

SUSPENSION AND WINDING UP OF BANKING COMPANIES IN INDIA: A CRITICAL ANALYSIS OF THE BANKING REGULATION ACT, 1949

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ABSTRACT

The banking sector is one of the most critical pillars of the Indian economy. It facilitates the circulation of money, promotes economic development, and encourages public savings. Since the banking system handles citizens' deposits and undertakes various financial operations with high economic impact, it is subject to a special legal framework. The Banking Regulation Act, 1949, gives the Reserve Bank of India (RBI) the exclusive authority to control and regulate the banking system. In other words, if a bank fails to operate in a solvent manner, the RBI can intervene and take necessary steps to protect the public. The law provides several legal provisions for the suspension of banking operations and the winding up of insolvent banks.

This paper aims to demonstrate the legal provisions of the Banking Regulation Act, 1949, which deal with the suspension and winding up of banking companies. The study further examines the relevant case laws in this area which have contributed to the elucidation of these statutes. By doing so, the paper seeks to provide an elaborate comprehension of the legal framework governing the winding up of banks and financial institutions in India.

Keywords: Banking Regulation Act, suspension, moratorium, winding up, Reserve Bank of India, depositor protection.

1. INTRODUCTION

Banks are an important component of a country's financial system. They receive deposits from the public and utilize them for the purposes of lending and investment. The deposits can be withdrawn through specified banking instruments such as cheques, drafts and other prescribed modes in accordance with the agreed terms. As banks deal with public funds, they are regulated by specific laws that govern the manner in which they operate, exercise control over their activities, regulate their working practices and safeguard the interests of the depositors.¹ In this league, the Banking Regulation Act, 1949 was enacted to consolidate and amend the law relating to banking system in India. It provides a comprehensive framework for the licensing, regulation, management, supervision, and winding up of banking companies.² The Act empowers the Reserve Bank of India (RBI), as the country's central

¹ R.N. Chaudhary, *Banking Law* 17-21 (Central Law Publications, 5th edn., 2022).

² Banking Regulation Act, 1949 (Act 10 of 1949), Preamble.

banking authority, to supervise banking institutions and take timely corrective measures whenever their financial condition poses a threat to depositors or to the stability of the banking system.³

One of the noteworthy features of this legislation lies in its mechanism dealing with the suspension and winding up of banking companies. A banking company may face financial distress due to poor management, insolvency, liquidity crises, fraud, or other factors requiring regulatory intervention. Suspension, generally through a moratorium under Section 45 of the Banking Regulation Act, provides temporary protection while corrective measures are considered.⁴ Where revival is not possible, the Act prescribes a special procedure for winding up banking companies under Sections 38 to 44, ensuring an orderly process while protecting the interests of depositors and creditors.⁵ Unlike ordinary companies, banking companies are governed by special provisions because they deal with public deposits. Accordingly, the Banking Regulation Act empowers the Reserve Bank of India to take appropriate action in the public interest.⁶

1.1 Research Questions

This paper seeks to address the following research questions:

1. What are the statutory provisions governing the suspension and winding up of banking companies under the Banking Regulation Act, 1949?
2. How has the judiciary interpreted these provisions, particularly in relation to the powers of the Reserve Bank of India?
3. What are the strengths and weaknesses of the existing legal framework in protecting depositors and maintaining financial stability?
4. What reforms are necessary to address emerging challenges in bank resolution?

1.2 Methodology and Scope

The present study adopts a doctrinal methodology, analysing the statutory provisions of the Banking Regulation Act, 1949, relevant case laws, and secondary literature. The scope is limited to the suspension and winding up of banking companies under the Act, with particular emphasis on the role of the Reserve Bank of India and the protection of depositors.

2. BANKING COMPANIES UNDER THE BANKING REGULATION ACT, 1949

Banking companies differ from other organizations because of their unique role in the financial system and the specialized services they provide to society. The nature of their activities, such as accepting public deposits and providing credit and other banking services, distinguishes them fundamentally from other types of commercial entities. Owing to their importance in the economy and the need to protect public funds, banking companies are subject to a specialized legal framework that regulates their functioning and safeguards the interests of depositors.⁷

³ *Id.*, ss. 21, 35 & 35A.

⁴ *Id.*, s. 45.

⁵ *Id.*, ss. 38–45.

⁶ *Id.*, ss. 35, 35A & 45.

⁷ *Supra* note 1 at 27–31.

The Banking Regulation Act, 1949 provides a statutory definition of a banking company. According to Section 5(c), a banking company means any company which transacts the business of banking in India.⁸

The expression "banking" has been defined under Section 5(b) of the Act as:

"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."⁹

From the above definition, the essential elements of banking are:

- Acceptance of deposits from the public;
- Acceptance of deposits for lending or investment;
- Repayment of deposits on demand or according to agreed terms; and
- Withdrawal of deposits through recognized banking instruments.

These characteristics distinguish banking companies from other financial institutions and commercial organizations.

2.1 Characteristics of Banking Companies

Banking companies possess certain distinctive characteristics that justify their separate legal treatment under the Banking Regulation Act, 1949.

