CHAPTER – I

DEVELOPMENT OF BANKING IN INDIA
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➢ Evolution of Money Economy:

From time immemorial, the banker has been an indispensable pillar of Indian society and economic activity was confined to exchange of good as and when needed – the 'Barter System'. The impracticability of barter system gave birth to the feeling in favor of common medium for Exchange of goods. The introduction of the division of labour, however, brought in its wake the use of money, without which there was a peculiar complexity and trouble in the matter of exchange. The medium of exchange was different like stones, wood, metals and ivory etc. Gradually value has been attached to such medium; and it got developed into what we call 'money' today. Money economy, in its turn, could not do without the institution of banking for any considerable time.

There is plenty of evidence to show that India was not a stranger to the conception of banking. Loans and usury were well understood in the olden days itself. (Civilization in Ancient India by R.C. Dutt, revisited edition, Vol.1, p.39). Reference is often made to debt contracted at dicing, to pay off a debt was called Rnam Sam-m. Allusions are also made to debts contracted without intension of payment. This shows that the giving and taking of credit in one form or other must have existed as early as the Vedic period. However, the transition from money lending to banking must have occurred before Manu, who has devoted a special section to the subject of deposits and pledges, where he says, “A sensible man should deposit his money with a period of good family, of good conduct, well-acquainted with the law, various having many relatives wealthy and honorable (Arya).” ² (The Laws of Manu by Buhler. The sacred Books of the East, (Vol.XXXV, p, 286, 1866). He further gives us rules, which governed the policy of loans and rates of interest. Sir Richard Temple’s testifies to the fact, that banking business was carried on in ancient India.³ (Sir Richard Temple’s lectures; Journal of the Institute of Bankers, Vol.2, 1881).

However, banking in those days must have meant largely money-lending, financings kings and their wars, through certain rudiments of modern banking functions were not unknown to the then bankers.
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Money Lending in Ancient Times:

The term ‘Bank’ literally means an establishment for storage or deposit money in an institution which borrowers money from and lends money to the public at large. The word is said to have derived from the Italian word ‘bancs’ which itself was the Italian version of the German word ‘banck’ meaning a joint stock fund.

Origin of the word “Bank” – There is difference of opinion in this regard. According to some authorities, the word “Bank” itself is derived from the word “bancus” or “banque”, that is, a bench. The early bankers, the Jews in Lombardy, transacted their business on benches in the market place. When banker failed his “banco” was broken up by the people, when the world “bankrupt”. There are others, who are of the opinion that the world “bank” is originally derived from the German world “back” meaning a joint stock fund. But “whatever be the origin of the word ‘bank’, “as Professor Ramchandra Rao says (Present – day Banking in India, 1st edition, p.88).” It would trace the history of banking in Europe from the Middle Ages.

Early History of Banking:

As early as 2000 B. (C), the Babylonians had developed a banking system. There is evidence to show that the temples of Babylon were used as banks. But the spread of irreligion soon destroyed the public sense of security in depositing money and valuable in temples, and the priests were no longer acting as financial agents. The Romans did not organize State Banks as did the Greeks, but their minute regulations, as to the conduct of private banking, were calculated to create the almost confidence. Aristotle’s dictum, that the charging of interest was unnatural and consequently immoral, was adhered to fanatically. Even now some Mohammedans, in obedience to the commands contained in that behalf in their religious books, refuse to accept interest on money loans. The followers of Aristotle’s dictum forgot that the ancient world, the Hebrews had maintained money lenders and made no sine of interest, but only of usury.

Impact of West:

However, upon the revival of civilization, growing necessity forced the issue in the middle of the 12th century, and banks were established at Venice and Genoa, though in fact they did not become banks as we understood them today. Again the origin of modern banking may be traced to the money dealers in Florence, who received money on deposit, and were lenders of money in the 14th century, and the names of the
Bardi, Acciajuoli, Perussi, Pitti and Medici soon became famous throughout Europe, as bankers.

In England, during the reign of Edward III, money changing—an important function of the bankers of those days—was taken up by a Royal Exchanger for the benefit of the Crown. He exchanged the various foreign coins, tendered to him by travelers and merchants entering the kingdom, into British money, and, on the other hand, supplied persons going out of the country with the foreign money they required.

The ground was prepared for modern banking in England, by the influx of gold from America and the simultaneous growth of foreign trade. Land ceased to be the only form of wealth, and the country gentlemen and the town merchants, began to hold part of their "capital" in cash. Impetus was given to public banking by the seizure, by Charles I in 1640, of £130,000 bullion left for safe custody by the city merchants at the Royal Mint. As a result of this Royal repudiation, the merchants began to entrust their cashiers with large sums, but the latter misappropriated their masters’ money for their own benefit. Finding that their employees had not treated them better than their king, the city merchants decided to keep their cash with goldsmiths, who in those days had strong rooms and employed watchmen.

Thus, large sums of money were left with the goldsmiths for safe custody against their signed receipts, knows as ‘goldsmiths’ notes,” embodying an undertaking to return the money to the depositor or to bearer on demand. Two developments quickly followed, which were the foundation of “issue” and “deposit” banking, respectively. The first was that the goldsmiths’ note became payable to bearer, and so was transformed from a receipt to a bank note. It was payable on demand, and enjoyed considerable circulation. Gradually, the goldsmiths discovered that large sums of money were left in their keeping for long periods and, following the example of Dutch bankers, they thought it safe and profitable to lend out a part of their customers’ money, provided such loans were re-paid within a fixed time. Further, realizing that the business of loaning of other people’s money at interest was profitable, and in order to attract larger amounts, the more enterprising of the goldsmiths began to offer interest on money deposited with them, instead of charging a fees for their services in guarding their client’s gold. This marks an important step in the development of banking in England. Business grew to such an extent that it soon became clear that a goldsmith could always spare a certain proportion of his cash for loans, regardless of the date at which his notes fell due. It equally became safe for him to make his notes payable at any time, so long as his credit remained good, he could calculate, on the law of average, the amount of gold he needed to meet the daily claims of his note-holders and depositors.
In 1672, English banking received a rude setback. Charles II borrowed heavily from the goldsmiths and, promptly like his father repudiated his debts. A crisis ensued, and was followed by a general suspension of payments. Confidence, however, was restored in spite of the shock and the general belief, which it produced among people that the goldsmiths were guilty of imprudence and exorbitant practices. It was soon after this date that the goldsmiths found that they could receive money on what is now termed "current account", i.e., money withdraws able without notice.

The Bank of England was started in 1694, largely as a result of the financial difficulties of William III, who was carrying on war with France. The public distrust of goldsmiths for the same was also responsible. One, Mr. Patterson, suggested a way out of the difficulties by offering to raise £1,200,000, which he was prepared to loan to the Government, if certain concessions, particularly the right to issue notes, were given to the proposed institutions. The Government agreed to the terms offered by Mr. Patterson, and an Act called the "Tonnage Act" was passed. The main provisions of the Act were as follows:

1. It authorized the raising of Pounds Sterling £1,200,000 by subscription, the subscribers forming a corporation to be called "the Governor and Company of the Bank of England".

2. No person could subscribe more than £10,000 before the first of July following, and even after that date, no one could subscribe more then £20,000 in total.

3. The Corporation was to lend the whole of its capital to the Government, and in return, it was to be paid interest at the rate of 8 per cent and £4,000 for expenses of management.

4. The Corporation was to have the privileges of a bank for twelve years, but the Government reserved the right of annulling the Charter after giving one year’s notice to the Corporation.

5. The Corporation was forbidden to trade in any merchandise whatsoever, but was allowed to deal in bills of exchange, gold or silver bullion, and to sell any wares or merchandise upon which it had advanced money.

