



CAIIB PAPER-4

Module-A Unit-3

**BANKING REGULATIONS AND
BUSINESS LAWS (BRBL)**



CAIIB Paper 4 (BRBL) Module A Unit 3: Regulation Of Banking Business

Power To Issue Directions

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.
- The RBI has been issuing directions from time to time **under Section 21 regulating rates of interest** and other terms and conditions of acceptance of deposits and making of loans and advances
- The Banking Regulation (Amendment) Act re-inserted two new sections viz. **35AA and 35AB** thereby empowering the Reserve Bank of India (RBI) to directly intervene in settling bad loan cases.

Nature of Directions:

- The directions issued by the Reserve Bank in exercise of powers **under Sections 21 and 35A of the BR Act**, being statutory directions, are binding on the banks.

Caution and Advice:

- As per **Section 36 of the BR Act**, the RBI is empowered to caution or give advice to Banking Companies, in addition to giving directions.
- **Section 36(1) (a)** stipulates “**The Reserve Bank** may - caution or prohibit banking companies or any banking company in particular against entering into any particular transaction or class of transactions, and generally give advice to any banking company.”

Acceptance Of Deposits

Types of Deposits:

- Banks accept different types of deposits, both time and demand deposits, from the public.
- The period of the deposit and rate of interest applicable to the deposit are matters to be agreed between the depositor and the bank under the terms of the deposit, subject to any directions given by the Reserve Bank in this regard.

Acceptance of Deposits:

- Acceptance of Deposits is one of the main activities carried out by Banks and this has been acknowledged in the definition of ‘**Banking**’ as per **Section 5(b) of the BR Act 1949**. However, regulations as regards acceptance of deposits does not find a place in the Act.

- Deposits garnered by all types of Banks including Regional Rural Banks and Cooperative Banks have been brought under the purview of The Deposit Insurance and Credit Guarantee Corporation, administered by RBI, as per **Deposit Insurance and Credit Guarantee Corporation (DICGC) Amendment Act, 2021 and funds up to Rs. 5 Lacs are returnable by a Bank to an account holder within 90 days** in the event of a bank coming under the moratorium imposed by the **Reserve Bank of India (RBI)**.

Returns 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 in the form and manner prescribed and should cover all deposits not operated for ten.
- The Amending Act of 2013 has introduced the setting up of a **Depositor Education and Awareness Fund, under Section 26 A to take over inoperative deposit account(s) which have not been claimed or operated for a period of ten years or more**, within a period of three months from the expiry of the said period of ten years, with provision for the amount to be claimed back by the original depositor/ legal heirs/nominees at any time by following due procedure.

As per RBI guidelines vide notification dated 21st march 2014, the eligible amounts to be credited to the DEAF account shall be the credit balance in any deposit account maintained with banks which **have not been operated upon for ten years or more, or any amount remaining unclaimed for ten years or more, which include:**

- ✓ Savings bank deposit accounts;
- ✓ Fixed or term deposit accounts;
- ✓ Cumulative/recurring deposit accounts;
- ✓ Current deposit accounts;
- ✓ Other deposit accounts in any form or with any name;
- ✓ Cash credit accounts;
- ✓ Loan accounts after due appropriation by the banks;
- ✓ Margin money against issue of Letter of Credit/Guarantee etc., or any security deposit;
- ✓ Outstanding telegraphic transfers, mail transfers, demand drafts, pay orders, bankers cheques, sundry deposit accounts, vostro accounts, inter-bank clearing adjustments, unadjusted National Electronic Funds Transfer (NEFT) credit balances and other such transitory accounts, unreconciled credit balances on account of Automated Teller Machine (ATM) transactions, etc.;
- ✓ Undrawn balance amounts remaining in any prepaid card issued by banks but not amounts outstanding against travellers cheques or other similar instruments, which have no maturity period;
- ✓ Rupee proceeds of foreign currency deposits held by banks after conversion of foreign currency to rupees in accordance with extant foreign exchange regulations.