Firstly, banks primarily deal with public deposits, creating a fiduciary relationship between the institution and its customers. Secondly, they operate under strict statutory regulation and continuous supervision by the Reserve Bank of India. Thirdly, banking companies significantly influence monetary stability and economic development through credit creation and financial intermediation. Finally, because of the public interest involved, special provisions relating to suspension, reconstruction, and winding up are applicable to banking companies, unlike ordinary companies governed solely by company law.¹⁰

2.2 Objectives of the Banking Regulation Act, 1949

The Banking Regulation Act, 1949 was enacted to strengthen the regulation of banking companies and ensure the stability of the banking system. Its principal objectives include:

- Regulating the business of banking companies;
- Ensuring sound management and corporate governance;
- Protecting the interests of depositors;
- Preventing unhealthy banking practices;
- Empowering the Reserve Bank of India to supervise banking institutions; and
- Maintaining public confidence in the banking sector.¹¹

⁸ *Supra* note 2, s. 5(c).

⁹ *Id.*, s. 5(b).

¹⁰ *Supra* note 1 at 335-337.

¹¹ *Supra* note 2.

These objectives of the Act show that the nature of the Act is not only regulatory but also, it serves as a protective measure for the public and economy.

2.3 Role of the Reserve Bank of India

The Reserve Bank of India is the main authority that oversees the regulation of banking companies in India. According to the Banking Regulation Act, the Reserve Bank has the power to give directions to other banks, conduct inspections, and take action against those companies that do not meet the requirements. The RBI also plays a significant role in addressing financial distress in banking companies by recommending appropriate regulatory measures in accordance with the provisions of the Act.¹²

2.4 Importance of Regulation of Banking Companies

Effective regulation of banking companies is essential because of their ability to influence public confidence and the stability of the economy. A poor regulatory framework leads to financial scandals, misappropriation of deposits, and destabilization of the entire system.

The regulation of the banking sector under the Banking Regulation Act aims to promote the sound management of banks, ensure their financial prudence, as well as their compliance with legal requirements. Such regulation ultimately contributes to financial stability and protects the interests of depositors and other stakeholders.¹³

3. SUSPENSION OF BANKING COMPANIES UNDER THE BANKING REGULATION ACT, 1949

The banking industry is run on the faith of the public. People deposit their money with the belief that it is secure and that they can access it whenever necessary. This is also why any sort of irregularity on the part of a bank can have damaging effects on not just the customers but the banking sector as a whole. This is why the Banking Regulation Act, 1949 allows for declaring a moratorium or suspension of operations for any banking company facing financial difficulties. This mechanism enables regulatory authorities to intervene before the financial condition of a banking company deteriorates further and allows sufficient time to assess the bank's viability and protect the interests of depositors.¹⁴

Unlike winding up, suspension is not an action that can be taken to wind up the affairs of a banking company. On the contrary, it is a temporary regulatory step taken to put a bank on hold so that measures can be taken to address the problems it faces. The power to initiate such intervention primarily rests with the Reserve Bank of India (RBI), which plays a crucial role in maintaining public confidence in the banking system.

3.1 Meaning of Suspension of a Banking Company

The Banking Regulation Act, 1949 does not expressly define the term "suspension." In banking law, suspension refers to the temporary restriction imposed on the normal operations of a banking company when its financial position becomes unsatisfactory or when it is unable to meet its obligations towards depositors and creditors. The Banking Regulation Act, 1949 provides that a banking company that has become temporarily unable to pay its debts may

¹² *Supra* note 6.

¹³ *Supra* note 2 at 315-319.

¹⁴ *Id.*, at 335-337.

apply to the High Court for the suspension of its business. An application under this section must ordinarily be accompanied by a report of the Reserve Bank of India stating that the banking company is likely to be able to pay its debts if the relief sought is granted. The High Court may also appoint a Special Officer to take charge of the assets, books, documents and other property of the banking company and to safeguard its interests during the period of suspension.¹⁵

The purpose of suspension is preventive rather than punitive. It allows regulatory authorities to examine the financial condition of the banking company and determine whether its operations can be restored without resorting to liquidation. During this period, certain banking transactions may be restricted to prevent further financial deterioration and safeguard public deposits.¹⁶

3.2 Moratorium under Section 45 of the Banking Regulation Act, 1949

The principal statutory provision relating to the suspension of banking companies is contained in Section 45 of the Banking Regulation Act, 1949.¹⁷

Under this provision, where the Reserve Bank of India is satisfied that a banking company is unable to pay its debts or that its affairs are being conducted in a manner detrimental to the interests of its depositors, it may apply to the Central Government for the imposition of a moratorium. Upon such application, the Central Government may issue an order staying the commencement or continuation of actions and proceedings against the banking company for a specified period. The period of moratorium shall not exceed six months.

The object of imposing a moratorium is to prevent a sudden collapse of the banking company and to provide an opportunity for the authorities to examine the financial position of the institution before taking further action.

