Act, 1934.

(d) at any time, if it is satisfied that in public interest or interest of banking policy or for preventing the affairs of banking company being conducted in a manner detrimental to the interest of the banking company or its depositors it is necessary so to do so.

Cases showing the powers of the RBI under the Banking Regulation Act

In Corporation Bank v. D.S.Gowda, the Supreme Court observed that under the B.R.Act, wide powers are conferred on the RBI to enable it to exercise

42 (1994) 5 SCC 213.
effective control over all banks. Any Bank which commits a breach is liable to be penalised under section 47A\(^43\) of the Act. In *Janata Sahakari Bank Ltd. v. The State of Maharashtra*\(^44\), the Court held that the RBI has the power to give directions. In *America Express International Banking Corporation v. Sundaresan*\(^45\), the Supreme Court held that directions by Reserve Bank cannot prevent payment of higher bonus in terms of the Agreement\(^46\). All the circulars issued by the RBI to the banks are not directives having statutory force which are binding on the banks\(^47\). In *Jameela Beevi v. S.B.T.*\(^48\), it was held that the directions issued to the Banks under Section 35A of the B.R.Act 1949 are statutory in nature and therefore binding on them. The Reserve Bank may also issue directions to the banks relating to matters under Foreign Exchange Regulation Act, 1973\(^49\). Section 5A provides that if the provisions of any memorandum, articles of association of any company, or agreement or

\(^43\) Section 47A relates to the power of the Reserve Bank to impose penalty on such banking company which commits default or contravention of its directions.

\(^44\) A.I.R. 1993 Bom252.

\(^45\) (1978) 1 SCC 101.


\(^48\) 1991 Bank J.427 (Kant).

resolution passed by any banking company, etc. are inconsistent or contrary to
the provisions of the Banking Regulations, such provisions will be void to that
extent and will not be enforceable\textsuperscript{50}.

Section 6\textsuperscript{51} of the Act provides for the form of business in which a
banking company may engage. This section is widely worded and any
business which a bank is required to undertake has been covered in the
definition. The banking company is prohibited from carrying on any kind of
incidental or allied business other than those enumerated in sub-clauses (a) to
(o) of sub-section (1) of section 6 of the Act\textsuperscript{52}. In the absence of any such
power, mere power of granting loans does not make a company a banking
company. The banking company cannot undertake the business of banking
without working as part of its name at least one of the words ‘bank’, ‘banking’

\textsuperscript{50} Mohant Vaishnava Das v. Taquir Chand, A.I.R. 1968 Del.6.

\textsuperscript{51} Notwithstanding anything contained in section 6 or in any contract no banking company shall
directly or indirectly deal in the buying or selling or bartering of goods except in connection with
realization of security given to or held by it or engage in any trade, or buy, sell or barter goods for
others otherwise than in connection with bills of exchange received for collection or negotiation or
with such of its business as is referred to in clause (1) of sub-section (1) of section 6.

\textsuperscript{52} Bishop of Kottayam v. Union of India, A.I.R. 1986 Ker.126. Also see Mahalaxmi Bank Ltd. v.
and 'banking company'\textsuperscript{53}. This has been done to ensure the interest of the depositors of the banks. No other company, firm, individual or group of individuals may use any of the words bank, banking or banking company as part of its name for or in connection with its business. The banking companies have been prohibited from carrying on any activity by way of buying or selling or bartering of goods\textsuperscript{54}.

Section 22 of the Act requires every bank to obtain a licence from the Reserve Bank for carrying on or commencing banking business in India. The intention is to check the growth of unsound banks and to arrest the indiscriminate floatation of mushroom banks. The RBI inspects the whole affairs of the company and satisfies itself that it is in a position to pay its depositors in full and that the bank affairs are not conduct to the detriment of

\textsuperscript{53} Section 7 of B.R.Act 1949- (1) No company other than a banking company shall use as part of its name 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, banker or banking company.