- Any amount payable in foreign currency under an instrument or a transaction, that has remained unclaimed for ten years or more, shall at the time of transfer to the Fund be converted into Indian Rupees at the exchange rate prevailing on that date
- As per the extant guidelines banks are required to calculate the interest payable on interest bearing deposits transferred to RBI at the rate of 4 per cent p.a. up to June 30, 2018, 3.5 per cent w.e.f. July 1, 2018 up to May 10, 2021 and at 3 per cent with effect from May 11, 2021 till the time of payment to the depositor/claimant.

Nomination

Repayment of Deposits:

- A depositor or depositors of a Banking Company (which term includes a Cooperative Bank) is empowered by **Section 45ZA of the Banking Regulation Act** to nominate one person, in the manner prescribed, as nominee.

Articles in Safe Custody and Safety Lockers:

- There are also provisions in the Banking Regulation Act for nomination in respect of articles kept in safe custody with banks and Safe Deposit Lockers.
- **Sections 45ZC and 45ZE** provide that any person, who leaves any article in safe custody and in Safe Deposit Lockers respectively with a banking company, may nominate one person as nominee to receive the article in the event of death of that person.

Loans And Advances

The Reserve Bank is empowered under Section 21 of the Banking Regulation Act to issue directions to control advances by banking companies.

The directions given by the Reserve Bank are binding on banking companies, and may be on one or more of the following matters:

- ✓ Purpose for which advances may or may not be made.
- ✓ Margins to be maintained in respect of secured advances.
- ✓ Maximum amount of advances which may be made to any company, firm, individuals.
- ✓ Maximum amount upto which guarantees may be given by a banking company
- ✓ Rate of interest and other terms and conditions on which advances may be made or guarantees may be given.
- RBI also has the powers to impose **Selective Credit Control (SCC)** measures. SCC stipulates the quantum of credit that can be extended and also the rate at which credit can be extended by Banks while financing against essential commodities like food grains, pulses, edible oils, sugar, jaggery, cotton and textiles.

- **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.
- 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.**

Regulation Of Interest Rates

- The Reserve Bank is authorized to regulate interest rates **under Section 21 of the Banking Regulation Act.** This includes rates of interest for loans and advances as well as deposits.
- The rates of interest on both deposits and loans have been deregulated by Reserve Bank of India now.
- At present SCBs and Small Finance Banks are allowed to offer differential rates of interest on term deposits on the basis of tenor and quantum for **single term deposits of Rs. 2 crore and above.** For Regional Rural Banks, they are allowed to offer differential rates of **term deposits of Rs. 15 Lakh and above.**

Base Rate

- The Base Rate system replaced the BPLR system with effect from July 1, 2010. Banks may choose any benchmark to arrive at the Base Rate for a specific tenor that may be disclosed transparently. Banks may determine their actual lending rates on loans and advances with reference to the Base Rate and by including such other customer specific charges as considered appropriate.
- The Base Rate of interest was replaced by RBI with Marginal Cost of Fund based Lending Rates (MCLR) w.e.f. 01.04.2016. Accordingly, all floating rate rupee loans sanctioned and renewed between July 1, 2010 and March 31, 2016 were priced with reference to the Base Rate which was taken to be the internal benchmark for such purposes.

Marginal Cost Of Lending Rate

- RBI implemented MCLR on 1 April 2016 to determine rates of interests for loans. The bank cannot grant any loan below that rate, except in certain cases permitted by the Reserve Bank of India.
- It considers unique factors like the marginal cost of funds instead of the overall cost of funds. The marginal cost takes into account the repo rate, which did not form part of the base rate. The fixed rate loans upto three years shall be priced with reference to MCLR.

It includes:

- Marginal cost of funds

- Negative Carry on account of CRR will be calculated as: $\text{Required CRR} \times (\text{marginal cost}) / (1 - \text{CRR})$
- Operating Costs
- Tenor premium

Banks shall publish the internal benchmark for the following maturities:

- Overnight MCLR,
- One-month MCLR,
- Three-month MCLR,
- Six-month MCLR,
- One year MCLR.