The provision has been described as a "nuclear option" that allows the RBI to take control of a distressed bank and formulate a scheme for its reconstruction or amalgamation. The Bombay High Court, in the context of the PMC Bank case, observed that Section 45 is a "non obstante provision" that operates independently and has effect over all other provisions in the Act or any law for the time being in force.¹⁸

3.3 Circumstances Leading to Suspension

A banking company may be subjected to suspension under several circumstances, including:

(a) Inability to Pay Debts

A bank that is unable to discharge its financial obligations towards depositors and creditors may require immediate regulatory intervention.

(b) Financial Mismanagement

Poor management decisions, imprudent lending practices, or ineffective corporate governance may weaken the financial position of a banking company.

¹⁵ *Supra* note 2, s. 37.

¹⁶ *Supra* note 10.

¹⁷ *Supra* note 2, s. 45.

¹⁸ *Bhalchandra Dinakr Gondekar & Ors. v. Reserve Bank of India*, 2026: BHC-AS:13184-DB.

(c) Liquidity Crisis

Where a banking company experiences a severe shortage of liquid funds, it may become incapable of honouring withdrawal requests from depositors.

(d) Fraud and Financial Irregularities

Large-scale frauds, concealment of non-performing assets, or manipulation of financial statements may seriously impair the functioning of a banking company.

(e) Public Interest

The RBI may also recommend regulatory intervention where continuation of the banking company's business is likely to adversely affect public confidence in the banking system.¹⁹

3.4 Role of the Reserve Bank of India

The Reserve Bank of India plays a predominant role in the suspension process. It monitors the banks and other financial institutions under its jurisdiction periodically and maintains a watchful eye on their performance. It keeps track of the reports submitted by the banks, and it also carries out inspections to ensure that the banks are operating in consonance with the existing regulations.

The RBI is empowered to:

- Conduct inspections under Section 35;
- Issue directions under Section 35A;
- Assess the financial condition of banking companies;
- Recommend the imposition of a moratorium under Section 45.

These powers enable the RBI to take timely action for protecting depositors and preserving financial stability.²⁰

3.5 Legal Consequences of Suspension

The declaration of a moratorium has several legal consequences.

First, there are restrictions on withdrawals and other transactions to prevent drain of the bank's assets.

Second, legal proceedings against the banking company may be stayed during the moratorium period.

Third, the RBI may supersede the management of the bank and appoint an Administrator to oversee its affairs.²¹

3.6 Difference Between Suspension and Winding Up

Although both the suspension and winding up procedures are initiated when a banking concern faces financial problems, there exists a significant difference between them. Thus, although both of them could be regarded as forms of liquidation, the first one is a provisional measure, allowing the authorities to restore the banking company's financial conditions. Suspended entities continue to exist but cannot perform their operations.

¹⁹ *Supra* note 2, s. 45.

²⁰ *Supra* note 6.

²¹ *Supra* note 19.

Contrary to this, winding up is a permanent solution, which simply means that they are disbanded once their assets are sold to settle the debts. Moreover, it should be noted that this procedure is only applied when the recovery of a given concern is impossible. Thus, suspension may precede winding up, but it does not necessarily result in liquidation.

3.7 Judicial Perspective

The Supreme Court has consistently acknowledged the need for regulation in the banking sector.

In *Joseph Kuruvilla Vellukunnel v. Reserve Bank of India*, it was held that banking companies hold a special position as they deal with public money. The Court upheld the validity of the special powers conferred upon the Reserve Bank of India, holding that such provisions are necessary for protecting depositors and maintaining public confidence in the banking system.²²

The Court observed:

"Banking companies cannot be compared with other companies. The ordinary companies deal with the money of the stockholders who own a share in the assets, who appoint their own Directors, for better or for worse, and whose liability is also limited. The banking companies are in an entirely different class, as they deal with the money of the depositors, who have no security except the solvency of the banking company and its sound dealings with their money."²³

The judgment is also notable for upholding the supervisory powers of the Reserve Bank of India under the Banking Regulation Act.

4. WINDING UP OF BANKING COMPANIES UNDER THE BANKING REGULATION ACT, 1949

The winding up of a banking company is one of the significant aspects of the Banking Regulation Act, 1949. Unlike suspension, this concept permanently brings the existence of a banking company to an end. It should also be noted that compared to the liquidation of ordinary companies, the termination of a banking company's operations is a much more serious matter. It is carried out through a special statutory procedure since such institutions store people's deposits and have a great impact on the economy. The provisions relating to winding up are intended to ensure that the affairs of a financially distressed banking company are settled in an orderly manner while safeguarding the interests of depositors and creditors.²⁴

The Banking Regulation Act, 1949 confers significant powers upon the Reserve Bank of India (RBI) to initiate winding-up proceedings whenever it is satisfied that the continuation of a banking company's business is prejudicial to the interests of depositors or the public. The Act therefore strikes a balance between financial stability and depositor protection by providing a specialized procedure for the liquidation of banking companies.

4.1 Meaning of Winding Up

Winding up is the legal process through which the affairs of a banking company are brought to an end. During this process, the assets of the banking company are collected and realized, its liabilities are discharged, and any remaining surplus is distributed in accordance with law.