The new bank proved a formidable competitor to the comparatively small private banking firms, which had grown up from the London goldsmiths, and to the country-banks.
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The year 1708 witnessed the passing of another important Act, which prohibited any other bank, with more than six partners, issuing promissory notes, i.e., bank notes. The most important clause of this banking legislation ran as follows:

“That during the continuous of the said Corporation of the Governor and the Company of the Bank of England, it shall not be lawful for any body, politic or corporate, whatsoever created, or to be created other than the said Governor and Company of the Bank of England, or for other persons whatsoever united or to be united, in covenants or partnerships Exceeding the Number of Six persons, in that part of Great Britain called England, to borrow, owe or take up any sums of money on their bills or notes payable on demand, or at less time than six months from the borrowing thereof”.

This Act, gave a monopoly of notes issue to the Bank of England, so far as joint Stock Banks were concerned, but left private banks, having not more than six partners free to issue notes. In London and the surrounding districts however, the notes of the private banks did not circulate to any appreciable extent; consequently these banks found the business of note issue unprofitable and gave it up; instead, they began to develop deposit banking. They received deposits, which were at first with drawable by letter, and later by cheques. Printed cheque forms were first issued between 1749 and 1759. Although, the Bank of England note continued to be supreme its notes were not popular beyond the metropolis, as the Bank did not have any outside branch. Private bank in the provincial cities began to play an important role after the middle of the 18th century, and their number continued to grow till it reached over 300 about the end of the century.

The crisis of 1825 marked a turning point, and tolled the death knell of the small country banks and of the note as the foundation of the banking system. Legislation quickly followed. It was realized that joint stock banks with the right of issue should be started outside London, and, therefore, in 1826 an Act was passed which allowed banks to be started with unlimited liability, consisting of more than six partners, with the right to Header issue notes, provided they had no office within a radius of 65 miles from London. This led to the starting of the joint stock banks in the country.5

However, the wrong impression, that no joint stock bank could be started within a radius of 65 miles from London, was removed by Mr. Joplin, who, after studying carefully the provisions of the various Charters of the Bank of England, came to the conclusion that no such monopoly was
intended. Opportunity was taken, on the occasion of the renewal of the
Bank's Charter in 1833, to clarify the position of the inclusion, in the
new Charter of Bank, of a cause giving legislative sanction to the
establishment of joint stock banks in London, and in 1834, the London
and Westminster Bank was started in London, being the first of the “Big
Five”.

At that time there was no limit to the amount of notes, which private
bankers, and after 1826 the country joint stock banks, were allowed to
issue, and this resulted in numerous banking crisis and bank failures.
In 1844, another important stage was reached in the development of
English banking when, by Peel’s Act of that year, the right to issue notes
in England was restricted to the banks then issuing notes in that
country, as well as to the extent of their note issue at the time, thus
providing for the gradual extinction of the right, and laying the
This marks an important turning point in the history and development of
English banking, and the deposit banking eventually came to
supplement note issue banking.

After the passing of Peel's Act of 1844, new banks with the right to issue
notes could not be started, and those allowed to issue notes could not
increase their circulation. Thus greater attention began to be paid
towards deposit banking and cheque currency. After 1890, the
movement in favor of bank amalgamation and absorption made its
appearance, and the number of joint stock banks, in England and Wales,
came down from 104 in 1890 to 12 in 1956, although the number of
banking offices shot up from 2203, to 10,700 by the end of 1961. In
terms of Currency and Bank Note Act, 1920, the Currency Note issue as
amalgamated with that of the Bank of England, which was given
exclusive right to issue notes of £ 5 and upwards. In November 1929,
the Bank of England organized a subsidiary company, named the
Securities Management Trust Ltd., in order take charge of the work
undertaken by the Bank in connection with the industrial re-
organization, and in the year 1930, a new company named the Bankers
Industrial Development Company Ltd., was created for bringing industry
and finance to close relations. In 1947, the Labour Government
nationalized the Bank of England, by transferring the then existing stock
to the nominee of the British Treasury and by vesting in the Crown the
power of appointing its Governor, Deputy Governor and Directors.6

The Socialization of banker in west had its impact on Indian Banking
Industry also. The banks started enlarging its activities and started
walking on a new path in sharp decision to the traditional path.
Now the banking system has increased the banking activity to many folds. They serve as custodians of stocks and shares and other valuables. Imports into and exports out of country are financed by banks, and documents relating to the goods so imported and exported, at one time or another, pass through the hands of bankers. Thus, they have to deal not only with bills of exchange, but also with bills of lading-railway receipts, warehouse warrants and receipts, marine insurance policies and various other documents. As bankers, they advance money on securities, and issue letters of credit, traveler’s cheques, credit cards and circular notes to customers wishing in travel abroad, as also to effect purchases and shipment of goods. They are often required to countersign indemnities and guarantees given by their customers, and they undertake the administration of estates, thus assuming the position of trustees; they assist industrial undertakings by under-writing their debentures and shares, providing them with working capital finance and to a certain extent, with finance for fixed capital requirements also. They sometimes even obtain passports for their customers, and deal with their incoming mail. On behalf of their customers, they carry on correspondence with income-tax authorities; make periodical payments such as rents, taxes, subscriptions, etc. And, on instructions from their customers, act as executors of their customers wills: in short, they do all they can to assist their customers. The more highly developed a country is, the greater is the instrumentality of the banker utilized to carry through commercial transactions. From its original narrow scope and modest purpose, banking has developed to such an extent that it can truly be said that in countries, such as England and the Untied States of America, there is hardly a single business deal in which the assistance in one form or another of a bank is not sought for.

In India the banking industry is entering several new activities in the areas of merchant banking, leasing housing finance, venture capital and financial services in genera. The range of services provided by our banks stretches from rural finance at one end to international banking at the other. The banking scenario the world over is undergoing rapid diversification and technological change and Indian Banking can be no exception with the changing policy of the Government of India in the areas of industrial, trade and exchange rate policies. The functions of the bank have changed to cope with the changes.

Although, in recent years, the history of banking has begun to receive attention, thanks to research workers in this field, it is not necessary, for the purposes of this thesis, to give any detailed description of the banking system, which served this country before the advent of modern economy. However, banking in those days must have meant largely money-lending, financings kings and their wars, though certain
rudiments of modern banking functions were not unknown to the then bankers.

Bankers in India have always been regarded as very important members of the community in Government, as well as in social circles. Land revenue was generally collected in kind while the services were almost invariably paid in cash. In the traditional economy the private and individual Bankers played a very vital role. The banker's assistance was more or less indispensable in this connection. Even in other financial matters of State, he was frequently consulted. In the unsettled days of civil wars, when insecurity was so pronounced a feature of the times, the banker was most the only shelter in money matters. He was the only reliable agency for the deposit of jewellery, cash and hoardings in other forms, as was the cash with the goldsmiths in England in the 17th century. State officials had not much reputation in this respect. The Indian banker, however, was highly esteemed, and regarded as a worthy specimen of commercial morality. The time-honored adage: "No salvation except through the preceptor; no credit except through the money-lender," is significant in this respect.

Reference to the earliest system of banking prevailing in India can be traced from our scriptures and religious texts.

The word "Hundi" is said to be derived from the Sanskrit root "hund", meaning to collect. Its derivation expressed the purposes for which originally such instruments were used, and has gradually attained the meaning "Collection of debets".

In the days of the Mahabharata

The public confidence, enjoyed by the Indian banker, can well be realized from the fact that his Hundis (inland bills of exchange) date back to the days of the Mahabharata. Hundis were quite in vogue during the Middle Ages.8

Even in modern times, bills of exchange are generally used for the collection of debts. For instance, when a merchant in Bombay sells goods to a merchant in Delhi, the former draws a bill of exchange on the latter, so as to collect the price of those goods.