Difference between MCLR and Base Rate

- The MCLR is determined by the current cost of funds, in contrast to the base rate, which is governed by the average cost of funds.
- The MCLR is calculated by considering tenor premium. Base Rate is calculated by considering minimum rate of return/profit margin.
- The MCLR is determined by considering deposit rates and repo rates, along with operating costs and cost of maintaining CRR. The Base Rate is also governed by operating expenses, and expenses needed to maintain cash reserve ratio.
- The MCLR takes into account the repo rate, which did not form part of the base rate.

External Benchmark Based Lending

All new floating rate personal or retail loans (housing, auto, etc.) and floating rate loans to Micro and Small Enterprises extended by banks from October 01, 2019 and floating rate loans to **Medium Enterprises from April 01, 2020 shall be benchmarked to one of the following:**

- Reserve Bank of India policy repo rate
- Government of India 3-Months Treasury Bill yield published by the Financial Benchmarks India Pvt. Ltd, Government of India 6-Months Treasury Bill yield published by the FBIL or any other benchmark market interest rate published by the FBIL.

In order to ensure transparency, standardization, and ease of understanding of loan products by borrowers, a bank must adopt a uniform external benchmark within a loan category.

Internet Banking Guidelines

Highlights of the RBI guidelines based on the recommendations of the Working Group on Internet Banking are as follows:

Technology and Security Standards

- Banks should have a security policy duly approved by the Board of Directors. Information Systems Auditor will audit the information systems
- Banks should introduce logical access controls techniques which may include user-ids, passwords, smart cards or other biometric technologies
- PKI (Public Key Infrastructure) should be the most favoured technology for secure Internet banking services.
- The information security officer and the information system auditor should undertake periodic penetration tests of the system.
- The backed-up data should be periodically tested to ensure recovery without loss of transactions in a time frame.
- All applications should have proper record keeping facilities for legal purposes. All received and sent messages to be kept both in encrypted and decrypted form.

Legal Issues

- All accounts opening requests received over Internet, should be opened only after proper physical verification of the identity of the customer.
- The Consumer Protection Act, 1986 defines the rights of consumers in India and is applicable to banking services as well.

Regulatory And Supervisory Issues

- Banks should obtain prior approval from RBI for providing the Internet Banking services.
- Banks will report to RBI every breach or failure of security systems and procedure and the RBI, may decide to commission special audit/inspection of such banks.
- Only institutions who are members of the cheque clearing system in the country will be permitted to participate in Inter-bank payment gateways for Internet payment.

RBI issued guidelines for providing Internet Banking Facility for customers of all licensed St CBs, DCCBs and UCBs which have implemented Core Banking Solution (CBS) and migrated to Internet Protocol Version 6 (IPv6). **These guidelines have been categorized as follows:**

- **Internet Banking (View Only) Facility:** Under this facility it should be ensured that the facility is strictly for non-transactional services. The cooperative banks have to report commencement of the service to the concerned Regional Office of RBI (and also NABARD in case of St CBs/DCCBs) within one month of operationalization of Internet Banking (View only) facility.
- **Internet Banking with Transactional Facility:** Under this facility Cooperative Banks shall ensure fulfilling the following criteria before offering Internet Banking with transactional facility
- CRAR of not less than 10 per cent.
- Net worth is Rs. 50 crore or more as on March 31 of the immediate preceding financial year.

- Gross NPAs less than 7% and Net NPAs not more than 3%.
- The bank should have made a net profit in the immediate preceding financial year and overall, should have made net profit at least in three out of the preceding four financial years
- It should not have defaulted in maintenance of CRR/SLR during the immediate preceding financial year.
- It has sound internal control system with at least two professional directors on the Board.
- No monetary penalty has been imposed on the bank for violation of RBI directives/guidelines during the two financial years, preceding the year in which the application is made.”