²² *Joseph Kuruvilla Vellukunnel v. Reserve Bank of India*, AIR 1962 SC 1371.

²³ *Ibid.*

²⁴ *Supra* note 1 at 337-340.

Upon completion of these proceedings, the banking company ceases to exist as a legal entity.²⁵

Unlike ordinary companies, the winding up of banking companies is not merely a matter concerning shareholders and creditors. Since banks hold public deposits, their liquidation directly affects thousands of depositors and may also have wider implications for the financial system. Therefore, the Banking Regulation Act prescribes special procedures to ensure that public interest is adequately protected.

4.2 Statutory Provisions Governing Winding Up

The provisions relating to the winding up of banking companies are primarily contained in Sections 38 to 44 of the Banking Regulation Act, 1949.²⁶ These provisions regulate the circumstances under which a banking company may be wound up, the role of the Reserve Bank of India, and the procedure to be followed by the competent court.

Unlike ordinary companies, where winding-up proceedings may be initiated by different stakeholders, the RBI has been entrusted with a central role in matters concerning the liquidation of banking companies because of its technical expertise and supervisory responsibilities.

4.3 Grounds for Winding Up

A banking company may be wound up under the Banking Regulation Act on various grounds.

(a) Inability to Pay Debts

The most important ground is the inability of the banking company to pay its debts. If the Reserve Bank of India is satisfied that the company has become incapable of meeting its financial obligations, it may apply to the appropriate court for winding up.²⁷

Section 38(4) provides that a banking company shall be deemed to be unable to pay its debts if it has refused to meet any lawful demand made at any of its offices or branches within two working days, if such demand is made at a place where there is an office, branch or agency of the Reserve Bank, or within five working days, if such demand is made elsewhere, and if the Reserve Bank certifies in writing that the banking company is unable to pay its debts.

(b) Failure to Comply with Statutory Requirements

Persistent violation of the provisions of the Banking Regulation Act or failure to comply with lawful directions issued by the RBI may justify winding-up proceedings.

(c) Public Interest

Where the continuation of the banking company is considered prejudicial to the interests of depositors or harmful to the banking system, winding up may become necessary.

²⁵ *Id.*, at 340-343.

²⁶ *Supra* note, ss. 38-44.

²⁷ *Supra* note 2, s. 38.

(d) Failure of Regulatory Measures

If regulatory measures adopted by the RBI fail to improve the financial condition of the banking company and there is no reasonable possibility of recovery, winding up may be initiated in accordance with the provisions of the Act.

4.4 Winding Up by the High Court

Section 38 of the Banking Regulation Act empowers the High Court to order the winding up of a banking company on an application made by the Reserve Bank of India.²⁸

The RBI may file such an application where it is satisfied that the banking company:

- is unable to pay its debts;
- has failed to comply with statutory requirements; or
- should not be permitted to continue its banking business in the interest of depositors or the public.

Where the Reserve Bank certifies in writing that the banking company is unable to pay its debts, the High Court is required to order its winding up in accordance with Section 38. The opinion of the RBI carries considerable weight because it is based on detailed inspections and financial supervision conducted by the central banking authority.

Further, the High Court may stay the winding-up proceedings for a specified period where the Court considers it necessary. Under this provision, the Court may intervene to ensure that the proceedings are conducted properly and that the liquidation of the banking company is carried out in an orderly manner.²⁹

Moreover, as per Section 42 of the Banking Regulation Act, 1949, the High Court may dispense with the meetings of creditors or contributories at any stage of the winding-up proceedings if it is of the opinion that such meetings would serve no useful purpose. This provision ensures that the process of liquidation of the company is expeditious and does not involve any unnecessary costs or delays.³⁰

4.5 Official Liquidator

The Official Liquidator plays a significant role in the winding up of a banking company. Once the High Court passes a winding-up order, the Official Liquidator takes charge of the affairs of the banking company, administers its assets, settles its liabilities, and ensures that the winding-up proceedings are conducted in accordance with law while safeguarding the interests of depositors and other creditors.

Section 38A of the Banking Regulation Act, 1949, provides for the appointment of the Official Liquidator for the purpose of winding up a banking company. As per this section, the High Court appoints an Official Liquidator to ensure that the winding-up proceedings are conducted properly and in accordance with the provisions of the Act.³¹

Further, as per Section 39 of the Banking Regulation Act, 1949, where an application for winding up is made by the Reserve Bank of India, the High Court may appoint the Reserve Bank of India, the State Bank of India, any other bank notified by the Central Government, or

²⁸ *Supra* note 2, s. 38.

²⁹ *Id.*, s. 40.

³⁰ *Id.*, s. 42.

³¹ *Id.*, s. 38A.

any person named in the application as the Official Liquidator. Such an appointment ensures that the winding-up proceedings are conducted under the supervision of a competent authority possessing the requisite expertise in banking matters.³²

Further, under Section 41 of the Banking Regulation Act, 1949, the Official Liquidator is required to submit the reports and statements prescribed under the Act to the High Court.³³ These reports assist the Court in supervising the winding-up proceedings and ensure that the liquidation of the banking company is carried out efficiently and in accordance with law.