Similarly, when a merchant in Calcutta desires to collect a debt, due smaller networks and other connected machines. Internet allows information about almost every topic, be it books, encyclopedias, countries, people, organizations, etc. In short, it is a system of form a

smaller networks and other connected machines. Internet allows information about almost every topic, be it books, encyclopedias, countries, people, organizations, etc. In short, it is a system of from a merchant in madras; the former may draw a Hund for the amount upon the latter.

Although probably strangers to the use of paper money, the Hindus, as we have seen had been accustomed to the use of the Hund from verify remote times. Among them, the banking business was confined to the issue and discount of bills of exchange, money lending and money changing. Very soon, banking business was carried on along with dealings in grains cloth, etc. or with agency business. The importance of the part played by the banker in commercial markets, as well as in agricultural circles, cannot be denied. The transfer of funds from one place to another, at a fair distance, took place with the help of the Hundis. The agriculturists, even at the present time, in spite of the development of co-operative credit societies, have to depend, to a large extent, on the village bankers for financial assistance.

Bankers lent money against personal, as well an other securities, such as, ornaments, goods and immovable property. For everyday loans, the banker's knowledge of individuals and their financial position on account of the narrow circle in which these transactions had to be carried out rendered him more useful than even the modern commercial banks which are practically impersonal in their character, and are hedged round with many formalities, thereby sometimes annihilating their utility at the critical moment. The personal relations between the banker and his customers were of a cordial nature.

Usury, or high rate of interest, was widely prevalent in India. Most writers attribute usury to the state of insecurity in India, and the risk involved on account of the low financial status of the borrowers. No doubt, these factors played a great part, but they were not invariably, the only cause. The force of custom and limited communications barred the free play of economic forces of supply and demand.

This most apt definition of banking given by the Bombay Provincial Banking Enquiry Committee is not wholly applicable to money-lending, which hardly constitutes banking, as it is understood in the modern monetary world. The early Indian banker had comparatively a little of deposit or discount business, or dealings in other people's money which is the unfailing characteristic of modern banking. He may therefore, be called a money-lender rather than a banker.
The times have changed, and in India indigenous banking of the "good old days" has undergone many alterations, on account of the different forms and function, and the extreme complexity of modern business. All the same, the old system still retains its importance, though not to the same degree. The payment of taxes in cash, better means of communications and transpirations, uniform currency, the unification of the country under one Central Government, the development of the co-operative movement, and the establishment of joint stock banks, have taken away a good deal of business from the hands of the Indian money-lenders, still it cannot be denied that even today he occupies an important place in the credit organization of the country.

Although the role of the indigenous banker is fast dwindling as he is unable to adjust himself to modern banking conditions, it must be presumed that the private banker is not yet extinct. His activities have been generally in the agriculture retail trade sectors and is spread amongst the various classes of small borrowers but, with the present policy of the banks to meet the needs of this sector and opening of branches in the rural areas, the role of the indigenous banker will decrease rapidly specially if credit is provided to these hitherto neglected borrowers on reasonable terms without cumbersome procedures. The co-operative banking institutions are also playing an important role in removing the indigenous bankers from the field. The All India Rural Credit Survey initiated by the Reserve Bank of India in August 1951, had for one of its objectives the assessment of the position which indigenous bankers occupy at present in different parts of the country. Constructive proposals for linking rural areas with money markets have emerged from the findings of the Survey. Meanwhile, measures have been taken towards implementation of the recommendations of the Rural Banking Enquiry Committee including expansion of banking facilities in rural areas; these comprised, among others, the liberalization of remittance facilities available to commercial and co-operative banks and the opening during the period July 1955 to December 1960 by the present State Bank of India of 429 branch offices. During the last few years' further progress has been made in the opening of new branches both by the State Bank as well as other banks and several schemes for helping co-operative credit movement have been sponsored by the Reserve Bank of India. The total number of offices of Commercial Banks in India, where were 8,262 in June 1969 have reached an astonishing figure of above 75,000 at the end of 2005.⁹

➢ **Historical Background of Banking in India:**

The earliest operations in the field of banking in India can be traced from the Calcutta Agency Houses, the trading firms, which undertook banking
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operations for the benefit of their constituents. Prominent among these were Messrs Alexander & Co, and Messrs Fergusson & Company.

That banking is incompatible with any other kind of business was illustrated by the commercial disaster of 1829-32. Banking needs to be run with great caution, while adventure to a certain extent is necessary for other kinds of business, e.g., industry and commerce. Reckless speculation, and a policy of placing profits before safety, was responsible for the failure of the agency houses which also involved and collapse of their banking departments. Having successfully withstood three severe runs on it, the Bank of Hindustan could not survive the failure of its parents firm in 1832 even in the case of the Solapur Bank Ltd, which went into liquidation in 1918; the failure was attributed to this fatal combination. Besides the usual banking business this bank had the power to do business of "Merchants or capitalists either as principal or agents. "The then Chief Justice of Bombay passed very strong strictures on such a practice.10 (Govind v. Ramnath, 32 Bom. L.R. 232), and suggested that legal prohibition of combining banking business with other commercial enterprises could have made what happened more difficult, if not impossible. The Indian Legislature recognized the principle of separation of banking business, from any other kind of commercial undertaking. Section 277 G(1) of the Indian Companies Act, 1013, laid down that no company formed after the commencement of the Act, for the purpose of carrying on business as a banking company or which uses as part of the name under which it proposes to carry on business, the word "bank", "banker", or "banking", shall be registered under the Act, unless its memorandum limits the objects of the company to the carrying on of the business of accepting deposits of money on current account, or otherwise subject to withdrawal by cheque, draft or otherwise, along with some types of business specified in Section 277F sub-section (2) of the Said section further provided that:

"No banking company whether incorporated in or outside Indian Union shall after the expiry of two years from the commencement of the said Act carry on any form of business other than those specified in Section 277F.

Provided that the Central Government. May, by notification in the Gazette of India specify in addition to the business set forth in clauses (1) to (17) of Section 277F other forms of business which it may be lawful under this section for a banking company to engage in".

The Indian Government did not awaken to the great need for banks in India till 1809, the year in which the Bank of Bengal obtained its charter with a capital of Rs.50 lacks, one-fifth of which was contributed by the
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Government, who shared in the privilege of voting and direction. The charter restricted the bank's rate of interest to a maximum of 12 per cent. The power of note issue, however, was not given to the bank till 1823 in 1839; the bank was given the power to open branches and to deal in Inland exchange. The two other Presidency Banks, viz., the Bank of Bombay and the Bank of Madras were established in 1840 and 1843, respectively. As the notes issued by the Presidency banks did not become popular, they were replaced by Government paper money in 1862.

The year 1860 marks a new era in the history of Public Banks in India, because it was in this year that the principle of limited liability was first applied to the joint stock banks. So far, little or no banking legislation existed in India. May banks had sprung up like mushrooms and failed, mostly due to speculation, miss-management and fraud, on the part of those responsible for their flotation, organization and management.

It was unfortunate for India that the crisis of 1862-65 should have come so soon after the introduction of this important banking legislation. India's cotton exports increased by leaps and bounds, as a result of the outbreak of the civil war in the United States of America. This brought immense wealth in precious metals to India, which led, among other speculative enterprises, to the flotation of banks, soon to be overtaken by disasters. Among several others, the Bank of Bombay originally established in 1840 went into liquidation in 1868, although it was re-started in the same year and with the same name. The failure of almost all these mushroom growths prejudiced the Indian public, who is by nature conservative, against banks run on modern lines. Between 1865 and 1895 only two banks, the Allahabad Bank Ltd and the Punjab National Bank Ltd established.