Regulation Of Money Market Instruments

Prudential limits for outstanding borrowing transactions in Call, Notice and Term Money Markets

Participant Category	Prudential Limit
Scheduled Commercial Banks (including Small Finance Banks)	Call and Notice Money: (i) 100% of capital funds, on a daily average basis in a reporting fortnight, and (ii) 125% of capital funds on any given day. Term Money: Internal board approved limit within the prudential limits for inter-bank liabilities.
Payment Banks and Regional Rural Banks	Call, Notice and Term Money: (i) 100% of capital funds, on a daily average basis in a reporting fortnight, and (ii) 125% of capital funds on any given day.
Co-operative Banks	Call, Notice and Term Money: 2.0% of aggregate deposits as at the end of the previous financial year.
Primary Dealers	Call and Notice Money: 225% of Net Owned Fund (NOF) as at the end of the previous financial year on a daily average basis in a reporting fortnight. Term Money: 225% of Net Owned Fund (NOF) as at the end of the previous financial year.

Certificate Of Deposit

CDs can be issued by

- ✓ Scheduled Commercial Banks;
- ✓ Regional Rural Banks; and
- ✓ Small Finance Banks.
- ✓ All India Financial Institution. CDs can be issued as discounted instrument and may be issued to all persons resident in India.
- In the primary market, CDs shall be issued only in dematerialized form and held with a depository registered with Securities and Exchange Board of India with a **minimum denomination of Rs. 5 lakh and in multiples of Rs. 5 lakh thereafter.**

- Minimum tenor shall **not be less than 7 days and shall not exceed one year. CDs shall be issued on a T+1 basis.**
- Banks are not allowed to grant loans against CDs, unless specifically permitted by the Reserve Bank.
- Buyback of CDs at the prevailing market rates can **be made only 7 days after the date of issue of the CD.**

Commercial Paper

- Companies, including Non-Banking Finance Companies (NBFCs) and All India Financial Institutions (AIFIs), are eligible to issue CPs. Other entities like co-operative societies/unions, government entities, trusts, limited liability partnerships and any other body corporate having presence in **India with a net worth of Rs. 100 crore can issue CPs**
- All residents, and non-residents permitted to invest in CPs under **Foreign Exchange Management Act (FEMA), 1999** are eligible to invest in CPs.
- A CP shall be issued in the form of a promissory note at a discount to face value and held in a dematerialized form through any of the depositories approved by and registered with SEBI.
- Minimum denomination of **CP shall be Rs. 5 lakh and multiples** thereof.
- No issuer shall have the issue of a CP underwritten or co-accepted.
- Options (call/put) are not permitted on a CP.
- Eligible issuers, whose total CP issuance during a calendar year is Rs. 1000 crore or more, shall obtain credit rating for issuance of CPs from at least two CRAs registered with SEBI.
- The minimum credit rating for a CP shall be 'A3' as per rating symbol and definition prescribed by SEBI.
- The buyback offer can be made at prevailing price and the same may not be made **before 30 days from the date of issue.**

Banking Ombudsman

RBI has announced revised guidelines in respect of the Integrated Ombudsman Scheme 2021 as follows:

- The Scheme integrates the existing three Ombudsman schemes of RBI namely, (i) the Banking Ombudsman Scheme, 2006; (ii) the Ombudsman Scheme for Non-Banking Financial Companies, 2018; and (iii) the Ombudsman Scheme for Digital Transactions, 2019.
- The Scheme also includes under its ambit Non-Scheduled Primary Co-operative Banks with a deposit size of Rs. 50 crore and above.
- A Centralised Receipt and Processing Centre has been set up at RBI, Chandigarh for receipt and initial processing of physical and email complaints in any language.
- The responsibility of representing the Regulated Entity and furnishing information in respect of complaints filed by customers against the Regulated

Entity would be that of the **Principal Nodal Officer** in the rank of a General Manager in a Public Sector Bank or equivalent.

