CHAPTER II

EVOLUTION OF BANKING AND COMPARATIVE ANALYSIS OF BANKING REGULATIONS IN INDIA, U.K. AND U.S.A.

2.1 Introduction

Origin of money is almost as ancient as the human civilization. Money is not itself the nature of a particular asset. Since the assets which function as money tend to change over time in any given country and among countries, it is best defined independently of the particular assets that may exists in the economy at any one time.

At a theoretical level, money is defined in terms of the functions that it performs. At traditional level these functions are medium of exchange/payments, store of value and standard of deferred payments and unit of account. Any asset that does not directly perform this function or cannot indirectly perform it through a quick and costless transfer into a medium of payments cannot be designated as money.

A developed economy usually has many assets which can perform such a role, though some do so better than others. The particular assets that perform this role vary over time, with currency being the only or main medium of payments early in the evolution of monetary economies.¹ It is complemented by demand deposits with the arrival of the banking system and then by an increasing array of financial assets as other financial intermediaries become established. A Banking Sector performs three primary functions in economy,

the operation of the payment system, the mobilization of savings and the allocation of saving to investment products.\(^2\)

### 2.2. Definition of Bank, Banker and Banking

Some jurists are of the opinion that the word “Bank” is derived from the word “bancus” means bench. The early bankers transacted their business on benches in the market place. When a banker failed his “banco” was broken up by the people, hence the word “bankrupt”.

But others, who are of the opinion that the word “bank” is originally derived from the German word “back” meaning a joint fund, which was Italianized into “banco”, when Germans were masters of a great part of Italy. But, whatever be the origin of the word “bank”, it would trace the history of banking in Europe from the middle ages.

The multifarious function performed by the banks has caused difficulty in giving common accepted definition of bank. At least it is cumbersome, to formulate a definition of banking which would be wide enough to embrace the diverse activities carried on by the bankers. One can give the word ‘bank’ a narrow meaning and call that a definition; or one could give it a much wider meaning and call that a definition. The truth is that before one can define the word, it is often necessary to examine the context in which it is used. With this in mind, bank or banker can be defined under three heads: (a) some definitions by text book writers, (b) some statutory definitions and (c) some of them are the views expressed by the courts while deciding matters before it.

The term ‘banker’ as given by the text book writers in America is often used in a very broad sense, embracing the capitalist, the financier, the stock broker and even high bank officials. Many attempts were made to explain the exact significance of the term, but nearly all of them had their own pitfalls. The earliest successful attempt was made by legislators in the U.S.A. who enacted the following definition ‘by ‘banking’ we mean business of dealing in credits’ and by “bank we include every person, firm or company having a place of business where credits are opened by the deposit or collection of money or currency, subject to be paid or remitted on draft, cheque or order, or money is advanced or loaned on stocks, bonds, bullion, bills of exchange (BOE), or promissory notes, or where stocks, bonds, BOE or promissory notes are received for discount or sale”.

The definition, which is more like a description, is used in an Act of the Congress. To define banking as merely ‘dealing in credit is wanting in precision and exactitude.

According to English author, H.L.A. Hart defined a banker or bank as “A person or company carrying on the business of receiving moneys, and collecting drafts, for customers subject to obligation of honouring cheques drawn upon them from time to time by the customers to the extent of the amounts available on their current accounts”.

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4 National Bank Act, 1863.
5 Herbert Lionel Adolphus, called as Hart was an influential legal philosopher of the 20th century. He was Professor of Jurisprudence at Oxford University and the Principal of Brasenose College, Oxford. His most famous work is The Concept of Law.
Likewise, Halsbury’s Laws of England defines a banker as “an individual, partnership or corporation, whose sole or pre-dominating business is banking, that is the receipt of money on current or deposit account and the payment of cheques drawn by and the collection of cheques paid in by a customer”.\textsuperscript{7} Sir John Paget, another great authority, according to whom there are four essential functions which persons desiring to be called bankers, must perform. “It is a fair deduction, that no person or body corporate or otherwise, can be banker who does not (1) take deposit accounts, (2) take current accounts, (3) issue and pay cheques, and (4) collect cheques crossed and uncrossed, for his customers”.\textsuperscript{8} This definition was given while reviewing the case \textit{Birkbeck Building Society}\textsuperscript{9} and other legal decisions at that time. But this definition was criticized that though it is fairly exhaustive, it did not include two important functions of the banker, which are agency functions and general utility services.

According to American Statutory definitions, U.S. Code classification table, sections 582 and 584 defines the term bank which means ‘a bank or trust company incorporated and doing business under the laws of the U.S. (including laws relating the District of Columbia) or of any State, a substantial part of the business of which consists of receiving deposits and making loans and discounts, or of exercising fiduciary powers similar to those permitted to national banks under authority of the Comptroller of the currency, and which is subject by law to supervision and examination by State, Territorial, or Federal

\textsuperscript{9} (1913)29, T.L.R., 219.
authority having supervision over banking institutions. Such term also means a domestic building and loan association’.

The term bank is generally used to refer to commercial banks. However, it can also be used to refer to savings institutions, savings and loan association and building and loan associations. A commercial bank is authorized to receive demand deposits (payable on order) and time deposits (payable on a specific date), lend money, provide services for fiduciary funds, issue letters of credit, and accept and pay drafts. A commercial bank serves not only its depositors but also offers loans on installment, lends long term commercial loans and provides credit cards. A savings bank in U.S. does not offer as wide a range of services. Its primary goal is to serve its depositors by providing loans for purposes such as home improvement, mortgage loan and education loan. By law, a savings bank can offer a higher interest rate to its depositors than a commercial bank in U.S.10

In 1901, American Supreme Court’s Justice Holmes while delivering judgment,11 described banker’s business as “The real business of the banker is to obtain deposits of money which he may use for his own profit by lending it out again”.

Under English law, there is a legislation which sets out to define banking. The Bills of Exchange Act, 1882, describes banker thus,

“[I]n this Act, unless the context otherwise requires... ‘banker’ includes a body of persons, whether incorporated or not, who carry on the business of banking”.12

11 Auten v, United States National Bank, 174, US 1899, 125.
12 Section 2 of the Bills of Exchange Act, 1882.
The Banking Act, 1979 introduced the concept of ‘recognized’ banks, that is to say, banks recognized by the Bank of England. Recognition was, however, solely for the purpose of the Act.\(^{13}\)

In United Dominions\(^{14}\), Lord Denning defined bank as “an establishment for the custody of money received from, or on behalf of, its customers. Its essential duty is to pay their drafts on it; its profits arise from the use of money left unemployed by them”. The view of majority in the above case was that the usual functions of banking are (a) acceptance of money from and collection of cheques for customers and placing of them to customer’s credit; (b) honouring of cheques or orders drawn on the bank by their customers when presented for payment; and (c) keeping of some form of current or running accounts in their books in which the credits and debits are entered.\(^{15}\) In addition to these functions banks also perform many other functions.\(^{16}\)

In 1921, Justice Atkin wrote,

“The bank undertakes to receive money and to collect bills for its customer’s account. The proceeds so received are not to be held in trust for the customer, but the bank borrows the proceeds and undertakes to repay them. The promise to repay is to repay at the branch of the bank where the account is kept, and during banking hours. It includes a promise to repay any part of the amount due against the written order of the customer addressed to the bank at the branch... Bankers never do make a payment to a customer in respect of a current account except upon demand”.\(^{17}\)

\(^{13}\)Later the repealed Act in 1987 stated that all the deposit taking institutions were “authorized institutions”.

\(^{14}\)(1966)1, All.E.R., 968.

\(^{15}\)Ibid at 783.

\(^{16}\)General Utility Service, agency function, issues of currency, etc. are some of the other functions banks does.

\(^{17}\)Joachimson v. Swiss Bank Corporation, (1921), All.E.R., 92.
In India, the earliest attempt was made by the Hilton Young Commission\(^\text{18}\), which described bank and banker as “the term ‘bank’ or ‘banker’ should be interpreted as meaning every person, firm or company accepting deposits of money subject to withdrawal by cheque, draft or order”.\(^\text{19}\)

The *Indian Companies (Amendment) Act, 1936*, though rejecting the former part of the definition proposed above and rightly so substantially accepted its latter part. In 1948, the Privy Council for the first time used these words to describe a bank as “… a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order…”.\(^\text{20}\)

After independence the *Banking Regulation Act 1949*,\(^\text{21}\) (herein after referred as B. R Act, 1949), defined banking company\(^\text{22}\) as ‘a company which transacts the business of banking in India’, and the word ‘banking’ has been defined\(^\text{23}\) ‘accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft or otherwise’.

Section 6 of the Act has laid the business which a banking company can carry. What is important to note is the negative part of the definition which states that a banking company shall not engage in any form of business other

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\(^{18}\)The Hilton Young Commission was a Commission of Inquiry appointed in 1927 to look into the possible closer union of the British territories in East and Central Africa. These territories were individually economically underdeveloped.

\(^{19}\)Under para 162 of Hilton Young Commission report.


\(^{22}\)Section 5(b) of the B R Act.

\(^{23}\)Section 5(c), Ibid.
than that stated under 6. And when we analyze the provision, except
manufacturing of products and selling of those manufactured products, banker
can carry on all types of business.

2.3. Early History

Ancient Mesopotamia has been identified as the ‘cradle of banking
operation’. In Mesopotamia, credit was made available, without dipping into
deposits as deposit taking which had not yet been stated as banking. All such
operations preceded the emergence of money, in the sense of standardized
metallic pieces, in a fixed denomination, whose value was certified by the
rulers stamp and took place in fungible items such as grain or silver.

Those operations were carried out, as a ‘secondary activity’ by temples,
palaces, merchants and landowners and that is to say all those in possession of
capital.24 Thus the emergence of banking operations in ancient Mesopotamia
led to neither the emergence of banking in full sense of the word, nor to the
appearance of banks and as distinct institutions. In short, limited banking
activity historically preceded both banking and banks. The banking system, in
true sense, was developed by Babylonians as early as 2000 B.C.

There is evidence to show that temples of Babylonians were used as banks
and such great temples as those of Ephesus and of Delphi’s were the most
powerful of the Greek Banking Institutions. The invention of coined money
affected banking in opposing directions.25 The other fundamental features of
modern banking, that is lending out of such deposits, as well as transfers from

24 http://journals.cambridge.org/action/displayAbstract?fromPage=online&aid=7585204. Accessed on
25th July, 2011.
25 It is claimed the Greeks were the ‘creators of the bank of deposit’.
the account of one customer to another can also be traced which were in rudimentary manner.  

