REPORT ON

BANKING LEGISLATION

FIRST REPORT OF THE STUDY GROUP REVIEWING LEGISLATION AFFECTING BANKING

BANKING LEGISLATION

BANKING COMMISSION
(Government of India)
BOMBAY
1971

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CONTENTS

STUDY GROUP TO REVIEW LEGISLATION AFFECTING BANKING

BANKING COMMISSION
(Government Of India)
''White House''
Walkeshwar Road
Bombay-6.

Date: 29th August 1971.

Dr. P. V. RAJAMANNAR,
D. Litt., LL.D.,
Chief Justice of Madras (Retd.)
CHAIRMAN

The Chairman,
Banking Commission,
(Government of India)
Bombay-6.

Dear Sir,

Report of the Study Group Reviewing Legislation Affecting Banking

I have pleasure in presenting the First Report of the Study Group Reviewing Legislation Affecting Banking, which deals with Banking legislation. I also enclose three copies of the Report.

Yours faithfully,

Dr. P. V. Rajamannar
CHAIRMAN.

Incls: 4

DETAILED TABLE OF CONTENTS

CHAPTER 3

BANKS, BANKING INSTITUTIONS AND BANKING REGULATION

CHAPTER 4

NATIONAL BANKS

CHAPTER 1

INTRODUCTORY

The Banking Commission was set up by the Government of India in February 1969 to review the working of the banking system as a whole and that of the non-banking financial intermediaries including indigenous bankers. The Commission has also been specifically asked to review the existing legislative enactments relating to commercial and co-operative banking. The Terms of Reference of the Commission are given in Appendix I.

1.2 In the broader perspective of the Terms of Reference of the Commission and with particular reference to the review of the enactments relating to commercial and co-operative banking, the Banking Commission constituted a Study Group on the 13th October 1969 with the following as its Members :

(1) Dr. P. V. Rajamannar, D.Litt., LL.D., Retd. Chief Justice of Madras, 9, Victoria Crescent Road, Madras-8 — *Chairman*

(2) Shri C. R. Pattabhi Raman, Former Union Minister, Ministry of Law, Barrister-at-Law, "The Grove", Teynampet, Madras-18

(3) Shri Mukund R. Mody, Ex-Judge of the Gujarat High Court, 27, L. Jagmohandas Marg, Bombay-6

(4) Shri R. M. Halasyam, Legal Adviser, Reserve Bank of India, Bombay-1

(5) Shri K. J. Natarajan, Officer on Special Duty, State Bank of India, Bombay-1

(6) Shri R. Krishnan, .. *Convener*
Assistant Legal Adviser,
Reserve Bank Cell attached to the
Banking Commission,
"White House",
91, Walkeshwar Road,
Bombay-6.

Subsequently, Shri R. K. Gandhi, Legal Adviser, Bank of Baroda, Bombay, was appointed as a Member of the Group on the 19th November 1969.

1.3 It is with deep regret that we record the passing way of Shri Mukund R. Mody on the 22nd February 1971.

Terms of Reference

1.4 The Terms of Reference of the Study Group are as follows :

(*i*) To make a study of the various enactments by the Centre and the States which have an impact on the working of the banking system;

(*ii*) To consider, in particular, the problems that arise in the working of the banking system as a result of its being subject to the Companies Act, 1956, and the Rules made thereunder ;

(*iii*) To examine the special legislation relating to banks and co-operative credit institutions ;

(*iv*) To examine the existing legislation in respect of non-banking financial intermediaries ; and

(*v*) To make recommendations in respect of (*i*) to (*iv*) above taking into account the future needs of the country in the matter of a flexible and adaptable system of banking institutions and non-banking financial intermediaries.

1.5 The Chairman of the Banking Commission inaugurated the first meeting of the Study Group on the 21st October 1969. The Group has met on the following dates :

1st	meeting	.. 21st October	1969
2nd	meeting	.. 6th December	1969
3rd	meeting	.. 7th January	1970
4th	meeting	.. 9th March	1970
5th	meeting	.. 14th May	1970
6th	meeting	.. 17th August	1970
7th	meeting	.. 20th & 21st May	1971
8th	meeting	.. 27th July	1971
9th	meeting	.. 29th August	1971

1.6 In addition to the formal meetings, the Chairman and the Convener of the Group discussed the matters pertaining to the Group at several informal meetings. During such discussions, the other Members of the Group, who were then available, were also invited for the discussions. Shri R. G. Saraiya, Chairman, Shri N. Ramanand Rao, Member, and Shri V. G. Pendharkar, Member-Secretary, of the Commission also attended some of the meetings of the Group. The Chairman and two Members of the Commission met the Chairman and some Members of the Study Group on 9th February and 23rd July 1971, when views were exchanged on the several questions arising for the consideration of the Group.

1.7 Since a review of the nature required of the Study Group had not so far been attempted in India and in order to initiate a meaningful dialogue and elicit useful views, the Group decided, at its inaugural meeting, to conduct preliminary studies of the several branches of laws which require to be considered. As a result of this decision, Shri R. Krishnan, the Convener of the Group, prepared several papers which served as the basis for the Group studying the various problems arising for consideration in the process of the review of the laws relating to, and affecting, banking. In the light of the study it was able to make of such laws, the Group found the need for a comprehensive review of such laws in our country. This left the Group with two alternatives. Either it could simply highlight the difficulties felt and stress on the need for a comprehensive review, or having noted the need for such review, the Group could itself initiate the review. The Group felt that as it has been constituted to review the laws affecting banking, the proper thing would be to attempt the latter. This, the Group was aware, required considerable time and labour. Moreover, this meant that the views of expert bodies such as law associations, banks, other representative bodies and concerned authorities, have to be ascertained and considered as part of such process of review. When the nature of such review and its implications were also brought to the notice of the Chairman and Members of the Commission at the meetings with them, the Group was encouraged to attempt such a review.

Questionnaire

1.8 In the light of the deliberations of the Group, a comprehensive questionnaire was drafted by the Convener under the guidance of the Chairman. The questionnaire was considered and approved by the Group before issue. The questionnaire highlights the problems arising for consideration with reference to the several branches of laws affecting banking, gives as background the prevailing position in developed countries and refers to the alternatives that could be considered to remedy the situation. The attempt was to make the questionnaire fairly exhaustive so that there could be a comprehensive coverage of the subject matter. The issue of the questionnaire was a necessary part of the process of review entrusted to the Study Group.

1.9 The questionnaire (given as Appendix II) issued, so far, has been sent out in three instalments. The first instalment was ready for issue on the 14th January 1970, the second on the 10th June 1970 and the third on the 12th December 1970. The questionnaire deals with topics such as the definition of banking, banks' obligation to maintain secrecy, giving/receiving of credit information by banks, payment by banks of balances and delivery of assets belonging to deceased customers, law relating to negotiable instruments and negotiable documents, law relating to loans and advances, guarantees, letters of credit, etc. It consists of 21 Parts.

1.10 Just before the first instalment of the questionnaire was ready for issue, the Chairman issued a Press Note drawing public attention to the issue of the Group's questionnaire and mentioning that those interested in giving their views/making their submissions on the matters covered by the Terms of Reference of the Group and/or its questionnaire, could obtain copies of the same and make their submissions to the Study Group. Several enquiries were received, and copies of the questionnaire and the Terms of Reference of the Group were sent to all those who expressed a desire to give their views thereon.

1.11 The Group considered that the questionnaire should also be issued to such authorities, institutions and others who are concerned with, or are particularly interested in, the matters falling for the consideration of the Group. Accordingly, it decided to send the questionnaire to the concerned departments of the Central Government, State Governments and the Administrations of the Union Territories, Reserve Bank, all commercial banks, selected co-operative banks, economists and other eminent men concerned with banking. The questionnaire was also issued to all law associations at the all-India level, State level and the District level, the all-India and regional associations of chartered accountants, representative bodies of industry, trade and commerce, and faculties of law.

1.12 Copies of the questionnaire were also sent to the experts suggested by the American Law Institute of U.S.A. and the Institute of Bankers, London, pursuant to the requests made to them in this regard. Of them, Mr. Carl W. Funk of U.S.A. and Mr. Maurice Megrah of U.K., noted authorities in those countries, have given the Group the benefit of their views on the matters referred to in the questionnaire. Copies of the questionnaire were sent to some expert bodies in U.S.A., U.K. and certain other countries as also to some international bodies.

1.13 The questionnaire on indigenous negotiable instruments (hundis) was also issued separately to several associations of indigenous bankers and others, and the questionnaire on documents of title to goods was also sent separately to associations of public carriers, warehousing agencies and the governmental authorities concerned therewith.

1.14 Though a time limit of one/two months from the date of receipt of the questionnaire was indicated by the Group for the submission of replies by those desiring to offer their views, the Group was aware of the fact that in view of the technical nature of the subject it may be neither desirable nor feasible to expect a strict adherence to the time schedule from those who may like to, and those who are in a position to, give useful replies. In view of this, the Group has had so far the benefit of the views of a substantial number of persons concerned with the legal aspects of the problems affecting banking, only with reference to matters covered by the first instalment (namely, Parts 1 to 4) of its questionnaire.

1.15 In respect of the second and third instalments (namely, Parts 5 to 21) also of the Group's questionnaire, quite a number of banks and some institutions have given their views. But these Parts of the Group's questionnaire relate to matters on which the public at large including the law associations and representative bodies of industry, trade and commerce are vitally concerned. The Supreme Court Bar and the All-India Bar Association have advised us that they have constituted separate committees to deal with our questionnaire. The All-India Institute of Chartered Accountants and the Indian Banks' Association have been able to send so far their comments/replies only as regards the first instalment of our questionnaire. Useful and meaningful replies in sufficient number are yet to be received, and we feel that on matters covered by the second and third instalments of its questionnaire it may not be appropriate for the Group at this stage to give its recommendations. However, in Chapter 8, we have indicated our *prima facie* views on the other laws relating to negotiable instruments, other negotiable documents and loans and advances, and have referred to the importance of the review of such laws from the point of view of banking development. Our recommendations on such laws will follow only after the views of the authorities and others concerned are received and considered.

1.16 In the above circumstances, the Study Group submits this first Report. Broadly, this deals with banking definition, classification of banking institutions, banking regulation and with certain other aspects which affect the carrying on of business by banks. Substantially, the field traversed in this Report relates to the matters covered by the first instalment of the Group's questionnaire, which has been answered by most of the banks, some law associations and other persons. The list of persons who have answered this instalment of the questionnaire, as on the 31st July 1971, is given as Appendix III. The replies of the foreign experts, namely, Mr. Carl W. Funk and Mr. Maurice Megrah, to the first instalment of the questionnaire, are given, with their consent, as Appendices IV and V respectively.

1.17 Of the Terms of Reference of our Group, the field traversed in this Report and that covered by the second and third instalments of the questionnaire substantially cover the following Terms :

(*i*) To make a study of the various enactments by the Centre and the States which have an impact on the working of the banking system ;

(*iii*) To examine the special legislation relating to banks and the co-operative credit institutions.

1.18 The Group has also been specially asked to study the provisions of the State Bank of India Act, 1955, the State Bank of India (Subsidiary Banks) Act, 1959, and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, and make recommendations. Considerable time and attention had to be bestowed on this. In Chapter 5, we have considered the provisions of the aforesaid enactments and given our recommendations.

1.19 Under its Term of Reference No. (*iv*), the Group has also to :

examine the existing legislation in respect of non-banking financial intermediaries.

There are two other Study Groups of the Banking Commission, which are dealing with non-banking financial intermediaries, namely, the "Study Group on Non-Banking Financial Intermediaries" and the "Study Group on Indigenous Bankers". They are also considering the regulation of concerns, other than banks, taking deposits for lending or investment. While concerns taking deposits from the public come in our scheme of banking regulation, we are not going into the details of the regulation that should apply to such concerns. We are also not now going into the details of the regulation that should apply to financial institutions which are not taking deposits from the public and which are considered by those Study Groups of the Banking Commission. These, we would be in a position to do only after we study the Reports of the aforesaid Study Groups and also have regard to other relevant matters.

1.20 Under its Term of Reference No. (*ii*) , the Group has to :

consider, in particular, the problems that arise in the working of the banking system as a result of its being subject to the Companies Act, 1956, and the Rules made thereunder.

There are many "banking companies" to which the Companies Act applies. Consequent on our recommendations in Chapter 3, the number of banking institutions coming under the Companies Act may increase. But, after the nationalisation of the 14 major Indian banks, the Companies Act has ceased to apply, to a substantial extent, to the banking system. Hence, we have not given priority for its consideration and our recommendations on this Term have to be postponed to a later date.

1.21 The Group's Term of Reference No. (*v*), namely :

> To make recommendations in respect of (*i*) to (*iv*) above taking into account the future needs of the country in the matter of a flexible and adaptable system of banking institutions and non-banking financial intermediaries

is linked to its other Terms of Reference and our comments on the other Terms would apply *mutatis mutandis* with reference to this Term.

1.22 In view of the weighty problems arising for consideration and the fact that such a study, in depth, as is contemplated under the review, has not so far been undertaken in India, when the Study Group discussed its implications with the Commission at a fairly early stage, it was given to understand that it could submit its first Report on the matters pertaining to banking legislation and allied matters and could give its Report on the remaining matters subsequently.

ACKNOWLEDGEMENTS

1.23 We acknowledge our sincere thanks to the Reserve Bank of India, other banks, financial institutions and others for furnishing us with information and materials useful to this Report. We also sincerely thank all those who have replied to our questionnaire, and in particular, Mr. Carl W. Funk of U.S.A. and Mr. Maurice Megrah of U.K. Several foreign offices and authorities (mentioned in Appendix VI) have readily obliged us by furnishing extremely useful information and materials relating to the comparable position in other countries, and our sincere thanks are due to them. We would also like to thank Shri R. G. Saraiya, Chairman, Shri N. Ramanand Rao, Member, and Shri V. G. Pendharkar, Member-Secretary, of the Commission, who attended some of our meetings and made valuable contribution to our discussions.

1.24 We wish to record our appreciation of the deep and extensive study and research made by our Convener-Member, Shri R. Krishnan, which enabled us to consider all relevant material including practice and precedent in foreign countries. His thorough preparation and expert drafting made the task of the Study Group comparatively easy. He has acquired a comprehensive knowledge of the several problems which relate to the laws concerning and affecting banking and such knowledge will be valuable in the further deliberations on the subject.

1.25 Shri Ch. Sreerama Murthy, Shri A. M. Dalvi, Shri A. K Shaw and Shri A. K. Seetharaman have considerably assisted the Convener in collecting the necessary materials, in analysing the replies to the questionnaire and in other respects. Shri N. K. Ramaswami, Private Secretary to the Chairman, and Shri V. Vembu have been attending to the work of the Group with efficiency. We commend their work.

CHAPTER 2

'BANKING'—DEFINITION

'Banking' has been understood differently at different times. Thus, for instance, the Privy Council has pointed out that the words 'banking' and 'banker' "may bear different shades of meaning at different periods of history and that their meaning may not be uniform *today* in countries of different habits and different degrees of civilisation"[1]. This poses difficulties in evolving a satisfactory definition of 'banking'. But, for the effective implementation of any scheme of regulation for the carrying on of banking business, a clear description of what really constitutes 'banking' is necessary. This serves to identify the persons who could be regarded as engaged in carrying on the business of banking in one form or another. In other words, 'banking' definition is the core of banking legislation.

2.2 In view of the difficulties involved in formulating a precise definition of 'banking', statutes and other authorities both in U.K. and in India often describe, or have described, 'banker' by the use of vague expressions, such as :

(*i*) A banker is one who carries on the business of banking[2]—this definition has been a "subject or ridicule"[3] ; "of derisive comment for many years"[4] ;

(*ii*) A banker is one who *bona fide* carries on the business of banking[5]—this definition is equally defective as (*i*) above ;

(*iii*) A banker is one whose name is found in a register of banks maintained by a specified authority[6]—a variation of this idea is found in the provisions which require a certificate by a statutory authority to decide, in cases of doubt, whether a person is carrying on the

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1 Bank of Chettinad Ltd. of Colombo *v.* The Commissioner of Income-Tax, Colombo (1948 A. C. 378).

2 Section 2 of the Bills of Exchange Act, 1882 ; the Cheques Act, 1957 ; Section 29, Schedule I (Exemption 2) of the Stamp Act, 1891 ; the Bankers' Books Evidence Act, 1879; Section 432 of the Companies Act, 1948 ; and Section 5(1)(7) of the Agricultural Credits Act, 1928 of U.K. ; and Section 3 of the Negotiable Instruments Act, 1881 ; Section 2 of Bankers' Books Evidence Act, 1891 ; and Section 2(1) of Indian Stamp Act, 1899.

3 Paget, 'Law of Banking,' Butterworth, 7th Edn. (1966), page 2.

4 Page 8, Vol. I of Law & Practice of Banking by J. Milnes Holden.

5 Section 30, Finance Act (No. 2), 1915 ; Section 4, Moneylenders Act, 1927 ; and Section 200(1) of the Companies Act, 1952 of U. K.

6 Paget, 'Law of Banking' Butterworth, 7th Edn.,(1966), page 12 paragraph 681 of the Report of the Indian Central Banking Enquiry Committee, 1931 ; and Section 4 of the Bank Act, 1967 of Canada.

business of banking[1]—no criteria are laid down indicating the basis on which such authority should classify an institution as carrying on banking business ;

(*iv*) Any person using as part of his name the word 'bank' or any of its derivatives is deemed to be a banker[2]—one has only to alter his name suitably if he does or does not want to be regarded as a 'banker'. Moreover, a person can hold himself out as carrying on the business of banking in every way other than that of using the word 'bank' or any of its derivatives as part of his business name[3] ;

(*v*) A banker is one who by reputation is understood to be a banker[4]—it introduces considerable ambiguity, and, at any rate, could not be applied to decide the nature of a person's business, at its inception.

Describing a 'banker' or a 'bank' on these lines really avoids the question of defining 'banking'. Again, any such definition would not be conducive to the effective implementation of banking regulation.

Necessity of a Definition of 'Banking'

2.3 In any scheme of banking regulation, a definition of 'banking' may have to be necessarily incorporated unless the scheme could be confined to named institutions. It is in this context that it becomes necessary to define the essential features of 'banking'. Even in U.K., where there is no banking regulation as such, the absence of a statutory definition of 'banking' has led to considerable ambiguity and given rise to various problems. In United Dominions Trust *v.* Kirkwood[5], Lord Denning, M. R., while referring to the provisions that give a privileged position to those carrying on banking business, observed that bankers "are an exclusive circle to which entry is limited", but regretted that :

> Parliament has conferred many privileges on 'banks' and 'bankers', but it has never defined what is a 'bank' and who is a 'banker'. It has said many times that a banker is a person who carries on 'the business of banking', but it has never told us what is the business of banking. It has imposed penalties on persons who describe themselves as a 'bank' or a 'banker' when they are not, but it has never told us how to decide whether or not they are bankers.

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1 Section 4 of the Bank of England Act, 1946 ; page 23 of Schedule VIII to the Companies Act, 1948 ; Sections 2 and 25(2) of the Protection of Depositors Act, 1963 of U.K.

2 Proviso to Section 277F of the Indian Companies Act, 1913, introduced by the Companies (Amendment) Act, 1942.

3 Paragraph 16 of Annexure 'B'.

4 This view propounded in a dissenting judgment in Davies *v.* Kennedy (1868), 3 Ir. Eq. 31 has been rejected by Harman, L. J., in United Dominions *v.* Kirkwood (1966 (1) All E.R. 968 at 983).

5 1966 (1) All E.R. 968.

Again, in his Gilbart Lectures (1970) on the "Business of Banking (Practical Aspects of the Legal Definition)", Mr. F. R. Ryder has referred to a considerable number of statutes in which there are references to 'bankers' or to the 'business of banking' and has shown how in U.K. "an enquiry as to what is a banker has real and practical commercial consequence". Though Mr. Ryder has not specifically suggested a statutory definition of 'banking' in U.K., there seems to be considerable body of opinion in that country in favour of the view that 'banking' should be statutorily defined[1]. In the context of banking regulation in India, the need for an adequate and satisfactory definition of banking is apparent.

2.4 In India the need for defining 'banking' has been felt, and we have statutory definitions of 'banking', in the context of banking regulation, in one form or another, since 1936. The question is whether the existing definition is adequate or it requires to be amplified or modified in any manner.

What 'Banking' Definition Should Contain

2.5 The expression 'banking' should be made clear so that the question whether or not a person carries on the business of 'banking' could be decided without embarking on an enquiry (every time the question arises) as to what 'banking' means. In deciding what strictly is 'banking', we have to note that all the forms of business, which a banker may undertake, could not be regarded as amounting to the carrying on of the business of 'banking'. Thus :

> Numerous other functions are undertaken at the present day by banks such as the payment of domiciled bills, custody of valuables, discounting bills, executory and trustee business, or acting in relation to stock ex-

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1 Mr. J. H. Thompson, in his review of Mr. F. R. Ryder's Gilbart Lectures, in the "Bankers' Magazine" of July 1970, has observed :

> Finally, in the fourth lecture, Mr. Ryder looks at existing statutory restrictions on bankers, of which, as the brief survey of the law of other European countries demonstrates, there are remarkably few. Mr. Ryder concludes that this is a desirable state of affairs, as he considers that legislation creates as many problems as it resolves, although he thinks that something (unspecified) should be done to prevent men of straw setting up as bankers. This conclusion is somewhat surprising since the preceding lectures have underlined the uncertainty which the lack of a statutory definition of banking has created, and have shown that ultimately legislation has in fact been needed to clarify the position. It is equally clear that dealing effectively with men of straw will also need further legislation, and that the present law, especially the Protection of Depositors Act, 1963, has proved singularly inadequate for this purpose. Mr. Ryder might have found an interesting parallel in the treatment of insurance companies by the Companies Act 1967. As a banker, he would doubtless seek to resist the introduction of such stringent controls into the field of banking, but to the outsider such a development would be logical and would provide a comprehensive solution to the problems identified by Mr. Ryder—it would ensure the maintenance of minimum solvency limits and the exclusion of undesirable persons, and—if the pattern of the 1967 Act were strictly followed—it would also produce a working, and, one would hope, workable definition of the business of banking.

The Crowther Committee (1970), while referring to the position in U.K., has said : ".... we cannot forbear from remarking on the confusion that results from the absence of any general-purpose definition of a bank or (*if the resources of the English language do not extend to that*) of a single consolidated list of acknowledged banks". (emphasis added)

> change transactions, and banks have functions under certain financial legislation, ... These functions are not strictly banking business.[1]

While dealing with the scope of the Constitutional Entry 'Banking', the Supreme Court has pointed out :

> In modern times in India as elsewhere, to attract business, banking establishments render, and compete in rendering, a variety of miscellaneous services for their constituents. If the test for determining what 'banking' means in the constitutional entry is any commercial activity which bankers at a given time engage in, great obscurity will be introduced in the content of that expression. The coverage of constitutional entry in a Federal Constitution which carves out a field of legislation must depend upon a more satisfactory basis.
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> *** *** ***
>
> The legislative entry in List I of the Seventh Schedule is 'Banking' and not 'Banker' or 'Banks'. To include within the connotation of the expression 'Banking' in Entry 45 List I, power to legislate in respect of all commercial activities which a banker by the custom of bankers or authority of law engages in, would result in re-writing the Constitution[2].

In other words, it is in the process of distinguishing 'banking' from any other activity, one is faced with the problem of understanding aright the true scope of 'banking'. Hence, a definition of 'banking' should contain its *sine qua non* or its essential features so that *any* person carrying on such business would be held as carrying on, in one form or another, the business of banking.

Considerations Relevant While Defining 'Banking'

2.6 Under the Federal set-up of our country, the executive and legislative powers on 'banking' are vested exclusively in the Union and the powers on 'moneylending and moneylenders' are vested exclusively in the States. Again, the powers on 'trade and commerce within the State' are vested in the States, subject to certain reservations. Thus, it becomes necessary to draw a line between 'banking' and pure moneylending, and 'banking' and non-banking business. While considering the constitutionality of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1969, the Supreme Court had occasion to deal with the Entry 'Banking' in List I of the Seventh Schedule of the Constitution. The Court held in that context that "a legislative entry being expressed in a broad designation indicating the contour of plenary power must receive a meaning conducive to the widest amplitude, subject however to limitations inherent in the federal scheme which distri-

1 Halsbury, 'Laws of England', Butterworth, 3rd Edition, Vol. 2, Art. 270, page 151, footnote (*g*).

2 R. C. Cooper *v.* Union of India (A.I.R. 1970 S. C. 564.).

butes legislative power between the Union and the constituent units. But the field of 'banking' cannot be extended to include trading activities which not being incidental to banking encroach upon the substance of the entry 'trade and commerce' in List II". Thus, 'banking' has to be defined in India having regard to its federal set-up.

2.7 The definition has a purpose, *i.e.*, of identifying the types of institutions which are to be considered as engaged in the carrying on of the banking business and to whom a scheme of banking legislation could apply. *Subject to the Constitutional position explained above, which arises by reason of the division of powers between the Union and the States, 'banking' may have to be defined in India on the one hand having regard to what is understood as 'banking' in other countries and so far in India, and on the other hand having regard to the objectives of banking regulation.* Generally speaking, the *objectives of banking regulation are* —

(*i*) to safeguard the interests of the depositors ;

(*ii*) to ensure that deposits are utilised having regard to public interest ; and

(*iii*) to ensure the effective implementation of monetary policy and credit policy.

2.8 Again, we may note that when the proposals for a comprehensive Banking Act first took shape in 1939, the definition of 'banking', as distinct from that of a 'banking company', was attempted, though the immediate aim was only to regulate banking companies. The object was to "make it possible, if considered necessary, to include legislation to cover individual bankers or groups or joint stock companies". Consistent with this aim, we may also note that while the Entry relating to 'banking' under the Government of India Act, 1935 was confined to the carrying on of banking business by corporate bodies, the corresponding Entry under the Constitution of India simply refers to 'banking' ; therefore, the present Entry would cover the carrying on of banking business by anybody whether it is an individual, firm, company or statutory corporation.

"Banking"—As Understood in Other Countries

2.9 In Annexure 'A' we have indicated, at some length, how 'banking' is being understood, or the nature of business dealt with under 'banking regulation', in U.K., Canada, U.S.A., Australia, South Africa, France, Italy, Switzerland, Belgium, Netherlands, Norway, Sweden, Finland, West Germany, Japan, Philippines, Indonesia, Malaysia and Ceylon. Here, we would only briefly refer to some broad patterns regarding the understanding of 'banking' in certain countries.

2.10 Institutions accepting deposits in current accounts for their customers and paying and collecting cheques for them are regarded as doing

'banking' in all the countries. In fact, this is regarded throughout as an essential form of 'banking'.

2.11 But in U.K. there has been no clear indication as to whether institutions which do not take deposits on current account and do not pay and collect cheques, but which accept other kinds of deposits of money, could be regarded as doing 'banking' ; the majority view seems to be that they could not be. The position in U.K., however, has been changing. At the beginning of this century, all forms of deposit taking had been considered in U.K. as amounting to 'banking'. With the development of the cheque habit and the sophistication in the business of established banks, emphasis has come to be laid on the acceptance of demand deposits and payment and collection of cheques. In U.K. there have been two significant developments that may be of relevance to us. One relates to the Protection of Depositors Act, 1963 which regulates the acceptance of deposits by concerns other than "banking companies" (as understood in U.K.). Secondly, for the purpose of determining certain privileges available to those carrying on the business of banking, under the Companies Act, under the Protection of Depositors Act, under the Income-tax Act, under the Bank of England Act and under the Agricultural Credits Act, 1928, a certificate/determination by the Board of Trade, or by the Treasury, or by the Department of Revenue, or by the Ministry, as the case may be, is held as decisive.

2.12 Thus, in U.K., though at present 'banking', strictly speaking, seems to be identified with the acceptance of deposits withdrawable by cheques (chequeable deposits) by customers, the business of accepting other kinds of deposits, by institutions other than established banks, is subjected to regulation. Again, no final view has been taken in that country as to what should be the definition of 'banking', and doubtful cases are left to be decided by specific authorities going into the individual cases on merits. In Canada, the Royal Commission on Banking and Finance (1964) has suggested the inclusion among banking liabilities of deposits payable on demand, or at short notice of, say, 100 days. This Commission has suggested the extension of the banking legislation, which was till then applicable to chartered banks, also to others accepting such liabilities. This Commission has also referred to provincial legislation, *e.g.*, in Ontario, which regulates the acceptance of deposits by institutions other than 'banks'.

2.13 In the United States of America, we find that Federal banking legislation lays emphasis on the operations of discount and deposits. Any national banking association is empowered to carry on the business of banking by discounting and negotiating instruments, by receiving deposits, by dealing in foreign exchange, coin and bullion, by lending money on personal security or by issuing notes. State banking legislation also regulates persons engaged in the business of receiving money for deposit or for transmission. However, banking legislation in the United States classifies institutions engaged in the different forms of banking and regulates their business appropriately.

2.14 In the context of the Australian Constitution, the Privy Council has held that the business of banking consists *inter alia* of the transfer and creation of credits and in the engaging of kindred activities. In South Africa, all persons accepting deposits of money from the public come under the sweep of the Banking Act. Depending upon the nature of deposits accepted, banking institutions are classified into "commercial banks", "people's banks", "loan banks" and "deposit receiving institutions". The definition of "commercial bank" would fit in with the U.K. concept of 'banking', *i.e.*, " a person who carries on a business of which a substantial portion consists of the acceptance of deposits withdrawable by cheque". "People's banks" are associations established for the purpose of promoting thrift among their members and making loans to their members. "Loan banks" are persons (other than people's banks) who carry on the business of accepting deposits of money and of granting small loans. "Deposit receiving institutions" are persons who carry on the business of accepting deposits of money but who are not commercial banks or people's banks or loan banks.

2.15 In France, persons accepting funds from the public for use on their own account in discount, credit or financial transactions generally come under the banking legislation. Others are prohibited from receiving deposits from the public repayable at call or within a period of less than 2 years. Banking legislation in France also classifies banking institutions into "deposit banks", "investment banks" and "long and medium-term banks". In Italy, acceptance of deposits in any form and the granting of credit are considered as activities of public interest and are governed by the Banking Law. The privilege of taking deposits from the public is confined only to institutions coming under banking legislation. We find a somewhat similar position in many other West European countries.

2.16 In Japan, institutions accepting deposits as a business are deemed banks. Such deposit taking is permitted only to licensed corporate bodies which are not permitted to engage in any manufacturing or trading activities. In Philippines, only duly authorised persons may engage in the lending of funds obtained from the public through the receipt of deposits or the sale of bonds or securities. Persons and entities which receive deposits only occasionally are not considered as banks but they are regulated by the Monetary Board of the Central Bank of the Philippines. Excepting those coming under the banking regulation, others are prohibited from soliciting or receiving deposits of money. In Indonesia, all institutions which accept money on deposit account or on current account and which engage in the granting of credits in private account are termed "commercial banks". Institutions, which accept moneys on deposit on such terms that the possibility of calling these moneys is subjected to limiting provisions, are termed "savings banks". In Malaysia, a distinction is made between "borrowing business" and "banking business". While both forms of business are regulated, and are allowed to be carried on only by corporate bodies, the definition of "banking

business" would correspond with the view of the majority in Kirkwood case.[1] In Ceylon, 'banking' is defined in the way originally defined in India in 1936 in the Indian Companies Act, 1913. This definition covers acceptance of all kinds of liabilities provided they are withdrawable against "cheque, draft or order".

2.17 Thus, 'banking' is related in almost all countries with the acceptance of liabilities from the public by way of 'deposits'. While in some countries the definition would cover also other forms of activities, in some it is sought to be identified only with acceptance of certain types of deposit liabilities, *e.g.*, deposits withdrawable by cheque, demand deposits. However, in many countries all forms of acceptance of deposit liabilities from the public are regarded as 'banking'.

How 'Banking' has been Understood in India So Far

2.18 In Annexure 'B' we have traced in detail how the first statutory definition of 'banking' in India was evolved in 1936, the experience gained of its working, the considerations bestowed on this question by those dealing with the proposals for a comprehensive Banking Act, and the factors which went into the formulation of the 1949 definition of 'banking'. Now the question which falls for our decision is whether the definition of 'banking' as it is at present should, in any respect, be simplified or modified. We give below the 1936 and 1949 definitions :

1936 definition	*1949 definition*
A banking company was defined 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"	a company which carries on the business of banking, that is to say, "accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise".

A comparison of these two definitions could usefully be made with reference to the following aspects :

	1936 definition	*1949 definition*
(1) Should the business be the principal business of the enterprise (to bring it under banking regulation)	Yes.	No.

1 1966 (1) All E. R. 968.

(2)	Acceptance of demand liabilities	Was covered provided the mode of withdrawal was by cheque, draft or order.	Was covered independent of mode of withdrawal.
(3)	Acceptance of time liabilities	-do-	-do-
(4)	Mode of withdrawal	Should be by cheque, draft or order.	Immaterial.
(5)	Purpose of accepting deposits	Immaterial	Should be for lending or investment.
(6)	Acceptance of deposits to finance one's own manufacturing or trading activities	Was covered.	Is not covered.*
(7)	Reference to deposit taking — "from the public"	No reference.	There is reference.

**Vide* also Explanation to Section 5(C) of the Banking Regulation Act, 1949.

2.19 In the light of the replies to our questionnaire, the information and material made available to us pertaining to the definition of 'banking' and having regard to the other relevant considerations, the following issues arise for our considerations :

(*a*) Should the acceptance of demand liabilities or 'chequeable deposits' be regarded as the *sine qua non* of 'banking' ?

(*b*) Should the acceptance of deposits by a person, for investment in his own business such as manufacture or trade, be held as 'banking'?

(*c*) Should the expression "from the public" in the present definition be retained, and if so, does it require any clarification ?

(*d*) How should the expression 'deposit' be understood ? Should it be defined ? If so, how ?

We proceed to deal with them.

(A) 'Banking' and Acceptance of "Demand Liabilities" and/or "Chequeable Deposits"

2.20 The decision of the majority in Kirkwood case[1] in U.K. may suggest that the maintenance of current accounts and payment and collection

1 1966 (1) All E. R. 968.

of cheques are essential before the business could be regarded as 'banking'. However, as we saw earlier, the concept of 'banking' has been understood differently at different times in U.K. in the absence of a statutory definition. We may also note herein that though the Protection of Depositors Act, 1963, regulates, in U.K., the acceptance of deposits by persons whom the U.K. law may not regard as engaged in the business of 'banking', there is no "banking regulation" as such in U.K[1]. Thus while considering the definition of 'banking', in the context of "banking regulation", the position in U.K. may not give us much assistance. Moreover, Dr. Walter Leaf[2], while suggesting a definition of *English banking* as receiving deposits repayable on demand by cheque has cautioned that this definition will not hold good in countries where the use of the cheque is too little developed.

2.21 In Canada, the Royal Commission on Currency and Finance (1964) has considered the whole question from the angle of extending banking regulation, which was till then being applied only to chartered banks which were in fact accepting chequeable deposits, to institutions described as "near banks" and which accept near-demand liabilities and effectively compete with the chartered banks. Actually, that Commission has referred to provincial legislation (*e.g.*, in the State of Ontario) providing for the regulation of the acceptance of deposits by companies (other than 'banks'). The law in Ontario referred to by the Royal Commission provides that "the Securities Commission must approve all advertising for deposits, receive quarterly reports from those accepting deposits, and has the right to inspect their books at any reasonable time. The Act sets out high liquidity requirements related to the size of the deposit liability"[3]. Thus, the trend in Canada is to regulate the business of acceptance of deposits (not merely the acceptance of demand or short-term liabilities), though it is not termed as amounting to 'banking' and the relevant legislation is partly Federal and partly Provincial.

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1 It has been stated that :

The attitude of English Law towards banks is a peculiar mixture of *laissez-faire* and indirect restriction. In theory anyone can start banking business without a licence of any kind. But the Board of Trade will refuse to allow the name 'bank' or 'banking' in a new company's name unless the circumstances justify it; and the Protection of Depositors (Contents of Advertisements) Regulations 1963 (S.I. 1963, No. 1397) made under the Protection of Depositors Act 1963 prohibit a company which advertises for deposits from using the words 'bank', 'banker' or 'banking' in advertisements in such a way as to suggest that the company carries on a banking business (Reg. 9). Since the Regulations also require a company to describe its business in its advertisements for deposits, a company which does in fact carry on the business of banking but is not recognised by the Board of Trade as a banker for the purpose of the Act is in a decided dilemma !

The difficulty of incorporating in England a company whose name contains the word 'bank' or 'banking' has led to the formation of banking companies outside the country—Guernsey is a favourite location—which can then carry on business in England using their corporate name without restriction. The controlling shareholders of an existing English company which legitimately has the word 'bank' in its name can by virtue of that fact alone command a substantial premium on sale of the shares.

(*vide* foot-note at pages 53-54 for the Article on "The Legal Regulation of Lending" appearing in "Instalment Credit" (1970 Edition), published under the auspices of the British Institute of International and Comparative Law.)

2 Dr. Walter Leaf, "Banking" Sykes Edition, 1935, pp. 24-25.

3 Report of the Royal Commission on Banking and Finance (1964), page 353.

2.22 The Federal banking legislation of the United States regulates all forms of deposit by National banks. The banking codes of the States of the United States of America also seem to regulate all forms of 'deposit-taking' (*e.g.*, Pennsylvania, District of Columbia). In Australia, South Africa, Italy, Norway, Sweden, Finland, West Germany, Japan, Philippines and Indonesia, we find that the concept of 'banking' would cover acceptance of all forms of deposit liabilities. In France, Belgium and Netherlands (under the proposed new Act), only licensed banking institutions are permitted to accept deposits repayable at call or within a period of less than two years. In Malaysia, though "banking business" seems to be defined in the sense understood by the majority of the Judges in Kirkwood's case, the business of accepting deposits which are *not* withdrawable against cheque (described as "borrowing business") is regulated under the Borrowing Companies Act, 1969. In Ceylon, the 'banking' definition is the same as that introduced under the Indian Companies Amendment Act, 1936, and this includes acceptance of time liabilities.

2.23 Moreover, in India, the statutory definitions of 'banking' (both of 1936 and the present one of 1949) have dealt with acceptance of time liabilities also as a form of 'banking'. While the 1936 definition included acceptance of term deposits withdrawable by "debit forms, written orders, withdrawal slips, cash orders, etc.", the 1949 definition covered also acceptance of deposits withdrawable against a simple receipt.[1] Though an attempt was made in the original Bill, as introduced in the Central Legislature in 1944/1946, following the definition of English banking suggested by Dr. Walter Leaf (as acceptance of deposits withdrawable by cheque), to confine 'banking' to acceptance of deposits withdrawable on demand, this did not find favour with the Central Legislature. Moreover, the proportion nowadays of demand to time deposits of the scheduled banks shows that the major portion of bank deposits consists of time deposits[2]. In view of this and as a main object of banking legislation is to protect primarily the interests of the depositors, the narrowing down of the scope of the definition to only taking of demand deposits would not serve to further the objectives of banking legislation. On the same reasoning, defining 'banking' to cover only deposits accepted as withdrawable by cheque or other negotiable instrument is not adequate, and it has been considered necessary to cover also acceptance of deposits withdrawable against mere receipts. We are of the same view.

Misdescription of Banking Institutions as Non-Banking Ones

2.24 However, we have to note that under the Banking Laws (Miscellaneous Provisions) Act, 1963, while attempting to control, *inter alia*, the acceptance of deposits by certain classes of financial institutions (for their business of lending or investment), certain provisions have been introduced

1 Paragraphs 7, 8 and 30 of Annexure 'B'.
2 Also paragraphs 23 of Annexure 'B'.

in 1963, in the Reserve Bank of India Act, 1934, on the assumption that such deposit taking may not amount to 'banking'. This is not a correct assumption, as the present definition of 'banking' covers the business of accepting all forms of deposits (for the purpose of lending or investment). Strictly speaking, the provisions of the 1963 legislation[1] may be inapplicable to them, and the provisions of the Banking Regulation Act (as regards companies) may apply. Moreover, the intention of the 1963 legislation was evidently not to vary the definition of 'banking'. Hence, the law has to be modified to deal with such financial institutions as a *class of banking institutions*, rather than as non-banking institutions. However, the importance of institutions taking demand deposits or chequeable deposits cannot be overlooked ; they are a class by themselves. Institutions accepting non-chequeable deposits need not be dealt with on par with those accepting chequeable deposits. But this is a matter to be looked into, and this we have done, while going into the scheme of banking regulation.

(B) Purpose for Which Deposits are Accepted

2.25 Under the 1936 definition, even textile and other manufacturing companies accepting deposits were classed as banking companies if their deposit taking (withdrawable against cheque, draft or order) was considered as their principal business. While the 1949 definition deleted the requirement that the carrying on of banking business by a company should be its principal business for it to qualify as a banking company[2], it introduced the requirement as to the purpose for which the deposits should be accepted, *viz.*, that it should be for lending or investment. The point is whether or not acceptance of deposits by a person for the purpose of investment in his own business such as manufacture or trade should be regarded as 'banking'.

2.26 It may be said that even commercial establishments, if they are to accept deposits, should do so only subject to their conforming to the requirements of banking regulation. This view derives support from the objectives of banking regulation. The depositor may not concern himself as to the purpose for which the 'deposits' are utilised by the person accepting such deposits, that is, the need for *safeguarding the interests of the depositors* (an objective of banking regulation) would remain whether the deposits are utilised for financing the person's own business such as trade or manufacture, or for financing the business of others (by way of lending, subscription to share capital, etc.). It has also been brought to our notice that deposits accepted by manufacturing or trading concerns are, in many cases, not utilised only for the purposes of manufacture or trade, but are passed on to other persons for financing their business. Hence, it may be urged that

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1 Reserve Bank of India Act, 1934, Chapter III-B.
2 Paragraphs 12 to 16 of Annexure 'B' for the difficulties felt in applying the criterion of principal business.

acceptance of deposits even by manufacturing or trading concerns, as part of their regular business, may have to be regulated due to *considerations of public interest and credit policy.*

2.27 In fact, Sections 45-J, 45-K, 45-M, 45-N and 45-O of Chapter III-B of the Reserve Bank of India Act, 1934, introduced in 1963, provide for the Reserve Bank restricting, regulating or prohibiting matters relating to the acceptance of deposits also by institutions which may accept deposits merely for financing their businesses as manufacturers or traders. We may, in this context, refer to the following observations of the Minister, made while introducing the aforesaid legislation in Parliament in December 1963 :

> The objectives of the Bill can be divided into three broad categories. Firstly, the deposits which are now received and handled outside the banking system, should be controlled, *not only in the interests of the depositors themselves, but also in the general and wider public interest* . . . . .
>
> ** ** **
>
> It is difficult to be certain, Sir, that the money which remains outside the organised banking sector is used only for essential purposes and not for speculation or other anti-social ends. Even when this money is obtained for more or less legitimate purposes, the consequences may not always be desirable. *It is not appropriate, for example, that we should allow institutions which are not themselves banks and which are not, therefore, bound by the inter-bank agreements, regarding deposit and lending rates, to compete with one another and also with banks for deposits, by pushing up interest rates, or in some odd cases by resorting even to unfair practices, which may be harmful to the interests of the depositors concerned.*[1]

2.28 Thus, a need has been felt for restricting, prohibiting or controlling the acceptance of deposits by persons for financing their business such as manufacture or trade. The only question is whether such regulation should be on the basis that the acceptance of liabilities by such persons should, or should not, be regarded as 'banking'. The regulation of the acceptance of deposits by such persons is considered necessary in furtherance of certain basic objectives of 'banking regulation'. Hence, it would be appropriate to regard such deposit taking as 'banking'. This conclusion is strengthened if we consider the understanding as to 'banking' in several developed countries.

2.29 The Federal and State banking legislation in U.S.A. lays emphasis on the business of receiving deposits, and not on the purpose for which deposits are accepted. Mr. Carl W. Funk, a Member of the Pennsylvania Banking Law Commission, has, in his reply to our questionnaire, stated :

> I would not favour a definition which states that a person will not be regarded as engaged in banking unless he accepts deposits from

1 Lok Sabha Debates on the 19th December 1963.

members of the public, repayable on demand, for purposes of lending or investment. Almost all acceptances of deposits from members of the public should be regarded as banking, whether they are repayable on demand or at a specified future date or after a specified period after notice to pay; and whether they are for lending or investment, or *some other purpose*. For example, a commercial establishment should not be permitted to accept deposits from members of the public and use these funds in its mercantile business unless it conforms to all of the regulations governing banking.

He has further stated that :

It seems best to treat all persons who engage in the business of receiving money for deposit or transmission as being engaged in banking and then to make certain exceptions, such as (*a*) hotels and other establishments who receive money from guests or customers for temporary safe-keeping ; (*b*) attorneys at law, real estate agents, fiscal agents and attorneys-in-fact to the extent that they receive and transmit money solely as an incident to their general business or profession ; (*c*) licensed stock and commodity brokers who engage in the receipt and transmission of money solely as an incident to the conduct of their brokerage business. This was the approach which was taken by the Pennsylvania Banking Law Commission, of which I was a member in drafting the Pennsylvania Banking Code of 1965.

2.30 Authorities in U.K. also feel that it is not necessary to indicate, in the definition, the purposes for which deposits are accepted. Diplock, L. J., in Kirkwood case[1] has said, "What makes a person a banker is not what he does with the money of which he obtains the use . . . . but the terms on which he obtains from other persons, his customers, loans of money which he can use as he thinks fit". He has further said "*What a company does with the money which it obtains from persons dealing with it is immaterial to the question whether it is* bona fide *carrying on the business of banking*".

2.31 The Banking Act, 1942 of South Africa proceeds on the basis that all deposit-receiving institutions are carrying on 'banking' in one form or another. In Italy, the business of accepting deposits is confined only to approved credit institutions. In U.S.A., U.K., Canada, South Africa, France, Italy, Norway, Sweden, West Germany, Japan, Philippines and Ceylon, either the definition of 'banking' is not viewed as related to the purpose for which deposit liabilities are accepted, or their banking codes aim to restrict or regulate the acceptance of deposits by persons for financing their own business such as manufacture or trade.

2.32 In 1913, the Government of India had addressed a letter to the Provincial Governments stating that it was not the intention of the Govern-

1 (1966) 1 All E. R. 968 at pp. 986 and 987.

ment to control all the numerous forms of banking operations and that it was not proposed to "include in the scope of such legislation the regulation of *a form of banking* undertaken by industrial companies which received deposits during their busy season in order to finance the business of the firm"[1]. The 1936 'banking' definition did not exclude from its scope companies accepting deposits for purposes of their trade or manufacture merely on that ground ; under this definition, the purpose for which deposits were accepted was not material[2]. The 1946 Select Committee, while linking deposit-taking with the purpose of such taking, *i.e.*, for lending or investment, aimed to preclude non-banking concerns (*i.e.*, manufacturing and trading concerns) from accepting demand deposits[3], *i.e.*, from doing 'banking' as defined in the 1946 Bill. (Though this prohibition was dropped as suggested by the 1948 Select Committee, under the directives of the Reserve Bank such a prohibition is now enforced). The point of the 1948 Select Committee[4] was that acceptance of deposits by manufacturing or trading concerns for financing their business "should not be regarded as 'banking' *within the meaning of the Act*", that is, it did not want the provisions relating to licensing, prohibition of trading, etc., to apply to them. That is quite reasonable and this could be taken care of by the scheme of the banking regulation.

2.33 Hence, having regard to the understanding as to 'banking' in other countries, the fact that prior to 1949 the purpose for which deposits were accepted was not material in the context of 'banking' definition and the fact that accepting of deposits by institutions for investment in their own field, that is, financing their business such as manufacture or trade, is now regulated under certain provisions of the Reserve Bank of India Act, 1934, for reasons which are really in furtherance of the objectives of banking regulation, we recommend that 'banking' definition should cover also the business of accepting deposits by a person for the purpose of investment in his own business such as manufacture or trade.

(C) Acceptance of Deposits "From the Public"

2.34 While the 1936 definition did not say that deposit taking should be "from the public", these words are found in the 1949 definition. This expression has given rise to difficulties in practical application and needs clarification.

2.35 Under the 1936 definition, the 'nidhis', 'permanent funds', etc., which accept deposits from their own members, were classed as 'banks' if they complied with the requirements of the definition in other respects. In the practical working of the 1949 definition the words "from the public"

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1 Report of the Indian Central Banking Enquiry Committee, 1931, paragraph 670.
2 Also paragraph 11 of Annexure 'B'.
3 Paragraph 26 *ibid.*
4 Paragraph 33 *ibid.*

found therein have been understood as excluding the acceptance of deposits by a concern from its own members. This, in our view, should not be. The pointed instance is the case of the 'nidhis'[1]. The 'nidhis' are taking deposits from their members who are required to take a share of the nominal value of Re 1. Their capital is divided into shares of Re. 1 each and thus they could deal with several thousands of persons ; in effect, the 'members' of a 'nidhi' may conceivably exceed the number of 'customers' of a small sized bank. Again, in the case of many co-operative credit institutions, a substantial portion of their deposit business may be from their members ; if deposit-taking from 'members' is not regarded as deposits taken from the public, banking regulation may not also effectively apply to co-operative credit institutions.

2.36 In Commissioner of Income-tax, Madras *v.* Kumbakonam Mutual Benefit Fund Ltd.[2], the Supreme Court has held that the position of the 'fund', which belongs to the class of companies known as 'nidhis', "was no different from an ordinary bank except that it lent money to, and received deposits from, its shareholders". The Court also held that it is not a mutual benefit society and that the dealings of the 'Fund' with its members are in no way different from an ordinary banking company lending to, or accepting deposits from, its shareholders.

2.37 Mr. Carl W. Funk, a Member of the Pennsylvania Banking Law Commission (1965), and several others who have answered our questionnaire relating to 'banking', are not in favour of excluding institutions taking deposits only from their members from the scope of the banking regulation, as such membership may run to several hundreds or thousands. The Canadian Royal Commission (1964) has suggested that deposit-taking institutions dealing with less than *50 people* may be excluded from the scope of banking regulation. The Borrowing Companies Act, 1969 of Malaysia (which deals with the acceptance of deposits by a person and the lending or investing of such borrowed funds) brings within the scope of the legislation the acceptance of any money on deposit or loan by a person from more than *10 persons*. In France, the expression "funds received from the public" has been defined as "the funds which a firm or a person receives in every form from or for the account of a third person, with the understanding that the funds will be returned". Deposits, which an enterprise may receive from its salaried employees, are regarded in France as deposits received from the public, unless the amount of such deposits does not exceed 10% of the paid-up capital of the enterprise.

2.38 Hence, the expression "from the public" (which was not there in the definition of 'banking' prior to 1949) needs clarification, if it is to be retained. We may clarify that expression in two ways. One way would be

1 Paragraph 28 of Annexure 'B'.
2 A.I.R. 1965 S.C. 96.

to provide that acceptance of deposits from more than a specified number of persons would be regarded as funds received "from the public". But this, in our view, may not be quite satisfactory. The reference to "number of depositors" unrelated to quantum may not be meaningful. It is difficult to cite instances of concerns engaging in the business of accepting deposits from persons from less than a number that could properly be specified as a minimum. The other alternative is to clarify that the acceptance of deposits by a body only from its members or shareholders would also amount to acceptance of deposits "from the public", and we consider that the expression "from the public" should be so clarified.

(D) Borrowings by way of "Deposits"

2.39 Both under the 1936 and the 1949 definitions, there should be acceptance of 'deposits' before the business could be considered as 'banking'. The English Common Law recognises a distinction between 'loans' and 'deposits'. That distinction is material under the Law of Limitation. If this distinction is applied to banking business, it causes avoidable difficulties in the enforcement of banking regulation. While there are a number of judicial decisions which have gone on the point whether a transaction evidences borrowing by way of loan or deposit, it does not appear that the distinction suggested could effectively and satisfactorily be applied in the context of banking regulation. As we would presently see, in the context of legislation aimed to protect the interests of depositors, in countries like U.K., Canada, France and Malaysia, it has not been considered necessary to apply such distinction. In its directives (issued under Chapter III-B of the Reserve Bank of India Act, (1934), the Reserve Bank has defined 'deposit' without applying the distinction between 'deposit' and 'loan'. We do not consider it necessary to observe this distinction for the purpose of banking regulation.

2.40 The Supreme Court has indicated that the terms of the agreement are not themselves decisive of the question as to whether a transaction is one of a 'loan' or of a 'deposit', and that it has to be judged from the intention of the parties and all the circumstances of the case.[1] In the case of a loan, it is said that the borrower is obliged to return the money without any demand therefor from the creditor. A demand is a necessary precondition for the obligation to repay to be enforced against a borrower accepting a 'deposit'. But this distinction becomes relevant only when the true nature of the transaction has been ascertained and does not help in determining its nature. In the case of a 'deposit', unlike in the case of a 'loan', it is said, the creditor entrusts the money with the borrower for ensuring its safe return. When deposits are made expecting also a return on them, it is difficult to apply this motive test.

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1 A.I.R. 1956 S.C. 12.

2.41 Generally, when amounts are borrowed on condition that they should be repaid on the expiry of a term, they are regarded as loans rather than as 'deposits'[1]. If 'deposit,' for the purpose of the 'banking' definition, is so understood, then concerns accepting only fixed deposits, which are repayable on the expiry of a term, would not be regarded as doing 'banking'. The 1946 Select Committee brought within the scope of 'banking' definition the acceptance of fixed deposits repayable on the expiry of a term, on which interest is payable and which are withdrawable merely against receipts. If term deposits are not regarded as 'deposits' for the purpose of banking regulation, it would not further the objectives of banking regulation. The aim of protecting the interests of such depositors would not be achieved.

2.42 While considering the legal relationship of banker and customer, it has been held that money paid in generally to a banker could not be considered as a case of *depositum*[2]. In Sims *v.* Bond,[3] the Chief Justice of the Queen's Bench said that "sums which are paid to the credit of a customer with a banker, *though usually called deposits, are, in truth, loans by the customer to the banker.*" In Foley *v.* Hill and others,[4] the House of Lords has held that the relation between a banker and his customer who pays money into the bank is the ordinary relation of debtor and creditor, with the superadded obligation arising out of the custom of bankers to honour the customer's cheques.

2.43 In Mancherjee *v.* Dorabjee[5], Farran, C. J., had observed : "Ordinarily, money paid into a banking account is regarded as a loan upon the authority of Foley *v.* Hill[4]. This is a well-known rule". In Sir Mohammed Akbar Khan *v.* Attar Singh[6], Lord Atkin observed that "it should be remembered that the two terms (*i.e.*, 'loan' and 'deposit') are not mutually exclusive. A deposit of money is not confined to a bailment of specific currency to be returned in specie as in the case of a deposit with a banker. It does not necessarily involve the creation of a trust, but may involve creation of the relation of debtor and creditor, *a loan* under conditions". In Motigavri *v.* Naranji[7], Kemp, J., said : "Really a 'deposit' and moneys paid in current account alike create the relationship of lender and borrower between the customer and his bank". In Hirabai *v.* Dhunjibai[8], the same Judge said : "There is no distinction between a deposit and a loan because they are both moneys lent by the customer to the bank . . . . . ".

2.44 In India, with reference to deposits accepted by banks, that the distinction of 'loans' and 'deposits' could not be validly drawn may further be

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1 Decision reported in 1958 (2) An. W. R. 621.
2 Carr *v.* Carr (1811) 1 Mer 541 n, 543.
3 (1833) 5 B & Ad. 389, per Deaman, C. J., at pp. 392-3.
4 (1848) 2 H.L. C. 28.
5 19 Bom. 775 at 776.
6 63 I.A. 279.
7 29 Bom. L. R. 423 at 425.
8 29 Bom. L. R. 427 at 429.

seen from the second proviso to Section 292(1) of the Companies Act, 1956, which provides that the acceptance by a bank, in the ordinary course of its business, of deposits of moneys from the public repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise, or the placing of moneys on deposits by a banking company with another banking company, shall not be *deemed* to be borrowings of money, or, as the case may be, the making of loans by a banking company for the purpose of Section 292(1) *ibid.* In other words, the implication is that, but for this saving provision, deposits with banks could be regarded as loans. Thus, the deposits accepted by banking institutions are really 'loans', though usually not so called.

2.45 In U.K., the Protection of Depositors Act, 1963, defines 'deposit' as meaning a loan of money at interest, or repayable at a premium. In Canada, the Royal Commission on Currency and Finance (1964) has noted that "all bank liabilities other than shareholders equity, contingent liabilities under letters of credit, guarantees and acceptances and a small amount of minor items are considered to be deposits, regardless of the terms and conditions of the liability". In France, enterprises would qualify as banks whether the funds borrowed from the public are by way of "deposits or otherwise". The Malaysian Borrowing Companies Act, 1969, defines a 'depositor' as "a person who deposits with *or* lends money to a licensed borrowing company". In the result, there is evidently no reason for applying the English Common Law distinction between 'loans' and 'deposits' while dealing with banking regulation in India. This distinction can be avoided by a statutory definition of 'deposit'.

'Deposit'—Definition

2.46 If we are to define 'deposit', following the pattern in other countries, in such a way as to cut across the distinction between 'loan' and 'deposit', we may have to exclude certain kinds of loans from the expression 'deposit', having regard to the objectives of banking regulation, the practice in other countries and the prevailing circumstances of our country. In most countries, *e.g.*, in U.S.A., U.K., Canada and France, acceptance of certain types of deposits is excluded from the scope of the regulatory provisions.

2.47 In U.K., the Protection of Depositors Act, 1963 defines 'deposit' as follows :

> In this Act 'deposit' means a loan of money at interest, or repayable at a premium, but does not include :
>
> (*a*) a loan to a company or other body corporate upon terms involving the issue of debentures or other securities ; or
>
> (*b*) a loan by a body corporate, firm or other person whose ordinary business includes the business of banking, or who carries on a busi-

ness of such other class or description as may be prescribed by regulations of the Board of Trade ;

and references to the deposit of money or the investment of money on deposit shall be construed accordingly.

While including loans, this definition of 'deposit' excludes the issue of debentures or securities by corporate bodies and borrowings from the banking system. But the definition of 'deposit' contained in the directives of the Reserve Bank (issued pursuant to the provisions of Chapter III-B of the Reserve Bank of India Act, 1934) has more number of exclusions.[1] In our view, the desirability of continuing all the exclusions now found in the Reserve Bank definition of 'deposit' (as given in the Reserve Bank directive) requires consideration. For instance, borrowing from 'members' or 'shareholders' by an association or a corporate body are excluded from the expression 'deposit'. From the earlier discussion on the scope of the expression "from the public", it follows that it is not desirable to provide for this exclusion. The exclusion of secured borrowing as also borrowings under guarantee of directors

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1 The definition under the directive runs as under :

'deposit' means any deposit of money with, and includes any amount borrowed by, a company, but does not include

(*i*) any loan received from Government ;

(*ii*) any loan raised on terms involving the issue of debentures or the creation of any mortgage, pawn, pledge or hypothecation, charge including floating charge, or lien on the assets of the company or any part thereof ;

(*iii*) any loan received from a banking company or from the State Bank of India or from a banking institution notified by the Central Government under Section 51 of the Banking Regulation Act, 1949 (10 of 1949) or from a co-operative bank as defined in clause (b) (*ii*) of Section 2 of the Reserve Bank of India Act, 1934 (2 of 1934) or from any person registered under any law relating to moneylending which is for the time being in force ;

(*iv*) any loan received from the Industrial Development Bank of India established under the Industrial Development Bank of India Act, 1964 or the Industrial Finance Corporation of India established under the Industrial Finance Corporation Act, 1948 or a State Financial Corporation established under the State Financial Corporations Act, 1951 or the Industrial Credit and Investment Corporation of India Ltd. or the Madras Industrial and Investment Corporation Ltd.;

(*v*) any loan received by a holding company from its subsidiary or by a subsidiary from its holding company or by a company from a subsidiary of any of its subsidiaries or from a subsidiary of its holding company or from a subsidiary of the holding company of its holding company or by a company from a holding company of its holding company ;

(*vi*) any loan received by a Government company from any other Government company ;

(*vii*) any loan received from a member of the company or any money received from a member by way of subscription to any share, stock, bonds and debentures (including calls or deposits received in advance) ;

(*viii*)) in the case of a chit fund company, or any other company carrying on chit or kuri business, any subscriptions received from the members of a chit or kuri series in terms of the contract, variola or other arrangement relating thereto, and in the case of a stock exchange or stock-broking company, any money received in connection with the purchase or sale of securities ;

(*ix*) in the case of a mutual benefit financial company any money received from its members or associate members by way of fixed, recurring, occasional or other deposits ;

(*x*) any loan received from, or guaranteed by, the managing agents, secretaries and treasurers or directors of the company ;

(*xi*) any money received from an employee of the company by way of security deposit ;

(*xii*) any money received from purchasing, selling or other agent in the course of or for the purposes of the business of the company or any advance received against orders for goods, properties or services ; and

(*xiii*) any money received in trust or any money in transit.

(they may or may not be creditworthy and this may facilitate acceptance of deposits on a large scale without coming under banking regulation) would substantially widen the scope of the exclusions. In this light, a definition of 'deposit' has to be framed. The definition of 'deposit' given in the U.K. Protection of Depositors Act seems to be more appropriate having regard to the objectives of banking regulation.

2.48 In the light of the foregoing, we are of the view that it is necessary to define the expression 'deposit' in the definition of 'banking'. 'Deposit', for this purpose, should include also borrowings by way of loans but exclude the following :

(*i*) borrowings by companies or other corporate bodies by way of debentures ;

(*ii*) borrowings from Government, banks, financial corporations established by statute, or from any other financial institutions that may be notified by the Central Government.

Conclusion

2.49 In conclusion, we find that the definition of 'banking', as found in the Banking Regulation Act, 1949, needs certain alterations for the sake of amplification and clarification. It now comprises acceptance of time liabilities and there is every reason for it to continue. The purpose of acceptance of deposits is strictly not relevant for the definition though it is germane for banking regulation. There is no need to distinguish between 'loans' and 'deposits' in the context of banking regulation, and for this 'deposits' should be defined having regard to what we have indicated earlier. But, there is the need to clarify the expression "from the public" in the manner we have indicated. In sum, 'banking' definition should cover all forms of acceptance of deposits from the public and banking regulation should deal with all the different types of banking.

2.50 Before concluding, we have to point out that our recommendations pertain to 'banking' definition in the context of banking regulation and have to be considered with the scheme of banking regulation we are recommending in the next chapter.

ANNEXURE 'A'

'BANKING' — AS UNDERSTOOD IN OTHER COUNTRIES

Here, an attempt is made to sketch briefly how 'banking' is being understood in U.K., U.S.A. and certain other countries. In countries where there is a comprehensive scheme of banking regulation in force, the need has been felt and we find a fairly precise definition of 'banking' ; where that is not the case, and the carrying on of banking business confers merely some privileges, as in U.K., the meaning of the expression 'banking' is left for the consideration of judicial and other authorities. Again, we see that while in U.K. and certain Commonwealth countries the business of banking is generally identified with the acceptance of demand, including possibly also near demand, liabilities, the trend in other Commonwealth and other developed countries is not to confine the scope of the expression 'banking' only to the acceptance of such liabilities, but to regard the expression as covering the acceptance of all forms of liabilities. A further aspect has been the importance or otherwise of the mode of discharge (withdrawal) of the liabilities (deposits), that is, whether the discharge is, or is not, pursuant to a negotiable order of the depositor/creditor. While in U.K. the majority view would lay stress on the discharge of the liabilities pursuant to a negotiable order, *i.e.*, cheque, in several other countries this question is not considered as *per se* decisive to determine whether the acceptance of the liabilities could be held as 'banking'. Thus, there seems to be a difference in scope, in the coverage of the expression 'banking', in U.K. and in other countries.

Position in U.K.

2. In U.K., we do not have any statutory definition of 'banking' though the absence of a statutory definition is now keenly felt. What is the business of 'banking' is left to be determined by judicial and other authorities, from time to time. From judicial decisions and the expositions of authorities on the subject, it is clear that in U.K. the understanding as to the scope of the expression 'banking' has been changing.

3. In his Treatise on Banking, J. W. Gilbart says that "the business of banking consists chiefly in receiving deposits of money, upon which interest may or may not be allowed ;—in making advances of money, principally in the way of discounting bills; — and in effecting the transmission of money from one place to another". In re Bottomgate Industrial Co-operative Society,[1] acceptance of deposits carrying interest and withdrawable at will was held as 'banking'. In re Shields Estate[2] (an Irish case),

1 (1891) 65 L. T. 712.
2 (1901) I.L.R. 172.

the receipt of money on deposit (for which first promissory notes and later deposit receipts were issued) and lending thereof was held sufficient to classify the institution as a bank, though no cheques, pass books, bills or letters of credit were handled and there were no current accounts. Fitzgibbon, L.J., observed in that case that "if his business is to trade for profit in money deposited with him for that purpose, he answers to the description of 'banker' ". Thus, institutions borrowing by way of deposits have been considered as doing 'banking' in U.K. at the beginning of the century.

4. Subsequently, however, 'banking' seems to have been identified in U.K. with acceptance of deposits withdrawable on demand and possibly also withdrawable by means of a cheque or other negotiable instrument. Dr. Walter Leaf, who was the Chairman of the Westminster Bank Ltd., had expressed that :

> It is now possible to give a definition of *English banking*, and to define a bank in terms of its deposit business. We can say that a bank is a person or corporation which holds itself out to receive from the public deposits payable on demand by cheque.[1]

But he had immediately added some words of caution about this suggested definition. He had said that the definition :

> does not express more than one part of the business of a bank ; but, it does express the characteristic by which a bank is, to the common apprehension of the public, distinguished from other financial institutions. But it must be repeated that the definition only holds good for Great Britain, including Ireland as well as Scotland, and perhaps for the United States.[2] *But it would not be applicable on the Continent, where the use of the cheque is too little developed to be regarded in any sense as a fundamental part of the operation of a bank;* and a definition would rather be sought from the discounting of bills and the giving of monetary credits.[1]

5. But, while dealing with the Ceylon Companies Ordinance of 1938, the Privy Council had occasion to express how 'banking' was understood in U.K. in 1932.[3] The Privy Council held that the description of 'banking' as "the accepting of deposits of money on current account *or otherwise*, subject to withdrawal by cheque, draft *or order*" in the Ceylon Companies Ordinance of 1938 in no way conflicted with the meaning attached to the word in England in 1932. But this definition of 'banking' differed from that given

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1 Dr. Walter Leaf, 'Banking,' revised by Sykes, 1935 Edition, pp. 24-25.
2 Dr. Walter Leaf's definition does not seem to indicate the present understanding in United States of the scope of the expression 'banking.' The position in the United States is dealt with later on.
3 Bank of Chettinad Ltd. of Colombo *v.* The Commissioner of Income Tax, Colombo (1948 A. C. 378).

by Dr. Walter Leaf, in that this comprised also the acceptance of time liabilities provided the withdrawal was by means of "cheque, draft or order" ; nor was it necessary under this definition that the withdrawal should be only by means of a negotiable instrument, as the reference to 'order' comprised also deposits repayable by means of debit or withdrawal slips. Thus, of the position in the thirties, the authorities in U.K. do not seem to agree.

6. In Kirkwood case,[1] Harman, L. J., has approved of the definition of 'banking' applying in Ceylon, which the Privy Council had considered earlier. He felt that collection of cheques was "at any rate *in recent times an additional requirement of English practice*". The requirement as to the maintenance of current account, he held, could perhaps be satisfied by deposits withdrawable on agreed notice "whether 7 days *or longer*". Lord Denning, M.R., however, felt that the characteristics of bankers were :

> (*i*) they accept money from, and collect cheques for, their customers and place them to their credit ; (*ii*) they honour cheques or orders drawn on them by their customers when presented for payment and debit their customers accordingly. These two characteristics carry with them also a third, namely, (*iii*) they keep current accounts, or something of that nature, in their books in which credits and debits are entered.

Diplock, L.J., had emphasised that acceptance of deposits repayable on demand or on notice was the essential feature of 'banking', but he decided not to pronounce on the question whether the payment and collection of cheques were necessary. Thus, in Kirkwood case[1], the Judges were not agreed as to what should be regarded as the essential characteristics of banking business though the majority view stresses, as the essential feature of 'banking', the maintaining of current accounts and the payment and collection of cheques. The editor of Paget's Law of Banking (7th Edition) Mr. Maurice Megrah, and Mr. F. R. Ryder, in his Gilbart Lectures on Banking 1970, favour this restricted view of 'banking'.

7. But, in R. V. Industrial Disputes Tribunal, *ex parte* East Anglian Trustee Savings Bank[2], Lord Goddard had rejected in 1954, the view that no one may be regarded as a banker unless he pays cheques drawn on himself. Dealing with the trustee savings banks, he had said that while they did more than the Post Office Savings Bank they did not carry on the business of banking in the same way as one of the Big Five banks in the sense of issuing cheque books and performing other services, but nevertheless they carried on the business of banking.

8. In U.K., the decision in Kirkwood case[1] has led to an amendment of the Companies Act providing that a certificate given by the Board of Trade

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1 1966 (1) All E. R. 968.
2 (1954) 1 W. L. R. 1093.

that for the purposes of the Moneylenders Act 1900 to 1927, a person can properly be treated "as being a person *bona fide* carrying on the business of banking shall, for those purposes, be conclusive evidence that he is so carrying on that business"[1]. Likewise, in U.K., for the purpose of certain provisions[2] of the Companies Act whether or not a company is to be treated as a banking company is left to the satisfaction of the Board of Trade. As in the case of the Moneylenders legislation, for the purpose also of the Protection of Depositors Act, 1963[3], a certificate of the Board of Trade that a company is carrying on the business of banking exempts it from the provisions of that Act. In fact, the Board of Trade has suggested to the Jenkins Committee on Company Law Reform that the exercise of the power so vested in them "has caused much difficulty" and had asked that Committee to consider whether it would be possible to define 'bank' or 'banking business' in terms that would make it unnecessary to vest this power in the Board. That Committee has not acceded to this suggestion. Similar powers have also been conferred on the Treasury in U.K., under the Bank of England Act, 1946[4].

9. The foregoing will illustrate that the position in U.K. has been changing, that the absence of a statutory definition of 'banking' has led to considerable difficulties, that even today there is no unanimity as to what constitutes 'banking', and that some procedures have been evolved to decide doubtful cases and they provide for the obtaining of the confirmation of a specified authority that a person is carrying on the business of banking by means of a certificate to be issued by such authority. "The result is that there exists a number of official lists of bankers, no two of which are identical".[5]

Canada

10. In Canada, the Royal Commission on Banking and Currency (1964) has gone into the definition of 'banking'. It noted the absence of a statutory definition of 'banking' in that country. In its approach to banking legislation, that Commission confined its consideration to institutions which mainly deal in short and medium-term claims. With reference to institutions accepting short-term claims and not covered by banking legislation, that Commission observed that "this has given rise to problems of inadequate regulation and supervision of some of the deposit-taking institutions". Hence, it has recommended that the system of inspection and supervision found in the Chartered Banking legislation[6] in Canada should be "extended to a broader group of institutions now doing essentially banking business, some

1 Section 123(*i*) of the Companies Act, 1967.
2 Paragraph 23 of Schedule VIII to the U. K. Companies Act, 1948.
3 Section 25(2) of the Protection of Depositors Act read with the Companies Act provision cited *supra*.
4 Section 4.
5 Crowther Committee Report (1970), page 61.
6 The Bank Act, 1967 of Canada applies to only banks named in Schedule 'A' to that Act. Schedule 'A' gives the names of ten banks.

of them without adequate public safeguards". It also recommended that those not covered by the banking legislation should be explicitly prohibited from engaging in 'banking'. This Commission has suggested the inclusion among *banking liabilities* of all term deposits, whatever their formal name, and other claims on institutions, maturing or redeemable at a fixed price, within 100 days of the time of original issue or of the time at which notice of withdrawal is given by the customer. That Commission feels that this dividing line between banking liabilities and others is admittedly arbitrary, but has suggested this to include "three-month claims with a margin to spare".

U.S.A.

11. In the United States of America, there are both Federal and State legislations on 'banking'. The Federal legislation deals with National Banks. The State legislations deals with State Chartered banks. The legislation provides for State banks (which are subject to the banking legislation of the States) converting themselves into National banks and *vice versa*. Persons uniting to form an association for carrying on the business of banking are required to state, *inter alia*, "the place where its *operations of discount and deposit* are to be carried on, designating the State territory or District, and the particular county and city, town or village". Any National banking association is empowered, *inter alia*, "*to carry on the business of banking ; by discounting and negotiating promissory notes, drafts, bills of exchange and other evidences of debt, by receiving deposits, by buying and selling exchange, coin and bullion ; by lending money on personal security ; and by obtaining, issuing and circulating notes . . . . . .*". The Federal law describes a State bank as "any bank, banking association, trust company, savings bank (other than a mutual savings bank), or other banking institution *which is engaged in the business of receiving deposits* and which is incorporated under the laws of any State . . . . ". Though 'banking'is not specifically defined, the legal provisions applicable to National banks indicate that the business of banking is understood mainly to consist of deposit and discount operations.

12. The position under the banking legislation of the States also seems to regard that essentially it is the acceptance of deposits and/or the carrying on of the business of discount operations that are regarded as 'banking' in its true sense. The Pennsylvania Banking Code of 1933 defined 'banking' as follows :

> 'Banking' means discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt ; receiving money and commercial paper on deposit or for transmission ; lending money on real or personal security ; buying and selling gold and silver bullion, foreign exchange, coin, or bills of exchange.

That Code has been replaced by the Pennsylvania Banking Code of 1965 which has been drafted by the Pennsylvania Banking Law Commission appointed to recommend revisions in the banking laws of Pennsylvania. The 1965 Code regulates banks, bank and trust companies, savings banks, private banks, employees' mutual banking associations and savings associations. It prohibits other persons from engaging in the "*business of receiving money for deposit or transmission*", unless they are authorised to do so under the Federal law. Thus, institutions engaged in the business of receiving money for deposit or transmission are covered by the Banking Code. In other words, unless authorised by the Federal banking legislation or by the banking legislation of the Commonwealth of Pennsylvania, it is not open to a person in Pennsylvania to engage in the business of receiving money for deposit or transmission. Thus, the essential feature of the business of banking in Pennsylvania is identified with the acceptance of money for deposit or transmission.

