Chapter II

Evolution of Payment Systems in India

2.1. Payment instruments and mechanisms have a very long history in India. The earliest payment instruments known to have been used in India were coins, which were either punch-marked or cast in silver and copper. While coins represented a physical equivalent, credit systems involving bills of exchange facilitated inter-spatial transfers.

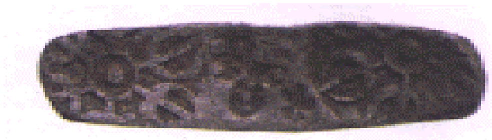

Figure 2.1. Early Punchmarked coin
(Courtesy - Museum Cell, RBI)

2.2. In ancient India, **loan deed** forms called *rnapatra* or *rnalekhya* were in use. These contained details such as the name of the debtor and the creditor, the amount of loan, the rate of interest, the condition of repayment and the time of repayment. The deed was witnessed by a person of respectable means and endorsed by the loan-deed writer. Execution of loan deeds continued during the Buddhist period, when they were called *inapanna.*

2.3. In the Mauryan period, an instrument called *adesha* was in use, which was an order on a banker desiring him to pay the money of the note to a third person, which corresponds to the definition of a bill of exchange as we understand it today. During the Buddhist period, there was considerable use of these instruments. Merchants in large towns gave letters of credit to one another. There are also numerous references to promissory notes.

2.4. The loan deed continued into the Mughal period. The deeds were called *dastawez* and were of two types: *dastawez-e-indultalab* which was payable on demand and *dastawez-e-miadi* which was payable after a stipulated time.

2.5. In the Mughal period, we have the testimony of foreign travellers regarding the use of bills of exchange in the then great commercial centres. From their writings, it may be noted that Indian bankers also issued bills of exchange on foreign countries, mainly for financing sea-borne trade. These bills were widely accepted and were traded at high discounts, as the discounts included the insurance premium covering the risk representing safe arrival of goods.

2.6. Another instrument in use during the Muslim period was the Pay order. **Pay orders** were issued from the Royal Treasury on one of the District or Provincial treasuries. They were called *Barattes* and were akin to present day drafts or cheques.

2.7. The most important class of credit Instruments that evolved in India were termed ***Hundis.*** Their use was most widespread in the twelfth century, and has continued till today. In a sense, they represent the oldest surviving form of credit instrument. Hundis were used

* as remittance instruments (to transfer funds from one place to another)
* as credit instruments (to borrow money [IOUs])
* for trade transactions (as bills of exchange)

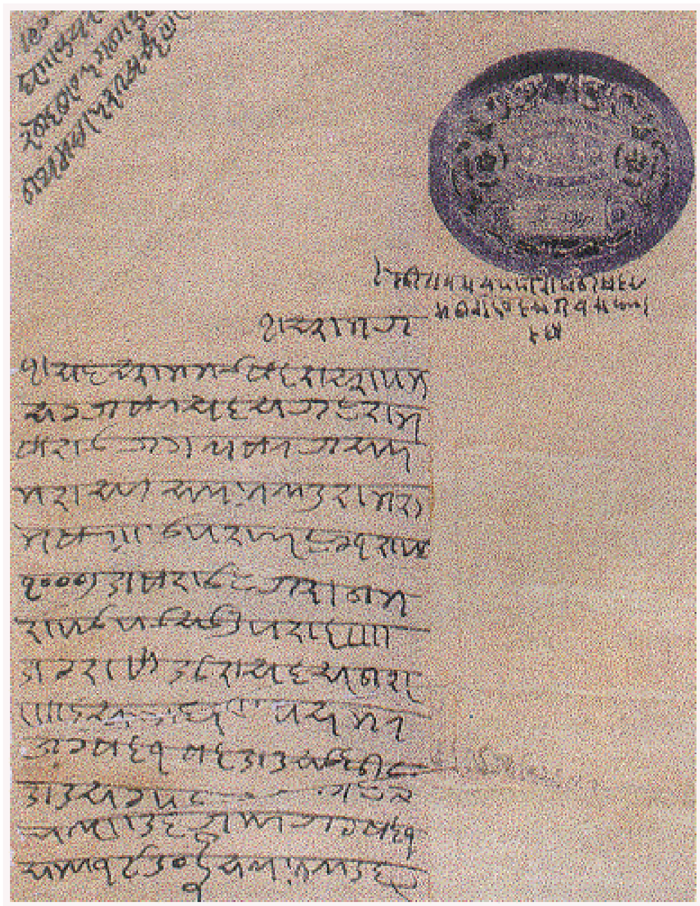

Figure 2.2. Nineteenth century Period Hundi
(Courtesy - Museum Cell, RBI)

2.8. Hundis were of various kinds and each type had certain distinguishing features.

Darshani Hundi : This was a demand bill of exchange, payable on presentation according to the usage and custom of the place. These were mainly of four types.

A] ***Sah-jog* -** was a hundi transferable by endorsement and delivery but payable only to a Sah or to his order. A Sah was a respectable and responsible person, a man of worth and substance who was known in the market.

B] ***Dhanni-jog* -** was a demand bill of exchange payable only to the dhanni, i.e. the payee. This hundi was not negotiable.