(3) Nothing in this section shall apply to-

(a) a subsidiary of a banking company formed for one or more of the purposes mentioned in subsection (1) of section 19, whose name indicates that it is a subsidiary of that banking company;

(b) any association of banks formed for the protection of their mutual interests and registered under section 25 of the Companies Act, 1956.

\textsuperscript{54} Section 8 of B.R.Act, 1949. See Syndicate Bank v. commercial Tax Officer, ILR 1995 Ker. 1753.

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the deposits before granting a licence to those banks established before the commencement of the Act of 1949. The Bank is also empowered to cancel a licence already granted. Section 22 prescribes a system of licensing of banking, having for its object regulating of banking business and does not violate the fundamental right of any person to carry on such business. In *Sajjan Bank (Pvt.) Limited, Alandur v. The RBI*55 where the R.B.I. refused to grant licence to the applicant, the Court held that the refusal of licence by the RBI does not mean stoppage of business, as the applicant can undertake the business as a money lender. Section 22 is not unconstitutional on the ground that it restricts the fundamental right of banking company to carry on its banking business. The licensing itself is vested in a statutory authority which is itself a Central Banking institution concerned with the currency and credit operations of the Country. The power vested in the Reserve Bank under this section are not one vested in a mere officer of the bank. The power given is regulated by the Statute and being entrusted to a statutory body is quasi-judicial in nature. Such a power cannot be said to be an arbitrary one. It is a mere licence granted as a matter of course to all genuine banking institutions run on sound lines as the judicial character of power would indicate. In

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Shivabhai v. RBI held that the H.C. cannot sit in appeal over the judgment of RBI unless it is shown that the decision is based on extraneous consideration or is perverse.

The Act also lays down certain important provisions regarding minimum paid-up capital and reserves. In terms of the Amendment Act of 1962, the limit of minimum paid up capital in the case of an Indian Banking Company commencing banking business for the first time after the commencement of the Banking Companies (Amendment) Act, 1961 is fixed as Rs.5 lakhs irrespective of whether it has only one place of business or places of businesses in only one State. According to the original provision it was possible for a bank with the only one place of business to be started with as low a capital as Rs.50,000/-.. Further, if a bank has places of business in more than one State and if any such place is situated either in Bombay, Calcutta or both, the minimum amount of paid-up capital is Rs.10 lakhs.

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57 Section 11.- Notwithstanding anything contained in section 149 of the Companies Act, 1956, no banking company in existence at the commencement of this Act, shall after the expiry of three years from such commencement or of such further period not exceeding one year as the Reserve Bank having regard to the interest of the depositors of the company may think fit in any particular case to allow to carry on business in India and no other banking company shall after the commencement of this Act, commence or carry on business in India unless it complies with such of the requirements of this section as are applicable to it. Section 149 of the Companies Act, 1956 provides for the restrictions on the commencement of business. See Appendix VI.
Further section 17 of the Act as amended in 1962, requires every banking company incorporated in India to transfer to its reserve fund a sum equivalent to not less than 20% of its profits irrespective of whether or not its reserves have equalled the paid-up capital. The Amendment Act was necessitated as a result of the fact that the paid-up capital and reserves of commercial banks have not kept pace with the increase in deposits brought about by the growing economic activity during the past few years. This provision is extended to act as a brake on the policy of declaring large dividends to satisfy the shareholders, thus undermining sound banking principles. Certain unscrupulous bankers used to mislead the ignorant public by showing large figures of authorised capital as against very fractional amounts of paid-up capital. So also by calling only a small portion of the subscribed capital, the promoters of the banking companies used to persuade persons to purchase a very large number of shares than they could actually afford to. The provision relating to the reserve fund of banking companies were introduced for the first time by Indian Companies (Amendment Act) 1936 which inserted section 277-K\textsuperscript{58} and 277-L(3)\textsuperscript{59} and provided that every