- **Impact of Swadeshi movement:**

The Swadeshi movement, prompted Indians to start many new institutions, the number of joint stock banks increased remarkably during the boom of 1906-13. The Peoples Bank of India Ltd., the Bank of India Ltd., the Central Bank of India Ltd. Indian Bank Ltd., and the Bank of Baroda Ltd., was started during this period. The boom continued till it was overtaken by the crash of 1913-17, the most severe crises that the Indian joint stock banks have so far experienced.

The Presidency Banks referred to above, were amalgamated into the Imperial Bank of India, which was brought into existence on the 27th January, 1921, by the Imperial Bank of India Act of 1920. This Act, however, gave the bank no power to issue notes and thus left it without control over currency of the country. But it was allowed to hold
Government balances and to manage the public debt and clearing houses till the establishment of the Reserve Bank of India in 1935. The Reserve Bank of India took over all these functions from the Imperial Bank of India. Although the Imperial Bank of India was created by a special Act called the Imperial Bank of India Act, 1920, the liability of its shareholders, like that the shareholder of any other bank registered under the Indian Companies Act, was limited. The only difference was that the world "limited" did not form a part of its name. With the passing of the State Bank of India Act 1955 the Imperial Bank of India was converted to the State bank of India. It has the largest number of branches all over India, and does considerable business in commercial banking into a central banking institution of the country. Section 51 of the Baking Regulation Act, 1949 provided that without prejudice to the provision. Of the State Bank of India Act, 1955, or any other enactment, the provisions of Sections 10, 13 to 15, 17, 19 to 21A, 23 to 28, 29 (excluding sub-section (3), sub-sections (1B), (1C) and (2) of Sections 30, 31, 34, 35, 35A, 36 (excluding clause (d) of sub-section (1),45Y, to 45ZF, 46 to 48, 50, 52 and 53 shall also apply, so far as may be to and in relation to the State Bank of India or any corresponding new bank or a Regional Rural Bank or any subsidiary bank as they apply to and in relation to banking companies.

Pursuant to the provisions of the State Bank of India (Subsidiary Banks) Act, 1959, the Bank of Bikaner, the Bank of Indore, the Bank of Jaipur, the Bank of Mysore, the Bank of Paithala, the Travancore Bank, the State Bank of Hyderabad and the State Bank of Saurashtra have been constituted as subsidiaries of the State Bank of India. This has extended the area of operation of the State Bank of India.

The earlier agency agreement between the former Imperial Bank of India and the Reserve Bank of India was replaced by an agreement between the State Bank of India and the Reserve Bank of India concluded on the 16th March, 1960 for the performance of agency functions.

The State Bank of India (Amendment) Act, 1959 simplified the procedure in regard to taking over of business of any banking institutions which the State Bank may acquire through negotiations under Section 35 of the State Bank of India Act, 1955. The Act also simplified the orderly winding up of the banking institutions, whose business is so acquired by the State Bank.

As stated earlier, the State Bank was constituted in July 1955 to take over the undertaking of erstwhile Imperial Bank of India. The Bank has made great strides since. It has played a pioneering role not only in mopping up the country's savings but also in the financing of Industries
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and rural credit. Its scheme for provision of credit to small scale industry needs special mention.13

➢ **Evolution of Joint Stock Banks:**

The Banking business is now carried on by the joint stock banking companies, although there exist some private banking institutions, indigenous banker and banks formed under special Acts or Royal Charters. We have already referred to the formation of the Imperial Bank of India in 1920 reconstituted into the State Bank of India in 1955. In spite of the fact, that banking business received no encouragement in its infancy from the Government. The Reserve Bank has made determined effort to place the banking and monetary structure of the country on a sound basis, either through advice or persuasion or through a well-devised system of inspection of banks. This function of the Bank has assumed a very great importance during the last few years owing to the failure of a few banks. It will not be incorrect to say that Bank’s monetary and credit policies have played an important part in ridding the country out of the grip of inflation and stabilizing the economy. By the Reserve Bank Amendment Act of 1948, it has been invested with statutory powers to control and regulate the activities of the banking institutions. These powers have been considerably strengthened and reinforced from time to time by amendments to that Act, so much so that the Reserve Bank is now in a position to control and influence practically all-important aspects of the various activities, including managerial set up etc., of a banking company. The powers of Reserve Bank were extended over private banks also by the Banking Laws (Miscellaneous Provisions) Act, 1963.

As stated earlier, the ideas of having a Central Bank of the Country as a Controller of Banks as well as a promoter of the economic policies into reality with the establishment of Reserve Bank in 1935: Although suggestion have been made from time to time that India ought to have a Central Bank, they did not take definite shape until 1926, when the Royal Commission on Indian Currency and Finance recommended that a Central bank should be started in India so as to perfect her credit and currency organization. The Commission was not in favor of converting the Imperial Bank of India into a Central Bank and consequently a bill to give effect to the recommendations was introduced in the Legislative Assembly on the 25th January, 1927, but it had to be dropped for constitutional reasons. The proposal assumed importance again in connection with the constitutional reforms, and a fresh bill was accordingly introduced by Sir. George Schuster in September, 1933. it was enacted in due course, and became law on the 6th March, 1934, and The Reserve Bank of India started functioning with effect from 1st April 1935. The Reserve Bank of India has played an important role,
particularly during recent years. In the first quinquennium of its life the Bank was new to its job and in consequence was slow in building up itself. In the next decade it was caught, like other Central Banking Institutions, in the grips of abnormal war time developments, with their stresses and strains on the country's financial mechanism. It is not always possible to have a complete idea of the part a Central Bank plays in regulating or formulating monetary policy, because of the Bank's intimate relations with the Treasury which, from their very nature, are more often than not shrouded in secrecy. At times the curtain is lifted (vide Sir. Chintaman Deshmukh's address on 20th March, 1948 before the Gokhale Institute of Politics and Economics, Poona), and the public is then able to have an idea of the scenes that were being enacted on the monetary canvas. It can be said that the Reserve Bank has played a significant role, both during the war and post-war years, in helping to keep the monetary ship on an even keel.

The question which arises is why the Reserve Bank of India was nationalized in 1948 soon after Independence. There are two/three reasons which account for the nationalization of the Reserve Bank of India. Firstly, immediately after the end of Second World War there was a trend towards nationalization of central banks all over the world. Secondly, in India there was inflation right from 1939 onwards it was thought advisable to nationalize the Reserve Bank of India in order to control inflation in the country effectively. Thirdly, as India had to embark upon a programme of economic development and growth, it was necessary to have a complete control over the activities of a central bank so that it could be used effectively as an instrument of economic change in his country.

The Reserve Bank of India performs all the important functions which are expected of a central bank. Most important are as follows:

a. The Reserve Bank of India issues and regulates the issue of currency in India. In fact the Reserve Bank of India is sole authority for the issue of currency in the country and thereby to regulate and control money supply in the country.

b. The Reserve Bank of India acts as a banker to Government. The Reserve Bank of India acts as a banker not only to the Government of India but also as a banker to the State Governments. The Reserve Bank of India looks after the current financial transactions of the Government and manages the public debt of the Government. As a banker to the government, the Reserve Bank of India has the obligation to transact the banking business of the Central Government. The Reserve Bank undertakes to accept money on account of
the Government, to make payment on behalf of the Government. It also carries out exchange remittance and other banking appertains including the management of public debts.

c. The Reserve Bank of India acts as a banker to the Commercial banks, just as the private individual keep and maintains their accounts with Commercial Banks; Commercial banks keep and maintain their accounts with the Reserve Bank of India. The commercial banks keep deposits with the Reserve Bank of India and they borrow money from Reserve Bank of India when necessary. In case of difficulties, the Reserve Bank of India acts as a lender of the last resort to commercial banks.

d. The Reserve Bank of India exercises its control over the volume of credit created by the commercial banks in order to ensure price stability.

e. The Reserve Bank of India has the responsibility to maintain not only the internal value of the currency, i.e., the Indian Rupee, but it has also to maintain the external value of the currency. In short the Reserve Bank of India is largely concerned with organization of a sound and healthy commercial banking system, ensuring effective co-ordination and control over credit through appropriate monetary and credit polices followed from time to time. However, in India the Reserve Bank of India is also concerned with development of rural banking, promotion of financial institutions and development of money and capital market in India.