- The Executive Director-in charge of Consumer Education and Protection Department of RBI would be the Appellate Authority under the Scheme.
- An award shall not be binding on a bank against which it is passed unless the complainant furnishes a letter of acceptance of the award within a period of fifteen days from the date of receipt of copy of the award.
- Within one month from the date of receipt by the bank of the acceptance in writing of the award by the complainant the bank has to comply with the award.
- However, if the bank or the complainant is aggrieved by the award, it/ he can make an appeal to the appellate authority (Deputy Governor, Reserve Bank) under the scheme. **The appeal must be made within 30 days of the Ombudsman's decision.**

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. The transfer to Reserve Fund was increased, by **RBI, to 25% of net profits after tax from 31st March 2001.**

Maintenance Of Cash Reserves

- Every banking company which is a **scheduled bank** has a duty to maintain certain cash reserve with the **Reserve Bank under Section 42 of the Reserve Bank of India Act**. In the case of non-scheduled banks, **Section 18 of the Banking Regulation Act** provides for the maintenance of cash reserve.
- A banking company which has the requisite capital and reserves of Rs. 5 lakh and the affairs of which are not conducted in a manner detrimental to the interests of depositors is eligible to be included in the second schedule.
- The cash reserve required to be maintained by a scheduled bank with the **Reserve Bank under Section 42(1) of the Reserve Bank of India Act (as amended in 2006) is an average daily balance**, being per cent of the total of the demand and time liabilities in India of that bank.
- **'Average daily balance'** for this purpose means the average of the balances held at the close of business of each day for a fortnight. The liabilities, for this purpose do not include paid-up capital and reserves and any credit balance in the profit and loss account.

The maintenance of CRR shall be reported to Reserve Bank of India under the following statutory returns:

- ✓ **Form A Return** for Scheduled Commercial Banks (including Regional Rural Banks (RRBs)), Small Finance Banks, Payments Banks and Local Area Banks
- ✓ **Form B Return** for Scheduled Co-operative Banks

- ✓ **Form I Return** for non-scheduled Co-operative Banks
- Every scheduled bank, small finance bank and payments bank shall maintain minimum CRR of not less than ninety per cent of the required CRR on all days during the reporting fortnight, in such a manner that the average of CRR maintained daily shall not be less than the CRR prescribed by the Reserve Bank.
- When the balance maintained by any scheduled bank falls below the stipulated minimum (presently 90 per cent of stipulated requirement) such a bank shall be liable to pay a penal interest to the Reserve Bank. During the first fortnight, when such shortage occurs, the penal interest shall be three per cent above the bank rate and if the shortage continues in the next fortnight, the penal interest shall increase to five per cent above the bank rate.
- In the case of banking companies, which are not scheduled banks under Section 18 of the Banking Regulation Act, the cash reserve need not be maintained with the Reserve Bank. It may be with the bank itself, or in a current account with the Reserve Bank. The balance maintained should not be less than three per cent of the demand and time liabilities as on the last Friday of the second preceding fortnight.

Maintenance of the Statutory Liquidity Ratio

- Every banking company has a duty to maintain a certain percentage of their Net Demand and Time Liabilities as assets in India, **under Section 24 of the Banking Regulation Act, 1949**, in the form and manner specified by the Reserve Bank.
- 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.
- For ensuring compliance with the above provisions, a monthly return has to be submitted to the Reserve Bank by every banking company

The maintenance of SLR shall be reported to Reserve Bank of India under the following statutory returns:

- ✓ **Form VIII Return (for SLR)** for Scheduled Commercial Banks (including Regional Rural Banks), Small Finance Banks, Payments Banks and Local Area Banks.
- ✓ **Form I Return (for SLR)** for all Co-operative Banks under Section 24 of the Banking Regulation Act, 1949.

Penalty for Default: If the balance on any alternate Friday (or the preceding working day, when such Friday is a holiday) 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 shortfall for the day. If the default recurs on the succeeding

alternate Friday, the penal interest is raised to five per cent above the bank rate on the shortfall.

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