

FAQs

Issues and Clarifications with regard to Applicability of Section 20 of Banking Regulation Act, 1949

(paragraph 2.1.2.4)

Query

Can a foreign bank sanction loan or advance to firms and companies in India when one of the Directors, whether a foreign or an Indian national, on the foreign bank's Board of Directors abroad has an interest in said firms or companies in India or are on the Board of such companies ?

Response

It is clarified that the sanction or grant of credit facilities to Companies in India by foreign banks having branches in India should be in compliance with the spirit of Section 20 of the Banking Regulation Act, 1949. Accordingly, a foreign bank branch in India should not lend to a firm / company in India, if a director in the foreign bank's Board abroad has (i) an interest in the firm / company or (ii) if the company is a subsidiary of any Indian / foreign parent in which the director is interested.

It may be noted that as per Section 20 of the Banking Regulation Act, 1949, a director would be considered to have interest in a company if he is a director / managing agent / manager / employee or guarantor in the concerned company and would be considered to have interest in a firm if he is a partner / manager / employee or guarantor in the concerned firm.

Query

To whom Sec 20 (1) (b) of the B. R. Act, 1949 will not apply.

Response

Section 20 (1) (b) of the B. R. Act, 1949 will not apply to

- a) subsidiary of the banking company, or
- b) a company registered under Section 25 of the Companies Act, 1956, or
- c) a Government company.

Query

Whether the provisions of Section 20 is applicable to Subsidiary Companies / Holding Companies ?

Response

In case a banking company is granting any loan or advance to a subsidiary of the holding company, the provisions of Section 20 would be attracted if any of the directors of the banking company is a director of the holding company, irrespective of whether any of the directors of the banking company is a director of the subsidiary or not.

Query

Whether the provisions of Section 20 would apply to advances granted / Commitments made prior to appointment of the common director ?

Response

The provisions of Section 20(1)(b)(iii) of the B R Act, 1949 are not attracted in case of advances granted or commitment made by the bank to a company prior to appointment of the Director of the company on the Board of the bank.

Query

Whether the provisions of the Section 20 would apply if the loan is renewed / loan limits have been enhanced after the Director of the Company is taken on the Board of the bank ?

Response

The bank is precluded from renewing the loan / limit after its expiry or enhancing the limit that may have been sanctioned prior to the date of company's Director becoming a Director of the bank as renewal / enhancement / change in terms would mean entering into fresh commitment by the bank. Alternatively, the director has to relinquish the directorship of either the bank or the company.

Query

Whether Section 20 would apply to Nominee Director ?

Response

Section 20 does not make any distinction between the directors on the basis of the interest they represent. Therefore, the prohibitions stipulated under Section 20 are applicable to nominee directors also.

Query

Whether Withdrawal against uncleared effects would attract Section 20 ?

Response

Purchase of cheques is specifically exempted from prohibitory provisions of section 20. However, withdrawal against uncleared effects (cheques presented for clearing) amounts to grant of advance and therefore will attract provisions of Section 20.

Query

Whether Section 20 applies to derivative transactions ?

Response

Derivative transactions are off balance sheet items and are treated on similar lines with non-fund based transactions and are out of purview of Section 20 provided it is ensured by banks that the transactions are genuine hedge transactions arising out of normal business requirements (not speculative ones) and no liability devolves on banks. The bank has to satisfy about the genuineness of the underlying exposure of the concerns. Banks also have to adhere to the instructions contained in Paragraph 1.2.7 of Master Circular DBOD.Dir.BC.20/13.03.00/2002-03 dated 30th July, 2004 and guidelines on 'Measurement of credit exposure of Derivative products contained in Circular DBOD.BP.BC.48/21.03.054/2002-03 dated 13th December, 2002.

Query

Whether Section 20 will apply to priority sector lending ?

Response

The priority Sector lending by itself is not given any exemption under Section 20. As such, provisions of Section 20 will also apply to priority Sector lending.

Query

Whether the provisions of Section 20 will be attracted if a trustee of a borrowing trust is on the Board of the lending bank ?

Response

In case the trust is a public trust, the provisions of Section 20 are not attracted.