During the Roman Empire, the predominance of coins arrested the development of banking and favoured payments in specie, thereby demoting the function of cashless payments (barter system). Roman temples which were involved in deposit taking, ‘did not lend money at all’.  

The bankers were called *Arjentarii, Mensarri or Callybistoe* and banks were called *Tabernoe Argentarioe*.  

Ironically, ‘the honour for the first full and efficient operation’ facilitating a nationwide circulation and transfer of credit developed in connection with grain warehousing banking and belonged to Egypt of the Ptolemy’s during the last quarter of the fourth century, namely, sometimes between the fall of Greece as a unified empire and the rise of Rome.  

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 result of administrative decentralization and demoralization of the government authority with its inevitable counterpart of commercial insecurity, banking degenerated for a period of some centuries into a system of financial makeshifts.  

The first banking system, characterized by features still recognizable in the modern one, existed in continental Europe, particularly in Italy, from the end of  

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Indeed, as a distinct type of institution, the bank originally emerged as a successor of the money changer, money dealing, in which money changers came to specialize, became an economic activity, a century or two after the invention of the coined money in the 7\textsuperscript{th} century.\footnote{Jagadish Handa, \textit{op cit.}, p. 27.} While there were documentary instances of early money changers becoming bankers by lending out of deposited funds, such an activity was not quick to institutionalize. Instead, gradually, well into the middle ages, money changers came to specialize in the transmission of funds between distant parties.

To that end, they developed the forerunner of the modern bill of exchange (BOE). Such an instrument was typically used in payment from debtor to a distant creditor, in connection with a commercial transaction between them for sale of goods.

To carry out payment, the debtor delivered the amount to be paid to a money exchanger in the debtors place and in coins and notes used as a medium of exchange in that place.\footnote{Thus instrument was then issued and sent to the creditor through a money changer at the creditor’s place in the creditor’s currency. This was done either through bilateral or multilateral clearing their global dealings.}

BOE was designed to avoid the risk of transport as well as the risk of payment in defective or counterfeit coins, in a currency in which counterparty may be familiar and which the debtor may not have been.\footnote{Jagadish Handa, \textit{op cit.}, p. 28.}
In the words of Holdsworth,\footnote{William S. Holdsworth, \textit{loc cit.}} ‘somewhere between 1270 and 1318 the money changers of Venice were becoming bankers in addition for carryout payments they received funds on deposit and lent them to other’. The Bank of Venice which was established in 1157 and is supposed to be the most ancient bank in the world.\footnote{K.C.Shekhar and Lekshmy Shekhar, \textit{op cit.}, p. 2.}

Originally, it was not a bank in the modern sense, being simply an office for the transfer of the public debt. History shows the existence of a \textit{Monte} a standing bank or amount of money, as they have in diverse cities of Italy. It is believed that there were ‘three bankers of Venice’ meaning three public loans or \textit{Monte}. And as early as 1349, the business of banking was carried on by the drapers of Barcelona. There it was subject to officials regulations. The drapers were not allowed to commerce this business until they had given sufficient security. During 1401, a public bank was established in Barcelona. It used to exchange money, receive deposits and discount bills of exchange both for the citizens and the foreigners. The Bank of Amsterdam\footnote{In 1609, Amsterdam opened the first exchange bank in northern Europe. The principal purpose of the Bank of Amsterdam was to discourage the circulation of debased coins. At the turn of the 17th century, Amsterdam suffered from a debasement problem because of the interactions between coins and commercial credit. And when credit suffered Amsterdam suffered.} was established in 1609 to meet the needs of the merchants of the city. It accepted all kinds of specie on deposits. These deposits could be withdrawn on demand or transferred from the account of one person to the account of another. Thus, system of withdrawal without notice began. It provided extensive inter account in house payment services, but restricted its lending to government and later to private customers against good security.
The bank also adopted a plan by which depositor received a kind of certificate entitling him to withdraw his deposit within six months. These written orders, in course of time came to be used in the same manner as the modern cheques.

It was granted monopolistic power by the State. These powers were often relaxed to the transmission of funds in International Trade.\(^\text{37}\) It is interesting to note that most of the European banks in existence were formed on the model of the Bank of Amsterdam in 18\(^\text{th}\) century. Groups of merchants and traders organized private banks to discount short term commercial papers and issued private bills of credit.

These bills of credit were very popular with the public in specie. In fact, these private banks can rightly be considered as precursors of commercial banks of later times.

**2.3.1. History of Banking in U.S.A**

Early history of American banking shows the existence of land banks which were operated by the colonial governments.

These land banks used to issue paper currency as loans of various kinds of land and improved real estate.\(^\text{38}\) In U.S., banking is regulated by both the federal and state governments.

In 1781, an Act of the Congress of the Confederation established the Bank of North America in Philadelphia, where it superseded the state chartered Bank of Pennsylvania founded in 1780 to help fund the American Revolutionary


War. The Bank of North America was granted a monopoly on the issue of bills of credit as currency at the national level.\textsuperscript{39}

Robert Morris, the first Superintendent of Finance appointed under the Articles of Confederation, proposed the Bank of North America as a Commercial Bank that would act as the sole fiscal and monetary agent for the government. He has accordingly been called “the father of the system of credit and paper circulation” in the U.S.\textsuperscript{40} He saw national profit and private monopoly following the footsteps of the Bank of England as necessary, because previous attempts to finance the Revolutionary War, such as continental currency emitted by the continental Congress had led to depreciation of money to such an extent that Alexander Hamilton considered them to be ‘public embarrassments’. After the war, a number of State Banks were chartered, including the Bank of New York and the Bank of Massachusetts during 1784.

Then the U.S. Constitution subsumed the Articles of Confederation, which still persist in the hard copy edition of US Code Title 1 as a foundation stone of the American Governments which chartered the First Bank of United States in 1791 to succeed the Bank of North America under Article 1, Section 8. However, Congress failed to renew the charter for the Bank of the United States, which expired in 1811. Similarly, the Second Bank of the United States was chartered in 1816 and shuttered in 1836.

\textsuperscript{39}Prior to the ratification of the Articles and Perpetual Union, only the States had sovereign power to charter a bank authorized to issue their own bills of credit. Later it was shared by Congress also.

\textsuperscript{40}T.H. Goddard, “History of Banking Institutions of Europe and the United States”, U.S., Carville, (1831), pp. 48-50.
Despite this (and more on the commercial banking side of the spectrum), in the early 19th century, up until around the mid 19th century, many of the smaller commercial banks were easily chartered as laws allowed to do so, primarily due to franchise banking. The rise of commercial banking saw an increase in opportunities for wealthy individuals to become involved in entrepreneurial projects as they would not involve themselves in, without someone to guarantee a return on their investment.

These early banks acted as intermediaries for entrepreneurs who did not have enough wealth to fund their own investment projects and for those who did have but did not want to bear the risk of investing in projects. American Commercial Banks may be broadly grouped under two heads, viz, the ‘State Banks’ and the ‘National Banks’.

The dual federal state banking system evolved partly out of the complexity of the US financial system, with its many kinds of depository institutions and numerous chartering authorities. It has also resulted from a variety of federal and state laws and regulations designed to remedy problems which the US commercial banking system had faced over the years.

2.3.2. Evolution of Banking in U.K.

In England the development of banking took place in scriveners Era. The business of banking, viz, borrowing in order to lend, was first carried on in England by the Scriveners, who were scribes and whose original business was

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41Thus, this private banking sector witnessed an array of insider lending, due to low banks actually spurred early investment and helped spur many later projects. Despite what some may consider discriminatory practices with insider lending, these banks actually were very sound and failures remained uncommon, further encouraging the financial evolution in the U.S.
to write legal documents. But neither paper money nor payment mechanism was instituted by them.\textsuperscript{42}

Scriveners preceded the Royal Exchangers. During the reign of Edward III, money changing was an important function of bankers of those days and 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.\textsuperscript{43}

English banking, precipitating the current design of the banking system worldwide goes back to goldsmith banking. In mid seventeenth century, merchant kept their surplus money in the king’s mint in the tower of London. During the course of the 17\textsuperscript{th} century and following Charles I forcible loan from the money that was in the king’s mint, in 1640, merchants began to leave their money in the hands of goldsmiths.\textsuperscript{44} Soon, during Cromwellian period, the goldsmith became a banker. Having acted as bailee or custodian of money in trust, for which he received interest, he was now fully authorized to make use of deposited money by lending it to others.

Goldsmiths issued receipts in respect of money’s deposited with them. A receipt was in favour of a payee or bearer. The instrument contained the goldsmiths undertaking to pay on demand when presented with the receipt. It came to be known as goldsmith or banker note and evolved into an early form

\textsuperscript{43}M.L.Tannan, \textit{op. cit.}, p.3.
\textsuperscript{44}\textit{Ibid} at 4.
of the promissory note, leading the way for subsequent Bank of England Note, viz, paper money. Alternatively, rather than taking goldsmiths notes, a depositor was allowed to draw upon the goldsmiths various amounts up to the amount of deposit. Such a draft, or bearer, was the forerunner of the modern cheque.

Indeed, cheques were used primarily by the nobility and landowning classes, whose signatures were widely known and accepted. At the same time, in as much as the financial standing and the authenticity of the signature were likely to be more certain in the case of a banker than in the case of an unknown depositor, bankers’ notes were more promising and widely used as a medium of exchange. In *Cooksey v. Boverie*, it was held that the note issued by the goldsmith for whole sum of money deposited with him and if any part of amount is paid off, the amount thus paid off was to be market as original note. Goldsmith banking was thus a source of the banknote, cheque and banking itself.