\textsuperscript{58} Section 277-K.- Transfer of non-scheduled banking companies before any dividend was declared of not less than 20\% of the annual profits to the reserve fund until such fund equated the paid up capital and for the investment of the reserve fund in Government or trustee securities or in a special account with a scheduled bank.
non-scheduled bank should maintain a reserve fund. The amount lying at the credit of the fund was required to be invested in Government securities or in securities mentioned in section 20 of the Indian Trust Act, 1882 or in a special account to be opened with a Scheduled Bank. The provision for creation of reserve fund by the banking companies is in existence in the banking laws of U.S.A., Switzerland, Sweden, etc.60 The reserve fund created under the section 1761 is a separate reserve and cannot be utilised for business purposes. Further the control of the banking company by the Act as amended in 1994, is that the maximum voting rights of any one shareholder is fixed at 10% of the total voting rights. This controls the concentration of power in any banking company by a few shareholders. Interlocking directorates which may pave the way of mis-management are prohibited under the Act. Section 16 of the Act states that no banking company incorporated in India shall have a director any person who is a director of another banking company. A banking company cannot be managed by any person who is a director of any other company, not

59 Section 277-L(3).- Maintenance by non-scheduled banking companies of a cash reserve of at least one and a half percent against their time liabilities and five percent against demand liabilities.


61 Section 17 of the B.R.Act, 1949.- Every banking company incorporated in India shall create a reserve fund and shall out of the balance of profit of each year as disclosed in the profit and loss account prepared under section 29 and before any dividend is declared transfer to the reserve fund a sum equivalent to not less than twenty percent of such profit.
being a subsidiary company of the banking company or a company registered under section 25 of the Companies Act, 1956. From this it can be inferred that a director of any other company can manage a banking company so long as he is not a managing director. But a person cannot manage a banking company, who is a managing director of any other banking company. Under the Companies Act, 1956, a director can be director in twenty public companies. But these restrictions are not applicable to the directors appointed by the Reserve Bank.

To protect the interest of depositors and to impose restrictions on indiscriminate loans and advances to directors and other concerns, the Act prohibits a banking company from granting loan or advances on the security of its own shares; or granting unsecured loans or advances to any of its directors or firms of private concerns in which the bank or any of its directors is interested as partner or managing agent. To safeguard the interests of the depositors, the Amendment Act 1958, provides for the simplification and speedy disposal of winding up proceedings of banks. Further, the Act provides for the public examination of directors and auditors of any bank under liquidation, who are found guilty in the promotion, formation of proper conduct of business of the bank. The Reserve Bank or National Bank may publish any information obtained by them from the Banking Companies in
consolidated form in public interest. The “public interest” is a term, which depends upon the facts and circumstances of each case and whether the matter should be published in the public interest or not, the decision of the Reserve Bank is final. But it should not affect the privacy of an account. The Reserve Bank has published the list of defaulters of the Bank loan in public interest.

A banker will be justified in disclosing information about his customer’s account on reasonable and proper occasions and is under statutory obligation to disclose the information relating to his customer’s account when the law specifically requires him to do so. The RBI collects credit information from the banking companies and also furnishes consolidated credit information from the banking companies. Every banking company is under a statutory obligation under section 45-B of the RBI Act, 1934 to furnish such credit information to the Reserve Bank. Under section 26 of the B.R.Act, every banking company is required to submit a return annually of all such accounts in India, which have not been operated upon for 10 years. Banks are required to give particulars of the deposits standing to the credit of each such account.

Section 28 of the B.R.Act 1949 states that the Reserve Bank or the National Bank or both if they consider it in the public interest so to do so, may publish any information obtained by them under this Act in such consolidated form as they think fit.
According to section 36 of the Act, the RBI is required to make an annual report to the Central Government on the trend and progress of banking in the Country, including its suggestion if any for the strengthening of banking business throughout the Country.