13. Legislation relating to "all savings banks, or savings companies, or trust companies, or other banking institutions" in the District of Columbia provides that if they have "an office or banking house located within the District of Columbia, *where deposits or savings are received*", they shall publish the reports required to be published by the Comptroller of Currency of national banking associations.

Australia

14. In Australia, a distinction is drawn between carrying on of "banking business" and that of "general banking business."[1] The Banking Act 1959-1967 and the Commonwealth Banks Act 1959-1966 contain the basic laws of the Commonwealth relating to the banking system but they do not cover "State banks." "State banking" has been held to cover 'banking' undertaken by a bank established and conducted by one of the six States which constitute the Commonwealth, or undertaken by an authority under State law and representing a State.

15. In State Savings Bank of Victoria Comrs. *v.* Permewan Wright & Co.,[2] the Australian High Court held that "the essential characteristics of the business of banking are the collection of money by receiving deposits upon loan repayable when and as expressly or impliedly agreed upon, and the utilisation of the money so collected by lending it again in such sums as are required." It was further held that "in order to bring a banker within the provisions of the Bills of Exchange Act, 1909 and the Instruments Act, 1890, it is not necessary that he should as part of his business collect cheques for his customers and pay their cheques." In Commonwealth of Australia and others *v.* Bank of New South Wales and others,[3] the Privy Council has held that in Australia the business of banking would be included in the ex-

1 Section 11 of the Banking Act 1959-1967 of Australia.
2 (1915) 19 C. L. R. 457.
3 L. R. (1950) A. C. 235.

pression "trade, commerce and intercourse," found in Section 92 of the Commonwealth of Australia Constitution, 1900. In this connectiom the Privy Council stated that "the business of banking, *consisting of the creation and transfer of credit*, the making of loans, the purchase and disposal of investments and other kindred activities, is a part of the trade, commerce and intercourse of a modern society."

South Africa

16. The Banking Act, 1942 of South Africa applies to persons or institutions which, as a regular feature of their general business, *accept deposits of money from the public.* A person is considered as carrying on the business of accepting deposits from the public, if he accepts as a regular feature of his general business, deposits from the general public, or from members in the case of a co-operative society, or if he advertises or solicits for such deposits. The Act groups banking institutions into four categories: "commercial banks," "people's banks," "loan banks" and "deposit receiving institutions." A "commercial bank" is defined as a person who carries on a business of which a substantial portion consists of the acceptance of deposits withdrawable by cheque. A "people's bank" is an association established for the purpose of promoting thrift among its members and of making loans to its members. A "loan bank" is a person (other than a people's bank) who carries on the business of accepting deposits and of granting small loans. All other persons carrying on the business of accepting deposits are defined as "deposit receiving institutions."

France

17. In France, enterprises or institutions whose cutomary business is to accept from the public, in the form of *deposits or otherwise*, funds which they use for their own account in discount, credit or financial transactions are considered as banks. The notion "funds received from the public" has been defined as the receipt of funds by an enterprise or a person in any form from a third party or on behalf of a third party, and which are subject to withdrawal. Deposits which an enterprise may receive from its salaried employees, unless the amounts of these deposits remain less than 10% of the capital of the enterprise, are regarded as deposits received from the public. Enterprises, other than banks, are prohibited from receiving from the public deposits repayable at call or for a period less than two years. Funds raised by issuing of bonds, or bonds not convertible into shares are also considered as deposits received from the public ; however, with the permission of the authorities, financial institutions can, for the exercise of their activity, use the funds obtained from debenture loans not convertible into shares for their economy and finance.

18. The Law of December 2, 1945 classifies banks into three categories: deposit banks, business banks (*banques d' affairs*) and long and medium-term

banks. Deposit banks are defined as banks whose principal activity consists in carrying out credit transactions and receiving from the public demand or time deposits. Business banks are banks whose principal activity in addition to granting credit, consists in acquiring and managing participations in business already in existence or in process of being formed. Long and medium-term credit banks are banks whose principal activity consists in granting credit for a minimum term of at least two years. They may not accept deposits, unless specifically authorised, for a term less than two years.

Italy

19. The *acceptance of deposits from the public, in any form,* and the granting of credit "are activities of public interest" governed by the Banking Law, 1936 of Italy. These activities are carried on by credit institutions incorporated under public law, banks of national interest, savings banks and private institutions, banks, agencies and enterprises authorised for such purposes. The privilege of taking deposits from the public are confined to these institutions and all other companies or firms are barred from taking deposits except from their own directors, partners, officials and employees.

Switzerland

20. The Banking Law of 1934 regards as banks "banks in the strict sense ; private bankers organised as individuals, firms or unlimited partnerships (*Kollektivgesellschaft*), or limited partnerships (*Kommanditgesellschaft*) savings banks ; and finance companies, similar to banks, which publicly solicit deposits."[1]

Belgium

21. In Belgium, enterprises which customarily receive deposits, payable on demand or within a period not exceeding two years, for the purpose of using them on their own account for banking, credit, or investment operations are subject to the Banking Law, 1935. Such enterprises are required to register with the Banking Commission, before they may undertake any operations.[2]

Netherlands

22. In Netherlands, the Act on the Supervision of Credit System, 1956, classifies credit institutions into commercial banks, agricultural credit banks, security credit institutions and general savings banks. "Commercial banks" are described as institutions making it their business to accept time or sight deposits and extend credit. There are proposals for a new Supervision of the

1 "Central Banking Legislation," Volume 2, page 725, published in 1967 by the International Monetary Fund.
2 Page 91 *supra.*

Credit System Act. Under the new Bill, credit institutions include general banks, agricultural credit institutions, security credit institutions and savings banks. "General banks" are described, under the new Bill, as "institutions which make it their business to a substantial extent to extend credit and on the other hand make investments, to obtain deposits on sight or on terms of up to two years and to attract savings deposits."[1]

Norway

23. In Norway, the Commercial Bank Act, 1961, applies to all enterprises which obtain funds for their activities by receiving deposits from an indeterminate body of depositors. "Commercial banks" shall be organised as joint-stock companies.[2]

Sweden

24. In Sweden, the Banking Act, 1955, concerns banking companies which have obtained Royal Charter to carry on banking business. Banking business includes acceptance of money deposits from the public.[3]

Finland

25. In Finland, the Bank Act, 1933, defines a 'bank' for the purposes of the said Act as a credit institution which accepts deposits from the public and generally uses the deposit money for banking operations.

West Germany

26. The Banking Law (1961) of the Federal Republic of Germany defines credit institutions as "enterprises engaged in banking transactions if the scope of the said transactions requires a commercially organised business enterprise. Banking transactions for purposes of the Law include the receipt of money from others as deposits, irrespective of the payment of interest (deposit business); the granting of money loans and acceptance credits (credit business); the purchase of bills and checks (discount business); the purchase and sale of securities for account of others (securities business); the custody and administration of securities for the account of others (safe-custody business); the incurring of the obligation to acquire claims in respect of loans prior to their maturity; the undertaking of guarantees and other warranties for others (guarantee business); and the effecting of transfers and clearings (giro business). The Federal Minister of Economics, may, after consultation with the Deutsche Bundesbank, designate by ordinance

1 Article on Netherlands' New Bank Act, in the 'Banker' of February 1971.
2 "Central Banking Legislation," Vol. II, page 518, published in 1967 by the tiInternaonal Monetary Fund.
3 Page 683 *.supra*

other transactions as banking transactions if this appears justified by usage and is compatible with the purpose of the Law."[1]

Japan

27. In Japan, under the Banking Law of 1927 an institution accepting deposits as a business is deemed a bank. An institution accepting deposits together with the lending of money or the discounting of bills, or which carries on exchange transactions is held as a bank. Banking business shall not be carried on by any other than a joint stock company, and unless a licence is obtained.

Philippines

28. In Philippines, only duly authorised persons and entities may engage in the lending of funds obtained from the public through the receipt of deposits or the sale of bonds, securities or obligations of any kind, and all entities regularly conducting such operations are considered as banking institutions and are subject to the provisions of the enactments regulating banks and banking institutions. The term "banking institutions" and 'bank' specifically include banks, banking institutions, commercial banks, savings banks, mortgage banks, trust companies, building and loan associations, branches and agencies in Philippines of foreign banks, and all other corporations, companies, partnerships, and associations performing banking functions in the Philippines. While these institutions are subject to banking regulation, others are prohibited from soliciting or receiving deposits of money.

29. Persons and entities which receive deposits only occasionally are not considered as banks, *but such persons and entities are subject to regulation by the Monetary Board of the Central Bank* nevertheless and in no case may the Central Bank authorise the drawing of checks against deposits not maintained in banks, or branches or agencies thereof.

Indonesia

30. The Government Ordinance bearing on the Supervision of the Credit System (1955) classifies credit institutions into commercial banks and savings banks. Commercial banks are "all enterprises and institutions, without regard to their legal form, which publicly offer, or, to a substantial extent, make it their business to accept monies on deposit *or* in current account and which engage in the granting of credits on private account." Savings banks are "all enterprises and institutions, without regard to their legal form, which devote themselves exclusively to the purposes of encouraging saving and, with that object, accept monies on deposit on such terms that the possibility of calling these monies is subjected to limiting provisions."

1 "Central Banking Legislation," Vol. II, page 278, published in 1967 by the International Monetary Fund.

Malaysia

31. In Malaysia, a distinction is made between a "borrowing business" and a "banking business"; but both are regulated. The Banking Ordinance, 1958 defines "banking business" as "the business of receiving money on current or deposit account, paying and collecting cheques drawn by or paid in by customers, and making advances to customers." The Borrowing Companies Act, 1969, defines "borrowing business" as :

(*a*) the acceptance of any money on deposit or loan by a person (in this definition referred to as 'the borrower') from more than ten persons wherein the borrower is under a liability (whether or not such liability is present or future) to repay the money to these persons ; and

(*b*) (*i*) the lending ;
(*ii*) the investment,

by the borrower, his agents or his servants (and if the borrower is a company, including its wholly-owned subsidiaries) of the borrower's funds,

and 'depositor' is defined as :

'depositor' means a person who deposits with or lends money to a licensed borrowing company.

The Borrowing Companies Act, 1969, is inapplicable to banks which :

(*a*) accept any money on deposit or loan which is repayable on demand by cheque, draft, order or any other instrument drawn by the depositor on the licensed borrowing company ; or

(*b*) deal in —

(*i*) gold ; or
(*ii*) foreign currency.

Under the Malaysian laws, the carrying on of "banking business" or the "borrowing business" is confined only to licensed companies.

Ceylon

32. In Ceylon, the Companies Ordinance, 1938, contains special provisions relating to banks. The definition of 'banking' referred to therein is the same as that introduced in India in 1936 in the form of an amendment to the Indian Companies Act, 1913. Thus, 'banking company' in Ceylon refers to a company which carries on as its principal business the acceptance of money on current account or otherwise, subject to withdrawal by cheque, draft or order.

ANNEXURE 'B'

'BANKING' DEFINITION OF 1949—HOW EVOLVED

Indian Companies Act Prior to 1936

The earliest enactment in India that dealt with the business of banking was the Indian Companies Act, 1913. While the nucleus of banking regulation came into being only by the amendment of the Indian Companies Act in 1936, even prior to that year, there were a few sections in that Act, which dealt with the business of banking, such as Section 4(1) which restricted the carrying on of the business of banking, otherwise than by incorporating the undertaking as a 'company', by any association or partnership consisting of more than ten persons and Section 136 which provided for certain statements to be published by banking and certain other types of companies.

Royal Commission on Indian Currency and Finance

2. The Royal Commission on Indian Currency and Finance, 1926, had stated that the term 'bank' or 'banker' should be interpreted as meaning every person, firm or company using, in its description or title, the word 'bank' or 'banker' or 'banking', and every company "*accepting deposits of money subject to withdrawal by cheque, draft or order*". However, that Commission had added that in view of the special conditions of indigenous banking in India, this matter would require more detailed consideration. We may note here that the 'banking' definition, which found legislative acceptance in 1936, was based on the definition suggested by this Commission in 1926.

Central Banking Enquiry Committee

3. The Indian Central Banking Enquiry Committee, 1931, after referring to the then position in this country, Canada and U.K., observed : "We find that the task of defining the term 'bank' or 'banker,' which has been regarded as well nigh impossible in other countries, is much more so in India where a definition cannot be drawn up without excluding many firms of indigenous bankers and individuals who do a considerable portion of the financing of the country".[1] That Committee was against the formulation of a precise definition. While stressing the need for a Special Bank Act,[2] that Committee observed :"what is really needed is a register of bankers without a hard and fast definition and we are of the opinion that the situation in India as regards indigenous bankers will best be met by an arrangement for the enrolment of

1 Report of the Indian Central Banking Enquiry Committee, 1931, p. 453.
2 Page 451 *ibid.*

such bankers as members of a recognised association".[1] The Committee further said :

> As regards companies using the term 'bank' or its 'equivalent' and desiring to be incorporated under the Bank Act, we recommend that the Act should lay down that adequate provisions*....should be incorporated in the Memorandum and Articles of Association of a company which wants to make use of the word 'bank' or the words 'savings bank', 'banking company', 'banking house', 'banking association' or 'banking institution', or any word or words of import equivalent thereto in connection with its operations. We also recommend that an existing company using any such title should arrange to conform to such provisions within five years after the Banking Act is passed, failing which registration in its existing name should be cancelled.[2]
>
> (* Here the Committee referred to the matters such a company should provide for in its Memorandum and Articles of Association).

From this requirement, "banks registered under the Indian Co-operative Societies Act or under any special charter or enactment, such as the Imperial Bank of India Act, and banks registered under laws of other countries" were to be exempted.[2] The Committee also visualised that "it would also be open to any unregistered firm or individual to use the term 'bank' " and that it would be "difficult to devise any means by which they can be prevented from doing so".[2] Thus, in the scheme of regulation envisaged by that Committee, it was not strictly necessary to define 'banking', though that Committee had referred to the summing up of the essential features of a 'banker' by Sir John Paget, the description of 'banking business' as given in the Enemy Banking Business Rules, 1918 of U.K. and the suggestion of the Royal Commission on Indian Currency and Finance, 1926, on the interpretation to be placed on the expression 'bank' or 'banker.'

1936 Difinition

Part X-A of the Indian Companies Act, 1913

4. As there was no immediate prospect of legislation dealing solely with banking companies, the nucleus of a scheme for the regulation of banking companies was introduced in 1936, by way of an amendment of the Indian Companies Act, 1913. While the provisions therein with reference to banking companies were based on the recommendations of the Central

1 Pages 454 and 455 *ibid.*
2 Page 455 *ibid.*

Banking Enquiry Committee, the actual proposals for legislation were formulated in the light of the report made by one Shri Sushil C. Sen, a lawyer with experience in the administration of Company Law. Shri Sen's report was considered by an informal committee appointed by the Government of India, consisting of business experts, under the Chairmanship of Sir N. N. Sirkar, Law Member to the Governor-General's Executive Council. The 'banking' definition which first gained statutory recognition and was enacted as part of Section 277F of the Indian Companies Act, 1913, was then proposed by Sir William Lamond,[1] who was a Member of that Committee and a Managing Director of the Imperial Bank of India. The aim of this definition was to identify a banking company, and this it did by defining it as a company "*carrying on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order*". This definition, as already stated, was based on the one suggested by the Royal Commission on Indian Currency and Finance, 1926. Companies registered *after* the commencement of the aforesaid 1936 amendment, *and* using as part of their business name, the expression 'bank', 'banker' or 'banking', were required to confine their business to—

(*i*) accepting of deposits of money on current account or otherwise subject to withdrawal by cheque, draft or order,

(*ii*) business permitted to be carried on by banking companies under Section 277F of the Indian Companies Act, 1913.

The provisions of the 1936 legislation, as regards banking companies, it was stated, "are intended to serve as a stop-gap legislation until such time as a comprehensive Banking Act is taken in hand".[2]

Scope of the 1936 Definition

5. What was the scope of the definition of 'banking' as contained in Section 277F of the Indian Companies Act, 1913? Apart from requiring that, to come within the scope of the legislation, 'banking' should have been carried on by the company as its principal business, the definition laid emphasis on "the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order".

Scope of the Expression "Cheque, Draft or Order"

6. The words "cheque, draft *or order*" meant that the withdrawal of deposits need not be by means of a negotiable instrument like 'cheque.' While an unconditional order, having the characteristics of negotiability, as a form of withdrawal, is implied in the words "cheque, draft", the expression "or order", at the end of this definition, requires a word of explanation.

1 Minutes of Proceedings of Company Law Amendment Committee, 1936.
2 Sushil C. Sen, "Indian Companies Act, 1913," 1937 Edn., page XXVIII.

7. In 1939, the Reserve Bank had tried to ascertain the extent to which cheques were used by non-scheduled banks. Of about 603 banks to whom the enquiry was addressed, 393 had replied. Of them, 274 issued cheques with respect to their current accounts. The practice varied with different banks as regards *savings deposits*. These deposits were mostly withdrawable by printed withdrawal forms accompanied by pass books and only a few banks had introduced cheques for this class of account. Fixed deposits were generally withdrawn on maturity on the presentation of the fixed deposit receipts duly stamped and discharged. Written orders by the customers were also permitted by many banks while withdrawing money from current and savings bank accounts and one bank had stated that people preferred to withdraw by written orders in spite of the introduction of the cheques. Banks which did not issue cheques generally used printed withdrawal forms which they called by various names, such as, *debit forms, written orders, withdrawal slips, cash orders, etc.* These orders often resembled the forms used in the Post Office for withdrawing savings bank deposits. A few banks did not use even withdrawal orders and in such cases, the customer or his representative went to the bank personally and signed in the bank's ledger in token of having withdrawn the money. In certain other banks, the practice was for the customer to ask personally for the money and to sign a receipt for the amount withdrawn. In the light of this, it is clear that the expression "or order" in Section 277F of the Indian Companies Act, 1913, referred to a form of withdrawal otherwise than by way of a negotiable instrument. This is further made clear by the comments of Sir N. N. Sirkar and Shri S. C. Sen, namely, that "the words 'or order' .... appear to have been inserted with the object of making the definition applicable to *ordinary loan companies* which do not use cheques or drafts and where monies are allowed to be withdrawn by depositors on orders signed by them".

Acceptance of Term/Fixed Deposits

8. The 1936 definition covered also acceptance of deposits whether repayable on demand or on the expiry of a term or after a specified period of notice, as the expression used was "current account *or otherwise*". Incidentally, we may mention here that the 1946 Select Committee (on the Banking Companies Bill, 1946) which had suggested the present statutory definition of 'banking' had also noted that the 1936 definition covered also the acceptance of time liabilities.

9. In the result, as per the definition of 'banking' which gained statutory recognition in 1936 (*vide* Section 277F of the Indian Companies Act, 1913), a company was regarded as a banking company if its *principal business* was acceptance of deposits whether repayable on demand or on the expiry of a term or after a specified period of notice. However, a company which accepted fixed deposits or even deposits repayable on demand which were withdrawable *otherwise* than by way of "cheque, draft or order", *e.g.*, by *a*

simple receipt, was not, under this definition, considered as carrying on the business of banking. As we will see later, the changes effected by the 1946 Select Committee ensured that acceptance of deposits withdrawable *otherwise* than by way of cheque, draft or order, *e. g.*, simple receipts, is also covered by the 'banking' definition.

Deposits "From the Public"

10. But, there were also certain other features of the 1936 definition, which deserve mention. There was no requirement that the acceptance of deposits should be "from the public". Even if a company accepted deposits only from its members or shareholders, that *per se* did not save the concern from being regarded as engaged in 'banking'.

Purpose of Acceptance of Deposits

11. Again, the purpose for which the deposits may be accepted was not a criterion as per the 1936 definition in considering whether a company qualified as a banking company. Thus, if acceptance of deposits withdrawable by any one of the said methods was the principal business of the company, the company was in law a banking company. In fact, companies having such acceptance of deposits as their principal business, but incorporated prior to the commencement of the Indian Companies (Amendment) Act, 1936, were not originally precluded from carrying on also manufacturing or trading activities. However, in 1942, the Indian Companies (Second Amendment) Act precluded *such* companies from having as part of their business any form of business other than those specified in Section 277F ; in the result, it was not open thereafter for banking companies to combine manufacturing or trading activities along with 'banking' business. Even thereafter, manufacturing and trading companies could take deposits withdrawable by "cheque, draft or order", so long as such acceptance was not regarded as their *principal business*.

Working of the 1936 Definition

"Principal Business"—Difficulty in Application

12. The concept of "principal business" posed considerable difficulties. The classification of companies into 'banking companies' and others was a problem faced by the Registrars of Companies after the Indian Companies (Amendment) Act, 1936. They could not decide the question easily. For instance, it was noted in November 1939 that out of an estimated total of 1,421 concerns which could have been considered as non-scheduled banks which operated in British India, only about 623 were giving their returns or maintaining their cash balances as required by the provisions of the Indian Companies Act applicable to banking companies. The rest had claimed that for various reasons they did not fall within the definition of 'banking

companies'. Test cases instituted against some of them by the Registrars of Companies, especially in Bengal, did not prove successful ; it was not possible to establish whether acceptance of deposits withdrawable by "cheque, draft or order" was their principal business or not. In fact, this drawback of the definition had been pointed out by Sir James B. Taylor, the then Deputy Governor of the Reserve Bank, to the Government of India in April 1936 while considering the proposals for the amendment of the Indian Companies Act, 1913. Sir James had then remarked :[1]

> Would it not be possible under the draft wording for a 'banking company' to evade the operations of this sub-clause by arguing that, though it did banking business as defined in Section 277E*, that business was not its principal business, *e.g.* a managing agency of a mill or similar company taking deposits ? If so, would this not drive a coach and four through the whole object of the draft which is to effect a clear separation between banking and other companies ?
>
> * later on renumbered as Section 277F)

Certain Companies Deemed to be Banking Companies

13. As the efforts of the Registrars of Companies by initiating certain test cases did not also prove helpful and as the Reserve Bank's proposal in 1939 to have a comprehensive Banking Act could not be put through by Government because of Government's pre-occupation with the Second World War, in 1942 it was considered necessary to amend the Indian Companies Act, 1913, in such a way that the Registrars could without much difficulty classify companies into banking companies and others, pending the proposals for a comprehensive Banking Act taking a formal shape. An amendment to the Indian Companies Act, 1913, was proposed suggesting that any company which used as part of its name the word 'bank', 'banker' or 'banking' should be deemed to be a banking company irrespective of whether the business of accepting deposits of money on current account or otherwise subject to withdrawal by cheque, draft or order was, or was not, its principal business. Opinions from the public were elicited by Government on this proposal.

Names Denoting Deposit Companies

14. On this, the Indian Institute of Bankers had suggested that the amendment should also cover "companies using as part of their names words

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1 In fact, Sir James had then suggested a restricted definition of 'banking,' namely, "accepting deposits of money on current account or otherwise subject to withdrawal by cheque." But this definition, by reason of the omission of the words "draft or order", would have left out many concerns accepting deposits which were not allowed to be withdrawn by the issue of cheques .In his subsequent proposals for a "comprehensive Bank Act," Sir James had proposed the definition suggested by him in 1936.

indicating their functioning as deposit companies in one form or another". Though the suggestion was logical, it was considered as not acceptable, as it was felt that :

> All we need guard against is depositors being misled by the use of a traditional designation

and as the :

> assumption of sound business management and regulation should be less strongly associated with institutions calling themselves by other similar names like '*deposit companies*', '*nidhis*', '*chit funds*' and what not, the degree of temptation to the depositor being in the descending order as the term used recedes further and further from synonymity with 'bank', 'banking', etc.

Moreover, it was felt, the number of companies using these miscellaneous terms in their designation formed a small proportion of the total number of companies likely to be affected by the proposed amendment. However, it was also then felt that :

> If experience shows later a tendency to circumvent this legislation by a change-over from 'bank', 'banking', 'banker' etc. to 'deposit', 'nidhi', etc. on a large scale and that the depositing public is thereby taken in, it might then be considered whether any further enlargement of the scope of the amendment is called for. By that time we may presume we should be in a position to proceed with our proposal for an Indian Bank Act and could embody therein an appropriate provision in this regard.

Amendment to Section 277F

15. As there was overwhelming support for the proposed amendment the following proviso to Section 277F of the Indian Companies Act, 1913, was enacted and this came into force with effect from the 1st November 1943 :

> Provided that any company, which uses as part of the name, under which it carries on business, the word 'bank', 'banker' or 'banking', shall be deemed to be a banking company notwithstanding that the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order, is not, or is not shown to be, the principal business of the company.

Registrars' Difficulties not Solved

16. However, it was also realised then that the amendment did not completely solve the difficulties faced by the Registrars of Companies in classifying companies as banking companies and others. Even after this

amendment, if a company carried on the business of banking as contained in Section 277F, the Registrar had to deal with it as a banking company if the acceptance of such deposits by the company was its principal business. Moreover, practically, it was possible to go out of the reach of the regulation and still carry on banking business (subject to the Registrar establishing that the principal business of the company was acceptance of such deposits — a possibility which was rather remote) by holding itself out as a company doing banking "in every way other than that of incorporating the word *in the name* under which it carries on business", *e.g.*, "Ramlal & Co. Ltd., Bankers and Agents. All kinds of banking business transacted". However, while this possibility was known, it was then felt that "no glaring type of cases imagined have come to notice and in any case the Registrar can still decide on merits if such a company is in reality a banking company".

'Banking' Definition under the Bank Act

Different Stages

17. The amendment of the company law in 1936 was only an interim measure, as there was "no immediate prospect of legislation dealing solely"[1] with banking companies. Soon after the amendment of the company law in 1936, proposals for a comprehensive Banking Act were taken up by the Reserve Bank with the Government. In November 1939, the proposals for a separate legislation for banking companies were submitted to Government by the Reserve Bank. The Government, however, could not bring forward its Bill before the Legislature till 1944, due to its pre-occupation with the World War. The 1944 Bank Bill lapsed and had to be introduced again by the Government in 1946, when it was named as the Banking Companies Bill, 1946. In 1946, the Bill was referred to a Select Committee which made radical changes in the Bill. Even the 1946 Bill was withdrawn by the Government. The Government introduced the measure again before the Constituent Assembly (Legislative) and again referred it to another Select Committee. After that Select Committee gave its Report, it was passed by the Constituent Assembly (Legislative) and the Act came into force with effect from the 16th March 1949. Thus, the proposals for a Bank Act which were conceived in 1939, had a long gestation of nearly a decade, and came into force as law after undergoing several modifications at various stages. Sir James Taylor, who formulated the original proposals in November 1939, and the two Select Committees of Parliament bestowed considerable attention to the 'banking' definition.

Sir James Taylor's Proposals

18. The original proposals took note of the fact that the definition as contained in Section 277F of the Indian Companies Act, 1913, had given

1 Statement of Objects and Reasons of the Indian Companies (Amendment) Act, 1936.

rise to difficulties in application. While Section 277F defined a 'banking company', for the first time it was considered that in the proposals for a comprehensive Banking Act, 'banking' should be independently defined "in a clearer and more definite form". "This procedure", it was felt, would "make it possible, if considered necessary, to include legislation to cover individual bankers or groups or joint families, etc., doing banking business even if they are not joint stock companies". The proposals, as drafted by Sir James Taylor, defined 'banking' as "*the accepting of deposits on current account subject to withdrawal by cheque*". Sir James felt that the definition should be limited to the minimum required, which was "to protect the public when they deposit their money with institutions or individuals calling themselves banks or bankers". "In this way", he expressed, "a clear general line could be drawn between the scope of the Companies Act and the proposed Bank Act. The scope of the former is generally to protect the shareholders, and that of the latter to protect depositors, in the same way as the object of the recent Insurance Act is to protect those who are insured, the protection of shareholders in Insurance Companies being left to the Companies Act. This of course is not correct in every detail, the two interests must impinge in places, but it would seem a sound general principle to follow to avoid confusion".

19. The definition suggested by Sir James Taylor differed in scope from the one contained in Section 277F of the Indian Companies Act, 1913, in the following respects :

(*i*) In the first place according to Section 277F the accepting of deposits withdrawable by cheque should be the *principal* business of a company if it is to be classed as a banking company. There is no reference to *principal* business in the definition given in the the bank bill .... Moreover by restricting the use of the word Bank only to such companies which carry on banking business according to the proposed definition the public will no longer be misled into keeping their deposits with semi-banking concerns. *Every institution therefore accepting deposits on current account however small will be called a bank* and will therefore be subject to the provisions of the Bank Act.

(*ii*) Secondly, the words 'or otherwise' after the words 'current account' have been omitted in the new definition. According to Section 277F a company could be a bank even if it carried on the business of accepting savings bank deposits withdrawable by cheque but the definition in the Indian Bank Bill makes it indispensable for an institution to accept deposits on current account before it can be called a bank. It is quite possible that many South Indian banks might try to evade the provisions of the Act by accepting fixed deposits and savings deposits subject to check only and drop current accounts altogether. It is assumed how-

> ever that they will be content in calling themselves as loan or finance companies or corporations. The general public however has come to regard institutions giving out cheque books as banks and it is therefore quite likely that many people would still be misguided by such companies into keeping a good deal of deposits on fixed and savings accounts with such institutions. Inasmuch as the proposed definition appears to regard cheque-system as *sine qua non* of banking it will be desirable to retain the words 'or otherwise' after the words 'current account'.

20. In the light of what was stated above, Sir James Taylor agreed to add the words "or otherwise" after the words "current account". But on the question whether only acceptance of deposits withdrawable by cheque should qualify as 'banking', he was not in favour of including within the scope of 'banking' the acceptance of deposits withdrawable otherwise than by way of cheque, and he did not accede to the suggestion to add the words "draft or order" after the word "cheque" in the definition proposed by him, though it was pointed out to him that :

> the words 'or order' in the opening part of the section (Section 277F) appear to have been inserted with the object of making the definition applicable to ordinary loan companies which do not use cheques or drafts and where moneys are allowed to be withdrawn by depositors on orders signed by them

and

> owing to the fact that the cheque habit is not widely spread in India some banks allow withdrawals of deposits by orders specially in the case of savings bank deposits. It may be added that there is no fundamental difference between a cheque and an order. If banks are permitted to allow their customers to operate on their savings bank account by means of orders some of the intentions of the proposed Act may be frustrated thereby. This point is highly important particularly in view of the fact that in most cases savings bank accounts are being operated upon as if they were current accounts. Moreover a bank can easily evade the intentions of the Act by accepting all kinds of deposits including current accounts subject to withdrawal by order and generally carry on banking business provided it does not call itself a bank.

But, Sir James Taylor felt that the addition of the words "draft or order" in the definition of 'banking' suggested by him would upset the whole basis of the definition as proposed by him, which was intended by him to connect 'banking' definitely with the issue of cheques. He expressed :

> As for the words 'draft or order' it might appear at first sight that most of the objections to our definition could be met if they

are added to the draft clause but this does not really help to solve the present difficulties to any considerable extent. The addition of the words will no doubt bring within the scope of the proposed Act a good many credit institutions like the loan companies in Bengal, but the difficulty about non-banking companies receiving deposits such as the Ahmedabad Textile Mills will still remain inasmuch as these Mills accept deposits withdrawable by order. It therefore appears that the definition suggested by us in the draft bill is preferable to that in the Indian Companies Act though it will leave out of account a good many institutions like the loan companies in Bengal which do not issue cheques.

Overlapping of the Definitions of 'Banker' and 'Cheque'

21. As per the definition suggested by Sir James Taylor, a banker would be one who accepted deposits on current account or otherwise subject to withdrawal by cheque. But a 'cheque' has been defined in the Negotiable Instruments Act, 1881, as an unconditional order on a *banker* payable on demand. Thus, there was a certain amount of overlapping of the definitions of 'banking' as then proposed and of 'cheque'. On a review, Sir James Taylor felt that "the words 'withdrawable by cheque' in the definition proposed in the draft Bill do not commend themselves and that it would be better to define 'banking' as the *accepting of deposits repayable on demand*". Sir James felt that the new definition had two advantages :

In the first place it will remedy the overlapping between the definitions of 'banking' or 'cheque' referred to above and secondly it will overcome the shortcomings arising out of the omission of the two words 'draft or order' in the bill. Under the definition now proposed the more important non-scheduled banks in Bengal will presumably be regarded as banks since so long as their deposits are repayable on demand they will have to conform to the bank law irrespective of whether such deposits are withdrawable by cheque, draft, or order. The new definition will not, moreover, inconvenience non-banking companies such as the Ahmedabad Textile Mills *so long as they do not accept demand deposits.* The only important objection to this definition, so far as can be seen, will be that certain institutions might attempt to evade the law by accepting only time deposits or deposits repayable after a few days and lending them to the public *thereby performing the main functions of banking* without being subject to the banking law. This difficulty however should be surmounted by confining the use of the word 'bank' to institutions accepting demand deposits and by prohibiting non-banking companies from using this nomenclature as provided in clause 5, so that if the public want the protection provided by the bank bill they must see that they invest only in institutions which call themselves banks.

Review of the Proposals in 1944

22. The 1939 proposals for a comprehensive Bank Act could not be proceeded with by Government till 1944 due to their pre-occupation with the Second World War, though, as already stated, some interim measures were taken in 1942. In the beginning of 1944, at the instance of its Central Board, a review was undertaken in the Reserve Bank of the proposals for banking legislation. In this review, on the definition of 'banking', as proposed in 1939, it was expressed :

> Our draft bill proposed to define banking as 'the accepting of deposits on current account or otherwise subject to withdrawal by cheque'. This definition was generally opposed, the opinion among the critics being that it was too narrow and restricted and that it would leave out of account a good many institutions which are not issuing cheques but which carry on the *primary functions of banking, viz. the collection of the savings of the community and placing them at the disposal of trade and industry.* In fact even now this is the greatest obstacle in the way of a satisfactory definition. In India there are a large number of companies which do not call themselves banks but which in essence carry on the functions of banking companies. To give only two instances we may cite the cases of the Nidhis and the Funds of the Madras Presidency and the Loan Offices of Bengal. It is extremely difficult to bring these two classes of companies under the definition of banking, and a large number of loan offices have already classed themselves as non-banking companies and their contention in some cases has been upheld by the Court. *A somewhat interesting result of the Indian Companies (Second Amendment) Act, 1942 has been that some of the Nidhis and Funds, have dropped the word 'bank', 'banker' or 'banking' from their names in order to evade the provisions of the Companies Act relating to banking companies.* The difficulties of defining banking companies are enhanced by the fact that in several countries of the world such as for instance, the United States and Great Britain, there are no legal definitions of banking, and the definitions already obtaining in certain countries such as the Argentina, Belgium, Italy, Japan, Denmark etc. do not appear to be suitable for India. . . . . the essential points to be made clear in the legal definition of banking are (*i*) if an institution calls itself a bank, it must conform to the law relating to banks and (*ii*) it should not be open to institutions which do not call themselves banks to perform the most essential functions of banks *i.e.*, to receive the public money on current account. On the whole it appears that *the matter can be simplified by retaining the existing definition as amended by the Indian Companies (Second Amendment) Act, 1942*, subject to further provision being made for prohibiting banks from trading activities . . . . .

In this connection, an apprehension was felt that the definition of 'banking' as proposed by the Reserve Bank would affect shroffs, mills or

concerns which accepted deposits on current account. The proposed legislation was to apply only to companies and shroffs would not have been affected. And, it was felt that :

> If mills accepted deposits on current account, they would be subjected to the discipline prescribed by the Act ..... there were varying practices as regards banking in different Provinces and .... we could not take notice of all of them in making a uniform set of legal provisions. We had therefore to keep before us the objective of safeguarding the interests of depositors and adopting the largest amount of common measure for this purpose.

The Reserve Bank finally took the view that the definition of 'banking' it has proposed, namely, "the accepting of deposits repayable on demand" should be adhered to and that industrial concerns or other companies which accept deposits should either convert such deposits into time deposits — it was felt that this should not be a difficult matter for them to arrange — or give up that type of business.

Draft Bank Bill

Accepting of Time Deposits vis-a-vis 'Banking' Definition

23. On the draft Bank Bill sent in 1944 by the Reserve Bank to the Government of India for consideration, a view was expressed in the Finance Department that time deposits appeared to form an essential feature of banking "since it is largely on the basis of time deposits that longer term investments can be made and so profit be earned by the bank". For this reason as well as to eliminate as far as possible any loopholes for escape from the operation of the Act, the inclusion within the scope of the definition the acceptance of both demand and time deposits was suggested. The Reserve Bank was not then agreeable to this suggestion. It was of the view that :

> The suggestion is beset with several difficulties. In the first place, there are a very large number of non-banking institutions in India such as the Bombay and the Ahmedabad Textile Mills which accept time deposits from the public and it is not the intention to bring such institutions within the scope of the definition or to prohibit them from accepting time deposits. Secondly, although the proportion of demand to time deposits of the scheduled banks before the war was 55 : 45, at present it has risen to 75 : 25 ; and even in the case of non-scheduled banks, the demand liabilities are nearly equal to the time liabilities. Thirdly our definition falls in line with that suggested by Dr. Leaf in the light of modern banking practice in his book 'Banking' and also with the one suggested in the book entitled 'Commercial Banking Legislation & Control' by Allen and others. Further ..... our primary aim is to

limit, by connecting banking definitely with the issue of cheques, the scope of the legislation to those institutions in which funds are deposited primarily to ensure their safety and withdrawability. Moreover, the orthodox commercial banking practice is against making long-term loans or locking up more than 50 to 60% of the deposits in commercial advances. In our opinion, the proposed addition of time deposits to the definition is not advisable.

Public Opinion on 'Banking' Definition in 1944

24. The Central Legislative Assembly agreed to the Finance Member's motion to circulate the Banking Bill, 1944, for public opinion. The views of the public were considered by the Reserve Bank in April 1945. The nature of the opinions expressed and the Reserve Bank's views thereon were stated as under :

> Sub-clause 5(b) defines banking as the accepting of deposits repayable on demand. The various opinions on the proposed definition once more serve to bring out the difficulties of evolving a definition of banking acceptable to all. Several critics including the Bombay Chamber of Commerce, Buyers and Shippers Chamber, Karachi, Cochin Chamber of Commerce, South Indian Joint Stock Banks' Association and Bank of India regard the definition as too wide inasmuch as it covers non-banking concerns, accepting deposits repayable on demand, while other critics such as the Bombay Shroffs' (Bankers) Association, Marwari Chamber of Commerce, Calcutta, Narang Bank of India, Lahore, Bihar Central Bank Ltd., Darbhanga, Commercial Bank of India, Lahore, consider the definition too narrow as it excludes institutions accepting only time deposits. Many others including the Imperial Bank of India prefer the existing definition contained in Section 277(F) of the Indian Companies Act, and a few prefer the definition of banking suggested by the Reserve Bank of India in 1939. Several drafting improvements in the proposed definition to prevent the circumvention of the definition and thereby of the Bill have been suggested, and various new definitions have also been put forward. No one has, however, been able to evolve a better definition, and we propose to adhere to the definition in the Bill which appears to be the most suitable and to enjoy the largest measure of agreement.

Some commercial bodies had felt that the proposed definition would affect many forms of commercial activity throughout the country. The Reserve Bank considered this objection and felt that :

> The Chamber of Commerce have probably in mind those commercial concerns which accept deposits. As a majority of such concerns accept only time deposits, they will not be affected by the present definition.

If they accept deposits repayable on demand, there is no reason why they should not be subject to the discipline of the banking legislation.

SELECT COMMITTEE, 1946

25. The Banking Bill, 1944, having lapsed, the Government reintroduced it again in 1946 under the name "the Banking Companies Bill, 1946" and referred it to a Select Committee of the Central Legislative Assembly. The Select Committee examined 17 witnesses including representatives of bankers, shareholders, etc. The Select Committee gave the go-by to the 'banking' definition as proposed in the Bill. Taking the 'banking' definition contained in Section 277F of the Indian Companies Act, 1913, as the basis, the Committee widened the scope of the definition in certain respects and restricted it in certain other respects. The definition now found in Section 5(b) of the Banking Regulation Act, 1949, is the one proposed by this Select Committee.

Views of the Select Committee Members

26. On 'banking' definition, the Select Committee Members had certain definite views. One section of the Committee favoured that '*banking business should be defined as receiving deposits from the public*'. This section was insistent that acceptance of time liabilities should be covered by the definition. While so doing, this section did not want that even acceptance of fixed deposits withdrawable against simple receipt should be excluded. There was another section of the Committee that wanted to exclude the acceptance of deposits by trading and manufacturing concerns from the scope of the 'banking' definition. The definition that ultimately commended itself to the Select Committee (1946) reflected both the views. The Select Committee accommodated the view that acceptance of time liabilities also should be brought within the scope of 'banking' definition, but added a rider providing that the acceptance of deposits should be *for the purpose of lending or investment.* The rider was added with a view to exclude from the scope of the definition the acceptance of deposits by trading or manufacturing concerns, in their capacity as such. This Select Committee, however, sought to preclude companies, other than 'banking companies' from carrying on the business of 'banking' *as originally defined in the Bill, i.e.*, "acceptance of deposits withdrawable on demand". These provisions read together aimed to confine the application of the scheme of banking regulation only to companies taking deposits (whether repayable on demand or otherwise) for the purpose of lending or investment ; but sought to prevent manufacturing and trading companies from accepting deposits withdrawable on demand which was considered as a very important form of banking.

Select Committee's Report

27. On the 'banking' definition, the Select Committee (1946) reported : 'Clause 5.—We have given earnest consideration to the definition of 'banking'

and while we appreciate the difficulties to which the present definition in the Indian Companies Act, 1913, has given rise, we feel that the brief definition in Bill is not altogether satisfactory. We have, therefore, after studying the definitions given by Halsbury and other authorities, elaborated the definition to include the acceptance of time deposits, while our *new clause 8* prohibits companies "other than banking companies from engaging in business of the nature specified in the Bill's original definition". This Select Committee defined 'banking' as :

> the accepting, for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise.

The Select Committee also proposed the new clause 8 providing that :

> No company other than a banking company shall accept deposits repayable on demand.

From the Public

28. While the Select Committee (1946) included acceptance of time liabilities within the scope of the 'banking' definition, it has added the words "from the public". The Select Committee has not given its reasons for this addition. These words were not there in the 1936 definition. Under that definition institutions such as 'Nidhis', 'Permanent Funds' which *accepted deposits only from their members* were also classed as 'banks', if they were companies. Some of them, as noted earlier, went out of the scheme of banking regulation by reason of their not having, or dropping the expression 'bank', 'banker' or 'banking' as part of their names. One section of the Select Committee (1946) actually felt that such companies should also come under the sweep of the banking regulation. No clear indication is available as to whether by the addition of the words "from the public" in the definition the Select Committee intended to exclude acceptance of deposits by companies from their own members; however, these words seem to have been so understood.

Mr. C. P. Lawson's Suggestions

29. Subsequent to the recommendation of the Select Committee (1946) to amend 'banking' definition, on the above lines, Mr. C. P. Lawson, M.L.A. (Central), who was also a Member of the Select Committee, had taken up with the Government the question of modifying the 'banking' definition in order to exclude from its scope companies which :

> borrow money repayable on demand or otherwise, for the express purpose of lending or investing either in the business of a subsidiary company or in other businesses in which the borrowing company may have a business interest.

Again, he had voiced that a company may take money by way of security deposit which is intended to be invested in Government paper or something of that kind until it is repaid, and that such activities should also be excluded from the scope of 'banking' definition. In order to achieve this, he had suggested that the words "or otherwise" at the end of the 'banking' definition as recommended by the Select Committee, may be omitted. It appears that the Reserve Bank was not disinclined to accept the suggestion, but had suggested some refinement to the amendment proposed by Mr. Lawson. As then suggested by the Reserve Bank, the 'banking' definition would have read as under :

> 'Banking' means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by a negotiable instrument or order.

Deposits and Borrowings

30. While the Government felt that the case of companies receiving security deposits would not be considered as "acceptance of deposits from the public", the Government also felt that in the definition as suggested by the Select Committee, it is likely that borrowings by companies for the purpose of lending or investment, in their subsidiaries, or in another company in whose business they are interested may be hit by the definition. This was on the view that :

> in law it would be difficult to draw a distinction between 'money deposited' and 'money borrowed', for the legal position is that money paid into a current account is money lent by the customer to the banker. In fact Lord Chancellor Cottenham expressly guarded against the misconception arising from the use of the word 'deposit' in connection with moneys paid to a banker, as will be seen from the following passage in Foley *v.* Hill [(1848), 2 H.L.C. at pp. 35-38] :
>
> > 'If . . . . a sum of money had been deposited with the banker—— I will not say 'deposited', but paid to the banker——. . . . . '

Significance of the Second 'Or Otherwise'

31. However, the suggestion of Mr. Lawson was not acceptable to the Government. This was on the view that this definition would have left out persons who accept only time deposits and that it was the considered opinion of the Select Committee (1946) that such persons too should be regarded as carrying on the business of banking. It was said :

> That being so, the retention of the gambit 'on demand or otherwise' is inescapable.

But the use of the second 'or otherwise' could be justified only on the hypothesis that the intention of the Select Committee was to rope in people who borrow money through 'fixed deposits' which are repayable on maturity on a simple receipt. If so, the second 'or otherwise' will also have to be retained notwithstanding the fact that the instances cited by Mr. Lawson will be caught by the definition.

In the result, the Government felt :

The words 'or otherwise' after 'repayable on demand' in the present definition were adopted by the Select Committee with the express object that banks working only on time and savings deposit should not be able to escape the provisions of the Bill. There is, therefore, no question of now going back to the original simple definition and any such proposal is not likely to be acceptable to the members of the Legislature.

For the same reason it is not possible to omit the words 'or otherwise' at the end of the definition since it is pointed out by the Legislative Department that fixed deposits are withdrawn by a simple receipt which is not a negotiable instrument. *By dropping the second 'or otherwise', the object for which the first 'or otherwise' has been introduced will be lost and banks which take only fixed deposits which can be withdrawn by merely signing a receipt at the back of the fixed deposit receipt will be removed from the purview of the Bill.* In the conditions as they exist in India small banks may in fact work only on time deposits and might, in the beginning of their life at least, find it difficult to operate current accounts. It is necessary that such banks should also be subjected to the provisions of the bill.

BANKING COMPANIES BILL, 1948

32. The Banking Companies Bill, 1946, was, however, withdrawn and a fresh Bill was introduced on the 22nd March 1948 incorporating a few more amendments. This was referred to another Select Committee. On the definition of 'banking' as proposed by the Select Committee, 1946, many industrial and commercial houses had suggested, in the meantime, the deletion of the words "order or otherwise" at the end of the definition. On this, the Reserve Bank had remarked :

The Select Committee of the 1946 Bill extended the scope of the definition so as to include banks working on time and savings deposits. It does not seem desirable to omit the words 'order or otherwise' at the, end of the definition since the Law Ministry has pointed out that fixed deposits can be withdrawn by a simple receipt. The point is, however, being further examined by the present Select Committee.

Select Committee, 1948

33. The Select Committee, 1948, met the delegation of the Indian Banks' Association headed by Sir Homi Mody, went through the memorandum containing the views of the said delegation, and submitted its views. On 'banking' definition as suggested by the 1946 Select Committee, this Committee mentioned in its Report :

> The mere acceptance of deposits by companies, like textile mills, etc., for the purpose of financing their own businesses should not be regarded as 'banking' *within the meaning of this Act*, and although we are given to understand that this would be so even under the existing definition of 'banking', we have thought it advisable to make the legal position clear by adding an Explanation to this effect in the definition of 'banking company'.[1]

The Explanation as suggested by the Select Committee ran :

> *Explanation*—Any company which is engaged in the manufacture of goods or carries on any trade and which accepts deposits of money from the public for the purpose of financing its business as such manufacturer or trader shall not be deemed to transact the business of banking within the meaning of this clause.[2]

The Select Committee also suggested the deletion of the Clause suggested by the 1946 Select Committee providing for the prohibition of non-banking companies accepting deposits repayable on demand. Thus, the move to ban manufacturing and trading companies from accepting deposits repayable on demand was dropped.

Addition of the Word "Merely"

34. During the clause by clause consideration of the Bill, the Finance Minister, Dr. John Matthai had suggested the addition of the word "merely" after the words "from the public" in the Explanation proposed "to make it absolutely clear that the class of companies which are excluded from the scope of this Bill are companies which accept deposits for the purpose of financing the business in which they are engaged".[3]

Summary of Developments in India regarding 'Banking' Definition

35. To summarise, though the framing of a satisfactory definition of 'banking' was beset with difficulties, in the context of banking regulation, a

1 Report of the Select Committee, 1948, page 1.
2 Report of the Select Committee, 1948, page 12.
3 Debate on the 10th February 1949 in the Constituent Assembly (Legislative).

statutory definition of 'banking' was framed in 1936. The definition is related to the objectives of banking regulation, namely, the safeguarding of the interests of the depositors, and the protection of public interest. The 1936 definition treated as banks all companies, having as their principal business, accepting of deposits from the public which were allowed to be withdrawn at the order of the depositor. As per this definition, the purpose for which deposits were accepted was not material ; nor was it necessary that the deposit should be accepted from the public at large. Considerable experience had been gained in the practical application of the 1936 definition. The test of 'principal business' did not prove to be of much help ; it created more problems than it solved. While acceptance of all types of deposits, *i.e.*, on current account, savings deposits, fixed deposits, etc., was included in the 1936 definition, a company could avoid the requirements of banking legislation by making the deposit withdrawable otherwise than on the 'order' of the depositor, say, by allowing withdrawal on a simple receipt from the depositor. Under the 1936 definition, the purpose for which the company accepted deposits was also not relevant ; hence, in the period 1936 to 1942 even mills and industrial concerns accepting deposits were liable to be classified as banks, if such deposit-taking was their 'principal business'. Since 1942, such concerns were forced *not* to have such deposit-taking as their 'principal business' (they were not stopped from taking deposits) if they wanted to combine 'banking' and 'non-banking' activities. Again, under the 1936 definition, even a company taking deposits from its 'members' was classed as a banking company.

36. The 1949 definition had profited by the experience gained in applying the 1936 definition. While the original proposals were to regulate only companies taking demand deposits from the public, the Select Committees and Constituent Assembly (Legislative) had amended the proposal so that the regulation would apply also to companies merely taking term/fixed deposits *even* though such deposits were withdrawable otherwise than by the 'order' of the depositor, *e.g.*, deposits allowed to be withdrawn by a simple receipt. In doing so, the legislature was having primarily the safety of the depositors in view. The test of 'principal business' was given up even at the stage of the original proposals for banking regulation in 1939. The 'purpose' of taking deposits became material, that is, for a company to come within the scheme of banking regulation as envisaged in the Act, it should accept deposits from the public for the purpose of lending or investment. Attempts to reduce the scope of 'banking', and thereby of banking regulation, only to companies taking deposits repayable on demand and/or on the strength of a negotiable instrument did not find favour with Government and the Constituent Assembly (Legislative).

CHAPTER 3

BANKS, BANKING INSTITUTIONS AND BANKING REGULATION

We have considered the definition of 'banking' for the purpose of banking regulation. While due to limitation of time and other practical considerations it is not possible for us now to go into details, we may, however, set out in brief outline the scheme, which we consider as desirable, for the regulation of 'banking'.

CATEGORIES OF BANKING INSTITUTIONS

3.2 Any scheme of banking regulation has to take note of, and provide for, the categories of institutions which could be regarded as carrying on banking business in one form or the other. This requires an appropriate classification of banking concerns. Such classification of banking institutions, in the conext of banking regulation, is found in most countries, *e.g.*, U.S.A. (both the Federal and the State banking legislations), France, South Africa, and Philippines. We consider that for the purpose of banking regulation in India, banking concerns should be appropriately classified. Having regard to the form of liabilities undertaken (demand/chequeable liabilities, or time liabilities, or both), the types of institutions accepting such liabilities and the purpose of such acceptance, banking institutions could be classified into certain categories.

3.3 Based on the form of liabilities undertaken, banking concerns could be classified as institutions which take deposits withdrawable by cheque or other like negotiable instruments (shortly, "chequeable deposits") and those which do not accept chequeable deposits. Having regard to the purpose for which deposits are obtained, deposit taking could be classified into acceptance of deposits either for the purpose of lending or investment, or for the purpose of financing the borrowing person's own business such as manufacture or trade. These distinctions are based on the form of banking business carried on. Again, from the legal status of the persons carrying on banking business, those who could be regarded as engaged in the business of 'banking' are either :

(*a*) Statutory corporations wholly or substantially owned by the Central Government, directly or indirectly (shortly, 'national banks') ; or

(*b*) Societies registered under the Co-operative Societies Acts ; or

(*c*) Companies incorporated under the Companies Act ; or

(*d*) Individuals and firms who carry on business as sole proprietary concerns, partnership firms or joint family firms.

Thus, banking regulation has to take note of the distinctions in the type of institutions carrying on banking business having regard to—

(*i*) the form of banking business carried on by them ; and/or

(*ii*) the legal status of the person carrying on the business.

We proceed to consider the scheme of regulation of concerns carrying on banking business in one form or the other. While dealing with the distinctions based on the form of banking business carried on, we shall also advert to the differences in the legal status of the persons carrying on such forms of banking.

A. Acceptance of Chequeable Deposits

3.4 First, we shall deal with the business of accepting chequeable deposits. Chequeable deposits are money in the economic sense ; they are near substitutes for legal tender currency. The two important characteristics of money, that is, being a store of value and a medium of exchange, are fulfilled by chequeable deposits. With the spread of the banking system, the use of cheques as an effective medium of payment is bound to grow. Hence, the need may be felt for such institutions strictly conforming to the provisions of the banking regulation intended to further the objectives of monetary policy. It may be that banking institutions which are not taking chequeable deposits need not be subjected to monetary control of the same kind as institutions accepting chequeable deposits.

3.5 Hence, it is that chequeable deposits are allowed to be accepted in most countries only by selected institutions which come under the close supervision and control of the monetary authority. Generally, such business is allowed to be carried on under the banking legislations of several countries only by institutions which are specially classified as 'banks', 'commercial banks', etc., and which are allowed to accept such deposits and carry on lending or investment activities. These institutions are subjected to stricter supervision and control. Such institutions, by reason of their power to create credit, play an important role in the economic development of the country. "This power of the banks to create credit is of great economic importance, and it is essential, therefore, that the monetary authorities should have power to control it according to the monetary policy they wish to pursue."[1] The importance of accepting chequeable deposits, in the context of national economy,

1 Hanson J. L. "A Dictionary of Economics and Commerce," Macdonald & Evans Ltd., 1965 Edn., page 108

has also been judicially recognised in our country.[1] If we look at the banking legislation in countries where there are comprehensive codes dealing with banking regulation (*e.g.*, U.S.A.—Federal and State banking legislations—, Philippines and South Africa), we find that the privilege of accepting chequeable deposits, or demand deposits, is confined only to a special class of banking institutions which are required to conform to higher standards under the schemes of the regulation applicable to them.

3.6 That is also the position in India. Only certain specified or approved institutions are now permitted to accept deposits withdrawable by cheque. Section 49A of the Banking Regulation Act, 1949, provides that no person other than a "banking company, the Reserve Bank, the State Bank of India, or any other banking institution, firm or other person notified by the Central Government in this behalf, shall accept from the public deposits of money withdrawable by cheque ; provided that nothing contained in the section shall apply to any Savings Bank scheme run by the Government". Though the section refers also to "firms or other persons", so far no firm or individual has been notified by the Central Government under Section 49A *ibid* and thus enabled to accept deposits withdrawable by cheque.

(*1*) *Ambiguity of Section 49A*

3.7 While referring to Section 49A *ibid* (which lays down that only certain approved banking concerns can accept deposits withdrawable by cheque), it is relevant to point out the existence of some ambiguity in the section by reason of the reference to 'cheque'. The Negotiable Instruments Act, 1881, defines 'cheque' as an unconditional order to pay on demand, *drawn on a banker.* This means that only certain approved banking concerns can accept deposits which could be withdrawn by an unconditional order to pay drawn on a banker. It may be difficult to apply this provision when the deposits are made withdrawable on demand at the order of the depositor, but the person taking such deposits does not admit that he is a banker. In fact, it was the overlapping of the definition of 'cheque' and the definition of 'banking' (as acceptance of deposits withdrawable by cheque) that made Sir James Taylor to modify his definition of 'banking', as "acceptance of deposits withdrawable on demand".[2] In view of this, and having regard to the object of the provision, the reference to 'cheque' may have to be substituted by the expression "cheque or other negotiable instrument payable on demand". Moreover, having regard to the *economic significance* of chequeable deposits, there is no justification for differentiating between deposits withdrawable by 'cheque' and other kinds of deposits repayable on demand against any negotiable instrument. Any such differentiation would also

1 Sajjan Bank Ltd. *v.* Reserve Bank of India (A.I.R. 1961 Mad. 8) ; and Itty Kurian and another *v.* Union of India and others (A.I.R. 1962 Kerala 267).
2 Paragraph 21 of Annexure 'B' of Chapter 2.

stultify the effectiveness of Section 49A of the Banking Regulation Act, 1949. Incidentally, we may also herein observe that the expressions 'deposit' and "from the public" in Section 49A have to be understood in the sense in which they are understood for the purpose of 'banking' definition.

3.8 The Kerala High Court, while upholding the constitutionality of Section 49A *ibid*, has expressed that banking concerns which are not permitted, or otherwise not specially approved, to accept chequeable deposits can still carry on banking business in other respects. The High Court observed :

> The business of banking includes also receipt of deposits withdrawable by draft, order or otherwise. No restriction or prohibition has been placed by Section 49A in respect of deposits of money repayable by draft, order or otherwise.[1]

Thus, a classification of banking concerns into those accepting chequeable deposits and those which do not is already there. Such a classification is reasonable and necessary.

3.9 Having found that acceptance of chequeable deposits is a particularly important form of banking business, and that those undertaking such business have to conform, in the interests of the national economy, to certain strict standards, we may briefly dwell on certain basic features of the regulation that, in our view, should apply to institutions accepting chequeable deposits.

(2) *Name—Use of the Word 'Bank'*

3.10 While 'banking' definition, as we pointed out in the previous chapter, should comprise the acceptance of all forms of 'deposits', we may also note the fact that in popular understanding and following the U.K. practice, the expression 'bank' is associated in India with institutions taking deposits withdrawable by cheque, namely, the present scheduled and non-scheduled banks which receive deposits on current account and which undertake payment and collection of cheque. Thus, the expression 'bank' has acquired a popular image. From the point of view of attracting deposits from the public, this image has a value. We are of the view that this popular image should be preserved. Moreover, it is only institutions taking chequeable deposits, which could carry on *all* forms of banking.

3.11 Even if we look at the position in certain other countries having comprehensive codes of banking regulation, the view that while 'banking' may comprise acceptance of several forms of liabilities, the term 'bank' should be associated mainly with institutions taking chequeable deposits, is streng-

1 A.I.R. 1962 Kerala 267.

thened. Thus, the Banking Code of Pennsylvania (1965), while it covers all forms of deposit-taking, defines a 'bank' as a corporation "authorised to engage in the *business of receiving demand deposits*". In South Africa, the Union Bank Act, 1942, defines a 'commercial bank' as a person whose substantial portion of business "consists in the acceptance of deposits of money withdrawable against cheque". The Act Regulating Banks and Banking Institutions of the Philippines (1948) defines a "commercial banking corporation" or a "commercial bank" as "any corporation which accepts or creates demand deposits subject to withdrawal by check".

3.12 Hence, we recommend that only institutions which are authorised to carry on *all* forms of banking, that is, the accepting of all kinds of deposits including chequeable deposits, that should be required and permitted to use as part of their business names the expression 'bank', 'banker' or 'banking'. Others, including other banking undertakings, should be precluded from using such expression as part of their business names.

(3) Types of Institutions that could Accept "Chequeable Deposits"

3.13 Going into the history of banking legislation in India, the Kerala High Court[1] had observed that the provisions of the Indian Companies Act, 1913, relating to banking companies, had this objective, namely :

> that as far as possible, the carrying on the business of banking must be done by a company registered under that Act so that it will be subjected to the various other provisions of that Act.

Specifically referring to the Indian Companies (Amendment) Act, 1936, that Court had felt that :

> the underlying idea in the amendment clearly reinforces the object of the legislature that the business of banking should, as far as possible, be done by a banking company which will be subject to control and directions which are necessary in the interests of the general public who deposit their money.

Again, the Central Banking Enquiry Committee (1931) had observed :

> The incorporation of a banking concern under an Act of the legislature invokes an obligation to comply with certain general requirements laid down therein. While such provisions cannot prevent fraud or mismanagement, they ensure a minimum standard of efficiency and integrity in the conduct of business of the institution.[2]

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1 A. I. R. 1962 Kerala 267.
2 Paragraph 676 of the Report of the Indian Central Banking Enquiry Committee (1931).

That Committee had further observed :

> One of the advantages of incorporation of banks under an Act of legislature is that it renders it possible for Government to prevent the growth of mushroom banks with insufficient capital which in the nature of things would have a less extensive distribution of risks and could be able less to withstand shocks than banks of larger size.[1]

3.14 While considering the practicability of extending a scheme of regulation to those carrying on banking business, without incorporation, the fact that such firms or individuals combine banking and trading activities has been considered as coming in the way of such extension. It is a feature of banking regulation to restrict the forms of business which banking concerns could undertake. Such restrictions are now found in the schemes of banking regulation in force in India[2] and elsewhere. This is due to the fact that "banking business is not compatible with trading."[3] It has been observed that "there have been instances on record in which banking institutions came to grief because of the trading operations or close contractual relations with trading concerns"[3]. In the absence of incorporation, it would be difficult to effectively segregate the assets and liabilities of a banking undertaking (including those of any business which could be allied to it) from the assets and liabilities of other kinds of business. Such segregation is necessary also to ensure that the outside creditors of a banking undertaking, who are mainly its depositors, get a preferential claim on the assets of the undertaking in the event of its dissolution. The essential provisions relating to banking regulation, such as the requirements of the provisions relating to capital, the creation of a reserve fund, the prohibition against the granting of loans and advances to, or the relations of, persons entrusted with the management of the undertaking, etc., could be effectively applied only with reference to incorporated undertakings. Even if we look at the schemes of banking regulation in other countries, we find the insistence on banking undertakings being incorporated. It had been expressed that the insistence on banking undertakings being organised as companies is "a requirement that is becoming increasingly common in commercial banking legislation".[4] Hence, it is desirable that persons carrying on banking business do so by getting the undertakings incorporated.

3.15 In U.S.A., banking legislation generally precludes the setting up of any banking undertaking unless the undertaking is incorporated. Though individuals and firms, who were carrying on banking business when banking regulation was originally introduced in the States, are allowed to continue,

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1 Paragraph 694, *ibid.*
2 Sections 6 and 9 of the Banking Regulation Act, 1949.
3 Paragraph 692 of the Report of the Indian Central Banking Enquiry Committee (1931).
4 Allen A. M. & Others, "Commercial Banking Legislation and Control," Macmillan and Co. Ltd., 1938 Edn., page 290.

they are very few in number and their number has become negligible[1]. In the Philippines, all domestic banking institutions (excepting building and loan associations) are required to be organised in the form of stock corporations[2]. In Malaysia, "banking business" is not allowed to be transacted except by licensed company[3]. The Borrowing Companies Act, 1969 of Malaysia also requires that only a licensed public company can carry on "borrowing business" (*i.e.*, accepting money on deposit or loan and lending or investing the funds so borrowed). But firms, which were carrying on borrowing business as on the date of coming into force of that Act, are authorised to carry on such business only "for a period not exceeding six months or for such further period or periods as may be prescribed by the Minister by notice in writing to the person". Firms (*i.e.*, natural and individual persons registered under the law relating to Registration of Business Names) have been required, in Malaysia, either to take steps for terminating their borrowing business, or to convert their undertakings into public companies and obtain licence to carry on "borrowing business", within the time specified.

3.16 In Australia, banking business is allowed to be carried on only by corporations which have secured from the Government an authority for doing so[4]. In Japan, banks (those carrying on the business of accepting deposits) could be organised only as joint stock companies which comply with the requirements of the Banking Law, 1929. Under the Commercial Bank Act, 1961 of Norway, commercial banks shall be organised as joint stock companies. In Denmark, "apart from savings banks which are subject to special regulations, banking may be carried on only by a company organised under the Joint Stock Companies Act". Thus, banking regulation in other countries recognises that for its effective implementation banking undertakings should be run by corporate bodies.

3.17 In the light of the above, and having regard to the importance from the point of view of the national economy, we recommend that the business of accepting "chequeable deposits", *i.e.*, deposits withdrawable against cheque or other kinds of negotiable instruments on demand, should be allowed to be carried on only by corporate bodies. By reason of Section 49A of the Banking Regulation Act, 1949, acceptance of deposits withdrawable by 'cheque' as defined in the Negotiable Instruments Act, 1881, is already confined to the corporate sector. But we are of the view that the business of acceptance of deposits withdrawable on demand by any kind of negotiable instrument, whether it is by means of 'cheque' or other similar instrument, should be confined to the corporate sector. This would mean

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1 We are advised by Mr. Carl W. Funk, a Member of the Pennsylvania Banking Law Commission, that in addition to Brown Brothers Harriman & Co., there seem to be "a few very small private banks" in the United States.
2 Section 7 of the Act Regulating Banks and Banking Institutions and for other purposes (Republic Act No. 337).
3 Sections 2 and 3(1) of the Malaysian Ordinance, 1958.
4 Sections 7 and 8 of the Banking Act, 1959-1967.

that such of the indigenous bankers as are accepting deposits withdrawable against hundis should either have their undertakings incorporated, or eschew the acceptance of such deposits, within such time as may be allowed to them for this purpose.

3.18 In A.I.R. 1962 Kerala 267, it has been held that "the power to legislate on the topic of legislation relating to 'banking' carries with it also the power to legislate on ancillary matters, namely, to prohibit private banks from accepting deposits from the public withdrawable by cheque". In the Bank Nationalisation Case, the Supreme Court has held that the "power to enact that the named banks shall not carry on banking business .... is incidental to the power to legislate in respect of banking". We have been advised that the laws of many States in U.S.A. "prohibit the formation of any new private bank and that there is nothing either in the Constitution of U.S.A. or of Pennsylvania" which prohibits their legislature from "restricting the business of banking to incorporated institutions"[1]. In Japan the Constitution guarantees "to the people the freedom to own property and choose occupations, much as has been done under our Constitution"[2]; still, as we saw earlier, the Banking Law of Japan provides that banking business shall not be carried on by persons other than joint stock companies. In the result, we feel that any provision, as part of a scheme of banking regulation, requiring that enterprises accepting "chequeable deposits" should have their undertakings incorporated and should otherwise conform to banking regulation would not be considered as an "unreasonable restriction".

(4) *Acceptance of Demand /Near Demand Deposits*

3.19 In trying to control the business of accepting non-chequeable deposits, the directives of the Reserve Bank (issued under Chapter III-B of the Reserve Bank of India Act, 1934) aim to confine the acceptance of demand, and near demand deposits, only to banks. The Royal Commission on Banking and Currency (1964) of Canada has also felt that no meaningful line can be drawn and administered between financial intermediaries issuing claims which serve as means of payments and those issuing claims which are close substitutes for such means of payments. In this view, that Commission has recommended that there should be no distinction between the regulation governing persons accepting deposits withdrawable against cheque or on demand and those accepting deposits repayable within 100 days. Hence, restrictions on the acceptance of demand and near demand deposits by persons other than banks may have to be there to ensure that concerns not authorised to accept chequeable deposits do not accept deposits which more or less have, in the economic sense, the traits of chequeable deposits and at the same time avoid application to them of the regulation governing acceptance of chequeable deposits.

1 Views of Mr. Carl W. Funk, Member of the Pennsylvania Banking Law Commission (1965)
2 A. I. R. 1962 S.C. 1371.

(5) *Classification of Banks*

3.20 In the light of the aforesaid consideration, if we consider the institutions which may be authorised to accept "chequeable deposits", they could be either Companies or Co-operative societies or statutory corporations. In other words, in this category would come the present scheduled and non-scheduled banks and such companies or other corporate bodies that may be authorised to carry on the business of accepting chequeable deposits hereafter. The Post Office Savings Bank also accepts "chequeable deposits", but it does not come under the present scheme of banking regulation. Its business does not comprise of lending or investment as in the case of other 'banks', and it is run as a Government Department ; hence, it may not be necessary for the scheme of banking regulation, which we are envisaging, to cover also the Post Office Savings Bank. Distinguished on the basis of their constitution, the 'banks' (*i.e.*, institutions accepting "chequeable deposits") are either—

(*i*) banking corporations set up under separate Acts of Parliament and which are wholly or substantially owned by the Central Government directly or indirectly (shortly "national banks") ; or

(*ii*) Co-operative Societies which accept chequeable deposits and which are registered under the Co-operative Societies Acts of the States (shortly "Co-operative banks") ; or

(*iii*) "companies" authorised to accept chequeable deposits (shortly "other banks").

(*i*) *NATIONAL BANKS*

3.21 The national banks form a class by themselves. They account for about 83.7 per cent of the total deposits of the entire commercial banking system of the country as on the 2nd July 1971. They are either wholly or substantially owned (directly or indirectly) by the Central Government. Moreover, they are expected to play a major role in banking development. All of them are permitted to accept, and are accepting, chequeable deposits. Hence, the legal provisions relating to their set-up, powers and functions require special consideration. They are considered in Chapter 4.

(*ii*) *CO-OPERATIVE BANKS*

3.22 "Co-operative Societies" is a State subject, while "banking" is a Union subject. Hence, in the regulation of credit institutions organised as "co-operative societies" and which carry on the business of banking, both the States and the Union are concerned. Such co-operative credit societies are incorporated under the Co-operative Societies Acts of the respective States, the provisions of which are administered by the Registrars of Co-

operative Societies, and they are also subjected (though not all of them) to the provisions of the Banking Regulation Act, 1949, which are administered by the Reserve Bank. The Banking Regulation Act, 1949 is made applicable to the State Co-operative banks, the Central Co-operative banks and the Urban Co-operative banks of specified size, but the provisions of that Act do not deal with the incorporation, management and dissolution of the co-operative banking institutions. The main problem in relation to co-operative banks relates to the reconciliation of the claims of these two jurisdictions so as to ensure that there is no avoidable duplication or ineffectiveness in the control or regulation over the co-operative credit institutions carrying on banking business.

3.23 As banking institutions, co-operative banks may have to use, by and large, the same methods and maintain the same standards as the other banks, though there are now certain differences[1] in the provisions applicable to them. There is also a considerable area for mutual competition between them. The Reserve Bank is the inspecting authority, the licensing authority, the lender of the last resort and the provider of other facilities to both the co-operative and the other banks. The Reserve Bank which is responsible for controlling money and credit, as the expert institution, has to look after the carrying on of banking business by both these types of banks. At the same time, since the co-operative banks are organised as co-operative societies, the States have jurisdiction over, and responsibilities towards, them. It has been pointed out that there is no particular reason why some banks should come under the exclusive jurisdiction of the Centre while certain others are regulated both by the Centre and by the States. On this basis, the suggestion has been made that for ensuring a co-ordinated approach towards regulation of co-operative societies carrying on banking business, such institutions should be subjected only to the Central legislation instead of being subjected to a dual control. However, we do not consider that for this purpose co-operative societies carrying on banking business should be subjected only to Central legislation.

3.24 The jurisdiction of the Centre and of the States could be reconciled without difficulty. The Co-operative Societies Acts of the States provide for the orderly development of the Co-operative Movement in accordance with the Directive Principles of State Policy enunciated in the Constitution. Insofar as banks are organised as co-operative societies, the States have certain responsibility towards them. At the same time as regards the

1 In the provisions that are applicable to the co-operative banks and the 'other banks', there are now certain differences especially in relation to such matters as pertain to the allocation and collection of share capital, the ceiling on dividend rates, the management, the linking up of maximum borrowing limit to the owned funds, the maintenance of statutory reserves, the nature and extent of liquid assets to be maintained, the granting of credit to non-members, the limits for granting unsecured loans, the availability of concessional finance and the terms subject to which such finance could be disbursed, the maximum limits for loans to individuals, the purposes for which credit facilities could be given, the registration of security and the recovery of loans, etc.

carrying on of banking business by such societies, the responsibility to regulate such business is that of the Centre. In a recent decision,[1] the Nagpur Bench of the Bombay High Court has held :

> If a society is registered under the Co-operative Societies Act, then it is the Co-operative department which is to have the control over the working of the said society and it is for the department to see that the administration of such society is carried on smoothly and if there are serious irregularities in the administration to carry on the administration by appointing administrators. There is no reason why an exception should be made with respect to the banking societies alone as regards their control by the Co-operative department. So far as the banking business as such is concerned the Reserve Bank will have control over its working and it has also got the power to cancel the licence of the society if such a step is found to be necessary. That, however, does not conflict with the control of the society by the co-operative department as the functions of the two bodies namely the Reserve Bank and the Co-operative Department or the Registrar are different.

In Sant Sadhy *v.* State of Punjab[2], the Punjab High Court has also held that "the State legislature has jurisdiction to regulate the function of the co-operative societies engaged in the business of banking". In view of the two Entries, *viz.*, "Co-operative Societies" and 'banking', being included in two different Lists, the best solution appears to be to make such banks subject to banking regulation in such matters as will not encroach on the States' jurisdiction.

(*iii*) *Other Banks*

3.25 The "other banks" are companies authorised to accept chequeable deposits. For this purpose, 'company' means any company as defined in Section 3 of the Companies Act, 1956, and includes a foreign company within the meaning of Section 591 of that Act (*vide* Section 5(d) of the Banking Regulation Act, 1949). Such companies are either scheduled or non-scheduled. They are either licensed to carry on banking business or not yet licensed (non-licensed).