And all such instruments or concepts can be traced to an early development, yet, the goldsmiths clearly deserve the credit for the combined effect and continuity of these concepts leading to modern banking. The trouble started when Charles II under his ministry borrowed heavily from the goldsmiths and repudiated all debts thereby the goldsmiths as well as English Banking received a rude set back. Charles II set up the Exchequer. He would pay none and ruined

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46A.E.Feaveyear, *loc. cit.*
48(1693), 2 Show, KB. at p. 296.
the goldsmiths.\textsuperscript{49} This resulted into distrust of goldsmiths by the people and due to this; there was the growth of private banks which finally led to the establishment of the Bank of England. The Bank of England was established in 1694 by passing \textit{The Tonnage Act}.\textsuperscript{50} Its chief and original function was that of a bank of issue (currency). It is said that the creation of the Bank of England was really the work of an impecunious government striving to borrow money in order to wage a war against France.\textsuperscript{51}

Its promoter, Mr. Patterson, promised to lend the government a vast amount of money. In return, they received the privilege of forming the first and for more than a century the only, joint stock bank in the country. It acted as banker to the government.\textsuperscript{52} Indeed, bill of exchange did not assume central banking functions until the 19\textsuperscript{th} century when it became lender of last resort and in fact, the curator of the banking system in England.\textsuperscript{53}

\textit{The Tonnage Act}, the first legislation, gave monopoly of note issue to the Bank of England. So far as private joint stock banks were concerned, they could issue notes provided they had more than six partners. In London and surrounding districts however, the notes of the private joint stock banks did not circulate notes to an appreciable extent. Consequently these banks found the business of note issue unprofitable and gave it up. Instead they began to

\textsuperscript{50}Bank of England was a public or state bank modeled on the goldsmith bank and not on the continental public or state bank as in U.S.
\textsuperscript{51}J.M.Holden, \textit{op. cit.}, p.87.
develop deposit banking. The crisis of 1825 marked a turning point and tolled the death knell of the small country banks which had laid foundation of the banking system in U.K. Legislations 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 issue notes, provided they had no office within a radius of 65 miles from London.

This led to the starting of joint stock banks in England. The said restriction was later relaxed by a gentleman named Mr. Joplin who, after studying carefully the provisions of 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 and a clarification was given to establish joint stock banks in London. Based on this, London and Westminster Bank was established in 1834 in London and is one of the first of the ‘Big Five Banks’ of U.K.

There was no restriction on amount of note issues on joint stock banks and other private banks. This resulted again in numerous banking crisis and bank failures. The monopoly to issue notes was reverted back to the Bank of England.

This marked as an important turning point in the history and development of English banking and the deposit banking eventually came to supplant note

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54 Printed cheques were first issued between 1749 and 1759.
55 The other four banks were National Provincial Bank, Ulster Bank in Ireland, The Royal Bank of Scotland and Bank of England.
56 This led to passing of Peels Act, 1844, which imposed restriction on note issue. Later it altogether extinguished the right to issue notes of joint stock banks and private banks.
issue banking.\textsuperscript{57} Later, some legislations like \textit{Bankers Books Evidence Act, 1879} and \textit{Bills of Exchange Act, 1882} were passed to protect the bankers.\textsuperscript{58}

After passing of \textit{Peel’s Act}, 1844 new banks with the right to issue notes could not be started and those which were previously permitted could not increase their circulation. Thus greater attention began to be paid towards deposit banking and cheque currency.

It was soon realized that cheque currency was almost as profitable as the issue of bank notes and thus gradually this activity gained more and more important. With the result that many new banks were started for this business was profitable, during the second half of the 20\textsuperscript{th} century.

Later, many banks went for amalgamation and absorption which led to decline in number of banks. In terms of the \textit{Currency and Bank Note Act, 1920}, the currency note issue was amalgamated with that of Bank of England, which was given exclusive right to issue notes. 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.

The promoters of the bank were given in exchange three percent long term government stock which gave the holders the same income as they were getting before.

The amount of the capital stock in the Bank of England at the time of its nationalization was 14,553,000 pound sterling in exchange for which

\textsuperscript{57} M.L. Tannan, \textit{op. cit.}, p. 6.

\textsuperscript{58} Halsbury’s Statues, (3\textsuperscript{rd} Ed.), England, Lexis Nexus, Butterworths, (1962), p. 188.
government stock of the face value of 58,212,000 pound sterling was issued.\textsuperscript{59}

This was the first Act of socialization on banks.

In 1973, Lord O’Brien, the Governor of the Bank of England, addressed the Institute of Bankers where he stated that independence of the Central Bank was back bone of the Nation’s economy. The position changed and during 1970 there was property boom. This led to establishment of what came to be known as ‘secondary banks’ or ‘fringe banks’.

They were formed only to finance property and were not regarded as banks by the Bank of England.\textsuperscript{60} When Bank of England did not recognize ‘secondary banks’ as banks, a White Paper was drafted were recommendations were made for recognizing any institution as bank. This led passing of The Banking Act, 1979. By this time first banking directives\textsuperscript{61} were issued by the European Economic Community and one of the directives was that banks and other financial institutions must be licensed.

The basic object of the Banking Act, 1979, is that, no person shall accept a deposit in the course of carrying on a deposit taking business unless the deposit taker is one of the institutions exempted from this prohibition or, less important, the transaction is one of the transactions exempted from the prohibition. Section 3 of the Act lays down the procedure for applying for

\textsuperscript{59}Ibid at 6.
\textsuperscript{60}This ‘secondary banks’ or ‘fringe banks’ closed down very soon as a result of collapse in property market in 1973. And government soon after this produced a White Paper in 1976 entitled ‘The Licensing and Supervision of Deposit Taking Institutions’. This White Paper stated the government’s intention of introducing a formal system of control and a system for licensing deposit takers. It put forward criteria for recognition of an institute as a bank and finally it recommended the establishment of a Deposit Protection Fund.
\textsuperscript{61}EU rules on capital requirements for credit institutions and investment firms aim to put in place a comprehensive and risk-sensitive framework and to foster enhanced risk management amongst financial institutions.
recognition or a license. The Act also deals with criteria for considering the said applications, provisions for revoking recognition or a license and the arrangements for supervising recognized or licensed institutions.

The distinction between recognized banks and licensed institutions is that, in case of recognized banks supervision continues on an essentially non statutory basis and that only recognized banks have an unqualified right to call themselves banks. Both recognized banks and licensed institutions must meet criteria for legal form, prudence and management.

Recognized banks must also meet requirements related to their range of services and reputation and standing. It is a criminal offence for a non authorized institution to take deposit within the meaning of bank. Thus so far as the English banking system is concerned, the entire matter is now covered by the Banking Act, 1979 which governs all the important aspects of the banking system in England. According to Sheldon in England there are five types of banks. First, the Bank of England, incorporated by Royal Charter and not affected by the Companies Act, second, the National Savings Banks, the National Giro and the Trustee Savings Banks, third, Joint Stock Banks registered under Companies Act, fourth, Joint Stock Banks with unlimited liability and the last is the Scottish, Irish, Overseas and Foreign Banks.

The distinction between recognized banks on the one hand and licensed deposit takers on the other hand, caused practical difficulties. The Bank of

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England supervision over the recognized banks was inadequate. In 1984 the matter became serious when one of the recognized banks i.e. Johnson Matthey Bankers Limited, got into financial difficulties. Bank of England decided to acquire the company as it posed threat to the stability of banking system in England. A committee was formed headed by Mr. Nigel Lawson, to look into the system of banking supervision and to make recommendations. Based on the recommendation, *The Banking Act, 1987* was passed.

There was an amendment to section 3 of the *Banking Act, 1979*. The authority to issue license was granted to the Bank of England and was according to the European Economic Community Directives. The Act does not differentiate between recognized banks and licensed deposit takers as did the 1979 Act. All the deposit taking institutions now are known as ‘authorized institutions’ and are subject to the same scrutiny. The Act further lays down the procedure for obtaining the authorization to take deposits. It sets out the ‘minimum criteria for authorization’. Some of them are, at least two individuals must effectively direct the business of the institution, the business of the institution must be conducted in a ‘prudent manner, the institution to maintain adequate accounting and other records of its business. Thus, banks in England today are well knit with legislative framework.

### 2.3.3. Evolution of Banking in India

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64 The amendment was to define banker which stated under section 3(1) of the *Banking Act, 1987* “no person shall in the United Kingdom accept deposit in the course of carrying on a business which for the purposes of the Act is a ‘deposit taking business’, unless that person is authorized by the Bank of England”.

65 *Supra note* 61.

66 The minimum criteria are the Bank has responsibilities in other bank-related activities, such as liquidity provision, crisis management, payments settlement, international negotiations, and lender of last resort.
From times immemorial, the banker has been an indispensable pillar of Indian society. The banking system, as it exists today, is the product of many centuries and is not the development in any particular period. 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 exchanger. Money economy, in its turn, could not do without the institution of banking for any considerable time. In the Smriti period which followed the Vedic period and the Epic Age as well, banking had become an activity in India. Provisions of banking are amply found in Kautilya’s Arthashastra, Gautame, Brihaspati and Budhayana’s writings. There is plenty of evidence to show, that even prior to advent of occidental ideas, India was not a stranger to the conception of banking. As has been mentioned by R.C.Dutt, ‘Usuary and Loans’ were well understood in ancient India. Loans were incurred without intention to repay. This shows that the giving and taking of credit in one form or other must have existed as early as the Vedic period.

There are references which prove that during the period of Ramayana and Mahabharata the banking has become a full fledged business. It is said that one Vriddhipajivi accompanied Bharat to jungle to bring back Lord Rama to Ayodhya. Vriddhipajivi means a member of the money lending community.

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67Barter system existed before introduction of money to Indian economy. Price of a product was decided on the demand of the other product.
Manu has devoted a special chapter in ‘Manu Smriti’ to deposits and pledge and has given rules for loans and rate of interest. In the ‘Laws of Manu’\textsuperscript{71}, Buhler says Manu have mentioned that ‘a sensible man should deposit his money with a person of good family, of good conduct, well-acquainted with the law, veracious, having many relatives, wealthy and honourable (Arya)’. He further gives us rules, which governs the policy of loans and rate of interest. Sir Richard Temple testifies to the fact that banking business was carried on in ancient India.\textsuperscript{72}

During the Buddhist period even the Brahmans and the Kshatriyas started taking banking business. In this period there are evidences to show that the bills of exchange (called *Hundi*) had come into use and practice. Kautilya in his *Arthashastra* talks about the maximum rate of interest which could be charged by the persons. The bankers in this period were known as *Shresthies, Sahukars* and *Mahajans*. Hence, banking was known and practiced in India at the time when the rest of the world had yet to evolve a medium of exchange in the form of money.\textsuperscript{73} The word ‘*Hundi*’\textsuperscript{74} is said to be derived from the Sanskrit root ‘*hund*’, which means to collect. Its derivation expresses the purposes for which originally such instruments were used. The public confidence, enjoyed by the Indian banker, can well be realized from the fact that *hundis* dates back to the days of Mahabharata. *Hundis* were quite in vogue during the middle ages.

\textsuperscript{72} Banking in those days meant money lending. Financing kings and their wars were the main functions of money lender, though certain rudiments of modern banking functions were not unknown to the then bankers.
\textsuperscript{73} D.S.Sarkar, ‘*Joint Stock Banking in India*’, Bombay, Popular Book Depot, (1938), p.10.
\textsuperscript{74} There were different kinds of *Hundis*. They are *Shah jog Hundi*, *Nam jog Hundi* and *Jawabi Hundi*.
According to one instance to show banking in India and use of bill of exchange, Bastupal Tejpal drew a *Hundi* for rupees ten crores on the Nagar Seth (city banker) of Ahmedabad and the temples of Dilwara were built with that money. In modern times same *Hundi* is known as Bills of Exchange as the functions of both are same. *Hundis* were used even during Mughal period.