The Reserve Bank is also empowered to inspect any banking company at any time to assure itself about the efficient performance of its responsibilities. Section 35 of the B.R.Act was incorporated with a view to safeguard the interests of shareholders and depositors of banking companies, as a result of which bank directors and managers are likely to be cautious in employing the funds of their institutions. The Reserve Bank may on the direction of the Central Government or on its own cause an inspection of a banking company through its officers. The correspondence between banks and the RBI regarding their affairs is a highly confidential matter\(^{63}\). A copy of the inspection or scrutiny report is required to be given to the banking company either on request or when an adverse action is taken. The Reserve Bank should furnish a copy of the report to the Central Government, if it was conducted on the direction of the Central Government. The Central Government after considering the representation from the Banking Company, prohibits it from

\(^{63}\) RBI v. Central Government Industrial Tribunal, (1959) ILJ 539.
accepting further deposits or directs the RBI to take action under section 38 for the winding up of the Banking Company. The circulars issued by the R.B.I. under section 35 of the B.R.Act, 1949 are statutory in nature and the banks are required to comply with the same. This is particularly useful to promote sound banking methods and the Reserve Bank is authorised to caution a bank or banks generally against a particular transaction or a class of transaction or to offer advice. It can also call a meeting of the directors of a bank or change its management when disclosures arising out of inspection make such a step advisable.

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64 Section 38.- Winding up by High Court.- Notwithstanding anything contained in section 391, section 392, section 433 and section 583 of the Companies Act, 1956, but without prejudice to its powers under sub-section (1) of section 37 of this Act, the High Court shall order the winding up of a banking company,-

a) if the banking company is unable to pay its debts or

b) if an application for its winding up has been made by the Reserve Bank under section 37 or this section.

65 Canara Bank v. P.R.W.Upadhyaya, A.I.R. 1998 SC 3000. The appeal was directed against an award made by the Banking Ombudsman, Hyderabad in a complaint filed by the respondents against the appellant bank. The question here was whether the Ombudsman is bound to comply with the directions issued by the R.B.I. as per section 21, 35 and 35A of the Banking Regulation Act. It was held that since the Ombudsman is appointed by virtue of Scheme framed under section 35A he is obliged to comply with the directions, circulars and notifications issued by the R.B.I. Various circulars, directions and notifications issued by the R.B.I. with regards to term loan or charge of interest have statutory force.
The Reserve Bank also has the power to remove and appoint the Chairman and other top personnel of the banks under Section 10A and 10B of the Banking Regulation Act, 1949\textsuperscript{66}. Section 36AA\textsuperscript{67} provides that the Reserve Bank has the power to remove any Chairman, Director, CEO, any officer or employee of a banking company in the public interest or if the affairs of the bank are being conducted in a manner detrimental to the interest of the depositor or for securing proper management of a banking company.

Restrictions\textsuperscript{68} are also placed on a banking company under section 19(2) of the B.R.Act. No banking company shall hold shares in any company whether as pledge, mortgage or absolute owner more than 30% of the paid-up share capital of that company or 30% of its own paid-up share capital and reserves, whichever is less.

\textsuperscript{66} See Appendix VIII.

\textsuperscript{67} Ibid.

\textsuperscript{68} A banking company shall not form any subsidiary company except a subsidiary company formed for one or more of the following purposes, namely,-

a) the undertaking of any business permissible under clause (a) to (o) of sub-section (1) of section 6 permissible for a banking company to undertake;

b) with the previous permission in writing of the Reserve Bank, the carrying on of the business of banking exclusively outside India, or

c) the undertaking of such other business, which the Reserve Bank may with the prior approval of the Central Government, considers to be conducive to the spread of banking in India or to be otherwise useful or necessary in the public interest.
In addition to this, the Central Government also has certain control and regulatory powers over the banks under the B.R. Act 1949 and the RBI Act 1934. Section 7^69 of the RBI Act, 1934 empowers the Central Government to issue such directions to the Reserve Bank after consultations with the Governor in public interest. Thus the Central Government may exercise control over the banks by issuing directions to the Reserve Bank.

