**2 Lectures study material for 13/03/2020 for B.A final year students sec A (Banking and Insurance) prepared by Ms. Durga Devi from Commerce Department**

**TOPIC- BANKING REGULATION ACT 1948**

The **Banking Regulation Act, 1949** is a legislation in [India](https://en.wikipedia.org/wiki/India) that regulates all banking firms in India. Passed as the Banking Companies Act 1949, it came into force from 16 March 1949 and changed to Banking Regulation Act 1949 from 1 March 1966. It is applicable in jammu and Kashmir from 1956. Initially, the law was applicable only to banking companies. But, 1965 it was amended to make it applicable to cooperative banks and to introduce other changes

Definition of Banking

A banking company is defined as a company which transacts the business of banking in India. The Indian Banking Regulation Act defines the business of banking by stating the essential functions of a banker. It also states the various other businesses a banking company may be engaged in and prohibits certain business to be performed by it.

Banking Regulation Act, 1949

As per Section 5(b) of Banking Regulation Act, 1949

Banking means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdraw able by cheque, draft, order or otherwise.

As per Section 5(c) of Banking Regulation Act, 1949―Banking Company" means any company which transacts the business of banking in India.

Important Provisions of Banking Regulation Act, 1949

**1. Use of words ‘bank’, ‘banker’, ‘banking’ or ‘banking company’ (Sec.7):** According to Sec. 7 of the Banking Regulation Act, no company other than a banking company shall use the words ‘bank’, ‘banker’, ‘banking’ or ‘banking company’ and no company shall carry on the business of banking in India, unless it uses the above mentioned words in its name.

**2. Prohibition of Trading (Sec. 8):** According to Sec. 8 of the Banking Regulation Act, a banking company cannot directly or indirectly deal in buying or selling or bartering of goods. But it may, however, buy, sell or barter the transactions relating to bills of exchange received for collection or negotiation.

**3. Disposal of banking assets (Sec. 9):**According to Sec. 9 “A banking company cannot hold any immovable property, howsoever acquired, except for its own use, for any period exceeding seven years from the date of acquisition thereof. The company is permitted, within the period of seven years, to deal or trade in any such property for facilitating its disposal”.

**4. Management (Sec. 10):**Sec. 10 (a) states that not less than 51% of the total number of members of the Board of Directors of a banking company shall consist of persons who have special knowledge or practical experience in one or more of the following fields:

a) Accountancy

b) Agriculture and Rural Economy

c) Banking

d) Cooperative

e) Economics

f) Finance

g) Law

h) Small Scale Industry.

**5. Requirements as to minimum paid-up capital and reserves (Sec. 11):**Sec. 11 (2) of the Banking Regulation Act, 1949, provides that no banking company shall commence or carry on business in India, unless it has minimum paid-up capital and reserve of such aggregate value as is noted below:

**(a) Foreign Banking Companies:**In case of banking company incorporated outside India, aggregate value of its paid-up capital and reserve shall not be less than Rs. 15 lakhs and, if it has a place of business in Mumbai or Kolkata or in both, Rs. 20 lakhs. It must deposit and keep with the R.B.I, either in Cash or in unencumbered approved securities:

**(i)**The amount as required above, and

**(ii)** After the expiry of each calendar year, an amount equal to 20% of its profits for the year in respect of its Indian business.

**(b) Indian Banking Companies:** In case of an Indian banking company, the sum of its paid-up capital and reserves shall not be less than the amount stated below:

**(i)** If it has places of business in more than one State, Rs. 5 lakhs, and if any such place of business is in Mumbai or Kolkata or in both, Rs. 10 lakhs.

**(ii)** If it has all its places of business in one State, none of which is in Mumbai or Kolkata, Rs. 1 lakh in respect of its principal place of business plus Rs. 10,000 in respect of each of its other places of business in the same district in which it has its principal place of business, plus Rs. 25,000 in respect of each place of business elsewhere in the State.

**(iii)** If it has all its places of business in one State, one or more of which are in Mumbai or Kolkata, Rs. 5 lakhs plus Rs. 25,000 in respect of each place of business outside Mumbai or Kolkata? No such banking company shall be required to have paid-up capital and reserve excluding Rs. 10 lakhs.

**6. Regulation of capital and voting rights of shareholders (Sec. 12):** According to Sec. 12, no banking company can carry on business in India, unless it satisfies the following conditions:

**(a)** Its subscribed capital is not less than half of its authorized capital, and its paid-up capital is not less than half of its subscribed capital.