And also during this period the issue of various kinds of metallic money in different parts of the country gave indigenous bankers great opportunities for developing a very profitable business of money changing and the most important amongst them were appointment of mint officers, revenue collectors, bankers and money changers to government in various parts of the Empire. Bankers in India lent money against personal as well as 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. In Bengal, money was frequently lent to farmers at forty and sometimes at sixty percent interest per annum, while the standing crop was mortgaged for

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repayment of the loan.\footnote{M.L. Tannan, \textit{op. cit.}, p.8.} The early Indian banker had comparatively a little of deposit or discount business or dealing in other people’s money which is the unfailing characteristic of modern banking. Hence, the ancient bankers are called money lenders and not bankers.

The times changed and the Indian indigenous banking of the ‘good old days’ extinguished. Though there are some stints of it, but to a negligible level. The payment of taxes in cash, better means of communication and transportation, uniform currency, the unification of the country under one Central Government, the development of co-operative movement and the establishment of joint stock banks have taken a good deal of business from the hands of the Indian money lenders. In 17\textsuperscript{th} century British East India Company came to India for trade. However, the flag followed the trade. They established their own agency at Port Towns of Bombay, Calcutta and Madras. The British Agency Houses were the combination of trade and banking and fore-runners of the modern joint stock banks on European lines. The beginning of occidental banking\footnote{Western system of Banking.} in India started with Calcutta Agency House which is the forerunner. It undertook banking operations for the benefit of their constituents. Prominent among these were Messrs Alexander & Co; and Messrs Fergusson & Co; agency houses at Calcutta which went into liquidation in the year 1832.\footnote{The agency houses went into liquidation as both had combined banking business with other kinds of business like manufacture and sale of products and both were the predecessors of the early joint stock banks in India.}

The banking was illustrated by the commercial disaster of 1829-32 due to fatal combination of banking with commercial enterprise. Reckless speculation
and policy of placing profits before safety was responsible for the failure of agency houses. Besides the usual banking business, these banks had the power to do business of “Merchants or capitalists either as principal or agents”. In Govind v. Ram Nath, the then Chief Justice of Bombay High Court heavily criticized the functioning of Agency Houses and ordered closure of speculative transactions which was recognized under section 277(G)(1) of the Indian Companies Act, 1913. The Indian legislature recognized the principle of separation of banking business from any other kind of commercial undertaking. Thus, section 277(G) (1) and section 277-F of the Indian companies Act, 1913 prohibited combination of banking business with merchant trading. Later, the same provision with little modification was inserted in the Banking Regulation Act, 1949.

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 lakhs, one fifth of which was contributed by the government who shared the privilege of voting and direction. The other two Presidency Banks, viz., the Bank of Bombay and the Bank of Madras were established in 1840 and 1843, respectively.

Note issue power was given to these Presidency Banks but it did not become popular, hence were replaced by government paper money in 1862. In 1860 an Act was passed for the establishment of banks on limited liability principle. Many banks had sprung up like mushrooms and failed, mostly due to the

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81 32 Bom (1930), L.R. 232.
speculation, mismanagement and fraud on the part of those responsible for their flotation, organization and management. And during this period there was crisis on India’s cotton exports due to outbreak of civil war in the U.S.A. Supply of American cotton had cut off and English cotton importers had to look to India to meet the supply.

This brought to India an immense wealth in precious metals which led, among other speculative enterprises, to the flotation of banks soon to be overtaken by disaster. Normalcy was resorted only when Indian mints were closed to the free coinage of silver. In 1895, Punjab National Bank Ltd. was established with its head office at Lahore.

The Swadeshi Movement started in 1905 and during this period many new banks were established by Indians. The period from 1906 to 1913 was a period of boon for Indian Banking. Some of the important banks, which were established during this period, are ‘The Peoples Bank of India Ltd’, ‘The Bank of India Ltd’, ‘The Central Bank of India Ltd’, ‘The Indian Bank Ltd’ and ‘The Bank of Baroda Ltd’.

There was closure of many banking during 1913 to 1917 due to various reasons and one of the reason being the beginning of First World War. In 1918 the First World War ended and for sometime the banks failures came to halt and number of new banks was also established. The matter of bank failures received considerable attention at the hands of the Central Banking Enquiry

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82 During this period Bank of Bombay went into liquidation in 1868 which was started in the same year. Only one bank during 1865-70 was established and survived was Allahabad Bank Ltd. Even there was fall in gold and silver prices during this period which was a big setback to Indian economy.
Committee. After analyzing the principal causes, such as insufficient capital and reserves, inadequate liquidity of assets, payment of exorbitant interest rates to attract deposits, injudicious advances, speculative investments and dishonest and incompetent management, the Committee recommended that a special Bank Act be passed, incorporating the existing provision of the *Indian Companies Act*.85

Though the recommendation were not incorporated, the Tata Industrial Bank was established during this period and the three Presidency Banks were amalgamated in 1920 and the Imperial Bank of India was formed which was later named as State Bank of India in the year 1955.86

The Imperial Bank was entrusted with certain central banking functions. In terms of an agreement signed between the Bank and the Secretary of State, which was for a period of ten years in the first instance, the bank was appointed as a sole banker to the government.

The Reserve Treasuries were abolished and all treasury balances were kept with the bank at its headquarters and at branches. The bank also managed the public debt of the Government of India (GOI).

To an extent, the Imperial Bank of India also acted as banker to banks. Leading banks in India kept a major portion of their cash balances with it,

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84This committee was constituted with B.N.Mitra as its chairman with the objects of developing banking in India with a view to the expansion of indigenous, co-operative and joint stock banking with special reference to the needs of agriculture, commerce and industry, the regulation of banking with a view to protecting the interest of the public and banking education to have a well qualified people to recommend in the sphere of banking in India.

85The new provisions recommended were relating to organization, management, audit and inspection and liquidation and amalgamation. This object was not, however, accomplished till 1949 though efforts in this behalf were made from 1939 itself.

though there was no such provision in the Statute; the Imperial Bank also granted accommodation to banks. 87

The bank conducted business of clearing house in the country and provided remittance facilities to banks and the public. 88 The functions of the proposed bank included, same functions performed by the Presidency Banks with relaxation of some restrictions, management of note issue, management of public debt in India, effecting remittance for the Secretary of State through the London Offices and acceptance of payments and making of disbursements on behalf of government at all places where the bank had a branch. As a government banker, the bank was to hold free of interest all government balances at Reserve Treasuries and in London with the exception of £1 million to be held as emergency reserve by the GOI, and balances held directly in the name of the Secretary of the State at the Bank of England.

The management of the mint and the custody of the Gold Standard Reserve were not to be entrusted to the bank. Many small banks failed later 89. There was a panic and instability all around and the need was felt for a strong Central Bank to India.

2.3.4. History of Reserve Bank of India

Although suggestions were made 90 from time to time that India ought to have a Central Bank, it did not take definite shape until 1926 when Royal Commission on Indian Currency and Finance recommended that a Central

87 Imperial Bank of India Act, 1921.
89 Ex. in 1923, the Alliance Bank of Simla failed along with the Tata Industrial Bank.
90 For the establishment of Central Bank in India.
Bank should be started in India so as to perfect her credit and currency organization.

This was also recommended by the Hilton Young Commission\textsuperscript{91} in 1925 and the Central Banking Enquiry committee\textsuperscript{92} in 1929. By this time, almost all the countries had central banks and financial crisis after 1\textsuperscript{st} World War all over the world insisted for its establishment. The Gold Standard and Reserve Bank of India Bill on the recommendation of Hilton Young Commission, was introduced in the Legislative Assembly on January 25, 1927. The Bank was to take over the management of the currency from the Governor General in Council and was to carry on the business of banking in accordance with the provisions of the Bill. The Bill was then referred to a Joint Committee of 28 members. The Bill was taken up for consideration twice and on both the occasions it was decided to postpone further as some of the clauses were not approved\textsuperscript{93}. The controversy on the Bill was confined only to certain aspects of the constitution and management rather than objectives it sought to achieve.\textsuperscript{94}

The report of the Joint committee was not unanimous. Of the twenty five members who signed the report, seventeen including the Finance Member Sir Basil Blackett, appended minutes of dissent, while three members (one of whom had appended a dissenting minute also) stated that they would move amendments in the House on the points on which they disagreed. The minute

\begin{itemize}
\item \textsuperscript{91} See note 18.
\item \textsuperscript{92} See note 8.
\item \textsuperscript{93} Like the initial proportion of gold and sterling assets to be held against the note issue, the valuation of the gold reserves to be taken over by the Reserve Bank from Government, the power of the Bank to take part in open market operations, the relations of the Reserve Bank with the Imperial Bank of India and the compensation to be paid to the Imperial Bank for the loss of some of its functions.
\item \textsuperscript{94} M.L. Tannan, \textit{op. cit.}, p. 29.
\end{itemize}
of dissent signed by the Finance Member and six others was mainly in respect of the controversial clauses relating to the ownership of the Bank and the composition and constitution of the Board.

They, however, made it clear that they had confined their observations only to clauses to which they attached ‘special importance’, and had refrained from commenting on other provisions with which also they were not in entire agreement. Three other members in separate minutes of dissent broadly supported the Finance Member in respect of the controversial clauses. Important changes were made by the Joint Committee in respect of these clauses.\(^95\)

The brief history of money and banking over hundred years prior to 1935 shows that there was a necessary framework for the central bank to begin operations, although the Indian money market was deficient in several respects. Banking habit had not developed extensively; the use of bank money was not insignificant.

About the time the Reserve Bank was inaugurated, deposit money of the order of Rs. 100 crores constituted 40 per cent of total money supply. In many countries including Sweden and U.K., where central banks have been in existence for about 275 years or over, the evolution of central banking has been slow, haphazard and controversial. In the case of the very old central banks, it was only after several decades that it came to be accepted that the central bank

\(^95\)The Joint Committee recommended that the capital of the Bank should be wholly subscribed by government. In other words, the Bank was to be a ‘State Bank’. The majority considered that a shareholders bank would tend to be controlled by vested interests and would therefore fail to secure the confidence of the Indian public and also that its utility to the public might even be endangered by a conflict of interest with in the management of the bank between Indian and external capital.
should have a monopoly of note issue, that it should be a banker to the government and a banker’s bank.