Moreover, in several matters, the Central Government is the appellate authority against the decisions of the Reserve Bank. Under Sections 10B^70 and 36AA^71 of the B.R. Act, the appeal lies to the Central Government against the removal of the managerial personnel. Appeal also lies to the Central Government against the order of the RBI under section 22 relating to

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^69 Section 7: Management. (1) The Central Government may from time to time give such directions to the Bank as it may, after consultation with the Governor of the Bank, consider necessary in the public interest.

(2) Subject to any such directions, the general superintendence and direction of the affairs and business of the Bank shall be entrusted to a Central Board of Directors which may exercise all powers and do all acts and things which may be exercised or done by the Bank.

(3) Save as otherwise provided in regulations made by the Central Board, the Governor and in his absence, the Deputy Governor nominated by him in this behalf, shall also have powers of general superintendence and direction of the affairs and the business of the bank and may exercise all powers and do all acts and things which may be exercised or done by the Bank.

^70 See Appendix VIII.

^71 Supra, p.262 .

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cancellation of licence and section 14A\(^{72}\) relating to refusal of certificate regarding floating charge on assets of the bank.

Section 22 of the B.R.Act states that no banking company can commence or carry on banking business in India until it holds a licence granted to it by the Reserve Bank for the purpose. In the case of banking companies to be started before granting a licence, the Reserve Bank may require to be satisfied whether the conditions given in sub-section (3) of section 22 are fulfilled. The Banking Laws (Amendment) Act of 1983 has widened the scope of the matters which the Reserve Bank may consider before granting a licence. It is observed in this context that while a banking company whose licence is cancelled by the Reserve Bank has the right of appeal to the Central Government, the latter's decision is final. But no such appeal can be preferred by a new company whose application for licence is turned down. In *Sajjain Bank (P) Ltd.*\(^{73}\) Case it was held that the provisions of section 22 of the B.R.Act, 1949 prescribe only a system of licensing, having for its object the regulation of the business of banking and does not violate fundamental right of

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\(^{72}\) Section 14.- (1) Notwithstanding anything contained in section 6, no banking company shall create a floating charge on the undertaking or any property of the company or any part thereof unless the creation of such floating charge is certified in writing by the Reserve Bank as not being detrimental to the interests of the depositors of such company.

(2) Any such charge created without obtaining the certificate of the Reserve Bank shall be invalid.

\(^{73}\) A.I.R. 1961 Mad.8.
any person to carry on the business of banking. It was also laid down that the powers vested in the Reserve Bank under this section are not vested with a mere officer of the Reserve Bank. This section originated with the demand for licensing of foreign banks doing business in India and was also recommended by the Indian Central Banking Enquiry Committee, mainly with the object of prohibiting the entry of banks started in countries which discriminated against banks in India. The above section, however introduces a comprehensive system of licensing of banks by the Reserve Bank and it also provides for the issue of conditional licence. Laws of certain foreign countries such as Switzerland, U.S.A. and Sweden have almost similar provisions. The section is basically dealing with the necessity of licensing and mode of applying for it, conditions for granting of licences, etc. It also provides for appeals against orders of such cancellations.

Under section 45, B.R.Act the Central Government after considering the application made by the Reserve Bank may make an order of moratorium staying the commencement or continuance of all acts and proceedings against the banking company for a fixed period on such terms and conditions as it thinks fit and proper. The Central Government is also

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74 Section 45 deals with the power of Reserve Bank to apply to Central Government for supervision of business by a banking company and to prepare scheme of reconstitution for amalgamation.
empowered under section 4 to suspend operations of the B.R.Act or give exemption from any provisions of the Act on the representation or recommendations of RBI under section 53\(^{75}\). The Central Government may notify other forms of business which a bank may undertake under section 6(o)\(^{76}\) of the B.R.Act. Only with the prior approval of the Central Government the Banking Companies may form a subsidiary company. Section 19 puts restrictions on the formation of a subsidiary company which the Central Government considers conducive to the spread of banking in India or otherwise useful or necessary in the public interest.