(*a*) *Scheduled and Non-scheduled Banks*

3.26 Of the 61 "other banks", only 11 were non-scheduled, by the end of June 1971. The distinction among them as those scheduled and those non-scheduled was first introduced in 1934, in the Reserve Bank of India Act, 1934, when banking companies were not required to obtain any licence to carry on banking business in India. We find that the present

1 Special Civil Application No. 897 of 1970 decided on 30th April 1971.
2 A.I. R. 1970 Punjab & Haryana, 528.

line of distinction between banks as those scheduled and those non-scheduled has lost all significance, and need not be retained.

3.27 Under Section 42(6) of the Reserve Bank of India Act, 1934, a banking institution could claim inclusion in the "Schedule" provided :

(1) it satisfies the Reserve Bank that its affairs are not being conducted in a manner detrimental to the interests of its depositors ; and

(2) its paid-up capital and reserves have an aggregate value of not less than Rs. 5 lakhs.

Similarly, the Reserve Bank of India has to direct the exclusion from the "Schedule" of any banking institution which does not satisfy either of the above two conditions.

3.28 All the banks come within the sweep of the Banking Regulation Act, 1949, and are obliged to satisfy the Reserve Bank that their affairs are not being conducted in a manner detrimental to the interests of their depositors. Hence, the only distinguishing feature now between the scheduled and the non-scheduled banks consists in their capital requirements.

3.29 The Banking Regulation Act, 1949, in its application to companies carrying on banking business, has got certain provisions providing for minimum capital requirements, though it did not originally require that the paid-up capital and reserves of all banking companies shall not be less than Rs. 5 lakhs. But, the Banking Companies (Amendment) Act, 1962, has now amended the Banking Regulation Act, 1949, and has provided that any banking company incorporated in India and commencing business after the coming into force of the said Amendment Act shall have paid-up capital of not less than Rs. 5 lakhs. This means that the distinction has to be continued, if at all, only for distinguishing the 11 banks (in June 1971) which are now classed as "non-scheduled".

3.30 In the present day conditions, the sum of Rs. 5 lakhs as aggregate value of the paid-up capital and reserves of a banking company may not have much significance. Moreover, the continuance of the classification, which is based merely on the capital structure of banks, and that too when the distinction is not substantial, has no merit. In the scheme of banking legislation we envisage, such distinction need not be continued.

(*b*) *Licensed and Non-licensed Banks*

3.31 The Banking Companies Act, 1949, came into force on the 16th March 1949. Under the scheme of the regulation embodied in it, companies which were then transacting banking business were required to apply to the Reserve Bank for a licence before the expiry of six months from the com-

mencement of the said Act, *i.e., on or before the 16th September 1949.* Companies wanting to commence banking business subsequent to the coming into force of the Act are required to obtain a licence as a precondition for engaging themselves in banking business. Hence, the "other banks" which are still to be licensed are only those which have been in existence at the commencement of the said Act and which have applied for licence on or before the 16th September 1949 as required by the Act and which are permitted to carry on banking business pending a decision by the Reserve Bank on their applications. Their number in June 1971 is only 17. If a decision could be taken on the few functioning "other banks" remaining to be licensed, then there would be no "other bank" which needs to be classified as "non-licensed". In our opinion, non-licensed banks being allowed to carry on business for a long time is an anomaly.

3.32 When companies, which are now accepting chequeable deposits or demand deposits which are not now subjecting themselves to banking regulation (*e g.*, such 'Nidhis' as are accepting demand deposits from their members), are brought within the scope of the regulation pursuant to our recommendations, till they are either licensed, or refused a licence, they have to be allowed to carry on such business and they would fall within the category of "non-licensed banks".

(6) *Other Aspects of the Regulation of Banks*

3.33 We have not gone into the details of the present scheme of regulation that governs banks as set out in the Banking Regulation Act, 1949. However, from the materials and information furnished before us and in the light of our study of the matter, we find that it would be appropriate to deal with the following aspects.

(i) *Forms of Business in Which Banks may Engage*

3.34 Section 6 of the Banking Regulation Act, 1949, sets out the forms of business that could be undertaken by a banking company. This section is based on Section 277F of the Indian Companies Act, 1913, introduced in 1936. Banks in other countries are permitted to, and do, undertake certain forms of business which are *not* now permitted under Section 6 of the Banking Regulation Act. For instance, banks in other countries buy machinery and other equipments and lease them out to their constituents ; such equipment leasing helps considerably the unemployed technical persons. Having regard to the objectives before the banking system, the provisions of Section 6 *ibid* require suitable modification. Though the Central Government is authorised to specify the forms of business "in which it is lawful for a banking company to engage", no notification has so far been issued permitting banks

to undertake any form of business other than those expressly referred to in Section 6 *ibid.* Having regard to all the circumstances, we recommend that—

(*i*) banks may be specifically authorised to engage themselves in the business of equipment leasing ;

(*ii*) and also to undertake any form of busjness which the Reserve Bank may notify with the prior approval of the Central Government.

(*ii*) *Restriction on Nature of Subsidiaries*

3.35 It has been the practice both in India and elsewhere and considered more advantageous that instead of banks carrying on certain forms of business directly they undertake such business by forming subsidiaries for such purpose(s). Here again, we find that the purposes specified in Section 19 of the Banking Regulation Act, 1949, for which banks could form subsidiaries, are not adequate to meet the present day situation. Section 19 does not permit the banks to form subsidiaries even for undertaking any form of business which the banks could themselves carry on directly. For instance, while a bank can directly finance hire-purchase transactions, the formation of a subsidiary for carrying on such business is not permitted under Section 19. While in the case of business which banks directly undertake there is a need to observe the principle of segregating banking from manufacturing or trading activities so that banks eschew the latter, in the formation of the subsidiaries by banks this principle need not be strictly observed; this is also seen from the businesses undertaken by subsidiaries of banks in U.K. and U.S.A. In the result, we recommend that Section 19 of the Banking Regulation Act, 1949, may be amended to provide that—

(*i*) banks may form subsidiaries for carrying on business which they are permitted to do under Section 6 of the Banking Regulation Act, 1949 ; and

(*ii*) banks may form subsidiaries for any purpose considered by the Central Government in consultation with the Reserve Bank, as conducive to the spread of banking or otherwise useful or necessary to be undertaken by banks in public interest.

It may also be clarified in this context that in such circumstances, it would be in order also for the national banks to form subsidiaries.

(*iii*) *Prohibition of Advances to Directors, etc.*

3.36 It has been pointed out that there is some difficulty in applying the principle underlying Section 20 of the Banking Regulation Act, 1949, with reference to persons nominated by Government or financial institutions

on the boards of Government companies or statutory corporations, and for their nomination on the boards of the national banks. At present, in such cases, Government is issuing separate notifications exempting the application of Section 20 in respect of transactions relating to loans and advances that may be entered into between a national bank and a Government company or statutory corporation. There is the need for a general exempting provision to provide for such cases has been suggested. We consider that it is desirable to add a proviso to Section 20 *ibid* for this purpose.

(v) Maintenance of Liquid Assets

3.37 It has been pointed out that the monetary authorities in other countries have the power to vary or to specify within a range permitted in the statute the requirements as to the maintenance of liquid assets, and that such provision enables the central banking authority to ensure the effective implementation of monetary discipline. Even now, the proviso to Section 42(1) of the Reserve Bank of India Act, 1934, enables the Reserve Bank to vary the cash reserves to be maintained by the scheduled banks within a range of 3% to 15% of the total of the demand and time liabilities. It has been pointed out that a provision somewhat on similar lines is necessary for the maintenance of liquid assets under Section 24 of the Banking Regulation Act, 1949. We recommend accordingly.

B. Acceptance of Non-Chequeable Deposits

3.38 Persons accepting "non-chequeable deposits" from the public could broadly be classified into two categories, that is, those accepting deposit liabilities for the purpose of—

(*i*) lending or investment activities ; and

(*ii*) financing their own business such as manufacture or trade.

For the purpose of banking regulation, the former could be termed "financial institutions" and the latter as "deposit receiving institutions". Though financial institutions, which are "companies", are even now "banking companies", banking regulation has not been effectively applied to them. Consistent with our recommendations on the definition of "banking", financial institutions and deposit receiving institutions accepting non-chequeable deposits from the public should be regulated as a class of banking concerns. However, while regulating such concerns, banking regulation may have to differentiate between them having regard to the purpose for which such deposits are accepted. There could also be some differentiation based on the legal status of such concerns.

3.39 "Banking", as defined in Chapter 2, would comprise also acceptance of deposits by a person even if such acceptance is only from members or

shareholders. However, private limited companies accepting non-chequeable deposits from their shareholders, companies taking such deposits from their directors, and firms accepting such deposits from their partners need not, in our view, be brought within the scheme of banking regulation. This exclusion is justified having regard to the limitations as to the number of persons from whom such deposits could be taken and the presumption that people so depositing would be familiar with the financial position and standing of the concerns accepting such deposits.

(*a*) *Acceptance of Non-Chequeable Deposits for Lending or Investment*

3.40 Prior to 1949, companies accepting "non-chequeable deposits" and having such acceptance as their "principal business" were classed as "banking companies" provided the deposits were withdrawable against the depositors' order. This was without reference to the purpose for the acceptance of deposits. As we saw earlier, the Banking Companies Act, 1949, removed the requirements as to "principal business" and withdrawability against "order" from the definition of 'banking'/'banking company', with the result that all companies accepting non-chequeable deposits from the public became "banking companies" provided such acceptance was related to their investment or lending activities.

3.41 Nevertheless, the provisions of the Banking Companies Act have not been effectively applied to companies accepting non-chequeable deposits for the purpose of their lending or investment. On the coming into force of the 1949 legislation, the Reserve Bank advised all the institutions which had been then classed as "banking companies" by the Registrars of Companies, under Chapter XA of the Indian Companies Act, 1913, of the requirements of the 1949 legislation. Some of them (which were treated as "non-scheduled banks") had taken the stand that they were not accepting deposits *from the public* and hence were not obliged to conform to the requirements of the Banking Companies Act, 1949. Again, we may mention that several loan companies, especially in the Provinces of Madras and Bengal, which were originally classified as "banking companies" by the Registrars of Companies under the Indian Companies Act, 1913, had dropped from their names the word 'bank', 'banker' or 'banking' after the Indian Companies (Second Amendment) Act, 1942, with a view to escape from the provisions of the Companies Act relating to banking.[1] Moreover, consequent on the widening of the 'banking' definition in 1949, to include also acceptance of term deposits withdrawable against simple receipts, companies accepting such deposits (for lending or investment) should have come within the scope of the banking regulation. However, notwithstanding such widening of the scope of the definition of 'banking' in 1949, many companies which might, or should, have come within the scope of banking regulation have stayed outside the range of the regulation.

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1 Paragraph 22 of Annexure 'B' to Chapter 2.

3.42 As we noted earlier, the Companies (Second Amendment) Act, 1942 had introduced one test, to solve the Registrars' difficulties, to decide whether a company was a "banking company". Any company using the expression 'bank' or its derivatives, as part of its name, was deemed to be a banking company. But this test was not of much help in deciding the nature of the business of a company not having such expression as part of its name. Thus, under the legislative provisions applicable to companies carrying on the business of banking, first introduced in 1936 as part of the Indian Companies Act, 1913, and later under a separate enactment called the Banking Companies Act, 1949, the question whether a company was a banking company or not was not concluded merely by the company having, or not having, as part of its name, any of the words 'bank', 'banker' or 'banking'. Ultimately, it rested, and has to rest, on the nature of the business carried on and not merely on the name under which the institution carried on, or carries on, its business.

3.43 Thus, under the Banking Regulation Act, 1949, companies accepting deposits from the public for their business of lending or investment (excluding investment in their business such as manufacture or trade) are regarded as "banking companies" whether or not they describe themselves as doing banking, and the provisions of the said Act apply to them as such. This involves their obtaining a licence from the Reserve Bank and conforming in other respects with the requirements of the said Act. If, however, such companies do not want to be regarded as banking companies, then they have to either eschew acceptance of deposits from the public or do not have lending or investment as part of their regular business. Whenever it came to the notice of the Reserve Bank that any company was having as part of its regular business the acceptance of deposits from the public and it was also having lending or investment as part of its business, the Reserve Bank was pointing out this position to the company and insisting that the company followed either of the two alternatives, namely, either to eschew acceptance of deposits from the public or do not have lending or investment as part of its regular business, if it wanted to be regarded as a non-banking company.

3.44 However, the Banking Laws (Miscellaneous Provisions) Act, 1963, which introduced Chapter III-B in the Reserve Bank of India Act, 1934, has created some ambiguity regarding the status of companies which accept deposits from the public and utilise them for their business of lending or investment. While the provisions of that Chapter are not made applicable to "banking companies", they are aimed to regulate, restrict or prohibit the taking of deposits not only by companies (including firms) accepting such deposits merely for the purpose of their business as manufacturers or traders, but also by those which are accepting deposits for the purpose of their business as lenders or investors, *e.g.*, loan companies, investment companies and hire-purchase finance companies. Applying the definitions of 'banking' and 'banking company' found in the Banking Regulation Act, 1949, these

"financial institutions" should be regarded as "banking companies" when, as part of their business, they accept deposits from the public. Thus, there is an inconsistency in trying to regulate such financing companies[1] taking deposits from the public as "non-banking companies".

3.45 There are two alternatives that could be considered to reconcile the aforesaid inconsistency. The first is to restrict the scope of the definitions of 'banking' and 'banking company' found in the Banking Regulation Act, 1949, so that such financial institutions would not be regarded as "banking companies". For the reasons given in Chapter 2, we do not favour this course. The second alternative is to exclude the applicability of Chapter III-B of the Reserve Bank of India Act, 1934, to such "financial institutions". Instead, the provisions that are considered necessary to be applied to them may be made a part of the scheme of banking legislation. These institutions may be regulated as a class of banking institutions which accept non-chequeable deposits from the public. We recommend accordingly.

3.46 It may be that financial institutions which accept deposits from the public for the purpose of their lending or investment activities could be further classified having regard to the nature of their lending or investment activities. The provisions of Chapter III-B of the Reserve Bank of India Act, 1934, referred to above, indicate three broad lines of classification, namely, institutions which carry on—

(*i*) as their business or part of their business the financing, whether by way of making loans or advances or otherwise, of trade, industry, commerce or agriculture ;

(*ii*) as their business or part of their business the acquisition of shares, stock, bonds, debentures or debenture stock or securities issued by a Government or local authority or other marketable securities of a like nature ; and

(*iii*) as their principal business hire-purchase transactions or the financing of such transactions.[2]

While regulating them as institutions carrying on banking business, further classification may be made, if necessary, on the aforesaid or other appropriate lines. The further question relates to the application of the scheme of regula-

1 The April 1971 issue of the Reserve Bank of India Bulletin gives the information that in March 1968 there were about 135 Hire-Purchase Finance companies and 614 other financial companies submitting to the Reserve Bank the returns showing their acceptance of deposits from the public.

2 Strictly, a distinction has to be drawn between concerns selling goods on hire-purchase basis and those merely financing such transactions ; it is only those accepting deposits and coming within the latter category, who could be held as doing 'banking' as per the definition found in the Banking Regulation Act, 1949. There is, however, a trend in developed countries like U.K. to bring within the scope of credit regulation, not only lenders' credit but also vendors' credit (Crowther Committee Report) ; a form of the latter is hire-purchase credit.

tion as set out in the Banking Regulation Act, 1949, to 'companies' and others accepting non-chequeable deposits for purposes of lending or investment. But we are not now going into these questions, not into the details of the regulation that should govern them. We could go into these matters only after considering the Report of the Banking Commission's Study Group on "Non-Banking Financial Intermediaries".

Private Banking

3.47 Then, we would like to deal in brief with the acceptance of non-chequeable deposits for the purpose of lending or investment by unincorporated undertakings, *i.e.*, firms and individuals. Since their business is 'banking', only banking regulation and not the legislation applicable to moneylending that could cover them.

Banking and Moneylending

3.48 In Itty Kurian and another *v.* Union of India and others[1], the Kerala High Court had occasion to go into the distinction between a 'banker' and a 'moneylender', in the context of individuals and firms carrying on the business of banking and the application to them of Section 49A of the Banking Regulation Act, 1949. Analysing the Report of the Central Banking Enquiry Committee, the High Court has observed :

> The Committee had opportunity to consider the position occupied by moneylenders and also the position occupied by persons dealing with the business of banking. In paragraph 113 of the Report, the Committee observes that the money-lenders generally work with their own capital. In paragraph 126 of the Report it is stated that the acceptance of deposits is one of the features that distinguishes a banker from a money-lender.

The Madras High Court, in Kadiresan Chettiar *v.* Ramanathan Chettiar,[2] had observed that while a moneylender lends his own money, a banker lends the moneys of his customers. Thus, the distinction between a person doing banking and a person doing moneylending really rests on the presence or absence, as part of such person's business, of the acceptance of deposits from the public. While a person doing "banking" relies on the deposits accepted by him from the public, wholly or partially, for carrying on his lending activity, the person doing "moneylending" does not seek or accept deposits from the public for his lending.

'Indigenous Bankers' and 'Banking'

3.49 An 'indigenous banker' is described as a person dealing in instruments of credit, such as hundis, who may or may not be accepting depo-

1 A.I.R. 1962 Kerala 267.
2 A.I.R. 1927 Madras 478.

sits. As described, this expression would comprise different classes of persons, some of whom may be merely moneylenders and only those of them accepting deposits from the public who may be regarded as doing banking.

3.50 The definition of 'banking' has been understood in India right through with reference to acceptance of deposit liabilities, and was never associated with discount operations. Even as early as in 1927, while dealing with the distinction between moneylenders and those doing banking, the Madras High Court had held that "the distinction between the two classes is broadly this : a money-lender lends his own moneys, whereas a banker lends the moneys of others *viz.*, his customers"[1]. However, in S. P. R. M. Valliammai Achi *v.* M. Ar. Al. Alagappa Chettiar,[2] it has been held that Nattukottai Chettiars (regarded as a class of 'indigenous bankers') could not be regarded as bankers "in the sense in which the term is understood under the law" since they do not keep current accounts enabling the customer to draw money on cheques. But, this view is not in accord either with the definition of 'banking' now found in the Banking Regulation Act, 1949, or with our recommendations on the definition of 'banking'. Hence, banking regulation *vis-a-vis* indigenous bankers may cover only such of them as are accepting deposits from the public.

Regulation of Private Banking

3.51 The Select Committees of 1946 and 1948 which went into the Banking Companies Bill, have expressed themselves in favour of bringing within the scope of banking regulation individuals and firms who may be considered as carrying on banking business[3]. But they have indicated that they could not then propose that individuals and firms carrying on the business of banking should be included under the scheme of banking regulation due to Constitutional difficulties. There was a suggestion that the Constituent Assembly (Legislative) should take steps to remove these difficulties[4]. Evidently, due to this, the scope of the Entry 'banking' under the present

1 A.I.R. 1927 Madras 478.

2 A.I.R. 1963 Madras 224 ; please see also the decisions in Ramaswami Chettiar *v.* Jeevaratnammal (A.I.R. 1957 Madras 106), and Karuppan Chettiar *v.* Somasundaram Chettiar (A.I.R. 1961 Madras 122).

3 The 1946 Select Committee observed :

Before discussing the details of the Bill we would observe that as the Bill is drawn it is applicable only to Banking companies and we are advised that there were Constitutional reasons against extending its provisions, *as we would have liked*, to partnerships or even individuals carrying on banking business. We desire to suggest that the question should be further examined with a view to introducing subsequent legislation extending so far as possible the provisions of this Bill to other banking concerns.

The 1948 Select Committee had this to say on the subject :

We considered the possibility of extending the scope of the Bill to cover partnerships or individuals carrying on banking business but found the same Constitutional objections as were present before the previous Select Committee.

4 In his Minute of Dissent to the Report of the 1948 Select Committee, Prof. K. T. Shah, a Member of that Committee, had said :

The Bill is styled to be 'A Bill to consolidate and amend the law relating to banking companies'. Notwithstanding this title and preamble, considerable sectors of the banking business

(Contd.)

Constitution is not limited as was under the Government of India Act, 1935. While the relevant Entry under the Government of India Act was :

> Banking, that is to say, the conduct of banking business by corporations other than corporations owned or controlled by a Federated State and carrying on business only within that State,

that under the Constitution is simply "Banking". Hence, there is no legal impediment on the Union legislating to regulate "private bankers" ; in fact, it is only the Union, and not the States, who could regulate private banking.

3.52 *While as regards moneylenders the States have enacted moneylending legislation, as regards private bankers at present there is no regulation either by the States or by the Union.* In view of what the Select Committees on the Banking Companies Bill had expressed and as there is no Constitutional inhibition for the Union to legislate in relation to private bankers as well, it appears necessary that the scheme of banking regulation covers also the private bankers.

3.53 In Itty Kurian and another *v.* Union of India and others[1], the Kerala High Court has held that private bankers form a separate class by themselves. Hence, all the provisions that apply to incorporated banks need not necessarily be applied to them. While dealing with the business of accepting chequeable deposits, we have indicated that in view of the importance of this form of banking for the national economy, acceptance of chequeable deposits should be confined only to corporate bodies. For the effective enforcement of the banking regulation, it is desirable if the business of accepting non-chequeable deposits from the public for lending or investment is run by corporate undertakings. But we do not consider that individuals and firms having such business should be compelled to incorporate their undertakings ; they may be given certain inducements, or other appropriate measures which would promote the incorporation of undertakings having such

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are left out of the purview of the proposed legislation. The Bill does not pay any attention to the entire system of private banking, including moneylending, which is not conducted by a joint-stock company. This seems to be an arbitrary distinction, and needlessly restricts the scope of the legislation, which cannot therefore be correctly described as a consolidating Bill.

There is, I understand, Constitutional reasons against the inclusion of this sector of banking within the scope of this Bill, which is said to lie within the provincial sphere, and not of the Central Legislature. This objection seems to me invalid, when we set out expressly to enact an integral, comprehensive, organic legislation. Even if Constitutional reasons stood in the way, a really 'consolidating' measure, applicable to the whole country, may be undertaken by agreement with the component parts of the Union, assuming that the Constitution, as it stands, does not allow the Central Legislature to undertake such a measure. If such an agreement between the Units and the Centre is not possible, and I see no justification for such an assumption, it must be remembered that we are, at this moment, making the Constitution of Free India ; and if at this moment, such snags are discovered while overhauling and consolidating such important legislation, there is no reason why the necessary and appropriate amendments be not introduced in the relevant Articles in the Draft Constitution when they come up for discussion and adoption.

1 A.I.R. 1962 Kerala 267.

business may be adopted. In a scheme of banking regulation it would be appropriate to differentiate between corporate bodies on the one hand, and firms and individuals on the other, carrying on banking business. In prescribing the conditions to be complied with by concerns undertaking such business to qualify as eligible concerns for any concession or inducement, incorporation can be made one of the conditions. Subject to this, all the provisions that apply to corporate undertakings carrying on such form of banking could also apply to the firms and individuals doing this business, with such necessary modifications as may be considered desirable, having regard to the difference in their legal status.

3.54 We may also refer to certain provisions of the Pennsylvania Banking Code of 1965 which could be considered for application to firms and individuals accepting non-chequeable deposits for lending or investment. The Pennsylvania Banking Code (1965) provides for the private banker obtaining a certificate of authorisation empowering him to continue in business. The application for obtaining such a certificate of authorisation is required to contain *inter alia*, sufficient information necessary to decide on the application. The Code also provides that no certificate of authorisation should be granted to a private banker unless he has a reserve fund for deposits in an amount at least equal to that required under the Code for an incorporated bank. There is also provision for segregation of the 'banking business.' Any change in the constitution of a firm is required to be approved by the concerned authorities. There are also special provisions in the Pennsylvania Banking Code for facilitating the conversion of private banking undertakings into incorporated institutions and for their dissolution. Provisions on those lines may be considered, subject to necessary modifications, while framing a scheme of regulation for firms and individuals carrying on the business of accepting non-chequeable deposits for lending or investment.

(*b*) *Acceptance of Non-Chequeable Deposits for Financing a Person's Business Such as Manufacture or Trade*

3.55 In our view, banking legislation should regulate also the acceptance of non-chequeable deposits by a person merely for investment in his own business such as manufacture or trade[1]. Acceptance of such deposits for such purposes is now regulated under the provisions contained in Chapter III-B of the Reserve Bank of India Act, 1934, on the assumption that they are "non-banking institutions". In accordance with our recommendations on the definition of 'banking' we recommend that acceptance of such deposits for such purposes by concerns may hereafter be regulated as one form of banking. Such concerns may be described as "deposit receiving institutions". But with reference to them, the objectives of the regulation would

1 The April 1971 issue of the Reserve Bank of India Bulletin refers to 1649 non-financial companies reporting to the Reserve Bank and having in March 1968 about Rs. 354.10 crores of deposits including Rs. 113.30 crores of exempted loans and receipts.

be met if the regulation deals with the terms (including the terms relating to period of repayment, payment of interest, etc.) subject to which the deposits could be accepted, and contains necessary provisions to ensure that the borrowing concerns have adequate repaying capacity. Having regard to public interest, the provisions may enable the authorities to restrict, regulate or prohibit the acceptance of deposits. The regulating authorities should also be given the necessary powers to enforce the observance of the requirements of the regulation by the "deposit receiving institutions". But, the licensing of such institutions should not be necessary for the purpose of banking regulation.

Licensing/Regulating Authorities

3.56 We have seen that different types of banking institutions require to be regulated and any regulation that may be framed has to take note of the differences in the forms of banking business undertaken by these various types of banking institutions. For an efficient implementation of the scheme of banking regulation, there should be a competent and effective body, or bodies, which should be responsible for the enforcement of banking regulation. In India, the Reserve Bank of India is in charge of the administration of the present banking legislation. But then, the present banking legislation effectively applies only to those accepting deposits withdrawable by cheque. Though the 1949 'banking' definition covers the acceptance of time liabilities (for the purpose of lending or investment), the scheme of the banking regulation has not been effectively applied to companies undertaking such business. Moreover, in the scheme of things that we envisage, quite a number of banking institutions and private bankers, other than 'banks', will have to be regulated. Having regard to the vastness of our country and the number of banking concerns that may have to be regulated, the existing arrangements for the licensing/regulation of banking concerns require a review. It may be necessary to provide for the licensing of all types of banking concerns other than those accepting non-chequeable deposits merely for the purpose of financing their own business such as manufacture or trade. But all of them may have to be regulated.

3.57 Keeping all these factors in view, we feel that it is desirable to have separate licensing/regulating authorities entrusted with statutory powers to administer the provisions of the banking regulation applicable to concerns accepting non-chequeable deposits from the public. We recommend the setting up of such authorities by Central legislation relating to banking. Such authorities may be set up at the State level with an apex body at the all-India level. While the authorities at the State level should be invested with statutory powers to deal with concerns accepting non-chequeable deposits (for the purpose of lending or investment or merely for the purpose of investment in their own business such as manufacture or trade), the apex body should act as a supervisory authority over the State

level authorities. The apex body should mainly concern itself with questions of policy and should be the authority to take decisions on matters of all-India importance. The State level authorities should deal with the administration of the regulatory/licensing provisions of the banking regulation applicable to concerns accepting non-chequeable deposits from the public. This arrangement would be conducive, in our view, to the effective implementation of banking regulation with reference to such forms of banking. The Registrars of Companies at the State level and the Company Law Board at the Centre may serve as an analogy. No doubt, the Reserve Bank has to be actively associated in the functioning, and it may also have to take the initiative for setting up such machinery to deal with all types of banking concerns other than banks. It would also be necessary to ensure co-ordination between the Reserve Bank and such a body to ensure effective implementation of the scheme of banking regulation.

Aim to have a Comprehensive Banking Act

3.58 Thus, there are different categories of institutions carrying on the business of banking in one form or the other. They also differ widely as regards their constitutional set-up. In almost all countries it is conceded that persons carrying on the business of banking should be subjected to regulation. There could be two approaches with regard to the regulation of these different categories of persons carrying on banking business. Either each of the categories could be regulated by separate enactments or there could be a comprehensive scheme of banking regulation covering in its fold all the different categories with provisions appropriate to each of them.

3.59 In fact, the proposals for a separate banking legislation emanated on the basis that there should be a comprehensive Bank Act. Even today, the preamble to the Banking Regulation Act, 1949, states that its aim is to *consolidate* and amend the law relating to banking. But the fact is that the Act does not contain any comprehensive scheme of banking legislation.

3.60 Co-operative banking institutions were not originally covered by the said Act, since there was already some control over them under the Co-operative Socieites Acts of the respective States, and as it was then felt that since "Co-operative Societies" was a Provincial subject, it may be appropriate to leave them to the States. Private banking was not regulated under the 1949 Act, as it was felt that under the Government of India Act, 1935, the Centre could not regulate them. The Imperial Bank of India was not brought within the scope of the banking legislation[1] as it had been set up under a separate enactment and it was considered to occupy a special position. With the result, what could ultimately be covered by the banking legislation enacted by the Constituent Assembly (Legislative) in 1949 was

1 However, certain sections of the Banking Companies Act, 1949, were extended to the Imperial Bank.

only institutions which were carrying on banking business as companies incorporated under the Companies Act and the branches of banks incorporated outside India.

3.61 However, several provisions of the Banking Regulation Act, 1949, have since been extended to the national banks, though these banks still have their separate enactments dealing with their set-up, management, business, etc. Even as regards co-operative banking institutions, the provisions of the Banking Regulation Act, 1949, have been applied with suitable modifications. The acceptance of non-chequeable deposits for lending or investment by concerns (called "financial institutions") is now controlled under certain sections of the Reserve Bank of India Act, 1934. These provisions also aim to control the acceptance of deposits by "deposit-receiving institutions" merely for the purpose of financing their business such as manufacture or trade. Thus, the acceptance of deposits from the public by practically all types of institutions (except firms and individuals carrying on any form of banking business) is now subject to some form of legislative control. In our view, there is now a need for bringing these different pieces of legislation under one comprehensive scheme. It would be conducive to the objectives of banking regulation if all the categories of persons accepting deposits from the public are dealt with as part of such a comprehensive scheme of banking legislation ; this would ensure that there is a proper perspective over the control that is exercised in regard to the different categories of banking institutions, having regard to certain common objectives such as the protection of the interests of depositors, the safeguarding of public interest and the effective implementation of monetary policy and credit policy.

Comprehensive Banking Code

3.62 In the light of the above, it is desirable to have a comprehensive banking code dealing with all the different categories of banking institutions. The code may contain both provisions which would be common to two or more of the said categories and those which could appropriately be applied only to any one of the said categories. Thus, the code can deal with the different categories of persons taking deposits from the public in one broad perspective, while at the same time recognising their individual features.

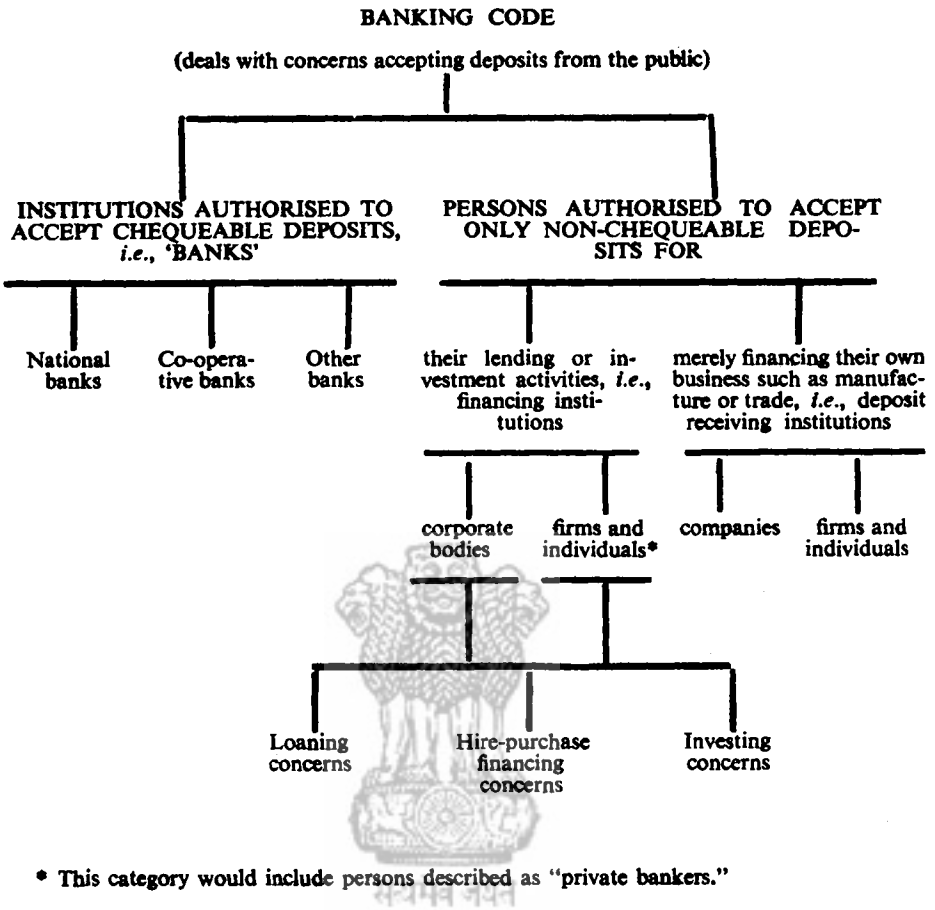
3.63 Similar codes have been framed in other countries and they are found to be highly useful in the context of banking regulation. In U.S.A., both as regards national banks and State banking institutions, such codes are found. Somewhat a similar pattern has been followed in the Union Bank Act of South Africa which deals with "commercial banks", "people's banks", "loan banks" and "other deposit-receiving institutions". Similar legislation is also found in the Philippines. The Banking Code of the Commonwealth of Pennsylvania (1965), drafted by a Banking Law Commission, deals with the different categories of banking institutions as parts of one comprehensive

scheme. In our view, a comprehensive banking code suited to the conditions of India and covering all types of deposit taking institutions would promote the objectives of banking regulation in our country.

3.64 The banking code which we recommend could classify concerns doing one or the other form(s) of banking business. In the light of the earlier discussion, this classification could be as shown in the following chart (*please see page 86*). To give effect to this scheme, the provisions of the Banking Regulation Act, 1949, and those of the enactments relating to the national banks, namely, the State Bank of India Act, 1955, the State Bank of India (Subsidiary Banks) Act, 1959, and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, will have to be modified suitably. While considering the provisions of the enactments governing the national banks, we have recommended that it is desirable to have a uniform scheme governing these banks and that all of them could be brought within one statutory framework. The present enactments governing them could be repealed and the provisions that are considered appropriate for them could be introduced as a separate part in the banking code. Chapter III-B of the Reserve Bank of India Act, 1934, may have to be repealed. Instead, the provisions that have to be made with reference to concerns accepting non-chequeable deposits for lending or investment and those accepting non-chequeable deposits merely for financing their business such as manufacture or trade could be placed as separate parts in the banking code. A scheme of regulation which is considered appropriate for firms and individuals having the business of accepting non-chequeable deposits for the purpose of lending or investment could also be made a part of the code.

3.65 The provisions of the Banking Regulation Act, 1949, in relation to their application to the present scheduled and non-scheduled banking companies and to those who may be authorised to accept chequeable deposits hereafter, could be retained in the comprehensive code, subject to such modifications as may be considered necessary therein. Similarly, the provisions of the Banking Regulation Act, 1949, applicable to co-operative banks could also be retained as a separate part with suitable modifications.

3.66 In dealing with each category of institutions that would be covered by the banking code, our recommendations made earlier, while dealing with them, may be taken note of. Our recommendation for a comprehensive banking code should not be the cause of any delay in promoting the scheme of legislation governing any category of banks or banking institutions. If necessary, legislation can deal separately with the different categories of banking institutions. But eventually there should be one comprehensive banking code dealing with all forms of banking business.



* This category would include persons described as "private bankers."

CHAPTER 4

NATIONAL BANKS

By "national banks" we refer to the banks set up as statutory corporations by Acts of Parliament, that is, the State Bank of India (State Bank) set up under the State Bank of India Act, 1955, its 7 Subsidiaries (Subsidiaries) governed by the State Bank of India (Subsidiary Banks) Act, 1959, and the 14 corporations ("new banks") set up under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970. In order to distinguish these banks, which are practically in the complete ownership of the Central Government, on the one hand from banks in which members of the public have substantial shareholding and on the other from banks in whose capital State Governments[1] hold shares, and in order to stress the national character of the banks set up by Acts of Parliament, we prefer to call them as "national banks".

A Distinct Class

4.2 While the "new banks" are wholly owned by the Central Government, the State Bank is substantially owned by the Reserve Bank of India (Reserve Bank) which is wholly owned by the Central Government. The Subsidiaries are substantially owned by the State Bank. The national banks form a class by themselves, due to the substantial stake and interest of the nation in these institutions. These banks also account for about 83.7 per cent of the total deposits of the commercial banking system of the country as on the 2nd July 1971. They occupy a dominant position in the banking system and are expected to play a decisive role in the adequate and effective functioning of the credit system of the country. Hence, the legal provisions relating to their constitution, function, powers and duties merit separate consideration.

HISTORICAL BACKGROUND

4.3 Even as early as 1860, Mr. James Wilson, India's first Financial Member, had referred to the proposal for setting up of *a national Banking establishment* capable of gradually embracing the great Banking Operations of India[2]. But as a clear concept of central banking, as distinct from com-

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1 State Governments hold shares in the capital of State Co-operative banks, and in the capital of some of the "other banks", *e.g.*, Jammu & Kashmir Bank, Sangli Bank.

2 "History of the Reserve Bank of India 1935-51", Reserve Bank of India (1970), page 12.

mercial banking, had not emerged till about the twenties of the century[1], the proposals for such banking establishment did not distinguish between central banking and commercial banking functions. The Presidency Banks were set up as quasi-Government institutions[2]. The war-time experience influenced the attitude of these banks to favour their amalgamation. These banks themselves submitted to Government a scheme for amalgamation. The amalgamation of the Presidency Banks took place in 1921, pursuant to the Imperial Bank of India Act, 1920. This led to the setting up of the Imperial Bank of India (Imperial Bank).

4.4 "The Imperial Bank was primarily a commercial bank, *transacting all the business formerly carried on by the Presidency Banks;* however, *the bank was also entrusted with certain central banking functions.* In terms of an agreement signed between the bank and the Secretary of State, which was to be in force for a period of 10 years in the first instance, the bank was appointed as the 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. 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, though there was no such provision in the statute ; the Imperial Bank also granted accommodation to banks. The bank conducted clearing houses in the country and provided remittance facilities to banks and the public"[3]. The Imperial Bank was not permitted under its statute to deal in foreign exchange. The bank was under an obligation to open 100 branches within five years of its establishment[4].

4.5 "In view of the Imperial Bank's position as sole banker to Government, Government exercised certain amount of control over it. Of the 16 members of the Central Board, ten were appointed by Government .... Government had also powers (*i*) to issue instructions to the bank on important financial matters, including safety of their funds, (*ii*) to tell the bank to furnish any information regarding its working, and (*iii*) to appoint auditors"[5]. However, "following the passing of the Reserve Bank of India Act, the Imperial Bank of India Act was also amended. Under the amended Act, the Imperial Bank of India ceased to be banker to Government ; it was, however, authorised to enter into an agreement with the Reserve Bank providing for its appointment as the sole agent of the Reserve Bank in places where it had a branch, but there was no branch of the Banking Department of the Reserve Bank. The amended Act made certain changes in the constitution of the bank, modified the Government control over it and also removed some of the restrictions on its activities such as engaging in foreign

1 "History of the Reserve Bank of India 1935-51", Reserve Bank of India (1970), page 4.
2 Page 13, *ibid.*
3 Page 25, *ibid.*
4 Page 63, *ibid.*
5 Page 26, *ibid.*

exchange business imposed by the original Act. A few restrictions, like those on land mortgage business[1], period of loans and advances, loans against shares, etc., however, were retained, since the bank was to continue to conduct Government treasury business in many places as the sole agent of the Reserve Bank"[2]. In substance, such restrictions continue to apply even now to the State Bank.

4.6 The All-India Rural Credit Survey Committee (1954) recommended that the Imperial Bank, the then 10 major State-associated banks (associated with Part 'B' States) and certain small State-associated banks should be amalgamated to establish the State Bank, with a view to create "one strong, integrated, State-sponsored, State-partnered commercial banking institution with an effective machinery of branches spread over the whole country" and *inter alia* to take over "cash work from non-banking treasuries and sub-treasuries and provide vastly extended remittance facilities for co-operative and other banks"[3]. Pursuant to this recommendation, the State Bank of India Act was passed in 1955, and this provided for the take over of the undertaking of the Imperial Bank. (The existence of the Imperial Bank, technically, was continued to smoothen the process of transfer of the assets and liabilities of its foreign branches to the State Bank[4]. The Imperial Bank still exists as a corporate body, evidently for this purpose.)

4.7 In 1956, the ownership and control over the Hyderabad State Bank were vested in the Reserve Bank when difficulties arose from the disintegration of the erstwhile Hyderabad State. After the passing of the States Reorganisation Act, 1956 (which provided for the abolition of the Part 'B' States), difficulties were felt by the reorganised States with regard to the carrying on of the Part 'B' State-associated banks, when the State Bank of India (Subsidiary Banks) Act, 1959 was enacted "for the formation of certain Government or Government-associated banks as subsidiaries of the State Bank of India and for the constitution, management and control of the subsidiary banks so formed and for matters connected therewith or incidental thereto". Under the 1959 legislation, the ownership (wholly or to a substantial extent), management and control of the Subsidiaries were vested in the State Bank. Simultaneously, the State Bank of Hyderabad Act, 1956 was amended to transfer the ownership and control of the bank from the Reserve Bank to the State Bank, and to bring that bank also under the scheme that applied to the other Subsidiaries. Thus, the Subsidiaries were not either formed or acquired by the State Bank *suo motu*, but they are full-fledged banks whose ownership (wholly or substantially), management and control are vested in the State Bank, while retaining their separate corporate status, under the State Bank of India (Subsidiary Banks) Act, 1959.

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1 This was amended later with reference to medium-term loans granted by the *State Bank*.
2 "History of the Reserve Bank of India 1935-51", Reserve Bank of India (1970), page 65.
3 General Report, Vol. II, All-India Rural Credit Survey Committee, page 404.
4 "Trend & Progress of Banking in India, 1955," Reserve Bank of India, page 16.

4.8 The Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, provided for the nationalisation of the undertakings of the 14 major Indian commercial banks, and the setting up of the "new banks". Though the enactment was passed in 1970, it took effect from the date of acquisition, *viz.*, 19th July 1969. The nationalisation was in fulfilment of certain social and economic objectives, in order that the banking system may be inspired by a larger social purpose and subserve national priorities and objectives. For this, it had been felt that the major banks should not only be socially controlled, but publicly owned. Governmental control over them was not prompted merely by the consideration that the undertakings were to perform certain central banking functions, such as acting as bankers to Government, or by the need to ensure the spread of banking to rural areas and extension of vastly expanded remittance facilities to co-operative banks, as was the case with the take over of the undertaking of the Imperial Bank and the formation of the State Bank and the Subsidiaries.

4.9 Thus, the schemes for the acquisition of the undertakings of the Presidency Banks, of the Imperial Bank, of the Part 'B' State-associated banks, and of the 14 major commercial banks in the private sector, were not uniform. But the differences in the schemes governing them are attributable mainly to historical reasons.

Need for a Uniform Scheme

4.10 Since the objectives before the national banks are now common, there may be no justification for continuing the differences in the schemes governing them. If, as is presumed, all the national banks are to have a common programme of functions and responsibilities in the development of the banking/credit system of the country, then it is necessary that a uniform scheme governs them. In evolving such a uniform scheme, it may be appropriate to discard from their present schemes such features as have more a historical rather than any substantial present day value. The intermediate central banking function of the State Bank is attributable to historical reasons; this should not affect its capacity to transact all kinds of business. When the Subsidiaries are also transacting Government business (passed on to them through the State Bank) and in principle it has been decided to entrust Government business also to the "new banks", continuance of the restrictions on the State Bank, in regard to its undertaking any form of business allowed to be carried on by the other national banks, has no merit. The constitution, functions, powers and duties of the national banks are not now uniform ; the relevant provisions for the State Bank are not on the same lines as those applicable to the Subsidiaries, and the pattern of both differs from that of the "new banks". While there are similar provisions with reference to many subjects, in essential features they differ. Similarities in the nature of legal provisions governing the national banks are to be expected ; but, the provisions which bring about differences between them *inter se* need to be explained.

But a study of the several provisions which are the cause of the differences in the pattern of the regulations governing their set-up, in relation to their capital, management, powers, functions, etc., will be useful in deciding on the framework of, or the essential features of, a uniform scheme that may have to be ultimately applied to all these institutions. Hence, a review of the relevant provisions of the schemes is undertaken in this chapter with a view to consider their appropriateness in the changed circumstances after the nationalisation of the 14 major Indian commercial banks.

Capital and Ownership

(*i*) *Division of Capital*

4.11 The capital of the State Bank and of the Subsidiaries is divided into shares, *viz.*, authorised, issued and paid-up, with provision for increasing the authorised and issued capital. The capital is divided into fully paid-up shares of Rs. 100 each. As regards the "new banks" there is no authorised or issued capital, but there is only paid-up capital. Provision for the division of capital into shares is necessary only when the capital is proposed to be held by more than one person.

4.12 The Acts of the State Bank and the Subsidiaries contain provisions for raising their authorised capital. Regarding the "new banks", Central Government is authorised to alter their capital structure under a Scheme so however that the paid-up capital of any of the "new banks" is not raised beyond Rs. 15 crores. Our attention has been drawn to certain studies made in other countries, especially in U.S.A., to decide on the capital requirements of a banking undertaking by adopting some scientific basis, such as the risk cover that is required with reference to different assets, and the nature of the liquidity of such assets. If such scientific standards are to be applied, then it would not be appropriate to have any rigid provision specifying a ceiling as regards the capital requirements of any of the national banks. Hence, the statute may provide for the capital of the national banks being raised or revised by them in consultation with the Reserve Bank and with the approval of the Central Government.

(*ii*) *Capital Holding*

4.13 The Central Government holds the entire capital of the "new banks". Government is not enabled to transfer its holdings to anyone else. Initially the entire paid-up capital of the State Bank was allotted to the Reserve Bank. Similarly, the entire paid-up capital of the Subsidiaries was allotted to the State Bank. Subsequently, to the erstwhile shareholders of the Imperial Bank/Part 'B' State-associated banks the Reserve Bank/ State Bank had transferred some of the shares of the State Bank/ Subsidiaries (as the case may be) in lieu wholly or partly of their claims for compensation for the acquisition of their shares in the Imperial Bank/Part 'B' State-associated banks. There may have been also transfer of shares of the State Bank/

Subsidiaries to others by the Reserve Bank/State Bank since the Acts governing the State Bank and the Subsidiaries require that at all times the Reserve Bank/State Bank shall hold a minimum of only 55 per cent of the issued capital of the State Bank/Subsidiaries. Moreover, the shares of the State Bank/Subsidiaries are freely transferable subject to certain conditions. The holdings of the Reserve Bank/State Bank shall not be reduced below 55 per cent of the issued capital of the State Bank/Subsidiaries. While an individual is not ordinarily permitted to hold in excess of 200 shares of the paid-up capital of the State Bank or any of the Subsidiaries, this restriction does not apply to any corporation, insurance company, local authority, co-operative society or trustee of a religious or charitable trust. There is also an inducement for the corporate bodies, trustees, etc., to hold the shares of the State Bank and of the Subsidiaries, as they are "approved securities" for the purpose of Section 20 of the Indian Trusts Act, the Insurance Act and the Banking Regulation Act.

(iii) General Body

4.14 As a result of the multiple ownership pattern , there is a "general body" of shareholders in the case of the State Bank and the Subsidiaries. The general body of these banks has the power only to discuss the annual accounts and the affairs of the banks. The shareholders, other than the Reserve Bank/State Bank, have a right to elect a certain number of directors depending upon their holding of paid-up capital not falling below certain levels. Such shareholders cannot also individually exercise voting rights in excess of 1 per cent of the paid-up capital of the bank (such a restriction of voting rights applies also to shareholders of banking companies). In the case of the "new banks" and three of the Subsidiaries, there are no shareholders, and hence there is no general body to go into their affairs and discuss their annual accounts.

(iv) Parliamentary Consideration

4.15 As there is no general body for the "new banks", their annual accounts, the auditors' reports and a report on their working are placed before each House of Parliament, for a period of not less than thirty days, for their consideration. No such Parliamentary consideration is provided for in respect of the annual accounts or of the report on the working of the State Bank and the Subsidiaries.

(v) Ownership Pattern for the Future

4.16 Thus, the capital and ownership structure of the State Bank and the Subsidiaries differs from that of the "new banks". This raises certain basic questions :

(*i*) Whether the Central Government should directly hold the capital of these banks or the capital should be held through an intermediary, *viz.*, the Reserve Bank and/or State Bank ?

(*ii*) Whether the capital of these banks should be held exclusively by the Central Government or the Reserve Bank/State Bank (as the case may be) or could it be transferred generally or to certain sections of the public ?

(*iii*) Should there be Parliamentary consideration of the annual accounts and the working of the national banks ?

We recommend that the decision on these questions should apply uniformly to all the national banks.

Reserve Bank as a 'Link'

4.17 The Reserve Bank is the country's central banking institution. It has to operate "the currency and credit system of the country to its advantage" and also to administer the provisions of the Banking Regulation Act, 1949. Pursuant to these responsibilities, the Reserve Bank *vis-a-vis* banks, including all the national banks, is vested with supervisory authority and with power to enforce on the banks monetary discipline. It is their inspecting authority. It has to ensure that the affairs of all the banks are conducted in a manner not detrimental to the interests of the depositors and in a manner conducive to the public interest. The question is whether it would be appropriate for this authority with supervisory responsibility over banks also to play the role of a person wholly or substantially owning the national banks. No doubt the arrangement, whereby the Reserve Bank is holding the capital of the State Bank, seems to have so far worked satisfactorily and that may suggest that the Reserve Bank may hold the capital of all the national banks ; but this is only a historical justification. On principle, however, it does not appear to be proper that a body entrusted with supervisory jurisdiction over these banks should also hold the whole or substantial portion of their capital.

State Bank as a 'Link'

4.18 The State Bank now acts as a holding corporation in respect of its seven Subsidiaries. The question is whether this position should be continued even after the nationalisation of the 14 major Indian commercial banks. This question is linked with that of the State Bank's responsibility for the management and the conduct of the affairs of these Subsidiaries. So long as the State Bank is made responsible for the running of the Subsidiaries, the existing position in this behalf may continue. If the Subsidiaries could manage their own affairs independent of the State Bank, then the existing links between them need review. However, if, in any future restructuring of the national banks, their number is to be reduced, then the existing position may prove to be helpful, in that the corporate distinction between the State Bank and the Subsidiaries could, by taking appropriate measures,

be abolished without difficulty and this would bring down the number of the national banks.

Outside Participation in the Capital

4.19 As already seen a small portion of the capital of the State Bank and of the Subsidiaries is held by a section of the public. However, the major portion thereof is held by the Reserve Bank in the case of the State Bank, and by the State Bank in the case of four of the Subsidiaries. The State Bank holds the entire capital of the other three Subsidiaries. Ordinarily, as already stated, an individual may have only upto 200 shares and could not exercise voting rights exceeding, in proportion, 1% of the paid-up capital of the bank. The actual percentages of outside participation in the capital of the State Bank and the four Subsidiaries are much less than the maximum limit of 45% upto which such participation could extend. Thus, the participation of persons other than the Central Government, Reserve Bank or the State Bank (as the case may be), in their role as shareholders or as elected representatives of such shareholders, in the management of the affairs of the State Bank and the four Subsidiaries could not be, and is not, significant.

4.20 But, the bringing in of other persons within the ownership scheme has made it necessary, in the case of the State Bank and the Subsidiaries, to have provisions for—

(*i*) a General Body of shareholders ;

(*ii*) the outside shareholders electing a few directors from amongst themselves depending upon the extent of the shareholdings ;

(*iii*) declaration of dividend ; and

(*iv*) annual General meeting of the shareholders before whom the accounts are placed.

The General Body (in the case of the State Bank and the Subsidiaries) at its annual meeting has, however, only the right to discuss the annual accounts and the affairs of the banks. The annual accounts and the statement as to the working of the affairs of the "new banks" are placed before both the Houses of Parliament as there is no General Body. Evidently, consideration by the General Body of the State Bank or of the Subsidiaries (where the outside shareholders have only an insignificant percentage of voting strength) cannot be as effective as the matter being placed before Parliament. We recommend that there should be a uniform provision, in respect of all the national banks, providing that their accounts should be placed before Parliament.

4.21 The Scheme for the "new banks" provides for each of them being managed by a Board of Directors composed of the following categories :

(*i*) representatives of employees, depositors, workers, farmers and artisans ;

(*ii*) men having special knowledge or experience useful to the bank ;

(*iii*) a representative each of the Reserve Bank and of the Central Government ; and

(*iv*) whole-time directors.

The underlying idea of the composition of the Boards of the "new banks" is to ensure that the Boards subserve public interest. The idea underlying the provision for giving representation to outside shareholders of the State Bank and the Subsidiaries on the Boards of these banks is to give a sort of proportional representation to minority shareholders. Reconciliation of both the ideas may be possible. This can be done by providing for representation, on the Boards of the State Bank and the Subsidiaries, to the categories specified in the Scheme for the "new banks", in addition to giving representation to outside shareholders. But this would mean a mix-up of two different and not too homogenous ideas.

4.22 The provision for a declaration of dividend is a consequence of outside participation in the capital of the State Bank and the Subsidiaries. The declaration of a dividend is the means for the distribution of "net profits", available as return on the capital, amongst those who have contributed to the capital. Resort to this means is unnecessary when there are no sharers in the capital of the bank.

4.23 In the result, provision for outside participation in the capital of the national banks runs counter to the Scheme governing the "new banks". The balance of convenience is not in favour of such a provision. We recommend that, in public interest, the shareholdings of the outside shareholders in the paid-up capital of the State Bank and the four Subsidiaries may be acquired by Central Government by legislation.

Profit and Reserves

4.24 In relation to all "banking companies", Section 17 of the Banking Regulation Act, 1949, requires transfer of 20% of their net profits to a reserve fund unless otherwise exempted. But this is a requirement arising for compliance before a banking company "declares a dividend". Though Section 17 is applicable[1] to all the national banks, there are doubts regarding its application with reference to the "new banks".

4.25 The doubtful position with reference to the "new banks" is due to this. While their Act allows them to make "*usual and necessary provisions*" it requires that the balance of the net profit *shall* be transferred to the Central Government. 'Provision' is sometimes understood differently from 'reserve',

1 Section 51 of the Banking Regulation Act, 1949, and Section 3(6) of the Act of the "new banks".

the former denoting special reserves created to meet any specific accrued or anticipated loss or liability, and the latter denoting free reserves which are not created specifically to meet any such loss or liability. Thus, in view of the compulsion of the provision relating to the transfer of the balance of the net profits of the "new banks", after making usual and necessary provisions, there may not be scope for the "new banks" to transfer a portion of their net profits to the general reserve, though their Act says that to their "reserve fund" may be added such amounts as may be transferred under Section 17 of the Banking Regulation Act, 1949.

4.26 As the intention seems to be that the "new banks" also should transfer a portion of their "net profits" to their general reserve, and thus build up adequate reserves, we recommend that it may be specifically provided that the transfer of the surplus to the Central Government would be only the balance of the net profits remaining after transfer to the general reserve fund.

Integration and Development Fund

4.27 The Integration and Development Fund, maintained by the State Bank, is treated as the property of the Reserve Bank and amounts held therein are not treated as "income, profit or gains" of the State Bank. The aim seems to be to keep the balance in the Fund at the level of Rs. 5 crores. The Fund is kept up from out of dividends payable to the Reserve Bank and from any contribution which the Reserve Bank or the Central Government may make to it.

4.28 In the case of the State Bank and the Subsidiaries, there is provision for the losses, they may incur while implementing any specific programme of development, being met from out of the Integration and Development Fund. Thus, these banks are at an advantage in that certain losses incurred by them need not be met by them from out of their current revenues (to the extent approved by the Reserve Bank). The benefit of this Fund is also available to the Subsidiaries indirectly. In their case, the State Bank is statutorily enabled to grant them subsidies to meet the cost of the whole or any part of any specific programme of development undertaken by such Subsidiaries. So long as the subsidies are granted by the State Bank with the approval of the Reserve Bank, they could be charged to the Integration and Development Fund.

4.29 We understand that the Fund was set up to ensure that on account of the State Bank and the Subsidiaries undertaking certain developmental activities (*e.g.*, opening of branches in remote rural areas), the outside shareholders are not deprived of their due share in the profits of these banks. If so, consequent on the implementation of our recommendation to acquire the outside shareholdings in the State Bank and the Subsidiaries,

there may be no need to continue the Integration and Development Fund. We also understand that the State Bank has voluntarily given up its reliance on the Fund.

Management

4.30 The managerial set up of the national banks could be considered from two aspects. Firstly, with reference to the *situs* of the authority having the powers to carry on the affairs of the banks, and whether the power is vested originally in such authority or is derived by delegation. Secondly, it could be seen with reference to the authority of their central organisation *vis-a-vis* their regional set-up. When one looks at the provisions relevant to these aspects in the enactments governing the State Bank, the Subsidiaries and the "new banks", it appears that the organisational framework in the case of the State Bank is appropriate for a sizeable all-India banking institution, while that of the "new banks" is not so. If the Subsidiaries are themselves regarded as regional banks, the absence of provision for the setting up of regional bodies will not be material in their case.

A. Organisation at the Central Level

(*a*) *Board of Directors*

(*i*) *Their Powers and Duties*

4.31 The superintendence and direction of the affairs and business of each bank, in all cases, vest in the respective Board of Directors. In the discharge of their functions, the Boards of the State Bank and the Subsidiaries are required to act "*on business principles, regard being had to public interest*" The provision in the Act of the "new banks" does not provide any such guideline. We recommend that in the management of their affairs, the Boards of the "new banks" may also be specifically required to act on "business principles, regard being had to public interest".

(*ii*) *Their Chairman*

4.32 The Chairman of the State Bank is also its Chief Executive. He is also the Chairman of the Boards of the Subsidiaries though he is not their Chief Executive. Thus, the State Bank Chairman has an effective voice also in the administration of the Subsidiaries. The General Manager of the Subsidiary, who is its Chief Executive, is not even a member of its Board. In the case of the "new banks", the Scheme provides separately for a Managing Director and a Chairman for their Boards. While both the capacities are now inhering in one person, it need not necessarily be so. Uniformity in pattern as regards the provisions applicable to the persons who should head the Boards of Directors of the national banks *vis-a-vis* the persons entrusted with powers to act as their Chief Executives is necessary.

4.33 The suggestion has been made that the functions of the Chief Executive of a national bank and those of the Chairman of the Board should not be identified in one person and that the latter should deal with policy matters and the former with the implementation of the policy. We see considerable force in this suggestion. In our view, the same person should not occupy the office of the Chairman of the Board of a national bank and also be its Chief Executive. If this is ensured, it would facilitate the objective appraisal by the Board of the performance of the administration headed by the Chief Executive. It would also enable the Chairman to bestow his attention mainly to questions of policy and not details of administration. Hence, we recommend that the scheme governing the national banks may ensure that the office of the Chairman of the Board and that of the Chief Executive of a national bank are held by different persons.

Vice-Chairman

4.34 In the case of the State Bank, there is also a provision for a Vice-Chairman who may be vested with, or to whom powers may be delegated by the Board. The Act also provides that the fact that the Vice-Chairman exercises any powers or does any act or thing on behalf of the bank is *conclusive proof* of his authority to do so. There is no provision for a Vice-Chairman in the case of the Subsidiaries and the "new banks". The necessity for the same may be considered.

Chairman/Vice-Chairman may be Whole-time or Part-time

4.35 Under the State Bank Act, the Chairman and the Vice-Chairman are appointed for a term on such "salary, fees, allowances and perquisites as may be determined by the Central Board with the approval of the Central Government". But their appointment may be either on a whole-time or part-time basis. In the case of the "new banks", while they could have either a full-time or part-time Chairman, there is no provision for payment of remuneration to a part-time Chairman. We recommend that appropriate provisions may be made in the enactments applicable to the national banks to enable the appointment of, and payment of remuneration to, the Chairman/ Vice-Chairman on a whole-time or part-time basis.

(*iii*) *Composition of the Boards*

4.36 The members of the Board of Directors of national banks could be classified into :

(1) representatives of persons engaged in particular occupations ;

(2) those having special knowledge or practical experience useful to the bank;

(3) representatives of the Central Government and the Reserve Bank ; and

(4) whole-time directors.

In addition, in the case of the State Bank and the Subsidiaries, there are a few directors representing the outside shareholders. The desirability of not continuing the outside shareholders in these banks has already been indicated.

(1) Representation to Men of Particular Occupations

4.37 The principle that in the Boards of the national banks there should be representation to men of particular occupations gained Parliamentary recognition, for the first time, in the Act of the "new banks". Hence, provision for such representation is found only in the case of the "new banks" ; no such provision is found with reference to either the State Bank or the Subsidiaries. This principle should also be recognised while determining the composition of the Boards of the State Bank and the Subsidiaries.

4.38 The Act of the "new banks" provides for the Scheme made thereunder, setting out the procedure for giving representation to :

(*i*) employees ;

(*ii*) depositors ;

(*iii*) farmers ;

(*iv*) workers ; and

(*v*) artisans.

The Act speaks of the Scheme providing for such representation by means of election or nomination. But the Scheme speaks only of nomination. The question is whether an elective process for selecting the representatives of persons engaged in the specified occupations could be implemented without difficulty. An elective process implies a clear demarcation and listing out of the persons who could be considered to be members of the specified occupations, evolving a procedure to call for nominations, to conduct elections and the constitution of an electoral authority for the purpose. We feel that the cost, time and trouble involved in following an elective process will not be commensurate with the objects in view, except in the case of the selection of the representatives of the employees. Hence, the reference in the Act of the "new banks" to an elective process in selecting such representatives may be deleted. However, in the case of selecting the representatives of employees, the provision which enables an elective process to be followed may remain.

(2) *Those having Special Knowledge or Practical Experience Useful to the Bank*

Position in "Banking Companies"

4.39 Section 10A of the Banking Regulation Act, 1949 (introduced in 1968 as part of "Social Control") provides that not less than *fifty-one per cent* of the composition of the Board of Directors of a banking company shall consist of persons who shall have special knowledge or practical experience in respect of one or more of the following matters, namely :

(1) accountancy,

(2) agriculture and rural economy,

(3) banking,

(4) co-operation,

(5) economics,

(6) finance,

(7) law,

(8) small-scale industry,

(9) any other matter the special knowledge of, and practical experience in, which would, in the opinion of the Reserve Bank, be useful to the bank.

The Section provides that out of the aforesaid number of directors, not less than two shall be persons having special knowledge or practical experience in respect of agriculture and rural economy, co-operation or small-scale industry. It is also required that persons selected as directors by reason of their special knowledge or experience in the aforesaid matters shall not have any substantial interest in, or be connected with (whether as employee, manager or managing agent), any company or firm which carries on any trade, commerce or industry, and shall not be proprietors of any trading, commercial or industrial concern, not being a small-scale industrial concern. In comparison with this provision of "Social Control", the position in the national banks may be seen.

Position in the State Bank

4.40 In the case of the State Bank, prior to 1964, there was a provision for nomination by the Central Government (in consultation with the Reserve Bank) to represent as far as possible "*territorial and economic interests* and in such manner that not less than two of them have special knowledge of the working of co-operative institutions and of rural economy and the others have experience in commerce, industry, banking or finance". However, in 1964 the

reference to "*territorial and economic interests*" was deleted. Instead, *not less than two and not more than six* directors are to be nominated by the Central Government in consultation with the Reserve Bank "from among persons having special knowledge of the working of co-operative institutions and of rural economy or experience in commerce, industry, banking or finance".

4.41 But the State Bank provision differs from the "Social Control" provision in the following respects :

(*i*) such men of special knowledge/experience are *not* required to be in the majority ;

(*ii*) the subjects, special knowledge/experience of which is indicated as qualifying a person for inclusion in the State Bank Central Board, are limited as compared to the subjects indicated in the "Social Control" provision ; and

(*iii*) there is no requirement that persons nominated under this category should not have substantial interest in, or be connected with any trading, commercial or industrial concern.

Position in the "New Banks"

4.42 The Scheme for the "new banks" provides for :

> not more than five directors, to be appointed by the Central Government, after consultation with the Reserve Bank, from among persons having special knowledge or practical experience in respect of one or more matters which are likely to be useful for the working of the nationalised bank.

The provision for the "new banks" differs from the "Social Control" one in all the respects indicated in the case of the State Bank and in addition, there is no indication of the subjects, knowledge of or practical experience in which could be considered as qualifying a person for nomination to their Boards.

Position in the Subsidiaries

4.43 There is no provision that the Boards of the Subsidiaries should necessarily include any person(s) having such special knowledge/experience.

4.44 The necessity for men with such special knowledge/experience on the Boards of the national banks needs no emphasis. While selecting persons, Government could be expected to take into account this factor. But it is also desirable to statutorily ensure this. The principle underlying the "Social Control" provision (Section 10A of the Banking Regulation Act,

1949) has validity with reference to all banks including the national banks. Moreover, the "Social Control" provision in this regard is more clear and precise. Hence, we recommend that provisions on similar lines may be made with reference to the national banks as well.

(3) Representatives of the Central Government and the Reserve Bank

4.45 There is provision now for the national banks having on their Boards a nominee of the Reserve Bank and a nominee of the Central Government. But there are some differences in the provisions providing for such representation and these differences need to be reconciled.

4.46 In the case of the Subsidiaries, the provision with reference to the Central Government nominee is not mandatory, and such nomination has to be done by the Central Government in consultation with the State Bank. While for the "new banks" the Central Government nominee shall be one of its *officials*, it need not be so in the case of the State Bank.

4.47 With reference to the "new banks" and the Subsidiaries, there is provision for an official of the Reserve Bank to be nominated on its behalf. Under the corresponding provision applicable to the State Bank, the nominee need not be an official of the Reserve Bank. Again, while for nomination to the Board of a "new bank" an official of the Industrial Development Bank of India is also regarded as an official of the Reserve Bank, there is no such deeming provision applicable to the Reserve Bank's nominee in the case of the State Bank and the Subsidiaries.

4.48 It is desirable to have uniform provisions governing all the national banks in the matter of the composition of their Boards as well. We would, however, like to deal specifically with the propriety of the Reserve Bank nominating its representatives on the Boards of the national banks. In our view, there is likely to be a conflict of interest in doing this. Having regard to the role of the Reserve Bank as the supervising authority entrusted with powers to administer banking regulation, *inter alia*, over the national banks, we do not consider it desirable that the Reserve Bank should have a direct participation in the management of these banks. We have for similar reasons recommended earlier that the ownership of the national banks should not, on principle, be vested in the Reserve Bank. For the same reason, we are of the view that it is not desirable to provide for the Reserve Bank having its representatives on the Boards of the national banks. If, however, it is considered necessary that the Reserve Bank should be closely in touch with the developments in the national banks and the decisions of their Boards, it would be sufficient to provide for the Reserve Bank appointing observers on the Boards of these banks. We recommend that appropriate provisions be made accordingly.

4.49 The provisions applicable with reference to the appointment of the representatives of the Central Government on the Boards of the "new banks" permit only the officials of the Central Government to be so appointed. We do not consider that the choice of the Government in selecting its representatives should be so restricted. In our view, it should be in order for the Central Government to nominate, as its representatives on the Boards of the national banks, either officials or non-officials. We recommend that the provision may be amended accordingly.

Members of Parliament/Legislature as Directors

4.50 Here, we find that the provisions applicable with reference to the State Bank and the Subsidiaries preclude a Member of Parliament or a Member of State Legislature from continuing as a director of any of these banks. These provisions evidently follow a similar provision found applicable to the Reserve Bank under its Act of 1934. However, no such prohibition applies with reference to the "new banks". It would be legally in order for a Member of Parliament/Legislature to be appointed on the Board of a "new bank" provided such appointment does not carry any remuneration. It is desirable to have uniform provision governing all the national banks. Either the prohibition found in the enactments governing the State Bank and the Subsidiaries should be applied also with reference to the "new banks" or such prohibition should be removed.

(*4*) *Whole-time Directors*

4.51 The number of whole-time directors to be appointed for any national bank has to depend upon its size, the volume of work and other related factors. In the State Bank there are provisions for a Chairman and not more than two Managing Directors who will be its whole-time directors. In the "new banks", the Scheme provides for not more than two whole-time directors to be appointed, of which one shall be the Managing Director. In the Subsidiaries, however, there is no provision for a whole-time director. If the General Manager (who is not at present a member of its Board) of a Subsidiary is made a member of its Board, then that would provide an effective link between the Board and the executive of the Subsidiary. We recommend that the General Manager of a Subsidiary may be made a member of its Board and designated as its Managing Director.

(*b*) *Committees of the Central Board*

4.52 There is provision for the constitution of Committees of the Boards of Directors of the national banks. Such Committees may be necessary to attend to the affairs of the banks, as the entire Boards of the banks may not be able to meet frequently, and to expedite or facilitate consideration of any particular matter or matters. But, while there are adequate provisions,

in the schemes applicable to the State Bank and even the Subsidiaries, dealing with the set-up, powers and functions of such Committees, the provisions regarding such Committees for the "new banks" do not appear to be adequate. Adequate provisions may be made in the statute with reference to the "new banks" also.

(*1*) *Executive/Managing Committee*

4.53 The State Bank Act specifically provides for the setting up of an Executive Committee, by its Central Board, to exercise such powers and perform such duties as the Board may delegate to it. The Subsidiaries Act enables the State Bank to provide by way of Regulations for "the constitution of the Executive Committee of the Subsidiary Bank and the conditions and limitations subject to which the Executive Committee may exercise its powers and the procedure to be followed at the meetings thereof"; and the Regulations framed in this behalf provide for the setting up of the Executive Committees for the Subsidiaries. In the *Act* of the "new banks", there is no provision for the setting up of an Executive/Managing Committee of the Board. But their Scheme provides for the setting up of a Managing Committee. It is desirable to provide for the setting up of Executive Committees for the "new banks" as well and the entrustment of powers to them. The provisions giving necessary powers in this behalf may be included in the statute instead of leaving the matter to subsidiary legislation.

Composition of the Executive/Managing Committee

4.54 The Act of the State Bank provides that its Executive Committee should comprise the Chairman, the Vice-Chairman, the Managing Director(s), the director nominated by the Reserve Bank and such other directors who are resident and present at the place where the meeting is held.

4.55 The Act of the Subsidiaries provides that their Executive Committee should consist of such directors "as may be prescribed". Their Regulations provide that the Executive Committee shall consist of 3 directors nominated for this purpose out of the 5 nominated by the State Bank to the Board of that Subsidiary and one of the elected directors. The other directors also may attend the meetings of the Executive Committee and if they do, they will be treated as members of the Committee for the meetings they attend.

4.56 In the case of a "new bank", the Managing Committee consists of the Chairman, the Managing Director, the nominated directors of the Reserve Bank and the Central Government, and not more than 4 other directors nominated by the Central Government after consultation with the Reserve Bank. There is no provision for the directors of the "new banks" not named as members of the Managing Committee participating in their Managing Committee, even if all, or any, of them are in a position to do so.

4.57 The Executive/Managing Committees are nothing but mini-Boards. They practically exercise all the powers of the Boards. They have been conceived because all the directors may not be in a position to attend to the affairs of the banks frequently. Hence, a director of the Board who is in a position to attend the meetings of the Executive/Managing Committee of the Board should be enabled to participate as a member of such Committee. On the pattern of the provisions applicable to the State Bank and the Subsidiaries, we recommend that it may be provided that any director of a national bank (including a whole-time director), though he is not named as a member of the Managing Committee, may participate in its meetings as a member provided he is able to attend the meetings of the Committee.

(2) *Other Committees*

4.58 The State Bank *Act* enables its Central Board to set up other Committees to exercise such powers and perform such duties as the Central Board may delegate to them. Similarly, the Subsidiaries *Act* empowers their Boards to constitute other Committees which may consist wholly or partly of persons other than directors "to exercise such powers and perform such duties" as the Boards may delegate to them.

4.59 The *Scheme* for the "new banks" provides for the constitution of Advisory Committees which may comprise wholly or partly of persons other than directors and for such Committees rendering advice to the Boards "on such matters as may be generally or specially referred to them" and for their performing such duties as the Boards may entrust to them. But, there is no provision in the Act of the "new banks" for setting up Committees by the Boards, which may, *inter alia*, comprise also outsiders.

4.60 We recommend that provisions for the setting up of other Committees and the power to associate outsiders with such Committees may be made in the enactments of the national banks.

(c) *Chief Executive Officer*

4.61 The Chairman is the Chief Executive of the State Bank. The General Managers are the Chief Executives of the Subsidiaries. The Managing Directors are the Chief Executives of the "new banks".

Inherent Powers

4.62 The State Bank's Chief Executive may, subject to the directions of the Board, "exercise all powers and do all acts and things as may be exercised or done by the bank". The Chief Executive of a Subsidiary is, subject to the control of the Board, vested with the "day-to-day administration and management of the affairs of the bank". The Chief Executive of

a "new bank" is not *per se* vested with any powers to act on behalf of the bank, as is found in the case of the Chief Executives of the State Bank and the Subsidiaries. He has only such powers as are specifically delegated to him. This may give rise to difficulties, in that he may have to refer even urgent or very minor matters to the Board if they did not fall within the ambit of powers delegated to him. The time of the Board is also likely to be consumed on comparatively minor or even routine matters. Alternatively, there has to be comprehensive delegation of powers to him by the Board ; the difficulty here is that the scope and validity of delegation could often be a matter in issue.

Delegated Powers

4.63 The necessity for conferment of any power by delegation is only to the extent the statute has not conferred on the Chief Executives such powers therefor. The *Chairman of the State Bank* requires no express delegated authority from his Board to act on behalf of the bank, nor the *General Manager of a Subsidiary* regarding the day-to-day administration of the bank. But the latter exercises also such other powers and performs such other duties as are delegated to him. Under the General Regulations, the General Manager of a Subsidiary has been entrusted with powers to transact "all the current business of the Subsidiary Bank" which is considered urgent, subject to subsequent reporting of his action to the Executive Committee.