In India too, there was experimentation in respect of the monetary standard and banking arrangements for government, but when the establishment of a central bank came to be pursued actively in the year 1927-34, there was hardly any controversy with regard to objectives and functions of the proposed institution.

The period of 1929-32 witnessed failure of many banks due to lack of control over them. In the words of B.Ramachandra Rao\(^96\) who described the situation in the following words-

"With no banking legislation, no official supervision, no fluid market for short term investments which consequently leads to an over investment in gilt edged securities, no co-ordinate policy of the different joint stock banks, no centralized banking in the way of the rate of interest, no check against the frequent happenings of swindles by directors or officers of banks and no national policy on the part of the State, the Indian joint stock banks have been unable to show any remarkable progress".

The proposal of establishment of Central Bank assumed importance again in connection with the constitutional reforms. The Reserve Bank of India Bill, 1933, drafted on the basis of the recommendation of the London Committee\(^97\), was introduced in the Legislative Assembly by the Finance Member, Sir George Schuster on September 8, 1933.

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\(^{97}\) The recommendation were that Reserve Bank of India should be a Government-owned bank, a very wide distribution of the ownership of the Bank’s share capital was envisaged through the demarcation of the country into five geographical areas and provision was made for close co-operation between the Bank and the Government in vital policy-making spheres and for the exercise of a measure of Government influence in the composition of the Directorate of the Bank, including its chief executives, namely, the Governor and the Deputy Governors.
The Bill was referred to a Joint Select Committee on September 13, 1933 and as amended by the Committee. It was introduced in Legislative Assembly on November 27, 1933, at a special session. This session was not attended by the Congress party which had vigorously and successfully championed the principle of state ownership of the proposed Reserve Bank.

The Bill was passed by the Assembly on December 22, 1933 and by the Council of State on February 16, 1934. The Bill received the assent of the Governor on March 6, 1934 and the Reserve Bank of India started functioning with effect from 1st April, 1935. The Statute (RBI Act, 1934) for the Indian Central Bank is an amalgam of the country’s experience and aspirations in monetary and banking principles evolved in other countries.

The bank was nationalized in the year 1948, soon after independence, following a postwar trend towards nationalization of central banks all over the world. The Bank of England was nationalized in 1946. Secondly, a central administered system had then become necessary to control a runaway inflation raging in India since, 1939.

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 banking so that a central bank could be used effectively as an instrument of economic change in the country.

2.3.5. Introduction of Banking Regulation to Commercial Banks in India

The partition of India in 1947 had adversely impacted the economies of Punjab and West Bengal and banking activities had remained paralysed for
months. India’s independence marked the end of a regime of the *Laissez faire*\(^{98}\) State for the Indian Banking. The GOI initiated measures to play an active role in the economic life of the nation and the Industrial Policy Resolution (five year plan) adopted by it in 1948 envisaged a mixed economy\(^ {99}\). This resulted into greater involvement of the State in different segments of the economy including banking and finance. The major steps to regulate banking were the establishment of RBI as India’s central banking authority which was nationalized\(^ {100}\) soon after independence in the year 1948 and had become an institution owned by the GOI and then in 1949 and the enactment of *the Banking Companies Act* which dealt with banking companies specially was enacted.\(^ {101}\) The new law empowered the RBI to regulate, control and inspect the banks in India. However, despite these provisions which imposed regulations, banks in India except the State Bank of India continued to be owned and operated by private persons. This position changed with the nationalization of major banks in India in 1969.\(^ {102}\)

The *Banking Regulation Act, 1949*\(^ {103}\) (herein after referred as B R Act) was the first legislation of its kind and was a landmark in the history and

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\(^{98}\) It is French word means ‘leave it alone’. It is used in an economic environment in which transactions between private parties are free from government restrictions, tariffs, and subsidies, with only enough regulations to protect property rights.

\(^{99}\) An economic system in which both the private enterprise and a degree of state monopoly (usually in public services, defense, infrastructure, and basic industries) coexist. All modern economies are mixed where the means of production are shared between the private and public sectors.

\(^{100}\) The RBI was nationalized because at that time most of the countries had nationalized their central banks, to regulate issue of bank notes, maintain reserve as security and to control credit of India.

\(^{101}\) Though the Act was originally named as *Banking Companies Act, 1949*, after nationalization of 14 major banks in the year 1969, it was renamed as *Banking Regulation Act, 1949*.

\(^{102}\) Nationalization is in accordance with our national policy of adopting socialist pattern of society. The Government of India issued an ordinance (‘Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969’) and nationalized the 14 largest commercial banks with effect from the midnight of 19 July 1969.

\(^{103}\) Act No. 10 of 1949.
development of banking in independent India. The B R Act, 1949, was passed to control the activities of the commercial banks in India.

The RBI was given very wide powers of control and supervision on all the banks incorporated in India. After this, smaller and weaker banks either liquidated or merged with other banks. In 1955, imperial Bank of India was nationalized and was renamed as State Bank of India. There existed some foreign banks also and were carrying on exchange and non-exchange business. Some Indian banks were also carrying on exchange business.

At the end of 1967, there were 13 foreign banks with 109 branches with deposit of Rs. 402 crores and total credit of 336 crores. They had branches mostly in big industrial centres.\textsuperscript{104} Two of the three major disquieting features related to banking at the time of independence, viz., nexus between the banks and the industry and neglect of agriculture continued to cause concern to the authorities even after 20 years of independence.

There was apprehension that a few business houses might acquire control over a significant proportion of country’s banking assets through the banks associated with them.

Besides, such control might also jeopardize the interests of the depositors if, as a consequence, banks became overexposed to individual firms or business groups.\textsuperscript{105}

\textsuperscript{105} M.L.Tannan, \textit{op. cit.}, p. 46.
The idea of ‘social control’ over banks, first emerged in 1967 which was the result of a compromise between two extreme viewpoints on banking held by the political class, mainly represented by the Congress party. The Economic Programme Committee in its report submitted in 1948, had strongly recommended that banking and insurance should be nationalized as part of a total package of establishing ‘a just social order’. This recommendation was endorsed by the All India Congress Committee (AICC) at its meeting held at Bombay in April 1948 and also at the annual session held at Jaipur in December, 1948.

But these matters rested for a decade and a half. On 1st February, 1969, 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 certain restrictions on advances by the Banking Companies. In the words of Tannan-

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106 There was apprehension that a few business houses might acquire control over a significant proportion of country’s banking assets through the banks associated with them. In order to address these concerns, the concept of social control over banking was introduced in December 1967 through the Banking Laws (Amendment) Act 1968, which came into force on February 1, 1969. In terms of the Act, not less than 51 per cent of the total members of the board of directors of a bank were to consist of persons who had special knowledge or practical experience in one or more of matters such as accountancy, agriculture and rural economy, banking co-operation, economics, finance, law and small scale industry. In addition, every bank was to have a whole-time chairman who was not an industrialist but was a professional banker and had special knowledge and practical experience of banking (including financial institutions) or financial, economic or business administration; his term was not to exceed five years at a time. The Reserve Bank was vested with the powers of appointment, removal or termination of the services of not only the chairman.

107 The majority of directors had to be persons with special knowledge or practical experience in any of the areas such as accountancy, agriculture and rural economy, banking, co-operative, economics, finance, law, small scale industries etc, no loans to directors, spouse of director, or person related to director or where there the director stands as surety to the debtor.
“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”.

The government enacted Banking Laws Amendment Act in the year 1968. The government set up National Credit Council (herein after referred as NCC) under this legislation. The Finance Minister was the chairman and the Governor of the Reserve Bank of India was the vice-chairman of the council. It consisted of 25 members of whom five were permanent members. The NCC was to perform functions relating to assessing of volume of credit required for the economy, providing guidelines for the distribution of credit to the priority sector and ensuring equitable distribution of credit in the economy. Although the above steps had been taken in January, 1969, by amending the B R Act for the purpose of imposing ‘social control’ with a view to remedy the basic weakness of the Indian banking system and to ensure that banks would cater to the needs of the needy people, it was felt that the imposition of ‘social control’ had not changed the position and there were many complaints that Indian commercial banks continued to direct their advances to large and medium scale industries and imports were also not receiving attentions from banks.

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108 This Act gave more power to the government to control banking. The objective of this Act was to ensure more equitable distribution of the resources of the banking system. The priority sectors like agriculture, small scale industry, public sector and self-employment were to receive their due shares in obtaining bank finance. Apart from this the banks were required to reconstitute their independent board of directors. Act No. 58 of 1968.

109 The National Credit Council (NCC) was said to have been fashioned on the lines of the French model in order to meet the need for aligning more closely the functioning of the banking and credit system of the country to the objectives and requirements of national economic development. The Council was constituted in terms of Government Resolution dated 1 February 1968, wherein particulars regarding the five permanent members and the names of the remaining twenty members were indicated to assist the Reserve Bank and the government in allocating credit.

Hence, on 19\textsuperscript{th} July, 1969 fourteen major banks\textsuperscript{111} were nationalized and taken over. The revolution did not merely signify a change of the ownership of these banks but it was the beginning of a coordinated endeavour to use an important part of the financial mechanism for the country’s economic development. Nationalized banks were expected to give priority to the schemes of neglected sectors and exports. Steps were also taken to protect banker from incurring bad debts by forming credit guarantee insurance. Though there was tough opposition from various sections of the society, the scheme of nationalization was finally drafted and an ordinance\textsuperscript{112} to the same received President’s assent on 19\textsuperscript{th} July, 1969. With a few amendments to the ordinance, the legislation was drafted and the law was called \textit{Banking Companies (Acquisition and Transfer of Undertakings) Amendment Act, 1970.}\textsuperscript{113}

The Act dealt mainly with three topics, which were, the mode and mechanics of transfer of the undertakings of the 14 existing banking companies, payment of compensation to the 14 banking companies and take over and management of the 14 new banks nationalized.

This was a mile stone in the history of banking in India. Six more banks were nationalized in the year 1980\textsuperscript{114}. The State Bank of India and its seven subsidiaries were nationalized in the year 1955. Total 28 commercial banks are nationalized in India.

\textsuperscript{111}The fourteen banks which were nationalized are Central Bank of India, Bank of Maharastra, Punjab National Bank, Dena Bank, Syndicate Bank, Canara Bank, Indian Bank, Indian Overseas Bank, Bank of Baroda, Union Bank of India, Allanabad Bank, Union Bank, UCO Bank and Bank of India.

\textsuperscript{112}Banking Companies (Acquisition and Transfer of Undertakings (Ordinance, 1969').