**(b)**Its capital consists of ordinary shares only or ordinary or equity shares and such preference shares as may have been issued prior to 1st April 1944.

**(c)**The voting right of any shareholder shall not exceed 5% of the total voting right of all the shareholders of the company.

**7. Restriction on Commission, Brokerage, Discount etc. on sale of shares (Sec. 13):**According to Sec. 13, a banking company is not permitted to pay directly or indirectly by way of commission, brokerage, discount or remuneration on issues of its shares in excess of 2½% of the paid-up value of such shares.

**8. Prohibition of charges on unpaid capital (Sec. 14):**A banking company cannot create any charge upon its unpaid capital and such charges shall be void.

**9. Restriction on Payment of Dividend (Sec. 15):**According to Sec. 15, no banking company shall pay any dividend on its shares until all its capital expenses (including preliminary expenses, organisation expenses, share selling commission, brokerage, amount of losses incurred and other items of expenditure not represented by tangible assets) have been completely written-off.

**10. Reserve Fund/Statutory Reserve (Sec. 17):** According to Sec. 17, every banking company incorporated in India shall, before declaring a dividend, transfer a sum equal to 25% of the net profits of each year (as disclosed by its Profit and Loss Account) to a Reserve Fund. The Central Government may, however, on the recommendation of RBI, exempt it from this requirement for a specified period.

**11. Cash Reserve (Sec. 18):**Under Sec. 18, every banking company (not being a Scheduled Bank) shall, if Indian, maintain in India, by way of a cash reserve in Cash, with itself or in current account with the Reserve Bank or the State Bank of India or any other bank notified by the Central Government in this behalf, a sum equal to at least 3% of its time and demand liabilities in India.

The Reserve Bank has the power to regulate the percentage also between 3% and 15% (in case of Scheduled Banks). Besides the above, they are to maintain a minimum of 25% of its total time and demand liabilities in cash, gold or unencumbered approved securities.

**12. Liquidity Norms or Statutory Liquidity Ratio (SLR) (Sec. 24):** According to Sec. 24 of the Act, in addition to maintaining CRR, banking companies must maintain sufficient liquid assets in the normal course of business. The section states that every banking company has to maintain in cash, gold or unencumbered approved securities, an amount not less than 25% of its demand and time liabilities in India.

This percentage may be changed by the RBI from time to time according to economic circumstances of the country. This is in addition to the average daily balance maintained by a bank.

**13. Restrictions on Loans and Advances (Sec. 20):** After the Amendment of the Act in 1968, a bank cannot:

**(i)** Grant loans or advances on the security of its own shares, and

**(ii)** Grant or agree to grant a loan or advance to or on behalf of:

**a)**Any of its directors;

**b)**Any firm in which any of its directors is interested as partner, manager or guarantor;

**c)**Any company of which any of its directors is a director, manager, employee or guarantor, or in which he holds substantial interest; or

**d)**Any individual in respect of whom any of its directors is a partner or guarantor.

**14. Accounts and Audit (Sees. 29 to 34A):**The above Sections of the Banking Regulation Act deal with the accounts and audit. Every banking company, incorporated in India, at the end of a financial year expiring after a period of 12 months as the Central Government may by notification in the Official Gazette specify, must prepare a Balance Sheet and a Profit and Loss Account as on the last working day of that year, or, according to the Third Schedule, or, as circumstances permit.

According to Sec. 30 of the Banking Regulation Act, the Balance Sheet and Profit and Loss Account should be prepared according to Sec. 29, and the same must be audited by a qualified person known as auditor. Moreover, every banking company must furnish their copies of accounts and Balance Sheet prepared according to Sec. 29 along with the auditor’s report to the RBI and also the Registers of companies within three months from the end of the accounting period.

* **2 Lecture Study material for 14/03/2020 for B.A Final year banking and insurance by Durga Devi**

**TOPIC-NON PERFORNING ASSESTS**

**Concept of Non Performing Assets in India**

Non Performing Asset means an asset or account of borrower, which has been classified by a bank or financial institution as sub-standard, doubtful or loss asset, in accordance with the directions or guidelines relating to asset classification issued by RBI. An amount due under any credit facility is treated as "past due" when it has not been paid within 30 days from the due date. Due to the improvement in the payment and settlement systems, recovery climate, upgradation of technology in the banking system, etc., it was decided to dispense with 'past due' concept, with effect from March 31, 2001. Accordingly, as from that date, a Non performing asset (NPA) shell be an advance where

1. interest and/or installment of principal remain overdue for a period of more than 180 days in respect of a Term Loan,

2. the account remains 'out of order 'for a period of more than 180 days, in respect of an overdraft/ cash Credit

3. the bill remains overdue for a period of more than 180 days in the case of bills purchased and discounted,

4. interest and/ or installment ofprincipal remains overduefor two harvest seasons but for a period not exceeding two halfyears in the case ofan advance grantedfor agriculturalpurpose, and

5. any amount to be received remains overduefor a period ofmore than 180 days in respect ofother accounts.