4.64 The *Chief Executives of the "new banks"* have to rely, as stated above, in performing their duties, on specific delegation. Such delegation is to be made by way of Regulations. No Regulations have so far been framed under the Act and until then, "the Articles of Association of the 'existing bank' and every regulation, rule, bye-law or order made by the 'existing bank' shall, if in force at the commencement of this Act, be deemed to be the regulations" under the Act "and any reference therein to any authority of the 'existing bank' shall be deemed to be a reference to the corresponding authority" of the "new bank". Thus, the powers delegated to the Chief Executives of the 'existing banks' may now be available to the Chief Executives of the "new banks". But, evidently, such powers may not be uniform even as regards those 14 "new banks".

4.65 We recommend that the Chief Executives of all the national banks may be vested with the same, or similar, powers. The Chief Executive should be the administrative head of the bank and should be entrusted with all necessary powers.

Appointment and Remuneration

4.66 The Chief Executive of the *State Bank* is appointed by the Central Government on the recommendation of its Board, in consultation with

the Reserve Bank. The General Manager of a *Subsidiary* is appointed on the recommendation of its Board by the State Bank with the approval of the Reserve Bank. These appointments are provided for in their respective *Acts*. The *Scheme* for the "new banks" provides for the appointment of a Managing Director by the Central Government after consultation with the Reserve Bank. There is no provision in their Act providing as such for the appointment of a Managing Director.

4.67 The remuneration of the Managing Director of a "new bank" is determined by the Central Government in consultation with the Reserve Bank for the first appointment and in consultation with the Board of that bank with reference to subsequent appointments. In the case of the State Bank, the remuneration of the Chief Executive is determined by its Central Board with the approval of the Central Government. The remuneration of the Chief Executive of a Subsidiary is determined by the State Bank with the approval of the Reserve Bank.

4.68 We recommend that provision may be made in the statutes governing the national banks for the appointment of their Chief Executives and for the remuneration payable to them, and such provision may be on uniform lines with reference to all the national banks.

Deputy Chief Executives

4.69 As seen already, the State Bank Act also provides for that bank having two Managing Directors to exercise such powers and perform such duties as may be entrusted or delegated to them by the Board, subject to the control of the Chairman and the Vice-Chairman. While the Chairman of the State Bank is its Chief Executive, the Managing Directors play the role of Deputy Chief Executives in that bank. While the Scheme for the "new banks" provides for two whole-time directors, one of whom shall be the Managing Director, there is no reference in the Act of these banks for such Deputy Chief Executives. Whether or not it is desirable to provide for such Deputy Chiefs in the other national banks has to be decided. We recommend that having regard to their size, extent, area of operation and such other relevant factors, the desirability of providing for Deputy Chief Executives for all the national banks may be considered.

B. Organisation at the Regional Level

(a) *Local Boards*

(1) *Their Powers*

4.70 The State Bank Act provides for the constitution of Local Boards at each of the bank's Local Head Offices and for entrusting them with sub-

stantial powers to carry on the business of the bank, subject to the overall control of the Central Board. Thus, the Local Boards of the State Bank may exercise :

> "all powers and perform all functions and duties of the State Bank in relation to any business that may be carried on by the State Bank" mainly relating to —
>
> (*i*) agency functions entrusted by the Reserve Bank (including the handling of Government transactions) and handling other types of agency work ;
>
> (*ii*) advancing and lending of money and the opening of cash credits upon security ;
>
> (*iii*) realisation of the dues and enforcing of the security ;
>
> (*iv*) dealing in bills (including foreign bills) and other negotiable securities ;
>
> (*v*) remittance transactions and letters of credit ;
>
> (*vi*) dealing in bullion ;
>
> (*vii*) accepting deposits and keeping cash accounts ;
>
> (*viii*) safe custody of valuables ;
>
> (*ix*) entering into contracts of indemnity, surety, or guarantee ; and
>
> (*x*) the carrying on of executor and trustee business.

Subject to the Central Board's power to give policy directions and otherwise control the Local Board (*e.g.*, by means of regulations, orders, etc.), the Local Boards function independently with their own powers and responsibilities. Though the Act of the "new banks" refers to Regulations being made for :

> the powers, functions and duties of Local Boards, and restrictions, conditions or limitations, if any, subject to which they may be exercised, the formation and constitution of Local Committees and Committees of Local Boards,

there is no provision in their Act for the setting up of regional boards with statutory power and responsibility to carry on their business independently, as in the case of the State Bank. We recommend that provision may be made in respect of the "new banks" for the setting up of regional Boards with statutory powers and responsibilities to carry on their business independently, as in the case of the State Bank, wherever necessary.

(*2*) *Their Composition*

4.71 The Local Boards of the State Bank consist of —

(*i*) Chairman (the Chairman of the State Bank, ex-officio) ;

(*ii*) Directors elected or nominated to the Central Board, residing in the area served by the branch register of the Local Head Office ;

(*iii*) Six members nominated by the Central Government in consultation with the Reserve Bank ;

(*iv*) One person to be elected from amongst the shareholders (other than the Reserve Bank) specified in the branch register, if they are holding upto 2 1/2 per cent or more of the issued capital ;

(*v*) Secretary and Treasurer of the Local Head Office (ex-officio).

The President and Vice-President of the Local Boards are appointed by the Governor of the Reserve Bank in consultation with the Chairman of the State Bank.

As regards the composition of the Local Boards, the question is whether it requires to be reviewed in the light of recent developments, that is —

(*i*) whether representation should be given at the local level for men engaged in specified occupations, and

(*ii*) whether it should be ensured that men with special knowledge or experience are associated in sufficient number.

It is necessary to include also at the local level representatives of the specified classes of persons and persons with special knowledge or experience, having regard to the purpose for which such persons are included in the Boards of the national banks. We recommend that provision may be made to provide also for such representation in the composition of the Local Boards of the national banks.

(*b*) *Committee of the Local Board*

4.72 The State Bank Act provides for a Committee of the Local Board comprising Chairman/Vice-Chairman, President/Vice-President, Secretary and Treasurer and any two members to be elected as equally as possible in rotation from among the members both elected and nominated, of the Local Board, other than the Chairman and the President. The Committee of the Local Board may, subject to the direction of the Central Board, "*deal with any matter within the competence of the Local Board.*"

4.73 We recommend that in the case of the "new banks" also provision may be made for constituting Committees of Local Boards having regard to relevant factors, such as their size, area of operation, etc.

(*c*) *Local Committee*

4.74 The State Bank Act empowers its Central Board to constitute Local Committees "*for any area*" to exercise such powers and perform such

functions as the Central Board may confer on, or assign to, it. The Local Committee shall consist of "such number of members as may be prescribed" with the Chairman as ex-officio member. We recommend that such enabling provision may be made with reference to the other national banks as well.

(*d*) *Chief Executive for the Region*

4.75 The State Bank Act provides for the Secretary and Treasurer of its Local Head Office being the Secretary of the respective Local Board and of the Committee of the Local Board. We recommend that appropriate statutory provisions may be made for the "new banks" also having regional Chief Executives, wherever necessary, on the pattern of the provisions applicable to the Secretary and Treasurer of the State Bank.

Regional Consultative Committees

4.76 The Act of the "new banks" does not, but it is only their Scheme that does, provide for the constitution of the five regional consultative committees by dividing the country into five regions. The committee's function is to "*review banking developments within the region*" and to make "*such recommendations as it may deem appropriate for the consideration of the Central Government and the Reserve Bank of India*". Evidently, the purpose for which such regional consultative committees are constituted has no direct nexus with the setting up of the "new banks", which alone is dealt with in their Act. The purpose of the regional consultative committee is "banking development in the region" and is not confined to, or only concerned with, the affairs of the "new banks". In "banking development", it may have to, *inter alia*, take note of the development not only of all the national banks but also of all other banks and the interests of the public. Hence, we recommend that the provisions relating to the set-up and functions of the Regional Consultative Committees may be embodied in a separate Chapter of the Banking Code.

4.77 The composition of the regional consultative committee, as provided for in the Scheme for the "new banks", is —

(*i*) 3 nominees of the Central Government ;

(*ii*) 2 representatives each of the States and 1 from each of the Union Territories included in the respective regions, to be nominated by the Government of the State or the Union Territory ;

(*iii*) 1 representative each to be nominated by "such of the nationalised banks having offices in the region as may be designated by the Reserve Bank".

These regional consultative committees are to be presided over by the Minister/Deputy Minister of the Ministry of Finance. The representatives

of the State Governments are now for the first time formally associated with the review of the banking developments in the region and for suggesting appropriate measures.

4.78 At present there is no provision for giving representation to the State Bank and the Subsidiaries in the regional consultative committees. In line with our recommendations suggesting same or similar treatment being given to all the national banks and having regard to the objectives for the setting up of the regional consultative committees, we recommend that representation to the State Bank and the Subsidiaries may also be provided for in the composition of such Committees. In fact, even banks other than the national banks having offices in a region are concerned with the working of, and may have a claim to be given representation in the regional consultative committees. Hence, we recommend that provision may also be made for giving representation to such banks, including the co-operative banks, in the composition of the regional consultative committees.

Authorised Business

(*a*) *Banking and Allied Business*

4.79 As we noted earlier, while the "new banks" and the Subsidiaries are authorised to carry on the business of 'banking' and also to engage in carrying on any form of business which "banking companies" are permitted to do under the Banking Regulation Act, 1949, the position in relation to the State Bank is different. Though the State Bank has been constituted, *inter alia*, "to carry on the business of banking and other business", in carrying on its 'banking' and allied business, the State Bank suffers from two major handicaps, namely,

(*i*) Section 33 of its Act, which enumerates the types of transactions that could be entered into by the bank, is not exhaustive enough to cover all transactions that could be carried on by the other banks in the course of carrying on of banking or allied business.

(*ii*) There is also a specific ban under Section 34 of its Act, prohibiting the State Bank from ordinarily entering into transactions of the following types —

(*a*) lending for periods in excess of 12 months ;

(*b*) lending upon the security of immovable property or documents of title relating thereto ;

(*c*) discounting bills of, and lending to, any individual or firm, for an amount exceeding the prohibited limit, except upon specified types of security ;

(*d*) discounting or otherwise lending on the security of any negotiable instrument unless it is backed by the several responsibilities of two independent persons or firms, and unless such instrument matures within a stated period.

Though, in the course of years since the State Bank was established, the State Bank Act has been time and again modified specifically permitting that bank to enter into one or the other types of transactions that would otherwise come within the prohibited, or not authorised, range of transactions, still, the State Bank is considerably at a disadvantage as compared with the powers of the "new banks", or for that matter, of its own Subsidiaries. It is desirable that the fetters in the State Bank Act on the bank entering into all types of banking and allied transactions should be removed, thereby giving that bank the same powers for the carrying on of business as are at present available to the "new banks" and the Subsidiaries.

(*b*) *Transaction of Government Business*

(*i*) *Central Government Business*

4.80 Sections 20 and 21 of the Reserve Bank Act require that the Reserve Bank shall —

(1) accept moneys for the account of the Central Government and make payments thereon "upto the amount standing to the credit";

(2) maintain the cash balances of the Government *free of interest* ;

(3) manage the remittance, exchange and banking transactions in India ; and

(4) manage the Public Debt of the Union.

In respect of the aforesaid functions, at places where the Reserve Bank has no branch of its Banking Department, the State Bank has ordinarily the monopoly of carrying on such kinds of business (in terms of Section 45 of the Reserve Bank of India Act and Section 32 of the State Bank of India Act). Since the Banking Department of the Reserve Bank is functioning only at a few places, the State Bank handles the substantial portion of the Central Government business.

Currency Chests

4.81 To facilitate the management of the remittance and exchange transactions of the Government, the State Bank is also entrusted with Currency Chests. "The mechanism of currency chests is, thus, also of assistance to the Central and State Governments *as well as the State Bank and its subsidiaries*, inasmuch as it *enables the Treasuries and the bank branches to work with*

relatively small balances"[1]. It is desirable that this facility is available to all the national banks.

4.82 The aforesaid advantages are not available to the "new banks", while the Subsidiaries, in their capacity as agents of the State Bank, handle Central Government business and are also given custody of the Currency Chests. In relation to the transaction of Government business, especially the Central Government business, we feel that all the national banks should be treated on par. We understand that Orders have been issued, under Section 45 of the Reserve Bank of India Act, 1934, by the Central Government indicating certain places where the "new banks" could act as agents of the Reserve Bank. Under Section 45 *ibid*, the general rule contemplated is that ordinarily it is the State Bank that should act as the agent of the Reserve Bank, wherever permissible.

4.83 We recommend that Section 45 of the Reserve Bank of India Act, 1934, may be amended in such a way that legally all the national banks are placed on the same footing in the matter of transacting Central Government business. Depending on administrative convenience, it may be decided whether at any place, all, or any one or more, of the national banks should act as the agent'(s) of the Reserve Bank in this behalf. We also recommend that the "new banks" may also be given the privilege of having the custody of Currency Chests on the same, or similar, terms, subject to which the State Bank and the Subsidiaries are entrusted with their custody.

(*ii*) *Business of State Governments*

4.84 Section 21A of the Reserve Bank Act enables the Reserve Bank to undertake by entering into agreements with the State Governments —

(1) the money remittance, exchange and banking transactions in India, including in particular, the deposit *free of interest* of the Government's cash balances with the Reserve Bank ; and

(2) the management of Public Debt and the issue of any new loans by the State Governments.

Agreements already entered into before the 1st November 1956 have effect as if such agreements were made on that date, subject to such modifications, if any, as are of a character not affecting the general operation of the agreements, as may be agreed upon between the Reserve Bank and the State Governments, or in default of such agreements, subject to such modifications as may be made by the order of the Central Government (*vide* Section 21B of the Reserve Bank Act).

1. "Functions and Working of the Reserve Bank of India", Reserve Bank of India, 1970 edition, page 15.

4.85 Sections 21A and 21B of the Reserve Bank Act, read with Section 45 of the said Act and Section 32 of the State Bank Act, effectively provide for the State Bank carrying on such business on behalf of the State Governments.

4.86 The Subsidiaries are getting the State Governments' business routed through the State Bank. Here again, the State Governments' business is carried on by the State Bank in its capacity as the agent of the Reserve Bank, pursuant to the agreements referred to above. The amendment of Section 45 of the Reserve Bank Act, as indicated already, may also help in the Reserve Bank routing the business of the State Governments through all the national banks including the "new banks". We recommend that it may be statutorily provided that any of the national banks may be entrusted with State Government business.

(*iii*) *Business of Local Bodies and Statutory Corporations*

4.87 Local bodies, statutory bodies and Government corporations/ companies are not generally under any statutory obligation with regard to the bank to which they could entrust their banking business. But the Central Government has issued administrative directions to such bodies for having their banking business ordinarily entrusted only to the State Bank and the Subsidiaries. However, in 1966 the Government appears to have also permitted such business to be entrusted to the State Co-operative banks and any other approved Central Co-operative banks (*vide* Government of India Office Memoranda No. F.II(1)-BC/64 dated the 11th March 1964 and No. F.16/3/66-SB dated the 18th June 1966). We recommend that Government may modify suitably its administrative instructions issued earlier, to enable all the national banks being entrusted with the banking business of local bodies and statutory corporations.

(*iv*) *Provisions in Special Enactments regarding Entrustment of Funds, etc.*

4.88 Under Section 7(3) of the Textile Committee Act, 1963, the Textile Committee is required to keep its funds only with the State Bank or invest the funds in approved securities. Paragraph 52 of the Employees' Provident Fund Scheme provides that all moneys belonging to the Fund should be deposited in the Reserve Bank/State Bank or any other scheduled bank as may be approved by the Central Government. Rule 27 of the Employees' State Insurance Rules, 1950, provides that all moneys belonging to the Insurance Fund, which are not immediately required, should be invested in approved securities or kept in deposit with the Reserve Bank/State Bank or the Subsidiaries. There are also other local laws in the different States providing for the banking transactions of specified bodies to be entrusted only to the State Bank or its Subsidiaries. The reference to the above provisions is only illustrative and does not exhaust all provisions of such

nature. The aforesaid provisions give an edge to the State Bank and the Subsidiaries and ensure that they get the business of Trusts and other statutory bodies, etc. It is logical to give all the national banks parity of treatment by making suitable amendments to the statutory or other applicable provisions. Hence, we recommend that the statutory and other applicable provisions in, or under, other Central or State enactments may be suitably modified so as to provide for the business of Trusts and other statutory bodies being given to any national bank.

National Banks as Intermediate Central Banks

4.89 We mentioned earlier, while dealing with the historical background for the setting up of a 'national banking establishment', that the Imperial Bank was performing certain central banking functions and that this continued in certain respects even after the setting up of the Reserve Bank. The State Bank, as the successor of the Imperial Bank, continues to play the role of an intermediate central bank. It has been pointed out to us that there is no justification for the State Bank continuing to play that role. Even without going into this question, we may observe that there seems to be no reason why all the national banks should not be treated on par in these respects.

4.90 We may refer to the main provisions relevant in the said context. They are Sections 18 and 24 of the Banking Regulation Act, 1949, and Section 42 of the Reserve Bank of India Act, 1934, which require the commercial and co-operative banks to keep 28 per cent of their 'liabilities' in India in the form of liquid assets.

4.91 As per the requirements of those provisions, the non-scheduled banks are required to maintain 3 per cent of their total demand and time liabilities in the form of cash or balances held in current account with the Reserve Bank, State Bank or a notified bank. Advances obtained from the Reserve Bank, State Bank and notified banks are not taken into account for determining the 'liabilities' in India for this purpose. The scheduled banks are to maintain 3 per cent of their total demand and time liabilities with the Reserve Bank and in determining such liabilities, loans taken from the Reserve Bank, State Bank and the notified banks are excluded. While the Subsidiaries have been notified for these purposes, the "new banks" do not seem to have been so notified yet.

4.92 Again, all banks are to maintain 25 per cent of the total of their demand and time liabilities in India in the form of liquid assets, namely, cash, gold or unencumbered approved securities. Balances held with the State Bank or the notified banks by —

(*a*) non-scheduled banks in excess of the amounts required to be maintained under Section 18 of the Banking Regulation Act ; and

(*b*) scheduled banks

are deemed to be cash maintained in India by such banks for this purpose. In computing "cash or balances maintained in India"—

(*a*) non-scheduled banks are permitted to take into account also the balances held with the State Bank or any other notified bank, in excess of the requirement under Section 18 *ibid* ; and

(*b*) scheduled banks are permitted to take into account the balances maintained by them with the State Bank or any other notified bank.

While the Subsidiaries have been notified for the purpose of Section 24, the "new banks" do not seem to have been notified yet.

4.93 It is desirable that all the national banks are given the same parity of status as regards the maintenance of balances with them by, or granting of loans by them to, the other scheduled and non-scheduled banks. Hence, we recommend that the references in Sections 18 and 24 of the Banking Regulation Act, 1949, and Section 42 of the Reserve Bank of India Act, 1934, to the State Bank may be substituted by the reference to the national banks.

Accounts

4.94 There should be uniformity in dealing with the annual accounts of the national banks. At present, the annual accounts and the auditors' reports of the State Bank are discussed at the annual general meeting; likewise, the annual accounts and the auditors' reports of the Subsidiaries are discussed at their annual general meetings. As there are no shareholders, there is no such annual general meeting to consider the annual accounts of the "new banks"; instead, their accounts are placed before both the Houses of Parliament. As we expressed earlier, there is no need to have any shareholder for either the State Bank or the Subsidiaries ; in which case, there need not be any annual general meeting. We recommend that the annual accounts of all the national banks may be placed before Parliament for consideration. There should also be uniformity as regards the persons who should sign the accounts and the time for the completion and submission of the accounts of all the national banks.

Secret Reserves

4.95 Our attention has been drawn to certain difficulties in the auditors certifying the balance sheets of the national banks as reflecting "a true and a fair view" when the bank concerned is keeping some undisclosed reserves.

4.96 The auditors have explained their difficulty as mainly due to certain differences in the provisions relating to "banking companies" and

the provisions that are applicable to the national banks. As regards the former, Section 211 of the Companies Act, 1956, specifically provides that the balance sheet and profit and loss account of a "banking company" shall not be treated as not disclosing the true and fair view of the state of affairs of the company resources which are *not* required to be published under the Banking Regulation Act, 1949 (*vide* Section 211(5)(ii) of the Companies Act). That provision applies only to a "banking company" (*vide* Section 29(3) of the Banking Regulation Act) ; "banking company" has the same meaning under the Companies Act as it has under the Banking Regulation Act (*vide* Section 2(5) of the Companies Act). The national banks are not "banking companies" as they are not "companies", and certain provisions of the Banking Regulation Act (those specified under Section 51 of the Act) alone are applicable to them. In view of this, the specific concession available to auditors certifying the balance sheets of "banking companies" is not available to the auditors of the national banks. In the absence of such a saving provision, the auditors of the national banks have pointed out that they are finding it difficult to certify as true and fair the balance sheets of these banks when there are undisclosed reserves.

4.97 No doubt, it may be urged that so long as the balance sheet and profit and loss account of the bank are in the forms specified (the provisions relating to the form permitting the maintenance of secret reserves), the auditor may not have any difficulty in certifying that the said accounts give a true and a fair view. However, if this view is to be valid, it has to be assumed that Section 211(5)(ii) of the Companies Act is redundant.

4.98 The position indicated above has led to certain differences of opinion between the auditors of the national banks and their managements on the propriety of their auditors certifying their balance sheets as true and fair when the banks are keeping undisclosed reserves. A qualified form of certificate has now been agreed upon and this provides for the auditors certifying that the bank's balance sheet and profit and loss account disclose "such matters as were required to be disclosed in the case of banking companies prior to nationalisation by virtue of the provisions of the said Act (Banking Regulation Act) read with the related provisions of the Companies Act, 1956"; and that "subject to the limitations of such disclosures and on the basis of the audit", the auditors could certify the balance sheet as giving a true and fair view of the affairs of the bank. It is no doubt desirable to place this matter beyond the pale of any legal doubt that may be felt by the auditors of the national banks. However, in the view we have taken in the next chapter on the propriety of the national banks being enabled to maintain undisclosed reserves, this difficulty would not continue.

Secrecy of the Affairs of the National Banks

4.99 While framing our questionnaire on the banks' obligation to maintain secrecy, we have noted that the provisions in the enactments govern-

ing the national banks provide for a form of declaration of secrecy to be subscribed to by every official of the bank, including its Chairman and directors, to the effect that he will not divulge any information relating to the affairs of the bank (as distinct from the declaration portion relating to the maintenance of secrecy of the affairs of customers) to anyone not legally entitled thereto. By reason of this statutory form of declaration, the national banks are handicapped in disclosing information relating to themselves, even in proper cases, except under compulsion of law. We recommend that a specific statutory provision may be made to the effect that by reason of the statutory form of declaration of secrecy provided for the officials of the national banks, the banks are not disabled from disclosing information relating to their affairs, as distinct from those of their individual customers.

Audit

4.100 We have found some minor differences in the provisions applicable to the national banks in relation to the appointment of their auditors, the carrying out of special audit, the remuneration of auditors, the form of the auditors' certificate, and submission and verification of the auditors' report. The provisions relating to audit should, in our view, be uniform for all the national banks.

Branch Audit

4.101 The auditors of the national banks have also felt certain difficulties in following the formula prescribed under the Companies Act, for the audit of the branches of national banks. In the absence of specific exempting provisions, they feel that it would not be in order to audit only certain branches of a national bank and leave out the rest. We consider that it is desirable to provide specifically for the branch audit of the national banks on the pattern of the provisions applicable to companies.

Central Government's Powers

4.102 The Central Government has certain powers in relation to the national banks and they pertain to (*a*) policy matters, (*b*) scheme making powers and (*c*) powers to frame rules.

Policy Matters

4.103 In relation to all the national banks, the Central Government can give directions in regard to matters of policy involving public interest, in consultation with the Reserve Bank. With reference to the State Bank, while giving such directions, the Central Government has to consult, in addition, also the Chairman of the State Bank and all directions "shall be given through the Reserve Bank". The Central Government's directions to

the State Bank can relate also to the State Bank's functions "relating to a Subsidiary Bank". We recommend that there should be a uniform rule with reference to all the national banks.

Scheme Making Powers

4.104 There is provision for the Central Government making a Scheme for the "new banks", but not in respect of the State Bank and the Subsidiaries. The scheme making power enables the Central Government (in consultation with the Reserve Bank) *inter alia* to alter suitably the capital structure, constitution of the Board, and to reconstitute, amalgamate or transfer their undertakings (wholly or in part) of the "new banks". It has no such power under the enactments governing the State Bank and the Subsidiaries. Since it would facilitate the restructuring of all the national banks, we recommend that appropriate provisions may be made in the enactments governing the national banks to give the Central Government similar powers with reference to all the national banks including the State Bank and the Subsidiaries.

Powers to Frame Rules

4.105 There is no provision in the "new banks" Act for the Central Government making any rules to give effect to the provisions of the Act, as the Central Government could with reference to the State Bank and the Subsidiaries Acts. It is desirable that Government has such power with reference to "new banks" as well.

Power to Acquire Other Undertakings

4.106 While Section 35 of the State Bank Act and Section 38 of the Subsidiaries Act enable these banks to acquire other banking undertakings pursuant to a scheme to be framed by the Central Government in this regard, these sections also exhaustively set out the matters that could be dealt with under such schemes. We recommend that on similar lines provision may be made with reference to the "new banks" as well.

RESTRUCTURING OF THE NATIONAL BANKS

4.107 As stated above, there is no provision in the State Bank Act or the Subsidiaries Act providing for their restructuring, as we find with reference to the "new banks".

4.108 Section 9(2)(c) of the "new banks" Act provides that the Central Government could by way of a scheme provide for —

(*a*) the reconstitution of any of the "new banks" into two or more corporations ;

(*b*) the amalgamation of any of the "new banks" with any other of these banks or with any other banking institution ;

(*c*) the transfer of the whole or any part of the undertaking of any of the "new banks" to any other banking institution ; and

(*d*) the transfer of the whole or any part of any other banking institution to any of the "new banks".

Under (*a*) above, the identity of the present bank would be, and under (*b*) it may be, lost when a new corporation would come into being. While the provisions of the Act define the powers and functions of the "new banks" that have been set up in the place of the "existing banks", there is no clear indication as to whether these powers, functions and duties would be applicable *mutatis mutandis* to the corporations that may spring into existence from out of the break-up or amalgamation of any of the "new banks". It may be noted that except Section 9(2)(c), the other provisions of the Act are with specific reference to the "new banks". The point is whether all these provisions that apply to the "new banks" will, or should, apply to the corporations that may spring into existence hereafter pursuant to Section 9(2)(c). It is doubtful whether the Scheme can set out the provisions that may be considered necessary to be applied to the corporations that may be established under the Scheme. We recommend that the provisions that should apply to the new corporations that may come into existence by reason of the break-up or amalgamation of any of the "new banks" may be laid down in the statute itself.

4.109 Under (*c*) above, if the whole of the undertaking of any of the "new banks" is to be transferred to any other banking institution, then the transferor "new bank" may have to be dissolved under Section 18 of the Act.

4.110 In the case of transfer of only a part of the undertaking of any of the "new banks" to any other banking institution and in the case of the transfer of the whole or part of any other banking institution to any of these "new banks", the continued existence of the concerned "new bank" is maintained and the provisions of the Act will continue to apply to the said "new bank" as hitherto.

4.111 Though Section 9(2)(c) of the Act would authorise the Central Government, under a scheme, to reconstruct or amalgamate any of the "new banks", or transfer the whole or any part of their undertakings to any other banking institution, or *vice versa*, insofar as the scheme seeks to touch other banking institutions, it may be necessary to comply with the provisions of the enactments/laws governing such banking institutions. This is because the scheme, as a piece of subsidiary legislation, cannot override the express provisions or requirements of any other law or statute. It may also be noted

in this regard that unlike in the case of the schemes framed under Section 45 of the Banking Regulation Act, 1949 [*vide* Section 45(14)], or the schemes framed under Section 35 of the State Bank Act [*vide* Section 35(3)], or the schemes framed under Section 38 of the Subsidiaries Act [*vide* Section 38(3)], the relevant provision (Section 9) of the "new banks" Act does not say that the provisions of the schemes framed thereunder should take effect notwithstanding anything contained in any other law. Absence of such a provision may give room to difficulties. Hence, we recommend that the pattern of the provisions found applicable to the Schemes that could be framed under the Banking Regulation Act, the State Bank Act and the Subsidiaries Act may be adopted with reference to the provisions to govern the Schemes that could be framed under the "new banks" Act.

4.112 While Section 12(4) of the "new banks" Act specifically provides that the transfer of the services of employees of the "existing banks" to the corresponding "new banks" shall not entitle such employees to any compensation (like that payable under the Industrial Disputes Act, 1947), there is no such provision applicable to a case where the services of the staff of any of these "new banks" may be required to be transferred to any other corporation or other banking institution, or *vice versa*, under a scheme. It is a matter of doubt whether this could be provided for in a scheme. It may be noted that there are specific provisions in the other enactments for the scheme providing for this (*vide* Section 45(5)(i) and (j), Section 35(8) and Section 38(8) respectively of the above mentioned enactments). Hence, the question arises whether a scheme providing for the transfer of staff pursuant to reconstruction, amalgamation, etc., could validly say (in the absence of a specific provision to that effect) that by reason of such transfer the concerned staff shall not be eligible for any compensation to which they may be entitled under the provisions of any other law, rule, etc., in such cases. Hence, we recommend that statutory provisions may be made to provide for this.

4.113 It may be observed that the aforesaid enactments contain enabling provisions which specify in detail the matters that can be provided for in the Schemes. Such enabling provisions help to decide whether or not the Scheme could deal with a particular matter. They reduce the scope for disputes regarding the validity of such Scheme provisions. Since the Act of the "new banks" does not specify expressly the matters that could be provided for in the Scheme framed under Section 9 of that Act, we recommend that similar provisions may be made in respect of the Schemes framed under the "new banks" Act.

4.114 It is desirable that there should be a provision for the reconstruction and restructuring of all the national banks in view of our recommendations.

4.115 We have seen so far the differences that prevail in the pattern of the provisions relating to the set-up, powers and functions of the national banks. These differences have to be reconciled and a uniform pattern evolved. This could be achieved by the separate Acts now governing these banks being repealed and all these banks brought within one statutory framework. This, as we have earlier suggested, could be a part of the comprehensive Banking Code which we envisage. While all the national banks have to be brought within one statutory framework, we have not considered whether their number should remain as they are now, or that they should all be merged into one monolithic banking corporation, or that they should be restructured into a specified number of units.

CHAPTER 5

BANKS AND SECRECY

Banks observe secrecy essentially with reference to the information they have regarding the affairs of their customers and generally as to their own affairs. As we will see hereafter, the obligation to observe secrecy as to the affairs of their customers rests on a statutory basis in the case of the national banks, and as an implied term of the contract between the banks and their customers in the case of the other banks. The provision regarding the observance of secrecy as to the affairs of banks, as distinct from the affairs of their customers, is something peculiar to the national banks. Further, banks maintain what are called "inner reserves" or "secret reserves" which are not disclosed in their published accounts. In this chapter, we deal with the nature, the extent, and the desirability or otherwise, of keeping confidential the affairs of the banks and those of their customers.

A. OBLIGATION AS REGARDS THE AFFAIRS OF CUSTOMERS

5.2 Though the relationship between the bank and the customer is primarily that of debtor and creditor, this has been somewhat coloured by the other possible relationships considered earlier in English law, *viz.*, (*a*) of principal and agent ; and (*b*) of trustee and beneficiary. The agent owes to his principal the duty of good faith and confidence in relation to his transactions and their accounts and in the case of Tournier *v.* National Provincial Bank,[1] it was considered that a similar position should exist as between banks and their customers. On this basis, it was held that the bank is under a "contractual duty of secrecy implied in the relation of banker and customer", the confidential relationship being very marked in respect, at any rate, of "all the transactions that go through the account, and to the securities, if any, given in respect of the account"[1]. Thus, in U.K., it is now well established that a bank has to keep confidential the information it receives of the affairs of its customers. Though there was originally a doubt whether such obligation was a legal or a moral duty, it is now understood as a legal duty, flowing as an implied term of the contract between the banks and their customers. In Tournier's case[1], Bankes, L.J., indicated that though the underlying principle may be the same, this obligation need not be the same in the case of the counsel, the solicitor, the doctor and the banker. This obligation is now statutorily recognised in the case of the national banks.[2]

1 Tournier's case, (1924) 1 K.B. 461.
2 Section 44(1) of the State Bank of India Act, 1955, Section 52(1) of the State Bank of India (Subsidiary Banks) Act, 1959, and Section 13(1) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.

There is general support for the view that the banks' obligation to treat as confidential the affairs of their customers should continue. In order to encourage the spread of the use of bank facilities, and instil in the public mind confidence in banks, we recommend that this obligation of banks should continue. But this obligation should be subject to recognised exceptions and qualifications.

5.3 In Tournier's case[1], Bankes, L.J., felt that it is not possible to frame any exhaustive definition of the banks' duty in this regard and the most that can be done is to classify the qualifications for the duty and indicate their limits. "On principle" he felt that "the qualifications can be classified under four heads : (*a*) where disclosure is under compulsion by law ; (*b*) where there is a duty to the public to disclose ; (*c*) where the interests of the bank require disclosure ; and (*d*) where the disclosure is made with the express or implied consent of the customer". For good reason he considered it desirable that the banks' obligation to keep in confidence the affairs of their customers should be subject to the said qualifications. Even now, it is so understood. But the difficulty relates to the determination of circumstances in which the banks could be considered as relieved of their obligation by reason of any of the aforesaid qualifications being attracted.

Disclosure of General Information

5.4 Before going into the aforesaid qualifications, we may refer to the disclosure of information by banks as to the affairs of their customers in a general way without revealing the identity of the individual constituents. Banks are asked to furnish, for statistical and other purposes, information as regards different classes of customers classified sectorally or groupwise.

5.5 As the obligation rests on an implied provision of the contract between a bank and its customers, the obligation is confined to keeping in confidence the affairs of the individual customer and would not cover cases of disclosure of information of a general nature relating to customers. The provisions applicable to the national banks[2] provide that a national bank should not divulge "*any information relating to or to the affairs of its customers*". These words literally understood may comprise also information of a general nature. However, from the Notes on Clauses attached to the relevant provision (at the Bill stage) it is seen that the intention of the provision is only to place an obligation on the bank as to secrecy regarding the accounts of the *individual* constituents of the bank. Still, we recommend that the position may be statutorily clarified by adding a proviso to the said provisions to the effect that the obligation is not to affect in any manner the banks furnishing

1 Tournier's Case, (1924) 1 K. B. 461.
2 Section 44(1) of the State Bank of India Act, 1955, Section 52(1) of the State Bank of India (Subsidiary Banks) Act, 1959 and Section 13(1) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970.

information of a general nature relating to the affairs of their customers without revealing the identity of the individual constituent. Now we may deal with the qualifications mentioned above.

(*1*) *Where the Disclosure is under Compulsion by Law*

5.6 Under this head, the regular exercise by the proper officer of actual legal power to compel disclosure is necessary. Some specific types of cases may be noticed while considering the operation of this qualification to the general rule. In Tournier's case[1], Bankes, L.J., gave, as an instance of this class of qualification, the duty to obey an order under the Bankers' Books Evidence Act.

(*a*) *Bankers' Books Evidence Act*

5.7 The Bankers' Books Evidence Act provides that no officer of a bank shall, in any *legal proceedings* to which the bank is not a party, be compellable to produce any of the bank's books, the contents of which can be proved under the Act. In A.F.G. Price *v.* Emperor[2], it has been held that where a police officer investigates a charge against a customer of the bank and asks for an inspection of the accounts with the bank, he is entitled to such inspection, and the proceedings before him during investigation are not "legal proceedings" within the meaning of the Bankers' Books Evidence Act. While a police officer, for the purposes of his investigation, may have a right to inspect the relevant books of the bank, considerable hardship would be caused if copies, instead of the originals, thereof are not permitted to be produced before the authorities investigating any crime (unless the originals, and not the copies, are considered necessary to prove the crime). The learned author, M. L. Tannan, in his book on the "Law and Practice of Banking in India" has favoured amendment of the law to provide that even during police investigation, it would be in order for the bank concerned to produce before the police authorities certified copies, instead of the originals, of its books[3]. In fact, a bank's book would ordinarily contain information about a number of its constituents, and production of the books may mean the unwarranted disclosure of information relating to the affairs of other constituents regarding whom there is no investigation. This should be avoided except under compelling circumstances. We recommend that a statutory provision be made in the Bankers' Books Evidence Act to the effect that during police investigations it should be sufficient for banks to produce before the police authorities certified copies of the relevant extracts from the books of banks, unless the production of the copies is considered by the authorities as not adequate for proving the crime.

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1 (1924) 1 K.B. 461.
2 A.I.R. 1937 Lahore 160.
3 Tannan M. L., "Law and Practice of Banking in India", Thacker and Co. Ltd., 12th Edition (1968), pages 35 and 36.

5.8 While dealing with the Bankers' Books Evidence Act, we may also refer to the fact that banks are faced with considerable problems for finding storage space for the preservation of their records. There is a suggestion that it should be made clear that it would be in order for the banks to microfilm their books and records and that under the Bankers' Books Evidence Act the positives of such microfilmed documents could be received in evidence. We feel that even at present when the original documents are destroyed by banks, due to want of space, in their regular course of business, and the documents have been microfilmed before such destruction, the relative positives of the films are admissible as evidence provided they are properly produced and proved in court. However, we recommend the amendment to the Bankers' Books Evidence Act expressly clarifying the position to this effect.

(*i*) *Use of Bank Records for Tax Investigation Purposes*

5.9 In U.S.A., Public Law 91-508 has been enacted in October 1970 requiring the insured banks to maintain certain records, to report certain transactions to the United States Treasury, and for other purposes. This legislation is, *inter alia*, based on the Congress finding that adequate records maintained by banks "*have a high degree of usefulness in criminal, tax and regulatory investigations and proceedings*". The Congress has also recorded a further finding that "microfilm or other reproductions and other records made by banks of checks, as well as records kept by banks of the identity of persons maintaining or authorized to act with respect to accounts therein, have been of particular value in this respect".

5.10 In India, since Independence, there is a growing awareness of the usefulness of bank records for checking tax evasion. The Income-tax Investigation Commission, in consultation with the Reserve Bank, had required the banks to preserve *all* their records till the work of the Commission was over. Later on, the books and papers that had to be so preserved were reduced to certain specified items. In 1954, the Supreme Court held in Sree Meenakshi Mills' case[1] that the proceedings before the Investigation Commission can no longer be continued under the procedure prescribed by the Taxation on Income (Investigation Commission) Act, 1947, after the amendment of Section 34 of the Income-tax Act, 1922, with effect from the 17th July 1954. This led to the termination of the Commission's activities. At the time of its closure, a memorandum recorded in the Commission stated as follows regarding the usefulness of bank records for purposes of income-tax investigation and the need for preservation of bank records :

> It is a well-known fact that the success of the Commission's investigations in most of the cases referred to it depended to a large extent on the information contained in the old Bank records. This information

1 A.I.R. 1955 S.C. 13.

consisted partly of the statements of deposits, advances, etc., obtained from Banks, but mainly on the original Bank records, *e.g.*, vouchers, paid cheques, and pay-in-slips, and other correspondence, etc., relating thereto. The importance of the old Bank records cannot thus be over-emphasized for the successful investigation of the cases which would be left uncompleted by the Commission and have to be dealt with by the Income-tax Department under Section 34(IA) of the Income-tax Act.[1] With a view to enlist the co-operation of Banks for the preservation of their old records, the Commission had to take the assistance of the Government of India, Ministry of Finance (Economic Affairs Department) and instructions were accordingly issued by the Ministry of Finance (Economic Affairs Department) from time to time, enjoining the preservation of Bank records for the life-time of the Commission. Due to lack of storage accommodation in big cities like Calcutta and Bombay and other reasons, Banks have been pressing for weeding out their old records, but in the public interest they have been asked to preserve the records till the Commission's work is over. The Commission is likely to be wound up shortly and if no other arrangements are made to secure further preservation of these records, the Banks may destroy all their old records and this would considerably jeopardise the investigations in the pending cases to be dealt with by the Department under Section 34(IA)[1]. Necessary instructions may, therefore, be issued by the Government to ensure continued preservation of the old Bank records for so long at least as it may be necessary for the Department to make full use of the information contained in them.

Subsequently, the question of preservation of bank records relating to any period was being decided, from time to time, under administrative arrangements. However, pursuant to the recommendations of the Company Law Amendment Committee, Section 209 of the Companies Act, 1956 has been amended making it obligatory for a 'company' to preserve its records for a minimum period of eight years.

5.11 The Reserve Bank drew the attention of banks to Section 209 *ibid* and pointed out that the provision applies to every company, including a banking company, and that the provision imposes a statutory obligation to preserve the books of the bank for a period of not less than eight years. It also stated that "Government desire that as banks are financial institutions whose records are of more direct and immediate interest from several points of view, they should preserve their records for a period of ten years immediately preceding the current year". In this connection, it was assumed both by the Reserve Bank and the Central Government that as vouchers are essential documents for verifying the correctness of entries made in the books of account of banks, they should be preserved. In 1963, Government had indicated a list of the records banks should preserve for the period requested by them.

1 Act of 1922.

In 1965, Government seem to have agreed to the reduction of the minimum period of preservation of certain bank records to five years and the other specified items for eight years. In 1965, Section 209 of the Companies Act, 1956 was also amended to clarify that the words "books of account" will also include vouchers which should be made available for inspection and investigation and should be preserved for a period of eight years.

5.12 In the meantime, as regards paid cheques, banks had raised the question that as under English law[1] the property in them may vest in the drawer of the cheque, the banks may not be justified in refusing the return of the paid cheques, if asked for, by the customer. Probably, due to this and other reasons, in 1963, Government of India permitted banks to return paid cheques to the constituents after obtaining a formal undertaking from them to the effect that they shall preserve the returned paid cheques for a period of ten years and produce such instruments before the Income-tax authorities whenever called upon to do so. This undertaking is not insisted upon in the case of the return of paid instruments drawn by Governments, public sector corporations, statutory corporations and consular offices. But a doubt has been expressed, and in our view rightly, on the usefulness of such an undertaking.

5.13 In our view, the position regarding preservation of records by banks requires to be clarified having regard to public interest, and the development of banking. Section 209 of the Companies Act, 1956 is inadequate for this purpose, as this provision does not as such apply to the national banks and the Co-operative banks. We, therefore, recommend that a separate statutory provision may be made for this purpose. The minimum period for which the banks should be required to preserve their several records should be fixed, for each type of record, having regard to —

(*i*) the period for which it would be desirable for banks to maintain them for their own needs ;

(*ii*) the period upto which such records could be usefully required in connection with tax or other regulatory proceedings ; and

(*iii*) the practical difficulties the banks may face in preserving their records beyond a reasonable length of time.

While providing for such preservation of records, we consider that such provision should also apply to all State Co-operative banks, Central Co-operative banks and Urban Co-operative banks. However it may be neither desirable

1 In page 16 of the "Practice and Law of Banking" by H. P. Sheldon (9th Edition), this position is stated as under :

A cheque remains the property of the holder until it is paid, when the property in it reverts to the drawer. The banker, however, is entitled to the possession of a paid cheque as a voucher, until such time as the account between him and his customer is a settled account. After this, the drawer is entitled to the cheque as a voucher between him and the payee.

nor feasible to apply such requirements to Primary Co-operative Credit societies carrying on banking business in view of their limited administrative and other resources. We also recommend that the statutory provisions to be made for the preservation of records by banks should provide for the period of preservation of various bank records being prescribed from time to time by the Central Government in consultation with the Reserve Bank.

5.14 As regards paid instruments, *e.g.*, paid cheques, the Committee on Banking and Currency of the U.S. Senate has referred to the testimony from law enforcement officials "on the high degree of importance of having access to copies of checks drawn on commercial banks" and to the effect that "microfilm copies of checks are important because they are frequently the direct evidence of a financial transaction which would otherwise be difficult to prove". Based on such finding, U.S. Public Law 91-508[1] *inter alia* requires an insured bank in U.S.A. to keep to the extent the regulations framed by the Secretary may require, microfilm or other reproduction of "each check, draft, or similar instrument drawn on it and presented to it for payment" and also keep a record of such instruments received for deposit or collection, in order to facilitate the detection of what are called "white collared crimes". In India, the Income-tax Investigation Commission has also recognised the necessity for the preservation of vouchers including paid cheques, pay-in-slips, etc. In the light of this, we have to decide on the practice of returning paid cheques to customers desiring to have them, with or without obtaining an undertaking from them.

5.15 The value of the undertaking, as already stated, is not much. One main reason for evolving this practice may relate to the questions raised regarding the right of the customer to claim return of paid instruments.

5.16 The practice of returning paid instruments in the case of instruments drawn by Government, statutory corporations, etc., also needs review. The object for the preservation of bank records, including paid instruments, for a specified period, is not solely with reference to the drawers' tax liability. As the U.S. Congress has found,[2] bank records have a high degree of usefulness in criminal or regulatory investigations or proceedings. It has been pointed out that several frauds have come to light in recent years, perpetrated in public-sector/government accounts where the vouchers which would reveal the identity of the perpetrators of the fraud have been abstracted and destroyed. It has been suggested that microfilming of all their vouchers by banks, or their safe custody for a reasonable period would eliminate perpetration of such frauds. There is considerable force in this suggestion.

5.17 Having regard to all the circumstances, we recommend that a period for the preservation of paid instruments may be statutorily provided.

1 Approved on 26th October 1970.
2 Section 101 of Public Law 91-508.

However, for certain valid reasons, customers may require the return of paid cheques before the expiry of such period. In such cases, return may be allowed only after the relevant instruments are microfilmed. The cost of microfilming shall be borne by the customer. This provision may be applied also to the return of paid instruments drawn by Governments and statutory corporations.

(*ii*) *Disclosure of Specific Information by Banks*

5.18 Paget has observed that under the provisions of the U.K. Income-tax Act, the income-tax officer will not be justified in asking for an inquisitorial investigation into all of a bank's customers and their accounts. However, in Attorney General *v.* National Provincial Bank[1], the bank was held liable to prepare and deliver lists of the names and addresses of all the persons on whose behalf it had received interest in respect of certain War Loans/ Bonds, as required by the income-tax authorities. Section 133(6) of the Indian Income-tax Act, 1961, now specifically empowers the tax authorities, *inter alia*, to require a bank to furnish information or statements of accounts and affairs in relation to such points or matters which the income-tax authorities consider as useful for, or relevant to, any proceeding under the Act. No exception can be taken to such provision.

5.19 Section 285 of the Income-tax Act, 1961, requires a person responsible for paying interest, other than "interest on securities", to furnish the income-tax authorities with the names and addresses of all persons to whom interest or aggregate interest exceeding an amount, not being less than Rs. 400, as may be prescribed, has been paid in each year. Under this provision, the banks would be obliged to divulge to the income-tax authorities information on interest paid in the accounts of their customers. A suggestion has been made before us that the minimum ceiling of Rs. 400 should be raised to Rs. 3,000 in view of the fact that interest on bank deposits, when it does not exceed Rs. 3,000 when grossed up with certain other items, is exempted from tax. This, we do not recommend. Firstly, the exemption limit may vary from time to time depending on the fiscal policy of the year. Secondly, the present exemption limit of Rs. 3,000 would apply only when grossed up with dividends received on shares, income received from the Units, etc., and it may not be correct to assume that interest on bank deposits up to Rs. 3,000 may not *per se* attract the incidence of tax. Thirdly, the comparative position in other countries does not also favour the raising of this limit. For instance, we have been told that under the United States Internal Revenue Code, the names and addresses of all persons to whom interest on deposits or dividends on shares, are paid in excess of $ 10.00, are required to be disclosed to the tax authorities.

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1 (1928) 44 T.L.R. 701.

(*iii*) *Use of Bank Records for Identification of Parties*

5.20 The All-India Institute of Chartered Accountants, have, while dealing with our questionnaire on the banks' obligation to disclose information relating to their customers, favoured the amendment of the law to make banks responsible for identification of parties having transactions with them. They have felt that tax evasion through *benami* bank accounts can be considerably checked if this requirement is enforced by law.

5.21 It appears that in some countries there is a system of banks insisting on proper identification of parties entering into transactions above a certain amount, even though they may be only deposits in cash, demand drafts, telegraphic transfers, etc. The U.S. Public Law 91-508, already referred to, provides for the maintenance of appropriate types of records by insured banks in the United States with a view to facilitate identification of parties by banks. Under this law "each insured bank shall maintain such records and other evidence, in such form as the Secretary shall require, of the identity of each person having an account in the United States with the bank and of each individual authorised to sign checks, make withdrawals, or otherwise act with respect to any such account". The Secretary of the Treasury is authorised to make such exemptions from any requirement as are consistent with the purpose of the law.

5.22 But, we are not presently going into this question since the All-India Institute of Chartered Accountants have stated that they have made submission to this effect before the Wanchoo Committee on Direct Taxation in reply to that Committee's questionnaire.

(*b*) *Sales Tax Acts*

5.23 Our attention has been drawn to certain provisions in the Sales Tax Act of Orissa, requiring banks to furnish monthly return to the sales tax authorities regarding bills collected by banks on behalf of their customer. It has been represented that such a provision not only increases the workload of the bank but also puts the bank to heavy expenditure and hampers its business.

5.24 We understand that prior to the enactment of the Central Sales Tax Act many States, *e.g.*, Madras, former Hyderabad State, Andhra Pradesh, Mysore and Kerala had framed Sales Tax Rules requiring banks to submit monthly returns in respect of all the bills, with or without documents, received for collection at their principal or head offices during the preceding month from outside the respective States. Many States seem to have deleted the provision after the enactment of the Central Sales Tax Act. We also understand that in framing such provisions and their subsequent repeal, the States had also taken into account the point of view of banks.

5.25 Just as for the purpose of collection of Central taxes (including Income-tax) the information available with banks is made use of by the tax authorities, so also it would be in order for the State law to provide for the relevant and material information with banks being disclosed to authorities to check evasion of State taxes like Sales Tax. However, the question should also be considered having regard to the impact of such provisions on the working of banks. It has been stated that information-gathering and information-furnishing activities of banks should not become their major activity. As in the case of maintenance of records by banks, furnishing of such return/information should also depend on the degree of its usefulness, keeping in view the additional work and expenditure which may fall on the banks. We recommend that while making such provisions, the State Governments may act after consultation with the Reserve Bank.

(*c*) *Companies Act, 1956*

5.26 Both in U.K. and in India, a company's bank is required to disclose the bank's books and documents relating to the company, in any investigation or the prosecution against the officials of the company by the Government or other competent officials[1]. These are desirable provisions and there is no need to change them.

(*d*) *Compulsion under Indian Law regarding Information with a Foreign Branch of an Indian Bank*

5.27 The question has been raised about the effectiveness of a requirement in India, under law, for the disclosure of information relating to the constituents of the foreign branches of Indian banks. This question has been raised in the context of disclosure of information regarding the affairs of Indian citizens relating to their accounts with the foreign branches of Indian banks, on the strength of an order requiring the disclosure of such information, served on the Indian office which has control over the foreign branches.

5.28 So long as the order to disclose is served in India on the office of an Indian bank, it could be urged that by the disclosure of such information by the Indian office, the foreign branch does not thereby contravene its obligation to maintain secrecy as regards the affairs of its customers. Again, it may also be urged that an Indian national having an account with a foreign branch of an Indian bank, as also the foreign branch concerned, are compellable under Indian law to disclose the information. But this question has not yet been decided authoritatively. Moreover, on practical considerations, we should also have regard, while dealing with this question, to the repercussions

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1 Section 167(5) and 334(5) of the U.K. Companies Act and Sections 240(6)(b) and 545(7) of the Companies Act 1956 of India.

such disclosure is likely to have on the business of the foreign branches of the Indian banks. Such questions should be considered also having regard to international practice and agreement between countries.

(2) *Duty to the Public to Disclose*

5.29 The concept "duty to the public" is a variable one. It depends on the prevailing notions of the community. Bankes, L.J., in Tournier's case[1], observed that many instances of this class might be given and that they may be summed up in the language of Viscount Finlay in Weld-Blundell *v.* Stephens[2] where he speaks of cases "where a higher duty than the private duty is involved as where danger to the State or public duty may supersede the duty of the agent to his principal." Though it had been stated that many instances can be given, it has been consistently felt that this expression is rather vague and places banks in a difficult situation. There has been general support for the view that this qualification should be explained, if not by defining it, at least by clarifying it by enumeration of certain instances. We agree that there is need for clarifying this qualification by enumerating certain instances which would attract this qualification.

5.30 Certain instances have been mentioned when the duty of the bank to the public could be considered as requiring the disclosure of the affairs of its customers, *e.g.*,

(*a*) when a bank is asked for information by a government official concerning the commission of a crime and the bank has reasonable cause to believe that a crime has been committed and that the information in the bank's possession may lead to the apprehension of the culprit ;

(*b*) when the bank considers that the customer is involved in activities prejudicial to the interests of the country ;

(*c*) where the bank's books reveal that the customer is contravening the provisions of any law ; and

(*d*) where sizeable funds are received from foreign countries by constituents.

We recommend that it may be statutorily laid down that in the aforesaid instances the bank is under a duty to disclose the relative information in public interest. It may also be statutorily provided that, if and when a bank *bona fide* forms an impression that it owes a duty to the public to disclose, it is relieved of its obligation to maintain secrecy if it discloses the relevant information to the concerned authorities.

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1 (1924) 1 K.B. 461.
2 89 L.J. K.B. at 708=1920 A.C. at 965.

5.31 Again, *for purposes of research*, scholars and students may require information which can be gathered from the books of banks. It may also relate to information regarding the affairs of particular constituents. While general information could be freely given by banks in such circumstances, we consider it desirable that there should be some caution observed in furnishing, in such circumstances, information regarding the affairs of particular constituents. However, it may not also be desirable in public interest to shut out completely the availability of material information for useful research purposes. Hence, regarding the disclosure of information pertaining to the affairs of particular constituents for research purposes, we consider that it would meet the requirements of the situation if the law would permit the furnishing, in such circumstances, of information regarding the affairs of its constituents provided the information furnished *relates to a period anterior to twenty years.*

Disclosure to Commissions or Committees Appointed by Government

5.32 Commissions or Committees consisting of responsible officials and public men are appointed by Government to go into matters of public interest. While such bodies could be constituted as Commissions, under the Commissions of Enquiry Act, 1952, and entrusted with powers to require the production, before them, of information they consider necessary, by persons who may be having them, all Commissions or Committees are not appointed by Government under the Commissions of Enquiry Act. When a Commission or a Committee appointed by Government calls for information under the Commissions of Enquiry Act, banks are required to furnish the information under "compulsion by law".

5.33 If, however, a Commission or a Committee is not vested with powers under the Commissions of Enquiry Act, then it does not ordinarily have powers to require banks to furnish the required information, unless giving of such information could be considered as falling within the scope of the qualification "duty to the public to disclose". We do not consider that banks should be saddled with the responsibility of deciding whether or not furnishing of information to such a Committee or a Commission could be considered by them as warranted pursuant to their "duty to the public to disclose". To obviate this, we recommend that a statutory provision may be made with reference to any Commission or Committee appointed by Government, though not under the Commissions of Enquiry Act, to empower the Government to declare that banks are obliged to disclose to such Commission or Committee, in public interest, such information as may be required by such Commission or Committee.

(*3*) *Where the Disclosure is in the Interest of the Bank*

5.34 Bankes, L. J., in Tournier's case[1], has, as illustration of this class of qualification, cited the instance of a bank applying for a writ claiming

1 (1924) 1 K.B. 461.

repayment of an overdraft. Really this class of qualification should not pose much difficulty. However, certain examples cited before us could be mentioned by way of illustration, namely, (*a*) disclosure to guarantor when claiming payment of the balance due from the principal debtor ; and (*b*) disclosure to vindicate any frauds perpetrated against the bank.

(*4*) *Disclosure with the Express or Implied Consent of the Customer*

5.35 Bankes, L. J., in Tournier's case[1], has mentioned as an instance of this class of qualification, the customer authorising a reference to his bank. Though the practice in banks of giving one another information as to the affairs of their respective customers is sought to be justified on the basis of the implied consent of the customers, it has no firm foundation in law. About this practice, Chorley has commented :

> It is to be feared that this is sometimes done without the knowledge or consent of the customer, and if so it would appear to be a breach of the duty which the banker owes to his customer of treating the account as confidential.[2]

Further, though such an implication may possibly be urged in the case of trading customers, this may not have an application in the case of others. The consciousness that the doctrine of implied consent cannot always be invoked, has led to the practice of banks giving credit information in rather vague and general terms with the rider that they do so "without responsibility". It does not appear sound that banks should rely on any implied consent of the customer for such disclosure as they may make of his affairs, except when such an inference is clearly warranted from the circumstances. A suggestion has been made that in the account opening forms, banks could be required to provide for the customer giving his consent for disclosure of credit information relating to him by the bank. We have considered this suggestion in Chapter 6.

B. Secrecy as to the Banks' Own Affairs

5.36 As mentioned earlier, the national banks are obliged not to disclose any information relating to their affairs to any person not legally entitled thereto. This position arises by reason of the statutory form of declaration to be subscribed to by the officials of the concerned banks, including their directors and Chief Executives. In the chapter on "National Banks", we have recommended that these banks should be free to disclose at their discretion any information relating to their affairs as distinct from the affairs of their customers.

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1 (1924) 1 K. B. 461.
2 Chorley, "Law of Banking", Pitman Paperbacks, 5th Edition (1968), page 176.

C. Secrecy as to Reserves of Banks

5.37 There is no obligation on the banks to disclose what are called "secret reserves" or "inner reserves". The statutory forms of balance sheet and profit and loss account for banks given in the Banking Regulation Act, 1949, do not require the disclosure of such reserves. Section 34A *ibid* statutorily recognises the maintenance by banks of "any reserves not shown as such in its balance sheet" and "any particulars not shown therein in respect of provisions made for bad and doubtful debts and other usual or necessary provisions". The maintenance of such undisclosed reserves by banks is generally supported on the plea that banks, as credit institutions, would require some cushion for meeting any unforeseen situations. But, in other countries, banks are either opting for full disclosure, or the law does not allow maintenance by them of "secret reserves". There is good reason for favouring full disclosure.

5.38 The propriety of banks being permitted to keep undisclosed reserves has been considered at length by several authorities in U.K. The majority of the Company Law Committee, 1962 (known as the Jenkins Committee) were not in favour of compelling banks to disclose the full picture of their assets and liabilities in their published accounts. But, they conceded that there had been "a marked change in public opinion . . . It is natural that the exemptions enjoyed by banks should be regarded by many as an anachronism". A minority of 5 out of the 14 members went further and said: "We think that the case for the banks disclosing their real profits is extremely strong". The Report of the Prices and Incomes Board on Bank Charges (1967) expressed itself in favour of "full disclosure as soon as is practicable".

5.39 The new Companies Act of U.K., which came into force in July 1967, left the matter in the hands of the Board of Trade. The Board of Trade was authorised to decide whether banks should or should not be allowed to keep undisclosed reserves. However, in December 1967, the Board of Trade decided then not to demand full disclosure. But the banks were required to give full information to the Bank of England about their profits and inner reserves. On the basis of this information, the Board was to review the position after a period of time.

5.40 The Monopolies Commission of U.K., while reporting on the proposed merger between Barclays, Lloyds and Martins banks, expressed that "because the banks have been permitted to conceal their true profits and their true reserves, they have escaped the stimulus to efficiency and competitiveness that informed comparison of performances and profitablity might have been expected to produce". In these circumstances, the clearing banks of U.K. collectively decided, in September 1969, to reveal their true

profits and reserves. It was then reported that Government had given them a hint that they would be forced to make full disclosure of their assets and liabilities if they do not do so voluntarily. Thus, the view in U.K. does not favour the continuance of the privilege enjoyed by banking companies of not disclosing their true profits and reserves.

5.41 In Canada, the Royal Commission on Banking and Finance (1964) has expressed that while there may still be a need for permitting non-disclosure, there is at the same time "no compelling case against the disclosure". That Commission was satisfied to leave the matter in the hands of the authorities and shareholders of banks. In the United States, the Report of the Advisory Committee on Banking to the Comptroller of the Currency, 1962 (known as the Saxson Committee) has recommended full disclosure, and it is said that the practice is now followed by many American banks. We have also received expert opinion from the United States to the effect that it is not necessary or desirable that banks should be permitted not to disclose any of their assets and liabilities in their published accounts.

5.42 Thus, the present trend is not to encourage the maintenance of secret reserves by banks. For reasons similar to those adduced by the Monopolies Commission of U.K., it is not desirable to encourage the maintenance by banks of such "undisclosed reserves". At any rate, it may not be necessary or desirable to provide for the maintenance of secret reserves with reference to the national banks. In their case there is no scope for the apprehension that public may lose confidence in them at any time and hence as a cushion to meet unforeseen situations they have to maintain certain reserves as secret. Moreover, the Scheme for the "new banks" provides for the participation in their management, of the representatives of employees. At the same time, Section 34A of the Banking Regulation Act, 1949, provides for the banks not being compelled to disclose before any Industrial Tribunal their true profits in a year. Association of employees' representatives in the management of banks implies that the employees in general are taken into confidence as to the true state of affairs of these banks. Therefore, there does not seem to be much justification for the national banks being allowed to maintain secret reserves or inner reserves. Regarding the other banks, we would not favour a different position, as otherwise there may be no meaningful comparison of the profitability and working of the national banks and the other banks. The present forms of balance sheet of banks, specified in the Banking Regulation Act, 1949, may also have to be suitably modified when the provision requiring "full disclosure" becomes effective.

5.43 Having regard to the purpose for which the undisclosed reserves have hitherto been kept and the desirability of ensuring that such reserves continue to be available to banks as 'reserves', we recommend that all "secret reserves" of banks, as on the date on which the provisions providing for full disclosure become effective should be transferred to the general reserves.

The point has also been made that in the event of banks not being permitted to maintain "secret reserves", there should also be a provision requiring banks to transfer to their general reserves (which are now disclosed) a larger percentage of their net profits to the general reserves. We recommend that such a provision may be made though the exact percentage may be left to be laid down by the Central Government in consultation with the Reserve Bank.

CHAPTER 6

CREDIT INFORMATION

Bank deposits are mainly to be utilised to extend different forms of financial assistance to industry, trade, commerce, agriculture and for other beneficial purposes. In a country like ours, this means that banks have to extend credit to countless number of persons. This requires banks to assess their "credit worthiness, credit standing, credit capacity, character, general reputation", etc. Information relevant to form such assessment is termed "credit information". The information available with a bank, including that furnished by the borrower, is no doubt very useful in this behalf, but this is not adequate for such credit rating of the numerous borrowers. Banks have perforce to rely on the supply of credit information from other sources. The other sources may be the other banking and financial institutions, or agencies specialising in the furnishing of such information in addition to the borrowers themselves. Hence, it is necessary that banks have reliable and fairly accurate credit information. Banks have a dual role to play, that is, they are both givers and receivers of credit information. Here, we consider the salient features of the law relating to the furnishing of credit information.

6.2 When banks in India were confining their activities essentially to big cities and urban centres and extending assistance only to well-established and reputed concerns, they probably did not have much of a problem regarding the credit rating of persons. Such credit information as they could secure was collected by themselves from indigenous agencies operating in the local market and was supplemented by information they could have through 'references' made to other banks. When banks are branching out to all parts of the country, and with the policy of making bank credit available to any common man, for any worthy purpose, the need for adequate provisions, for furnishing necessary credit information, and for enabling fairly accurate credit rating of, persons seeking credit facilities from banks, becomes vital. For convenient handling of the subject, we consider the nature of the provisions that may have to be made, in this behalf, under the following heads, namely —

(*i*) furnishing of credit information by banks ;

(*ii*) furnishing of such information by specialised agencies ; and

(*iii*) furnishing of such information by the borrower himself.

A. Furnishing of Credit Information by Banks

6.3 As seen in Chapter 5, the legal basis for the practice of banks answering 'references' on their customers rests on the assumption of the implied consent of the customers. In Tournier's case[1], Atkin, L.J., felt that this could be the only basis to justify the practice of banks to give one another information as to the affairs of their respective customers. According to Chorley, it would appear to be a breach of duty if the 'opinion' of the bank is given without the knowledge or consent of the customer. While, in the case of the trading customers, Paget feels that an assumption of implied consent may be justified, he has pointed out that no such assumption is possible in the case of others.

6.4 Moreover, banks have a duty not only to those on whom they answer 'references' or give 'opinions', but also to those to whom the information is given. In giving credit information, banks are under a duty to observe "common honesty". Hence, banks have also to ensure that they give a fair account to those who are likely to rely and act on the information.

6.5 The decision in Banbury *v.* Bank of Montreal[2] on the interpretation of the Lord Tenterden's Act (Statute of Frauds Amendment Act, 1828) has led to a practice in U.K. of banks giving 'references' orally or unsigned. There is no such provision in India as is found in the Lord Tenterden's Act. Hence, the form in which banks answer the 'references' on their customers has no basic significance in India. A suggestion has been made recently that banks may exchange credit information on their customers by giving "opinions and hints" in informal meetings between bank managers. Strictly, by this approach, the exchange of credit information is not regularised.

6.6 The result of the obligations of banks furnishing credit information on their customers, on the one hand to their customers, and on the other to those to whom such information is given, has led to the banks giving information in vague and general terms with the superadded rider that it is given "without responsibility". Banks are overwhelmingly conscious of their obligation to maintain secrecy as regards the affairs of their customers. It has been stated that "even after all these years we still do not know exactly what is meant by the time-honoured reply, 'Respectable firm which keeps a satisfactory account and is good for engagements'. We rather suspect it merely means at times, 'Yes ; they have an account with us' — just that and nothing more".[3] Thus, considerable vagueness and uncertainty have crept into the credit reports of banks on their customers. This materially affects the usefulness of the credit information furnished by banks.

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1 (1924) 1 K.B. 461 at 486.
2 1918 A.C. 626.
3 Article on "The London Information Market" by B. B. Boreham at pp. 89-91 of the August 1945 issue of "The Banker".

6.7 While banks have a general duty to observe secrecy as to the affairs of their customers, such duty should not be allowed to come in the way of their giving a fair credit report to other banks and financial institutions. As the United States Congress, in enacting the Fair Credit Reporting Act, 1970, has found :

> The banking system is dependent upon fair and accurate credit reporting. Inaccurate credit reports directly impair the efficiency of the banking system, and unfair credit reporting methods undermine the public confidence which is essential to the continued functioning of the banking system.

Thus, for the development of the banking system and of the country's economy, it is imperative that banks are permitted to give fair and accurate credit reports without the apprehension, that they are thereby likely to trench on their obligation to the customers, or that they are thereby likely to become liable to those to whom information is given.

6.8 The suggestion has been made that in the account opening forms banks may provide for their customers giving their express consent for answering 'references' or giving 'opinions' on them. This may not be adequate. Being contractual, the customer may try to revoke the consent later. This is also likely to give room for doubts and disputes on the scope and the nature of information that can be given as also the persons to whom it could be furnished. This will not also take care of the banks' duty to those to whom the information is given. The Study Group on Term Loan Participation Arrangements appointed by the Reserve Bank has also pointed out that in order to encourage common appraisal and follow up procedures, the financial institutions should share freely with each other credit information, and for this, the financial institutions should be protected *by legislation* against any action for damages by parties who may be adversely affected by credit reports. We recommend that statutory provision may be made giving protection for banks and financial institutions freely exchanging credit information on the affairs of their customers. The law should also provide that the concern or the bank receiving such information shall keep it in confidence and shall not disclose it except to those to whom such information could be legally given.

6.9 While the banks should thus be enabled to give credit information relating to the affairs of their customers, we may also recognise the special position of the national banks. The need for exchanging mutual confidence on the affairs of their customers is much greater with the national banks, having regard to their objectives. Moreover, if the outside shareholdings in the capital of the State Bank and the Subsidiaries are acquired (as recommended by us in Chapter 4), the capital of all the national banks would be solely held by the Central Government, directly or indirectly. On this

basis, what differentiates the national banks *inter se* will be only their corporate veil. This should not, in our view, come in the way of a full, free and frank exchange of information on the affairs of their customers among the national banks, as that would facilitate credit dispersal, protect against sanction of excessive credit to persons, tend to reduce their bad and doubtful debts and generally promote the development of the credit system of the country. Having regard to the special role assigned to the national banks, such exchange of information would be necessary. Hence, we recommend that the statute governing the national banks should expressly provide for full, free and frank communication of credit information among the national banks *inter se*.

B. Furnishing of Credit Information by Specialised Agencies

6.10 In addition to the free exchange of credit information between banks, the need has been felt for adequate machinery to collect, collate, process and furnish credit information to banks and other financial institutions which are engaged in developmental activities. The Seyds in U.K. and the Dun and Bradstreet in U.S.A. are examples of such agencies. They have developed in the private sector in those countries. In view of the fact that by and large the major banks and financial institutions which feel the need for such specialised agencies are not in the private sector, the setting up of such an agency, or agencies, may have to be provided for, in India, by legislation.

6.11 The idea of having a credit information bureau which could supply adequate and reliable credit information to banks had been engaging the attention of the Reserve Bank since 1946. A proposal had then been circulated to the scheduled commercial banks, regarding the setting up of such a bureau by the Reserve Bank. It was then noted that such credit bureaux existed in Argentina, Brazil and Mexico and that they had been set up in the central banks of these countries either by law or by voluntary co-operation with beneficial results to the banks. The aim was to prevent the grant of excessive credit by banks to any individual, firm or company, due to insufficient information in regard to the total amount of credit obtained by a constituent from various banks. The proposal was to collect information on a daily basis regarding the grant of advances in excess of Rs. 10,000 by scheduled banks and to furnish the total amount of a constituent's indebtedness to banks. This, it was hoped, would reduce the chances of persons availing of excessive credit from the banking system. It was intended to set up such a bureau in the Reserve Bank with the voluntary co-operation of the scheduled banks. However, this scheme did not materialise as the banks were not then in favour of setting up such an agency. One main reason for this was that banks were apprehensive that thereby they might be committing a breach of their obligation to maintain secrecy as regards the affairs of their customers.

However, in 1950, it appears that the Indian Banks' Association had considered a suggestion regarding the pooling of information on parties. Though such pooling of information was considered advantageous, the matter was dropped due to practical and legal difficulties in implementing the suggestion at that time.

6.12 The idea of setting up of a credit information bureau in the Reserve Bank was revived again in 1958. The proposal then was that the bureau should collect information from banks regarding the credit facilities of various types granted to constituents and furnish the banks, on request, with consolidated figures relating to the limits obtained and availed of by the *bigger constituents* from all the banks. At that time, in countries like France, service of the type envisaged in the proposal was being rendered by the central banking authority. While the information that could be had from the credit information bureau was of potential value to the individual banks in the event of the customer attempting to overtrade or to bolster up an unstable position by borrowing over a wide field and using credit obtained from some to repay others which had been outstanding over a long period, the banks had to make independent enquiries about the standing and creditworthiness of the borrowers, as the scheme did not envisage the furnishing of information to banks as to the means, net worth or total assets of the borrowers as also the borrowers' personal and business records, financial conditions, etc. Thus, the object was limited to the pooling and exchanging of information relating to the total indebtedness to banks of persons availing of credit facilities above a certain limit.

6.13 Ultimately, the proposal resulted in the enactment which introduced, in 1962, Chapter III-A of the Reserve Bank of India Act, 1934. This led to the setting up, in that year, of a credit information bureau in the Reserve Bank. The information collected by the bureau relates to the nature of advances, the extent of credit availed of and the nature of security obtained. The aim of the bureau is only to furnish particulars relating to the extent of indebtedness to banks and it does not give any credit rating regarding the prospective borrower. The bureau does not collect information relating to the borrowings of constituents from outside the banking system. There is also a considerable time lag between the time when information is made available and the time to which it relates, and this materially affects the value of the information. Thus, the Credit Information Bureau set up in the Reserve Bank is not adequate to meet the needs of banks and financial institutions.

6.14 In response to our questionnaire, many banks, other institutions and individuals have expressed that there is urgent need for the setting up of a credit information bureau which could give up-to-date and adequate information sufficient to make an assessment as to the credit rating of those seeking financial assistance from banks. The Indian Banks' Association

has sent us the draft notes, prepared at its instance, by two students of the Indian Institute of Management, Ahmedabad, which relate to the setting up of a credit information bureau on the lines of the Dun and Bradstreet of U.S.A.

6.15 There are two alternatives. The first is to enlarge the scope of the credit information bureau in the Reserve Bank so that it could furnish to banks such reliable and adequate credit information as would enable banks to ascertain readily the credit rating of those who come to banks seeking financial assistance. This would mean that information relating to operations in the account, an assessment of credit capacity, etc., have to be gathered, processed and made available to banks and financial institutions. We do not consider that the central bank of the country could, or should, undertake the responsibility to collect and furnish, on a large scale, useful and necessary information sufficient to assess the creditworthiness of numerous persons, big and small. What really matters is that it is not sufficient to collect information on credit limits only. The other alternative is the setting up of a separate specialised agency, or agencies, on the lines of the institutions in U.K. and in U.S.A., which would collect, collate, process and furnish credit information to banks and financial institutions, on those seeking financial assistance from them. It is necessary to provide a statutory set-up for such an agency.

6.16 While setting up such an agency, some aspects have to be kept in view. The first relates to the legal provisions that have to be made for banks and other financial institutions being relieved of their obligation to keep in confidence the affairs of their customers as regards the furnishing of information by them to such an agency. Secondly, some safeguards have to be provided to ensure that the credit reports are fairly accurate. Thirdly, the agency has to be subject to some form of legal regulation, and given statutory protection to enable it to collect and furnish to banks and financial institutions credit information.