\textsuperscript{113}Act No. 5 of 1970.

Of late electronic banking has invaded in the era of globalization, privatization and liberalisation. The banking sector in this phase has evolved to a significant extent in response to financial sector reforms initiated as a part of structural reforms encompassing trade, industry, investment and external sector, launched by the Central Government (CG) in the early 1990’s in the back drop of a serious balance of payments problem. In order to realize the full potential of reforms in the real economy, the need was felt for a vibrant and competitive financial sector, particularly, banking sector. A major issue faced by the banking sector in the early 1990’s was its fragile health, low profitability and weak capital base. A related issue was also to assess the true health of the banking sector as the health code system being followed then was based on subjective considerations and lacked consistency. With a view to improving the health of the banking sector, internationally accepted prudential norms relating to income recognition, asset classification and provisioning and capital adequacy were introduced in April 1992 in phased manner to all commercial banks in India.

2.4. Comparative Study of Banking Regulations in India and U.K.

The history shows that it was true to the statement that ‘Rome was not built in a day’, so is the banking system of all the countries. The research is on for suggesting better legislation and mechanism to solve the problems that is arises as and when there is a social and technological change. Hence, a comparative

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115 A high powered Committee headed by Shri M. Narasimham was constituted by the Government of India in August 1991 to examine all aspects relating to the structure, organization, functions and procedures of the financial system in India. The Committee’s recommendations were later inserted to form a strong financial stability.

116 In order to address these issues, several mutually reinforcing measures were initiated.
study of legislations of different countries with Indian law would provide
certain insight to overcome the problem can be meted out.

Indian Regulations pertaining to banking are many. But few of important
legislations have been significant for traditional banking, such as Banking
Regulation Act, 1949, Reserve Bank of India Act, 1934117 and the Negotiable
Instruments Act, 1881.118

2.4.1. Banking Regulation Act, 1949.

The said Act is applicable to various kinds of Banks viz., Banking
Companies which are not nationalized, which are nationalized including their
subsidiaries and to the Regional Rural Banks (RRB) and also to Co-operative
Banks. Certain important provisions of the Act are discussed here. Section 5 of
the Act defines Banking Company119 and bank.120 No banking company in
India can use the word ‘bank’ or ‘banking’ unless it has a license from the
RBI.121 And the company which does the business of banking must use the
word ‘bank’ or ‘banking’. In Vimal Chandra Grover v. Bank of India,122
Supreme Court of India has ruled out that money lenders who deals in money
or traffics in money cannot be called Bank/Banker.

Sub section ‘a’ to ‘o’ of section 6 the Act lists out the business which can be
carried by a banking company in India. When this section is analyzed, the only

117 Act No. 2 of 1934.
118 Act No. 26 of 1881.
119Section 5(c) "banking company" means any company which transacts the business of banking in
India.
120Section 5(b) "banking" means the accepting, for the purpose of lending or investment, of deposits of
money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or
otherwise.
121 Section 7 of the B.R.Act, 1949.
122AIR 2000 SC 2181.
business which a banking company in India cannot carry is manufacturing of a product and sale of such product. This restriction was the resultant of banks failure due to fatal combination of banking with other business. The B.R. Act further imposes restriction on capital and brokerage.\textsuperscript{123} This provision has been updated from time to time by the RBI considering the money value, international market, business of the bank, etc. The B.R. Act also covers topics concerning minimum paid up capital, reserves, conditions for the commencement of business of banking, powers and functions of directors, procedure for liquidation and winding up of banking company. The law prohibits banking companies from creating charge on their unpaid capital.\textsuperscript{124} All these provisions are to protect the customers and the creditors of the bank.

The banking companies are restricted from holding of shares in other companies except a subsidiary company or in any company formed under section 6 of the Act with previous permission of RBI. If the company’s business is considered to be conducive to spread of banking in India or otherwise necessary in the interest of public, then with the permission of CG and the RBI it can hold shares in other companies also.\textsuperscript{125}

Section 10 of the B.R. Act, prohibits employment of a managing agent or person whose remuneration or part of his remuneration is in the form of commission or share in the profits of the company, or any person having

\textsuperscript{123} Section 12 of the B.R. Act, 1949, which states ‘that the subscribed capital of the company is not less than one-half of the authorized capital, and the paid-up capital is not less than one-half of the subscribed capital and that, if the capital is increased, it complies with the conditions prescribed by the Reserve Bank and that the capital of the company consists of ordinary shares only.'

\textsuperscript{124} Section 14 of the B.R. Act, 1949.

\textsuperscript{125} Section 19, \textit{Ibid.}
contracted with the company for its managing agent for a period exceeding five years.

The Act also prohibits common directors to a banking company and a non-banking company. The object behind this is the director should only concentrate on the banking company and should not divert funds to non-banking company. And also the principle behind this is to check unhealthy manipulations between two or more banks by interlocking directorates.

Very comprehensive provisions have been laid down with a view to prevent the employment of managing agents or a manager whose remuneration is to be based upon the profits of the banking company. The Act lays down certain disqualifications for employment of persons by a banking company. The wording of the provisions does not apply to a director of a banking company who is not its employee and consequently in such cases the provisions of the Companies Act, 1956 shall apply.

Section 10-A of the Act deals with the qualification of Board of Directors.\textsuperscript{126} At least two persons should have special knowledge or practical experience in agriculture or rural economy or co-operation or small scale industry. The Act also emphasizes on appointment of a whole time chairman to every banking company.\textsuperscript{127}

This restriction was essential in the interest of the bank as well as in the interest of the nation to implement the five year plan. The Act deals with

\textsuperscript{126} Section 10-A was added by the Amending Act in 1968. Under this provision, not less than fifty one percent of the total number of the directors should consist of persons who are described in the marginal note to section 10-A as ‘persons with professional or other experience’ and in section 10-A (2) as having ‘special knowledge or practical experience in respect of one or more the matters specified in sub clause (i) to (ix) of clause (a) of sub- section (2).

\textsuperscript{127} Section 10-B of the B.R.Act, 1949.
shareholders of the bank and their rights.\textsuperscript{128} The voting rights of a shareholder on poll in respect of any shares held by him are limited to one percent of the total rights of all the shareholders of the banking company.

Moreover, notwithstanding anything contained in any law for the time being in force or in any contract or instrument, no suit or other proceeding shall be maintained against any registered share holder of the company on the ground that the title to the said share vests in a person other than the registered holder provided that contents of this sub-section shall not apply for a suit by a \textit{bonafide} transferee of the share or transferee of the share on behalf of the minor or a lunatic on the ground that the registered holder hold share on behalf of the minor or lunatic. Section 20 of the Act lays down the restriction on loans and advances which states that banking company cannot grant any loans or advances on the security of its own shares.

Even the commitment for granting any loan to any of its directors or to any firm in which any of its director is interested as partners, manager, employee or guarantor is also prohibited. Section 21-A of the Act, restricts the powers of the court on the matters relating to the rate of interest charged by banking companies. The constitutional validity of the section has been upheld in \textit{N.M.Veerappa v. Cannara Bank},\textsuperscript{129} where the courts have held that the section cannot be regarded that it is intending to override the provisions of Civil Procedure Code (CPC) of order XXXIV rule II\textsuperscript{130}.

\textsuperscript{128}Section 12, \textit{Ibid.}
\textsuperscript{129}AIR 1998 SC 1101.
\textsuperscript{130}Suits relating to mortgages of immovable property.
Again in *H.P.Krishna Reddy v. Canara Bank*,\(^{131}\) it was observed that the mandate of this section is that the courts cannot re-open the account relating to a transaction between a banking company and its customer on the ground that the rate of interest charged, in the opinion of the courts is excess or unreasonable. It is only RBI which can prescribe and scrutinize the rate of interest charged by the banks. To meet the demands of the depositors and create trust in the banking, the Act has imposed on banking companies to maintain certain percentage of liquid assets.\(^{132}\) The required liquid ratio is 20% and 3% of reserve fund and cash reserve of the total of its demand and time liabilities in India. For good governance of a bank such a restriction is essential. In order to ensure the said amount is maintained, the RBI has mandated the banks to submit in a prescribed form within one month from the end of every quarter a return showing its assets and time and demand liabilities in India as at the close of business of the last Friday of every quarter.

Section 22 makes a mandate for every company doing the business of banking must obtain a license from the RBI. The RBI has power to prescribe the place of business and also restrict on transfer of existing place of business of banking companies. Prior permission of RBI is essential to open a branch or transfer any branch.\(^{133}\) This is to protect the larger interest of the public. Every banking company, under section 27 needs to submit monthly, quarterly, half yearly and yearly returns to the RBI which will be audited by one internal auditor and an external auditor by the RBI.

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\(^{131}\) AIR 1985, Kant 228.

\(^{132}\) Section 18 & 24 of the B.R.Act, 1949.

The banks are also required to submit returns on unclaimed deposits to RBI u/s 26. Unclaimed deposits are deposits which have not been operated for a period of ten years. Banks have to also publish information relating to matters mentioned in the law from time to time. The audited report shall be displayed in the premises of the banks head office on the first Monday of February and on first Monday of August every year.134

Apart from the above powers given to the RBI, the Act has also empowers it to give directions in the matters relating to scheme for amalgamation, alteration of memorandum of association, examine records in winding up proceeding, change of name of banking company, advice CG in the matters relating to making rules relating to banking laws, exempt any bank from the provisions of the Act and on appointment and removal of Chairman or Director of a bank. The Act is a comprehensive legislation relating to banking sector in India and barely has undergone through major amendment. The Act also gives certain powers to CG in the matters relating to making rules relating to banking business, moratorium order for a period not exceeding six months, reconstruction and amalgamation and acquire banking company in consultation with the RBI.135

Section 37 of the Act provides that when a banking company is temporarily unable to meet its obligations, persons who may apply136 to the High Court (H.C) praying for an order of staying the commencement or continuance of all actions and proceedings against it for a period not exceeding six months. Such

134 Section 29, Ibid.
135 Section 52, Ibid.
136 Shareholders of the bank, creditors, RBI and the GOI may apply for the same.
suspension of business is generally called moratorium. H.C. has also the power
to order for winding up of a banking company\textsuperscript{137} or order for amalgamation.\textsuperscript{138}

*The Banking Laws (Amendment Act), 1968*\textsuperscript{139}, has introduced punishments
for certain activities in relation to banking companies. The offences committed
by the banker such as obstructing any person from lawfully entering or leaving
bank, hold within office premises any demonstration which is violent or acting
in any manner which undermines the confidence of the depositors in the
banking company shall be punished up to six months imprisonment or fine
which may extent to Rs. 1000/- or both.