Section 24(2)\(^{77}\) of B.R.Act empowers the Central Government to notify the banks for the purpose of maintenance of assets. Section 29\(^{78}\) of

\(^{75}\) Section 53 deals with the power of the Central Government to exempt in certain cases. The Central Government may on the recommendation of the Reserve Bank declare by notification in the official gazette that any or all of the provisions of this Act shall not apply to any banking company or to any class of banking companies either generally or for such period as may be specified.

\(^{76}\) Section 6(o) refers to 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.

\(^{77}\) Section 24(2) states that in computing the amount for the purpose of maintenance of assets to be made with the Reserve Bank by a banking company incorporated outside India and any balance maintained in India by a banking company in current account with the Reserve Bank or the SBI or with any other Bank which may be notified in this behalf by the Central Government, including in the case of a scheduled bank, the balance required under section 42 of the RBI Act 1934 to be so maintained and shall be deemed to be cash maintained in India.
B.R.Act empowers Central Government to make provisions for the preparation or other matters relating to the balance sheet or profit & loss account. Under section 277F of the Companies Act of 1913, it was not necessary to state the bad or doubtful nature of debts of a banking company in the balance sheet. The banking company should be doing a banking business. The Central Government is empowered under section 35 to issue directions for inspection of banks and under section 36A to acquire undertaking of banks. It also has power to make rules under sections 45Y\textsuperscript{79} and 52 of B.R.Act\textsuperscript{80}. Section 45 specifies the power of the Central Government to make rules for the

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\textsuperscript{78} Section 29 states that at the expiration of each calendar year or at the expiration of a period of twelve months ending with such date as the Central Government may by notification in the official gazette specify in this behalf, every banking company incorporated in India, in respect of all business transacted by it and every banking company incorporated outside India in respect of all business transacted through its branches in India shall prepare with reference to that year or the period as the case may be, a balance sheet and profit and loss account on the last working day of the year or the period as the case may be in the form set out in the third schedule.

\textsuperscript{79} In Re G.Natesan, A.I.R. 1949 Mad.657.

\textsuperscript{80} The powers of the Central Government to make rules as per section 52 are as follows:-

(1) The Central Government may after consultation with the Reserve Bank make rules for the purpose of giving effect to the provisions of this Act and all such rules be published in the official gazette.

(2) Without prejudice to the generality of the foregoing power, such rules may provide for the details to be included in the returns required by this Act.

(3) The Central Government may by rules made under this section, annul, alter or add to or any of the provisions of the Fourth Schedule.

(4) Every rule made by the Central Government under this Act shall be laid as soon as may be after it is made before each House of Parliament.
preservation of records and section 52 for the purpose of giving effect to the provisions of this Act.

The RBI and the Government of India acquired draconian powers under the RBI Act 1934 and the B.R.Act 1949. But the concept of mass-banking – a change from class banking, the directed lending policy and subsidized bank lending over a period of time has resulted in many of these banks making losses and also becoming inefficient and incompetent. To camouflage the public, the asset classifications became illusory\textsuperscript{81}. The RBI and the Government under the dictates of the I.M.F. and the World Bank brought in the prudential norms of asset classifications as some of the nationalised banks became weak and sick and the merger of the weaker and stronger banks started\textsuperscript{82}.

The Narasimham Committee also is of the opinion that the Indian banking systems at present is over-regulated and over-administered\textsuperscript{83}. There is excessive control over administrative and other aspects of bank organisations and functioning. The Committee is firmly of the opinion that the duality

\textsuperscript{81} B.Gupta, \textit{Statistics} (1990), p.74.


control over the banking system between the Reserve Bank and the Central Government should end and that the Reserve Bank should be the primary agency for the regulation and control of the banking system\textsuperscript{84}. For this purpose it is necessary to look into the working and operation of the central banking in other countries and how they function independently of the Government in controlling their banking system.

\textsuperscript{84} \textit{ibid.}
CHAPTER IV