6.17 A statutory provision making it obligatory for banks and financial institutions to furnish the credit information bureaux with such information, and in such form, as the bureau may require, would safeguard the banks from any action by constituents, as the furnishing of information would amount to disclosure under compulsion by law.

6.18 As regards fairness in credit reporting, we may refer to the Fair Credit Reporting Act of the U.S.A. Under the scheme of the said legislation, consumer reporting agencies are required to exercise "their grave responsibilities with fairness, impartiality and a respect for the consumer's rights to privacy". The said Act also requires consumer reporting agencies to adopt reasonable procedures "in a manner which is fair and equitable to the consumer with regard to the confidentiality, accuracy, relevancy and proper utilisation of such information".

6.19 There is also State legislation[1] in U.S.A. providing the procedure for the constituents moving to correct any incorrect statements in the credit reports on them. The Civil Code of California enacts that any credit reporting organisation, which provides a client or customer a written credit rating report on any person, shall, within five working days thereafter, mail a copy of the credit rating report to the person investigated. It also provides that if the person investigated contests the truth of any fact contained in the report and wishes it changed, he shall transmit written specifications of objections to the credit rating organisation within a specified time. The credit rating organisation may either affirm or correct its report on the receipt of such objection.

6.20 The Report of the Committee appointed in U.K. to go into consumer credit[2] has also referred to the need to ensure fairness in credit reports. It has observed that after the credit information has been recorded by the bureau :

> it may be thought essential to give the debtor a right to see the record, so that he can satisfy himself as to its accuracy and can have an opportunity to explain the circumstances surrounding an apparently adverse entry. We can foresee certain difficulties if this principle were to be extended to subjective credit evaluations, which might in certain cases be highly derogatory of the debtor (with good reason) and might thus generate ill-will, if not proceedings for defamation. In this context the question of privilege would have to be carefully considered. It has to be borne in mind that a right to obtain details of filed information is of little value unless the debtor is aware that information is being recorded, knows where and by whom it is kept and understands the procedure for obtaining details.[3]

6.21 While providing for credit reporting agencies collecting and furnishing credit information to banks and financial institutions, there should be provision for such agencies adopting reasonable procedures in a manner which is fair and equitable. There should also be opportunity given to the reported person to ask for correction of any error in the report on him.

6.22 Subject to the credit reporting agencies acting according to law and in good faith, legislation in U.S.A. protects them from any action in the nature of defamation, invasion of privacy, or negligence with respect to the reporting of information.[4] The Civil Code of California exempts a credit reporting organisation from civil or criminal liability for untrue allegation

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1 Sections 1722—1724 of the Civil Code of California.
2 Crowther Committee (1970).
3 Page 374 *ibid.*
4 Section 610(e) of the Fair Credit Reporting Act.

of fact in credit rating report, which is not due to any wilful misrepresentation, if the report relates only to such matters as the investigated person's ability to pay, his habits of payment and his general credit standing. The English law on the point would seem to confer a qualified privilege as regards credit information supplied by agencies on a non-profit basis, but not as regards information *sold* by agencies to their customers[1]. Possibly, the position would be the same in India.

6.23 Hence, we recommend that provision may be made for the credit reporting agencies being statutorily indemnified from any action for damages or other losses that may be suffered by any person so long as they exercise their powers and perform their functions *bona fide* and in good faith. Such protection should also be available to banks when they furnish credit information on their constituents.

C. Furnishing of Credit Information by the Borrowers Themselves

6.24 Credit information on constituents is required in order to verify and confirm their statements, as to their assets and liabilities and on other relevant particulars, to assess their credit capacity, reputation, etc. In a country like ours where the specialised credit reporting agencies are yet to be set up, statements made by those seeking credit form the main basis for the evaluation of their credit capacity, creditworthiness, etc. In other countries, customers seeking financial assistance from banks are compelled by law to give only the correct information to banks while asking for financial assistance from them and any failure of such a duty is made punishable.

6.25 For instance, in Argentina, it appears that all borrowers are required, since 1952, to submit a declaration form to their banks at the time of making an application for credit facilities, giving an undertaking to utilise the funds/credit for the purpose stated in the application and setting out the particulars of the credit facilities obtained by the applicant from other banks. In fact, it had been felt that by reason of such declaration being obtained, the continuance of the credit information bureau which was being operated by the Central Bank of Argentina became unnecessary.

6.26 In U.S.A., to ensure that the financial statements furnished to banks are adequate and free from wilful and false representation, a number of States have enacted the False Statement Acts, which impose penalties on any person who misrepresents his true financial condition in any statement for the purpose of securing any form of financial assistance.

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1 London Association for Protection of Trade *v.* Greenlands Limited (1916). Macintosh *v.* Dun (1908) and the Article "Law relating to Credit Information" by O. H. Giesen, LL. M. at pp. 91-95 of the August 1945 issue of "The Banker".

6.27 Having regard to the objectives set for the banking system and the developmental role it is expected to play, we recommend that simultaneously with the taking up of measures to set up a Credit Information Bureau for furnishing adequate and reliable credit information to banks and financial institutions, legislative measures may also be taken providing that the financial statements furnished to banks by their borrowers (including prospective borrowers), which are relied on by banks in extending credit to them, shall be true and correct and that any wilful breach of this obligation is punishable.

CHAPTER 7

REPAYMENT OF DEPOSITS AND RELEASE OF ASSETS BY BANKS

Public interest requires that deposits obtained by banks are repaid to the depositors in time. In the term 'depositors' we include all those in whose name(s) the account stands and those claiming as their heirs or representatives. Provisions providing for such prompt repayment instil confidence in, and tend to attract more deposits with, banks. The provisions under the general law relating to debtor and creditor, which are now applicable, do not seem to be adequate to meet the situation. Having regard to the vast number of people who keep their savings in the form of bank deposits, it is essential to ensure that their savings, kept with banks, will be available to them, or their representatives, in time, without the necessity of having to follow any protracted or expensive procedures. Similar consideration is also necessary for the valuables entrusted with banks for safe custody and with reference to the release of assets charged to, or pledged with, banks. Special provisions, which aim to achieve these, are found in our own country with reference to savings entrusted with the Post Office Savings Banks or the co-operative credit institutions, or invested in the Public Debt. Such special provisions are also found in the banking legislation applicable in many States of the United States of America. The need for special provisions in our country relating to the repayment of deposits and release of assets by banks, is mainly felt with reference to the accounts maintained by individuals either singly or jointly. In this chapter, we consider the need and the scope for such special provisions.

Joint Accounts

7.2 Following the U.K. practice, banks accept deposits from two or more persons on terms which provide for their repayment to any one, or more, jointly, or to the survivors or survivor. Such accounts are styled merely as joint accounts or "either (any one) or survivor(s) accounts". A third, but a rare form of account is the "former or survivor(s) account". While in the case of accounts opened in joint names, to be operated upon jointly, the bank may not face any difficulties in the event of the death of one of the account holders, in the case of the "either (any one) or survivor(s) account" or the "former or survivor(s) account" it does face difficulties in deciding on the person to whom the balance in the account could be repaid. In "either (any one) or survivor(s) account", banks usually repay to the survivor(s)

the deposits held in the account without insisting on the production of any legal representation by the survivor(s). This form of account in a way serves the purpose of nomination. This enables persons to provide for the availability of the funds deposited to the survivor(s). But, in this form the joint account holders could operate the account singly or jointly according to the contract, even before they become survivor(s). In the "former or survivor(s)" account, the right to operate the account is limited to the "former" or the first-named, and the right of the survivor(s), to the amounts held in the account, is recognised only in the event of his/their qualifying as survivor(s).

7.3 The present legal basis for the banks permitting the opening of such types of accounts rests on the terms of the contracts, express or implied, with the customers. But, banks in India are encountering difficulties in giving effect to such terms when there are conflicting claims on the balances held in joint account/s.

7.4 In Shantimoyee Debi *v.* Bengal Central Bank[1], the Calcutta High Court has held that a joint account opened in the names of husband and wife and payable to either or survivor can be operated upon by the wife after the death of the husband and that the bank has to carry out the instructions of the surviving depositor unless a competent court orders otherwise. However, in Nagarajamma *v.* State Bank of Hyderabad[2], in an interpleader action, the Andhra Pradesh High Court has held, on the facts of the case, that the survivor was not entitled to the funds. This has led to some apprehension on the part of the banks as to the propriety of banks paying the balance in the account to the survivor. That decision, given in an interpleader action, may not really be considered as affecting the question as to whether it is in order for a bank to pay the balance in an "either (any one) or survivor(s)" account, to the survivor(s). Still, we find that even in an "either (any one) or survivor(s)" account banks sometimes require production of legal representation when the survivor(s) claims/claim the balance. One of the national banks, in response to our questionnaire, has stated :

> Even when either or survivor accounts are opened with banks they are treated as joint accounts with mandates permitting operation by only one of them. If the mandate is withdrawn by one of them during the currency of the account, banks naturally will find it difficult to continue to treat the account on the original basis and will have to treat the balance as belonging to both and in the event of death of any one of them rules of succession may have to be invoked and the bank will have to call for a regular succession certificate before it can agree to part with the balances of the assets.

The legal position requires to be clearly enunciated.

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1 53 Cal. W. N. 680.
2 A.I.R. 1962 Andhra Pradesh 260.

7.5 There are clear legal provisions in many States of the United States of America specifically dealing with joint accounts which do not leave the banks and the depositing public in any doubt as to the rights of joint account holders. Thus, for instance, the Pennsylvania Banking Code, 1965, provides that a bank may receive deposits in an account in the names of two or more persons, and that any such deposit and all interest thereon may be paid in whole or part to —

(*a*) one or more of the depositors pursuant to an arrangement with the bank previously agreed upon by all of the depositors, even though one or more individuals named in the account may have :

(*i*) died and the bank may have received written notice of that fact, or

(*ii*) become incompetent, unless, such incompetence has been adjudicated by a court and written notice of the appointment of a guardian has been received by the bank and unless the arrangement agreed upon has no provision for payment of the account despite such notice ;

(*b*) the survivor in the case of an account in the joint names of a husband and wife, unless an arrangement with the bank provides otherwise ; or

(*c*) all of the depositors in any case not covered by (a) and (b) above.

The District of Columbia Code provides that when a deposit is made in the name of two or more persons, including husband and wife, payable to either, or payable to either or survivor or survivors, such deposit or any part thereof, or any interest thereon, may be paid to either of the said persons whether either or others are living or not, and the receipt or acquittance of the person to whom such payment is made shall be a valid, sufficient and complete release and discharge for the bank for any payment so made. On the lines of the provisions set out above, we recommend that express statutory provisions be made regarding the payment by banks of deposits held in such accounts opened in the names of more than one individual.

Notice of Adverse Claim to Deposit

7.6 There is also a further desirable saving provision in the banking codes of the States of the United States of America dealing with adverse or conflicting claims to deposits held in bank accounts. The District of Columbia Code states that notice to any bank of an adverse claim to a deposit standing on its books to the credit of any person shall not be effective to cause the said bank to recognise the said adverse claimant, unless such claimant either procured a restraining order, injunction, or other appropriate process, against the bank, from a court of competent jurisdiction, in a case being instituted by him, wherein the person to whose credit the deposit stands, is

made a party and served with summons, or executes to the said bank a bond indemnifying it from any and all liability, loss, damage, cost and expenses for, and on account of, the payment of such adverse claim, or the dishonour of the cheque, or other order of the person to whose credit the deposit stands on the books of the said bank. This provision does not, however, apply with reference to any person standing in a fiduciary relationship to the adverse claimant when the facts constituting such relationship and other facts that may be sworn to in an affidavit of the claimant show that the fiduciary is about to misappropriate the said deposit. The Pennsylvania Banking Code, 1965, also provides that a bank shall not be required, in the absence of a court order, or such indemnity, to recognise any claim to, or any claim of authority to exercise control over, a deposit account. In our view, a provision on these lines would considerably reduce the chances of banks getting involved in litigation between the account holders and others making a claim for balances held in the accounts. We recommend a statutory provision on those lines.

Provision for Nomination Facilities

7.7 Individuals opening accounts with banks, in joint names, usually stand in close relationship to each other. In such cases, they wish to open joint accounts, mainly with a view to enable the survivor(s) of them to have access to the funds held in deposit, without any difficulty. Thus, joint accounts serve as a sort of a substitute for nomination. However, while a joint account would facilitate the survivor(s) claiming the balance in the account, this form is of no help when it is intended that some other person, who is not a joint account holder, should receive the funds held in the account on the demise of any one of the joint account holders. While on a contractual basis by opening an appropriate joint account it is possible for a person to provide for the funds held in his account to be paid to a joint account holder on his death, if he wants the payment to be effected to a person other than a joint account holder, this cannot be done at the direction of the person desiring to make such nomination. This is so, as the mandate of the customer lapses on his death, unless the mandate is given in a form that would qualify as a testamentary disposition. Even if regarded as a testamentary disposition, the question of legally proving the disposition, and the obtaining of probate thereon, are matters that would require resort to legal proceedings and involve considerable expense and delay.

7.8 Provision for nomination already exists in the Post Office Savings Banks Rules and is available to individual account holders opening accounts either singly or jointly in Post Office Savings Banks. However, under the Post Office Savings Banks Rules, there is a ceiling as to the maximum amount that could be kept in an account, *i.e.*, Rs. 25,000 in a single account and Rs. 50,000 in a joint account. Subject to this, it is open to anybody even now to keep his funds in the Post Office Savings Banks and have the benefit of the provision for nomination.

7.9 Even as regards co-operative credit institutions, under the Co-operative Societies Act, there is a provision for paying the moneys due to a deceased member to his nominee. For instance, Section 24 of the Madras Co-operative Societies Act provides that a registered society may pay all moneys (including the value of the share or his interest in the capital of the society) due from the society to the deceased member, to his nominee. But this provision for nomination is not applicable in the case of deposits from non-members.

7.10 The Public Debt Act, 1944, contains provisions for nomination (the benefit of these provisions are available in relation to non-negotiable Government securities) and they provide that notwithstanding anything contained in any law or in any disposition, testamentary or otherwise, where a nomination is made as per the Rules, in respect of a Government security, the nominee shall, on the death of a holder of the security, become entitled to the security, and to payments thereon, to the exclusion of all other persons. Where the amount due is payable to two or more nominees, and either or any of them is dead, the title to the security vests in the survivor or survivors of those nominees and the amount for the time being due thereon is to be paid accordingly. *Any payment to the nominee gives a full discharge to the Government in respect of the security, but these provisions do not affect any right or claim which any person may have against the person to whom any payment is made on the strength of such nomination.*

7.11 The question of providing nomination facilities in respect of bank deposits had been raised earlier by the Indian Banks' Association. At that time, Government did not favour any such provision except in relation to very small amounts. Then, the view seems to have been taken that there was no special case for dealing with bank deposits. There was also the apprehension that a provision for nomination in relation to bank deposits might affect the Government's small savings schemes. There was also a feeling that such a provision might affect the assets available to meet the liabilities of the estate of the deceased customers and interfere with the rights of legal heirs.

7.12 The question whether or not Government's small savings schemes are likely to be affected should not as such influence the decision on this question. As we saw earlier, nomination facility is available to a person investing his savings in the Public Debt, or to a member depositing funds with co-operative credit institutions, or to a person depositing in Post Office Savings Banks. After the nationalisation of the major Indian banks, the national banks have amongst themselves nearly 83.7% of the total deposits of the commercial banks as on the 2nd July 1971. As the deposits with these national banks are utilised for extending financial assistance for purposes which will be conducive to the development of the country's economy, we consider it appropriate that the depositors of the national banks should also have the

facility of nomination in relation to their deposits. Such a provision will also help to augment the deposit mobilisation of the banks.

7.13 We have received expert opinion from the United States of America to the effect that it is desirable to make statutory provision to enable banks to repay deposits with them on the strength of nominations. It has been stated that :

> this system is widely in effect in the United States and accounts of this nature are opened in the name of 'John Smith in trust for Richard Jones'. Upon John Smith's death, the bank is permitted to pay the funds directly to Richard Jones. These accounts are sometimes known as 'Totten trusts' or 'tentative trusts' and, I believe, originated in New York without statutory provisions concerning them. However, in Pennsylvania the practice is sanctioned by statute and this is probably true in a number of other States. Of course, accounts merely in the name of the depositor alone are paid at death only to his executor or administrator ; and accounts in the names of two or more persons may be paid to the survivor if one of them dies, if such an agreement is entered into at the time the account is opened. There is no monetary limit on the amount that can be placed in a Totten or tentative trust but the balance in such an account at the time of death is normally regarded as part of the estate of the decedent for purposes of death duties, although not for administration[1].

7.14 Moreover, a substantial amount is held by banks by way of unclaimed deposits. The amounts are held in a number of accounts and the balance per account is very small. A reason for banks holding such number of unclaimed deposit accounts is due to the heirs or legal representatives of deceased depositors not finding it worthwhile to comply with the formalities and incur the expenses necessary for obtaining legal representation. We understand that as at the end of 1969, a sum of Rs. 7.75 crores was held by banks in India as unclaimed deposits in about 6,22,389 accounts. This works out to an average of about Rs. 124.50 as balance held in one account. If there is a provision for nomination, it would facilitate the reduction of the number of unclaimed deposit accounts. This may also reduce considerably the trouble of banks in maintaining such unclaimed deposit accounts and the public in general would be benefited.

7.15 As we saw earlier, by the opening of "either (any one) or survivor(s)" or "former or survivor(s)" types of accounts, the benefit arising by way of nomination is obtained even now. But it is mainly those who are not aware of such benefits arising from the opening of a joint account that are hit by the absence of a provision for nomination. In our view, having regard

1 Reply of Mr. Carl W. Funk, Member of the Pennsylvania Banking Law Commission, 1965, to our questionnaire.

to public interest, there is a strong case for providing nomination facility in relation to deposits with banks by individuals. We recommend accordingly.

Effect of Nomination

7.16 There is a question as to the effect that should be given to a nomination. Under the Public Debt Act, 1944, while any payment to the nominee gives a full discharge to the Government in respect of the security, the nomination provision does not affect any right or claim which any person may have against the person to whom payments are made on the strength of the nomination. In response to our questionnaire, a general support has been indicated for a provision which would give adequate protection and a valid discharge to a bank, on its making payment to the nominee, without at the same time affecting in any manner the claims or rights of others in relation to the balance held in the account of the deceased. Such a provision would not also affect the availability of the assets of the deceased to meet his liabilities. In this view, we recommend that nomination facility should be provided in relation to bank deposits on the lines of the provisions contained in the Public Debt Act, 1944, and that banks should be required to make payment to the nominee(s) unless restrained by an order of a competent court.

Release of Assets Charged to Banks

7.17 In relation to assets charged to banks difficulty is felt, in determining the person entitled to repay the debt and obtain release of the assets charged by the deceased borrower, especially when there are more than one person claiming such right. This delays the repayment of the debt, increases the liabilities of the estate of the deceased and locks up the funds of banks.

7.18 In response to our questionnaire, a general support has been expressed for a provision for nomination, by an individual borrower availing of credit facilities from a bank, of a person who could be allowed to repay the debt and obtain redemption of the assets charged to the bank, in the event of the death of the borrower. This, in our view, is desirable. While such a redemption should give a good discharge to the bank, it should not affect the rights and claims of other parties to the assets of the deceased. It may also be provided that the nominee obtaining release of the charged assets will have a prior claim for getting himself reimbursed of the amounts expended by him to obtain the release of the charged assets. Such a nomination should not also affect such other rights the bank may have for realising any of its other dues recoverable from the estate of the deceased. We recommend statutory provisions may be made on those lines.

7.19 Similarly, in relation to immovable properties mortgaged to banks, it may be provided that on the death of the mortgagor a nominee indicated by him would have the right to redeem the mortgage by repaying the amount due to the bank in respect of such mortgage. Such a provision could also be made by way of an amendment to the Transfer of Property Act. It may be provided that the nominee so redeeming the property will be subrogated to the rights of the mortgagor *vis-a-vis* other persons who may have claims on the property. Such a nomination should not, however, affect the rights of individual parties *inter se* claiming under the mortgagor. From the replies to our questionnaire, we find that there is general support for a provision of this nature. We recommend that such statutory provisions may be made.

Nomination in relation to Assets Lodged with Banks for Safe Custody

7.20 Here again, a statutory provision enabling banks to return the articles kept in safe custody with them, to the nominees of the depositors, may be useful. The forms providing for acceptance of valuables and securities for safe custody may provide for a depositor nominating a person to whom the valuables and securities may be handed over in the event of the depositor's death. The effect of the provision in this behalf should be to relieve the bank from any obligation in relation to such assets, but should not affect the rights *inter se* of the nominee and others claiming under the depositor. We recommend a statutory provision on those lines.

Nomination in relation to Access to the Safety Lockers

7.21 There is also general support for the making of a statutory provision for enabling a customer of a bank renting the lockers, to indicate the person to whom access may be allowed to the safety locker in the event of his death. However, while so providing, it would be necessary to ensure that the valuables kept in the locker are inventoried in the presence of a responsible bank official and/or the tax authority, to see that neither the estate of the deceased, nor the creditors of the estate of the deceased, including public revenue, suffer. We understand that it has been the experience of the tax authorities in the United States of America that death duties have been evaded by members of the family who were permitted to open the safe deposit box and divide among themselves, either as they saw fit or as they knew the deceased intended, the cash, jewellery and other similar properties which were kept in the lockers. In Pennsylvania, a safe deposit box in the name of a deceased alone, or a deceased and some one other than his spouse, cannot be opened for the first time (except to search for a will in the presence of a bank official), unless a representative of the tax authorities is present to list out the contents of the box. The expert opinion we have received from the United States of America questions the exception allowed

in the case of a safety locker rented jointly by the deceased and his wife. In the circumstances, while it is desirable to provide for those renting safety lockers from banks, indicating the persons to whom access may be allowed to the lockers, on their death, or on the death of any one jointly renting the lockers, it should be provided that before any such access is allowed on the death of such person(s), a responsible bank official, or a representative of the taxing authorities, should be present, when an inventory should be taken of the contents of the locker(s) in his/their presence. We recommend accordingly.

CHAPTER 8

OTHER LAWS AFFECTING 'BANKING'

In the earlier chapters, we have given our views on banking definition, classification of banking institutions, banking regulation and certain aspects of the law governing the carrying on of business by banks. This substantially covers the field traversed by us in this Report. But, it is also necessary now for us to indicate in brief our approach to the review of the other laws affecting banking, and also set out what we have been able to do so far. The other laws affecting banking are mainly those pertaining to :

(*a*) negotiable instruments and negotiable documents, and

(*b*) the making of loans and advances.

The laws that govern the carrying on of certain kinds of business allied to 'banking' may also be mentioned in this regard. Hence, for the sake of convenience, we divide this chapter into the following sections :

I. Business allied to 'banking' ;

II. Law relating to Negotiable Instruments and Negotiable Documents ;

III. Law relating to Loans and Advances ;

IV. Need for a constant review ;

V. Review by the Study Group

and proceed to give our comments or views under the appropriate divisions.

I. BUSINESS ALLIED TO 'BANKING'

8.2 Banking, that is to say, the acceptance of 'deposits' from the public, is essentially with a view to the profitable application of the funds. Generally, it takes the form of lending or investment, though concerns may also, within the limits allowed, directly accept deposits from the public for financing their manufacturing or trading requirements. In the business of lending there is a close nexus between banks, financial institutions and moneylenders. It is necessary in public interest that there should be some

similarity in the treatment meted out to all cash lenders. Thus, there are certain types of businesses which are closely allied to banking. We may, in this connection, refer to the business of 'moneylenders', and to that of 'indigenous bankers' who are not carrying on the business of 'banking'.

(*i*) *Moneylending*

8.3 In our country while 'banking' is a Union subject, 'moneylending' is within the exclusive purview of the States. Thus, two different jurisdictions deal with those who lend with, and without taking, deposits from the public. While the difference in jurisdiction may be appropriate, having regard to the importance of the subject from the National and State perspectives, the need for co-ordination of the regulation applicable to moneylenders *vis-a-vis* that applied to banks (and financial institutions), on the lending aspect, is obvious. While the lending policy of banks is supervised by the monetary authority (Reserve Bank of India), moneylending legislation of the States does not provide for any agency which would effectively regulate the lending operations of moneylenders. Though a review of the moneylending legislation may not strictly be within our purview, we recognise the need for, and recommend, a review of the laws governing moneylending.

(*ii*) '*Indigenous Bankers*' *Who do not do* '*Banking*'

8.4 The appellation 'indigenous bankers' for certain classes of persons is partly a matter of history and only partly functional. An 'indigenous banker' is generally regarded as one who deals in hundis and who may, or may not, accept deposits. Of them, those who accept deposits are doing 'banking' and have to be regulated as such. But, those who do not accept deposits but mainly deal in hundis form a separate class of financiers. In this category would come the business ordinarily carried on by a class of indigenous bankers, *viz.*, Multanis. Their business consists mainly in making advances to persons against usance promissory notes or bills (called 'Muddati Hundis') and later on rediscounting them with commercial banks. Though they rely mainly on bank credit for carrying on their business, the money they obtain from banks by rediscounting some of these hundis cannot be regarded as acceptance of 'deposits' from the public. Their business could be compared with the business of "discounting, accepting as collateral or cashing commercial paper, cheques or Government securities" which is regulated under French Law[1] as business allied to 'banking'. In relation to them, there are no regulatory provisions now applicable, but the need for regulation has been suggested. In this context, the French example merits consideration. In relation to such forms of business allied to banking, the Law of

1 Article 27(2)(c) of the Law of June 13, 1941 of France.

June 14, 1941[1] of France has prescribed a scheme of regulation. We are not going into the details of the regulation to be applied for the carrying on of such business, as that has to be considered in the light of the recommendations of the Banking Commission's Study Group on Indigenous Bankers.

8.5 But, we may deal with the question as to whether the power to regulate such business rests with the Union or the States. Under the Constitution, the entry "bills of exchange, cheques, promissory notes and other like instruments" falls within the Union List. But at the same time if a person merely lends against such instruments, it may be regarded only as a form of moneylending, and in this view, may appropriately fall within the jurisdiction of the States. In Prafulla Kumar Mukherjee *v.* Bank of Commerce Ltd., Khulna[2], the Privy Council has held that legislation on 'moneylending' could validly cover also lending against negotiable instruments, *e.g.*, loans against promissory notes. In this view, the business of lending against usance hundis would be only a form of moneylending that comes within the jurisdiction of the States. Hence, while we would like to stress on the need for the regulation of those carrying on such business allied to banking, *e.g.*, Multanis, appropriate legislative measures may have to be taken by the various State Governments. In order to ensure that regulation of such business is uniform, a model legislation may be framed for the consideration of the States.

II. Negotiable Instruments and Negotiable Documents

(*a*) *Negotiable Instruments*

8.6 For a considerable time it has been felt that the Negotiable Instruments Act, 1881, requires substantial revision in the light of the developments in India and elsewhere since then. The Law Commission has gone into this and has given a report in 1958, on the lines on which the said Act

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1 Those whose customary business *inter alia* consists of the carrying on of such business are subject to the following regulations :

(*i*) The National Credit Council is required to register all such enterprises. The formalities and time limits for registration as well as the sanction and powers of the Council in case of the refusal or revocation of registration are the same as those applicable to banks. But such enterprises are under obligation *not* to publish or refer in correspondence to the power exercised by the National Credit Council and the Banking Control Commission over these enterprises.

(*ii*) Such enterprises and persons are required to be members of a professional association whose constitution shall be approved by the National Credit Council.

(*iii*) Depending on the kind of transactions carried on, the legal form of the concern and the number and the location of its permanent business establishment, all enterprises are required to have capital equivalent to an amount that may be fixed by order by the Minister of Finance. The minimum capital is required to be fully paid-up. The enterprises are always required to be in a position to prove that their assets actually exceed their liabilities towards third persons by an amount equal to their paid-up capital.

(*iv*) The Banking Control Commission is required to specify the procedure for publication providing information about the kinds of such enterprises.

2 A.I.R. 1947 P.C. 60; also A.I.R. 1944 F.C. 18; A.I.R. 1945 F.C. 2; and 1940 F.C.R. 188

could be amended. Opinions of banks have also been obtained on a draft Bill prepared on the basis of the recommendations of the Law Commission. While dealing with this subject, the Commission has been guided by the provisions of the Uniform negotiable Instruments Law of U.S.A. and the Bills of Exchange Act and the Cheques Act of U.K. The provisions of the Cheques Act had just then come into force in U.K. and not much experience had been gained. Hence, the Commission was not in a position to decide on the advisability of having provisions on similar lines in India. Since then, considerable experience has been gained in U.K. on the working of the Cheques Act. The Cheques Act avoids duplication of labour, expedites and saves the cost of the handling of cheques by banks. Hence, the desirability of having provisions in India on the lines of the Cheques Act has to be gone into. The Negotiable Instruments Law in U.S.A. is now no longer based on the provisions of the Uniform Negotiable Instruments Law. While the Law Commission had taken into consideration the provisions of the Uniform Negotiable Instruments Law in giving its report, this has yielded place in U.S.A. to Article 3* of the Uniform Commercial Code. The proposed legislation on Negotiable Instruments should be considered keeping in view the desirability of having provisions in India on the lines of the Cheques Act of U.K. as also the developments in U.S.A. resulting in the adoption of Article 3 of the Uniform Commercial Code.

8.7 The International Chamber of Commerce has framed Uniform Rules for the collection of Commercial Paper. Banks in India have noted certain difficulties in following the Uniform Rules in view of an apprehension that some of the provisions of the Uniform Rules may not be consistent with the requirements of the law relating to Negotiable Instruments. This, and the effective means by which Uniform Rules could be applied in India have to be gone into.

(*b*) *Indigenous Negotiable Instruments*

8.8 Though the Select Committee which went into the Negotiable Instruments Bill, 1879 felt that the mercantile community would gradually discard the numerous local usages governing the indigenous negotiable instruments ("hundis", as they are called), this has not transpired and in the words of the Law Commission, our businessmen still continue to stick to the "bewildering usages governing these instruments". This raises certain questions such as whether the law should permit the continuance of such indigenous negotiable instruments; if so, whether the usages and practices governing them should be codified and they should be brought within the scope of the Negotiable Instruments Law. The views, in this behalf, of the Banking Commission's Study Group on Indigenous Bankers have also to be taken into consideration.

* This Article represents a complete revision and modernization of the Uniform Negotiable Instruments Law. Part 9 of our questionnaire refers to certain important provisions of Article 3.

(*c*) *Negotiable Instruments for Payment of Money not in the Nature of Cheques, Bills or Notes*

8.9 A suggestion has been made that there should be uniform legislation dealing with the law regarding the negotiation of quasi-negotiable instruments, such as debentures, bonds issued by companies, bearer bonds, bearer scrips, bearer debentures, treasury bills, postal orders, share certificates, insurance certificates/policies, deposit receipts, dividend warrants, etc. Though the Law Commission has expressed that this cannot come within the framework of the Negotiable Instruments Act, the question of codification of the law regarding the negotiation of quasi-negotiable instruments remains for consideration. In U.S.A., Article 8* of the Uniform Commercial Code which deals with "Investment Securities", has codified this branch of the law. In this connection, reference may also be made to the need felt in developed countries for increasing the types of negotiable instruments and the practice in U.S.A. of issuing negotiable certificates of deposits.

(*d*) *Negotiable Instruments—Conflict of Laws*

8.10 The law regarding negotiable instruments should have some uniformity with the laws in this behalf in other countries. This is necessary for the promotion and development of international trade. This would facilitate promotion of our country's foreign trade. Again, the parties to the negotiable instrument may not be citizens of the same country and the laws of different countries may govern their rights and liabilities. Hence, questions of conflicts of law come in for consideration, while dealing with the law relating to negotiable instruments. These have led to the consideration of the suggestion for having an International Negotiable Instrument by the United Nations Commission on International Trade Law (UNCITRAL) and other international bodies such as the Commission on Banking Technique and Practice of the International Chamber of Commerce.

(*e*) *Bank Deposits and Collections*

8.11 As part of their business, banks undertake for their customers the payment and collection of negotiable instruments. The special role of banks, in paying negotiable instruments drawn on them and in the Collection by them of negotiable instruments on behalf of others, has been recognised in law. But the extent to which they are protected in carrying out these transactions and their other rights and liabilities are not codified and the position has to be ascertained partly from the Negotiable Instruments Law and partly from the Clearing House Rules and partly from the terms of the contract, express or implied. The tremendous number of cheques handled by banks and the country-wide nature of the bank collection process have to be kept in view while considering the question of codifying this branch of

* Article 8 is likened to a negotiable instruments law dealing with securities. This deals with bearer bonds, registered bonds, certificates of stock, and other additional types of investment paper.

the law. In U.S.A., under Article 4* of the Uniform Commercial Code, the law regarding bank deposits and collections has been codified. In the interest of the development of banking, it is desirable that this branch of the law is codified and suitably revised.

(f) Documents of Title to Goods

8.12 For the development of banking and commerce, it is necessary that the law regarding the documents of title to goods is simple, precise and uniform, as far as possible. Again, it will facilitate the financing of the movement of goods if the law as regards their negotiation is standardised. Further, it would considerably be helpful to improve the warehousing position if warehouse receipts could be easily accepted as documents of title to the goods warehoused. In this connection, the status of warehouse receipts, railway receipts, truck receipts and also air consignment notes has to be considered. Article 7† of the Uniform Commercial Code has consolidated and revised the law relating to the negotiation of documents of title to goods. An effort towards such consolidation and revision of the law relating to the negotiable documents of title to goods in India is overdue.

III. Law relating to Loans and Advances

8.13 In the vast majority of cases, the ease with which bank credit could be made available would depend on the adequacy and effectiveness of the security. Loans and advances by banks and financial institutions may be classified as either secured or unsecured. While a person's ability to give adequate security *per se* does not make him creditworthy, the laws should facilitate prompt repayment of credit. Otherwise, the resources of banks and financial institutions may get locked up in certain places and, to that extent, would affect the grant of accommodation to other creditworthy causes. In other words, if the laws relating to secured transactions do not adequately safeguard the interest of, or are not conducive to the easy realisation of the amounts lent by, and owing to, banks and financial institutions, they have to either —

(*i*) insist on the borrower furnishing security that would be disproportionately high to the quantum of the credit given ; or

(*ii*) run the risk of the related credit becoming sticky or bad.

If the laws relating to secured transactions are modern and suitable, the banks may be expected to relax their insistence on the offering of security dispro-

* Article 4 adopts many of the rules of the American Bankers Association Code that are still in current operation, the principles and rules of the Deferred Posting and other statutes, codifies some rules established by court decisions and in addition states certain patterns and procedures that exist even though not heretofore covered by statute. Part 11 of our questionnaire deals with the law relating to bank deposits and bank collections.

† Article 7 is a consolidation and revision of the Uniform Warehouse Receipts Act and the Uniform Bills of Lading Act, and embraces also the provisions of the Uniform Sales Act relating to negotiation of documents of title.

portionately high to the amount of loan, and there is less chance for the advance becoming sticky or bad.

8.14 Broadly, the laws relating to loans and advances could be considered as those pertaining to lending against assets which may be either movable or immovable or fixtures, and those pertaining to lending on the guarantee, or credit of third persons, or on the credit of the borrower himself. On the basis of the study we were able to make, it became apparent that our laws relating to secured transactions require a comprehensive revision. As a result of such awareness, we decided to compare the position in this behalf in India with that in developed countries. On a *prima facie* appraisal, we are of the view that there is considerable room for improvement of the laws relating to secured transactions in India, in the light of significant and far-reaching revision of the laws which has taken place in other countries, especially U.S.A.

A. Advances Against Movable Assets

8.15 In order to clarify the position, we may refer to a few of the branches of the laws relating to secured transactions, *e.g.*, laws relating to trust receipts, hypothecation advances and instalment credit transactions.

(*i*) *Trust Receipts*

8.16 Trust receipts are documents obtained by banks and financial institutions for the release of the goods, or the documents of title relating to the goods, pledged with the lending institution, to enable them to be dealt with by the borrower without at the same time affecting the interest of the lending institution, over the goods or the proceeds thereof. Certain judicial decisions have clearly brought out the fact that pursuant to a trust receipt there is no trust as such created, that ordinarily no action for breach of trust may lie, that release of the goods/documents against trust receipts may not also preserve the priority of charge in cases of subsequent fraudulent dealings with the goods, and that in the event of insolvency of the borrower, no preferential claim may be sustained. The Central Banking Enquiry Committee, 1931, had indicated the need for further examination of the legal position and the taking of appropriate measures to enhance the status of trust receipts. Though the matter has continued to be under consideration, nothing positive, that would go to make trust receipts an acceptable form of security, has emerged so far.

8.17 In fact, the Bombay Exchange Banks' Association which had been pleading for remedial legislation in India on the lines promoted in U.S.A., had pointed out :

> To the extent that a trust receipt can be made to provide effective security in merchandise or its proceeds, it would operate as a facility

for merchants whose unsupported credit might be insufficient. Hence, in the case of a country at the present stage of India's development, it would be desirable to adopt legislation which, by bringing certainty and effectiveness, stimulates the commercial development of the comparatively smaller dealers and traders in India, rather than letting them remain at a disadvantage as against established concerns due to the fact that their credit position has not yet been so well established.

Thus, if trust receipts could be made an acceptable form of security, it would help in the giving of credit to small concerns which have not established themselves. In fact, the need to provide for this is considerably more important in the present day conditions.

8.18 Now, we may briefly mention the developments in U.S.A. regarding trust receipts. Difficulties somewhat similar to those felt in India have been felt in the United States with reference to trust receipts, and this led to the framing of the Uniform Trust Receipts Act by the National Conference of Commissioners on Uniform State Laws, in 1933. This was adopted, in due course, by the States of the United States. This measure provided for registration of trust receipts, the reconciliation of conflicting claims of security interest over the related goods and also facilitated the popularity of trust receipts as a form of security device. Not merely content with that, subsequent research and consideration have been bestowed in that country and this has resulted in the framing of Article 9 of the Uniform Commercial Code which has been adopted by all the States except Louisiana. Article 9 of the said Code which enlarged the scheme of the Uniform Trust Receipts Act, has also brought within one comprehensive scheme the other forms of secured financing (on the security of movables and fixtures) and has set out the rights and liabilities of parties having regard to the substance of the arrangement and not the form or the device adopted for clothing the transaction.

8.19 As already stated, if trust receipts are made more acceptable as a form of security, this would considerably benefit the small businessmen in availing of bank finance. In other words, instead of the facility of allowing advances to remain on the strength of trust receipts, being confined to only certain reputed and well-established concerns and for all practical purposes the relative advance being treated as merely unsecured advances, by continuing the security interest of the lending institution over the pledged goods, or documents of title relating thereto, by means of a trust receipt, the small businessmen could be enabled to obtain release of the goods/documents, arrange for taking delivery of the goods transhipped and/or dispose of them and remit the proceeds in satisfaction of the dues.

(ii) Hypothecation of Goods

8.20 The law in India does not adequately protect the interest of the lending institution when the advance is given against hypothecation of goods.

This is specially so when the related advance is given to non-company borrowers. In such cases the advance has to be, and is being, treated for all practical purposes as unsecured. This is not a satisfactory position.

8.21 In this connection, we may note that all types of advances against goods or other movables (including fixtures) are brought, under Article 9 of the Uniform Commercial Code, into one comprehensive scheme. The developments in U.S.A. embodied in Article 9 of the Uniform Commercial Code merit our serious considerations in our efforts to evolve a rational scheme of legislation to govern advances secured against movables including fixtures.

(iii) Instalment-credit Transactions

8.22 There is no legislation in India dealing specifically with the provision of instalment credit. By "instalment credit" we mean credit given in the form of hire-purchase, credit-sale or conditional sale. Promotion of legislation to deal with hire-purchase transactions is now engaging the attention of the Government. This, as we may see hereafter, does not deal with the whole field of instalment credit.

8.23 The Law Commission, when it considered the Sale of Goods Act, observed that it is desirable that a separate Act "on the lines of the English Hire Purchase Acts and other similar laws should be enacted in India to regulate hire purchase transactions". Subsequently, the said Commission has given its report in 1961 and has suggested a scheme of legislation that could be considered for India. Its recommendations have been given taking into consideration the Hire Purchase Act, 1938 (known as Miss Wilkinson's Act) and the Hire Purchase Act, 1954 of U.K., and the Uniform Conditional Sales Act of U.S.A. drafted in 1918 by the National Conference of Commissioners on Uniform State Laws. The Law Commission has said :

> While taking into consideration all the above materials we have adopted the English Acts of 1938 and 1954 as basis for the present draft, introducing therein such alterations as would seem to be called for in the conditions prevalent in this country.

8.24 The Law Commission had to consider the basic question whether a law on hire-purchase should cover also instalment credit sales. On this question, it observed :

> Hire purchase agreements and credit sale contracts being thus fundamentally different in character and in their legal incidence, the question is whether the present legislation[1] should apply also to the latter. The

1 Legislation suggested by the Law Commission for regulating hire-purchase.

argument in support of their inclusion is, that the two classes of agreements have so many features in common, that it may not always be possible to distinguish between them, that if these transactions are excluded from the operation of this legislation[1] it will be easy for the owner to circumvent it by disguising hire purchase agreements under the trappings of credit sale agreements, and the legislation will be bereft of much of its utility. That, no doubt, is a result which must be avoided. But the question to be considered is whether, for achieving this object, it is necessary to bring credit sale agreements, within the purview of this legislation[1]. There should be no difficulty in distinguishing an agreement of hire purchase from a credit sale agreement, when it is understood that the cardinal point of distinction between the two is whether the so-called hirer or purchaser has an option to purchase or not. . . . . We have therefore decided to exclude them from this legislation[1]. If it should become necessary at any time, owing to the exigencies of business, to enact legislation for granting relief to purchaser, under credit sale agreements, that should, in our view, be more appropriately done by inserting special provisions in the Sale of Goods Act, 1930.

8.25 However, the Law Commission noted that though the Hire Purchase Act, 1938 of U.K. applied also to certain sales on credit, such application was only in relation to "matters of form and not of substantive rights of the parties under the agreement". The Commission had also noted that in some Australian States the provisions of the Hire Purchase Acts applied not only to formalities but also to substantive rights. In the result, the Commission preferred to follow "the precedent of the English Hire Purchase Acts, 1938 and 1954 to the enactments in some of the Australian States". However, the position in U.K. has since changed substantially. Under the Hire Purchase Act of 1964, "for the first time, too, conditional sale agreements were specifically dealt with and placed in virtually the same position as contracts of hire purchase"[2]. The Hire Purchase Act of 1965 of U.K. is a statute consolidating the legislation on hire-purchase, credit sale and conditional sale agreements. It has repealed and re-enacted the provisions of the earlier Acts. Thus, the precedent of the Hire Purchase Acts of 1938 and 1954 of U.K., which was relied on by the Law Commission for its recommendation to exclude credit sale (as also conditional sale) contracts, from the scope of the legislation proposed by that Commission, has not been followed in U.K.

8.26 The Crowther Committee has noted that "the greatest weakness of the present law of credit, and that from which most of the other defects stem, is the failure to look behind the form of a transaction and deal with the substance. This manifests itself in the drawing of distinctions between one

1 Legislation suggested by the Law Commission for regulating hire-purchase.
2 Guest A. G., "The Law of Hire Purchase", Sweet and Maxwell, 1966 Edn., pages 3 and 4.

type of transaction and another which are based on legal abstractions and are regarded in the commercial world as unrealistic. Typical are the distinctions made by the law between the hire-purchase agreement and the conditional sale agreement; between a hire-purchase or conditional sale agreement and a purchase-money chattel mortgage; and between the discounting of debts with recourse and the lending of money on the security of debts. None of these distinctions has any validity in the real world; yet the law continues to adhere to them in deference to theoretical concepts developed two centuries ago"[1]. The focal point of the proposals of that Committee is that credit transactions, whether by way of lender credit or vendor credit, shall be governed by a Lending and Security Act containing provisions applicable to credit transactions generally; and a Consumer Sale and Loan Act containing any special provisions considered necessary to regulate, in any of their aspects (sale, loan or security), those transactions that fall within the definition of a consumer credit transaction. The Consumer Sale and Loan Act will replace the whole of the existing legislation regulating consumer credit and will fuse the various existing forms of legal protection into one rationally coherent enactment[2]. Thus, the trend now, as seen from the legislation and considered views in U.K., U.S.A., Australia and other countries, is to unify the scheme of legislation relating to credit for the acquisition of goods, whether the relative transaction is couched as hire-purchase or credit sale or conditional sale.

8.27 While these developments have taken place elsewhere, efforts have been pursued for enacting a hire-purchase law in India on the lines recommended by the Law Commission. The Hire Purchase Bill, 1968, was introduced in the Rajya Sabha in July 1968, and subsequently referred to a Joint Committee of Parliament. The Joint Committee reported on this in February 1970. The proposed legislation is essentially confined to strictly hire-purchase transactions and does not cover credit sale, or conditional sale, agreements. In view of what has been stated above and as the trend in other countries is to bring within a unified scheme the regulatory provisions applicable to both vendors' credit and lenders' credit, it is desirable that a fresh look is taken at the proposed legislation.

(iv) Uniform Personal Property Security Law

8.28 In U.K., the Crowther Committee has concluded, after an examination of the law relating to credit transactions that it suffers from fundamental deficiencies which necessitate widespread reform. That Committee has found that broadly the defects in the law fall into seven groups[3]:

(*i*) Regulation of transactions according to their form instead of according to their substance and function.

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1 Report of the Crowther Committee, 1970, page 175.
2 Pages 20 and 237 *ibid.*
3 Page 175 of its Report.

(*ii*) The failure to distinguish consumer from commercial transactions.

(*iii*) The artificial separation of the law relating to lending from the law relating to security for loans.

(*iv*) The absence of any rational policy in relation to third party rights.

(*v*) Excessive technicality.

(*vi*) Lack of consistent policy in relation to sanctions for breach of statutory provisions.

(*vii*) Overall, the irrelevance of credit law to present day requirements, and the resultant failure to provide just solutions to common problems.

In our view, these criticisms would be equally valid in our country with reference to our laws relating to credit transactions.

8.29 In Canada, the Model Uniform Personal Property Security Act aims to eliminate the "profusion of common law, equitable and statutory security devices and the complex and frequently overlapping legislation regulating them, and substitutes in their place the single concept of an integrated 'security interest'."[1] Under this legislation (proposed), "all consensual security interests will be governed basically by a common set of rules involving the rights of the parties *inter se* and the position of the secured parties *vis-a-vis* third parties. Such distinctions as remain will follow accepted functional lines and will not be based on the accidents of history or of antiquated legal doctrines"[1]. This proposed measure has also greatly clarified and rationalised the "rules governing inventory and accounts receivable financing"[1].

8.30 Thus, the developments in U.S.A., U.K. and Canada have focussed attention on the deficiencies of the law governing Credit transactions on the security of movable property. It is necessary that we should rationalise our laws relating to the granting of credit against movable assets, in public interest and in the interest of the development of banking.

B. Advances Against Fixtures

8.31 By 'fixtures' we mean the goods and machinery which may be, or are to be, attached to earth, or to things attached or imbedded to earth. Fixtures come in the twilight area in which to draw the line amidst them as movable or immovable assets, is, in most cases, difficult. While courts have agreed on the tests to be applied, till there is a judicial determination in respect of a disputed asset, it appears that opinion cannot be definite

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1 Article "The Model Uniform Personal Property Security Act—A new deal in chattel security law" by Jacob S. Ziegel in "The Canadian Banker"—January, February 1971.

as to whether a fixture is movable or immovable. In fact, one High Court has remarked that "while general tests pointed out by judicial decisions in the light of specific facts, may be borne in mind, eventually the decision on the question should depend upon how the court, looking at the facts as a whole, feels on the matter". As the mode of creation of the charge, its method of enforcement and the rights of parties depend now on the question whether the fixture in relation to which the charge is claimed is a movable or immovable asset, the present position is not a satisfactory one.

8.32 The law relating to fixtures has undergone a revision in Article 9 of the Uniform Commercial Code of U.S.A. That Article sets out in clear terms the rights and obligations of parties borrowing against fixtures, those lending on the strength of fixtures, and third parties who may deal with the fixtures. These rules are not dependent for their application on the result of the question whether the fixture is or is not considered as an immovable asset. As banks and other financial institutions, when providing necessary credit for irrigation and other facilities involving the installation of motors, other machinery, pump-sets, etc., may have to have their advances mainly secured against such assets acquired from out of the bank finance, it may be necessary to consider the making of suitable legislative provisions on the pattern of those now found in Article 9 of the Uniform Commercial Code in relation to fixtures.

C. Advances Against Immovable Assets

8.33 While making advances to the agricultural sector, banks may have to rely to a substantial extent on the security of the land. Obtaining a charge over land brings in its wake questions relating to the time and trouble involved in investigating title, the comparatively high cost involved in obtaining a charge over immovable *vis-a-vis* movable assets, the peculiarities of land tenure, restrictive legislation regarding land ceilings and fragmentation of holdings, multifarious claimants in respect of the same land, and protracted procedures that have to be gone through for the enforcement of the charge against the land. All these make land not a good form of security from the point of view of banks, especially for giving short-term or medium-term advances.

8.34 One of the Provincial Banking Enquiry Committees (1929-30) has reported that "the use of land as basis of credit could be greatly facilitated by a radical and comprehensive revision of the Transfer of Property Act"[1]. The Central Banking Enquiry Committee has also drawn attention to the need for removal of certain legal impediments to ensure the availability of credit at reasonable rates. In the context of extending credit to the agricultural sector, it becomes necessary to ensure that lending institutions accept the charge against land without much difficulty. Considerable improvements

[1] Burma Provincial Banking Enquiry Committee, Vol. III, paragraph 728, page 324.

have been made in the countries which follow the Torrens System[1] of Land Title Registration. This facilitates the ascertainment of a person's title to land. The feasibility of adopting such system in India has to be considered.

8.35 The Expert Group appointed by the Reserve Bank under the Chairmanship of Shri R. K. Talwar has recommended that to facilitate banks extending credit to agriculture, it is necessary that the special provisions which apply to co-operative banks providing credit against charge on land should be made applicable also to banks and financial institutions extending such credit. In the light of the recommendations of that Group, the need for special provisions with reference to banks and financial institutions as regards their advances to agriculture requires to be considered.

D. Provision of Credit Against the Security of Guarantees, etc.

8.36 The United Nations Commission on International Trade Law and the International Chamber of Commerce have made a study of the legal aspects that arise for consideration with reference to bank guarantees. Article 5 of the Uniform Commercial Code deals with the law relating to letters of credit. The Uniform Customs and Practice for Documentary Credits drawn up by the International Chamber of Commerce is generally followed with reference to letters of credit arising in connection with international transactions. There are also certain aspects to be looked into with reference to making of unsecured advances. In any review of the law relating to loans and advances, attention will have to be bestowed also on the legal aspects relating to the provision of credit secured not against any tangible asset but against the guarantee or credit of third persons or that of the borrower himself.

IV. Need for Constant Review

8.37 With the increasing reliance on the banking system for the development of the country, it is essential to ensure that the laws both relating to, and affecting banking, are rational, devoid of complications and complexities and are conducive to the spread and the effective functioning of the banking system. We consider that this could be achieved only by a *constant* review of the laws concerning, and affecting, banking. The approach should be not merely to review the laws from the perspective of the banks, but essentially having regard to the public interest. The imperative need for such constant review is keenly felt when we compare the pace at which laws

1 Sir Robert Torrens established the system in Australia in 1858. Under this system, the original certificate of title, which is similar to a ledger page, is in the Registrar's office and the duplicate is with the owner as his evidence of title. In order to ascertain the condition of title, it is necessary only to scrutinise this ledger page certificate and whatever may be noted there may be finally and absolutely accepted as the condition of title. No mortgage, judgment, lien, or any other claim can be set up or claimed unless it is noted upon this certificate. The Torrens system is calculated to prevent law suits. The success of this scheme caused it to spread rapidly to various other countries, namely, England, Ireland, Canada, several States of U.S.A., Philippines, etc.

relating to and affecting banking have been reviewed, and suitable remedial measures taken, elsewhere and in India.

8.38 Even in U.K., the need for regular review of credit laws has been emphasised by the Crowther Committee, and we may refer, in this context, to the following observations of that Committee :

> However far-seeing a law may appear when first enacted, changes occur in commercial practice, and in social attitudes and problems, for which no suitable provision has been made. In the absence of any regular review, large sectors of credit law have become increasingly inapt and divorced from reality. It is nearly 90 years since the enactment of the statute governing security bills of sale. Yet this relic of a by-gone age, passed at a time when conditions were vastly different from those now prevailing, has continued in force wholly unchanged. One of the important tasks . . . will be to ensure that credit law is not allowed to ossify in this way in the future but is periodically brought up to date. This can only be achieved by keeping abreast of social and commercial developments, by maintaining continuous contact with informed opinion and by conducting detailed research. . . . . What is needed above all is receptiveness to new ideas and a willingness to discard precedent where necessary.
>
> . . . . It does not, of course, follow that a law which is good for another country will be suitable in Britain. Account has to be taken of differences in the social structure, in the size and mix of the population and in a range of other factors. But all too often in the past these differences — whether relevant to a projected reform or not — have been adumbrated as a justification for ignoring legislation in other countries and going our own way. By ready interchange of ideas and information with those in other countries who are involved with credit and credit law we can both obtain and impart a new insight into familiar problems and perception of problems and solutions hitherto unexplored. The need for this exchange of ideas becomes the more compelling in view of the increase in the volume and speed of international trade . . . . There is growing pressure for uniformity in commercial law and practice. By ensuring that we are properly informed of developments both here and abroad we shall be much better placed to influence the shape of any uniform legislation affecting credit transactions.[1]

Now we may note the major developments at the international level, and at the national level in other countries, regarding the review of the laws concerning and affecting banking.

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1 Report of the Crowther Committee, 1970, page 390.

(*a*) *Reviews at International Level*

(*i*) *United Nations Commission on International Trade Law*

8.39 The United Nations Commission on International Trade Law (UNCITRAL) was established under a resolution dated the 17th December 1966 of the General Assembly of the United Nations and this is bestowing its attention on evolving rules for international sale of goods, international payments including negotiable instruments, bankers' commercial credits, guarantees and services, international commercial arbitration, international legislation on shipping, etc. The said Commission is also, following the recommendations of the General Assembly, collaborating with international associations active in the field of international trade law, by associating observers of other organisations, arranging for intersessional working groups, having consultations on specific subjects with interested organisations and affording opportunities for organisations to submit suggestions to the Commission.

(*ii*) *International Chamber of Commerce*

8.40 Then, reference has also to be made to the International Chamber of Commerce which has a Commission on banking technique and practice and a Commission on international commercial practice. Under the auspices of these Commissions, the International Chamber, in co-operation with the UNCITRAL, is constantly reviewing the law governing international sale of goods and that relating to international payments including the laws pertaining to guarantees, securities and negotiable instruments.

8.41 Thus, at the international level the trend is now to modernise and bring about uniformity of laws with which banks and bankers are vitally concerned. Any review of the laws relating to and affecting banking has to take note of this development, which would provide the necessary background for the review of our laws in the respective fields.

(*b*) *Progress of Developed Countries in Legal Reforms*

8.42 Significant changes have taken place in U.K., U.S.A. and Canada regarding the laws affecting banking.

Developments in U.S.A.

Pennsylvania Banking Code

8.43 In U.S.A., in the States, *e.g.*, Pennsylvania, a Banking Law Commission had been appointed for having a critical look at the laws relating to banking. As a result of the efforts of that Commission, the Pennsylvania Banking Code (1965) has been enacted in that State.

Uniform Commercial Code

8.44 The Uniform Commercial Code of the United States of America is acknowledged even in U.K. as having brought about a reform in commercial law, the breadth and width of which are both "awe-inspiring and challenging". The Uniform Commercial Code is a product of the joint efforts of the National Conference of Commissioners on Uniform State Laws (a body dedicated to unity of legislation in the different States of U.S.A.) and that of the American Law Institute. The Code is a comprehensive one and covers fields such as sale of goods, hire-purchase and credit sales, negotiable instruments, documents of title to goods, trust receipts, letters of credit, and bank deposits and collections. The Uniform Commercial Code was first published in 1951. It was later revised on several occasions and the current version is the 1962 Official Text. The Code has been enacted, with some minor variations, in every State (except Louisiana) and in the District of Columbia. Article 9 of the said Code applies to "any transaction (regardless of its form) which is intended to create a security interest" in personal property and fixtures. The great attraction of Article 9 is said to be "its conceptual unity".

8.45 We note that on a detailed study of Article 9 from the point of view of English law it has been found that subject to certain modifications, "Article 9 is eminently suited for importation"[1]. The Crowther Committee has gone into the desirability of having legislation in U.K. on the pattern of Article 9 of the Uniform Commercial Code. That Committee has observed that :

> The widespread adoption of the Code appears to be due, in no small measure, to the outstanding merits of Article 9 which gave the common law world, for the first time, a comprehensive and rational legal structure for the regulation of security interests in personal property. We have been much influenced by the underlying concepts of Article 9 . . . . .[2]

That Committee has further said that Article 9 :

> represents the distilled wisdom and knowledge of a great number of lawyers and others concerned in the field of personal property security and we imagine that few, if any, enactments or model laws have been subjected to such critical and prolonged analysis during the drafting stages. Article 9 deserves the closest scrutiny by all those concerned with the modernisation of British personal property security law. While we do not consider that British law requires such elaborate classifications as those laid down in the Code and we do not wholly subscribe to

1 R. M. Goode and L. C. B. Gowar, "Is Article 9 of the U.C.C. exportable ? Commonwealth reactions", a paper presented at a Conference of Comparative Commercial Law at McGill University, September, 1968.

2 Report of the Crowther Committee, 1970, page 183.

the policies embodied in the Code for regulation of priorities, we consider that Article 9 is in concept and structure an admirable prototype of a modern law of personal property security.[1]

8.46 "The impact of Article 9 is not limited to the United States, but already has resulted in the enactment of the Ontario Personal Property Security Act, 1967, which is substantially modelled on it. Article 9 has also attracted widespread interest in Australia and New Zealand."[2]

Permanent Review of the Code

8.47 The sponsors of the Uniform Commercial Code have also set up a Permanent Editorial Board to maintain a constant review of the provisions of the Code and suggest such amendments thereto as may be considered necessary in the light of experience gained in its working. The Joint Committee on Continuing Legal Education of the American Law Institute and the American Bar Association are also conducting courses of study for bankers and others concerned with the working of the Code.

Uniform Consumer Credit Code

8.48 The National Conference of Commissioners on Uniform State Laws have also recently brought forth a "Uniform Consumer Credit Code" which contains the consumer protection legislation of the type found in the Hire Purchase Act, 1965 of U.K.

8.49 Thus, in U.S.A., so far as the laws relating to and affecting banking are concerned, we find that there are active bodies entrusted solely with the task of constantly reviewing the application of such laws and suggesting any remedial measures that they may consider necessary at any time.

Developments in Canada

Personal Property Securities Act, 1967

8.50 In Canada, the State of Ontario has passed the Personal Property Securities Act, 1967, which is closely modelled on the pattern of Article 9 of the Uniform Commercial Code of U.S.A. It is stated that several of the Provinces of Canada are also showing interest in the Ontario Act. A Committee of the commercial law section of the Canadian Bar Association, under Prof. Jacob Ziegel's Chairmanship, is reportedly considering whether a statute of this kind should be promulgated in Canada as a uniform Act. It is understood that this Committee has drafted a Uniform Personal Property

1 Report of the Crowther Committee 1970, page 197.
2 Page 186 *ibid.*

Security Act. The Ontario Act "is of particular significance in that it represents the first attempt to transplant Article 9 into a common law country outside the United States"[1].

Section 88 of the Canadian Bank Act

8.51 Again, in Canada, Section 88 of the Bank Act, known as the "Key to the Canadian Banking System" and as "one of the most distinctive features of the Canadian banking", enables the borrower to give the bank security in "simple form", which is an one page document, in one of the statutory forms prescribed in the schedules to the Act whereby the borrower assigns to the bank all of his present and future goods falling within one of the categories enumerated in Section 88, to secure the bank's advances from time to time. This document is held as creating a fixed charge of a legal character, though the security has the earmark of a floating charge. The Section 88 agreement is not required to be registered, but a simple Notice of Intention signed by the borrower has only to be filed with the proper authorities. Once this Notice is filed, it is effective for three years. This Notice of Intention has similarity to the Financing Statement required to be filed under Article 9 of the Uniform Commercial Code of U.S.A. It is said that Canada is perhaps the first Commonwealth country to have adopted this type of Notice-filing. Some of these developments in the Canadian law may be of considerable interest in the context of banking development in India.

Developments in U. K.

Cheques Act, 1957

8.52 In U.K., recently, there have been significant changes in the laws affecting banking. The Cheques Act of 1957 has been found to be working satisfactorily. The Hire Purchase law has been recently consolidated and this covers now also credit sales and conditional sales.

Report of the Crowther Committee

A Committee appointed under the Chairmanship of Lord Crowther to review the legislation dealing with the provision of consumer credit has recommended the repeal of the moneylending legislation and the hire-purchase legislation, and a radical review of the laws and further measures including the framing of legislation on the lines of Article 9 of the Uniform Commercial Code of U.S.A.

8.53 As we saw earlier, in several fields of laws concerning bankers. and banking, there is room for considerable improvement in our country.

1 Report of the Crowther Committee, 1970, page 197.

If the banking system is to serve effectively the needs of the community, the laws relating to and affecting banking will have to be considerably simplified and codified. As may be seen from the above, significant changes have taken place in this regard in advanced countries and at the international level. It is essential to constantly review our laws in these fields in the light of these developments specially having regard to the Indian setting and our special needs.

State Legislation

8.54 There is also another field where there is room for constant review. This relates to the different State enactments now affecting banking and other financial institutions. The laws affecting banking are not only those coming for the consideration of the Union. In U.S.A., the States have considerable areas reserved for their own consideration. Realisation that it would be conducive for the development of trade, industry and commerce if there is unity of approach within the country has led to the setting up of the National Conference of Commissioners on Uniform State Laws. However, in India, many of the laws with which banking is concerned fall within the jurisdiction of the Union and hence, the scope for divergence in the laws applicable in the different States is eliminated to a substantial extent. However, there still remain laws coming for the consideration only of the States and with regard to which there is need for —

(*i*) the examination of the prevailing laws of the States with a view to bring them in line with the developments in other countries and having regard to the local conditions ;

(*ii*) the different States being apprised of the developments in other countries of the laws on those subjects ;

(*iii*) assisting in the taking of particular steps by the different States for promoting legislation ; and

(*iv*) providing a forum for mutual discussions and periodical reviews of the laws in force in the different States on the subjects with which bankers and banking are concerned.

Special Machinery to deal with the Review of Laws Affecting Banking

8.55 In order to deal with this situation, we recommend the setting up of a special body to be constituted by the Central Government, which should be presided over by a jurist. Its members should be drawn from the legal profession, from legal experts who have worked with or are working with banks, and from experienced bankers and others possessing expert knowledge or experience considered necessary or useful for such review. Such a body should be entrusted with the task of reviewing the laws concerning and affecting banking and falling within the jurisdiction either of the Union or

of the States. The Reserve Bank may be asked to give such assistance as may be required by the reviewing body. It may also provide for meeting its expenses. While ultimately the responsibility for a constant review of the laws concerning and affecting banking has to be entrusted to such a body, we have, as a result of the studies undertaken by us initiated a review on the subjects falling within our consideration and with which the business of banking is intimately connected, *viz.*, codification of commercial law, the law relating to negotiable instruments and documents, law relating to loans and advances including letters of credit, guarantees, etc.

V. Review by the Study Group

8.56 As may be seen from Chapter 1, and in the circumstances stated therein, the Group has initiated a review of the laws relating to, and affecting banking. As part of the process of review, the Group took note of the problems arising for consideration and has issued a comprehensive questionnaire which gave as background the prevailing position in developed countries on the several matters relating to laws concerning and affecting banking, and posed for consideration the alternatives available to remedy the situations. The questionnaire so far issued by us, and pertaining to subjects other than those considered already by us in the earlier chapters, falls under the following Parts :

Part 5 — Codification of commercial law.

Part 6 — Indigenous negotiable instruments (Hundis).

Part 7 — Negotiable instruments for payment of money not in the nature of cheques, bills or notes.

Part 8 — Negotiable instruments — Conflict of laws.

Part 9 — Negotiable instruments — General.

Part 10 — Cheques.

Part 11 — Bank deposits and collections.

Part 12 — Documents of title to goods.

Part 13 — Loans and advances by banks — General.

Part 14 — Local legislation affecting bank lending.

Part 15 — Charge on immovable property.

Part 16 — Charge on movable assets.

Part 17 — Charge on fixtures.

Part 18 — Guarantees.

Part 19 — Letters of credit.

Part 20 — Unsecured advances.

Part 21 — Special provisions relating to recovery, etc.

They relate to the second and third instalments of the questionnaire of the Group. There are in all 406 questions in these Parts.

8.57 While we have received the replies on many Parts from most of the banks, still the views of the law associations, the body of chartered accountants, bar councils, chambers of commerce and others have not yet come in sufficient number to enable us to proceed and form conclusions on the basis of the replies. We have been advised that the Bar Association of India and the Supreme Court Bar have formed separate sub-committees to go into our questionnaire. Having regard to the comprehensive nature of the questionnaire, the mass of material that will have to be gone into, and the value of the replies from such technical and professional bodies, such as the law associations, bar councils, Indian Banks' Association, the Institute of Chartered Accountants, concerned authorities and others, we consider it necessary to give such bodies reasonable time to go into the questionnaire and give us the benefit of their views.

8.58 Many of the associations have also expressed a desire to place their views before the Study Group. We feel that at least with reference to important bodies and individuals including Government authorities, it may be useful and necessary to consider their views before formulating our recommendations on the matters covered by the questionnaire.

8.59 In view of all these, our recommendations on the various other laws affecting banking have necessarily to be postponed to a later date. An indication of this has also been given earlier to the Commission, and their concurrence obtained for adopting this course. Hence, on the other laws affecting banking, we have, in this Report, only dealt with certain aspects to emphasise the need for a study in depth and a comprehensive review.

CHAPTER 9

SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

While giving a summary of our conclusions and recommendations made in the earlier chapters, we do not want to restate the full context in which they are made, as that would be an unnecessary repetition of the arguments. So, we have avoided this. But we are indicating the number of the relevant paragraph of the chapter relating to the conclusion/recommendation, to facilitate the same being understood in the context in which it is made.

'BANKING'—DEFINITION

(1) "Banking" has to be defined in India, for the purpose of banking regulation, on the one hand having regard to what is understood as "banking" in other countries, and so far in India, and on the other hand having regard to the objectives of banking regulation. The objectives of banking regulation are —

(*i*) to safeguard the interests of the depositors ;

(*ii*) to ensure that the deposits are utilised having regard to public interest ; and

(*iii*) to ensure the effective implementation of the monetary policy and credit policy.

The definition should also have regard to the division of powers between the Union and the States under the federal set-up of our country. (2.7)

(2) The narrowing down of the scope of the definition to taking of only demand deposits would not serve to further the objectives of banking legislation. The definition of "banking" should not also be confined to cover only deposits withdrawable by cheque or other negotiable instrument. (2.23)

(3) "Banking" should be defined to include also the business of accepting deposits by a person for the purpose of investment in his own business such as manufacture or trade. (2.33)

(4) The expression "from the public" in the definition of "banking" should be clarified as covering also the acceptance of deposits by a body from its members or shareholders. (2.38)

(5) There is no reason for applying the English Common Law distinction between "loans" and "deposits" while dealing with banking regulation in India. This distinction can be avoided by a statutory definition of "deposit". (2.45)

(6) It is necessary to define "deposit" in the context of the definition of "banking", and "deposit" for this purpose should include also borrowings by way of loans, but should exclude the following :

(*i*) borrowings by companies or other corporate bodies by way of debentures ; and

(*ii*) borrowings from banks, or other financial institutions that may be notified by the Central Government. (2.48)

(7) In the light of our earlier recommendations, "banking" definition, for the purpose of banking regulation, should cover all forms of acceptance of deposits from the public. (2.49)

BANKS, BANKING INSTITUTIONS AND BANKING REGULATION

(8) Banking undertakings may be classified having regard to the form of banking business undertaken, the purpose for which deposits are obtained by them and their legal status. (3.3)

(9) The expression "cheque" found in Section 49A of the Banking Regulation Act, 1949, should not be understood as confined only to instruments which would satisfy the definition given for that expression in the Negotiable Instruments Act, 1881. Such an understanding would stultify the effectiveness of the provision. Moreover, having regard to the economic significance of deposits withdrawable on demand against a negotiable instrument, there should be no differentiation in law between deposits withdrawable by "cheque" and other kinds of deposits repayable on demand against any negotiable instrument. The expressions "deposit" and "from the public" in Section 49A of the Banking Regulation Act, 1949, have to be understood in the sense in which they are understood for the purpose of "banking" definition. (3.7)

(10) The acceptance of chequeable deposits is a particularly important form of banking business and those undertaking such business have to conform, in the interests of the national economy, to certain strict standards. (3.9)

(11) It is only institutions which are authorised to carry on *all* forms of banking, that is, the accepting of all kinds of deposits including chequeable

deposits, that should be required and permitted to use as part of their business names the expression "bank", "banker" or "banking". Others, including other banking undertakings, should be precluded from using such expression as part of their business names. (3.12)

(12) The business of accepting chequeable deposits, that is, deposits withdrawable on demand against cheque or other kinds of negotiable instruments (*e.g.*, deposits withdrawable against hundis), should be allowed to be carried on only by corporate bodies. Firms and individuals who are now having the business of accepting chequeable deposits should be required to have their undertakings incorporated within a reasonable time, or eschew the acceptance of such deposits. (3.17)

(13) The directives issued by the Reserve Bank under Chapter III-B of the Reserve Bank of India Act, 1934, aim to confine the acceptance of demand, and near demand, deposits only to banks. Such restrictions may have to be there for the effective implementation of the regulation relating to the business of accepting chequeable deposits. (3.19)

(14) Institutions authorised to accept chequeable deposits could be classified into "national banks", "Co-operative banks" and "other banks". By "national banks" we refer to the State Bank, the Subsidiaries and the "new banks", that is, the banks owned by the Central Government directly or indirectly. They form a class by themselves. By "Co-operative banks" we refer to the Co-operative credit societies carrying on the business of accepting chequeable deposits. By "other banks" we refer to banks which are not either national banks or Co-operative banks. (3.20)

(15) Co-operative credit institutions carrying on banking and subject to banking regulation are to comply with certain provisions of the Banking Regulation Act, 1949 (a Central enactment) administered by the Reserve Bank. They have also to comply with the provisions of the Co-operative Societies Acts (States' enactments) administered by the Registrars of Co-operative Societies. The best way of reconciling the schemes of these two jurisdictions would be to make such co-operative societies subject to banking regulation in such matters as will not encroach on the States' jurisdiction. (3.24)

(16) The present classification of banks as scheduled banks and non-scheduled banks need not be continued. (3.30)

(17) Of the "other banks", the present non-licensed ones are those which have applied for licence on or before the 16th September 1949. The continuance of non-licensed banks for such a long time is an anomaly. (3.31)

(18) When companies accepting chequeable deposits or demand deposits which are not now subjecting themselves to banking regulation (*e.g.*,

such Nidhis as are accepting demand deposits from their members) are brought within the scope of banking regulation, they would fall within the category of "non-licensed banks", since they have to be allowed to carry on such business till they are either licensed or refused a licence. (3.32)

(19) Section 6 of the Banking Regulation Act, 1949, may be amended to authorise banks –

(*i*) to engage themselves in the business of equipment leasing ;

(*ii*) and also to undertake any form of business which the Reserve Bank may notify with the prior approval of the Central Government. (3.34)

(20) Section 19 of the Banking Regulation Act, 1949, may be amended to provide that banks may form subsidiaries —

(*i*) for carrying on any business which they are permitted to do under Section 6 of the Banking Regulation Act, 1949 ; and

(*ii*) for carrying on any other business considered by the Central Government in consultation with the Reserve Bank, as conducive to the spread of banking or otherwise useful or necessary in public interest.