With a view to moving towards international best practices and to ensure greater transparency, it has been decided to adopt the '90 days overdue' norm for identification of NPAs, form the year ending March 31, 2004. Accordingly, with effect form March 31, 2004, a non-performing asset (NPA) shall be a loan or an advance where;

1. interest and/or installment ofprincipal remain overdue for a period ofmore than 90 days in respect ofa Term Loan,

2. the account remains 'out oforder 'for a period ofmore than 90 days, in respect ofan overdraft/ cash Credit(OD/CC),

3. the bill remains overdue2 for a period of more than 90 days in the case of bills purchased and discounted,

4. interest and/ or installment ofprincipal remains overdue for two harvest seasons but for a period not exceeding two half years in the case of an advance granted for agricidturalpurpose, and

5. any amount to be received remains overdue for a period of more than 90 days in respect ofother accounts.

* Effect of NPA (Non performing assets) in Banking Sector

The role of the banking sector in economic transformation is significant as banks play a vital role in providing the desired financial resources to the needy sectors. Bank itself posses the controlling power of the economy. The flow of money person to person, business to business, country to country just due to the banking system. Banks fuels the economical vehicle to run smoothly, and also said as the backbone of the economy.

## Impact of NPA On Banks

“NPA’s Non-performing assets are the assets of the banks which are not performing, banks to run the economy also provide short-term and long-term loans to the industries, individuals, farmers, a bank also gives loan against the home, vehicles and many more.

In some cases, the borrower unable to pay the interest amount on time as well as unable to return the principal amount too, in that case, bank declares that amount as nonperforming.

The bank also runs the recovery scenario for that amount, the impact of NPA on the profitability of banks brings a dent on the balance sheet of the bank, but until then the amount is nonperforming.

## Impact of Non Performing Assets on Balance Sheet

High Non Performing Assets are the foremost problem for the banking system for any economy, that shakes the whole banking system of the country.

The confidence level of the investor, Depositors, Stack holders also effects. This also causes the rotation of money.

### Profitability due to NPA

Non Performing Assets not only reduces the profit of the Bank but also increases the Loss.

Also, banks also providing 25 % to 30% additional provision on Non Performing Assets which directly impact the Profitability of the Bank.

### Liability Management

Due to high Non Performing Assets, Bank for forced for lower the interest rates of the deposit and on advances likely to pay Higher interest rates on advances.

This situation is a very difficult situation and also hamper the banking business.

## Types of Non-Performing Assets (NPA)

### Standard Assets

Standard Assets brings regular income to the organization, Such an asset should not be an NPA because of the risk of borrower fails. In some scenario, standard assets are leaded to get fixed income, if the borrower fails to make repayment regularly and on time, the standard assets said to be NPA.

### Sub Standard Assets

The assets which repayment is due for more than 90 days but less than 1 year. Earlier credit card users would get 120 days before being classified as NPAs, as per new amendment if the minimum card payment is not paid within 90 days, it would be treated as sub-standard assets.

### ****Doubtful asset****

Doubtful assets speak itself and explain the meaning, in this category if substandard assets remain unpaid for more then 12 months. Going further, doubtful assets are those advances that have a considerable list of defaults or are regularly failing to comply with the norms of “standard asset”.

### Loss Assets

When the performance of the assets across all the levels of substandard and doubtful category and audit team also declared the loss of the asset, An asset as NPA for a period of more than **36 months** is treated as a lost asset.

**2 Lectures study material for 21/03/2020 for B.A Final year (Banking and Insurance)Prepared by**

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**TOPIC-UNDERSTANDING BALACE SHEET OF BANK**

**Understanding a Bank's Balance Sheet**

A bank's balance sheet is different from that of a typical company. You won't find inventory, accounts receivable, or accounts payable. Instead, under assets, you'll see mostly loans and investments, and on the liabilities side, you'll see deposits and borrowings.

The three crucial elements in all financial analyses include:

* Liquidity: ability to meet the obligations of liquid funds.
* Solvency: credit quality and adequacy of the bank’s own resources (indebtedness).
* Profitability: ability to generate income/profit from allocated capital.