Part V of the Act deals with only one provision i.e. section 56, which
applies to certain co-operative banks. Co-operative society means a society
registered or deemed to be registered under the *Co-operative Societies Act,
1912* or any other law in force. Co-operative bank is defined as meaning a State
Co-operative Bank, a Central Co-operative Bank and a Primary Co-operative
Bank.\textsuperscript{140}

**2.4.2. Reserve Bank of India Act, 1934**

Reserve Bank of India is the Central Bank of India was established in the
year 1935 and was nationalized in the year 1948\textsuperscript{141}. The role of RBI has
increased manifold over the years.

The RBI was started originally as a shareholder’s bank with a paid up
capital of Rs. 5 crores.

\textsuperscript{139} Act No. 58 of 68.
\textsuperscript{140} Section 5(cci) of B R Act, 1949.
\textsuperscript{141} Act No. 62 of 1948.
After the establishment of RBI it took over the functions of currency issue from the Government of India and the power of credit control from the then Imperial Bank of India.

The Preamble of the RBI Act\textsuperscript{142} provides the following-

\textit{“An Act to constitute a Reserve Bank of India whereas it is expedient to constitute Reserve Bank of India to regulate the issue of Bank notes and keeping of the reserves with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage.”}

RBI performs various functions. Among them few are issue of Bank of note in India, it acts as a banker to the Government, it acts as a banker to the commercial banks, in case of difficulties to commercial banks it acts as a lender of last resort, it exercises its control over the volume of credit created by the commercial banks in order to ensure price stability by adopting quantitative method and qualitative method\textsuperscript{143} and it maintains internal and external value of currency.\textsuperscript{144}

The affairs of the RBI are managed by the Central Board consisting of a Governor and not more than four Deputy Governors appointed by the CG, four directors nominated by CG and one government official nominated by the CG.

The RBI operates through many departments. Section 17 list out the transaction which can be carried by the RBI and section 19 lists out the business which cannot be carried by the RBI.

\textsuperscript{142}Act No. 2 of 1934.
\textsuperscript{143}Section 21 of the Reserve Bank of India Act, 1934.
\textsuperscript{144}Apart from the traditional functions the RBI also carries certain promotional roles for the benefit of Indian economy like establishment of bill market scheme, establishment of financial corporations, assist commercial banks to open branches in foreign countries, promotion of research in the areas of banking, etc.
After amendment to the RBI Act in the year 1962\(^\text{145}\), the bank is empowered to collect credit information. The Narasimham Committee\(^\text{146}\) recommended that the supervisory function be separated from the more traditional central banking functions of the RBI and that a separate agency which could be a quasi autonomous Banking Supervisory Board under the *algis* of the RBI be set up. Based on the recommendation the government has set up the Board of Financial Supervision.\(^\text{147}\) The RBI also acts as a custodian of Exchange Reserve.

The RBI also performs supervisory functions over banking companies in India and also exercises control over non-banking financial institutions u/s 45 of the RBI Act. The main restriction imposed on non-banking financial institution is on accepting deposits from the public. In *D.Parish v. Union of India*,\(^\text{148}\) the Supreme Court held that such a restriction is valid and does not form fundamental right to accept deposit to carry on business. The Act also prescribed penalties for certain offences by the banking company.\(^\text{149}\) They are for making false statements, for default in furnishing information and for disclosure of credit information.

The RBI has power to issues circulars and notifications from time to time to supervise the banking companies. It has stood as a pillar of strength during financial crisis. And now when the rupee value has gone down in favour of

\(^{145}\)Act No. 35 of 1962.

\(^{146}\)The Narasimham Committee was set up in the year 1991. It was tasked with the progress review of the implementation of the banking reforms since 1992 with the aim of further strengthening the financial institutions of India.

\(^{147}\)A special legislation on par with this was drafted which was named as ‘Reserve Bank of India (Board for Financial Supervision) Regulations, 1994 to give effect to section 58 of the *RBI Act*.

\(^{148}\)AIR 2000 SC 2047.

\(^{149}\)Section 58-B of the *RBI Act, 1934*. 
dollars, the RBI is playing a pivotal role in controlling the value of Indian currency in the International market.

**2.4.3. Negotiable Instruments Act, 1881**

The *Negotiable Instruments Act, 1881*, (herein after referred as NI Act, 1991) defines the instruments that which are to be called as negotiable instruments i.e promissory note (p.n.), bill of exchange (B.O.E) and cheque. The Act is exhaustive enough to cover all the aspects dealing with the paying banker and collecting banker including the protection given to them under the law. It also deals with foreign bills, acceptance of payment of bills, liabilities of the parties in case of non-acceptance and non-payment and payment and acceptance for honour. The main provision in the law is relating to dishonour of cheques. Numerous cases have been instituted in the court of law for dishonour of cheques. The role of banks has been vigilant in this respect, as the law has imposed rigorous punishment for wrongful dishonour of cheques. The N.I. Act was amended by Banking, Public Financial Institutions and *Negotiable Instruments Laws (Amendment) Act, 1988*, wherein a new Chapter XVII was incorporated for penalties in case of dishonour of cheques due to insufficiency of funds in the account of the drawer of the cheque. These provisions were incorporated with a view to encourage the culture of use of cheques and enhancing the credibility of the instrument. In *M/S Dalmai Cement (Bharat) Ltd. v. The Galaxy Traders & Agency Ltd.*, the Supreme Court observed:

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150 Section 138 of the N.I.Act, 1881.
152 AIR 2001 SC 676.
“The law relating to negotiable instruments is the law of commercial world, legislated to facilitate the activities of trade and commerce, making provision of giving sanctity to the instruments or credit which could be deemed to be convertible into money and easily passable from one person to another. In the absence of such instruments, including a cheque the trade and commerce activities in the present day are likely to be adversely affected as it is impracticable for the trading community to carry with it the bulk of currency in force. The negotiable instruments are in fact the instruments of credit being convertible on account of legality of being negotiated and are easily passable from one hand to another.”

2.4.4. English Legislations on Banking

English drafted their first legislation to govern their banks dates back to 1817 with the introduction of Saving Bank Bill in the House of Commons. But the basic legislations which govern the commercial banks in England are Banking Act, 1979 and the amended version of the same in 1987, the Consumer Credit Act, 1974 and the Bank of England Act, 1694 amended last in 2009.

2.4.5. The Banking Act, 1979

This was the first Act to deal comprehensively with certain aspects relating to banks. It provided for two types of deposit taking institutions namely, recognized banks and licensed deposit takers. This was based on European Economic Community Banking Directives. This law was introduced in order to limit the use of the word banking and descriptions to recognized banks and also to retain for recognized banks as the informal type of supervision which

153 The European Union sought to create a single financial area across Europe where consumers in one country benefit from financial markets and activities in other countries. With the emergence of the internet as a platform for the provision of online banking services, the creation of a pan European market for banking had become realistic. It requires establishment of single European market comprising an area without internal frontiers in which the free movement of financial services and capital.
the Bank of England exercised over them, whilst applying more rigorous controls over the licensed deposit takers.\textsuperscript{154}

The Act was outcome of secondary banking crisis\textsuperscript{155} and also directions issued by council of the European Communities of its First Directives. The Act lays down the standards applicable in the United Kingdom (U.K). The cornerstone of the Act was the prohibition of the acceptance any deposits from the public by any person carrying on a deposit taking business except certain bodies empowered to do so exempt from the prohibition under the Act.\textsuperscript{156} But the Act did not apply uniformly to all the institutions covered by it. Instead, it divided deposit taking institutions into four groups viz., the Bank of England, Recognized Banks, Licensed Institutions described as ‘Licensed Deposit Takers’ and Institutions listed in schedule 1 of the Act, such as building societies and the central banks of EC member countries, which were entitled to accept deposits from the public without securing a license or authorization. The main distinction between the licensed deposit takers and the recognized banks concerned the use of word ‘bank’ or of any derivative of it in the institutions name.

Many of the inadequacies of the 1979 Act surfaced after the collapse of John Matthey Bank in 1984. The question of bank supervision was reviewed by a committee set up by the Chancellor of the Exchequer in December 1984 and chaired by the governor of Bank of England, a new legislation i.e. \textit{The Banking


\textsuperscript{155}The Secondary Banking Crisis of 1973–75 was a dramatic crash in property prices in Great Britain which caused dozens of small ("secondary") lending banks to be threatened with bankruptcy.

\textsuperscript{156}Section 1 of the \textit{Banking Act, 1979}.
Act 1987 was drafted. The Act provided that\textsuperscript{157} ‘no person shall in the U.K. accept a deposit in the course of carrying on (whether there or elsewhere) a business which for the purposes of the Act is a ‘deposit taking business’, unless that person is authorized by the Bank of England’.

Section 6(1) provides that a business is a ‘deposit taking businesses’ if in the course of the business money received by way of deposit is lent to others or any other activity of the business is financed wholly or to any material extent, out of the capital of or the interest on money received by way of deposit.

The Act does not differentiate between recognized banks and licensed deposit takers. All the deposit taking institutions are known as ‘authorized institutions’ which are subject to the scrutiny of Bank of England. The Act lays down the procedure which must be followed when an institution applies to Bank of England for authorization to take deposits.\textsuperscript{158}

Section 106 of the Act defines bank as an institution as a body corporate or a partnership carrying on banking business. As an individual person cannot be an ‘institution’, he cannot apply to Bank of England for authorization to take deposits. Schedule 3 sets out the ‘minimum criteria for authorization’.

The Act further says the business of banking must be carried in a ‘prudent manner’; for example, it must maintain adequate capital, adequate liquidity and adequate provision for bad or doubtful debts.\textsuperscript{159} The Banking Act, 1987 contains a number of provisions which are intended to resolve problems which

\begin{itemize}
\item \textsuperscript{157} Section 3(1) of the Banking Act, 1987.
\item \textsuperscript{158} Section 8, Ibid.
\end{itemize}
the Leigh-Pemberton Committee\(^{160}\) had identified. Section 39(1) of the Act empowers Bank of England to obtain ‘such information’ as the bank may reasonably require for the performance of its functions under the Act. Bank of England is empowered to intervene in the business of the bank\(^{161}\) and appoint auditors\(^{162}\).

Other restrictions are Governor to be ex-officio member of the bank, a person who wants to become minority, majority or principal shareholder must notify to Bank of England\(^{163}\), use of the word bank only by institutions with a paid up share capital not less than Pound Sterling five million\(^{164}\), all the institutions to contribute to Deposit Protection Board to protect the deposits of the depositors and the Bank of England u/s 1(3) must prepare an annual report to the Chancellor on its activities under the Act.