It may also be clarified in this context that in such circumstances it would be in order also for the national banks to form subsidiaries. (3.35)

(21) There is some difficulty in applying the principle underlying Section 20 of the Banking Regulation Act, 1949, with reference to persons nominated by Government or financial institutions on the boards of Government companies or statutory corporations, and for their nomination on the boards of the national banks. At present, in such cases, Government is issuing separate notifications exempting the application of Section 20 in respect of transactions relating to loans and advances that may be entered into between a national bank and a Government company or statutory corporation. It is desirable to add a proviso to Section 20 *ibid* giving a general exemption for such cases. (3.36)

(22) The proviso to Section 42(1) of the Reserve Bank of India Act, 1934, enables the Reserve Bank to vary the cash reserves to be maintained by the scheduled banks within a range of 3 per cent to 15 per cent of the total of the demand and time liabilities. Provision somewhat on similar lines is necessary for the maintenance of liquid assets under Section 24 of the Banking Regulation Act, 1949. (3.37)

(23) Concerns accepting non-chequeable deposits could be classified into those accepting deposit liabilities (*i*) for the purpose of lending or invest-

ment, and (*ii*) for the purpose of financing their own business such as manufacture or trade. For the purpose of banking regulation, the former could be termed "financial institutions" and the latter as "deposit-receiving institutions". Though financial institutions, which are "companies", are even now "banking companies", banking regulation has not been effectively applied to them. Consistent with our recommendations on the definition of "banking", financial institutions and deposit-receiving institutions accepting non-chequeable deposits from the public should be regulated as a class of banking concerns. (3.38)

(24) Private limited companies accepting non-chequeable deposits from their shareholders, companies taking such deposits from their directors, and firms accepting such deposits from their partners need not be brought within the scheme of banking regulation. This exclusion is justified having regard to the limitations as to the number of persons from whom such deposits could be taken and the presumption that people so depositing would be familiar with the financial position and standing of the concerns accepting such deposits. (3.39)

(25) It may be that financial institutions which accept deposits from the public for the purpose of their lending or investment activities could be further classified having regard to the nature of their lending or investment activities. While regulating them as institutions carrying on banking business, further classification may be made, if necessary, on appropriate lines. There is also the question of applying the scheme of regulation as set out in the Banking Regulation Act, 1949, to "companies" and others accepting non-chequeable deposits for the purpose of lending or investment. We could go into these matters only after considering the Report of the Banking Commission's Study Group on "Non-Banking Financial Intermediaries". (3.46)

(26) The distinction between a person doing banking and a person doing moneylending really rests on the presence or absence, as part of such person's business, of the acceptance of deposits from the public. While a person doing "banking" relies on the deposits accepted by him from the public, wholly or partially, for carrying on his lending activity, the person doing "moneylending" does not seek or accept deposits from the public for his lending. (3.48)

(27) The expression "indigenous bankers" would comprise different classes of persons. Of them, only those who accept deposits from the public may be regarded as doing banking and the others only moneylenders. (3.49)

(28) Under our Constitution, it is only the Union that could legislate for the regulation of firms and individuals carrying on the business of banking. While as regards moneylending, the States have enacted moneylending legislation, as regards firms and individuals doing "banking", there is at present

no regulation. It is necessary for the Union to frame, with reference to them, a scheme of regulation by legislation. (3.52)

(29) For the effective enforcement of banking regulation, it is desirable that concerns accepting non-chequeable deposits from the public for the purpose of lending or investment have their undertakings incorporated. But, we do not consider it necessary that firms and individuals carrying on such business should be compelled immediately to incorporate their undertakings. However, in any scheme of regulation, it would be appropriate to differentiate between corporate bodies carrying on such business, and firms and individuals doing it. In prescribing the conditions to be complied with by concerns undertaking such business to qualify as eligible concerns for any concession or inducement, incorporation can be made one of the conditions. Subject to this, all the provisions that apply to corporate undertakings carrying on this form of banking should also apply to firms and individuals doing this business, with such necessary modifications as may be necessary, or considered desirable, having regard to the difference in their legal status. (3.53)

(30) The provisions of the Pennsylvania Banking Code (1965) can be considered while framing a scheme of regulation for firms and individuals carrying on the business of accepting non-chequeable deposits for lending or investment. (3.54)

(31) The directives issued by the Reserve Bank under Chapter III-B of the Reserve Bank of India Act, 1934, regulate the deposit-taking business of concerns accepting non-chequeable deposits for financing their own business such as manufacture or trade ("deposit-receiving institutions)". They may be regulated as banking concerns. But with reference to them, the objectives of the regulation would be met if the regulation deals with the terms (including the terms relating to period of repayment, payment of interest, etc.) subject to which the deposits could be accepted, and contains necessary provisions to ensure that the borrowing concerns have adequate repaying capacity. Having regard to public interest, the provisions may enable the authorities to restrict, regulate or prohibit the acceptance of deposits. The regulating authorities should also be given the necessary powers to enforce the observance of the requirements of the regulation by the "deposit-receiving institutions". But, the licensing of such institutions should not be necessary for the purpose of banking regulation. (3.55)

(32) It is desirable to have separate licensing/regulating authorities entrusted with statutory powers to administer the provisions of the banking regulation applicable to concerns accepting non-chequeable deposits from the public. Such authorities may be set up by Central legislation relating to banking. Such authorities may be set up at the State level with an apex body at the all-India level. While the authorities at the State level should be invested with statutory powers to deal with concerns accepting non-che-

queable deposits (for the purpose of lending or investment or merely for the purpose of investment in their own business such as manufacture or trade), the apex body should act as a supervisory authority over the State level authorities. The apex body should mainly concern itself with questions of policy and should be the authority to take decisions on matters of all-India importance. The State level authorities should deal with the administration of the regulatory/licensing provisions of the banking regulation applicable to concerns accepting non-chequeable deposits from the public. This arrangement would be conducive to the effective implementation of banking regulation with reference to such forms of banking. The Registrars of Companies at the State level and the Company Law Board at the Centre may serve as an analogy. The Reserve Bank has to be actively associated in the functioning, and it may also have to take the initiative for setting up such machinery to deal with all types of banking concerns other than banks. It would also be necessary to ensure co-ordination between the Reserve Bank and such a body to ensure effective implementation of the scheme of banking regulation. (3.57)

(33) There is need for bringing the different pieces of legislation governing the carrying on of the business of banking in one form or another, under one comprehensive scheme. It would be conducive to the objectives of banking regulation if all the categories of persons accepting deposits from the public are dealt with in a comprehensive scheme of banking regulation. This would ensure that there is a proper perspective over the control that is exercised in regard to the different categories of banking institutions, having regard to certain common objectives, such as the protection of the interests of the depositors, the safeguarding of public interest and the effective implementation of monetary policy and credit policy. (3.61)

(34) In the light of the above, a banking code may be enacted which would classify and regulate all forms of banking. The classification could be as shown in the chart (*given at page 86*). The banking code would contain the scheme of the Banking Regulation Act, 1949 (with suitable modifications) in its application to institutions taking chequeable deposits. The present enactments governing the national banks could be repealed and the provisions that are considered appropriate for them could be introduced as a separate Part in the banking code. Chapter III-B of the Reserve Bank of India Act, 1934, may be repealed; instead, the provisions that should govern the concerns accepting non-chequeable deposits for lending or investment and those accepting non-chequeable deposits for their business such as manufacture or trade may be included as separate Parts of the banking code. A scheme of regulation which is considered appropriate for private bankers (non-corporate private bankers) may form another Part of the code. Our recommendation for a comprehensive banking code should not be the cause for any delay in promoting any scheme of regulation governing any category of banks or banking institutions. If necessary, legislation can deal

separately with the different categories of banking institutions. But eventually there should be one comprehensive banking code relating to all forms of banking business. (3.64-3.66)

NATIONAL BANKS

(35) The State Bank, its seven Subsidiaries and the 14 "new banks" are practically owned by the Central Government. They could be appropriately described as "national banks". The national banks form a class by themselves. (4.1 and 4.2)

(36) The provisions governing the State Bank, the Subsidiaries and the "new banks" are not uniform. There is no justification for continuing the differences in the schemes governing all the national banks, as they are attributable mostly to historical reasons. If the national banks are to have a common programme of functions and responsibilities in the development of the banking/credit system of the country, it is necessary that they are governed by a uniform scheme. In evolving such a uniform scheme, such features as have more a historical, rather than any present day value, may be discarded. Though there are similar provisions with reference to many matters, the constitution, functions, powers and duties of the national banks are not, in essential features, uniform; the relevant provisions of the State Bank are not on the same lines as those applicable to the Subsidiaries, and the pattern of both differs from that of the "new banks". The schemes governing all the national banks should be uniform. Similarities in the nature of legal provisions governing the national banks are to be expected; but the provisions which differentiate between them *inter se* need to be explained. (4.10)

(37) It is not appropriate to have rigid provisions as to ceiling as regards the capital requirements. The statute may provide for the capital of the national banks being raised or revised by them in consultation with the Reserve Bank and with the approval of the Central Government. (4.12)

(38) The future ownership pattern of the national banks should be uniform with reference to all of them. (4.16)

(39) On principle, it is not appropriate that the Reserve Bank, which is a body entrusted with supervisory jurisdiction, *inter alia*, over the national banks, should also hold the whole or a substantial portion of their capital. (4.17)

(40) So long as the State Bank is made responsible for the running of the Subsidiaries, its links with the Subsidiaries may have to continue. However, if, in any future restructuring of the national banks, their number is to be reduced, the Subsidiaries could be merged with the State Bank. (4.18)

(41) In public interest, the shareholdings of the outside shareholders in the paid-up capital of the State Bank and its Subsidiaries (only four of the Subsidiaries have such shareholdings) may be acquired by the Central Government by legislation. (4.23)

(42) As the intention is that the "new banks" should also transfer a portion of their net profits to their general reserves, and thus build up adequate reserves, it may be specifically provided that the transfer of the surplus to the Central Government would be only the balance of net profits remaining after transfer to the general reserve fund. (4.26)

(43) Consequent on the implementation of our recommendation for the acquisition of the individual shareholdings in the State Bank and four of its Subsidiaries, there may be no need to continue the Integration and Development Fund. (4.29)

(44) In the discharge of their functions, the Boards of the State Bank and the Subsidiaries are required to act "on business principles, regard being had to public interest". There is no such provision applicable with reference to the "new banks". Similar guidelines should be laid down also for the "new banks". (4.31)

(45) Uniformity in pattern is necessary as regards the provisions dealing with the persons who should head the Boards of Directors of the national banks *vis-a-vis* the persons entrusted with powers to act as their Chief Executives. (4.32)

(46) The same person should not occupy the office of the Chairman of the Board of a national bank and also be its Chief Executive to facilitate the objective appraisal by the Board of the performance of the administration headed by the Chief Executive. It would also enable the Chairman to bestow his attention mainly to questions of policy, and not details of administration. (4.33)

(47) There is no provision for a Vice-Chairman in the case of the Subsidiaries and the "new banks". The necessity for the same may be considered. (4.34)

(48) Appropriate provisions may be made in the enactments applicable to the national banks to enable the appointment of, and payment of remuneration to, the Chairman/Vice-Chairman on a whole-time or part-time basis. (4.35)

(49) The principle of giving representation to persons of particular occupations on the Boards of the national banks has gained Parliamentary recognition in the Act of the "new banks". This principle should also be recognised while determining the composition of the Boards of the State Bank and the Subsidiaries. (4.37)

(50) Having regard to the cost, time and trouble involved in following an elective process for selecting representatives of the specified classes of persons like depositors, farmers, workers and artisans, the reference in the Act of the "new banks" to the election of such representatives may be deleted. However, in the case of selecting the representatives of employees, the provision which enables an elective process to be followed may remain. (4.38)

(51) Section 10A of the Banking Regulation Act, 1949, provides for the majority of the Board of Directors consisting of persons who have special knowledge or practical experience in respect of matters specified therein. The principle underlying Section 10A *ibid* has validity with reference to all banks. Provisions on similar lines may be made with reference to the national banks as well. (4.44)

(52) It is not desirable to provide for the Reserve Bank having its representatives on the Boards of the national banks. If, however, it is considered necessary that the Reserve Bank should be closely in touch with the developments in the national banks and the decisions of their Boards, it would be sufficient to provide for the Reserve Bank appointing observers on the Boards of these banks. (4.48)

(53) It should be in order for the Central Government to nominate, as its representatives on the Boards of the national banks, either officials or non officials. (4.49)

(54) The provisions applicable with reference to the State Bank and the Subsidiaries preclude a Member of Parliament or a Member of State Legislature from continuing also as a director of any of these banks. However, no such prohibition applies with reference to the "new banks". Either the prohibition found in the enactments governing the State Bank and the Subsidiaries should be applied also with reference to the "new banks" or such prohibition should be removed. (4.50)

(55) The General Manager of a Subsidiary may be made a member of its Board and designated as its Managing Director. (4.51)

(56) While there are adequate provisions in the Acts of the State Bank and the Subsidiaries, dealing with the set-up, functions and powers of the Committees of the Central Board, the provisions regarding such Committees for the "new banks" are not adequate. Adequate provisions may be made in the statute with reference to the "new banks" also. (4.52)

(57) Provision may be made in their statute itself, instead of leaving the matter to subsidiary legislation, for the setting up of an Executive Committee for the "new banks" and the entrustment of powers of it. (4.53)

(58) Following the pattern of the State Bank and the Subsidiaries, it may be provided that any director (including the whole-time director) of a national bank, though he is not named as a member of the Managing Committee, may participate in the meetings of the Executive Committee as a member provided he is able to attend its meetings. (4.57)

(59) Provision for the setting up of other Committees and the power to associate outsiders with such Committees may be made in the enactments of the national banks. (4.60)

(60) The Chief Executives of all the national banks may be vested with the same, or similar, powers. The Chief Executive should be the administrative head of the bank and should be entrusted with all necessary powers. (4.65)

(61) Provision may be made in the statutes governing the national banks for the appointment of their Chief Executives and for the remuneration payable to them, and such provision may be on uniform lines with reference to all the national banks. (4.68)

(62) Having regard to the size, extent and area of operation and such other relevant factors, the desirability of providing for deputy chief executives (*e.g.*, Managing Directors in the State Bank) for all the national banks may be considered. (4.69)

(63) There are no provisions in respect of the "new banks" for the setting up of regional Boards with statutory powers and responsibilities to carry on their business independently, as in the case of the State Bank. Provision may be made to enable the constitution, in the "new banks", of such regional Boards with statutory powers and responsibilities to carry on their business independently, wherever necessary. (4.70)

(64) In the matter of the composition of the Local Boards for the national banks, it is necessary to include also at the local level, representatives of the specified classes of the persons and persons with special knowledge or experience, having regard to the purpose for which such persons are included in the Boards of the "new banks". Provision may be made to provide also for such representation in the composition of the Local Boards. (4.71)

(65) In the case of the "new banks" also, provision may be made for constituting Committees of Local Boards, having regard to relevant factors, such as their size, area of operation, etc. (4.73)

(66) The State Bank Act empowers its Central Board to constitute Local Committees for any area to exercise such powers and perform such functions as the Central Board may confer on, or assign to, such Committees. Such enabling provision may be made with reference to the other national banks as well. (4.74)

(67) Appropriate statutory provisions may be made for the "new banks" also having regional chief executives on the pattern of the provisions applicable to the Secretary & Treasurer of the State Bank. (4.75)

(68) The Act of the "new banks" does not, but it is only their Scheme that does, provide for the constitution of the Regional Consultative Committees. Since the Committees' function is to review the banking development in the region and make appropriate recommendations, the Committees have to take note of the developments not only of the "new banks" but also of other banks and the interests of the public. Hence, the provisions relating to the set-up and functions of the Regional Consultative Committees may be embodied in a separate Chapter of the Banking Code. (4.76)

(69) The State Bank and the Subsidiaries may also be given representation on the Regional Consultative Committees. Similar representation may also be given to the non-national banks including the Co-operative banks. (4.78)

(70) The fetters in the State Bank Act, on the bank entering into all types of banking and allied transactions should be removed, thereby giving that bank the same powers for the carrying on of business as are at present available to the "new banks" and the Subsidiaries. (4.79)

(71) In relation to the transaction of Central Government business, all the national banks should be treated on par. Section 45 of the Reserve Bank of India Act, 1934, may be suitably amended for this purpose. (4.82 and 4.83)

(72) The mechanism of the Currency Chests, it is reported, enables the State Bank to operate with slender cash balances. The "new banks" may also be given similar privileges. (4.83)

(73) It may be provided statutorily that any of the national banks may be entrusted with State Government business. (4.86)

(74) Government may modify suitably its administrative instructions issued earlier to enable all the national banks being entrusted with the banking business of Local Bodies and statutory corporations. (4.87)

(75) The statutory and other applicable provisions in, or under, other Central or State enactments should be suitably modified so as to provide for the business of Trusts and other statutory bodies being given to any national banks. (4.88)

(76) The references in Sections 18 and 24 of the Banking Regulation Act, 1949, and Section 42 of the Reserve Bank of India Act, 1934, to the State Bank may be substituted by a reference to the "national banks". (4.93)

(77) The annual accounts of all the national banks may be placed before the Parliament for consideration. There should also be uniformity as regards the persons who should sign the accounts and the time for the completion and submission of accounts of all the national banks. (4.94)

(78) A specific statutory provision may be made that by reason of the statutory form of declaration of secrecy provided for the officials of the national banks, the banks are not disabled from disclosing information relating to their affairs as distinct from those of their individual customers. (4.99)

(79) There are some minor differences in the provisions applicable to the national banks in relation to the appointment of their auditors, the carrying out of special audit, the remuneration of auditors, the form of the auditors' certificate, and submission and verification of the auditors' report. The provisions relating to audit should be uniform for all the national banks. (4.100)

(80) The auditors of the national banks have felt certain difficulties in following the formula prescribed under the Companies Act, for the audit of the branches of national banks. It is desirable to provide specifically for the branch audit of the national banks on the pattern of the provisions applicable to companies. (4.101)

(81) While in the case of the "new banks" the Central Government may directly give them directions on matter of policy involving public interest, with reference to the State Bank and the Subsidiaries, the Central Government is required to act through the Reserve Bank. There should be a uniform rule with reference to all the national banks. (4.103)

(82) While with reference to the "new banks" the Central Government has powers, by framing a scheme, to alter suitably their capital structure, the constitution of their Boards and to reconstitute, amalgamate or transfer their undertakings (wholly or in part), it has no such power under the enactments governing the State Bank and the Subsidiaries. Since it would facilitate the restructuring of all the national banks, if the Central Government has similar powers with reference to all the national banks, including the State Bank and the Subsidiaries, their statute may provide for this. (4.104 and 4.114)

(83) While the Central Government has powers to make Rules to give effect to the provisions of the State Bank and the Subsidiaries Acts, it has no such power with reference to the "new banks" Act. It is desirable that such power is vested in the Government. (4.105)

(84) Section 35 of the State Bank Act and Section 38 of the Subsidiaries Act enable these banks to acquire other banking undertakings pursuant to a

Scheme framed by the Central Government. These provisions also exhaustively set out matters that could be dealt with under such Schemes. Provision on similar lines may be made for the "new banks" as well. (4.106)

(85) Provisions that should apply to the new corporations that may come into existence by reason of the break-up or amalgamation of any of the "new banks" may be laid down in the statute itself. (4.108)

(86) The pattern of the provisions found with reference to the Schemes that could be framed under the Banking Regulation Act, the State Bank Act and the Subsidiaries Act may be adopted with reference to the provisions to govern the Schemes that could be framed under the "new banks" Act. (4.111)

(87) There are specific provisions, in the enactments governing the State Bank and the Subsidiaries, providing that in the event of the transfer of the services of the staff, pursuant to any Scheme, the employees will have no claim for compensation (like that payable under the Industrial Disputes Act, 1947). There is no such provision applicable with reference to the Schemes framed under the "new banks" Act. Statutory provision may be made to this effect. (4.112)

(88) The State Bank and the Subsidiaries Acts, as also the Banking Regulation Act, 1949, contain enabling provisions specifying in detail the matters that can be provided for in the Schemes framed thereunder. Such enabling provisions help to decide whether or not the Scheme could deal with a particular matter. They reduce the scope for disputes regarding the validity of such Scheme provisions. The Act of the "new banks" does not specify expressly matters that could be provided for in the Scheme. Similar provisions could be made in respect of the Schemes framed under the "new banks" Act. (4.113)

(89) The differences in the provisions relating to the set-up, powers and functions of the different classes of national banks have to be reconciled and a uniform pattern evolved. This could be achieved by the separate Acts now governing these banks being repealed and all these banks brought within one statutory framework. This could find place as a Part of the comprehensive Banking Code which we envisage. (4.115)

BANKS AND SECRECY

(90) The obligation of banks to maintain in confidence the affairs of their customers should continue in order to encourage the spread of the use of the bank facilities and instill in the public mind confidence in banks. But this obligation should be subject to recognised exceptions and qualifications. (5.2)

(91) The obligation of a bank to observe secrecy regarding the affairs of its customers should not affect in any manner the banks furnishing information of a general nature relating to the affairs of their customers without revealing the identity of the individual constituents. This position may be statutorily so clarified. (5.5)

(92) A statutory provision may be made in the Bankers' Books Evidence Act to the effect that during police investigations it should be sufficient for banks to produce before the police authorities certified copies of the relevant extracts from the books of banks, unless the production of the copies is considered by the authorities as not adequate for proving the crime. (5.7)

(93) When the books or other records are destroyed by banks, in the regular course of business, and the documents have been microfilmed before such destruction, the relative positives of the films are admissible as evidence, provided they are properly produced and proved in court. A statutory amendment to the Bankers' Books Evidence Act may expressly clarify the position. (5.8)

(94) The position regarding the preservation of records by banks requires to be clarified having regard to public interest and the development of banking. Section 209 of the Companies Act, 1956, is inadequate for this purpose, as this provision does not as such apply to the national banks and to the Co-operative banks. A statutory provision may be made for this purpose. The minimum period for which the banks should preserve their several records should be fixed, for each type of record, having regard to

(*i*) the period for which it would be desirable for banks to maintain them for their own needs ;

(*ii*) the period up to which such records could be usefully required in connection with tax or other regulatory proceedings; and

(*iii*) the practical difficulties the banks may face in preserving their records beyond a reasonable length of time.

Provision for such preservation of records should also apply to all State Co-operative banks, Central Co-operative banks and Urban Co-operative banks. However, it may be neither desirable nor feasible to apply such requirements to Primary Co-operative credit societies carrying on banking business, in view of their limited administrative and other resources. The statutory provision that should be made for the preservation of records by banks should provide for the period of preservation of various bank records being prescribed from time to time by the Central Government in consultation with the Reserve Bank. (5.13)

(95) Having regard to all the circumstances, a statutory provision may be made fixing the period of preservation by banks of paid instruments.

When, for valid reasons, customers require the return of the paid instruments before the period specified for their preservation, the relevant instruments may be returned only after being microfilmed. The cost of microfilming shall be borne by the customer. This provision may be applied also to the return of paid instruments drawn by Governments and statutory corporations. (5.17)

(96) Just as for the purpose of collection of Central taxes (including Income-tax) the information available with banks is made use of by the tax authorities, so also it would be in order for the State laws to provide for the relevant and material information with banks being disclosed to authorities to check evasion of State taxes, like Sales Tax. While making such provisions, State Governments may act after consultation with the Reserve Bank. (5.25)

(97) There is need for clarifying one of the qualifications for the bank's obligation to observe secrecy regarding the affairs of its customers, *i.e.*, "duty to the public to disclose", by enumerating certain instances attracting such qualification. (5.29)

(98) In the following instances it should be statutorily laid down that the bank is under a duty to disclose the relevant information in public interest :

(*a*) when a bank is asked for information by a Government official concerning the commission of a crime and the bank has reasonable cause to believe that a crime has been committed and that the information in the bank's possession may lead to the apprehension of the culprit ;

(*b*) when the bank considers that the customer is involved in activities prejudicial to the interests of the country ;

(*c*) where the bank's books reveal that the cusomer is contravening the provisions of any law; and

(*d*) where sizeable funds are received from foreign countries by constituents.

It may also be statutorily clarified that if and when a bank *bona fide* forms an impression that it owes a duty to the public to disclose, it is relieved of its obligation to maintain secrecy if it discloses the relevant information to the concerned authorities. (5.30)

(99) In public interest, a statutory provision may be made permitting the disclosure of information by banks, for research purposes, regarding the affairs of their constituents, provided the information furnished relates to a period anterior to twenty years. (5.31)

(100) A statutory provision may be made to the effect that with reference to any Commission or Committee appointed by Government, though not under the Commissions of Enquiry Act, the Government is empowered to declare that banks are obliged to disclose to such Commission or Committee, in public interest, such information as may be required from them by such Commission or Committee. (5.33)

(101) There is not much justification for the national banks being allowed to maintain undisclosed reserves or "secret reserves". It is also not desirable to differentiate in this regard between the national banks and the other banks. The present forms of balance sheet and profit and loss account of banks, specified in the Banking Regulation Act, 1949, may have to be amended suitably when the provision requiring 'full disclosure' becomes effective. (5.42)

(102) The undisclosed reserves, or "secret reserves", of banks, existing as on the date on which the requirements as to full disclosure become effective, should be statutorily required to be transferred to their general reserves (which are now disclosed). There should also be a provision (taking effect thereafter) for banks transferring to their general reserves a larger percentage of their net profits. The exact percentage may be left to be laid down by the Central Government in consultation with the Reserve Bank. (5.43)

CREDIT INFORMATION

(103) It is necessary that there should be adequate provisions for banks and financial institutions giving and receiving of credit information, and for the fairly accurate credit rating of persons seeking financial assistance from such institutions. (6.2)

(104) Statutory provision may be made giving protection for banks and financial institutions freely exchanging credit information on the affairs of their customers. The law should also provide that the concern or the bank receiving such information shall keep it in confidence and shall not disclose it except to those to whom such information could be legally given. (6.8)

(105) The statute governing the national banks should also expressly provide for full, free and frank communication of credit information among national banks *inter se.* (6.9)

(106) Specialised agency, or agencies, for collecting, collating, processing and furnishing credit information to banks and financial institutions may have to be set up in India, by legislation. (6.10)

(107) The Credit Information Bureau set up in the Reserve Bank is not adequate to meet the needs of banks and financial institutions. (6.13)

(108) It may not be desirable for the central bank of the country to undertake the responsibility of collecting and furnishing on a large scale, to banks and financing institutions, credit information useful and necessary to assess the creditworthiness of numerous persons, big and small. It is necessary to provide by legislation for the setting up of separate specialised agencies, on the lines of the institutions in U.K. and U.S.A., for this purpose. (6.15)

(109) A statutory provision making it obligatory for banks and financial institutions to furnish the credit information bureaux with such information and in such form, as the bureaux may require, would safeguard the banks from any action by their constituents. (6.17)

(110) While providing for credit reporting agencies collecting and furnishing credit information to banks and financial institutions, there should be provision for such agencies adopting reasonable procedures in a manner which is fair and equitable. There should also be opportunity given to the reported person to ask for correction of any error in the report on him. (6.21)

(111) A statutory provision may be made for the credit reporting agencies being indemnified from any action for damages or other losses which may be suffered by any person consequent on the credit information being given on, or for the use of, such person, so long as such agencies exercise their powers and perform their functions *bona fide*. Such protection should also be available to banks when they furnish credit information on their constituents. (6.23)

(112) Simultaneously with the taking up of measures to set up specialised agencies for furnishing adequate and reliable credit information to banks and other financial institutions, legislative measures may also be taken for providing that the financial statements furnished to such institutions by their borrowers (including prospective borrowers) shall be true and correct, and that any wilful breach of this obligation is punishable. (6.27)

REPAYMENT OF BALANCES AND RELEASE OF ASSETS BY BANKS

(113) On the lines of the provisions found in the banking codes of the States of the United States of America, *e.g.*, Pennsylvania Banking Code (1965) and the District of Columbia Code, for the repayment by banks of deposits held in accounts opened in the names of more than one individual, express statutory provisions may be made. (7.5)

(114) Statutory provisions may be made on the lines of the provisions found in the banking codes of the States of the United States of America, to facilitate banks dealing with adverse or conflicting claims to deposits held in bank accounts. (7.6)

(115) Statutory provision may be made for giving nomination facility in relation to deposits by individuals with banks. (7.15)

(116) The effect of a nomination in relation to bank deposits should be statutorily provided for on the lines of the provisions contained in the Public Debt Act, 1944, and banks should be required to make payment to the nominee(s) unless restrained by an order of a competent court. (7.16)

(117) A statutory provision may be made for an individual borrower availing of credit facilities from a bank nominating a person(s) who could be allowed, in the event of the death of the borrower, to repay the debt and obtain redemption of the assets charged to the bank by the borrower. While such redemption should give a good discharge to the bank, it should not affect the rights and claims of other parties to the assets of the deceased. It may also be provided that the nominee obtaining release of the charged assets will have a prior claim for getting himself reimbursed of the amounts expended by him to obtain the release of the charged assets. Such a nomination should not also affect any other rights the bank may have for realising any of its other dues recoverable from the estate of the deceased. (7.18)

(118) In relation to immovable properties mortgaged to banks, it may be provided that on the death of the mortgagor, a nominee indicated by him would have the right to redeem the mortgage by repaying the amount due to the bank in respect of such mortgage. Such a provision could also be made by way of an amendment to the Transfer of Property Act. It may also be provided that the nominee so redeeming the property will be subrogated to the rights of the bank *vis-a-vis* other persons who may have claims on the property. Such a nomination should not, however, affect the rights *inter se* of individual parties claiming under the mortgagor. Statutory provisions may be made accordingly. (7.19)

(119) Statutory provision may be made for enabling banks to return the articles kept in safe custody with them to the nominees of the depositors. The form for acceptance of valuables and securities for safe custody may provide for a depositor nominating a person to whom the valuables and securities may be handed over in the event of the death of the depositor. The effect of the provision should be to relieve the bank from any obligation in relation to such asset, but should not affect the rights *inter se* of the nominee and others claiming under the deceased depositor. (7.20)

(120) Statutory provision may be made for those renting safety lockers from banks indicating the persons to whom access may be allowed to the lockers on their death, or on the death of any one jointly renting the lockers, and when any such access is allowed on the death of the person(s), a responsible bank official or a representative of the taxing authority should be present and an inventory should be taken of the contents of the locker(s) in his/their presence. (7.21)

OTHER LAWS AFFECTING BANKING

(121) It is necessary in public interest that there should be some similarity in the treatment meted out to all cash lenders. (8.2)

(122) There is the need for co-ordination of the regulation relating to lending by moneylenders on the one hand and the banks and financial institutions on the other. For this purpose, there should be a review of the moneylending legislation of the States. (8.3)

(123) A model legislation may be framed for the consideration of the States regarding the regulation of the business of lending against hundis which would only be a form of moneylending. (8.5)

(124) With the increasing reliance on the banking system for the development of the country, it is essential to ensure that the laws, both relating to and affecting banking, of the Union and of the States are rational, devoid of complications and complexities and are conducive to the spread and effective functioning of the banking system. This could be achieved only by a constant review of such laws. The approach should be not merely to review the laws from the perspective of banks, but essentially having regard to public interest. There is an imperative need for such constant review when we compare the pace at which the laws relating to and affecting banking have been reviewed and suitable remedial measures taken elsewhere and in India. (8.34)

(125) For the purpose of such review, there should be a special body constituted by the Central Government. This should be presided over by a jurist. Its members should be drawn from the legal profession, from legal experts who have worked with or are working with banks, and from experienced bankers and others possessing expert knowledge or experience considered necessary or useful for such review. The Reserve Bank may be asked to meet the expenses of, and give such assistance as may be required by, the reviewing body. (8.55)

Dr. P. V. Rajamannar—*Chairman*

Shri C. R. Pattabhi Raman

Shri R. M. Halasyam

Shri K. J. Natarajan

Shri R. K. Gandhi

Shri R. Krishnan—*Convener*

BANGALORE,
29th August 1971.

APPENDIX I

An Extract from the Resolution (No. F. 4(70)-BC./68) of the Government of India, Ministry of Finance, Department of Economic Affairs, dated 3rd February 1969

2. The terms of reference of the Banking Commission will be as follows:

(*i*) To enquire into the existing structure of the commercial banking system having particular regard to size, dispersion and area of operation and to make recommendations for improving the structure ;

(*ii*) To make recommendations for extending the geographical and functional coverage of the commercial banking system ;

(*iii*) To make recommendations for improving and modernising the operating methods and procedures and the management policies of commerical banks ;

(*iv*) To examine the cost and capital structure and to review the adequacy of available surplus and reserves, having regard to the developmental needs of the banking system and to make recommendations in the light of the findings ;

(*v*) To review the existing arrangements relating to recruitment, training and other relevant matters connected with manpower planning of bank personnel and to make recommendations for building up requisite professional cadre of bank personnel at all levels of management ;

(*vi*) To review the working of cooperative banks and to make recommendations with a view to ensuring a coordinated development of commercial and cooperative banks, having regard, in particular, to (*ii*) above ;

(*vii*) To review the role of various classes of non-banking financial intermediaries, to enquire into their structure and methods of operation and recommend measures for their orderly growth ;

(*viii*) To review the working of the various classes of indigenous banking agencies such as multanies and shroffs, evaluate their utility in the money market complex and to make recommendations in the light of the findings ;

(*ix*) To review the existing legislative enactments relating to commercial and cooperative banking ;

(*x*) To make recommendations on any other related subject matter as the Commission may consider germane to the subject of enquiry or on any related matter which may be specifically referred to the Commission by the Government.

Appendix II

BANKING COMMISSION
(Government of India)

STUDY GROUP TO REVIEW LEGISLATION AFFECTING BANKING

QUESTIONNAIRE

Part 1—Definition of 'Banking' and Allied Matters

Group 1—Definition of 'banking'

1.1.1 'Banking' is defined in the Banking Regulation Act, 1949, as 'accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise'. Do you consider this definition adequate, or not? Or, do you consider the definition too wide?

1.1.2 The present definition of 'banking' under the Banking Regulation Act, 1949, covers also acceptance of deposits —

(*i*) repayable on the expiry of a term, or after notice, and

(*ii*) withdrawable in any mode (need not be by way of cheque, draft or order).

Do you consider that the definition of 'banking' should include, or not, the acceptance of such deposits?

1.1.3 Would you favour a definition which states that unless a person accepts deposits from members of the public, repayable on demand, for purposes of lending or investment, he cannot be regarded as engaged in 'banking'? If so, would it also be necessary to stipulate that such deposits should be withdrawable only by cheques or other similar kinds of instruments?

1.1.4 Having regard to the fact that the definition of 'banking' is bound to be somewhat arbitrary, where would you like to draw the line between 'banking' and other functions?

1.1.5 A view has been expressed that only persons accepting deposits from members of the public, repayable on demand or within a short period, should be deemed to carry on the business of banking. Would you accept this view? Assuming that you do, what, in Indian conditions, should be the maximum period upto which acceptance of short-term deposits could be comprised in banking?

1.1.6 What should the expression 'deposit' comprise? Would you like to make a distinction between a loan and a deposit? If so, how? Would you exclude any type of 'loans' from the definition of 'deposit'?

1.1.7 Would you like to define the expression 'from the public' in the existing definition of 'banking'? If so, how? When an institution accepts deposits exclusively from its members, would you regard such deposits as deposits from the public? In this context, how would you define the term 'member'? Would you say that only a person who has a right either to participate in the management of the institution or to share in the profits of the institution, or to both, can be regarded as 'member'?

1.1.8 Having regard to all relevant factors and circumstances, can you suggest a proper definition of 'banking'?

Group 2—Exceptions

1.2.1 The Banking Regulation Act, 1949, excludes from the scope of its definition of 'banking' the acceptance of deposits of money from the public by a company engaged in the manufacture of goods or the carrying on of any trade, merely for the purpose of financing its business as such manufacturer or trader. Are you in favour of the exclusion, or not? Or, would you suggest any alteration or modification?

1.2.2 It has been suggested that banking regulation should not apply to the following—

(*i*) Non-financial institutions holding funds of customers for specific purposes and lending on short-term.

(*ii*) Deposit taking institutions dealing with a small number of people (if so, specify the number).

(*iii*) Investment dealers and stock and share brokers holding customers' funds.

(*iv*) Moneylenders, shroffs and indigenous bankers, even if they accept deposits from the public.

Please give your views on the desirability or otherwise of applying the aforesaid exceptions, with or without any modifications.

1.2.3 Would you like to exclude from 'banking', any other kinds of transactions, or from 'banking regulation' any other institutions or persons accepting deposits from the public and having either lending or investment as their business?

Group 3—Financial Institutions accepting deposits

1.3.1 In your opinion, should institutions and persons engaged *inter alia* in the business of investment or lending and accepting deposits from the public for their business, such as Investment/Financing/Hire-purchase companies, trusts and loan companies, sales finance companies, certain deposit-taking institutions and credit societies, be governed by the banking legislation with or without modification? Do you think that separate legislation for such institutions is necessary?

1.3.2 Would you like to exclude from the scope of the definition of 'banking', the acceptance from the public by such institutions of all or any of the following classes of deposits :

(*i*) demand deposits

(*ii*) deposits repayable within a short term (if so, please specify the period)

(*iii*) deposits repayable beyond such period as specified under (*ii*) above?

1.3.3 In relation to acceptance of deposits by financial institutions (which may not be doing 'banking' business) from the members of the public, do you consider it necessary or desirable that there should be legislation regulating the business of such institutions?

PART 2—BANKS' OBLIGATION TO MAINTAIN SECRECY

Group 1—Secrecy as to affairs of customers

2.1.1 Except in the case of the State Bank of India, its Subsidiaries and the recently nationalised banks, the obligation of the bank to observe secrecy regarding the affairs of its customers is deemed to arise from an implied provision of the contract between the bank and its customers. Do you think it necessary and/or desirable to place this duty or obligation on a statutory basis?

2.1.2 It is well recognised that this obligation to maintain secrecy is not absolute but qualified and the qualifications broadly fall under the following categories :

(*a*) Where disclosure is under compulsion by law ;

(*b*) Where there is a duty to the public to disclose ;

(*c*) Where the interests of the bank require disclosure ; and

(*d*) Where the disclosure is made with the express or implied consent of the customer.

If, in your opinion, there should be a statutory provision regarding secrecy, would you agree that the bank's obligation to maintain secrecy should be subject to the exceptions mentioned above? Would you suggest any other qualifications?

2.1.3 Would you include in the first category the disclosure to police authorities in the course of investigation?

2.1.4 It has been suggested that the scope of the Bankers' Books Evidence Act should be widened so as to allow banks to produce copies, instead of originals, of their books or documents, before police authorities, as per orders issued under Section 94 of the Criminal Procedure Code, for the purposes of police investigation. Do you agree?

2.1.5 Section 285 of the Indian Income-tax Act, 1961, *inter alia*, requires a banker to disclose to the income-tax authorities the names and addresses of all persons to whom interest exceeding an amount, not being less than Rs. 400/-, has been paid in each year. Do you consider that the bankers should be asked to disclose this to the tax authorities? Or, would you like that the bankers should be obliged to disclose also any other information received by them in the course of their dealings with their customers, which may have a bearing on the Income or other tax liability of their customers? If so, please state the nature of information you would like to require the bankers to disclose.

2.1.6 It has been felt that the condition 'where there is a duty to the public to disclose' is not clear enough for application. Would you consider that there should be a more detailed statement of this qualification? for instance, by enumerating specific examples when such a duty may be deemed to arise. If so, give some specific examples.

2.1.7 Would you consider it necessary or desirable to provide that as part of its 'duty to the public to disclose', the bank should be obliged to disclose information, relating either to its affairs or the affairs of its constituents, to Commissions or Committees appointed by the Government?

2.1.8 Would you consider that there should be a more detailed statement of the qualification 'Where the interests of the bank require disclosure?' for instance, by enumerating specific examples. If so, give some specific examples.

2.1.9 Is the doctrine of implied consent of the customer too vague to furnish a guiding rule? If so, should its scope be sufficiently clarified as not to leave the bank in doubt?

2.1.10 Do you consider it necessary to extend the bank's obligation as to secrecy even to information of a general nature, for example, that relating to different classes or groups of customers, without reference to any individual customer?

2.1.11 Are you satisfied with the statutory provisions imposing the duty of secrecy on the State Bank of India, its Subsidiaries and the recently nationalised banks?

2.1.12 The State Bank of India, its Subsidiaries and the recently nationalised banks are required to disclose information relating to the affairs of their customers 'where it is in accordance with law or practice and usage customary among bankers'. Does this give room for doubt and uncertainty and consequent controversy? If so, do you consider that there should be a more detailed statement of this qualification? If you consider so, please indicate the lines on which this qualification could be made more explanatory.

2.1.13 Can you say that there are well-established practices and usages customary among bankers in this country? If so, could you please enumerate the practices and usages considered by you as so established?

Group 2—Secrecy as to the affairs of the bankers

2.2.1 (To be answered only by banks) Do you obtain any declaration of fidelity and/or secrecy from your employees? If so, please furnish the *pro formae* of such declarations or undertakings.

2.2.2 As regards disclosure of information about themselves, do you approve of a distinction being made between the State Bank of India, its Subsidiaries and the recently nationalised banks and other banks?

2.2.3 The officials of the State Bank of India, its Subsidiaries and the recently nationalised banks including the Directors/Custodians of such banks are statutorily obliged to subscribe to a declaration *inter alia* that they will not communicate, or allowed to be communicated, to any person not legally entitled thereto, any information relating to the affairs of their banks. In view of this

declaration, these banks are not in a position to disclose to any person not legally entitled thereto, any information relating to themselves. Do you consider this prohibition necessary or desirable, especially as the other banks are not under any such legal disability ?

2.2.4 Would you favour an amendment of the law to enable the State Bank of India, its Subsidiaries and the recently nationalised banks to disclose information relating to their affairs, whenever they consider it necessary or desirable to do so ?

2.2.5 What are your views regarding banks disclosing information relating to their affairs ?

Group 3—Secrecy as to the assets of banks

2.3.1 Do you consider it necessary or desirable that banks should be permitted not to disclose any of their assets or liabilities in their published accounts ?

2.3.2 Section 34A of the Banking Regulation Act, 1949, allows banks to claim immunity from disclosing such unpublished assets in proceedings under the Industrial Disputes Act. Do you consider this necessary or desirable ?

2.3.3 Do you consider that the legal provisions relating to the keeping of secret reserves by banks are adequate or satisfactory ?

PART 3—GIVING/RECEIVING OF CREDIT INFORMATION BY BANKS

Group 1—General

3.1.1 There is a practice among bankers to give one another information as to the affairs of their respective customers but there is no legal foundation for such a practice. Do you think it desirable to support this practice by a statutory provision ?

3.1.2 This practice has been sometimes sought to be justified upon the basis of an implied consent of the customer. Are you convinced of the soundness of this basis ?

3.1.3 At least, as between banks, would you advocate free and frank exchange of information relating to the affairs of their respective customers, in order that no person obtains from such banks any disproportionate or undue credit compared to his means and genuine needs ?

3.1.4 (To be answered only by banks.) In case any of your customers so desires, do you obtain and pass on to him credit information pertaining to the standing, means and respectability of any party? If so, what would be the form and content of such information?

Group 2—Obligation to customers on whom credit reports are given

3.2.1 Under what circumstances do you consider that bankers should be enabled to answer references about the credit of their customers?

3.2.2 From the mere opening of an account do you consider that a banker has the implied authority of his customer to disclose information relating to his credit and standing?

3.2.3 Do you consider that a banker should be free to disclose the nature of operations in the customer's account while answering a reference about him?

3.2.4 Do you consider it necessary or desirable that banks should obtain, at the time of opening of an account with them, the express consent of the customers to answer references about their credit and standing? Would you like to have a statutory provision enabling banks to freely divulge information about their customers in answer to references from other banks? Should it also extend to cover enquiries from other persons?

Group 3—Duty to persons to whom credit information is given

3.3.1 Do you feel that the banker owes any duty to the person to whom he furnishes credit information about any of his customers? If so, what, in your opinion, should it be?

3.3.2 Do you favour the continuance of the practice of bankers furnishing information about the credit of their customers 'without responsibility'? Do you consider that this practice affects the quality or the usefulness of the information furnished?

3.3.3 Do you consider that the current practice of bankers answering references about their customers in a very general way serves the needs of banks and others of obtaining reliable credit information about persons?

3.3.4 Do you consider that the banker's obligation, if any, to the person to whom credit information is given depends, or should depend, on the form in which the information is given, *e.g.*, given in writing or orally, signed or unsigned?

3.3.5 Do you consider that a bank supplying information has any duty to the customer for whose benefit another bank obtains the said information ?

Group 4—Machinery for supplying credit information to banks

3.4.1 Do you think there is need for setting up a machinery for supplying reliable credit information about borrowers to banks ? Do you consider that it is necessary and would be feasible in Indian conditions to have an agency for supplying credit information to banks on lines similar to that of the agencies functioning in this regard in U.K., U.S.A., Canada, etc. ? If so, give your views describing the specific type of agency in other countries you have in mind.

3.4.2 Do you consider that the provisions of Chapter IIIA of the Reserve Bank of India Act, 1934, which provides for a Credit Information Bureau to be run by the Reserve Bank of India, adequate and effective ? Or, would you like to suggest any modifications to the said provisions ?

3.4.3 The Reserve Bank of India Act, 1934, defines 'Credit Information' as confined to credit facilities granted to a borrower or class of borrowers and not covering operations on the account of the borrower. Do you consider it necessary to include the latter to form an objective assessment of the credit and standing of the person about whom information is supplied ?

3.4.4 Have you any suggestions to make for the setting up of an agency to supply reliable credit information to banks ? Do you consider that this could be done by suitably modifying the provisions relating to the Credit Information Bureau of the Reserve Bank of India ? If so, on what lines you would like to modify them ? Or, do you consider it necessary to set up an independent agency for this purpose ? If so, how would you like to have it ?

Part 4—Payment by Bankers of Balances and Delivery of Assets Belonging to Deceased Individuals

Group 1—General

4.1.1 What kind of difficulties, if any, are experienced in making/obtaining payments by/from banks of balances or assets lying with them and belonging to deceased individuals ?

Group 2—Nomination in relation to deposits

4.2.1 (To be answered by institutions.) Is your institution providing for the making of nominations in relation to deposits by customers? If so, are any safeguards taken in such cases?

4.2.2 Do you consider it necessary or desirable to make statutory provision to enable banks to repay deposits with them on the strength of nominations made in relation to them at the time of deposit? If so, do you consider allowing such facility subject to any limits as to amount of deposit or class or accounts, etc. ?

4.2.3 Under the Post Office Savings Banks Rules, nominations are allowed in relation to the amounts deposited in individual accounts, which can be Rs. 25,000 in a single account and Rs. 50,000 in a joint account. Do you consider that up to the said amounts, facility for nominations could be provided for in relation to deposits in banks?

4.2.4 Under the Co-operative Societies Acts of different States, the co-operative banking institutions are enabled to repay the deposits of their members to their nominees, on the death of such members. Do you consider that the facility of nomination could be made available also to non-member depositors of co-operative banking institutions? If so, should it be subject to any limit as to amount or class of accounts?

4.2.5 (1) Nominations by holders of Government securities entitle the concerned nominees to the security and to payment thereon, notwithstanding any testamentary or other disposition in relation to the securities. But the payment to the nominee only discharges the Government and does not affect any right or claim which any person may have against the person to whom the payment is made (*vide* Sections 9B and 9C of the Public Debt Act, 1944).

(2) Nominations in favour of a member of the family of the deceased, under the Provident Funds Act, 1925, vest title to the amount in the nominees.

Are you in favour of a provision for nomination in relation to deposits in banks on the lines of the Public Debt Act, 1944? If so, in relation to nominations in favour of members of one's 'family', would you desire the nomination to have the effect of vesting title to the amount in the concerned nominee? Please indicate what, according to you, should be the scope and effect of nomination?

Group 3—Nomination in relation to the assets secured to the banks

4.3.1 Do you consider that it is necessary or desirable for making provision for nominating the person/s who could be allowed to repay the debt and redeem the goods pledged with the banks? If so, should it be subject to any limit as to the quantum of the debt or the value of the security?

4.3.2 Do you consider that it is feasible to have a provision providing for the release of the immovable assets secured to a banker, on payment of the debt by the nominee specified in this regard by the deceased debtor? In such cases, should the nominee be subrogated to the rights of the banker before such discharge?

Group 4—Nomination in relation to the articles kept with banks for safe custody

4.4.1 Do you consider it necessary or desirable that banks should be permitted to return the articles kept in custody with them to the nominees of the depositors of such goods?

Group 5—Nomination in relation to access for safety lockers

4.5.1 Do you consider that there should be a provision for nomination providing for the person who could be allowed by the banker to have access to the safety locker rented by a customer, after his death? In such cases, would you like to provide for any safeguards, for example, an inventory of the articles kept in the locker to be taken while giving the nominee such access?

PART 5—CODIFICATION OF COMMERCIAL LAW

Group 1—General

5.1.1 The Select Committee on the Indian Sale of Goods Act, 1930, felt that "in commercial transactions, there ought to be as far as possible uniformity of law in countries which have dealings with one another". Do you agree? If so, what measures would you suggest for promoting such uniformity in commercial law?

Group 2—Vis-a-vis the provisions of the Uniform Commercial Code

5.2.1 In 1958, the American Law Institute and the National Conference of Commissioners on Uniform State Laws have brought forth the "Uniform Commercial Code" (UCC) which has now been adopted by all the States of the U.S.A. except Louisiana. The

underlying purposes and policies of the UCC, *inter alia*, are (*a*) to simplify, clarify and modernise the law governing commercial transactions and (*b*) to promote a continued expansion of commercial practices through custom, usage and agreement of the parties. The UCC deals with the laws relating to sale of goods, negotiable instruments, bank deposits and collections, letters of credit, bulk transfers, warehouse receipts, bills of lading and other documents of title, investment securities and secured transactions. The UCC has replaced in America, the Uniform Negotiable Instruments Law, the Uniform Sales Act, the Uniform Conditional Sales Act, the Uniform Trust Receipts Act, the Uniform Bills of Lading Act, the Uniform Warehouse Receipts Act and the Uniform Stock Transfer Act. The concept of the UCC is that "commercial transactions", notwithstanding its many facets, is a single subject of the law because of the close relationship of each phase of a complete transaction to every other phase.

Do you consider that codification of the law relating to commercial transactions on the pattern of the UCC is necessary or desirable in India ?

Group 3—Vis-a-vis the provisions of the Geneva Conventions

5.3.1 In order to avoid the difficulties caused by differences in the laws of countries as regards commercial paper (negotiable instruments), the Geneva Conventions of the League of Nations (Conventions Nos. 3313 to 3317 of the League of Nations Treaty Series Vol. CXLIII, 1933-34) were drawn up. While many countries have adopted these conventions, they have not been adopted by U.K., U.S.A. and the Commonwealth countries. Hence, the law relating to commercial paper differs in several aspects* between the countries which have adopted the Conventions and those which have not. As negotiable instruments are the usual medium of the ever expanding international trade and commerce, do you consider that such differences should be eliminated or reduced ?

Group 4—Vis-a-vis the uniform provisions suggested by the International Chamber of Commerce

5.4.1 The International Chamber of Commerce has drawn up the following and suggested their adoption by banks and institutions of all countries:

(*i*) Uniform Customs and Practice for Documentary Credits ; and

(*ii*) Uniform Rules for the Collection of Commercial Paper.

* Some of the aspects of differences are set out in the sueceding parts of this Questionaire.

Do you consider it desirable to have a uniform set of rules on these lines in India? If so, should it be by way of statutory provisions?

Negotiable Instruments

The Law Commission has, in its 11th Report, in September 1958, given its views on the Negotiable Instruments Law, mainly with reference to the provisions of the "Negotiable Instruments Act, 1881" (NIA). Its proposals are contained in Appendix I to its Report in the form of draft provisions. But, since then, several notable changes have taken place in our country and elsewhere, like the nationalisation of the 14 named banks in India, the latest revision of the Negotiable Instruments Law by the UCC in the U.S.A., and the Rules for Collection of Commercial Paper framed by the International Chamber of Commerce. Hence, the questions relating to negotiable instruments are asked in the following Parts *inter alia* with reference to the Report of the Law Commission and the legal provisions in this behalf in other countries.

Part 6—Indigenous Negotiable Instruments (Hundis)

Group 1—General

6.1.1 The Select Committee which went into the Negotiable Instruments Bill in 1879 had observed :

> "Any sudden abolition of the numerous local usages (there is no general custom) as to hundis, uncertain and undefined as they often are, would cause much and justifiable dissatisfaction . . . but we believe that the effect of the Bill, if passed with the saving of the local usages in question, will be not . . . to stereotype and perpetuate these usages, but to induce the native mercantile community gradually to discard them for the corresponding rules contained in the Bill. The desirable uniformity on mercantile usages will thus be brought about without any risk of causing hardship to native bankers and merchants. How long this change will take is of course impossible to prophesy."

However, the Select Committee's expectation has been belied and our businessmen still continue to stick to the "bewildering usages governing these instruments." Hence, what measures would you suggest for the fulfilment of the above expectation of the Select Committee ?

Group 2—Instruments in oriental language

6.2.1 Local usages in relation to a negotiable instrument in any oriental language are at present saved, though they are inconsistent with

the provisions of the NIA, unless an intention that the legal relations of the parties shall be governed by that Act is indicated in the instrument. It has been suggested that in respect of any instrument falling within the definition of "negotiable instrument" under that Act, any usage contrary to its provisions should not be applicable. Do you agree ?

Group 3—Discontinuance of hundis

6.3.1 It would be a great advance towards securing uniformity of the law if all instruments could be brought under the Negotiable Instruments Act. Hence, a suggestion has been made to provide by law for the discontinuance of indigenous negotiable instruments not coming within the scope of the Negotiable Instruments Act, after the expiry of a specified period. Do you agree ? If so, please specify the period on the expiry of which such instruments could be discontinued.

6.3.2 A view has been expressed that the use of hundis should not be prevented so long as we are not in a position to have an efficient bank in each village. In view of the recent developments and the aim of the banking system now to reach, if not each village, at least each group of villages, do you think that the time is ripe for considering the abolition of indigenous negotiable instruments not coming within the scope of the Negotiable Instruments Act ?

Group 4—Continuance of hundis

6.4.1 If you do not favour the discontinuance of hundis, do you prefer the codification of their peculiar incidents and usages ? If you favour such codification, are you in favour of bringing them under the Negotiable Instruments Act or would you suggest a separate enactment in this behalf ?

Group 5—Forms of hundis

6.5.1 The following types of hundis have been referred to :

(1) Darshani Hundi

(2) Dhani Jog Hundi

(3) Shah Jog Hundi

(4) Dekhanhar Hundi

(5) Muddati Hundi

(6) Firman Jog Hundi

(7) Jokhmi Hundi

(8) Jawabi Hundi

(9) Nam Jog Hundi

(10) Nishan Jog Hundi

Is there any other type of indigenous negotiable instrument you have come across?

6.5.2 Could you kindly procure for us specimen copies (with English translation) of the types of indigenous negotiable instruments you are familiar with?

6.5.3 Are all the types of hundis referred to still in use? Or, have any of them fallen into disuse? If so, please name them.

6.5.4 Is any type of hundi popularly associated only with any particular group of indigenous bankers or financiers? If so, please indicate.

Group 6—Terms of hundis

6.6.1 Please give the usual terms of, usages and incidents applicable to, the different kinds of indigenous negotiable instruments.

6.6.2 Are there any characteristics or incidents which are common to the indigenous negotiable instruments in general? If so, please specify them.

6.6.3 Do you consider that all the usages and incidents now applicable to the different types of indigenous negotiable instruments could be given legal recognition or that any of them should not be given legal sanction as opposed to any principle of law or public policy?

6.6.4 Can all the different types of indigenous negotiable instruments be regarded as containing "unconditional orders" to pay? Please give your views with reference to each type of instrument, with reasons.

6.6.5 Do hundis specify the rate of interest payable thereon? If not, do you think it desirable to provide for the rate of interest payable on them on the lines of Section 80 of the NIA?

6.6.6 Are any amounts other than the principal and interest payable on the instrument? If so, what are they and under what circumstances they are payable?

6.6.7 How are the different types of hundis negotiated? Is it by endorsement and delivery or by mere delivery? Please reply with reference to each type of hundi.

6.6.8 Are hundis drawn in sets? If so, how are they done and under what circumstances?

6.6.9 Do you consider that all the provisions of the NIA should be made applicable to hundis? If not, please indicate the provisions which you consider should not be applied to hundis.

6.6.10 With respect to each type of indigenous negotiable instrument, please indicate whether you consider any practice, usage or incident should be prohibited or rendered invalid.

PART 7—NEGOTIABLE INSTRUMENTS FOR PAYMENT OF MONEY NOT IN THE NATURE OF CHEQUES, BILLS OR NOTES

Group 1—General

7.1.1 A major suggestion is to bring within the scope of the Negotiable Instruments Act the following types of negotiable documents under which money is payable:

Debentures; bonds issued by companies; bearer bonds; bearer scrips; bearer debentures; treasury bills; postal orders; share certificates; insurance certificates/policies; deposit receipts; pay warrants, etc.

Do you think it feasible and/or desirable?

7.1.2 If you do not favour bringing such negotiable instruments under the Negotiable Instruments Act, do you regard a separate legislation dealing with such types of instruments necessary or desirable?

7.1.3 Bonds, certificates of stock and other types of investment securities are now dealt with under separate but common legislative provisions in the U.S.A., which are "likened rather to a negotiable instruments law dealing with securities." Do you consider such legislation necessary or desirable in India?

(*vide* Article 8 of the UCC)

Group 2—Trend to increase the types of negotiable instruments

7.2.1 The NIA defines a negotiable instrument as a note, bill or a cheque payable to order or to bearer (Section 13). However, in U.S.A., any writing—

(*a*) signed by the maker or drawer; and

(*b*) containing an unconditional promise or order to pay a sum certain in money, and no other kind of promise or order ; and

(*c*) payable on demand or at a definite time ; and

(*d*) payable to order or bearer

is held as a negotiable instrument. Do you consider it desirable to have in India a provision as in U.S.A. ?

Group 3—Certificate of deposit

7.3.1 In U.S.A., the "negotiable certificate of deposit" issued by a bank is specifically stated as a negotiable instrument and is governed by the Negotiable Instruments Law. Do you consider it necessary or desirable to specifically provide for such recognition in India of certificates of deposits, if any, issued by banks ?

PART 8 — NEGOTIABLE INSTRUMENTS — CONFLICT OF LAWS

Group 1 — Parties' power to choose applicable law

8.1.1 Under the American law, when a transaction relating to a negotiable instrument bears a reasonable relation to more than one State or nation, the parties may agree that the law of either shall govern their rights and duties. Would you favour such liberty being given to the parties to such an instrument in India ?

(*vide* Section 1-105 of the UCC)

Group 2—Special provision for banks

8.2.1 In U.S.A., the liability of a bank, or the branch of a bank, for action or non-action with reference to any instrument handled by it for purposes of presentment, payment or collection, is governed by the law of the place where the bank or the branch of a bank, as the case may be, is located. Do you consider a provision on these lines necessary or desirable in India ?

(*vide* Section 4-102 of the UCC)

Group 3—Formal validity of the contract

8.3.1 A negotiable instrument involves a composite contract consisting not only of the original contract between the parties to the instrument but also of the "supervening contracts" made by the acceptor or indorser. Each of these contracts may be entered into at

different places and it has been suggested that the validity of each must be determined according to the law of the place where such contract was made. Do you agree? Or, would you suggest any other rule ?

Group 4—Capacity of parties

8.4.1 For determining the capacity of parties to a contract, in relation to a negotiable instrument, the choice is between the law of domicile and the law of the place where the contract is made. Generally, the law of the place where the contract takes place is considered as the more appropriate. However, as per the Geneva Conventions, the capacity of a person is determined by his national law with this qualification, namely, if the person lacks capacity as per his national law, he will nevertheless be bound if his signature had been given in any territory in which, according to the law in force there, he would have the requisite capacity. Which law, according to you, should determine the capacity of parties ?

8.4.2 If the rule is to apply the law of the place where the contract takes place, the following exceptions have been suggested, namely :

(*a*) that the absence or inadequacy of stamp and effect thereof, as per the requirements of the foreign law, need not affect the admissibility or enforceability of the instrument in India, if it satisfies the requirements of the Indian Stamp Law ; and

(*b*) that the validity of any acceptance or indorsement made in India should not be affected by reason that the instrument made, drawn, accepted or indorsed out of India but in accordance with the law of India, is invalid according to the foreign law (Section 136 of the NIA).

Please give your views regarding each of the exceptions.

Group 5—Liability of parties

8.5.1 The liability of a maker or drawer of a foreign instrument is determined by the law of the place where the instrument is made, while the liability of an acceptor or indorser is determined by the law of the place where the instrument is made payable (Section 134 of the NIA). It has been suggested that even the liability of the maker or drawer should also be determined by the law of the place where the instrument is payable. Are you in favour of this suggestion ?

8.5.2 The provisions relating to dishonour, notice of dishonour, the due date, the duties of holder with respect to presentment, acceptance or payment, it has been suggested, must be governed by the law of the place where the money is payable. Do you agree ?

8.5.3 All questions relating to payment and satisfaction including interest, it has been suggested, should be governed by the law of the place where the instrument is payable. Do you agree ?

PART 9—NEGOTIABLE INSTRUMENTS—GENERAL

Group 1—Drawee

9.1.1 In U.S.A., unlike in U.K., the order to pay under the negotiable instrument may be addressed to one or more persons in the alternative. This recognises the practice of corporations issuing dividend warrants and of other drawers who for commercial convenience name a number of drawees, usually in different parts of the country. Do you consider such a provision necessary or desirable ? If so, would you also like to provide that in such cases the holder should not be required to make more than one presentment of the instrument ?

[*vide* Section 3-102(*b*)' of the UCC and Section 6(2) of the "Bills of Exchange Act of U.K." (BEA)]

Group 2—Banker

9.2.1 The definition of "banking" under the Banking Regulation Act, 1949, covers also acceptance of deposits which are withdrawable otherwise than by cheque, draft or order. Do you consider this definition appropriate in the context of defining a "banker" for the purpose of the NIA ?

9.2.2 Under Section 49A of the Banking Regulation Act, 1949, only a banking company, the Reserve Bank of India, the State Bank of India or any other notified banking institution, firm or person can accept deposits of money from the public withdrawable by cheque. In view of this, would you like to provide in the NIA that a banker is one who is eligible to accept deposits withdrawable by cheque under Section 49A of the Banking Regulation Act, 1949 ? If not, how would you like a "banker" to be defined for the purpose of the NIA ?

Group 3—Payee

9.3.1 In U.S.A., by drawing, making or accepting, the party is deemed to admit, as against all subsequent parties including the drawee,

the existence of the payee and his then capacity to indorse. Do you consider such a provision necessary or desirable in India ?

(*vide* Section 3-413(3) of the UCC)

9.3.2 Considerable difference of opinion and difficulty arise when dealing with an instrument drawn in favour of a "fictitious or non-existent person". Hence, the UCC (Section 3-405) has eliminated the reference to "fictitious or non-existent person". In like circumstances, the UCC provides that an indorsement by any person in the name of the named payee is effective. Do you consider that a provision on those lines is necessary or desirable in India ?

9.3.3 (To be answered by banks only) It is said that the insistence on the identification of the payee of an order cheque affects the spread of the cheque habit. Do you consider identification for payment of order cheques presented across the counter necessary? What is the practice followed in your bank in this behalf? Do you consider it necessary or desirable for banks to adopt a uniform practice? If so, what practice you would suggest ?

9.3.4 Do you consider that any provision of the NIA makes such identification necessary ? If so, do you consider any modification in this regard necessary or desirable ?

Group 4—Accommodation party

9.4.1 Are you in favour of allowing the accommodation character of a party to an instrument to be proved by oral evidence ? If so, would you also like to provide that, as against a holder in due course without notice of the accommodation, such evidence shall not be admissible ?
(*vide* Section 3-415(3) of the UCC)

9.4.2 Would you regard an indorsement which is apparently not in the chain of title as notice of its accommodation character ?

(*vide* Section 3-415(4) of the UCC)

Group 5—Bearer

9.5.1 It has been suggested that "bearer" should mean a person who by negotiation comes into possession of an instrument payable to bearer. However, the corresponding provision in U.K. and U.S.A. does not refer to the person in possession having obtained the instrument as a result of negotiation. Do you consider it

necessary or desirable to insist on the condition that the instrument comes into his possession as a result of negotiation ?

(*vide* Section 2 of the BEA and section 1-201(5) of the UCC)

Group 6—Holder

9.6.1 It has been suggested that the definition of "holder" should expressly exclude a beneficial owner claiming through a benamidar. Do you consider this necessary or desirable ?

9.6.2 The law in India enables a holder to ask for a duplicate of a bill, if he claims that it is lost, after furnishing an indemnity. It has been suggested that the scope of this provision should be widened to cover all negotiable instruments. Do you agree ?

9.6.3 Difficulties are experienced in determining when a negotiable instrument can be held to have been lost before it is overdue. Is it possible to lay down any general criteria on the satisfaction of which it could be assumed that the instrument has been lost? If so, please indicate them.

9.6.4 Difficulties are also experienced in deciding the extent of indemnity to be obtained when a duplicate of an instrument is asked for. Is it possible to lay down any standard that could be applied in such cases? If so, please indicate. Should the indemnity cover also the right to ask for adequate collateral or other security ?

9.6.5 It has been suggested that a transferee for value without indorsement of an instrument should have all the rights which the transferor had in it and in addition, the right to have the indorsement of the transferor or his representative. Do you consider this desirable ?
(*vide* Section 31(4) of the BEA)

Group 7—Holder in due course

9.7.1 Do you consider that a person, to be a holder in due course, should have taken the instrument for consideration, whether the instrument is payable to bearer or order ? Please give your views with reasons therefor.

9.7.2 The UCC (Section 3-305) provides that, as against a holder in due course, the following defences could be urged :

(*a*) infancy, to the extent that it is a defence to a simple contract; and

(*b*) such other incapacity, or duress, or illegality of the instrument, as renders the obligation of the party a nullity; and

(*c*) such misrepresentation as has induced the party to sign the instrument with neither knowledge nor reasonable opportunity to obtain knowledge of its character or its essential terms; and

(*d*) discharge in insolvency proceedings; and

(*e*) any other discharge of which the holder has notice when he takes the instrument.

Do you agree that such defences should be available as against a holder in due course in India ? If so, do you consider an express provision on the aforesaid lines desirable ?

Group 8—Transferor by delivery

9.8.1 It has been suggested that a transferor by delivery should not be liable on the instrument except that he gives certain warranties to his immediate transferee for consideration. Do you agree? If so, would you like to confine the scope of Section 43 of the NIA only to transfer of instruments by indorsement and delivery ?

Group 9—Minors

9.9.1 Do you consider the legal position relating to deposit of monies by minors in banks and withdrawals by them satisfactory? If not, what improvements you would like to suggest to the present position ?

9.9.2 A suggestion has been made that minors who have attained a certain age of understanding may be legally permitted to give a valid discharge for monies withdrawn by them from bank accounts. Do you consider that such a provision is necessary or desirable ?

Group 10—Negotiable instruments and drafts

9.10.1 In Haji Sheikh Hasanoo *vs.* S. Natesa Mudaliar & Co. (A.I.R. 1959 Bom. 267), the Bombay High Court has held that a draft drawn by one branch of a bank on another is not a negotiable instrument under the NIA. Do you consider this decision satisfactory? If not, do you favour an amendment of the law; in which case, on what lines ?

9.10.2 Would you like to apply all the general provisions of the NIA to such drafts, or would you like to apply to them only the provisions relating to cheques ?

Group 11—Sum certain

9.11.1 The UCC (Section 3-106) specifically provides that the amount payable under an instrument is "sum certain" even though it is to be paid—

(*a*) with stated interest or by stated instalments; or

(*b*) with stated different rates of interest before and after default or a specified date: or

(*c*) with a stated discount or addition if paid before or after the date fixed for payment; or

(*d*) with exchange or less exchange, whether at a fixed rate or at the current rate ; or

(*e*) with cost of collection or an attorney's fee or both upon default.

Do you agree that under the aforesaid circumstances the sum payable could be regarded as certain? If so, would you like this to be specifically clarified ?

Group 12—Unconditional order

9.12.1 Under the UCC (Section 3-105), a promise or order otherwise unconditional is not made conditional by the fact that the instrument —

(*a*) is subject to implied or constructive conditions; or

(*b*) states its consideration, whether performed or promised or the transaction which gave rise to the instrument, or that the promise or order is made or the instrument matures in accordance with or "as per" such transaction; or

(*c*) refers to or states that it arises out of a separate agreement or refers to a separate agreement for rights as to pre-payment or acceleration; or

(*d*) states that it is drawn under a letter of credit; or

(*e*) states that it is secured, whether by mortgage, reservation of title or otherwise; or

(*f*) indicates a particular account to be debited or any other fund or source from which reimbursement is expected; or

(*g*) is limited to payment out of a particular fund or the proceeds of a particular source, if the instrument is issued by a government or governmental agency or unit; or

(*h*) is limited to payment out of the entire assets of a partnership, unincorporated association, trust or estate by or on behalf of which the instrument is issued.

However, a promise or order does not become unconditional if the instrument —

(*a*) states that it is subject to or governed by any other agreement; or

(*b*) states that it is to be paid only out of a particular fund or source except as stated above.

Do you agree that a promise or order could be regarded as unconditional in all or in only some of the aforesaid circumstances? If in only some, please state them. Would you like a specific provision providing for such circumstances ?

Group 13—Definite time

9.13.1 Would you regard the time for payment of an instrument as definite if by its terms it is payable —

(*a*) on or before a stated date or at a fixed period after a stated date ; or

(*b*) at a fixed period after sight ; or

(*c*) at a definite time subject to any acceleration ; or

(*d*) at a definite time subject to extension at the option of the holder, or to extension to a further definite time at the option of the maker or acceptor or automatically upon or after a specified act or event ?

If so, do you favour a provision clarifying this ?

(*vide* Section 3-109(1) of the UCC)

Group 14—Inchoate instruments

9.14.1 Would you like to expressly provide that the completion by the holder, of an incomplete instrument, as per authority given to him, should be "within a reasonable time and strictly in accordance with the authority given" ? If so, would you like to provide that any failure to comply with this requirement shall not be set up as against a holder in due course ?

9.14.2 It has been observed that the practice of delivering a blank paper containing a signature (which may be on a stamp paper) with

a view that it may be filled in as a negotiable instrument for an adequate amount had utility only when communications were slow and difficult, that the practice has become obsolete, affords obvious opportunity for fraud, and should not be encouraged. Hence, it has been suggested that the provision that the delivery of such blank paper operates as *prima facie* authority to fill it up could be omitted. Do you agree?

(*vide* Section 20 of the NIA)

9.14.3 If an incomplete instrument is stolen before its issue, and afterwards it is filled up and negotiated to an innocent party, he cannot be a "holder in due course" under the Law Merchant, though, in India, this point is not free from doubt. This rule has been criticised and dispensed with in the U.S.A. Are you in favour of its retention or deletion?

Group 15—Ambiguous instruments

9.15.1 It has been suggested that where words are ambiguous or uncertain, reference should be made to the figures to fix the amount. Do you favour a provision to that effect?

(*vide* Section 3-118(*c*) of the UCC)

9.15.2 When a person draws a bill on himself, the holder has now the choice to treat it as either a bill or a note. But, under the UCC [Section 3-118 (*a*)], it is effective as a note. Which do you prefer?

9.15.3 Under the UCC [Section 3-118(*b*)], handwritten terms control typewritten and printed terms, and typewritten control printed. Do you consider a provision to that effect desirable in India?

Group 16—Issue

9.16.1 The BEA (Section 2) defines "issue" as "the first delivery of an instrument *complete in form* to the person who takes it as a *holder*." It is felt that this is not consistent with the provisions relating to incomplete instruments and not sufficient to cover the case of a remitter. Do you agree? If so, can "issue" be defined as the first delivery of an instrument to a holder or a remitter?

(*vide* Section 3-102(1)(*a*) of the UCC)

Group 17—Completion of an instrument by delivery

9.17.1 Do you agree that as against a holder in due course, a defence based on "non-delivery", "conditional delivery" and "delivery for special purpose" shall not be allowed to be set up?

Group 18—Instrument payable to bearer

9.18.1 Do you regard an instrument as payable to bearer when by its terms it is payable to "cash" or the order of "cash" or any other indication which does not purport to designate a specific payee? Would you favour a specific provision clarifying the position in this behalf?

(*vide* Section 3-111 of the UCC)

Group 19—Instrument payable to order

9.19.1 Under the UCC (Section 3-110), an instrument made payable both to order and to bearer is one payable to order unless the "bearer" word is handwritten or typewritten. Do you consider such a provision necessary or desirable?

Group 20—Date, ante-dating and post-dating

9.20.1 A provision that ante-dating or post-dating of an instrument will not make it invalid unless it is done for an illegal or fraudulent purpose, has been suggested. Do you favour such a provision or would you suggest any modification thereof?

9.20.2 The UCC (Section 3-114) specifically provides that—

(1) the negotiability of an instrument is not affected by the fact that it is undated, ante-dated or post-dated ; or

(2) where an instrument is ante-dated or post-dated, the time when it is payable is determined by the stated date if the instrument is payable on demand or at a fixed period after date ; or

(3) where the instrument or any signature thereon is dated the date is presumed to be correct.

Do you agree with the principles underlying these provisions? If so, do you consider a provision on those lines necessary or desirable in India?

Group 21—When an instrument is overdue

9.21.1 It has been suggested that an on demand instrument shall be deemed to be overdue when it appears on the face of it to have been in circulation for an unreasonable length of time. In this connection could you please indicate what period you would regard as reasonable length of time for cheques, bills and notes payable on demand? Are you in favour of statutorily clarifying the position?

9.21.2 A cheque drawn and payable in U.S.A. is regarded as overdue 30 days after its issue while the banker is obliged to pay a cheque which is presented to him not more than six months after its date and has an option to pay or not to pay thereafter. Please give your views as regards the reasonableness of these periods. Do you favour a specific provision providing when a cheque could be regarded as having become overdue and the period up to which a banker is obliged to honour cheques drawn on him?

(*vide* Sections 3-304(3)(*c*) and 4-404 of the UCC)

Group 22—Defective title

9.22.1 Would you like to provide when the purchaser of a negotiable instrument could be regarded as having notice of a claim or defence or of the fact that an instrument is overdue?

9.22.2 Under the following circumstances, the UCC [Sections 3-304(1) and (2)] provides that the purchaser of an instrument has notice of a claim or defence—

(*a*) when the instrument is so incomplete, bears such visible evidence of forgery or alteration, or is otherwise so irregular as to call into question its validity, terms or ownership or to create an ambiguity as to the party to pay; or

(*b*) when he has notice that the obligation of any party is voidable in whole or in part, or that all parties have been discharged; and

has notice of a claim—

when he has knowledge that a fiduciary has negotiated the instrument in payment of or as security for his own debt or in any transaction for his own benefit or otherwise in breach of duty.

Do you agree that in the aforesaid circumstances, knowledge of a claim or defence can be imputed to the purchaser? If so, do you favour a specific provision to that effect?

9.22.3 A person is held to have notice that an instrument is overdue, under the UCC [Section 3-304(3)], when he has reason to know—

(*a*) that any part of the principal amount is overdue or that there is an uncured default in payment of another instrument of the same series; or

(*b*) that acceleration of the instrument has been made; or

(*c*) that he is taking a demand instrument after demand has been made or more than a reasonable length of time after its issue.

Do you agree that in the aforesaid circumstances the purchaser could be regarded as having notice of the fact that an instrument has become overdue ? If so, do you favour such a provision ?