4.6 Voluntary Winding Up

Section 44 of the Banking Regulation Act places restrictions on the voluntary winding up of banking companies.³⁴

A banking company cannot voluntarily wind up merely at the discretion of its shareholders. Such winding up is permitted only when the banking company is capable of paying all its debts in full. This restriction protects the bank depositors from the unilateral decisions of the bank that may negatively impact them.

Section 44 provides that no banking company which holds a licence granted under Section 22 may be voluntarily wound up unless the Reserve Bank certifies in writing that the company is able to pay in full all its debts to its creditors as they accrue.

The requirement suggests that the banking activity is subject to the public interest and should not be treated as an ordinary commercial enterprise.

4.7 Role of the Reserve Bank of India in Winding Up

The Reserve Bank of India performs a central role throughout the winding-up process.

Its functions include:

- examining the financial position of the banking company;
- conducting inspections and investigations;
- determining whether the banking company is unable to pay its debts;
- applying to the High Court for winding up where necessary; and
- assisting in ensuring that the winding-up process protects the interests of depositors.

These statutory powers enable the RBI to act promptly whenever the continued operation of a banking company threatens financial stability.

4.8 Protection of Depositors

One of the objects of the Banking Regulation Act is the protection of depositors. In particular, the Act seeks to ensure that depositors are treated fairly during a winding-up process, and that the funds of the banking company are distributed to them in accordance with the statutory priority. During the liquidation process, the Official Liquidator is required to issue notices to preferential claimants, secured and unsecured creditors, inviting them to submit statements of their claims within the prescribed time. This enables the liabilities of the banking company to be accurately determined and claims to be settled in an orderly manner,

³² *Id.*, s. 39.

³³ *Id.*, s. 41.

³⁴ *Id.*, s. 44.

thereby facilitating the smooth completion of the liquidation process and protecting the interests of the depositors.³⁵

The protection of depositors is further strengthened through the Deposit Insurance and Credit Guarantee Corporation (DICGC), which provides insurance cover to eligible deposits up to the limit prescribed by law.³⁶ Currently, DICGC provides insurance cover of up to ₹5 lakhs per depositor per bank.

These measures enhance public confidence in the banking system and reduce the financial hardship caused by bank failures.

4.9 Judicial Interpretation

The Supreme Court has repeatedly recognized the special position occupied by banking companies in the economy.

In *Joseph Kuruvilla Vellukunnel v. Reserve Bank of India*, the Court upheld the constitutional validity of the provisions empowering the RBI to initiate winding-up proceedings. The Court observed that banks deal with public funds and therefore require special statutory regulation different from that applicable to ordinary companies.³⁷

The judgment affirmed that the protection of depositors and maintenance of public confidence justify the conferment of extensive powers upon the Reserve Bank of India.

The Court further noted the historical context of the Act's enactment:

"A large number of banking companies had failed during the years, 1947, 1948 and 1949. Between 1926 and 1937, 23 Banks had suspended payment. In 1938 and 1939, 46 Banks failed, from 1940 to 1946, 95 Banks were involved. But, in 1947, 1948 and 1949 there were as many as 123 failures involving outside liabilities of Rs 82 crores! ... In the winding-up proceedings that followed, many unsatisfactory features were noticed. It was noticed that the realisations were insignificant, while the costs were great, and enormous expenditure of time took place."

This historical context underscores the necessity for special provisions for banking companies.

4.10 Importance of Special Winding-Up Provisions

The winding up of banking companies differs significantly from the liquidation of ordinary companies because banks perform functions that directly affect the financial system.

The special provisions contained in the Banking Regulation Act ensure:

- protection of depositors;
- orderly settlement of liabilities;
- prevention of financial panic;
- maintenance of confidence in the banking sector; and
- preservation of financial stability.

³⁵ *Id.*, s. 41A.

³⁶ Deposit Insurance and Credit Guarantee Corporation (DICGC), "Deposit Insurance", *available at*: <https://www.dicgc.org.in>.

³⁷ *Joseph Kuruvilla Vellukunnel v. Reserve Bank of India*, AIR 1962 SC 1371.

Without such statutory safeguards, the failure of a banking company could have serious consequences for the economy and the public at large.

5. CRITICAL ANALYSIS, CHALLENGES & SUGGESTIONS

The Banking Regulation Act, 1949 contains provisions that enable the Reserve Bank of India to regulate, suspend, and wind-up banks. The provisions related to the moratorium and winding up are aimed at protecting the depositors and the general public and maintaining the faith of the community in the banking system.³⁸ The RBI has in the past intervened in the case of banks facing financial difficulties and took regulatory actions against them. Due to the dynamism of the banking sector, the increasing complexity of finance, and the growing number of banking risks, some of these provisions encounter challenges during actual implementation. Therefore, it is necessary to critically examine the existing legal framework to assess its effectiveness and identify areas requiring improvement.

5.1 Judicial Perspective on Banking Regulation

Indian courts have consistently held that banking companies hold a special position in the economy due to their involvement in the custody of deposits and impact on economic stability, resulting in a cautious approach when reviewing decisions made by the Reserve Bank in its regulatory role.