### 2.4.6. The Consumer Credit Act, 1974

A license to carry on a consumer credit business is required under section 21 of the *Consumer Credit Act, 1974*. If, therefore, a bank wishes to carry on this type of business a license must first be obtained. If the bank canvasses as to any debtor-creditor agreements off trade premises it is an offence.\(^{165}\) Section 51(1) of the Act provides that it is an offence to supply a person with a credit card, if he has not asked for one.

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\(^{160}\)The Leigh Pemberton Committee established in the December 1984 under the chairmanship of the Governor of the Bank of England. Its members included the Deputy Governor, the associate Director of the bank responsible for banking supervision, the permanent secretary and a deputy secretary of the Treasury and an independent member who was a Director of Barclays Bank. The Committee reported in June 1985. It suggested a number of improvements in U.K. Banking System.

\(^{161}\)Section 12 of the *Banking Act, 1987*.

\(^{162}\)Section 46, *Ibid*.

\(^{163}\)Section 21, *Ibid*.

\(^{164}\)Section 68, *Ibid*.

\(^{165}\)Section 49 of the *Consumer Credit Act, 1974*. 

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The country has a central bank that controls the flow of currency, regulates the banking industry and sets the lending interest rate for the banks. The bank of England being the central bank of the U.K. is also responsible for monetary policy, setting the prime borrowing rate and the stability and regulation of the commercial banking industry. The bank is one of eight banks authorized to issue bank notes in U.K, but has a monopoly on the issue of banknotes in England and Wales and regulates the issue of banknotes by commercial banks in Scotland and Northern Ireland. Objective of the bank is to protect and enhance public confidence in the stability of the banking systems of the U.K., to protect depositors, to protect public funds and to avoid interfering with property rights of the customers.

The Bank of England performs all the functions of a central bank. The most important of these is supposed to be maintaining price stability and supporting the economic policies of the British Government, thus promoting economic growth. There are two main areas which are tackled by the bank to ensure it carries out these functions efficiently.

The first deals with monetary stability which is prime most one. Stable prices and confidence in the currency are the two main criteria for monetary stability. Stable prices are maintained by making sure price increases to meet the government’s inflation target.

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166 State Aid N 650/2008 "Modification to the Financial Support Measure to the Banking Industry in the UK".

167 Apart from Bank of England, Bank of Scotland, Clydesdale Bank and Royal Bank of Scotland are authorised to issue their own notes in Scotland. In Northern Ireland, the authorised banks are: Bank of Ireland, Danske Bank (formerly known as Northern Bank), First Trust Bank, and Ulster Bank.

The bank aims to meet this target by adjusting the base interest rate, which is decided by the Monetary Policy Committee and through its communications strategy such as publishing yield curves. Second is maintaining financial stability. Maintaining financial stability involves protecting against threats to the whole financial system. Threats are detected by the bank’s surveillance and market intelligence functions. The threats are then dealt with through financial and other operations, both at home and abroad. In exceptional circumstances, the bank may act as the lender of last resort by extending credit when no other institution will.

All functions that are performed by the bank does not in any way hinder the corporation from dealing in Bill of Exchange (B.O.E) or in buying or selling Bullion, Gold or Silver or in selling any goods, wares and merchandise whatsoever which is left or deposited with the corporation for money lent and advanced. The bank also has authority to sell these articles after the time has elapsed by giving notice of three months.\(^\text{169}\)

In addition, the bank has power to appoint liquidator, maintain insurances in respect of the business and property of the bank, to do all things necessary for the realization of property of the bank and to make payment which is necessary or incidental to perform the liquidator function.\(^\text{170}\)

Comparing the laws relating to banking in India and U.K., there is a thin line difference between the two systems. In both the countries the apex bank controls the whole banking system.

\(^{169}\) Section 27 of the Bank of England Act, 1694.
The provisions relating to license, minimum paid up capital, reserve fund, constitution of board of directors and control over the bank, are all almost similar to the Indian Law.

The difference lies where; in India it has commercial banks and co-operative banks, in England; they have licensed banks and recognized banks as the type of banks. Whether it is commercial banks, co-operative banks in India, they have to obtain licence from the RBI and in case of U.K. whether it is licenced bank or recognized banks they have to obtain licence from the Bank of England. Major difference is where India is taking time to bring changes in its Apex Banks Regulation which has become necessary due to inventions in technology has not been carried on par with U.K. The issue will be dealt later in the preceding chapters.

2.4.8. Banking Regulation in United States of America (U.S.A)

Banking regulation in the United States (U.S) is highly fragmented compared with other countries, where most countries have only one bank regulator, U.S. has two. U.S banking is regulated both at the federal and state level. Depending on the type of charter banking organization has and on its organizational structure, it may be subject to numerous federal and state banking regulations.

Banks can choose to operate under a state charter or a national charter, and while the differences between the two are seldom important, or even noticeable, to everyday customers, it has a significant impact on the regulation of the bank. State banks receive their charter from, and are regulated by, an
agency of the state, in which they operate, often called a "Department of Banking" or "Division/Department of Financial Institutions."

At this level, regulators can establish rules on permitted practices and restrict the amount of interest banks can charge for loans. State agencies are also responsible for auditing and inspecting banks, and periodically reviewing their compliance with regulations as well as their financial performance. State banks can also choose to belong to the Federal Reserve System. Participation in the Federal Reserve System brings certain advantages to a bank, including greater access to capital, but also greater regulation. The Federal Reserve is also a major regulatory body within the U.S. banking system.

Banks are not only regulated in terms of their balance sheet and capital ratios, but their conduct as well. Unlike U.K (where regulatory authority over the banking securities and insurance industries is combined into one single financial service agency), the U.S maintains separate securities, commodities and insurance regulatory level. The Federal Reserve System is one of several banking regulatory authorities. The Federal Reserve regulates state-chartered member banks, bank holding companies, foreign branches of U.S. national and state member banks and state-chartered U.S. branches and agencies of foreign banks. National banks must be members of the Federal Reserve System; however, they are regulated by the Office of the Comptroller of the Currency.

The central bank of the United States is the Federal Reserve System (FRS). The FRS came into being in 1913, after the passage of the Federal Reserve

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171 Equal Credit Opportunity Act of 1974, Community Reinvestment Act of 1977, etc. govern the banks in this respect.  
Act\textsuperscript{173} and largely in response to the bank panic of 1907. Since the formation of the FRS, Congress has passed numerous additional laws adding or altering the powers and responsibilities of the Federal.\textsuperscript{174} The FRS is run by a board of governors and the Chairman.

The Federal Reserve Board (FRB) includes seven members and all members, including the Chairman, are appointed by the President of the United States, confirmed by the Senate and serve automatically on the FOMC (Federal Open Market Committee). A bank’s primary federal regulator could be the Federal Deposit Insurance Corporation (governed by \textit{Federal Deposit Insurance Corporation Improvement Act, 1991}), the FRB or the Office of Comptroller of the currency.

Within the Federal Reserve Board are 12 districts centered on 12 regional Federal Reserve Banks, each of which carries out the FRB’s regulatory responsibilities in its respective district. FRB is also responsible for the regulation of the commercial banks within its own particular district.

Credit Unions are subject to most bank regulations and are supervised by National Credit Union Administration. The Federal Financial Institutions Examination Council establishes uniform principles, standards and reports the same for other agencies.\textsuperscript{175}

\textsuperscript{173}The Federal Reserve Act is an Act of Congress that created and set up the Federal Reserve System, the central banking system of the United States of America, and granted it the legal authority to issue Federal Reserve Notes (now commonly known as the U.S. Dollar) and Federal Reserve Bank Notes as legal tender. The Act was signed into law by President Woodrow Wilson.

\textsuperscript{174}The Glass-Seagull Act, the Bank Holding Company Act, the Federal Reserve Reform Act, the Gramm-Leach-Bliley Act and the Dodd-Frank Act.

\textsuperscript{175}Bank regulations are a form of government regulation which subject banks to certain requirements, restrictions and guidelines. This regulatory structure creates transparency between banking institutions and the individuals and corporations with whom they conduct business among other things.
The objectives of bank regulation and the emphasis vary between jurisdictions. The most common objectives are prudential that is to reduce the level of risk to which bank creditors are exposed and protect the depositors, systematic risk reduction, avoid misuse of banks and reduce the risk of banks being used for criminal purposes\textsuperscript{176} and to protect banking confidentiality credit allocation by directing credit to favoured sectors.

There are numerous restrictions on the banks imposed by the law. The most important are maintaining minimum capital, license by the regulator to carry banking business and disclosure of financial and other information to depositors and creditors. The Federal Bank Regulatory Agency also looks into the matter that the fund is not invested in unnecessary risk and thus shareholders are also protected.

Confidence in the soundness of the banking and financial systems is what mobilizes a society’s savings, allows the savings to be channeled into productive investments and encourages economic growth. When compared to Indian banking system to U.S, the basic legislation are again similar with a minor difference.

The apex bank being the Federal Bank controls the financial stability of the country like in India. The difference lies where India has one central bank U.S has twelve for each district. There are number of commercial banks and investment banks in U.S as well as in India. There are also regulations which are drafted to maintain them and also they are controlled by the Federal Bank.

\textsuperscript{176}Dodd-Frank Act, 2010.
In India it has single legislation for the Central Bank i.e. RBI Act, whereas in U.S each federal bank has its own laws. RBI controls the whole banking system of India. The difference in the system lies where India is a Union within it are many states and U.S. is Union of many states. As regards commercial banks, legislation governing them is few in India. In U.S. there are numerous legislations.177

2.5. Conclusion

Banking has developed slowly but steadily. There were numerous experiments carried to achieve today’s banking system. This experiment is worldwide. English banking developed with pits and falls. After the establishment of Bank of England by passing the Tonnage Act, the English Central Banking and the whole banking system became strong. Yet, there were lacuna’s which were filled by many legislation. Legislations were introduced regulating commercial banks which stabilized the banking system in England and Whales.

The same story followed in U.S banking system also. Federal laws were enacted and amended whenever there was a lacunae in the existing legislation. India followed the footstep of English banking system as it was common law country and the Reserve Bank was established during the British regime.

Though, roots of India banking system can be traced back to Vedic period, the modern banking are influenced by British rulers as they brought their system into our country. Over the years International Banking has also grown

especially with the advent of WTO and number of International Conventions to regulate services. Invention of new technology, liberalisation of world trade and regulation of banking has posed many problems to the old system. Thus, an overview of the same is essential to analyse the system of today’s banking.