> **Banker’s Service to public:**

The Reserve Bank of India, as a central bank of our country, has to perform not merely the negative role of controlling credit and currency in the economy to maintain the internal and external value of the rupee to ensure price stability in the economy, but also to act as a promoter of financial institutions in the country so that its policies could be effective in promoting economic growth as per the guidelines and polices formulated by the Government. When the Reserve Bank of India was established in 1935, our country was a backward country, which lacked a well-developed commercial banking system apart from the absence of well-developed money market in the country. After 1948 the Reserve Bank of India became very active to take steps to promote and develop financial institutions so that the
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Reserve Bank of India can pursue appropriate credit and monetary policies for economic growth and development in an era of planned economic development of the country.

The Reserve Bank of India has, therefore, taken the following steps as promotional measures:

(1) The Reserve Bank of India established the bill market scheme in 1952.
(2) The Reserve Bank of India has tried to help the establishment of financial corporation to provide credit to the agriculture sector of economy and also the industrial sector of the economy.
(3) The Reserve Bank of India has promoted regional rural banks with the help of commercial banks to extend banking facilities to rural areas.
(4) The Reserve Bank of India has taken steps to enable the commercial banks to open branches in foreign centers and has helped the establishment of an export-import bank in India to provide finance to exporters.
(5) The Reserve Bank of India encourages and promotes research in the areas of banking.

➤ Banking Organization (RBI):

The affairs of the Reserve Bank of India are managed by the Central Board of Directors. The Central Board of Directors consists of:

(1) A Governor and not more than four Deputy Governors appointed by the Central Government under Section 8(1) (a) of the Reserve Bank of India Act, 1934,
(2) four Directors nominated by the Central Government, one from each of the four Local Boards in terms of Section 8(1)(b),
(3) Ten Directors nominated by the Central Government under Section 8(1)(c)
(4) One Government official nominated by the Central Government under Section 8(1) (d).

The Reserve Bank of India has a Local Board with Head quarters at Bombay, Calcutta, Madras and New Delhi, Local Boards consists of five members and these members are appointed by the Central Government to represent territorial and economic interest and the interest of cooperatives and indigenous banks.

The Chairman of the Central Board of Directors of the Reserve Bank of India is called the Chief Executive Authority of the Bank and he is known as the Governor. He Governor has the powers of general
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Superintendence and direction of the affairs and business of the bank and he is authorized to exercise all the powers which may be exercised by the bank. In the absence of the Governor, the Deputy Governor nominated by him exercises his powers.

The Commercial Banks maintain accounts with the Reserve Bank of India and borrow money when necessary from the Reserve Bank of India. He Reserve Bank of India thus provides credit to commercial banks and commercial banks in turn provide credit to their clients to promote economic growth and development. However, credit cannot be extended to an unlimited extent because it would disturb price stability in the country and therefore, it becomes necessary for the Reserve Bank of India to control the activities of the commercial banks in the interest of price stability. The Reserve Bank of India controls the activities of the commercial banks by virtue of the powers vested in it under the Banking Regulation Act of 1949 and Reserve Bank of India Act, 1934.16

Under the Banking Regulation Act, 1949, the Reserve Bank of India is given a power to issue license to commercial banks to open branches. No commercial bank can commence the business without obtaining license from the Reserve Bank of India. The Reserve Bank of India has also power to withdraw the license once granted in case it is found the affairs of the bank are not managed properly. The Reserve Bank of India has been given a power to inspect the commercial banks under Section 17 of the Banking Regulation Act. Under this power, the Reserve Bank can itself at any time cause an inspection to be carried out by one or more of its officers of any bank and its books and account and if there are defects, the banks concerned are required to rectify them and the Reserve Bank of India has power to appoint Additional Directors on the Boards of Directors.

Under the Banking Regulation Act, the Reserve Bank of India has wide powers of over-all control over the management of banks. Under this Act, Section 18, the approval of the Reserve Bank of India is necessary for the appointment or re-appointment or termination of an appointment of a Chairman, Managing or whole Time Director. The Reserve Bank of India has a power to prevent a commercial bank from undertaking certain types of transactions.

Under Section 21, the Reserve Bank of India has been given a power to control advances granted by the commercial banks. This power is known as the power of Selective Credit Control. Under this Section, the Reserve Bank of India is empowered to determine the policy in relation to advances to be followed by banks generally or by any bank in particular and under this Section, the Reserve Bank of India has been authorized to issue directions to banks as regards the purpose of the advances, the
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margins to be maintained in respect of the secured advances and it can also prescribe the rate of interest and other terms and conditions on which advances may be made.

Apart from the Selective Control of Credit exercised by the Reserve Bank of India, the Reserve Bank of India controls the volume of credit in a quantitative way so as to influence the total volume of bank credit. The Reserve Bank of India does this through the use of following instruments:

(1) The Bank Rate
(2) Open Market Operations
(3) Variable Cash Reserve Requirement

The Bank Rate is the rate of interest at which the Reserve Bank of India re-discounts the first class bills of exchange from commercial banks or other eligible paper. Whenever the Reserve Bank of India wants to reduce credit, the bank rate is raised and whenever the volume of bank credits is to be expanded the bank rate is reduced. This is because by change in the bank rate, the Reserve Bank of India seeks to influence the cost of bank credit. However, the efficacy of the bank rate depends on the extent of integration in the money market and also it depends upon how far the commercial banks resort to borrowings from the Reserve Bank of India.

The Reserve Bank of India can influence the reserves of commercial banks, i.e., the cash base of commercial banks by buying or selling Government Securities in open market. If he Reserve Bank of India buys Government Securities in the market from commercial banks, there is transfer of cash from the Reserve Bank of India to the commercial banks and this increased the cash base of the commercial banks enabling them to expand credit and conversely if the Reserve Bank of India sells Government Securities to the Commercial Banks, the commercial banks transfer cash to the Reserve Bank of India and therefore their cash base is reduced thus adversely affecting the capacity of commercial banks to expand credit. The success of open market operation as a technique of credit control depends upon of size of Government Securities available, their range in variety and the ability of the market to absorb them.

The commercial banks are required to keep a certain percentage of deposits as reserves with the Reserve Bank of India. The Reserve Bank of India is legally authorized to raise or lower the minimum reserves that the bank must maintain against the total deposits. If the percentage of reserves to be maintained is increased, the commercial banks will be left with less cash and therefore, they have to contract credit and if this limits reduced, the commercial banks will have more cash with them and
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they would be able to expand credit. The Reserve Bank of India has got the power to use the variable reserve requirements as instruments. Of monetary control only in 1956 when the bank was authorized to vary the minimum cash reserve requirement to be maintained by commercial banks between 5% and 20% of demand deposits and 2% and 8% of time deposits.

In addition to this, the Reserve Bank of India was empowered to impound banks' reserves in excess of a certain level reached in a phased period. The commercial banks are also required to maintain Statutory Liquidity Ratio and to arrive at the statutory liquidity ratio; the following assets are taken into account.

(a) Cash in hand in India.
(b) Balance in the current accounts with State Bank of India and its subsidiaries in India.
(c) Balances with Reserve Bank. In excess of the minimum reserve requirement at 7 per cent of total demand and time liabilities.
(d) Investments in Government Securities, treasury bills and other approved securities in India

Borrowings from the Reserve Bank of India against approved securities and borrowings from State Bank of India and other notified banks. The remainder of the liquid assets expressed, as a percentage of the total demand and time liabilities is the statutory liquidity ration.