In *Joseph Kuruvilla Vellukunnel v. Reserve Bank of India*, the Supreme Court upheld the constitutional validity of the provisions empowering the Reserve Bank of India to initiate winding-up proceedings against a banking company. The Court observed:

“Banking companies constitute a distinct class of institutions, as they deal with the money of the depositors, who have no security except the solvency of the banking company and its sound dealings with their money. Ex facie, the banking companies must be regulated somewhat differently, and the interests of the depositors must be paramount.”³⁹

The Court also emphasised that the Act was designed to secure the interests of depositors through the instrumentality of the Reserve Bank:

"The first is that the whole intent and purpose of that Act is to secure the interests of the depositors. The second is that the Reserve Bank is the instrumentality by which this intent is to be achieved. The Act, at every turn, makes the Reserve Bank the authority to sanction, permit, certify, inspect, report, advise, control, direct, license and prohibit."

Similarly, in *Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd.*, the Supreme Court emphasized that financial regulation involves specialized economic and technical considerations. The Court recognized the RBI as the expert regulatory authority and held that its regulatory decisions deserve considerable judicial deference unless they are arbitrary or contrary to law.⁴⁰

In the more recent case of *Bhalchandra Dinkar Gondekar v. Reserve Bank of India*, the Bombay High Court upheld the RBI's action in superseding the Board of Directors of PMC Bank under Section 36AAA read with Section 56 of the Banking Regulation Act, and

³⁸ *Supra* note 2 at 335-337.

³⁹ *Supra* note 37.

⁴⁰ *Reserve Bank of India v. Peerless General Finance and Investment Co. Ltd.*, 1987 (1) SCC 424.

subsequently formulating a scheme of amalgamation with Unity Small Finance Bank under Section 45. The Court noted:⁴¹

"Since the financial condition of the PMC Bank was alarming and its net-worth had turned negative, appreciating the downfall of PMC Bank, the RBI was forcefully required to step in and exercise the powers available to it under Section 36AAA read with Section 56 of the BR Act."

The Court further observed that the RBI's action was in the interest of depositors, as liquidation would have resulted in eligible depositors receiving no more than ₹5 lakhs from DICGC, and the process would have been long and uncertain.⁴²

5.2 Challenges

Despite the comprehensive statutory framework, there are various practical difficulties concerning the suspension and winding up of banking companies. Some of them have been discussed below:

(a) Delayed Regulatory Intervention

Timely intervention through regulation is of paramount importance if one wishes to avoid the financial crisis of a banking company. Despite the wide range of powers at its disposal, the Reserve Bank of India may find itself in a situation where the affairs of a banking company have become permanently insolvent without its knowledge. Consequently, the Reserve Bank may impose a moratorium, causing significant damage to the trust of the general public in the banking system. Thus, the process of discovering problem banks needs to be expedited.

(b) Loss of Public Confidence

The announcement of a moratorium or winding up proceedings provokes uncertainty amongst depositors. Withdrawal restrictions can lead to panic and consequent loss of confidence, especially if the reasons are not clearly communicated.

(c) Balancing Revival and Liquidation

One of the dilemmas faced by regulatory authorities is the decision between shutting down or attempting to rescue a financially troubled bank. Although early terminations of insolvent banks can have adverse impacts on depositors, continuing to prop up failing banks can undermine the financial system.

(d) Emerging Financial Risks

Rapid technological advances, cyber frauds, digital banking, and complex financial transactions present new challenges not anticipated by the lawmakers who authored the Banking Regulation Act. These challenges require adaptations to this regulatory framework.⁴³

(e) Coordination Among Regulatory Authorities

The effective resolution of banking failures requires close coordination among the Reserve Bank, Central Government, DICGC, and other supervisory agencies. Timely resolution of distressed banks could be undermined if these agencies fail to act expeditiously.

⁴¹ *Supra* note 18.

⁴² *Ibid.*

⁴³ Dr. Pravin Rathod, "Cyber Frauds in Digital Banking: Legal Challenges and Preventive Framework in India" 9 *International Journal of Law Management & Humanities* 2139 (2026).

(f) Absence of a Comprehensive Resolution Framework

India currently lacks an integrated holistic legal framework for resolving banks and financial firms. The Financial Resolution and Deposit Insurance (FRDI) Bill, 2017, which sought to create a consolidated framework for monitoring and resolving failing financial firms, was withdrawn in August 2018 due to apprehensions raised by stakeholders. The FRDI Bill aimed to establish a Resolution Corporation to anticipate, monitor and take corrective actions in the case of failure of a bank. However, concerns regarding the "bail-in" tool and the prohibition of jurisdiction of any court over the decisions of the Resolution Corporation led to its demise.⁴⁴

5.3 Critical Analysis

The provisions concerning the suspension and winding up of banking companies have contributed significantly to the stability of the Indian banking system. Since banking companies differ from other ordinary companies in their essential functions, the Banking Regulation Act provides specific special provisions for them. At the same time, the Act gives the Reserve Bank of India extensive powers over banking companies to enable it to intervene in case of financial difficulties at the earliest stage.