A **bank’s activity**, on the other hand, is included in its balance sheet as a variation in the volume of lending, in the assets, and comparing this with the variation of customer deposits or other financing instruments on the liabilities side. In retail banks, these two items represent the vast majority of their total assets and of the sum of equity and liabilities

By analyzing a balance sheet, conclusions can be drawn regarding a **bank’s increase or decrease in activity** and the resources employed to finance lending.

A bank, however, has unique classes of balance sheet line items that other companies won’t. The typical structure of a balance sheet for a bank is:

* Assets
  + Property
  + Trading assets
  + Loans to customers
  + Deposits to the central bank
* Liabilities
  + Loans from the central bank
  + Deposits from customers
  + Trading liabilities
  + Misc. debt
* Equity
  + Common and preferred shares

**ASSETS = LIABILITIES + EQUITY**.

For Example

## ICICI Bank’s balance sheet

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| **Assets** | **Rs. In cr.** | **%** | **Liabilities** | **Rs. In cr.** | **%** |
| Cash | 336 | 6.0% | Net Worth | 731 | 13.0% |
| Investments | 1688 | 30.0% | – Equity capital | 12 | 0.2% |
| – SLR | 986 | 17.5% | – Reserves | 719 | 12.8% |
| – Equity Investments in Subsidiaries | 120 | 2.1% | Deposits | 3090 | 54.8% |
| – RIDF and related | 229 | 4.1% | – Savings | 935 | 16.6% |
| Advances | 3178 | 56.4% | – Current | 404 | 7.2% |
| Fixed assets | 433 | 7.7% | Borrowings | 1454 | 25.8% |
|  |  |  | Other liabilities | 360 | 6.4% |
| **Total** | **5635** | **100%** | **Total** | **5635** | **100.0%** |

This data is taken from the September 2013 disclosures of ICICI Bank.

## Assets in a bank’s balance sheet

Cash is self explanatory.

SLR stands for Statutory Liquidity Ratio. SLR is prescribed by the Reserve Bank of India. A bank is expected to hold a certain ratio (presently 23%) of their Net Demand and Time Liabilities (NDTL) in approved securities like government securities, cash or gold. I suggest reading this link by IDFC MF on [Net Demand and Time Liabilities](http://www.caporbit.com/understand-analyze-balance-sheet-bank/gamechangers.idfcmf.com/wp-content/uploads/2013/07/net-demand-and-time-liability.pdf) to understand NDTL better.

Investments – SLR covers investments made into approved securities towards the SLR requirement.

RIDF stands for [Rural Infrastructure Development Fund](http://www.ekikrat.in/Rural-Infrastructure-Development-Fund-RIDF) which is set up by the Government of India. Banks are expected to deploy money towards the RIDF to the extent they lend less towards agriculture as compared to mandated lending requirements.

Advances – This is the most important heads on the asset side. This talks of the core business of a bank. This is also called the loan book. Banks report the breakup of their loan book by borrower type (retail, small and medium enterprises (SME) and large corporates). They also usually report the sector-wise breakup of their loan book.

Fixed assets broadly covers the money spent to develop the bank’s branch network and corporate offices.

## Liabilities on a bank’s balance sheet

Net worth is the shareholders’ capital in the bank. This is also called as the book value of a bank. As is the case for any business in general, a shareholder would like to see a growing book value year on year. This is what is left if one subtracts all the other liabilities from the assets side.

Deposits is a key item in the liabilities. This is part of the core business of [intermediation](https://en.wikipedia.org/wiki/Intermediation)of capital – borrow from depositors and lend to borrowers. Deposits are broadly of three kinds.

1. Savings accounts – Depositors receive 4% or higher. Recently the RBI has deregulated savings bank account interest rates and we have seen some banks offer rates of around 6% which is 50% more than the 4% that depositors would receive earlier. Money in savings accounts can be withdrawn at any time. It does not have an associated time period.
2. Current accounts – Used by companies. A bank does not pay interest on current accounts.
3. Others – Fixed deposits and the like where depositors receive higher interest than a savings bank account. They have a definite time period and usually there are penalties in place for premature withdrawal.

Borrowings are made up of bonds, debentures and certificates of deposit where the bank borrows money of varying tenor.

One should look at the deposits and borrowings from the perspective of respective interest rates and corresponding cash inflow and outflow for the bank. If you were the owner of a bank you would like to pay the least amount of money on your deposits and borrowings.