C] ***Firman-jog* -** hundis came into existence during the Muslim period. Firman is a Persian word meaning order and therefore, firman-jog hundis were payable to the order of the person named. These hundis could be negotiated with a simple or conditional endorsement.

D] ***Dekhavanhar* -** hundi was a bearer demand bill of exchange payable to the person presenting it to the drawee. Thus it corresponded to a bearer cheque.

Muddati Hundi : This is a usance bill and is payable after stipulated time or on a given date or on a determinable future date or on the happening of a certain stipulated event. Muddati hundis of Sah-jog, dhanni-jog and firman-jog types had the same features as those attached to the same types of darshani hundis. However, the most important type of muddati hundi was the jokhami hundi, which was a documentary bill of exchange corresponding to the present day bill of lading. This had been in use for centuries and payment was conditional on the safe arrival of goods.

2.9. The princely states of India had their own distinct coins. An example of this was the Arcot Rupee coin struck by the Nawab of Arcot in the Madras Presidency. By 1740, the Europeans had secured the privilege of coining this rupee, and the coins came to be known as English, French and Dutch arcots. In 1835, the East India Company introduced the Company's Rupee to bring about uniformity of coinage over British India.

2.10. Paper money, in the modern sense, has its origin in the late 18th century with the note issues of private banks as well as semi-government banks. Amongst the earliest issues were those by the Bank of Hindoostan, the General Bank in Bengal and Behar, and the Bengal Bank. Later, with the establishment of three Presidency Banks, the job of issuing notes was taken over by them. Each Presidency Bank had the right to issue notes within certain limits. The Bank of Bengal notes generally circulated within the environs of Calcutta and were mainly used for effecting large transactions. The largest proportion of the Bank of Bengal notes consisted of notes of Rs.100 and upwards. The notes sometimes bore a small premium, so great was the public confidence in the bank. The Paper Currency Act of 1861 conferred upon the Government of India the monopoly of Note Issue bringing to an end note issues of private and Presidency Banks.

2.11. The private banks and the Presidency Banks introduced other payment instruments in the Indian money market. Cheques were introduced by the Bank of Hindoostan, the first joint stock bank established in 1770.

2.12. Post Bills were introduced by the British in 1827. These were Inland Promissory notes issued by the bank on a distant place, the holder of which would be paid on acceptance after a specified number of days (seven days' sight or thirty days' sight) and were similar to muddati hundis. These bills had a much smaller currency than bank notes, mainly because the government refused to authorise their receipt in payment of public dues. They were mainly used by European businessmen for purposes of internal remittances.

2.13. In 1833, cash credit accounts were added to the Bank of Bengal's array of credit instruments. The bank used to grant loans against the security of Company's paper, bullion, plate, jewels or goods of non-perishable nature or goods not liable to great alteration in their value up to a limit of 1 lakh sicca rupees.

2.14. Buying and selling bills of exchange became one of the items of business to be conducted by the Bank of Bengal from 1839.

2.15. In 1881, the Negotiable Instruments Act (NI Act) was enacted, formalising the usage and characteristics of instruments like the cheque, the bill of exchange and promissory note. The NI Act provided a legal framework for non-cash paper payment instruments in India.

2.16. With the steady growth in volumes of trade and commerce and the growing confidence of the public in the usage of cheques etc., transactions through the use of these payment instruments grew at a rapid pace. Bank employees had to frequently walk to other banks, collect cheques and drafts, and present them to drawee banks and collect cash over the counter. There was danger of loss in transit of the instruments. Besides, such methods could only serve for limited volumes of instruments. With the development of the banking system and higher turnover in the volume of cheques, the need for an organised cheque clearing process emerged amongst the banks. Clearing associations were formed by the banks in the Presidency towns and the final settlement between member banks was effected by means of cheques drawn upon the Presidency Banks. With the setting up of the Imperial Bank in 1921, settlement was done through cheques drawn on that bank.

2.17. The Calcutta Clearing Banks' Association, which was the largest bankers' association at that time, adopted clearing house rules in 1938. The association had twenty-five large banks as its members and eight sub-members. There were two ordinary clearings on each business day, except on Saturday when there was one clearing. However, the association did not cover many banks functioning in Calcutta. The cheques, drafts etc. of such non-clearing banks were collected by the clearing banks only on payment of charges. This affected their business prospects adversely, as the public was not likely to maintain accounts with banks whose cheques suffered a serious handicap of market acceptability. To overcome this problem, these banks formed themselves into a group called the Metropolitan Banking Association with fifty members, which conducted the Metropolitan Clearing House, in 1939. This association arrived at an understanding with the Calcutta Clearing House in 1940. In addition, two other clearings were conducted in Calcutta - the Pioneer clearing and the Walks Clearing.

2.18. The Bombay Clearing House was the only association to conduct clearings in Bombay. It had no parallel systems/institutions comparable to the Metropolitan Clearing House of Calcutta. The uniform procedures and charges for collection of non-clearing banks' cheques, drafts, dividend warrants etc. were adopted by the Bombay Clearing House in 1941-42.

2.19. After the setting up of Reserve Bank of India under the RBI Act 1935, the Clearing Houses in the Presidency towns were taken over by Reserve Bank of India.