First, the special provisions concerning the suspension and winding up of banking companies serve to highlight the importance of such companies to the economy. By giving extensive powers to the Reserve Bank of India over banking companies, this Act ensures that banking companies do not fail when such failure is not contemplated. For instance, Section 45 gives the Reserve Bank of India the power to recommend declaring a moratorium if a banking company's affairs are so far gone that it cannot be profitably continued and it threatens the depositors' interests.

Moreover, the distinction between the suspension and winding up of banking companies highlights the Reserve Bank of India's obligation to minimize the costs associated with such measures. The Act views winding up as a final measure only applied when all expectations of reviving a banking company have vanished.

Furthermore, the Act's provisions on winding up and suspension of banking companies received the consistent support from the judiciary. Courts have recognized the special position of banking companies in the economy, which has led to banking companies being placed under the special supervision of the Reserve Bank of India. As a result, whenever the question of suspension and winding up of a banking company arises, the judiciary tends to defer to the decisions of the Reserve Bank of India unless its actions have been found to be illegal or irrational.

However, even though the Act provides for extensive measures for the restoration of a banking company facing financial difficulties, there are still some shortcomings requiring the legislature's attention.

The main issue concerning the suspension and winding up of banking companies is the possibility of delayed regulatory action. Despite the wide range of powers at its disposal over banking companies, the Reserve Bank of India may find itself in a situation where the affairs of a banking company have become permanently insolvent, without its knowledge. Consequently, the Reserve Bank of India may impose a moratorium, causing significant

⁴⁴ Neetu Shikha and Nalin Agnihotri, "Strengthening the Resilience of Small and Medium Banks in India: Challenges, Performance, and Regulatory Landscape" 11(1) *Solventia* 1-45 (2025).

damage to the trust of the general public in the banking system. Thus, the process of discovering problem banks needs to be expedited.

Moreover, the Reserve Bank of India must increase efforts to educate the public about banking company failures. For example, declaring a moratorium always creates uncertainty in the minds of the depositors of the failed banking company, which often leads to them trying to withdraw their deposits from other banks as well. Despite being a necessary step to prevent the collapse of the banking system, such protective measures can make the general public unnecessarily nervous. In addition, it is crucial that the Reserve Bank of India and the Government take steps to assure the public that their deposits are safe.

The development of new technologies poses new questions for the legal framework regarding the suspension and liquidation of banks. In its turn, the Act should periodically be amended in order to remain relevant and appropriate for regulating modern banking activities. Today, banking companies face new risks related to information technologies, such as fraud and cybercrime. Although the Reserve Bank of India has issued several regulatory guidelines on the matter, banking institutions should implement innovative technologies in a responsible manner.

Furthermore, the effectiveness of the legal framework concerning the winding up and suspension of banks is largely dependent on the Deposit Insurance and Credit Guarantee Corporation's ability of settling claims. The DICGC currently provides insurance cover of up to ₹5 lakhs per depositor. While this covers the vast majority of depositors, those with larger deposits may face significant losses or prolonged waiting periods. In the PMC Bank case, while 95.98% of depositors were able to withdraw their entire deposits immediately after the scheme implementation, depositors with larger amounts had to wait for staggered payments over five years. The scheme provided for payments of ₹50,000 at the end of the first and second years, ₹1,00,000 at the end of the third year, ₹2,50,000 at the end of the fourth year, and ₹5,50,000 at the end of the fifth year. Thus, cooperation between the Reserve Bank of India, the Deposit Insurance and Credit Guarantee Corporation, and the Government should be strengthened in order to ensure seamless claim settlement procedures.⁴⁵

Additionally, the absence of a dedicated resolution framework for financial firms remains a significant gap. The Insolvency and Bankruptcy Code, 2016, was extended to certain non-banking financial companies and housing finance companies, but its application to banks remains limited. The FRDI Bill, had it been enacted, would have provided a comprehensive framework for bank resolution. Its withdrawal has left a void that needs to be addressed.⁴⁶

5.4 Suggestions

In order to strengthen the legal framework for suspension and winding up of banking companies, the following suggestions could be considered:

1. Early Warning Systems: The Reserve Bank of India should develop mechanisms for early identification of trouble to take corrective action at the preliminary stage. This includes strengthening off-site surveillance, using data analytics to identify emerging risks, and conducting more frequent on-site inspections of vulnerable banks.⁴⁷

⁴⁵ *Supra* note 18.

⁴⁶ Pratik Datta, "Resolving Financial Firms in India: The Way Forward" 13(1) NUJS Law Review 1-38 (2020).

⁴⁷ Shikha Neeraj and Kapsis Ilias, "Bank Crisis Management and Resolution after SVB and Credit Suisse: Perspectives from India and the European Union" 33(1) *International Insolvency Review* (2024).

2. Corporate Governance Reforms: Banking companies must exercise prudence in their operations by improving their corporate governance to prevent financial scams. The RBI should strengthen requirements relating to board composition, professional competence, and risk management systems.