9.22.4 The UCC [Section 3-304(4)] does not regard knowledge of the following facts as *per se* giving the purchaser notice of a defence or claim :

(*a*) that the instrument is ante-dated or post-dated ;

(*b*) that it was issued or negotiated in return for an executory promise or accompanied by a separate agreement, unless the purchaser has notice that a defence or claim has arisen from the terms thereof ;

(*c*) that any party has signed for accommodation ;

(*d*) that an incomplete instrument has been completed, unless the purchaser has notice of any improper completion ;

(*e*) that any person negotiating the instrument is or was a fiduciary ;

(*f*) that there has been default in payment of interest on the instrument or in payment of any other instrument, unless it is one of the same series.

Do you agree that knowledge of the above facts shall not be regarded as giving the purchaser notice of a defence or claim ? Do you favour a similar provision in India ?

9.22.5 Would you like to provide that to be effective a notice must be received by a person at such time and in such manner as to give him a reasonable opportunity to act on it ?

(*vide* Section 3-304(6) of the UCC)

Group 23—Material alteration

9.23.1 What kinds of alterations of an instrument would you regard as material, and what not ?

9.23.2 Would you regard alterations in relation to an instrument, namely, any alteration of the date, of the sum payable, of the time or the place of payment, of the name of the payee or drawee,

of the place of drawing, of the nature of the instrument, of the crossing and the addition of a place of payment without the acceptor's assent, as material alterations or not?
Please give your views with regard to each, with reasons.

9.23.3 The UCC [Section 3-407(1)] defines material alteration as—

> any alteration of an instrument which changes the contract of any party thereto in any respect, including any such change in
>
> (*a*) the number or relations of the parties ; or
>
> (*b*) an incomplete instrument by completing it otherwise than as authorized ; or
>
> (*c*) the writing as signed, by adding to it or by removing any part of it.

Do you consider this definition satisfactory and adequate?

9.23.4 A material alteration renders the instrument void as against anyone who is a party thereto at the time of such alteration if he does not assent to the alteration. To this, an alteration by a stranger made without the assent of, or any negligence or fraud on the part of, the holder has been suggested as an exception. Do you agree?

9.23.5 Under the UCC [Section 3-407(2)] there is a distinction as regards alterations which are both fraudulent and material and those which are not, only the former discharging any party. This distinction is not found in the U.K./Indian provisions. Are you in favour of this distinction or not?

9.23.6 Under the UCC [Section 3-407(3)] and under the Geneva Conventions (Articles 69 and 77 of Convention No. 3313 regarding bills and notes and Article 51 of Convention No. 3316 regarding cheques), a holder in due course may hold the party liable only according to the *original tenor* of the altered instrument. Proviso to Section 64(1) of the BEA is similar in regard to bills. But Section 89 of the NIA enables a holder in due course to charge the person liable according to the *apparent tenor* of the instrument. Do you consider that the obliged party should be held liable to the holder in due course according to the original tenor or the apparent tenor of the altered instrument?

9.23.7 The BEA [proviso to Section 79(2)], the UCC [Section 4-401(2) (*a*)] and the NIA (Section 89) protect the payment of an altered instrument in good faith by a banker. While the BEA gives

such protection only in relation to cheques, the UCC and the NIA extend this to payments in relation to any altered instrument. While under the BEA and the NIA the banker can charge the customer according to the apparent tenor of the altered instrument, the UCC enables him only to charge the customer according to its original tenor. Please indicate—

(*a*) whether the protection to a banker paying an altered instrument in good faith should be confined to cheques, or extended to other instruments also ? and

(*b*) whether the banker can charge the customer according to the original tenor or the apparent tenor of the instrument ?

9.23.8 Do you expect a banker to detect also alterations invisible to the naked eye by the use of particular machines ? Is it possible to evolve uniform standards to be observed by banks in this behalf ? If so, please give your comments thereon.

Group 24—Cancellation of an instrument

9.24.1 Under the BEA [Section 63(1)and (2)] and the UCC [Section 3-605(1)(*a*)], an intentional cancellation by a holder or his representative, of a bill, or the signature of any party liable thereon, which is *apparent*, discharges the bill or the party whose signature is cancelled, as the case may be. The Indian Act refers only to an intentional cancellation of the signature of a party liable on the instrument, but it does not specify that the cancellation should be apparent. Do you think it desirable to provide that a cancellation of the signature of a person liable, or of the instrument itself, should be apparent before such person or the instrument could be held as discharged ? In addition, in the case of a cancellation of the instrument, would you like to provide, on the lines of the UCC provision [Section 3-605(2)] that it will not, without its surrender, affect the title thereto ?

Group 25—Negligence contributing to alteration

9.25.1 It has been judicially held that a drawer of a cheque rendering it easy for a forger to make alterations is bound to bear the loss, and not the bank. While there is no statutory provision in this behalf either in U.K. or in India, the UCC has a provision (Section 3-406) that any person who by his negligence substantially contributes to a material alteration of an instrument or the making of an unauthorised signature is precluded from asserting the alteration or lack of authority against a holder in due course or against the drawee or other payer who pays the instrument in

good faith and in accordance with the reasonable commercial standards of the drawee's or payer's business. Do you consider that such a provision is necessary or desirable in India ?

Group 26—Signature

9.26.1 Do you consider it desirable to define "signature" ? If so, could it be defined as "the writing or otherwise affixing a person's name or a mark to represent his name, by himself or by his authority, with the intention of authenticating a document as being that of or as binding on the person whose name or mark is so written or affixed" ? Would you also like to include in the above definition "the fascimile of the name so affixed in print, by perforation or in some other form" ?

9.26.2 Under Section 47 of the Companies Act, 1956, a bill, hundi or note has to be signed on behalf of the company by any person acting under its authority express or implied in the name of, or on behalf of, or on account of, the company. Similar provisions are found in Section 147 of that Act. As these provisions apply only to companies registered under the Companies Act, do you favour a provision on these lines in the NIA so that they may apply to all corporate bodies ?

9.26.3 Under the law in India and U.K., while an unauthorised signature could be ratified, a forged one cannot be. This principle has now been altered in U.S.A. on the ground that a forged signature could at least be adopted without in any way affecting the liability under the criminal law (Sections 3-404 (2) and 1-201(43) of the UCC). Do you favour such change ? If so, would you like to provide that the retention of benefits received in the transaction with knowledge of the unauthorised or forged signature amounts to implied ratification of the unauthorised signature or forgery, as the case may be ?

9.26.4 Under the UCC (Section 3-404) an unauthorised signature operates as the signature of the unauthorised signer against a person who in good faith takes it for value. Do you consider such a provision necessary or desirable in India ?

9.26.5 It is suggested that a person signing an instrument otherwise than as a drawer, maker or acceptor shall be presumed to be an indorser unless there is express indication in the instrument to the contrary. Do you consider such a provision desirable ?

9.26.6 Under the Geneva Conventions (Articles 30,31,32 and 77 of Convention No. 3313), payment of a bill or a note may be

guaranteed by the signature of a third person and expressed by words such as "good as aval." The system of "aval" is not recognised in India. Do you consider it desirable to provide for its recognition ?

9.26.7 The UCC (Section 3-416) specifically provides that a person can be guarantor under an instrument, and that the guarantee may be expressed by words such as "payment guaranteed" or "collection guaranteed" or by general words of guarantee. Do you consider a provision on these lines necessary or desirable in India ?

Group 27—Indorsements

9.27.1 It has been suggested that when the payee or indorsee is wrongly named or misnamed in an order instrument, he may specifically be enabled to indorse the bill in the same manner or by his proper signature. Do you consider such a provision desirable ? If so, would you also like to provide that a person paying or giving value for the instrument may require the signature of the person in both the names ?

(*vide* Section 3-203 of the UCC)

9.27.2 The general rule is that negotiation of an instrument is not effective unless it is for the entire amount or for the amount remaining as unpaid residue. Would you like to provide in such cases, on the lines of the UCC (Section 3-202), that a partial indorsement "operates only as a partial assignment" ?

9.27.3 Under the NIA (Section 50) a restrictive indorsee is not empowered to further transfer or negotiate the instrument unless specifically authorised, nor he could be a holder in due course. Under the UCC (Sections 3-205 and 3-206), a restrictive indorsement as such does not prevent further transfer or negotiation, and a restrictive indorsee may also be a holder in due course provided he has acted consistently with such indorsement. Please indicate whether you consider it necessary or desirable—

(*a*) to allow a restrictive indorsee to further transfer or negotiate the instrument ; and

(*b*) to enable a restrictive indorsee to be a holder in due course subject to his acting consistently with such indorsement.

9.27.4 If you favour the UCC provisions regarding the rights of a restrictive indorsee, would you like to bring conditional indorsements also within the scope of those provisions as in the UCC ?

9.27.5 Do you favour a presumption that the indorsers of an instrument are liable to one another in the order in which their signatures appear on the instrument ?

(*vide* Section 3-414(2) of the UCC)

Group 28—Date of maturity

9.28.1 If a person contracts to pay an amount due under an instrument on demand, he could as well have fixed a time limit to suit his convenience. In this view, the provision for *days of grace* is considered as unnecessary. This is also not allowed under the Geneva Conventions and the UCC. Are you in favour of abolishing the rule as to days of grace or its retention ? Please give your views with reasons.

9.28.2 When the date of maturity falls on a public holiday, under the present rule the instrument is payable on the "next preceding business day." It has been suggested that to avoid difficulties, the "succeeding business day" rule should be applied. Under the UCC [Section 3-503(3)] it is the "next following day which is a *full business day for both parties*" and it thus excludes half-holidays like Saturday. Which rule you consider should properly be applied in India and why ?

Group 29—Presentment

9.29.1 A drawee of a bill is not liable on it unless he assents or accepts. But to charge the drawer and indorser, presentment for acceptance is considered obligatory under the BEA [Sections 39(1) and (2)] and the UCC [Section 3-501(1)(*a*)] provisions only when—

(*a*) the bill is payable after sight ;

(*b*) there is an express stipulation to this effect ; and

(*c*) the bill is drawn payable elsewhere than at the residence/place of business of the drawee.

But under the NIA, this is necessary only when the bill is payable after sight. Please indicate the circumstances when you would consider presentment for acceptance necessary or desirable to charge the drawer and indorser.

9.29.2 Do you consider presentment for payment necessary in the case of a cheque to charge the drawer and indorser ?

9.29.3 Whether presentment for payment is necessary or not to charge the maker and the acceptor is not free from ambiguity. This is

not necessary under the BEA or the UCC or the Geneva Conventions. Do you consider presentment for payment necessary to charge the maker or acceptor ?

9.29.4 Presentment for payment is necessary under the BEA [Section 87 (1)] to charge the maker of a note payable at a specified place. This is now necessary in India if such note is payable on demand (exception to Section 64 of the NIA). But presentment for payment is not necessary to charge the maker of any note, under the UCC or the Geneva Conventions. Do you favour the present position or would you like to dispense with presentment for payment as necessary to charge the maker of any note ?

9.29.5 Under the UCC [Section 3-511(3)(*b*)], presentment for acceptance or payment is entirely excused when the acceptance or payment is refused but not for want of proper presentment. Do you agree with this provision ?

9.29.6 Under the BEA [Sections 45(3) and (7)], presentment for payment is not excused when the person liable is dead or bankrupt. But the UCC [Section 3-511(3) (*a*)] entirely excuses presentment in such cases, except in the case of documentary draft, on the ground that where immediate payment or acceptance is impossible, or is so unlikely, the holder cannot reasonably be expected to make presentment and instead can have his immediate recourse upon the drawer or indorser. Which provision you prefer ?

9.29.7 Please indicate whether in all or any of the following circumstances presentment for acceptance could be excused:

(*a*) if the maker, acceptor or drawee intentionally prevents the presentment ;

(*b*) as against any party to be charged therewith, if he has engaged in writing to pay without such presentment ;

(*c*) as against any party if, after maturity, with knowledge that the instrument has not been presented for acceptance, he makes a part payment on account of the amount due on the instrument or promises to pay the amount due thereon in whole or in part or otherwise waives his right to take advantage of any default in presentment;

(*d*) as against the drawer, if he cannot suffer damage from want of such presentment ; and

(*e*) as regards an indorser, where the instrument was made, drawn or accepted for the accommodation of that indorser and he has no reason to expect that the instrument would be paid even if presented for acceptance.

9.29.8 Under the BEA [Sections 41(1)(*b*) and 45(6)] where there are two or more drawees, unless they are partners or one man has authority to act for all, presentment for acceptance or payment should be made to all of them. The UCC [Section 3-504(3)(*a*)] provides that presentment in such cases need not be to all, and may be made to any one of them on the reason that the holder is entitled to expect that any one of the named parties would pay or accept and that he should not be required to go to the trouble and expense of making separate presentment to a number of them. Which provision you prefer and why ?

9.29.9 It has been felt that when an instrument is payable in instalments and default is made in the payment of one of them, the point whether it is necessary to present the instrument for payment as regards the subsequent instalments, in the absence of an acceleration clause, is not clear. Would you like to clarify the position ? If so, how ?

9.29.10 While presenting an instrument for acceptance, do you consider it necessary in all cases to exhibit the original instrument ? Will it not be adequate if this is done only if specifically required by the party to accept ?

9.29.11 While presenting an instrument for payment, do you consider it necessary to send the original, or an attested copy thereof ? Or, do you regard that presentment for payment could be made by a mere demand as under the UCC (Section 3-504) ?

9.29.12 Under the UCC (Section 3-505) , the party to whom the presentment is made may, without dishonour, require—

(*a*) exhibition of the instrument ; and

(*b*) reasonable identification of the person making presentment and evidence of his authority to make it if made for another ; and

(*c*) that the insrument be produced for acceptance or payment at a place specified in it, or if there be none at any place reasonable in the circumstances ; and

(*d*) a signed receipt on the instrument for any partial or full payment and its surrender upon full payment.

Are you in favour of a provision on these lines ?

9.29.13 What is the practice you follow when you have to make presentment for acceptance and for payment ? Do you regard the practice as fully consistent with the requirements of law ? If not, in what respects, and what remedy you suggest ?

9.29.14 It is said that there is a practice among banks to make presentment by giving only an intimation to the person liable to pay. Is this practice justifiable under the present law? Are you in favour of making any special provision giving legal recognition to this practice? If so, do you favour a provision on the lines of Section 4-210 of the UCC whereby a collecting bank is permitted to present an instrument (not payable by, through, or on a bank) by sending to the party to accept or pay, a written notice that the bank holds the instrument for acceptance or payment?

9.29.15 Do you agree that in the case of a bill accepted or a note made payable at a bank, presentment should only be by production of the instrument?

(*vide* Section 3-504(4) of the UCC)

9.29.16 At present while presentment for acceptance could only be on a business day, presentment for payment can be on a day which is not a business day provided it is not a public holiday. In U.K., any presentment could be made only on a business day (Sections 41(1)(*a*) and 45(3) of the BEA). Under the UCC [Sections 3-503(3) and (4)], the presentment has to be "on a day which is a full business day for both parties, and if at a bank, during its banking day". In the light of this, please indicate whether you favour the continuance of the existing position or desire any change. If you want a change, on what lines?

9.29.17 It has been suggested that the party who is to make the presentment for payment could adopt any means convenient to him including the use of postal communication. Do you agree? If so, would you like to provide similarly also as regards presentment for acceptance?

(*vide* Section 3-504(2) (*a*) of the UCC)

9.29.18 If presentment by post could be allowed, do you consider it necessary to stipulate that it should be by registered post?

Group 30—Interest

9.30.1 Do you favour the rate of interest payable on negotiable instrument being varied by the provisions of the local State enactments?

Group 31—Notice of dishonour

9.31.1 A notice of dishonour can be given in India, U.K. and U.S.A. orally or in writing. It has been suggested that in order to impart more certainty to this important act, the notice should be re-

quired to be given in writing. Do you favour this change? If notice has to be in writing, should it also be required to be signed, or need not be as under the BEA?

Group 32—Noting and protest

9.32.1 Under the BEA (Section 94), in the absence of a Notary, a protest could be effected by "any householder or substantial resident of the place attesting the dishonour of a bill in the presence of two witnesses." As the services of the Notary may not be available at all places, please indicate the persons who could be authorised in India to note and/or protest.

9.32.2 Do you favour the Notary being permitted to make presentment ordinarily through post?

9.32.3 Under the UCC (Section 3-509), a person authorised to protest is allowed to do so "upon information satisfactory to such person." It has been stated that this provision is not intended to affect any personal liability of the officer for making a false certificate but to leave it to his responsibility for determining whether he has satisfactory information. It has also been stated that the requirement that the person making protest must certify as of his own knowledge, has been more honoured in the breach than in the observance, and in practice, protest is made upon hearsay which the officer regards as reliable. Please give your comments on this and indicate how this can be avoided.

9.32.4 Under the Geneva Conventions, the holder of a bankrupt's acceptance is allowed to exercise his right of recourse. But under the BEA [Section 51(5)] and the NIA (Section 100) the holder is required to wait till the bill falls due before he can sue any party, and the protest for better security does not excuse a subsequent protest for non-payment, if the bill is not met at maturity. Do you consider it desirable to modify the Indian law on the lines of the provisions of the Geneva Conventions in this regard?

PART 10—CHEQUES

Group 1—General

*10.1.1 The Committee on Finance for the Private Sector (the Shroff Committee) has suggested for consideration the question of making the issue of a cheque on a bank without sufficient funds a criminal offence. Do you consider that such a provision is necessary or

* *Vide* Section 22—1410 of the District of Columbia Code, 1967.

desirable ? If you do, are you in favour of a proviso to such a provision on the following lines ?

> "Provided the maker or drawer of such a cheque has not paid the holder thereof the amount due thereon within a specified number of days after receiving notice that the cheque has not been paid."

*10.1.2 Would you favour a statutory provision, as in several States of the U.S.A., to the effect that a refusal of payment by the drawee because of insufficient funds shall be *prima facie* evidence of an intention to cheat ?

*10.1.3 Do you favour that a provision on the aforesaid lines should cover also other classes of negotiable instruments ?

10.1.4 Do you consider it necessary or desirable to provide for certification of cheques on the lines of the provisions applicable in this behalf in U.S.A.?

10.1.5 Do you consider that it is necessary or desirable to promote issue of cheques with receipt forms attached thereto? If you hold such a view, do you consider that any amendment of the law is necessary for such promotion ? If so, please give your suggestions.

Group 2—Cheques Act, 1957 of U.K.

10.2.1 The Cheques Act of U.K., which came into force on the 17th October 1957, seems to be working satisfactorily. Please state your views on the desirability or otherwise of a law in India on the lines of the Cheques Act.

10.2.2 The provisions of the Cheques Act extend also to documents which may not be negotiable instruments provided they are intended to enable a person to obtain payment of a sum. If you consider that provisions on the lines of this enactment are necessary or desirable in India, would you like to cover also non-negotiable instruments for the payment of money ?

10.2.3 Under the provisions of the Cheques Act, a paying banker, when he acts in good faith and in the ordinary course of business, is not concerned with, nor does he incur any liability merely by reason of or the absence of, or irregularity in, indorsements. Do you consider provisions on these lines necessary or desirable in India ?

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* *Vide* Section 22—1410 of the District of Columbia Code, 1967.

10.2.4 Under the Cheques Act, an unindorsed cheque paid by the banker on whom it is drawn is held as evidence of the receipt by the payee of the amount payable on the cheque. Do you consider such a provision desirable in India ?

10.2.5 If you view that it is not desirable to have in India provisions on the lines of the Cheques Act, do you consider that at least in the case of not-negotiated cheques, the paying banker may not concern himself with the absence of or irregularity in the indorsement of the payee ?

10.2.6 Under the Cheques Act, a banker collecting a cheque payable to order delivered to him by the holder for collection without indorsement has such rights as he would have had if the holder had indorsed it in blank. Do you consider such a provision necessary or desirable in India ?

10.2.7 Under the Cheques Act, the collecting banker is not held as having acted negligently merely by his failure to concern himself with the absence of or irregularity in indorsements. Do you favour such a provision in India ?

10.2.8 Under the Cheques Act, where a banker in good faith and without negligence receives payment for a customer or credits a customer's account with the amount of the instrument and receives payment for himself and it is found that the customer has no title or has defective title, the collecting banker does not thereby incur any liability to the true owner of the instrument. Section 131 of the NIA, which protects a collecting banker acting in good faith and without negligence, covers only cases of defective title and is also limited to crossed cheques handed over for collection. Do you consider it necessary to extend the scope of the protection to the collecting banker on the lines of the Cheques Act provision?

10.2.9 A collecting banker is protected only in respect of collection of amounts of crossed cheques. Do you favour an extension of the scope of this protection to include also uncrossed cheques ?

Group 3—Crossing

10.3.1 Would you like to provide that cheques crossed "account payee" should be made not negotiable by law? In that case, do you favour a provision for the protection of a banker who pays or collects in good faith the cheque in which the "account payee" crossing has been obliterated or altered when such obliteration or alteration is not apparent ?

10.3.2 If you do not favour cheques crossed "account payee" to be made not negotiable, do you consider it necessary or desirable to extend the protection to the collecting banker also to collection by him of negotiated cheques crossed "account payee" ?

10.3.3 Do you favour that cheques crossed "not negotiable" should be placed on the same footing as cheques crossed "account payee"? Or, would you favour the continuance of the existing position under which the person can become a holder but not a holder in due course of a cheque crossed "not negotiable" ?

10.3.4 Under the Cheques Act, the provisions relating to crossing of cheques are made to have effect in relation to instruments other than cheques, to which the provisions of the Cheques Act apply, though thereby such instruments are not made negotiable instruments. Do you consider a provision on these lines necessary or desirable ?

PART 11—BANK DEPOSITS AND COLLECTIONS

Group 1—General

11.1.1 The governing provisions relating to bank deposits and collections are to be found in certain provisions of the NIA dealing with the paying and the collecting bankers, Clearing House Rules, and the terms of the contract express or implied. It is stated that there should be uniformity in the rules relating to bank collections, with ample provision for flexibility, in view of the large volume of cheques handled by banks and the countrywide nature of bank collection process. Do you agree ?

11.1.2 Article 4 of the UCC has codified the law relating to payment and collection of instruments by banks, including *inter alia*, the rights and responsibilities of banks in the matter of presentment for collection, payment, charging the customer's account and handling of documentary bills. Do you favour such codification of the law in India covering these aspects ?

Group 2—General provisions

11.2.1 Do you favour the application of rules relating to bank collection also to any instrument for the payment of money though it is not negotiable, as under Article 4 of the UCC ?

11.2.2 In U.S.A., Federal Reserve Regulations, Operating Letters, Clearing House Rules and the like have the effect of agreements, whether or not specifically assented to, binding all the parties interested in

the instruments handled. On similar lines would you like to give the same effect to the Clearing House Rules in India? Would you also like to give such status to any other provision applicable in this behalf?

11.2.3 Would you favour a provision that in the absence of special instructions, action or non-action consistent with the Clearing House Rules and the like, or the general banking usage not contrary to law *prima facie* constitutes the exercise of ordinary care expected of bankers?

(*vide* Section 4-103(3) of the UCC)

11.2.4 Do you consider that in the absence of bad faith the measure of damages for the banker's failure to exercise ordinary care in handling an instrument should be the amount of the instrument reduced by the amount which could not have been realised by the use of ordinary care?

(*vide* Section 4-103(5) of the UCC)

11.2.5 Would you define a "customer" as any person having an account with a bank or for whom a bank has agreed to collect instruments and including a bank carrying an account with another bank?

(*vide* Section 4-104(1)(c) of the UCC)

11.2.6 Would you like to provide that, for the purpose of bank collection rules and Negotiable Instruments Law, a branch or separate office of a bank is a separate bank for the purpose of computing the time within which and determining the place at or to which action may be taken or notices or orders shall be given?

(*vide* Section 4-106 of the UCC)

11.2.7 (To be answered only by banks) Please indicate how and under what provision your bank is closed for the day for transactions with the public for handling of monies and instruments, for the purpose of allowing time to process the instruments, to prove balances, to make the necessary entries in your books, and to determine the position for the day. Do you consider a statutory provision in this regard necessary or desirable? If so, would you also like to provide that instruments or deposits received after such time may be treated as received at the opening of the next banking day?

(*vide* Section 4-107 of the UCC)

11.2.8 Do you favour a statutory provision providing that delay by a collecting bank or a payer bank beyond the prescribed or permitted

time limits is excused if caused by interruption of communication facilities, suspension of payments by another bank, war, emergency conditions or other circumstances beyond the control of the bank, provided it exercises such diligence as the circumstances require ?

(*vide* Section 4-108(2) of the UCC)

11.2.9 Would you like to enable a collecting bank, without affecting the liability of secondary and prior parties, to waive, modify or extend the prescribed or permitted time limits in an effort, in good faith, to secure payment ? If so, what is the limit of time a collecting bank may grant ?

(*vide* Section 4-108(1) of the UCC)

Group 3—Collection of instruments

11.3.1 Would you like to provide that when an instrument is indorsed "Pay any bank" and the like, only a bank may acquire the rights of a holder until the instrument has been returned to the customer initiating collection or it is specially indorsed by a bank to a person who is not a bank ?

(*vide* Section 4-201(2) of the UCC)

11.3.2 Would you agree that a collecting bank acting with due care shall not be liable for the insolvency, negligence, misconduct, mistake or default of another bank or person or for the loss or destruction of an instrument in transit or in the possession of others ?

(*vide* Section 4-202(3) of the UCC)

11.3.3 Do you agree that the collecting bank may supply any indorsement of the customer which is necessary to title unless the instrument contains the words "payee's indorsement required" or the like, and that, in the absence of such a requirement, a statement on the instrument by such bank to the effect that the instrument was deposited by a customer or credited to his account is effective as the customer's indorsement ?

(*vide* Section 4-206 of the UCC)

11.3.4 It is stated that if an owner of an instrument indorses it "for deposit" or "for collection", he usually does so in the belief that such indorsement will guard against further negotiation of the instrument to a holder in due course by a finder or thief; but, that, to justify this belief, it is adequate if one bank in any chain of banks

collecting the instrument has a responsibility to act consistently with the indorsement. Do you agree ? Is so, would you like to provide that any bank, to which an instrument is transferred in the course of collection, or the paying bank shall not be put on notice nor otherwise affected by a restrictive indorsement of any person other than the first collecting bank's immediate transferor?

(*vide* Section 4-205(2) of the UCC)

11.3.5 To permit the simplest possible form of transfer, would you like to provide that any agreed method which identifies the transferor bank is sufficient for the instrument's further transfer to another bank ?

(*vide* Section 4-206 of the UCC)

11.3.6 Under the UCC [Section 4-207(1)], each collecting bank which obtains payment or acceptance of an instrument warrants to the paying bank who in good faith pays or accepts the instrument that —

(*a*) it has a good title to the instrument or is authorised to obtain payment or acceptance on behalf of one who has a good title; and

(*b*) it has no knowledge that the signature of the maker or drawer is unauthorised except that this warranty is not given by any collecting bank that is a holder in due course and acts in good faith —

(*i*) to a maker with respect to the maker's own signature; or

(*ii*) to a drawer with respect to the drawer's own signature, whether or not the drawer is also the drawee ; or

(*iii*) to an acceptor of an instrument if the holder in due course took the instrument after the acceptance or obtained the acceptance without knowledge that the drawer's signature was unauthorised ; and

(*c*) the instrument has not been materially altered, except that this warranty is not given by any collecting bank that is a holder in due course and acts in good faith —

(*i*) to the maker of a note; or

(*ii*) to the drawer of a bill whether or not the drawer is also the drawee ; or

(*iii*) to the acceptor of an instrument with respect to an alternation made prior to the acceptance if the holder in due course took the instrument after the acceptance,

even though the acceptance provided "payable as originally drawn" or equivalent terms; or

(*iv*) to the acceptor of an instrument with respect to an alteration made after the acceptance.

Do you consider it necessary or desirable that a bank paying or accepting an instrument should have the benefit of the aforesaid warranties ?

11.3.7 Do you agree that each customer and any bank handling the instrument for collection who transfers an instrument or receives a settlement or other consideration should be deemed to warrant to his transferee and to any subsequent collecting bank which takes the instrument in good faith that —

(*a*) he has a good title to the instrument or is authorised to obtain payment or acceptance on behalf of one who has a good title and the transfer is otherwise rightful; and

(*b*) all signatures are genuine or authorised; and

(*c*) the instrument has not been materially altered; and

(*d*) no defence of any party is good against him ; and

(*e*) he has no knowledge of any insolvency proceeding instituted with respect to the maker or acceptor or the drawer of an unaccepted instrument; and

(*f*) he engages that upon dishonour and any necessary notice of dishonour and protest he will take up the instrument ?

(*vide* Section 4-207(2) of the UCC)

11.3.8 In U.S.A. for determining its status as a holder in due course a bank is regarded as having given value to the extent it has a security interest in the instrument. It is regarded as having a security interest in an instrument —

(*a*) to the extent the credit given for the instrument has been withdrawn or applied ;

(*b*) to the extent it gives right of withdrawal; or

(*c*) if it makes an advance on or against the instrument.

Do you consider these provisions satisfactory ? If so, would you like to provide on these lines ?

(*vide* Sections 4-208 and 4-209 of the UCC)

11.3.9 Would you like to provide that any knowledge, notice or stop order received by, legal process served upon or set-off exercised

by a paying bank, whether or not effective under other rules of law to terminate, suspend or modify the bank's right or duty to pay an instrument or to charge its customer's account for the instrument, *comes too late* to so terminate, suspend or modify such right or duty if the knowledge, notice, stop order, or legal process is received or served and a reasonable time for the bank to act thereon expires or the set-off is exercised after the bank has done any of the following :

(*a*) accepted the instrument ;

(*b*) paid the instrument in cash ;

(*c*) settled for the instrument without reserving a right to revoke the settlement and without having such right under statute, clearing house rule or agreement ;

(*d*) completed the process of posting the instrument to the indicated account of the drawer, maker or other person to be charged therewith or otherwise has evidenced by examination of such indicated account and by action its decision to pay the instrument; or

(*e*) become accountable for the amount of the instrument.

(*vide* Section 4-303(1) of the UCC)

11.3.10 It is stated that when more than one order in relation to an account are received, through clearing or simultaneously the paying banker is faced with a difficulty when he can honour some but not all of them. To meet this difficulty, would you favour a provision providing that in such circumstances a banker may charge the indicated account of his customer in any order convenient to the bank ? If not, how the banker should be required to act ?

(*vide* Section 4-303(2) of the UCC)

11.3.11 Do you consider as necessary or desirable a specific provision providing that a bank can charge a customer's account with any instrument which is otherwise properly payable from that account, even though the charge creates an overdraft ?

(*vide* Section 4-401(1) of the UCC)

11.3.12 (To be answered only by banks) If oral instructions are received from a customer countermanding payment of an instrument, how do you act on the instructions ?

11.3.13 In U.S.A., an oral stop order is effective for 14 days and has to be confirmed in writing within that period and written order is effective for 6 months unless renewed in writing. Please give your views on the desirability or otherwise of a provision on these lines.

(*vide* Section 4-403 of the UCC)

11.3.14 In U.S.A., a paying or collecting bank's authority to accept, pay or collect an instrument or to account for proceeds of its collection is not rendered ineffective by incompetence of either bank's customer existing at the time the instrument is issued or its collection is undertaken, if the bank does not have knowledge of such incompetence. Do you consider a provision on these lines necessary or desirable ?

(*vide* Section 4-405(1) of the UCC)

11.3.15 In U.S.A., death or incompetence of a customer does not revoke the authority of the bank to accept, pay, collect or account until the bank knows of the fact of the death or of the incompetence *and* has reasonable opportunity to act on it. Do you consider a provision on these lines necessary or desirable ?

(*vide* Section 4-405(1) of the UCC)

11.3.16 In U.S.A., unless ordered to stop payment by a person claiming an interest in the account, banks are enabled to honour cheques drawn on or prior to the date of the death of the customer(even with knowledge of such death) for ten days after the date of the death. Do you consider a provision on these lines necessary or desirable in India ?

(*vide* Section 4-405(2) of the UCC)

11.3.17 (To be answered only by banks) Do you return to the customer the paid cheques and/or other instruments drawn on his account ? If so, under what circumstances ?

11.3.18 Do you consider that the customer of a bank should have the right to ask for the return of cheques and/or other instruments paid on his account ?

11.3.19 Under the UCC (Section 4-406), when a bank sends to its customer a statement accompanied by instruments paid in good faith in support of the debit entries or otherwise in a reasonable manner makes the statement and instruments available to the customer, the

customer is required to exercise reasonable care and promptness to examine them to discover his unauthorised (including forged) signature or any alteration of an instrument and to notify the bank promptly after discovery thereof. Are you in favour of casting such a statutory obligation on the customer of a bank ? If so, do you favour a provision on the aforesaid lines ?

11.3.20 Under the UCC (Section 4-407), a bank, when it makes improper payment, is given a right of subrogation to the rights of any holder in due course, payee, or any holder, drawer or maker, to prevent unjust enrichment and to the extent necessary to prevent loss to it. Do you consider such a provision necessary or desirable ?

Group 4—Collection of documentary bills

11.4.1 Under the UCC (Section 4-504), a presenting bank which, following the dishonour of a documentary bill, has seasonably requested instructions but does not receive them within a reasonable time, is empowered to store, sell, or otherwise deal with the goods in any reasonable manner. For its reasonable expenses incurred by such action, the presenting bank is given a lien upon the goods or their proceeds, which may be foreclosed in the same manner as an unpaid seller's lien. Do you consider such a provision necessary or desirable ?

PART 12—DOCUMENTS OF TITLE TO GOODS

Group 1—General

12.1.1 It is said that the unsettled state of the law relating to documents of title to goods is the main reason for the unpopularity of advances by banks against such documents. Please give your suggestions to remedy the situation.

12.1.2 Please state the nature of difficulties experienced as regards advances against the various kinds of documents of title to goods. What remedies you suggest ?

Group 2—Definition

12.2.1 Do you consider the definition of "documents of title to goods" as contained in Section 2(4) of the Indian Sale of Goods Act, 1930 satisfactory ? Or, would you like to suggest any amendment thereto ?

12.2.2 In U.S.A., documents of title to goods may cover goods in the bailee's possession, which are either identified or are goods of which any unit is, by nature or usage of trade or by agreement, the equivalent of any other like unit (fungible goods). Do you consider that it would be useful or desirable to amend the definition of "documents of title to goods" so as to cover also such goods ?

(*vide* Sections 1-201(15) & (17) of the UCC)

Group 3—Desirability of separate legislation

12.3.1 It has been suggested that there should be a separate legislation dealing with the law relating to negotiation of documents of title to goods. Do you consider this necessary or desirable ? If so, please give your views about the scheme of such legislation.

12.3.2 Article 7 of the UCC has consolidated and revised the provisions of the law relating to negotiation of documents of title to goods. Do you consider that on similar lines there could be a separate legislation in India in this behalf ?

Group 4—Rights of holder

12.4.1 When title to goods is transferred by transfer of documents of title relating thereto, a transferee in good faith and for value now gets a better title than that of the transferor only —

(*a*) when the owner of the goods by his conduct is precluded from denying the seller's authority to sell ;

(*b*) when the pledge or transfer is in the ordinary course of business by a mercantile agent who is in possession of the documents of title with the consent of the owner ;

(*c*) when the transfer is by one of the joint co-owners;

(*d*) when the seller's right is voidable and has not till then been avoided ;

(*e*) when the transfer is by a seller in possession of the goods after sale ;

(*f*) when the transfer is by a purchaser in possession of the goods before his rights over the goods become absolute; or

(*g*) when the sale is by an unpaid seller in exercise of his lien or right of stoppage in transit.

(*vide* Sections 27 to 30 and 54(3) of the Indian Sale of Goods Act, 1930)

It has been suggested for documents of title to goods to be fully negotiable, a person holding them should get an unimpeachable title to the goods irrespective of any defect in the title of his transferor when he is a *bona fide* holder in due course. Do you consider it necessary or desirable to provide so ?

12.4.2 Under the UCC (Sections 7-502 and 7-503), a transferee to whom a document of title is negotiated acquires thereby —

(*a*) title to the document ;

(*b*) title to the goods ;

(*c*) all rights accruing under the law of agency or estoppel including rights to goods delivered to the bailee after the document was issued; and

(*d*) the direct obligation of the bailee to hold or deliver the goods according to the terms of the document, free of any defects or claim except those arising, under the terms of the document, or in specified circumstances.

These rights are also not ordinarily defeated by the exercise of any stoppage or surrender of such goods by the bailee and are not impaired even though the negotiation constituted a breach of duty or a person has been deprived of possession of the document by misrepresentation, fraud, accident, mistake, duress, loss, theft or conversion, or even though a previous sale or transfer of the goods or document has been made to a third party.

If you want to protect a *bona fide* holder in due course of a document, would you consider a provision on these lines satisfactory?

Group 5—Warehouse receipts

12.5.1 Would you like to enable, by legislation, all licensed warehouses to issue negotiable warehouse receipts ?

12.5.2 Do you consider that it would be necessary or desirable to provide by legislation for "field warehousing", namely, when the owner of the goods, such as a manufacturer, may keep the goods in his own place and have a warehouse company take control over the same so that it may issue a warehouse receipt for the goods even though they are in the premises of the owner ?

12.5.3 The Bombay Warehouses Act, 1959 (Section 32) provides that a receipt issued by a warehouseman, unless otherwise specified on the receipt, is transferable by indorsement and shall entitle its lawful holder to receive the goods specified on it. The Bombay

Warehouses Rules, 1960, provide for the issue of warehouse receipts both in negotiable and non-negotiable forms. Do you consider these provisions adequate ?

12.5.4 Under the Agricultural Produce (Development and Warehousing) Corporations Act, 1956, the Central and State Warehousing Corporations have been set up. Do you consider any amendment of law necessary or desirable for improving the status of the warehouse receipts issued by such Corporations ?

Group 6—Form of warehouse receipt

12.6.1 Do you consider the following as the essential features of a warehouse receipt, namely—

(*a*) the location of the warehouse where the goods are stored ;

(*b*) the date of issue of the receipt ;

(*c*) the consecutive number of the receipt ;

(*d*) a statement whether the goods received will be delivered to the bearer, to a specified person, or to a specified person or his order ;

(*e*) the rate of storage and handling charges, except that where goods are stored under a field warehousing arrangement a statement of that fact is sufficient on a non-negotiable receipt ;

(*f*) a description of the goods or of the packages containing them ;

(*g*) the signature of the warehouseman, which may be made by his authorised agent ;

(*h*) if the receipt is issued for goods of which the warehouseman is owner, either solely or jointly or in common with others, the fact of such ownership ; and

(*i*) a statement of the amount of advance made and of liabilities incurred for which the warehouseman claims a lien or security interest. If the precise amount of such advances made or of such liabilities incurred is, at the time of the issue of the receipt, unknown to the warehouseman or to his agent who issues it, a statement of the fact that advances have been made or liabilities incurred and the purpose thereof is sufficient.

(*vide* Section 7-202(2) of the UCC)

Do you consider that any other features are essential and have to be stated in the warehouse receipt ?

12.6.2 Do you favour a provision that a warehouseman should be held liable for damages sustained by a person by the omission to state any of the essential features ?

12.6.3 Under the UCC [Section 7-202(3)], a warehouseman may insert in his receipt, in addition to the essential features, other terms which do not impair his obligation of delivery or his duty of care. Do you consider such a provision necessary or desirable ?

Group 7—Delivery orders

12.7.1 Please indicate the types of delivery orders which are treated as negotiable in India. Are any of them mainly in use only in relation to certain types of goods and/or in certain parts of the country ? If you could, please send specimen copies of, and the terms and conditions applicable to, the delivery orders.

12.7.2 Do you consider the legal position as regards the Pucca Delivery Orders issued by jute mill companies satisfactory ? Do they qualify as decuments of title to goods ? Please give your views with reasons.

(*vide* decisions in I.L.R. 38 Cal. 127 ; A.I.R. 1961 S.C. 1214 and 70 C.W.N.741)

12.7.3 Under what terms and conditions the Tea Delivery Orders are issued ? If you could, please send specimen copies thereof. Do you consider the legal position as regards these delivery orders satisfactory ? Please give your views with reasons and suggestions, if any.

Group 8—Documents of title to goods issued by common carriers

12.8.1 Do you consider it necessary or desirable to provide for uniform rules, as in U.S.A., setting out the rights and liabilities of the consignors, consignees and the carriers in relation to documents of title issued by common carriers accepting goods for carriage by sea, rail or air ? Do you consider that it would also be possible to have such uniform provisions applied in relation to documents isued by common carriers carrying goods by road ? Please give your views with reasons.

12.8.2 In U.S.A., the bill of lading serves as a document for marine, rail or air transportation of goods. Do you consider that docu-

ments issued by common carriers evidencing the receipt of goods for carriage by any of such modes could be dealt with in India as bills of lading ?

12.8.3 In U.S.A., the definition of bill of lading covers also a freight forwarder's bills and bills issued by contract carriers. Do you consider that the definition of the bill of lading in India could be extended to cover such bills ?

Group 9—Bills of lading

12.9.1 As regards bills of lading evidencing carriage of goods by sea, do you consider that the law relating thereto requires any modification in any aspect ? If so, please give your views.

Group 10—Railway receipts

12.10.1 Do you consider the status of railway receipts in India as documents of title to goods satisfactory ? Please give your views with reasons.

(*vide* the decision in Morvi Mercantile Bank's case—A.I.R. 1965 S.C. 1954)

12.10.2 It is stated that the Railway authorities issue railway receipts with vague description of the goods consigned by the addition of the words such as "Said to contain". Do you consider that issue of railway receipts with such description of goods should be avoided ? If you consider that the Railway administration should be required to give full description of the goods for which they issue railway receipts, would you suggest any legal provision in this regard ?

12.10.3 It has been suggested that the Railway authorities should not ordinarily release goods, after obtaining suitable indemnities, without insisting on the production of the relative railway receipt. Do you agree ? If so, what measures you would suggest to ensure this ?

Group 11—Truck receipts

12.11.1 Do you consider the legal status of truck receipts as documents of title to goods satisfactory ? If not, please give your suggestions to improve them.

(*vide* A.I.R. 1968 Mysore 133)

12.11.2 The absence of uniform or standard practice among consignors, consignees, operators, banks and other financial institutions in relation to—

(*a*) the surrendering of the original truck receipt before goods covered by the receipt can be cleared ; and

(*b*) the right to the goods of the holder or of the transferee by indorsement of the truck receipt has affected the status of the truck receipts as negotiable documents of title to goods. Please give your suggestions to rectify this. Would you like to provide for this by legislation ?

Group 12—Air consignment note

12.12.1 Do you consider that the status of air consignment notes as documents of title to goods satisfactory ? Or, would you like to suggest any modification thereto ? Do you favour any statutory provision in this regard ?

Law relating to Loans and Advances by Banks and other Financial Institutions

While the general law relating to loans and advances by banks and other financial institutions is found mainly in the Contract Act, the Transfer of Property Act, the Stamp Act, the Registration Act and the English Common Law as applied in India, there are special provisions applicable to co-operative societies, companies and some statutory financial corporations. It is necessary that for the development of the credit system of the country, the laws as to loans and advances by financial institutions have to be simple, certain, flexible and capable of being adapted to the growing needs of the society. Hence, the law has to be reviewed having regard to the needs of the changing times and the developments in other advanced countries. To facilitate such review, the following Parts of the questionnaire have been framed with reference to the provisions of the aforesaid enactments and the law in certain other countries, especially U.K. and U.S.A.

Part 13—Loans and Advances by Banks—General

Group 1—Vis-a-vis the law in other countries

13.1.1 Do you consider it necessary or desirable that the law in India relating to loans and advances by banking and other allied institutions should, as far as possible, be in line with the law in other developed countries ?

13.1.2 Article 9* of the Uniform Commercial Code (UCC) of the United States of America sets out, in a codified form, a comprehensive scheme for the regulation of security interests in personal property and fixtures. But there is no such statutory scheme in India. Do you consider it necessary or desirable to have a similar statutory scheme in India ?

13.1.3 The Agricultural Credits Act, 1928** of U.K. contains special provisions for an easy and simple method of creation of charges in favour of banks in relation to their advances to the agricultural sector.

(*a*) Do you consider it necessary or desirable to have such special statutory provisions in favour of banks in India ? If so, would you like to have similar provisions applied in relation to all classes of banks ? Or, would you confine such provisions to any class of banks ?

(*b*) Do you consider that such special provisions should apply in relation to all types of advances by such banks or that they should be confined only to particular types of advances, such as advances to agricultural sector, small-scale industries, etc. ? If you favour the latter, please indicate the types of advances in relation to which such special provisions could be applied.

(*c*) Do you also consider it necessary or desirable that such special provisions should be available only in relation to advances by banks up to a specified sum ? If so, please indicate the limit.

Group 2—Special provisions relating to financial institutions

13.2.1 The co-operative credit societies and the land development banks have the benefit of special provisions† relating to creation of the charge, enforcement thereof, recovery of dues, etc.

(*a*) Do you consider that generally it is necessary or desirable to have similar provisions applied in relation to other classes of banks ? If not, would you favour their extension only to some class of them ; in which case, please specify.

(*b*) Do you favour the application of such special provisions in relation to all types of advances by such banks or do you regard that they should be confined to particular

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* Some of the salient features of Article 9 of the UCC are referred to in Parts 16 and 17 of the questionnaire.

** Some of the salient features of the Agricultural Credits Act, 1928 of U.K. are referred to in Parts 16 and 17 of the questionnaire.

† Some of the salient features of the Co-operative Societies enactments are referred to in Parts 14, 15 and 16 of the questionnaire.

types of their advances, such as advances to the agricultural sector, small-scale industries, etc.? If you favour the latter, please indicate the types of advances in relation to which such special provisions could be applied.

(*c*) Do you consider it necessary or desirable that such special provisions should be available only in relation to loans and advances up to a specified sum? If so, please indicate the limit.

13.2.2 The Industrial Finance Corporation Act and the State Financial Corporations Act have special provisions for facilitating the expeditious enforcement of their claims against the borrowers.

(*a*) Do you consider it necessary or desirable to have similar provisions applied also in relation to all classes of banks generally? If not, would you favour their extension to some of them; in which case, please specify them.

(*b*) Do you favour the application of such special provisions in relation to all types of advances by such banks or do you regard that they should be confined to particular types of advances, such as advances to the agricultural sector, small-scale industries, etc.? If you favour the latter, please indicate the types of advances in relation to which such special provisions could be applied.

(*c*) Do you consider it necessary or desirable that such special provisions should be available only in relation to loans and advances up to a specified sum? If so, please indicate the limit.

PART 14—LOCAL LEGISLATIONS AFFECTING BANK LENDING

Group 1—Land tenures and land reform measures

14.1.1 The land tenures, as modified by the land reform measures, do not give to all types of agriculturists an interest in the land which they could freely charge for their credit needs. What measures would you suggest to safeguard advances to agriculturists who are not in a position to offer land or any interest therein, as security.

14.1.2 It has been suggested that agriculturists having no rights to charge land under their personal cultivation should statutorily be given the right to charge the land, or their interests therein, in favour of a bank for the purpose of obtaining financial assistance for agricultural purposes. Are you in favour of such a measure?

14.1.3 It is said that from a purely banking point of view it is necessary that steps should be taken to remove all impediments to the free transfer of lands. Please state the present impediments in your State regarding the free transfer of lands, together with your suggestions for overcoming them. If such impediments are based on statutory provisions, please furnish, if you could, copies of such provisions.

14.1.4 The local legislations restricting the sale or mortgage of land generally provide for suitable exemptions, *inter alia*, in favour of co-operative banks. Generally do you favour such exemptions also in relation to all other classes of banks or only to certain classes of them (in which case, please specify) ?

14.1.5 It has been suggested that commercial banks should be exempted (as in the case of co-operative banks in some States) from the provisions of the local legislations providing for ceilings on, or against fragmentation of, holdings of agricultural lands. Do you consider this necessary or desirable ?

14.1.6 It has been suggested that agriculturists availing themselves of credit facilities from banks against a charge/mortgage of the lands under their cultivation should not be permitted to lease or create tenancy rights thereon without the permission of the lending bank. Do you agree that such a provision is necessary or desirable ?

14.1.7 Even in cases where the land could not ordinarily be sold in pursuance of a civil decree on account of any provision affecting agriculturists, it has been suggested that it should be allowed to be attached and sold through court when the decree is in favour of a bank. Do you agree ?

14.1.8 It has been suggested that in execution banks should be permitted to purchase in public auction, the property charged in their favour. Do you consider it necessary or desirable to provide for such a general provision in favour of banks ?

14.1.9 It has been felt that during the period banks are in possession of agricultural land charged in their favour, by subsequent purchase or otherwise, they should be permitted to lease out the property to any person subject to the conditions that the lease does not exceed one year at a time and that such lessee should not acquire any larger interest in the property notwithstanding any other local law. Do you consider such a provision as necessary or desirable ?

Group 2—Debt Relief legislation

14.2.1 It is said that the Debt Relief legislation comes in the way of the agriculturists availing themselves of necessary credit from financial institutions. Are you in favour of exempting all classes of banks from the purview of such legislation ?

14.2.2 Please state whether the Debt Relief legislation in your State exempts all or any classes of banks from the scope of its provisions.

14.2.3 If, in your State, any class of banks is not wholly exempted from the provisions of the Debt Relief legislation, please indicate the nature of the provisions applied to them and how, if at all, they adversely affect the banks concerned. If possible, please give the extracts of the relevant provisions.

Group 3—Moneylending legislation

14.3.1 As banking is a Central subject, do you consider that legislation relating to moneylending should not apply to banking institutions ?

14.3.2 Assuming that such legislation can relate to banking institutions, please state whether all or any of the provisions (please furnish copies of the relevant provisions) of the moneylending legislation in your State are applicable to any class of banks. If so, do you favour the exemption of all classes of banks from the applicability of such provisions ?

PART 15—CHARGE ON IMMOVABLE PROPERTY

A. INVESTIGATION OF TITLE

Group 1—General

15.1.1 It is felt that the present sources for determining title to land, especially agricultural land, are not satisfactory. Do you agree ? If so, have you any suggestions for providing expeditious means for the determination of title to land, especially, agricultural land ?

Group 2—Ascertainment of encumbrances on land

15.2.1 While the registration rules in some States, like Andhra Pradesh, Kerala and Tamil Nadu, provide for the grant of certificates showing the existence or otherwise of encumbrances over the

land, the rules in some other States do not so provide. Do you consider that it would be advantageous if the facility for granting "encumbrance certificate" could be extended to all the States ?

Group 3—Lis pendens

15.3.1 At present, a charge on immovable property in favour of the lending institution is subject to the result of any pending litigation in relation to the property, whether or not the lending institution has notice of the pendency of the litigation. Do you consider that it is necessary or desirable to provide for any means by which the lending institution could ascertain the existence or otherwise of any pending litigation relating to the immovable property to be charged ?

15.3.2 In Gujarat and Maharashtra, such charge is affected by the result of any pending litigation only if "a notice of the pendency of a suit or proceeding is registered under section 18 of the Indian Registration Act, 1908, prior to the creation of the charge. Do you consider it necessary or desirable to have a similar provision applied throughout India ?

(*vide* State amendments to Section 52 of the Transfer of Property Act and Section 18 of the Indian Registration Act)

Group 4—Torrens System of Land Title Registration

15.4.1 Under a system of land title registration (known as Torrens System) introduced in Australia, a certificate of title is issued to the holder of a land and any encumbrance or claim in relation to the land is recognised only if it is noted in that certificate. This scheme saves considerably the cost and time for ascertaining the title to land, and has been successfully adopted in Canada, U.K. and some other Commonwealth countries, Ireland, Philippines and many States of the United States of America. Do you consider that any such scheme is feasible and necessary or desirable in India ?

Group 5—Title deeds of agricultural lands

15.5.1 In the absence of title deeds, the determination of title to agricultural lands becomes difficult and this also affects adversely the cost of creation of charges on such lands. What measures would you suggest for overcoming this ?

15.5.2 It has been suggested that the State Governments should provide for the grant of title deeds to all holders of agricultural land. Do

you consider such an action necessary or desirable ? Please state if there are any provisions to this effect in your State. Could you please send copies of such provisions with your views on the experience gained so far in the working of the provisions and suggestions, if any, for their improvement ?

15.5.3 Do you consider that Patta, or Sanad, or other similar document should have the status of a document of title to facilitate creation of charges on agricultural lands ? Do you consider their present status satisfactory ? If not, would you like to have the position statutorily clarified ?

B. Creation of Charge/Mortage on Land

Group 6—Under the Transfer of Property Act

15.6.1 Do you consider that the different forms of mortgages and the different rights of the parties to such mortgages serve any useful purpose nowadays and do you like to retain them ? If not, what changes you would suggest ?

15.6.2 Are you in favour of providing for only two types of mortgages, *viz.*, possessory and non-possessory ?

15.6.3 Under the Transfer of Property Act (TPA), the mortgagee (excepting the Government) has the right of private sale only under certain specified circumstances. Are you in favour of conferring the right of private sale in relation to all mortgages ? Or, in any event, with reference to mortgages in favour of banks ? If not in relation to all classes of banks, at least in relation to some classes of them (please specify) ?

15.6.4 Under the TPA, though the mortgage is in English form, the right of private sale is not available if the parties to the mortgage belong to specified communities. Are you in favour of doing away with this distinction ?

15.6.5 Though the creation of mortgage by deposit of title deeds saves time, trouble and expense in registration, ordinarily the third parties have no means to know of the transaction. Would you suggest any method by which third parties could be put on notice of the transaction ?

15.6.6 Under the TPA, mortgage by deposit of title deeds could be created only in specified places. It has been suggested that at least all places with a minimum population (please specify the minimum) should be notified as places where such mortgage could be created. Do you agree ?

15.6.7 It has also been expressed that it would be dangerous to extend this facility to places where people are illiterate and backward. Do you agree ?

15.6.8 In some States, like West Bengal, the local law does not permit the creation of mortgages over agricultural land by way of deposit of title deeds. Please state such impediments, if any, in your State, for the creation of charges on lands by way of deposit of title deeds. If possible, please give the extracts of the relevant provisions. Please also state whether all or any classes of banks should be exempted from such provisions.

15.6.9 Under the TPA, where the mortgaged property is situated in Calcutta, Madras, Bombay, or other notified place a power of sale without the intervention of the court could be reserved under the mortgage deed. Do you feel that the places now notified are adequate ? If not, do you favour more number of places to be notified ? Can you give the criteria that should be applied, in your view, for notifying a particular place under this provision ?

Group 7—Cost of creation of charges

15.7.1 Do you favour the reduction of duty payable by all or any classes of banks on bonds and mortgage deeds ?

15.7.2 The Agricultural Credits Act, 1928 of U.K. exempts from stamp duty, instruments executed by cultivating farmers in favour of banks. Do you consider it necessary or desirable to extend a similar concession in favour of cultivating farmers in India ?

15.7.3 Persons availing themselves of credit from co-operative banks against charge/mortgage of their lands are not liable to pay any stamp duty or incur registration charges. It has been suggested that similar concession should also be available to agriculturist-borrowers of commercial banks. Do you agree ? Would you also like to provide for such concession in relation to advances by commercial banks to priority sectors, such as to small-scale industries ?

15.7.4 Certain State Governments, like Gujarat, Mysore and Tamil Nadu, are providing some concessions in relation to stamp duty and/or registration charges for agricultural loans and advances by commercial banks up to certain specified limits. Please indicate such type of concessions in your State. If possible, please give the extracts of the relevant provisions. Do you consider these concessions adequate ? If not, please state what further concessions should be given.

C. Special Provisions in Favour of Co-operative Societies

Group 8—Statutory Charge by declaration

15.8.1 The Co-operative Societies Acts provide for a charge on the immovable property, or any interest therein, of the borrower-member, being created by a declaration which is to be registered with the Registrar of Assurances. Do you consider that such a provision is a desirable one? If so, would you like to extend the benefit of such a provision to all classes of banks, or would you like to confine such a provision to any class or classes of banks?

15.8.2 Please give your experience, if any, on the working of the provision in the co-operative societies enactments providing for a charge by means of a declaration on the immovable properties of the borrower-member of a co-operative society.

15.8.3 If you are in favour of a charge on land that could be created by a mere declaration, do you consider it necessary or desirable that the borrower should be prohibited from subsequently transferring or further encumbering the property without the prior consent of the lending institution, as is now the position in the case of the declaratory charge in favour of co-operative societies?

15.8.4 Generally, a declaratory charge in favour of a co-operative society extends also to future advances that may be made by the society. If you are in favour of a declaratory charge, would you also like to cover the lending institutions' future advances? If so, should such charge extend to future advances only subject to such maximum as may be determined at the time of the declaration?

15.8.5 In your view, should the effect of the charge, as per declaration, be to give the financing bank priority over any secured claims excepting arrears of land revenue, or amounts due to Government recoverable as land revenue, or only as regards secured claims arising subsequent to the creation of the declaratory charge?

15.8.6 Would you prefer that a declaratory charge as above should be available to all types of lendings by banks or should it be confined to particular types of advances like advances to agricultural sector, small-scale industries, etc.? If you prefer the latter, please indicate the types of advances to which you would like to confine the scope of such a charge.

Group 9—Statutory first charge over land

15.9.1 The Uttar Pradesh Co-operative Societies Act, *inter alia*, provides in favour of a co-operative society a first charge (subject to priority in respect of certain Government dues) over the land when the loan is given for—

(*a*) irrigational development of the land ;

(*b*) purchase or redemption of the land ;

(*c*) purchase or construction of any house or building on the land ;

(*d*) reclamation or protection or for effecting improvement of the land ;

(*e*) preparing the land for orchard or plantation purposes.

Do you favour such a provision ? If so, would you like an extension of such a provision in favour of all or any classes of banks ?

Group 10—First charge over workshop, godown or other place of business

15.10.1 The Co-operative Societies enactments generally provide for a first charge on any "workshop, warehouse or business premises" acquired out of any loan of money given by the co-operative society. Are you in favour of such a provision being extended to all or any classes of banks ?

Group 11—Statutory first charge over unspecified properties

15.11.1 Under the Uttar Pradesh Co-operative Societies Act, when a loan is advanced for the purchase of cattle or other livestock or for acquiring agricultural implements or other equipments relating to transport, dairy or animal husbandry, a first charge is created on the land of the borrower-landlord in addition to the charge on the assets so acquired. Do you consider this provision a necessary or desirable one ? If so, do you favour that this provision could be extended to all or any classes of banks ?

15.11.2 The Orissa Co-operative Societies Act provides for a first charge (subject to priority in respect of certain Government dues), *inter alia*, on the lands of a member, or a past or deceased member, in respect of any debt or outstanding due from him to the society. Do you favour such a provision ? If so, would you like the extension of such a provision in favour of all or any classes of banks ?

Group 12—Priority of charge in favour of land development banks

15.12.1 The Co-operative Societies enactments generally provide for the mortgage in favour of land development banks ranking in preference to any claim of the Government arising out of any loan under the Land Improvement Loans Act granted after the execution of such mortgage deed. Do you consider it necessary or desirable for such priority to be given to medium-term or long-term loans that may be granted by all or any classes of banks ?

15.12.2 The Madras Co-operative Land Mortgage Banks Act, 1968 provides that a mortgage in favour of a land mortgage bank shall have priority over all other claims against the property secured by such mortgage, subject to the claims of Government in respect of land revenue. Are you in favour of this provision ? If so, would you like such priority to be made available in relation to advances by all or any classes of banks ?

D. Registration of Charges

Group 13—Registration in the Record of Rights

15.13.1 In the case of co-operative banks, there is a provision for registering the encumbrances in their favour in the Record of Rights. Do you consider that similar mention of the encumbrances in favour of all classes of banks should also be provided for in the Record of Rights ?

15.13.2 By giving a suitable statutory basis, could the Record of Rights be made to serve as a basic and reliable source for ascertaining the encumbrances over land ? If so, would you also like to provide that entering of a charge in the Record of Rights shall constitute notice of such charge to all persons who may be subsequently dealing with the property ?

Group 14—Registration of statutory charge

15.14.1 Do you consider that in cases where a statutory charge is provided on the immovable assets of a borrower, it is necessary for such charge to be duly registered with an authority so that third parties dealing with those assets of the borrower may have means of knowing the applicability of such charge in relation to his assets ? If you so agree, please indicate whether such registration could be provided for with the Registrar of Assurances or any other authority.

15.14.2 Under the Co-operative Societies enactments in the case of charges on "any workshop, warehouse or business premises," at present there seems to be no provision for registration. Do you consider it necessary or desirable for the registration thereof, so that third parties dealing with those assets of the borrower may have means of knowing the applicability of such charge in relation to those assets? If you so agree, please indicate whether such registration should be provided for with the Registrar of Assurances or any other authority.

Group 15—Registration with Registrar of Companies

15.15.1 In the case of companies, the registration is required to be made both with the Registrar of Companies and with the Registrar of Assurances. Do you consider that this dual system of registration is necessary? If not, do you favour that it would be adequate if a scheme of registration provides for registration with anyone duly constituted authority?

15.15.2 As in the case of companies do you consider it necessary or desirable to provide for a scheme of registration of charges on the assets of co-operative societies? If so, who should be the registering authority?

15.15.3 Mortgages over the assets of companies by way of deposit of title deeds do not suffer from the drawback of third parties dealing with the charged properties not knowing the existence of the transactions, in view of the provision for registration of such charges with the Registrar of Companies. As this considerably helps the companies to avail themselves of credit at less cost, do you consider that even in relation to the assets of borrowers other than companies, an inexpensive scheme of registration applicable to all types of charges could be evolved? If so, please give your suggestions in this regard.

Group 16—Registration by post

15.16.1 The Agricultural Credits Act, 1928* of U.K. provides for registration of an agricultural charge being effected by sending by post to the Land Registrar a memorandum of the instrument with other particulars of the charge together with the prescribed fees. Do you consider that a provision for registration of charge by post on these lines could be provided for in India?

* *Section 9(3):* "Registration of an agricultural charge shall be effected by sending by post to the Land Registrar at the Land Registry a memorandum of the instrument creating the charge and such particulars of the charge as may be prescribed, together with the prescribed fee; and the Land Registrar shall enter the particulars in the register and shall file the memorandum."

15.16.2 The Maharashtra Co-operative Societies Act provides that mortgages (or leases) in favour of land development banks need not be registered provided the development bank sends a copy of the deed to the concerned registering officer, and that such registering officer should file the copy in Book No. 1. In order to minimise the time taken, and avoid other procedural delay in registration, do you consider it necessary or desirable to provide on the aforesaid lines with reference to charge/mortgage in favour of all classes of banks?

15.16.3 The Co-operative Societies enactments of certain States provide that it shall not be necessary for an officer of a land development bank to appear in person or by an agent at any registration office in any proceedings connected with the registration of an instrument executed by him in his official capacity, or to sign as provided in Section 58 of the Indian Registration Act. Are you in favour of such provision? If so, would you like to provide so in relation to all classes of banks?

Group 17—Tax clearance certificates

15.17.1 Under Section 230A of the Income-tax Act, document creating charge over land (other than agricultural land) valued at more than Rs. 50,000 is not allowed to be registered unless the borrower produces tax clearance certificates. Do you consider that in relation to loans and advances granted by banks it is necessary to insist on the production of such certificates before the registration of the relative document charging such immovable property of the borrower?

Part 16—Charge on Movable Assets

Group 1—General

16.1.1 Please state the difficulties, if any, in obtaining movable assets as security for loans and advances. Do you consider that the law in relation thereto requires any modification? If so, please indicate the lines on which such modifications may be desired.

16.1.2 The law as regards taking movables as security (except as regards pledges) has no statutory basis and rests on the Common Law of U.K. as judicially interpreted in India. Are you in favour of codifying the law as regards taking movable assets as security for loans and advances?

16.1.3 In U.S.A., Article 9* of the UCC has codified the law as to taking of moveables as security. Are you in favour of any legislation in India on those lines ?

Group 2—Hypothecation—Nature of

16.2.1 Do you regard the hypothecation over the movable assets of their borrowers obtained by banks in India as creating in their favour only an "equitable charge" over the relative assets ? Please give your views with reasons.

(*vide* (1935) A. C. 53 at 64)

16.2.2 If you regard the hypothecation document obtained by banks as conferring in their favour only an "equitable charge", do you agree that as the law in India recognises no distinction between legal and equitable estates, such 'equitable charge" confers in favour of banks only personal rights and as such conveys no interest in property ?

(*vide* Mulla's Transfer of Property Act, 5th Edition, page 51)

Group 3—Hypothecation and future advances

16.3.1 Do you consider that at present it is legally necessary to specify the limit in relation to future advances up to which movable assets offered as security can be a valid cover ? If so, would you like to suggest any change to this position ?

16.3.2 In U.S.A., it is not necessary to indicate a ceiling limit up to which future advances could be secured against the security of moveables. Do you favour a provision on these lines ? If not generally, at least in relation to advances by banks and financial institutions ?

(*vide* Section 9-204(5) of the UCC)

Group 4—Hypothecation—After acquired property

16.4.1 Do you experience any difficulty in relation to hypothecation documents covering also after acquired property ? Would you like to have the position clarified in India ?

(*vide* in re Ambrose Summers, I.L.R. 23 Cal. 592)

16.4.2 In U.S.A., a charge over specified types of movable assets by way of security could cover also such types of after acquired properties

* Some of the salient features of Article 9 are dealt with in the questions that follow.

of the borrower. Are you in favour of a similar provision in India ?

(*vide* Section 9-204 of the UCC)

16.4.3 In U.S.A., a lender cannot obtain a security interest in the after acquired property of the borrower when the security relates to future crops coming into existence one year after the agreement creating the charge, unless such security is offered in conjunction with the interest in the land and is to last only so long as such interest lasts. Do you consider that provision on these lines is desirable in India in relation to hypothecation of crops ?

(*vide* Section 9-204(4)(*a*) of the UCC)

Group 5—Hypothecation—Enforceability against third parties

16.5.1 Hypothecation over movable assets obtained by banks is not enforceable against third parties dealing with such assets without notice of the transaction. What steps are taken to notify third parties of the hypothecatees' interest in such assets ? Do you consider that such steps are effective ? If not, would you suggest any measures to safeguard the interests of the lending institution ?

16.5.2 In relation to hypothecated assets of companies, registration of the banks' charge with the Registrar of Companies constitutes notice of the charge of third parties dealing with such assets. Hence, in relation to such charges, are any precautions, other than registration, taken to notify third parties of the charge ?

16.5.3 The provision in the Companies Act, 1956, providing for registration of the hypothecation in favour of banks with the Registrar of Companies enables companies to effectively create a charge over their stock-in-trade at low cost. Do you consider that it is necessary or desirable to have a similar position with reference also to borrowers other than companies ?

16.5.4 If you feel so, what measures you would suggest to ensure that hypothecation charge in favour of banks over the assets of borrowers other than companies are known to third parties dealing with the assets ?

16.5.5 Article 9 of the UCC provides a scheme for registration with a common authority, of charges over the movable assets of all types of borrowers. Do you consider that it would be necessary

or desirable to provide for a scheme of registration of hypothecation charges over the assets of all types of borrowers, including companies, with an authority to be constituted in this regard? If so, what type of machinery would you envisage for this purpose?

16.5.6 Under the Bills of Sales Acts of U.K., assignment of moveables, other than documents of title to goods, is ordinarily required to be registered. On similar line do you feel it desirable to provide for registration of mortgages over moveables in India?

16.5.7 Both under Article 9 of the UCC and the Bills of Sales Acts of U.K., an assignment, by way of security, of moveables has to be by a written instrument. Do you feel that it is necessary or desirable to provide so in India?

16.5.8 If you are in favour of providing for a scheme of registration in relation to hypothecation or mortgage of movable assets, would you like to exempt from such a scheme transactions below a a particular amount? If so, please indicate the limit.

Group 6—Hypothecation—Enforceability against Official Assignee/Receiver

16.6.1 Do you consider that at present, on the insolvency of the borrower, the banker has a preferential claim for his dues against the hypothecated assets in the possession of the borrower? Would you like to clarify the position? If so, how would you like to?

(*vide* I.L.R. 3 Cal. 58 ; 1895 A.C. 56 ;
I.L.R. 23 Cal. 592 and A.I.R. 1932 Cal. 680)

16.6.2 In U.K., a letter of hypothecation (synonymous with trust receipt) in favour of the banker takes the relative goods out of the purview of the reputed ownership clause in bankruptcy. Do you consider that the position in India should also be the same or different?

(*vide* in re Hamilton Young, 1905 (2) K.B. 381)

16.6.3 It is said that the reputed ownership clause in insolvency law will not apply to goods in the possession of the borrower and hypothecated to the bank provided the bank has taken such steps as displaying its name-board, posting its watchmen, etc. on the premises where the goods are kept. Do you consider that the position in this regard is sufficiently clear? If not, would you like to provide that on such steps having been taken by the banker, the preferential claim of the banker shall not be

affected by reason of the reputed ownership clause on the insolvency of the borrower ?

16.6.4 If you are in favour of such a provision, what steps you would expect a banker or a lending institution to take for excluding the relative goods from the operation of the reputed ownership clause ?

16.6.5 It has been felt that the doctrine of reputed ownership is a serious invasion on the rights of the owner and the tendency of the courts in England has been to limit its application within narrow limits. Please give your views on the same.

16.6.6 Would you like to exclude from the scope of the reputed ownership clause the hypothecated assets of borrowers ? If not generally, at least in relation to hypothecation in favour of banks and financial institutions ?

16.6.7 Do you consider that the reputed ownership clause has any application in relation to winding up of companies ?

(*vide* Section 529 of the Companies Act, 1956)

16.6.8 In any event, do you consider that the hypothecated assets of companies would go out of the reach of the reputed ownership clause provided the relative hypothecation has been duly registered with the Registrar of Companies ?

16.6.9 Do you consider that if hypothecation of assets of all types of borrowers could be registered with a public authority, the interest of the lender would be adequately protected on the insolvency of the borrower ?

Group 7—Hypothecation—Motor vehicles

16.7.1 Have you noticed any difficulty in enforcement of a charge in favour of the lending institution over motor vehicles ? If so, please state them with your suggestions, if any, for remedying the same.

16.7.2 In all the States, do the existing rules and enactments relating to motor vehicles permit the noting, in the registration certificate, of the charge in favour of the lender against the vehicles ? If not, would you suggest any specific provision therefor ?

(*vide* Section 31A introduced by the Motor Vehicles Amendment Act, 1969)

16.7.3 In U.S.A.* a charge against a motor vehicle, trailer or any equipment or accessories fixed or shown to be fixed thereto is not valid against persons not having notice thereof unless and until the charge is registered in the registration certificate of the vehicles. Do you consider that a provision on these lines is necessary or desirable in India to safeguard the interests of the lending institutions and third parties dealing with motor vehicles ?

16.7.4 In U.S.A.* any charge or lien in relation to a motor vehicle is also indicated in a register maintained by an official, which is available to the public for inspection. Do you consider it desirable or necessary to have similar provisions in India with reference to charges over motor vehicles ?

16.7.5 In U.S.A.* the person having the first charge in relation to a motor vehicle has the right of claiming possession of the registration certificate. Do you consider it necessary or desirable to statutorily provide in India for such a right in favour of the lending institutions ?

Group 8—Hypothecation—Stamp duty

16.8.1 Generally, hypothecation documents are subjected to stamp duty as mortgage of moveables ; but, the duty on attested instruments evidencing agreements relating to hypothecation is reduced to the duty leviable on agreements relating to deposit of title deeds, pawn or pledge, while the duty on such unattested instruments is remitted. Do you consider that the reductions and the remissions in relation to hypothecation documents are adequate in all the States ? If not, please give your suggestions in this behalf.

16.8.2 While duty on unattested hypothecation documents over assets other than crops is generally remitted, duty on hypothecation document covering crops is on an *ad valorem* basis. Do you consider that in the interest of facilitating advances to the agricultural sector, it is necessary or desirable to remit the duty payable on instruments evidencing hypothecation of crops ?

Group 9—Hypothecation—Priorities

16.9.1 As between persons claiming the same asset as security on what basis you would like to determine the order of priority ? Would

* *vide* Chapter 7, Title 40 of the District of Columbia Code, 1967 Edition.

you like this to be on the basis of the date of creation of the charge or the date on which possession is taken pursuant to the charge, or the date on which action is initiated on the charge? If there is a provision for registration and the charges are registered, how would you like to determine priorities?

(*vide* A.I.R. 1932 Cal. 524; (1935) 62 Cal. 1046; and 1933 (40) C.W.N. 625)

16.9.2 In U.S.A., ordinarily the priorities between conflicting claims over the same asset as security are decided in the following order:

(*a*) In the order of registration if both the conflicting claims are registered;

(*b*) The registered claim in preference to the unregistered one, irrespective of the date of creation of the charge;

(*c*) In the order of creation of the charge when both the conflicting claims are not registered.

Would you generally favour a provision on the aforesaid lines to settle the rules as regards priority in India?

(*vide* Section 9-312(5) of the UCC)

16.9.3 In U.S.A., charges in relation to the following types of advances are ordinarily given a special preference over other types of charges on the same asset:

(*a*) Finance towards current crop production—in relation to such crops.

(*b*) Financing the acquisition of stock-in-trade or other asset—in relation to such stock-in-trade or other asset.

(*c*) Financing the acquisition of replacements of parts, etc., of machinery or other goods (accessions)—in relation to such accessions as against a claim on the machinery or other goods.

Do you consider that it is necessary or desirable to provide in India for such preferential claim in relation to such types of financing?

16.9.4 Do you consider that under the following circumstances, the interest of the first hypothecatee is protected:

(*a*) A subsequent hypothecatee taking possession of the hypothecated asset either with or without notice of the earlier

hypothecation (*vide* (1871) 3N.W.P. 54 ; (1871)3N.W.P. 71 ; and (1866) 5 W.R. 189)?

(*b*) The borrower pledging the hypothecated goods with another person who has or has not notice of the earlier hypothecation (*vide* 1918 (42) Mad. 59 ; 1929 (56) Cal. 868 ; 25 Mad. 406 ; (1874) No. 70 Punj. Rec. 223 ; and 10 I.C. 869) ?

(*c*) When a subsequent pledgee sells the hypothecated asset (*vide* 1920 (1) Lahore 422 ; 1924 (47) M.L.J. 704 ; 1927 (5) Rangoon 633 and 1887 (10) Allahabad 20)?