Thus the Reserve Bank of India has been empowered to control the volume of credit quantitatively through the use of bank rate, open market operations and variable reserve requirements apart from impounding of deposits beyond a certain level and the Reserve Bank. An influence the volume of credit in certain selected areas through the use of selective credit control by prescribing the margins to be maintained in respect of secured advances against commodities, rate of interest on advances and by regulating the purpose or purposes for which advances may or may not be granted by the banking system as a whole or by group of banks or by a single bank as the case may be.

➢ Establishment of Financial Institutions:

The Narasimhim Committee recommended that the supervisory function be separated from the more traditional central banking functions of the Reserve Bank and that a separate agency which could be a quasi-autonomous Banking Supervisory Board under the aegis of the Reserve Bank be set-up. The Committee also proposed that the Board should have supervisory jurisdiction not merely over the banking system but
also over the development finance institutions, non-banking financial intermediaries and other Para banking financial institutions.

The Government has approved the statutory regulation under the provisions of Section 58 of the Reserve Bank of India Act, 1934 in connection with the setting up of the Board for Financial Supervision and notification has been issued to this effect on 28.7.1993 to give operational support to BFS. The Board will undertake supervisory of commercial banks and in due course its supervising functions would be extended to financial institutions and non-banking financial companies as well. The department of supervision has been set-up with its Central Office at Bombay and 16 Regional Offices at various Centers:

The DOS is presently designing an appropriate reporting system to enable it to exercise off-site surveillance over commercial banks. Special investigations including those connected with compliance and frauds and the work relating to appointment of statutory auditors for 217 public sector banks and 7 public financial institutions and the Reserve Bank are being attended to by the new department.

Under Section 35A of the Banking Regulation Act, 1949 the Reserve Bank may issue directions to banking companies who are bound to company with such directions.

➢ **Concept of Social Obligation and Social Control:**

The classical function of a Central Bank in a country is to control the currency and credit of that country and to mobilize its reserves, but the constitutional structure and powers vary in details according to the prevailing economic conditions, the organization of money and capital market, etc., in a country. No doubt due to the acute economic conditions prevailing in India as well as all over the world during the last few years, the functions of a Central Bank have become more important. The words of the Macmillan Committee “that a Central Bank is expected to keep the financial structure upon an even keel” still hold good. Broadly speaking, a Central banking Institutions has to stimulate banking enterprises in the country. The development of saving habits and the utilization of idle money are still the dominate problems of Indian banking. The Reserve Bank’s first duty is to see that the banking business is carried on sound principles as well as to help the provision of banking facilities all over the country. The growth of banking cannot be fostered by mere laws, as has been brought out by the failure of Palai Central Bank in Kerala, nor can it be developed by any artificial means and ingenious devices. It is gratifying to record the part played by the Reserve Bank in the field of banking legislation and control. In the field of agricultural credit and industrial finance also, the bank is doing
considerable pioneering work and assisting the Government of India. Thus, the present activities of the Reserve Bank combine traditional Central Banking functions with developmental activities and the dynamic role played by it in either sphere—has not only put the national economy on a surer footing but has also been instrumental in the planned development of the country. Recently with the Government policy of liberalization and globalization, the duty and role of Reserve Bank has increased and it is making effort to stabilize the inflation by control of flow of money and other credit control. The foreign exchange balance, which became very low, has increased to a great extent by the steps taken by the Government of India on the advice of Reserve Bank of India.  

Co-operative Banks have also played a limited but important role in the banking system of the country. There are number of such banks which include State Co-operative Banks (SCBs), Central Co-operative Banks (CCBs), Primary (Urban) Co-operative Banks (PCBs), Land Development Banks (LDBs), Primary Agricultural Credit Society (PACs), Farmer Service Societies (FSS), Large-sized Adivasi Multi-Purpose Societies (LAMPS).

The functions of co-operative banks are mainly to cater to the need of the rural areas and small borrowers and are concerned more with the financing of agriculturists. Although they also perform the main banking functions, their range is limited as compared to that of commercial banks.

➢ **Nationalization of Banks:**

From 1.2.1969 the Government imposed “Social Control” on banks by introducing certain provisions in the Act. It imposed severe restrictions on the composition of the Board of Directors and internal management and administration of banking companies. It also introduced restrictions on advances by banking companies. These were intended to ensure that the bank advances were not confined to large scale industries and big business houses, but were also directed, in due proportion, to other important sectors like agriculture, small-scale industries and exports.

With effect from the 19th July, 1969 fourteen major Indian Banks having deposits of more than Rs 50 crores were nationalized. The Undertakings of these fourteen Banks were taken over by and have vested in 14 new corporate bodies established under the Banking Companies (Acquisition and Transfer of Undertaking) Act, 1970. The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 has been amended Banking Companies (Acquisition and Transfer of Undertakings) Amendment Act, 1994, according to which the share capital up to 49% of the nationalized banks can be held by the public and cost of the share
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capital will be owned by the Government of India. These fourteen banks are now managed by the Government of India through the Board of Directors appointed by it.

On 15th April, 1980 six more banks having demand and time liabilities of not less than Rs.200 crores were nationalized. The undertakings of these banks are taken over and vest in six corresponding new banks under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980.

In 1931 the Indian Central Banking Enquiry Committee had made a detailed study of the working and problems of banking in India. Before a number of Committees such as Chamberlain Commission of 1914 and Hilton Young Commission had reviewed and reported on the banking structure of the country. The repeated changes and developments which have taken place in the banking system in India since the termination of the second world war and Independence, reflecting necessary changes in the political ideology, have during the period affected very much the thinking, attitudes, objectives and working of the banking industry. With a view "to take a close look at the banking system" a Commission under the Chairmanship of Mr. R.G. Saraiya was appointed in 1969. The terms of reference of the Commission were very wide and exhaustive and included the examination of the structure and the operations not only of the commercial banks but also of co-operative and financial institutions as well as financial activities. The recommendations cover all aspects of the terms of reference and are divided into 5 major areas: (a) Sharpe, structure and organization of banking, financial and specialized institutions; (b) Re-organization of their functions and service; (c) Simplification of systems and procedures for improving efficiency and reducing costs; (d) Legislation for promoting growth and ensuring regulation; and (e) Management development, management information and research.

One of the main proposals relates to the reconstruction of the banking system. At present there are 29 public sector banks consists of the State Bank of India, its seven subsidiaries and the 20 nationalized banks. According to the Commission, these are too many. So the Commission has put forward a plan under which these will be "recognized" into eight or nine banks, consisting of there all-India banks (the State Bank and two the nationalized banks with widespread branch network) plus five or six regional banks with overlapping jurisdiction over the neighboring areas. The guiding factor in this suggested reform of the structure is that a reasonable choice will always be available to bank customers to choose their banks, and that the proposal will ensure that persons residing in district towns will have a choice between the three all-India banks and at lest two regional banks. For places smaller than district
towns, there will be at least two commercial banks in each district in addition to the network of co-operative banks. This suggestion has been considered at different levels, but it does not appear to have found favor with Government or banking circles. Apparently the implementation of such a scheme would raise several administrative and personnel problems which would cancel out the benefits, if any, arising therefore. It is also believed that retention of the identity of individual banks has kept up a spirit of healthy competition which has been helpful in the defaulter of banking on sound lines. The retention of the identity of banks which have along history and tradition has been helpful in fostering a sense of belonging in the staff and executives which makes them take a keen interest in the progress and development of the institutions to which they belong.24

➢ Implementation of the Banking Commission's & Recommendations:

The Government of India has studied the report of Baking Commission and has taken a decision on some of the committee made by the Commission. The Reconstruction on which decisions have been taken by the Government soar is as under:

1. The Government of India has accepted almost all the recommendations made by the Commission in regard to the banks' operating methods and procedures so as to achieve simplification of credit procedures and rationalization of internal control system and organization management in order to improve functional and operational efficiency. However, the Government has not accepted two recommendations of the Commission:
   
   (i) The committee to establish a common inspection agency for all banks has not found favor with the Government.
   