3. Inter-Agency Coordination Mechanism: A coordination mechanism at the top level between the Reserve Bank of India, Central Government and Deposit Insurance and Credit Guarantee Corporation should be developed for effective resolution of banking crises. This should include clear protocols for information sharing and decision-making during crisis situations.

4. Public Awareness: There must be a thrust on awareness generation about deposit insurance and legal safeguards for the protection of the interests of depositors so that confidence of depositors is not shaken in case of any default by the banks. This includes educating depositors about the limits of deposit insurance and the procedures for making claims.

5. Periodic Review of the Act: It is essential to review the Banking Regulation Act, 1949, from time to time to deal with new challenges like digitalisation, cyber security and other emerging challenges in the Banking sector.

6. Comprehensive Resolution Framework: India should consider enacting a comprehensive resolution framework for financial firms, either by reviving a modified version of the FRDI Bill or by developing a new framework. Such a framework should address the concerns raised regarding the bail-in tool, ensure adequate judicial oversight, and provide for differentiated treatment of systemically important and non-systemically important banks.

7. Strengthening DICGC: The deposit insurance coverage limit should be periodically reviewed and adjusted for inflation. Consideration should also be given to risk-based premium structures, where banks with higher risk profiles pay higher premiums, as currently the burden of premium contribution is highly skewed: in FY 2024-25, commercial banks contributed 94.7% of the total deposit insurance premium (₹25,352 crore), while co-operative banks contributed only 5.3% (₹1,412 crore). This disproportionate burden is further highlighted by the fact that co-operative banks account for approximately 98.7% of net claims paid by DICGC, despite contributing only about 6% of premiums.⁴⁸

8. Expedited Resolution Process: The resolution process for distressed banks should be expedited to minimize uncertainty and preserve asset value. This includes setting clear timelines for RBI action, DICGC claim settlement, and implementation of resolution schemes.

In summary, the existing legal framework concerning the winding up and suspension of banks has contributed to the stability of the Indian banking system for many years. However, given the complexity and volatility of the banking system, as well as the development of modern technologies, the adequacy of the current legal and regulatory framework concerning the suspension and liquidation of banks must be regularly reviewed and updated. Enhancing supervisory strategies, depositor awareness, inter-agency cooperation, and legal provisions in line with contemporary developments will further improve India's banking system and ensure public confidence in it.

⁴⁸ Reserve Bank of India, *Financial Stability Report* (June 2025), Table 3.6, available at: <https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/OFSRJUNE20253006258AE798B4484642AD861CC35BC2CB3D8E.PDF>; See also, Deposit Insurance and Credit Guarantee Corporation, *Annual Report 2024-25* (September 2025), Press Release, available at: <https://www.dicgc.org.in>.

CONCLUSION

The Banking Regulation Act, 1949 lays down the legal framework pertinent to regulation, suspension, and winding up of banking companies in India. By recognizing the importance of banks as institutions responsible for mobilizing public deposits and supporting the smooth running of the economy, the Act provides that the Reserve Bank shall have extensive powers to supervise and control the working of banks. The provisions governing moratorium under Section 45 and those governing winding up of banks under Sections 38 to 44 are meant to deal with problem banking firms and protect the interests of depositors and creditors.

The present study reviews the law relating to suspension and winding up of banks, the role of the Reserve Bank, and the judicial principles evolved in interpreting the law. The study demonstrates that the provisions relating to the suspension and winding up of banking companies contained in Chapter IV of the Banking Regulation Act, 1949 are of special importance in regulating the working of banks and financial institutions. Courts have always taken a special view of the functioning of banks as financial agencies and have laid down special principles in relation to the winding up of banks.

In numerous cases, the courts have emphasized the desirability of having specialized legislation for banks so that not only does it help in plugging loopholes but also ensures justice and proper redressal to the complainants and depositors of funds.⁴⁹

While the Banking Regulation Act, 1949 has played a major role in regulating the Indian banking sector, there is a need to update the legal framework governing the suspension and winding up of banks to meet the changing needs of the banking sector. The dynamic nature of the banking industry as well as the growing complexities of financial markets as well as new challenges posed by new technological developments such as information technology and its impact on the security of banking systems necessitate a closer look at the regulatory system so that prompt remedial action can be taken whenever necessary.

The withdrawal of the Financial Resolution and Deposit Insurance (FRDI) Bill, 2017, has left a gap in India's legal framework for resolving financial firms. The FRDI Bill sought to establish a comprehensive framework for monitoring and resolving failing financial firms, including a Resolution Corporation to anticipate, monitor and take corrective actions in the case of failure of a bank. However, concerns regarding the bail-in tool and the exclusion of judicial oversight led to its withdrawal. Addressing these concerns and developing a comprehensive resolution framework remains an important task for policymakers.

In conclusion, the provisions relating to the suspension and winding up of banking companies under the Banking Regulation Act, 1949 continue to play a crucial role in maintaining the soundness and stability of the Indian banking system. By combining effective regulatory supervision, judicial oversight, and depositor protection, the Act contributes significantly to the orderly functioning of the banking sector and the protection of the larger public interest.

⁴⁹ *Supra* note 37.