(*d*) When the subsequent hypothecatee comes to the court first (*vide* 1933 (40) C.W.N. 625) ?

(*e*) When any person subsequently obtains with or without notice a legal mortgage over the goods covered by the earlier hypothecation agreement in favour of the bank ?

Do you consider that the first hypothecatee's interests are not adequately protected in all or any of the above cases ; if you do, please indicate what statutory provision need be made to safeguard his interests ?

Group 10—Hypothecation—Proceeds

16.10.1 Do you consider that at present the hypothecatee has a valid claim to the sale proceeds of the goods hypothecated to him ? If not, do you consider it necessary or desirable to recognise such claim ?

(*vide* I.L.R. 5 Mad. 330)

16.10.2 In U.S.A., the lender's claim over the secured asset could cover also any identifiable proceeds (which may be cash proceeds or non-cash proceeds) thereof including collections received by the borrower. Do you consider it necessary or desirable to provide so in India ?

(*vide* Section 9-306 of the UCC)

16.10.3 In U.S.A., the lender's claim ordinarily continues not withstanding the sale, exchange or other disposition by the debtor of the secured asset, unless disposition is authorised by the lender. Do you favour such a position in India ?

(*vide* Section 9-306 of the UCC)

16.10.4 In U.S.A., when the secured goods have become part of a product or mass, the interest of the lender is continued in such product

or mass even if the identity of the secured asset is lost in the course of manufacturing, processing, assembling or mingling them. The extent of the lender's interest is determined on the ratio of the cost of the secured asset to the cost of the total product or mass. Do you consider it necessary or desirable that a hypothecatee s interest need be preserved also when the identity of the asset is lost in the course of such manufacture, etc. ? If so, would you favour the UCC position ?

(*vide* Section 9-315 of the UCC)

Group 11—Hypothecation—Rights of a hypothecatee

16.11.1 Do you consider that the rights of the hypothecatee in the event of default are adequate to preserve and enforce his claim against the hypothecated asset ?

16.11.2 It is said that the effect of hypothecation obtained by banks gives them only a right of realisation by judicial process in case of non-payment of the debt. Do you agree ? If so, do you consider that in the interest of the lending institution and to make hypothecation a more acceptable form for advances by banks, the hypothecatee should be given any further rights in relation to such asset ?

16.11.3 In the event of the borrower defaulting, have you noticed any difficulties in getting possession of the hypothecated assets ? If so, please state them and give your suggestions regarding them.

16.11.4 Where the borrower refuses to part with possession, but possession is nevertheless taken by the creditor, do you consider that the hypothecatee has the right of private sale in relation to the goods as a pledgee ? Do you consider that it is necessary or desirable to clarify the position ?

(*vide* Section 148 of the Indian Contract Act and Sections 2(2) and 66(3) of the Indian Sale of Goods Act).

16.11.5 In U.S.A., in respect of secured asset in the hands of the borrower, the lender has the following rights when the borrower defaults :

(*a*) the right of foreclosure or judicial sale ;

(*b*) the right of direct collection of intangible assets like book debts, negotiable instruments and documents of title to goods ;

(*c*) the right to take possession of the secured assets and obtain control over any proceeds to which the security interest

extends—this could be without judicial process if this can be done without breach of peace; if not, by judicial action;

(*d*) the right to sell, lease or otherwise dispose of any or all of the security in its then condition or following any commercially reasonable preparation or processing—this could be done (except in the case of negotiable instruments or documents of title to goods) even when the assets are lying in the debtor's premises, provided the disposal is as per reasonable commercial standards ;

(*e*) the right to appropriate the security in satisfaction of the dues when the borrower and others having interest therein do not object to such appropriation within a specified time.

(The rights are cumulative and are not in the alternative)

Do you consider that it would be desirable or necessary to provide in India for such remedies in favour of the lender in relation to hypothecation charges ?

16.11.6 Do you consider that at present the hypothecatee has any right to "accessions" of the hypothecated assets ? If not, do you consider it necessary or desirable to give such rights to the hypothecatee ?

Group 12—Floating charge over moveables—Nature of

16.12.1 In U.K., a floating charge is defined as "an equitable charge on the assets for the time being of a going concern". Do you regard a floating charge in India as creating an "equitable charge" or a "legal charge"?

(*vide* 1897 A.C. 81 at 86)

16.12.2 If you consider a floating charge as conferring only an "equitable charge" in favour of the lender, do you regard that in India by the creation of such a charge a lender would get an interest in property or only personal rights enforceable against the immediate parties and others dealing with the property with notice thereof?

(*vide* Mulla's Transfer of Property Act, 5th Edition, page 51)

Group 13—Floating charge—How determined

16.13.1 How do you obtain a floating charge over the movable assets of the borrower for advances ?

(To be answered by banks and financial institutions)

16.13.2 It has been stated that floating charge is created when —

(*i*) the assets charged are both present and future ;

(*ii*) the assets are in a state of flux ; and

(*iii*) the borrower is allowed to carry on business in such assets in the ordinary way until some step is taken by the floating charge holder.

Do you agree that a document containing the above provisions would create a floating charge ?

(*vide* 1888 (13) A.C. 520 ; 1897 A.C. 81 ; 1904 A.C. 355 ; and 1910 (2) K.B. 979)

16.13.3 Do you regard the hypothecation obtained by banks in India over the stock-in-trade of the borrower as creating in their favour only a floating charge ?

(*vide* also 1926 (50) Bom. 547 ; and
1926 (54) Cal. 513)

Group 14—Floating charge—Companies and others

16.14.1 Do you consider that it is legally permissible to create floating charges over the assets of borrowers other than companies ? Are you aware of the creation of such charge ?

16.14.2 If a floating charge is only an "equitable charge" in India and confers only personal rights, and it is enforceable only against those having notice thereof, do you consider that there is an impediment in floating charge being obtained over the assets of borrower other than companies ?

16.14.3 Do you consider that floating charge obtained by banks over the assets of borrowers who are companies is more secure by reason of the provision as to registration ? If so, would you consider that to make the floating charge an acceptable form of security also in relation to borrowers other than companies, it is desirable to provide for a scheme of registration of such floating charge ?

Group 15—Floating charge—Agricultural Credits Act, 1928 of U. K.

16.15.1 In U.K., a cultivating farmer is statutorily enabled, *inter alia*, to create in favour of a bank a floating charge in respect of his farming stock and other agricultural assets as security for his obligations to the bank. Do you consider it necessary or desirable to so statutorily provide in India ?

16.15.2 In U.K., after a floating charge is so created, any fixed charge on, or a bill of sale comprising any of, the property comprised in the floating charge, is void so long as the floating charge is in force. Do you consider that it would be conducive to the financing of agriculture by banks if there could be a similar provision in India ?

16.15.3 In U.K., such a floating charge is specifically excluded from the operation of the reputed ownership clause on the insolvency of the borrower. Do you consider that it is necessary or desirable to have similar provision in India ?

16.15.4 In U.K., all agricultural charges, including floating charges, are required to be registered with the Land Registrar. Such registration constitutes notice to all persons and for all purposes connected with the property comprised in the charge. Do you consider that provisions on similar lines would be necessary or desirable in India ?

Group 16—Floating charge—Registration

16.16.1 It has been suggested that the Registration Act should be amended to provide for registration of floating charges with the Sub-Registrar in Book I (which is available for inspection by public). Do you consider it necessary or desirable ?

Group 17—Pledge—Documents of title to goods

16.17.1 Do you consider that there is any difficulty in India for borrowers creating a pledge on their goods by pledging the documents of title relating thereto ?

(*vide* Morvi Mercantile Bank's case, A.I.R. 1965 S.C. 1954)

16.17.2 By reason of receipts issued by carriers for carriage of goods, like truck receipts, not qualifying as documents of title to goods, it is felt that banks are not in a position to advance against the goods covered by the relative documents by the pledge of such document. Have you any suggestions to facilitate the pledge of such goods by lodging the relative document as security ?

(*vide* A.I.R. 1968 Mysore 133)

Group 18—Pledge—Shares

16.18.1 It is felt that the distinction between pledge and mortgage of shares is not clear and gives rise to avoidable litigation. How do you

like to make a distinction between these? Or would you prefer to statutorily provide for the rights of parties when advances are made against the security of shares?

(*vide* A.I.R. 1956 Patna 32; and A.I.R. 1960 A.P. 273)

16.18.2 Do you consider that ordinarily a pledgee of shares should have his claim extended also to cover the dividends, rights and bonus shares issued in respect of the shares originally pledged?

(*vide* A.I.R. 1969 Delhi 313)

Group 19—Pledge—Stock-in-trade

16.19.1 Some banks obtain a pledge over goods relying on the doctrine of constructive possession, *viz.*, by displaying name boards and locks bearing the bank's name affixed to godowns, premises, etc., where the pledged goods are stored and stationing godown watchmen. In some cases, the stationing of watchmen is also waived and keys to the premises are left with the borrower against an agreement that the keys are retained by him for the express purpose of obtaining access to the goods for processing and manufacturing. How would you rate the status of the security? Could it rank as a pledge or as a hypothecation?

16.19.2 (To be answered by banks and financial institutions) Have you experienced any difficulty in establishing your claim to goods covered by key loan advances in the event of—

(*i*) the insolvency of the borrower; and

(*ii*) the borrower fraudulently further pledging the goods in favour of another person who may take the goods with or without notice of the earlier pledge?

16.19.3 (To be answered by banks and financial institutions) What precautions you take to ensure that you retain control over the stock-in-trade pledged in your favour and in regard to which the borrower is given the right of disposal?

16.19.4 How would you distinguish between pledge of specific assets left in the borrower's business premises with a licence to the pledgor to dispose of them in the course of his business and a floating charge in relation to such assets? If this distinction is not clear under the law as at present, would you like to set out the criteria on which a distinction could be based? If so, would you like to have them statutorily provided for?

(*vide* 1926 (50) Bom. 547; and 1926 (54) Cal. 513)

Group 20—Pledge—Registration

16.20.1 In relation to company-borrowers, as there is no provision for registration of the pledge over their assets as distinct from a hypothecation of such assets, the bank ceases to have any protection if it allows the borrower to deal with the goods and the company fraudulently charges or disposes of the goods to persons having no knowledge of the pledge. This implies that when the goods are completely left in the possession and control of the borrower as in the case of hypothecation, the interest of the lending institution is comparatively more secure rather than when borrower is allowed to deal with the goods for a limited purpose. In view of this, do you consider it necessary or desirable to permit registration also of such type of pledge transactions ?

(*vide* Sections 125 and 126 of the Companies Act, 1956)

16.20.2 If you favour any provision for registration even in relation to pledges, would you consider it necessary or desirable to extend the scheme also to cover pledge over the assets of borrowers other than companies ?

Group 21—Trust receipts—Nature of

16.21.1 It has been stated that from the banker's point of view trust receipts may be considered valueless in view of the legal decisions in our country in relation to them. As granting of trust receipt facilities by banks in India, it is felt, would stimulate the commercial development of the comparatively smaller traders and dealers, what measures would you suggest for safeguarding the rights of the lender who parts with the pledged goods against trust receipts ?

(*vide* Indian Central Banking Enquiry Committee Report, 1931, para. 565 ; and Tannan on Banking, 12th Edition, page 382)

16.21.2 In Mercantile Bank of India Ltd. *v.* Chartered Bank of India, Australia and China and Strauss & Co. Ltd. (in liquidation) [(No. 2) (1937 (4) All E.R. 651)], it was held that instruments headed "trust receipts" did not create a trust and, therefore, not registrable under the Indian Trusts Act, 1882, but that such instruments created an equitable charge. In view of this, would you regard trust receipts as creating in favour of the lending institution any charge on the property and the relative advances as secured ?

(*vide* Paget, 7th Edition, page 550 ; and Mulla's Transfer of Property Act, 5th Edition, page 51)

16.21.3 While on the insolvency of a borrower, goods released against trust receipts are not affected by the reputed ownership clause in U.K., in India they are. Do you consider it necessary or desirable to effect a change in this regard ?

(*vide* in re Hamilton Young, 1905 (2) K.B. 381 ; and A.I.R. 1932 Cal. 680)

16.21.4 Over the goods or documents of title relating thereto released to the borrower-pledgor for the purpose of disposal or for other special purposes against trust receipts, it has been held that no valid trust is created in favour of the pledgee-bank. Do you consider it necessary to impress such goods with the character of trust property ?

16.21.5 It has been held that when documents of title to goods are released to the borrower for the disposal of the goods, against a trust receipt, the borrower qualifies as a mercantile agent and that any unauthorised pledge of the documents of title by him will give such subsequent pledgee an effective pledge over the relative goods. Would you suggest any measures to protect the lending institution releasing the documents against trust receipts from such contingencies ?

(*vide* 1938 (2) K.B. 147)

16.21.6 It has been felt that it may not be possible under the present law to prosecute a borrower to whom the goods are leased against a trust receipt, if he subsequently deals with them unauthorisedly. Do you consider that the borrower should be made criminally liable for unauthorisedly dealing with the assets covered by the trust receipt ?

Group 22—Trust Receipt—Legislation in U.S.A.

16.22.1 In U.S.A. the law relating to trust receipts is now codified as part of the law relating to the creation of security over moveables. Do you consider it necessary or desirable to codify in India the law relating to trust receipts ?

Group 23—Trust Receipt—Special legislation

16.23.1 In order to provide for the spread of trust receipt facility, do you consider it necessary or desirable to promote any special legislation for making trust receipts a more acceptable form of security for advances by lenders ? If so, whether or not you consider that the scope of such legislation should be confined only to trust receipts obtained by banks and other financial institutions ?

16.23.2 It has been expressed that the basic features of a trust receipt legislation should be—

(*a*) to define what is a trust receipt ;

(*b*) to set out the types of financial transactions in which, and the parties by whom, trust receipts may be employed within the protection of the Act ;

(*c*) to clarify the nature of the security interest which will be afforded by the trust receipt in the several types of transactions in which it may be employed ;

(*d*) to provide a machinery for registration of trust receipts or particulars thereof with a view to afford notice to third parties ; and

(*e*) to regulate the conditions under, and the circumstances in, which the lender in a trust receipt transaction will be protected against the claims of the borrower's trustee or liquidator in insolvency and those of third party purchasers or pledgees for value.

Do you consider that legislation in relation to trust receipts should provide for the above ? Or, would you like such legislation to cover also any other matters ? Please give your suggestions, if any, with reference to the matters you would like such legislation to cover.

Group 24—Comprehensive scheme of legislation regarding charges on movable assets

16.24.1 The rights of parties in relation to charges over movable assets are now mainly determined having regard to the form of the document obtained from the borrower, *e.g.*, whether the document is considered as evidencing a mortgage, hypothecation, pledge, floating charge or trust receipt over the relative movable assets. Do you consider it necessary or desirable to have the rights of parties in relation to a secured transaction determined mainly on the substance of the arrangement, such as the nature of the security, the purpose of the advance, whether it is possessory or not, whether there are means for the third parties to have a notice of the arrangement or not ?

16.24.2 Article 9 of the UCC provides for a "simple and unified structure within which the immense variety of present day secured financing transactions can go forward with less cost and greater certainty . . . The traditional distinctions among security devices based largely on form are not retained". Do you consider it necessary or desirable to have a similar unified scheme relating to charges over movable assets in India ?

16.24.3 Under Article 9 of the UCC, the rights of persons are determined essentially having regard to whether—

(*a*) the asset secured is in the possession of the lender or is left with the borrower or a bailee ;

(*b*) the charge is in respect of assets in existence or to be acquired later ;

(*c*) the charge secures an advance for enabling the borrower to acquire the asset charged or it relates to asset to which the borrower is already entitled ;

(*d*) the charge is perfected (*e.g.*, by registration or possession) or it remains unperfected ;

(*e*) the assets are tangible goods, such as "consumer goods", "equipment", "farm products" or "stock-in-trade", or intangibles, such as documents of title to goods, negotiable instruments or chattel paper (*e.g.*, hire-purchase agreement) or book debts or other contractual rights.

Do you consider it necessary or desirable to have a scheme of legislation determining the rights of parties essentially having regard to the aforesaid criteria ?

16.24.4 If you are in favour of such a legislative scheme, would you, or would you not, like that to cover the following types of trasactions :

(*a*) mortgage over moveables ;

(*b*) hypothecation over moveables including actionable claims ;

(*c*) floating charge over moveables ;

(*d*) trust receipt for moveables ;

(*e*) pledge of moveables including documents of title to goods ;

(*f*) hire-purchase financing of goods ?

16.24.5 The UCC provides generally for registration of charges (in relation to non-possessory claims), which not only makes information in the registers more easily accessible but also reduces considerably the cost of procuring credit information. Do you consider it necessary or desirable to evolve a similar scheme in India ?

Group 25—Special provisions for banks

16.25.1 Under the co-operative societies enactments, the co-operative banks get a statutory first charge—

(*a*) upon the crops or agricultural produce of the member for the raising of which the loan was taken from the co-operative bank by the member ;

(*b*) upon the cattle, fodder for cattle, agricultural produce or industrial implements, machinery or raw materials for manufacture supplied or purchased in whole or in part out of the loan given by the co-operative bank or upon any articles manufactured from the raw materials so supplied or purchased.

Do you consider it necessary or desirable to provide for such first charge in relation to such advances given by all or any classes of banks ?

16.25.2 The Gujarat Co-operative Societies Act, 1961, provides that the society shall have a first charge (subject to Government's dues in respect of land revenue) for the dues of a borrower-member, *inter alia*, upon "any movable property which may have been hypothecated, pledged, or otherwise mortgaged by him with the society and remaining in his custody". Do you consider it a desirable provision in the light of the equities to be observed between different classes of lenders ? If so, would you like to give such first charge in relation to such security in favour of all or any classes of banks ?

16.25.3 Under the co-operative societies enactments, a property subject to the aforesaid charge is not to be sold or otherwise transferred or converted in any manner without the permission of the society. Are you in favour of such a provision in relation to all or any classes of banks ?

16.25.4 Under the co-operative societies enactments in certain States, *e.g.*, Tamil Nadu and Pondicherry, a co-operative bank has the power of calling upon the borrower-member or his representative to deposit with or entrust to the custody of the co-operative bank property which is subject to such charge until the debt or outstandings are fully paid, the expenses in connection therewith to be borne by the borrower-member or his representative. Do you consider that it is necessary or desirable to have a similar provision in favour of all or any classes of banks ?

16.25.5 In relation to such priorities in respect of advances by co-operative banks, do you consider it necessary or desirable to provide for a

scheme of registration of such charges to enable others dealing with the charged assets to have notice thereof? If you consider so, please give your suggestions as to the scheme of registration that could be contemplated in this behalf.

PART 17 — CHARGE ON FIXTURES

Group 1 — General

17.1.1 Please state the difficulties, if any, you are aware of, in relation to advances against machinery or other movable assets which are, or which are to be, attached or annexed to immovable property.

Group 2 — Distinction between movable and immovable assets

17.2.1 The mode of creation and the manner of enforcement of a charge on a fixture now depends mainly on the question whether the fixture is a movable or an immovable asset. Do you consider that while making advances against fixtures, such as, machinery and other like assets, the question whether they are movable or immovable assets is easy of determination?

17.2.2 It has been stated that to decide whether a fixture is a movable or an immovable asset, "certain tests have been formulated in particular contexts, which, if literally applied, may not yield always a proper and correct result" and that "while general tests pointed out by judicial decisions, in the light of specific facts, may be borne in mind, eventually the decision on the question should depend upon how the Court, looking at the facts as a whole, feels on the matter". In view of this, do you consider that the rights and obligations of parties while making advances against fixtures should be made to depend on the question whether ultimately the asset would be regarded as "movable" or "immovable" by the Court?

(*vide* 1968 (2) M.L.J. 493=A.I.R. 1969 Mad. 346; and 1968 (2) M.L.J. 596)

17.2.3 Under the UCC* the rights and obligations of parties in relation to advances against fixtures (other than goods such as lumber, bricks, tiles, cement, glass, metal work and the like incorporated into an immovable structure) are determined without reference to the question whether the fixture is to be regarded as a movable or an immovable asset. Do you consider that while dealing with finance against fixtures it is necessary or desirable to so determine the rights and obligations of parties in India?

* Some provisions of the American scheme relating to fixtures are referred to in the questions that follow.

Group 3—Charge on machinery, etc., which subsequently become fixtures

17.3.1 Do you consider that the mode of creation of a charge over machinery or other like goods should depend on whether or not such asset is subsequently going to be a fixture and an immovable asset ?

17.3.2 Do you consider that at present the hypothecation or other charge over machinery or other like goods (on the basis that they are movable assets) is affected when subsequently such asset becomes a fixture and an immovable asset ? Or, do you consider it necessary or desirable to clarify the position in this regard ?

17.3.3 Under the UCC, a secured claim over machinery or other like goods is not affected by reason of the fact that such asset has become a fixture and an immovable asset. Do you consider it necessary or desirable to provide so in India ?

Group 4—Priority as to fixtures

17.4.1 How are the rights of those claiming a charge on the fixture and those claiming a charge on the immovable structure of which the asset is a fixture, now reconciled ? Do you consider that the position in this regard is not sufficiently clear ? If so, would you like to have it statutorily clarified ?

17.4.2 In U.S.A., a charge, on machinery or other like goods, which attaches *before* they become fixtures, generally takes priority in relation to such fixture over the claims of all persons who have an interest in the real estate. Are you in favour of such a general provision ?

(*vide* Section 9-313 of the UCC)

17.4.3 In U.S.A., a charge over machinery or other like goods created *after* they became fixtures is generally valid only against persons acquiring interest in the real estate subsequent to the creation of the charge over the fixture, but not against any person already having an interest in the real estate unless he acquiesces to the charge on the fixture. Do you feel that a provision on these lines is necessary or desirable in India ?
(*vide* Section 9-313 of the UCC)

17.4.4 In U.S.A., a charge on such fixture does not rank in priority over the claims of—

(*a*) subsequent purchaser for value of any interest in the real estate ; or

(*b*) a creditor with a lien on the real estate subsequently obtained by judicial proceedings ; or

(*c*) a creditor with a prior encumbrance on record on the real estate to the extent that he makes advances

if such subsequent purchase/lien/advance is made/obtained/contracted without knowledge and before perfection (*e.g.*, registration) of the charge on the fixture. Do you consider that if the charge on the fixture is to be maintained against persons claiming interest in the real estate, the aforesaid classes of persons should be exempted ?

(*vide* Section 9-313 of the UCC)

Group 5—Fixtures—Rights of a charge holder

17.5.1 Do you consider that when a lending institution obtains a charge on machinery or other like goods, it can have the right of removing the fixture from the real estate ? Would you like a specific provision on these lines ?

17.5.2 In U.S.A., a person advancing against a fixture may, on default by the borrower, remove the fixture from the real estate, but he must reimburse any encumbrancer or the owner of the real estate (other than the debtor) for the cost of repair of any physical injury, but not for any diminution in value of the real estate, caused by the absence of the goods removed or by any necessity for replacing them. Do you consider that it is necessary or desirable to have such a provision in India ?

(*vide* Section 9-313(5) of the UCC)

17.5.3 Do you consider it necessary or desirable to provide for the lending institution advancing against fixture the same rights as are allowed to it if it were a mere charge on a movable asset ?

Group 6—Fixtures—Registration of charge thereon

17.6.1 Do you consider it necessary or desirable to provide for a scheme of registration of charges over the fixtures, whether they are part of the real estate or not ?

17.6.2 Under the UCC, a charge on a fixture is ordinarily perfected only if it is registered. Do you consider it necessary or desirable to provide so in India ?

17.6.3 In U.S.A., a charge on goods which are, or which are to become, fixtures is ordinarily required to be registered in the office where a mortgage on the real estate concerned would be registered. Do you consider that charges on goods which are, or which are to become, fixtures could be required to be registered with the concerned Sub-Registrar in India? If so, would you like them also to be registered with the Registrars of Companies (as is now done)?

(*vide* Section 9-401 of the UCC)

17.6.4 If charges on fixtures are required to be registered, would you like to ensure that the cost of such registration by way of stamp and registration charges is eliminated or reduced to the minimum in order to facilitate advances against fixtures by banks?

Group 7—Charge on fixtures vis-a-vis special provisions in favour of co-operative banks

17.7.1 Under the co-operative societies enactments, a co-operative bank/land development bank is given a priority to recover its dues against the immovable assets of the borrower. Do you consider that to facilitate advances against fixtures by commercial banks and other financial institutions, it is necessary or desirable to provide that such priority in favour of the co-operative bank/land development bank does not come in the way of the charge in favour of the institution financing against the fixtures?

Group 8—Uniform legislation to cover also fixtures

17.8.1 Under the American scheme, the codification of the law as to transactions secured against movable assets covers also those secured against fixtures, and the general provisions also apply to fixtures as security, so far as they may be. On similar lines, do you consider it necessary or desirable for a scheme of legislation covering charges over movable assets to cover also fixtures, whether they are regarded as movable or immovable assets?

PART 18—GUARANTEES

Group 1—General

18.1.1 Please specify the legal difficulties, if any, felt in relation to—

(*i*) guarantees issued by banks; and

(*ii*) guarantees taken as security for loans and advances granted by banks.

Group 2—Guarantees in relation to international transactions

18.2.1 The International Chamber of Commerce has felt the need to draw—

(*a*) standardised terminology ;

(*b*) model clauses for specimen contracts of guarantees ; and

(*c*) a set of general conditions

in relation to tender guarantees, performance guarantees and repayment guarantees issued by banks and other financial institutions with reference to international transactions. Do you consider it necessary or desirable to promote such standardisation of terms, clauses and conditions of guarantees issued in such cases by banks and other financial institutions ?

18.2.2 The United Nations Commission on International Trade Law (UNCITRAL) has advocated "that a study should be undertaken of the legal nature of guarantees of payment, that unified rules for such guarantees should be drawn up and that standard forms should be prepared of different types of bank guarantees that could be used in the context of international transactions". Do you consider this necessary or desirable ? If so, please give your views on these aspects and indicate what steps you would suggest for bringing about the required standardisation of procedure in relation to such transactions in India.

Group 3—Guarantees in favour of Governments

18.3.1 Please state the difficulties, if any, you have noticed with reference to guarantees by banks in favour of Governments. Are you in favour of any statutory provisions to eliminate or overcome such difficulties ? If so, please indicate the nature of the provisions you would like to make in this behalf.

PART 19—LETTERS OF CREDIT

Group 1—General

19.1.1 Please indicate the legal difficulties, if any, you have noticed in relation to letters of credit.

Group 2—Uniform Customs for Documentary Credits

19.2.1 The Uniform Customs and Practice for Documentary Credits drawn up by the International Chamber of Commerce and revised

in 1962 have been adopted by banks in most countries. Have you noticed any difficulties in applying the provisions of the Uniform Customs, or in making them applicable, to international transactions relating to letters of credit ?

19.2.2 Do you consider it necessary or desirable to place the applicability of the Uniform Customs and Practice for Documentary Credits on a statutory basis in India ?

Group 3—Uniform Commercial Code

19.3.1 In U.S.A., Article 5 of the UCC has introduced a comprehensive scheme of legislation on the subject of letters of credit, dealing mainly with documentary credits. Do you consider that it is necessary or desirable to have a comprehensive piece of legislation in India on letters of credit ? If so, would you like such legislation to deal with only documentary credit, or cover also other types of letters of credit issued by banks ?

19.3.2 It has been felt that legislation would foster the use of, and enable banks to issue, letters of credit in relation to domestic transactions. Do you agree ?

PART 20—UNSECURED ADVANCES

Group 1—General

20.1.1 Please indicate the legal difficulties, if any, you might have noticed in relation to the provision of credit by banks and other financial institutions on an unsecured basis.

Group 2—Definition

20.2.1 Section 5(n) of the Banking Regulation Act, 1949, defines a "secured loan or advances" as one made on the security of *assets* the market value of which is not at any time less than the amount of such loan or advance. Do you consider this definition as satisfactory? If not, would you suggest any modification thereof ?

20.2.2 It is stated that there is lack of uniformity in the practice followed by banks, different banks adopting different bases for classifying their advances as secured or unsecured. How would you regard advances against the following :

(*i*) Government supply bills ;

(*ii*) bills (both demand and usance) arising out of *bona fide* commercial or trade transactions ;

(*iii*) other types of bills ;

(*iv*) trust receipts ;

(*v*) hypothecation of goods ;

(*vi*) truck/lorry receipts ;

(*vii*) guarantees ;

(*viii*) book debts ;

(*ix*) negative lien ?

Group 3—Negative lien

20.3.1 In U.S.A., it is stated that negative pledge or negative lien, *viz.*, an undertaking by the borrower not to encumber or alienate his interest in property till the advance is repaid, is accepted by lending institutions as a form of security. Do you consider that this could be so in India ?

(*vide* also (1917) 39 Allahabad 244 F.B.)

20.3.2 It has been suggested that such negative lien, when coupled with an agreement to transfer the security in favour of the lending institution in the event of default of repayment, should be treated as creating a charge and therefore be made an acceptable form of security, as this would considerably reduce the cost of borrowing. Do you consider that it is necessary or desirable to provide for this in India ?

20.3.3 Do you consider that in relation to immovable assets if such negative lien coupled with an agreement to transfer the security in favour of the lending institution in the event of default of repayment could be compulsorily required to be registered, it could be made an acceptable form of security for the financing institution ?

PART 21—SPECIAL PROVISIONS RELATING TO RECOVERY, ETC.

Group 1—General

21.1.1 Having regard to the vital role played by banks, do you consider it necessary or desirable to provide for a special machinery, as for instance by setting up Commercial Courts, for settling the disputes in relation to, and for the recovery of, loans and advances granted by banks ?

Group 2—Reconciliation of claims of co-operative and commercial banks

21.2.1 It has been suggested that the provisions of the co-operative societies enactments giving a priority to the dues of co-operative bank

should not prevail over the recovery of the dues of the commercial bank from the same borrower, and that as between co-operative and commercial banks priorities shall be determined according to the time of creation of the security. Do you agree ? If so, would you like to statutorily provide therefor ?

Group 3—Special provisions for recovery of banks' dues

21.3.1 In relation to commercial banks' advances to the agricultural sector, it has been suggested that the State Governments should be empowered to appoint an authority whom a commercial bank may approach for an order directing the agriculturist-borrower to pay the amount due to the bank on account of the financial assistance availed of by him, failing which the authority may order the sale of any property or any interest therein charged or mortgaged in favour of the bank. Do you consider that it is necessary or desirable to so provide ?

21.3.2 It has also been suggested that any order passed by such authority shall be deemed to be a decree of a civil court and be capable of execution accordingly. Do you agree ?

21.3.3 If you favour such provisions, do you consider that it is necessary or desirable also to make them applicable in relation to other types of commercial banks' advances ? If not generally, at least in relation to advances to priority sectors, such as small-scale industries, etc. ?

Group 4—Recovery of banks' dues as arrears of land revenue

21.4.1 It has been suggested that the dues to commercial banks should be made recoverable as if they are arrears of land revenue. Do you favour a statutory provision to provide for this in respect of the dues of all or any classes of banks ? If so, do you consider it necessary or desirable that by reason of such a provision, such dues should have any claim as to priority in status available to land revenue payable to Government ?

Group 5—Charge over Hindu Undivided Family property

21.5.1 It has been suggested that a mortgage in favour of a bank by the manager of a joint Hindu family shall be presumed to be valid and binding on every member of the family and that the burden of proving that it is not so binding shall be on the disputing member of the Hindu Undivided Family. Do you consider it necessary or desirable to so provide ? Or, would you like to confine it to

advances by banks to the agricultural sector and advances to priority sectors, such as small-scale industries ?

21.5.2 In order to facilitate financing by banks against joint family assets, it has been suggested that the reference to the court in the Hindu Minority and Guardianship Act, 1956, shall be construed as reference to the District Collector or his nominee not below the rank of a Gazetted Officer. Do you consider that a provision on these lines is necessary or desirable ?

Group 6—Summary procedure

21.6.1 Do you consider that the present provisions of the Civil Procedure Code for recovering the dues of a lender through summary procedure are effective ? If not, how would you like to modify them?

21.6.2 Do you consider it necessary or desirable that the Chapter of the Civil Procedure Code relating to summary procedure should be made applicable to all civil courts of original jurisdiction in any event with reference to advances by banks ?

Group 7—Execution proceedings

21.7.1 Do you consider that the present provisions for the recovery of dues, in execution, of amounts decreed, are satisfactory ? If not, would you suggest any modifications in the procedures relating thereto to expedite the recovery of dues in execution of the decree?

Group 8—False Statement Acts of U.S.A.

21.8.1 The banks rely on the financial statements and other information given by the borrowers about themselves while assessing their credit needs. To ensure that such financial statements are adequate and free from wilful and false representations, a number of States in the U.S.A. have enacted the False Statement Acts which impose penalties on any person misrepresenting the true condition in such statements. Do you consider that it would be desirable or necessary to promote such a legislation in India ?

Appendix III

List of Persons who have Answered the Questionaire (Parts 1-4)

I—BANKS

(A) National Banks

1. Allahabad Bank
2. Bank of Baroda
3. Bank of India
4. Bank of Maharashtra
5. Canara Bank
6. Central Bank of India
7. Dena Bank
8. Indian Bank
9. Indian Overseas Bank
10. State Bank of Hyderabad
11. State Bank of India
12. State Bank of Indore
13. State Bank of Patiala
14. State Bank of Saurashtra
15. State Bank of Travancore
16. Syndicate Bank
17. United Commercial Bank

(B) Foreign Banks

18. American Express International Banking Corporation
19. Bank of America[1]
20. Banque National de Paris
21. British Bank of the Middle East
22. Chartered Bank

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1 Replied to Part 1 only.

23. Eastern Bank Ltd.
24. First National City Bank
25. General Bank of the Netherlands
26. Hongkong & Shanghai Banking Corporation
27. Mercantile Bank Ltd.
28. National & Grindlays Bank Ltd.

(C) Co-operative Banks

29. Andhra Pradesh State Co-operative Bank Ltd.
30. Assam Co-operative Apex Bank Ltd.
31. Andaman & Nicobar State Co-operative Bank Ltd.
32. Gandhi Co-operative Urban Bank Ltd., Vijayawada
33. Gujarat State Co-operative Bank Ltd.
34. Madhya Pradesh State Co-operative Bank Ltd.
35. Nagpur District Central Co-operative Bank Ltd.[1]
36. Nicholson Co-operative Town Bank Ltd., Thanjavur
37. Orissa State Co-operative Bank Ltd.
38. Shri Bharat Co-operative Bank Ltd., Baroda
39. Uttar Pradesh Co-operative Bank Ltd.

(D) Other Banks

40. Belgaum Bank Ltd.
41. Bank of Cochin Ltd.[2]
42. Bank of Karad Ltd.
43. Bank of Madura Ltd.
44. Benaras State Bank Ltd.
45. Canara Banking Corporation Ltd.
46. Catholic Syrian Bank Ltd.

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1 Replied to Part 1 only.
2 Replied to Parts 1 and 2 only.

47. Dhanalakshmi Bank Ltd.
48. Federal Bank Ltd.
49. Hindusthan Commercial Bank Ltd.
50. Hindusthan Mercantile Bank Ltd.
51. Jammu & Kashmir Bank Ltd.
52. Karnatak Bank Ltd.
53. Karur Vysya Bank Ltd.
54. Kashinath Seth Bank Ltd.
55. Kumbakonam City Union Bank Ltd.
56. Lord Krishna Bank Ltd.
57. Miraj State Bank Ltd.
58. Nainital Bank Ltd.
59. Nedungadi Bank Ltd.
60. New Bank of India Ltd.
61. Parur Central Bank Ltd.
62. Ratnakar Bank Ltd.
63. Sangli Bank Ltd.
64. South India Bank Ltd. (Tinnevelli)
65. South Indian Bank Ltd. (Trichur)
66. Tanjore Permanent Bank Ltd.
67. United Western Bank Ltd.
68. Vijaya Bank Ltd.
69. Vysya Bank Ltd.

70. II—INDIAN BANKS' ASSOCIATION, BOMBAY.

III—STATE & OTHER ALLIED FINANCIAL INSTITUTIONS

71. Andhra Pradesh State Financial Corporation, Hyderabad*
72. Assam Financial Corporation, Shillong
73. Export Credit Guarantee Corporation Ltd., Bombay@

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* Replied to Parts 2 & 3 only.
@ Replied to Part 3 only.

74. Gujarat State Financial Corporation, Ahmedabad
75. Industrial Finance Corporation of India, New Delhi*
76. Punjab Financial Corporation, Chandigarh*
77. Tamil Nadu Industrial Investment Corporation Ltd., Madras*
78. Shri M. S. Ram, I.A.S., Chairman, Tamil Nadu Industrial Development Corporation Ltd., Madras
79. Uttar Pradesh Financial Corporation, Kanpur*

IV—LAW ASSOCIATIONS

80. Andhra Pradesh High Court Advocates' Association, Hyderabad
81. Advocates' Association, High Court, Madras
82. Bombay Incorporated Law Society, Bombay
83. Madura Bar Association, Madurai
84. Revenue Bar Association, Madras

85. V—INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA, NEW DELHI

VI—CHAMBERS OF COMMERCE & INDUSTRY MERCHANTS ASSOCIATIONS, ETC.

86. All India Importers' Association, Bombay
87. All India Plastic Manufacturers' Association, Bombay
88. Indian Chamber of Commerce, Calcutta
89. Indian Merchants' Chamber, Bombay
90. Bharat Chamber of Commerce, Calcutta
91. Andhra Pradesh Oil Millers' Association, Hyderabad@
92. Bengal National Chamber of Commerce & Industry, Calcutta
93. Madras Chamber of Commerce & Industry, Madras
94. Merchants Chamber of Commerce, Calcutta
95. Hyderabad Karnatak Chamber of Commerce & Industry, Gulbarga
96. Madura Ramnad Chamber of Commerce, Madurai
97. Bengal Glass Manufacturers' Association, Calcutta

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* Replied to Part 1 only.
@ Replied to Parts 1, 2 and 3 only.

98. Bombay Piecegoods Merchants' Mahajan, Bombay

99. Madras Stock Exchange Ltd., Madras

VII—GOVERNMENT

100. Sri B. D. Jatti, Lt. Governor, Pondicherry

101. The Secretary, Law Commission, Govt. of India, New Delhi@

102. The Registrar of Companies, Madras£

103. The Secretary to Government, Finance Department, Govt. of Andhra Pradesh, Hyderabad

104. The Secretary to Government, Food & Agriculture Department, Govt. of Andhra Pradesh, Hyderabad

105. The Registrar of Co-operative Societies, Government of Andhra Pradesh, Hyderabad

106. The Secretary to the Government, Finance Department, Government of Assam, Shillong

107. The Registrar of Co-operative Societies, Government of Assam, Shillong

108. The Secretary to the Government, Finance Department, Government of Gujarat, Gandhinagar

109. The Registrar of Co-operative Societies, Goa, Diu & Daman, Panaji

110. The Secretary to the Government, Finance Department, Government of Kerala, Trivandrum£

111. The Secretary to the Government, Agriculture & Co-operation Department, Government of Maharashtra, Bombay

112. The Commissioner for Co-operation and Registrar of Co-operative Societies, Maharashtra State, Poona

113. The Registrar of Co-operative Societies, Madhya Pradesh, Bhopal

114. The Secretary to Government, Co-operation Department, Government of Madhya Pradesh, Bhopal

115. The Secretary to Government, Finance Department, Government of Mysore, Bangalore

116. The Registrar of Co-operative Societies, Government of Mysore, Bangalore

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@ Replied in general, with reference to particular aspects.
£ Replied to Part 1 only.

117. The Secretary to Government, Development Department, Pondicherry

118. The Financial Commissioner, Finance Department, Government of Rajasthan, Jaipur@

119. The Registrar of Co-operative Societies, Government of Rajasthan, Jaipur

120. The Secretary to Government, Government of Tamil Nadu, Commerce & Industries Department, Madras-1

121. The Director of Industries, Uttar Pradesh, Kanpur

122. The Secretary to Government, Finance Department, Government of West Bengal, Calcutta

VIII—EDUCATIONAL & TRAINING INSTITUTIONS

123. Indian Council of Economic Affairs, Calcutta

124. Indian Institute of Economics, Hyderabad

125. Bankers' Training College, Bombay*

IX—FOREIGN EXPERTS

126. Mr. Carl W. Funk, Drinker Biddle & Reath, 1100 Philadelphia National Bank Building, Broad and Chestnut Streets, Philadelphia (U.S.A.)

127. Mr. Maurice Megrah, 5, Paper Buildings, Temple, London (U.K.)

X—INDIVIDUALS

128. Shri Biswanath Bajpayee, Member, Bar Council of India, New Delhi

129. Shri P. P. Ginwala, Barrister-at-law, Calcutta

130. Shri J. R. Gupta, C/o United Commercial Bank, Moga (Punjab)

131. Shri P. C. Goyal, Retd. Income-tax Commissioner, Kanpur

132. Shri Harkaran Singh, Registrar of Companies, Jammu & Kashmir, Srinagar

133. Shri Jayantilal C. Patel, Member, Federation of Gujarat Mills & Industries, Baroda

134. Shri Keshava Ammanayya, Agriculturist, Panja Village (S. Kanara)

@ Replied on behalf of the Chief Secretary and the Secretaries to the Finance and the Agriculture Departments, Govt. of Rajasthan.

* Replied to Parts 1 & 4 only.

135. Shri K. B. Krishna Murty, Advocate, Hyderabad

136. Shri Manjunatha Pai, C/o Syndicate Bank, Panaji*

137. Shri V. P. Mittal, Advocate, Meerut@

138. Shri Nanubhai B. Amin, Member, Federation of Gujarat Mills & Industries, Baroda

139. Dr. T. M. A. Pai, President, Academy of General Education, Manipal

140. Shri Ram Rakha, C/o State Bank of India, Calcutta

141. Shri S. Swaminathan, Advocate, Madras

142. Shri T. S. Santhanam, 37, Mount Road, Madras

143. Shri P. Venkateshwara Rao, C/o Andhra Bank Ltd., Vijayawada

144. Shri K. Venkoba Rao, Advocate, Madras

145. Shri T. V. Viswanatha Aiyar, Senior Advocate & President, Revenue Bar Association, Madras

* Replied to Parts 1 & 2 only.
@ Replied to Parts 2, 3 & 4 only.

APPENDIX IV

Replies of Mr. Carl W. Funk* to the Questionnaire (Parts 1 to 4)

PART 1—DEFINITION OF "BANKING" AND ALLIED MATTERS

Group 1—Definition of "banking"

1.1.1 I consider the definition of "banking" in the Banking Regulation Act, 1949 is adequate and not too wide. The definition of "banking" in the Pennsylvania Banking Code of 1933 was as follows:

> "'Banking' means discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt; receiving money and commercial paper on deposit or for transmission; lending money on real or personal security; buying and selling gold and silver bullion, foreign exchange, coin, or bills of exchange."

1.1.2 I consider that the definition of banking should include the acceptance of deposits repayable at the expiry of a term or after notice and withdrawable in any mode.

1.1.3 I would not favour a definition which states that a person will not be regarded as engaged in banking unless he accepts deposits from members of the public, repayable on demand, for purposes of lending or investment. Almost all acceptances of deposits from members of the public should be regarded as banking, whether they are repayable on demand or at a specified future date or after a specified period after notice to pay; and whether they are for lending or investment, or some other purpose. For example, a commercial establishment should not be permitted to accept deposits from members of the public and use these funds in its mercantile business unless it conforms to all of the regulations governing banking.

1.1.4 See answer to 1.1.3. The line between banking and other functions is indeed difficult to draw. It seems best to treat all persons who engage in the business of receiving money for deposit or transmission as being engaged in banking and then to make

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* Member of the Pennsylvania Banking Law Commission, and of the Review Committee on Article 9 of the Uniform Commercial Code;
Counsel to the Permanent Editorial Board of the American Law Institute, and the Conference of Commissioners on Uniform State Laws; and an
Author on Uniform Commercial Code.

certain exceptions, such as (*a*) hotels and other establishments who receive money from guests or customers for temporary safekeeping; (*b*) attorneys at law, real estate agents, fiscal agents and attorneys-in-fact to the extent that they receive and transmit money solely as an incident to their general business or profession; (*c*) licensed stock and commodity brokers who engage in the receipt and transmission of money solely as an incident to the conduct of their brokerage business. This was the approach which was taken by the Pennsylvania Banking Law Commission, of which I was a member, in drafting the Pennsylvania Banking Code of 1965.

1.1.5 I would not accept the view that only persons accepting deposits from members of the public, repayable on demand or within a short period should be deemed to be carrying on the business of banking. While the duration of the period at the end of which money is repayable is a factor in determining whether a transaction constitutes a deposit or a loan, many deposits are made today in the United States for as much as two years, and perhaps longer, and persons who receive such deposits should be deemed to be in the business of banking.

1.1.6 It is often difficult to draw the precise line between a deposit and a loan. At one time in the United States a deposit was defined by courts as the acceptance of money repayable on demand without interest. Where the money was to be repaid at a specified time with interest, the transaction was considered a loan. Today, however, banks accept "time deposits" repayable on a particular date or after a specific period of notice, and pay interest on such deposits. These have the characteristics of loans, but are treated as deposits and are covered by deposit insurance. The only way I can distinguish today between a bank deposit and a loan, where the funds are not subject to check is to look at the words which are applied to the transaction by the parties to the transaction. If it is labeled a deposit, either in a written agreement between bank and its customer or in a certificate of deposit, it will be regarded by the governmental authorities and the courts as a deposit, against which the bank must maintain reserves and which will be protected by deposit insurance. Where a loan is intended, the bank will usually execute a promissory note or issue a "capital debenture", which will probably state that it is not a deposit.

1.1.7 I do not believe that it is feasible to define the expression "from the public." It involves too many varied factors and requires the application of judgment. It is best left to the discretion of

courts, at least in countries following the English common law, as we do in the United States.

Similarly, it may be too difficult to formulate a definition of "member" which will fit all circumstances, and I believe it would be unwise to exclude an organization from regulation under the banking laws merely because it received deposits only from its members. Such an organization might have a membership of many hundreds or even thousands.

1.1.8 I believe the Pennsylvania definition of "banking" quoted in 1.1.1 is a satisfactory one.

Group 2—Exceptions

1.2.1 I would not be in favour of excluding from the definition of "banking" the acceptance of deposits of money from the public by a manufacturing or trading company, even though such deposits were used merely for the purpose of financing its own business. Such a use involves major risk of loss. Manufacturing or trading companies should obtain their funds either by borrowing from financial institutions or by selling their obligations or shares under stringent restrictions, such as those of the United States Securities Act of 1933.

1.2.2 (*i*) I think it would be undesirable to exempt from banking regulation non-financial institutions holding funds for customers for special purposes if such funds can be loaned on short term, or

(*ii*) to exempt deposit-taking institutions dealing with small numbers of people. On the other hand, as stated above, I would favour exempting investment dealers and stock and share brokers holding customers' funds. I express no opinion concerning moneylenders, shroffs and indigenous bankers as I am unfamiliar with their activities.

1.2.3 Except as stated above, I would not like to exclude from banking or from banking regulation any other institutions or persons accepting deposits from the public.

Group 3—Financial institutions accepting deposits

1.3.1 In my opinion, investment or financing or hire-purchase companies, trust and loan companies and sales financing companies, etc., should not be permitted to accept deposits from the public and except to this extent, should not be governed by banking

legislation. Separate legislation regulating such companies seems to me to be necessary.

1.3.2 I would not exclude from the definition of banking the acceptance from the public by such institutions of deposits of any character, and I would forbid them to accept any deposits.

1.3.3 As stated above, I consider it necessary to have legislation regulating the business of the foregoing institutions, even though I would not permit them to accept deposits.

PART 2—BANKS' OBLIGATION TO MAINTAIN SECRECY

Group 1—Secrecy as to affairs of customers

2.1.1 I do not consider it necessary or desirable to place the obligation of a bank to observe secrecy on a statutory basis in a country which follows common law principles. I do not recall any such legislation in the United States. The duty to observe secrecy is based upon the contract between the bank and its customer.

2.1.2 If the duty to maintain secrecy is based upon a statutory provision, I agree that it is qualified and that it need not be observed:

(*a*) Where disclosure is under compulsion by law ;

(*b*) Where there is a duty to the public to disclose ;

(*c*) Where the interests of the bank require disclosure; and

(*d*) Where the disclosure is made with the consent of the customer.

However, there may be many situations where secrecy must be observed by the bank even where it would benefit by making disclosure.

2.1.3 I would not include disclosure to police authorities in the course of investigation unless the disclosure was required by a properly issued subpoena from a court, or from a legislative committee or an administrative body authorized to issue subpoenas.

2.1.4 I agree that a bank should be permitted to produce copies instead of originals of their books and documents before police authorities when duly subpoenaed. This practice is widely followed in the United States.

2.1.5 I consider that bankers should be required to disclose to the tax authorities the names and addresses of all persons to whom interest on deposits or dividends on shares have been paid in amounts in excess of a specified figure, which in the case of the United States Internal Revenue Code, is $ 10.00. Other information, however, should be disclosed to the tax authorities only pursuant to subpoena.

2.1.6 I consider that there should be a more detailed statement of when "there is a duty to the public to disclose", by enumerating specific examples when the duty may be deemed to arise. For example, I believe there is such a duty when a bank is asked for information by a government official concerning the commission of a crime, and the bank has reasonable cause to believe that a crime has been committed and that information in the bank's possession will lead to the apprehension of the culprit.

2.1.7 I consider it necessary to provide that as part of its duty to the public to disclose, the bank should be obliged to disclose information relating to itself or its customers to commissions or committees appointed by the government, provided that the legislature or parliament has given the commission or committee the power of subpoena.

2.1.8 An example of a situation where the interests of the bank require disclosure would be where it and another bank were both lending to the same customer and one of them learned of facts, such as a practice of the customer in overdrawing its deposit account, which would show that the financial condition of the customer was much less favourable than either bank had believed at the time it granted credit to the customer.

2.1.9 I would favour clarifying the doctrine of implied consent of the customer if it can be done, but find it difficult to think of an example of such implied consent. A bank should always endeavour to obtain the customer's express consent.

2.1.10 I do not consider it necessary to extend the bank's obligation as to secrecy to information of a general nature, where it does not disclose the names of or details concerning any particular customer, and where the recipient of the information will not be able to identify any specific customer or customers.

2.1.11 I refrain from answering this question because of lack of knowledge of the statutory provisions referred to.

2.1.12 In my judgment there should be a more detailed statement of the qualification concerning the State Bank of India, its subsidiaries and recently nationalised banks, because the clause "where it is in accordance with law or practice and usage customary among bankers" is too vague, and leads to doubt, uncertainty and consequent controversy. However, I have difficulty formulating a more precise statement.

2.1.13 I refrain from answering this question because of lack of knowledge concerning the situation in India.

Group 2—Secrecy as to the affairs of the bankers

2.2.1 This question is to be answered only by banks.

2.2.2, 2.2.3, 2.2.4, 2.2.5 I refrain from answering these questions because of lack of knowledge of the situation in India.

Group 3—Secrecy as to the assets of banks

2.3.1 I do not consider it necessary or desirable that banks should be permitted not to disclose any of their assets or liabilities in their published accounts. I agree that the names of borrowers should not be disclosed but there should be disclosure as to the amounts of a bank's cash, government securities, other securities, loans, real estate, and other assets ; and also how much of its liabilities are composed of its deposits, borrowings, reserves, capital, surplus and undivided profits.

2.3.2, 2.3.3 I refrain from answering these questions because of lack of knowledge of the situation in India.

PART 3—GIVING/RECEIVING OF CREDIT INFORMATION BY BANKS

Group 1—General

3.1.1 I do not think it desirable to support by a statutory provision the practice among banks to give one another information as to the affairs of their respective customers.

3.1.2 I am by no means convinced that the practice can be based on an implied consent by the customer. In fact, I question very much whether the customer does consent.

3.1.3 I think that only general information relating to the affairs of its particular customers should be given by one bank to another bank, and that care should be taken not to give information that is too specific or detailed.

3.1.4 This question is to be answered only by banks.

Group 2—Obligation to customers of whom credit reports are given

3.2.1 As stated above, I think that banks should answer references about the credit of their customers only in a general way, without any disclosure of the details of the transactions between the bank and that customer.

3.2.2 I do not consider the mere opening of an account gives a banker any implied authority to disclose information relating to a customer's credit and standing.

3.2.3 I do not consider that a banker should be free to disclose the nature of operations in the customer's account while answering a reference about him.

3.2.4 I do not consider it necessary or desirable that banks should obtain, at the time of opening an account with them, the express consent of the customers to answer references about their credit and standing. I believe most customers would refuse to give such consent. I would not like to have a statutory provision enabling banks to freely divulge information about their customers in answer to references from other banks or to cover enquiries from other persons.

Group 3—Duty to persons to whom credit information is given

3.3.1 I believe a banker owes a duty to the person to whom he furnishes credit information to see that the information is accurate.

3.3.2 I favour the continuance of the practice of bankers furnishing information about the credit of customers to do so "without responsibility", but I do not think that this practice affects to any great degree the quality or the usefulness of the information furnished. For example, I do not think a bank should be held liable for furnishing information which proves to be inaccurate if it

believes the information itself to be correct, if it has not acted negligently; but if the bank has been negligent it may be held liable despite its disclaimer of responsibility.

3.3.3 I consider that the current practice of bankers answering references about their customers in a very general way serves the needs of banks and others of obtaining reliable credit information.

3.3.4 I do not consider that the banker's obligation in furnishing information should vary with the form in which the information is given. The obligation is just as great in giving oral or unsigned information as in giving written signed information.

3.3.5 I consider that a bank supplying information probably has some duty not only to the bank to which the information is given, but also to the customer of that bank.

Group 4—Machinery for supplying credit information to banks

3.4.1 If a country does not have machinery for supplying reliable credit information about borrowers to banks, I believe its banking institutions will be at a substantial disadvantage. Much valuable information is obtained by banks in the U.S.A. from Dun & Bradstreet. I do not know whether it would be feasible in Indian conditions to organize a similar agency.

3.4.2 I refrain from answering this question because of lack of knowledge of the situation in India.

3.4.3 I do consider information concerning the operation of the account of a borrower necessary to form an objective assessment of his credit and standing.

3.4.4 I do not have sufficient knowledge to judge whether the Credit Information Bureau of the Reserve Bank of India meets the needs of banks, or whether an independent agency should be set up to supply reliable credit information. One essential is to have a system which permits the correction of errors which occur in the files of persons furnishing credit information. The experience in the United States has been that erroneous information which was very damaging to customers has crept into the records of some credit reporting agencies and that the persons involved have found it almost impossible to force the agencies to correct their records. This is one of the principal causes of the adoption by the United States Congress of the Fair Credit Reporting Act of 1970.

PART 4—PAYMENT BY BANKERS OF BALANCES AND DELIVERY OF ASSETS BELONGING TO DECEASED INDIVIDUALS

Group 1—General

4.1.1 Very little difficulty, if any, is experienced in the United States in making or obtaining payment by or from banks of balances or assets lying with them and belonging to deceased individuals.

Group 2—Nomination in relation to deposits

4.2.1 This question is to be answered only by institutions.

4.2.2 It is desirable to make statutory provision to enable banks to repay deposits with them on the strength of nominations made in relation to them at the time of deposit. This system is widely in effect in the United States and accounts of this nature are opened in the name of "John Smith in trust for Richard Jones". Upon John Smith's death, the bank is permitted to pay the funds directly to Richard Jones. These accounts are sometimes known as "Totten trusts" or "tentative trusts" and I believe originated in New York without statutory provisions concerning them. However, in Pennsylvania the practice is sanctioned by statute and this is probably true in a number of other states. Of course, accounts merely in the name of the depositor alone are paid at death only to his executor or administrator; and accounts in the names of two or more persons may be paid to the survivor if one of them dies, if such an agreement is entered into at the time the account is opened. There is no monetary limit on the amount that can be placed in a Totten or tentative trust but the balance in such an account at the time of death is normally regarded as part of the estate of the decedent for purposes of death duties, although not for administration.

4.2.3, 4.2.4, 4.2.5 I refrain from answering these questions because of lack of knowledge of the situation in India.

Group 3—Nomination in relation to the assets secured to the banks

4.3.1, 4.3.2 I refrain from answering these questions because of lack of knowledge of practice in India concerning the repayment of debts by persons other than the borrower or the executor or administrator of a deceased borrower.

Group 4—Nomination in relation to the articles kept with banks for safe custody

4.4.1 I refrain from answering this question because of lack of knowledge of the practice in India of returning articles kept in custody to persons other than the customer or his duly authorized agent.

Group 5—Nomination in relation to access for safety lockers

4.5.1 There should be a provision preventing anyone from having access to the safety locker of a customer after his death. It has been the experience of the taxing authorities in the United States that death duties have been evaded in many instances where cash, jewellery and similar property was abstracted by members of the family who were permitted to open the safe deposit box and were divided among them either as they saw fit or as they knew the decedent intended. In Pennsylvania a safe deposit box in the name of a decedent alone or a decedent and someone other than his spouse cannot be opened for the first time (except to search for a will in the presence of a bank official) unless a representative of the taxing authorities is present to list the contents of the box. I question whether there should be an exception in the case of a box rented jointly by the decedent and his wife.

APPENDIX V

Replies of Mr. Maurice Megrah* to the Questionnaire

(Parts 1 to 4)

PART 1—DEFINITION OF 'BANKING' AND ALLIED MATTERS

Group 1—Definition of 'banking'

1.1.1 I would think that the definition of 'banking' to be found in the Banking Regulation Act, 1949 should include the requirement that a bank should undertake the collection of cheques et cetera for customers. This is an essential function of bankers in the United Kingdom and it may well be so in India also. In this connection, see the judgment of the Court of Appeal in *United Dominions Trust* v. *Kirkwood* (1966) 2 Q.B. 431. I do not think it necessary to indicate the purposes for which deposits are accepted—they must include lending and investment or the bank could not survive.

1.1.2 The definition must, I think, include acceptance of deposits, but it should not be limited to that function.

1.1.3 Once the essential functions are determined, to state the matter in the negative form would be reasonable only if 'banking' were to be limited to those functions and not to include other activities. There should be no limitation regarding methods of withdrawal, but the inclusion of withdrawal by cheque is essential.

1.1.4 I would not draw a line between banking and other activities, except that where a person or company undertakes other activities as well as banking operations as finally settled in law, the former should form a small part of the whole. Banking operations should predominate or the value of the bank to the public as a bank would be restricted. It is impossible to say what the proportion of such operations should be.

1.1.5 It is important in banking to avoid borrowing short and lending long. This has been the basis on which banks in this country have

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* Editor of : Paget's "Law of Banking", Byles "Bills of Exchange", Gutteridge's "The Law of Bankers' Commercial Credits" and the last four volumes of "Legal Decisions affecting bankers" published by the Institute of Bankers, London.

operated; they are now finding that they have to meet medium and long term lending and they mostly do so through special subsidiary companies. It would seem not to matter for how long deposits are received, so long as there is proper balance between deposit periods and those for which advances are given.

1.1.6 A loan is not a deposit ; but a deposit may be is often the result of a loan. A deposit may take one of two forms—the placing of money with a banker, *i.e.*, the making of a loan to the banker, or the crediting an account by the banker by way of lending to the customer. In order to be quite clear the term 'loan' should be confined to the case where, as opposed to an overdraft, an advance is made by the crediting of a current account. It is, in my view, misleading to include loans in deposits.

1.1.7 I would exclude from the term 'bank' any institution which limits the receipt of deposits to any particular group of people.

1.1.8 I prefer the statement of functions as laid down in Paget, with the added requirement that it is not sufficient merely to offer the stated facilities ; they must actually be provided (per Diplock, L. J. in the *United Dominion Trust* case). I would suggest something on the lines of the following :

> " 'Banking' includes (*a*) the receipt from customers of moneys on current or deposit account repayable, on demand or otherwise, by cheque, draft or other order; and (*b*) the collection for customers of cheques and other orders or promises to pay."

Group 2—Exceptions

1.2.1 If the receipt of deposits is ancillary to the main purpose of the company, the latter should not be regarded as engaged in banking.

1.2.2 & 1.2.3 I am not sure what is meant by 'banking regulation', but I would exclude (*i*), (*iii*) and (*iv*) from the category of banks. As regards (*ii*), if the institution performs all the essential functions of a bank it should not be excluded from the category by reason merely that it deals with a small number of people.

Group 3—Financial Institutions accepting Deposits

1.3.1 The functions of these institutions being so different from each other I think it wise, where there is a need for control, to legislate separately. This has been done in the United Kingdom through the Protection of Depositors Act, the Prevention of Frauds Act,

the Hire Purchase Acts, the Moneylenders Acts and so on. All companies, of course, must conform to the Companies Acts.

1.3.2 No; I see no need to do so, assuming that the institutions otherwise perform the functions of banking.

1.3.3 The answer to this question must, I think, depend upon the extent of the necessity to safeguard the public. As you will know, this matter is governed in the United Kingdom by the Protection of Depositors Act.

PART 2—BANKS' OBLIGATION TO MAINTAIN SECRECY

Group 1—Secrecy as to affairs of customers

2.1.1 I think that the obligation to maintain secrecy regarding a customer's affairs is an obligation of the utmost importance and that no one, government departments, central banks or otherwise should encroach upon the right to have one's affairs kept secret, without strong evidence of fraud, tax evasion or what not. This is, however, essentially a matter for decision by the country concerned and I cannot speak as to the need in India, for I have no information on which to base an opinion. If the State Bank of India and its subsidiaries and the nationalised banks are freed by statute from any obligation to disclose, other banks of similar quality and responsibility ought also to be so freed. But if it is the law in India that even without statutory authority a bank cannot be compelled to disclose, *i.e.*, if it is part of the banker-customer contract that a bank shall regard its customers' affairs as secret, nothing more is necessary unless there should be an adverse decision of the courts on the matter.

2.1.2 I do not know how the four categories mentioned—which are found in the United Kingdom also by reason of the decision of the Court of Appeal in *Tournier* v. *National Provincial Bank* are embodied in the law of India. However I think that the four categories must in general be excluded from any absolute obligation to maintain secrecy. It is difficult to suggest any other qualification. The four categories are obvious, but they have to be interpreted in a proper way and I would see no great difficulty in leaving it to the Courts, rather than attempt a most difficult piece of legislation which might give little room for manoeuvre.

2.1.3 I would not include in the first category disclosure to the police unless they were in possession of an order of a court, judge or magistrate.

2.1.4 The United Kingdom Bankers' Books Evidence Act, 1879 provides by s. 6 that a banker shall not be required in legal proceedings to produce any book unless by order of a judge. By s. 3 a copy shall be receivable in all legal proceedings. I would not approve any extension to police authorities unless these are "persons before whom a legal proceeding is held or taken."

2.1.5 The United Kingdom Income Tax Act, 1952, s. 29 is to similar effect. I think that bankers should not be asked to disclose, but if it is thought proper to require them in the case of interest of such small amount as £ 15, why draw the line there? This is the thin edge of the wedge.

2.1.6 I agree that the 'duty to the public to disclose' is not clear, but it would probably be a mistake to try to define the condition more closely. It may not be relevant to India, but there has been singularly little discussion on the point in the Courts of the United Kingdom.

2.1.7 I would not consider it either necessary or desirable that banks should be obliged to disclose information to government commissions or committees, unless the commission or committee has the power to compel disclosure possessed by the Courts. This would seem to be a matter for the Legislature, and any authority should be used sparingly.

2.1.8 This should be unnecessary. The obvious case is where the bank is engaged in legal proceedings; even in this case if the bank brought an action frivolously or recklessly it might be held that the disclosure for its own benefit or ends was not justified.

2.1.9 In this respect also it would be virtually impossible to draft a guiding rule. The bank may always refuse, except in the other three cases mentioned in question 2.1.2, to disclose and it is best left to the bank to decide whether it has its customer's consent or not.

2.1.10 I would not think that there can generally be objection to a bank's disclosing information as to classes of customers but, again, this could hardly be called for (and hardly justified), except in the case of the central bank or the Indian equivalent of the Board of Trade, for instance.

2.1.11 I do not know the statutory provisions imposing the duty of secrecy on the State Bank of India et cetera, but unless they give considerable licence to disclose they should be appropriate.

2.1.12 If it is the law in India that banks may not disclose save in the four exceptional cases, the State Bank requirement would seem not

to be objectionable. But I see no reason for treating the State Bank of India, its subsidiaries and the nationalised banks any differently from other institutions which satisfy the legal conditions as to banking. I would suggest cutting out the words "or practice and usage customary among bankers", for if the law were changed practice and usage would go by the board.

2.1.13 I know little about the practices of banks in India, but I would imagine that the practice of banks of British origin that are not affected by statute would be similar to that in the United Kingdom and in the light of what I gather from the questionnaire as to the law in India, those practices should be satisfactory.

Group 2—Secrecy as to the affairs of the bankers

2.2.2 and 5 I am not competent to answer this question, but there would always seem to be a case for disclosure to the central bank of information essential to the conduct of monetary policy and insofar as this includes information about the banks themselves this would appear to be justified.

2.2.3 This prohibition seems to be desirable and the freedom from disclosure should be extended to all banks properly so called.

2.2.4 I would not favour such an amendment. It would have a very unsalutary effect on the banking population.

Group 3—Secrecy as to assets of banks

2.3.1 On the whole I would think not, but this is a large question on which I do not feel able to comment. I would only say that the trend in the United Kingdom is in favour of full disclosure.

2.3.2 I do not know the Indian Industrial Disputes Act.

2.3.3 I do not know what the legal provisions are.

PART 3—GIVING/RECEIVING OF CREDIT INFORMATION BY BANKS

Group 1—General

3.1.1 The legal foundation is surely the implied consent of the customer. The implication is, perhaps, stronger in the case of a trading customer. It seems to me that the practice is an essential practice

probably founded in custom also and should not need to be supported by legislation if the law is clear.

3.1.2 On the whole, yes ; but the practice could be abused, not by banks but by persons enquiring. Normally, however, an enquiry is not made save for a reason and I incline to think that it would be better not to legislate—which would be difficult and probably too clumsy a solution. An aggrieved customer has his remedy, though by reason of the implication this would probably have little value in most cases.

3.1.3 I think that there is no great objection to the exchange of information between banks ; this is a safeguard for both the banks and the public and the advantages must outweigh any disadvantages.

Group 2—Obligation to customers of whom credit reports are given

3.2.1 I think that this is answered by the reply to 3.1.2. I cannot see how it would be possible to distinguish between one case and another if the enquiry is, as it should be, by one bank of another.

3.2.2 There is, I think, no doubt in the case of customers of whom trading references are essential ; the implied consent of the customer must be there. However, the case of the private customer is different and it might well be that in India the case for assuming implied consent of private customers is not so strong as it is in these days in the United Kingdom. The matter must, I think, be considered in the light of what I may call the public attitude to banks in India ; but even if it were felt desirable to restrain enquiry and disclosure in the case of private customers I doubt if it could be achieved by legislation. Prohibition alone would be possible. I think that the banks themselves are in the best position to judge and I would be content to leave it to them. The practice or custom is available to banks only.

3.2.3 I think that a banker should not give details of a customer's account ; his answer should be in general terms only.

3.2.4 If banks obtained authority to disclose, on the opening of the account, there should be no problem, provided that the bank was satisfied that the customer was competent to give the authority and understood its significance. I take it that there is nothing today in Indian law to prevent a bank from taking such a mandate. A statutory authority would, I think, be a mistake and it would not be likely to solve the problem. It would, further, be wise, in my view, that banks should not answer enquiries emanating from institutions and persons other than banks.

Group 3—Duty to persons to whom credit information is given

3.3.1 and 3.3.2 There is little doubt that a banker owes a duty to be honest in his reply and I incline to think that he should be reasonably accurate according to the information he has at his disposal ; by 'reasonably accurate' I mean that he should not mislead and that if his answer would be clear to the ordinary intelligent business man that would be sufficient. It is, however, because of the enormous difficulty of choosing words which express the banker's opinion accurately without disclosing details of the customer's affairs, that banks give their answers 'without responsibility'. This is to my mind inevitable. The fact may well affect the quality or usefulness of the answer, but enquirers must accept the fact. Their own bankers, who make the enquiry, should normally be able to interpret the answer.

3.3.3 The current practice is, I think, as good as it can be unless banks are to be relieved of any responsibility in the matter—which would be bad.

3.3.4 If there is a duty, this should not depend on whether the answer is given orally or in writing, signed or unsigned ; but, obviously, the giving of the answer must be proved in the event of any dispute and this may well prove impossible unless the answer is in writing at least.

3.3.5 Continuing 3.3.4, there is the question whether the duty is to the enquiring bank alone or to that bank's customer ; I incline to think the latter, though the duty may be to the former also. But that, I think, is not important—the question is what is the law in India, a question which it may be no easier to answer than it is in the United Kingdom.

Group 4—Machinery for supplying credit information to banks

3.4.1,2,3 & 4 I have no special thoughts on this subject.

PART 4—PAYMENT BY BANKERS OF BALANCES AND DELIVERY OF ASSETS BELONGING TO DECEASED INDIVIDUALS

Group 1—General

4.1.1 There should ordinarily be no difficulty. Moneys are payable and securities et cetera deliverable to the deceased's executors or administrators upon production of the deceased's will or of

letters of administration. This is in the case of an individual customer. Where, however, moneys or securities are held on joint account, the right to withdraw may pass to the survivor; at any rate the bank may normally safely pay him. What the bank needs in every case is evidence of title or the right to require payment or delivery.

Group 2—Nomination in relation to deposits

4.2.2 If by 'nomination' is meant the granting of authority to the bank to permit withdrawal by a third party, the authority comes to an end on the death of the customer. A mere mandate is not sufficient to permit the bank to pay or withdraw; the customer must make his arrangement by will or by gift *inter vivos* or by joining the third party in joint account, in which case the property will normally pass by right of survivorship. I would think it neither necessary nor desirable by legislation to give banks the power to transfer to a nominee. I think I need only add, in answer also to questions 4.2.3, 4 and 5 that if in India there are proper legal means of achieving the desired end, it is best to rely on them and not to make further provision unless its purpose is to make it possible for people with little financial resources and no knowledge of affairs to obtain the possession of the deceased's property without difficulty. But where and why would the line be drawn?

Group 3—Nomination in relation to the assets secured to the banks

4.3.1 I am not sure what underlies this question. Normally the bank would have a power of sale, but it would consult the executors or administrators before exercising it. What would the position be in India if there were a nomination as well as executors; how would the conflict be resolved?

4.3.2 Again, I think that I cannot answer the question without knowing the purpose of and reasons for nomination. Nor do I see how a nominee could be subrogated to the rights of the banker before discharge of the deceased customer's debt.

Group 4—Nomination in relation to the articles kept with banks for safe custody

4.4.1 This question would appear to be answered in the reply to 4.1.1

Group 5—Nomination in relation to access for safety lockers

4.5.1 Again, the executors or administrators would be entitled. If the customer wishes to appoint a nominee, can he not appoint an executor? A nominee would be appointed by mandate which would fail on the mandator's death.

APPENDIX VI

Foreign Offices who gave information/materials relating to other countries

1. United Nations Information Centre,
   21, Kasturba Gandhi Marg,
   New Delhi.

2. Mr. Walter Gill,
   Secretary General,
   International Chamber of Commerce,
   38, COURS ABERT Ier,
   Paris VIII.

3. Shri P. Chentsal Rao,
   Secretary,
   Indian National Committee,
   International Chamber of Commerce,
   Federation House,
   New Delhi.

4. Shri S. S. Marathe,
   Minister (Economic),
   Embassy of India,
   (Economic Wing),
   Washington D. C. 20008.

5. Mr. Frances D. Jones,
   Executive Secretary,
   National Conference of Commissioners on Uniform State Laws,
   1155 East 60th St.,
   Chicago, Illinois 60637.

6. Mr. Paul A. Wolkin,
   Assistant Director,
   The American Law Institute,
   4025 Chestnut Street, Philadelphia,
   Pennsylvania, 19104.

7. Mr. G. Allen Patterson,
   Secretary of Banking,
   Commonwealth of Pennsylvania,
   Department of Banking,
   Harrisburg Pa. 17120,
   U.S.A.

8. Mr. Walter A. Lundy,
Financial Attache (Acting),
Treasury Department,
Embassy of the United States of America,
New Delhi.

9. Mr. Carl W. Funk,
Drinker, Biddle & Reath,
1100 Philadelphia National Bank Building,
Broad and Chestnut Streets,
Philadelphia, Pa. 19107.

10. The Secretary General,
Institute of Bankers,
10, Lombard Steet,
London E. C. 3.

11. United States Information Service, Madras and Bombay.

12. British Council Library,
N. K. M. International House,
178, Backbay Reclamation,
Bombay-20 (BR).

13. Deutsche Bundesbank,
6, Frankfurt 1,
West Germany.

14. Mr. Jean Piere TEYSSIER,
Trade Commissioner for France,
"The Beacon", 7th Floor,
Foreshore Road,
Backbay Reclamation,
Bombay-1.

15. Mr. Sadao Ishida,
Chief, Special Research Section,
Economic Research Department,
The Bank of Japan,
Tokyo.

16. Mr. H. G. Pardy,
Second Secretary,
Office of the High Commissioner for Canada,
4, Aurangzeb Road,
New Delhi-11.

17. Mr. K. Sarup,
Marketing Officer,
Office of the Deputy High Commissioner for Australia,
"Express Towers" 9th Floor,
Nariman Point,
Bombay.

18. Mr. Romeo D. Fernandez,
Charge d'Affaires a.i.,
Embassy of the Philippines,
50-N, Nyaya Marg,
Chanakyapuri,
New Delhi -21..

TABLE OF CASES

(referred to in the chapters of the Report and the annexures thereto)

1. Numbers given opposite to the cases indicate the number of the chapter, and of the paragraph of the chapter.

2. References 'A' and 'B' indicate the annexure to Chapter 2, and the paragraph number of the annexure.

INDEX

Since a detailed table of contents has been given, the index is merely one of names.

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