   (ii) The Bank Giro system recommended by the Commission has not been accepted.25

2. The Government has not accepted the recommendations of the Commission for establishment of a separate merchant banking institutions. This is because the Government wants to study the progress of merchant banking divisions set up by leading commercial banks in the country.

The Government has not accepted the recommendations for setting up specialized institutions for consumer credit. The Government agrees with the Commission that there is no need for a specialized savings bank or specialized discount house in the country. However, the Reserve Bank might consider on merits proposal from persons of other banks and specialized institutions.
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for promoting acceptance or discount houses. The Discount and Finance House of India (DFHI) has now been set up w.e.f. July 28, 1988.

3. The Government is amending some of the statues governing banks in view of the recommendations made by the Commission. Section 19 of the Banking Regulation Act is amended to allow the banks to form subsidiaries for carrying on any business permitted to be transacted under the Act. The Banking Commission felt the necessity for evolution of a uniform scheme for national banks if they have to have a common programme of functions and responsibilities in the development of banking and credit system in the country. The committee involves mainly the question of effecting amendments to the statutes under which these banks have been established. Some amendments have already been effected recently to the State Bank of India Act taking into account the Commission's recommendations for a uniform scheme. The Government has constituted a public service commission for the recruitment of the banking personnel in the nationalized banking industry. The Banking Service Commission Act, 1984 (Act 44 of 1984) has been enacted in this regard. The Banking Laws (Amendment) Act, 1983 (Act 1 of 1984) has also amended the Banking Regulation Act, 1949 and some other Acts in pursuance of the recommendations of the Banking Commission.

The Government of India set up a Committee under the Chairmanship of Shri M. Narasimham to examine the (I) existing structure of the financial system and its various components and to make reconstruction for improving the efficiency and effectiveness of the system with particular reference to the economy of operations, accountability and profitability of the commercial banks and financial institutions (ii) to make recommendations for improving and modernizing the organizational systems and procedures as well as managerial policies, (iii) to make recommendations for infusing greater competitive viability into the system so as to enable the banks and financial institutions to respond more effectively to the emerging credit needs of the economy and other related matters. The Committee submitted its report to the Government on all the issues and made recommendations; among other things restricting the banks and change of policy to make the banks and financial institutions viable. The Committee also recommended capital adequacy norms for the banks. The Government of India and Reserve Bank have accepted, any recommendations of the Committee and taken steps to implement the said recommendations.26
Evolution and Development of Banking Law in India:

The Law of contract, the Law of Torts and other branches of Commercial and Civil law are applicable to banks as to others. It may be stated that Indian Banking law is based to a very large extent, though not entirely, upon the English Banking law; it is therefore, necessary to pass in review the main landmarks of the history of banking legislation in England.

Banking law in general is a part of the law merchant, or as it is sometimes known Lex Moratoria. Lex Moratoria began to take its shape in the 13th century and it was based upon the customs of merchants. Gradually these customs were ratified by courts of law, and became a part of the general law, which courts were bound to recognize. No doubt additions were made from time to time. The practice of marking bills of exchange payable to order and transferring them by endorsement dates back to the beginning of the 17th century. In 1964, the first Banking Act, which brought into existence the Bank of England, was passed. This was followed by acts passed in 1826 and 1833. None of these pieces of legislation dealt generally with banking law, as they dealt with only a few aspects of the banking business. In 1836, attention was drawn in the House of Commons against “the vast and growing system of joint stock banking” and the necessity for statutory regulation of banking “As a result an Act was passed in 1844 which provided for (a) subscribed and paid-up capital of new banks’ (b) permission for opening new banks; (c) retirement of directors every four year in rotation and prohibition of re-election for two year after retirement; (d) prohibition of loans against banks; own shares; and (e) publication of balance sheets once a month.27

During the post-industrial revolution period Banking Law was largely judge-made-law, which was the outcome of the recognition of certain customs governing banking and commercial practices. Lord Mansfield whose name is considered perhaps the most important in the history of English mercantile law, tried to lay the foundation of English banking and commercial law upon the customs of merchants of the advanced European countries. The rulings of Lord Mansfield, which were considered the most important and authoritative pieces of judge-made law, continued to be the law on the subject, and later, whenever the law pertaining to banking or commerce was codified, it was based mostly on the rulings or judgments of Lord Mansfield and certain other judges.28

Speaking generally, the English Law relating to negotiable instruments was applied by courts in India, when the contesting parties were Europeans, but, in the case of the Hindus and Mohammedans, their was

27.Journal of NIBM: June 1982
applied by courts in India, when the contesting parties were Europeans, but, in the case of the Hindus and Mohammedans, their respective laws and usages were made applicable; where, however, the parties belonged to difference communities; the law and usage which governed the defendant were applied. As neither the Hindu texts dealing with hundies, nor the Mohammedan books on the subject, dealt adequately with the matter, customs prevailing among merchants of the respective communities were recognized by the courts.

Act of 1840 represented the earliest attempt in this country to regulate the law relating to bills of exchange and promissory notes. In 1866 a Bill to codify the law regarding negotiable instruments was drafted; the draft underwent several changes and it was not until 1881 that the Indian Negotiable Instruments Act was passed.

The Negotiable Instrument Act 1881 recognizes local usages and certain customs prevalent among Indian merchants. It extends to the whole of India, but does not affect local usages relating to instruments in India languages.²⁹

There was no clear indication in the Act, whether the local usages of the place where an instruments was made or of the place of its payment was to apply when the two differed. The question in each case was to be decided probably by a reference to the intention of the parties to the Instruments. Sir Henry Chalmar, in his commentary on the Negotiable Instrument Act has given rules relating to foreign instruments which may lend useful guidance to the determination of the question. The title Instrument Act has given rules relating to foreign instruments which may lend useful guidance to the determination of the question. The title of the Negotiable Instrument Act itself is considered misleading, as the Act does not deal with all kinds of negotiable instruments. It is for this reason that the English statute on the same subject is known as the Bills of Exchange Act.

The Negotiable Instrument Act, as its preamble shows, is intended “to define and amend the law relating to promissory notes, bills of exchange of ‘cheques’, whether negotiable or not.” Moreover, the Indian Act even now is not as comprehensive as it should be, although it has been amended several times, since the passing of the Act 27.

There was some time a variance in law in practice and theory due to slow
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fusion of English Banking Law in India. This anomaly was brought home to by a ruling of the Bombay High Court where the point involved was, whether striking off the word "bearer" on cheque, without adding the word "order", amounted to a restriction of the rights of the payee to negotiate Income Tax although evidence was given to prove that the bankers, in Bombay, as in England, treated such cheques as order cheques, the learned judge held that the law of this country as it stood then, did not allow it, and, therefore, such cheques were not negotiable.30

Negotiable Instrument Amendment Act, 1919 however, removed this incongruity between banking law and practice in India. Similarly, although in England the protection given to the collecting banker was extended to crossed cheques, credited, though not collected it was not given to bankers in this country, until the law was amended.

The next importance piece of legislation which is made for Bankers alone in this country is the Bankers' Books Evidence Act, 1891. It is a special Act giving certain privileges to Banks as regard the mode of proving of entries in their books and the production thereof in Courts of law.

The law of evidence requires that the existence, condition or contents of a document can be proved before a Court only by producing the original document. So long as the original document is available a copy cannot be produced Section 65 of Indian Evidence Act lays down certain exceptions to this Rule and allows copies of a document to be produced before a Court even when the original is available. One of such an exception is when the original is document of which a certified copy is permitted by any law. The Bankers' Books Evidence Act is one of the provisions of the law which allows the production of certified copy of a document.

There are two important definitions in that Act which are necessary to understand its provisions. One such definition is of "Bankers' Books" as given in Section 2(3) of the Act as under:

"Bankers' Books" include ledgers, day books, cash books, account books and all other books used in the ordinary business of a bank.

The other definition is that of "a certified copy" given in section 2(8). The section as amended by the Banking Laws (Amendment) Act, 1983 (Act 1 of 1984)

31. Journal of NIBM: June 1982
“Certified copy” means a copy of any entry in the books of a bank together with a certificate written at the foot of such copy that it is a true copy of such entry, that such entry is contained in one of the ordinary books of the bank and was made in the usual and ordinary course of business, and that such books is still in the custody of the bank, and where the copy was obtained by a mechanical or other process which in itself ensured the accuracy of the copy, a further certificate to that effect, but where the book from which such copy was prepared has been destroyed in the usual course of the bank’s business after the date on which the copy had been so prepared, a further certificate to that effect, each such certificate being dated and subscribed by the principal accountant or manager of the bank with his name and official title.

The Amendment Act, 1983 has amended this clause so as to provide that a copy made from the original document by mechanical or other process ensuring the accuracy of such copy, together with a certificate to that effect, is also a copy prepared from the original document prior to the destruction of the original by a bank in the usual course of its business, together with a certificate to that effect shall be admissible in evidence. The amendment is based on the recommendations of the Banking Commission.

Section 4 of the Bankers’ Books Evidence Act reads as under:

“Subject to the provisions of this Act, a certified copy of any entry in a banker’s book shall in all legal proceedings be received as prima facie evidence of the existence of such entry, and shall be admitted as evidence of the matters, transactions and accounts therein recorded in every case where, and to the same extent as, the original entry itself is now by law admissible, but not further or otherwise.”

Having regard to the language of the section, it should be borne in mind that the Act merely authorizes certified copies to be produced instead of the originals and does not in any way affect the provisions of the Evidence Act regarding the proof of a document. In Chandradhar Goswami v. Gauhati Bank Ltd., the facts brought to the notice of the Supreme Court were that in the suit before the trial court Gauhati Bank Ltd., relied on the certified copy of its books to prove that a sum of Rs.10, 000/- was advanced to the defendant. The defendant contended that the accounts of the Bank were not kept correctly in the regular course of business and were fraudulent and were therefore not relevant and not admissible in evidence. The Supreme Court held that in view of the

32. United Industrial Bank Ltd V V.G.Dey
contention of the defendant mere reliance by the Bank on the production of certified copies was not sufficient. The basis of this view was section 34 of the Evidence Act which provides that “entries in books of accounts, regularly kept in the course of business, are relevant whenever they refer to a matter into which the Court has to inquire, but such statements shall not alone be sufficient evidence to charge any person with liability”. Since the bank wanted to charge the defendant with the liability of a debtor, the certified copies would not constitute evidence for the purpose. The Court held that the certified copies are of the evidentiary value to the same extent as the original entry itself and no further. Therefore, where the entries are not admitted, it is the duty of the bank, to produce evidence in support of the entries to show that the money was advanced, and thereafter the entries would be of use as corroborative evidence. An officer of the plaintiff bank produced a statement of account of the defendant with the bank duly certified by the Branch Manager under the Bankers’ Books Evidence Act and deposed to the correctness of the statement. It appeared that a certain sum was due and the plaintiff demanded payment of the overdraft balance then outstanding by two letters the copies of which were also produced, but the defendant failed and neglected to pay the same. The Court held that the plaintiff’s claim ought to succeed although the defendant filed a written statement and chose not to appear.\textsuperscript{33}

Section 4 of the Bankers’ Books Evidence Act reads as under:

“No officers of a bank shall in any legal proceeding to which the Bank is a party be compellable to produce any banker’s book, the contents of which can be proved under this Act, or to appear as a witness to prove the matters, transactions and accounts therein recorded, unless by order of the Court or a Judge made for special cause”.

It must be noted that the above section applied only when the bank is not a party to the proceeding. Further, the section does not apply to an investigation by a police officer. Under Section 94 of the Criminal Procedure Code, an officer in-charge of a Police Station can compel a Bank officer to produce the books without the order of a Court.\textsuperscript{34} (A.F.G. Price v. Emperor).

Section 2(4) of the Bankers’ Books Evidence Act, 1891 as amended by the Banking Laws (Amendment) Act, 1983 reads as under:

‘Legal proceedings’ means-

\textsuperscript{33}\textsuperscript{AIR.1974.cal 154}
(i) any proceedings or inquiry in which evidence is or may be given;
(ii) an arbitration; and
(iii) any investigation or inquiry under the Code of Criminal Procedure 1973 (2 of 1974), or under any other law for the time being in force for the collection of evidence, conducted by
(iv) a police officer or by any other person (not being a Magistrate)
(v) authorized in this behalf by a magistrate or by any law for the time being in force”.

The Amendment Act, 1983 has amplified the definition of the term “legal proceeding” by including therein any investigation or inquiry under the Code of Criminal Procedure, 1973, or under any other law for the time being in force for the collection of evidence conducted by a police officer or by any other person (not being a magistrate) authorized in this behalf by a magistrate or by any law for the time being in force. The amendment is based on the recommendations of the Banking Commission.

Section 6 of the Bankers’ Books Evidence Act reads as under:

(1) “On the application of any party to a legal proceedings the Court or a Judge may order that such party be at liberty to inspect and take copies of any entries in a Banker’s book for any of the purposes of such proceeding or may order the bank to prepare and produce, within a time to be specified in the order, certified copies of all such entries, accompanied by a further certificate that no other entries are to be found in the books of the bank relevant to the matters in issue in such proceedings, and such further certificate shall be dated and subscribed in manner here-in-before directed in reference to certified copies.

(2) An order under this or the preceding section may be made either with or without summoning the bank, and shall be served on the bank three clear days (exclusive of bank holidays) before the same is to be obeyed, unless the Court or judge shall otherwise direct.

(3) The bank may at any time before the time limited for obedience to any such order as aforesaid either offer to produce their books at the trial or give notice of their intention to show cause
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against such order, and thereupon the same shall not be enforced without further order."

It is in the discretion of the Court to order that a party to a legal proceeding can inspect and take copies of Bankers' books. An order under the section is made only when the entries are relevant for the purpose of any issue in the proceeding. Courts are always averse to giving anything in the nature of a roving or fishing inquiry when commissioning to inspect document (Central Bank of India Ltd. v. Shamdasani).  

Where the inspection of the books of a third party was sought the Court held that the same ought not to be allowed as it involves a serious inroad upon his normal right as a citizen. (Satyanarayan v. Punjab National Bank,)  

The words “party to a legal proceeding” used in Section 6 of the Bankers’ Books Evidence Act enable inspection to the made only if such inspection was necessary for the purposes of such proceedings. In other words there should be a main proceeding in which the court might came to the conclusion that such inspection was necessary and it would only in such proceeding that order could be passed for inspection. If there is no legal proceedings pending, the court cannot order for the inspection of Bankers’ books under Act (Kattabomman Transport Corporation. Ltd. v. State Bank of Tranvancore).  

The Banking Laws (Amendment) Act, 1983 has incorporated a new Section 8 in the Bankers’ Books Evidence Act, 1981, so as to provide that the order of a court or judge for production and inspection of books of the bank shall be construed as referring to an order made by an officer of a rank not lower than a Superintendent of Police as may be specified in this behalf by the Government by which the police officer or any other person conducting the investigation or inquiry is employed.

35. (39) Bombay L.R.1187
36. (39) Bombay L.R.1187
37. AIR 1977 Cel 280