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A Commercial Bank Regulation Act At Last

During the war years the Indian banking system witnessed substantial expansion, with an all-round increase in the number of banks, their branches and deposit resources. Establishment of banks and securing deposits had been all too easy, while there was scope to make considerable profits. The absence of adequate statutory authority to regulate the establishment and running of banks had led to various unsound practices, as already described in Chapter 15**.** However, under the artificial conditions of the war, with a continuous rise in capital values, the weaknesses in the banking system remained obscured. It was obvious that with the return of peace, the banking system would have to face hard times, possibly leading to a crisis for a number of new and small units in particular, if adequate precautionary measures were not taken by the authorities. Hence, the Reserve Bank's main concern at the close of the war was to consolidate the war-time growth and ensure the development of banking on sound lines by eliminating the unhealthy features at an early stage. The Bank tried its utmost to get the Banking Companies Bill enacted on a priority footing, but the constitutional changes and the Government's preoccupation with the more pressing problems following the partition of the country delayed the passage of the Bill till March 1949**,** However, owing mainly to the Bank's insistence, interim regulatory measures were adopted between 1946 and 1948, bringing into effect in advance some of the more important provisions of the Bill.

The post-war transition was marked by the occurrence of localised banking scares, arising in some cases from the unsound policies pursued by banks, and precipitated in others by the disturbed conditions accompanying the partition of the country or by the failure of certain

banks. These, however, did not assume serious dimensions as the Reserve Bank stood by to provide necessary assistance to banks through purchase of Government securities. Besides, the Bank came in to provide special assistance to banks in deserving cases by getting its Statute amended for the purpose. The dislocation of banking business in the border areas of the Punjab in the wake of civic commotions also necessitated special measures to alleviate the difficulties of banks and their depositors in the area.

While banking regulation took up the major part of the Bank's attention during the period, the promotional and developmental aspects of banking were not overlooked. The gradual adaptation of trade and industry to normal peace-time conditions brought with it increased demands for bank credit. The banking system had to find the necessary resources for meeting these demands by bringing about a gradual reduction of their swollen holdings of Government securities. The purchase of Government securities by the Bank on a substantial scale and its advances against these securities enabled the banks to meet their requirements in an orderly manner.

On the Bank's initiative, the Rural Banking Enquiry Committee was appointed by the Government in 1949 to consider important policy issues relating to the extension of banking facilities in the country. This will be covered in Chapter 23. The Bank also played an active role in the establishment of the Industrial Finance Corporation of India and of State Financial Corporations.

INTERIM BANKING LEGISLATION AND CONTROL

Banking Companies (Inspection) Ordinance, 1946

We may begin with the regulatory measures taken on an interim basis prior to the adoption of full-fledged banking legislation.

Addressing the shareholders of the Bank in August 1945, the Governor warned that 'while the general banking picture continues to be healthy and encouraging, there are certain undesirable- tendencies, which, if not checked in time, might react unfavourably on the country's -banking structure '. The Bank was strongly of the view that during the difficult years of transition from war to peace, it was essential that the Government and the Reserve Bank should be armed with effective powers to safeguard the health of the banking system. Apart from suggesting the, inclusion in the Banking Bill of a system of licensing of banks and branches in India, the Bank recommended to the Central Government in September 1945 the promulgation of an Ordinance to

bring into immediate effect the provisions in the Banking Bill regarding inspections; the Ordinance was to be operative until the enactment of the Banking Bill. Accordingly, in January 1946, the Banking Companies (Inspection) Ordinance was promulgated.

Under the Ordinance, the Central Government were empowered, at any time, to direct the Reserve Bank to undertake an inspection of the books and accounts of any banking company incorporated under the Indian Companies Act and to make a report to the Central Government. If, after considering the Bank's report of inspection, the Central Government were of the opinion that the concerned bank's affairs were being conducted to the detriment of the interests of its depositors, the Government could prohibit the bank from receiving fresh deposits or refuse its inclusion in the Second Schedule or, if it had been so included, direct its exclusion from the Schedule. The Ordinance further prescribed penalties for contravention of its provisions and empowered the Central Government to publish the whole or any part of the inspection report after giving reasonable notice to the concerned bank.

Incidentally it may be pointed out that the drafting of the Ordinance was found to be somewhat defective. In terms of the Ordinance, a 'banking company' referred to a company 'as defined in Section 277F of the Indian Companies Act, 1913 '; this meant that it was applicable only to banks in British India, other than the Imperial Bank and the exchange banks, and that the Reserve Bank had no authority to inspect banks incorporated in the Indian States or branches in Indian States of banks incorporated in British India. This serious lacuna was pointed out to the Government by the Bank, ' but the matter was not proceeded with owing to the inadvisability of amending the Ordinance and the fact that the inconvenience was only a temporary one since the Banking Companies Bill would soon be replacing the Ordinance '.

Prior to the promulgation of this Ordinance, the inspections carried out by the Bank to determine the eligibility of banks for inclusion or retention in the Second Schedule were confined to ascertaining the real value of the paid-up capital and reserves of banks. The scope of inspection under the Ordinance was much wider as it involved a qualitative assessment of a bank's management, policy and methods of business from the point of view of the depositors' interests. Soon after the promulgation of the Inspection Ordinance, the Central Government issued instructions, on the suggestion of the Bank, that all inspections of banks incorporated in British India should thenceforth be carried out under the provisions of the Ordinance, including those .for the purpose of determining the eligibility of banks for inclusion or retention in the Second Schedule.

The vesting of the power of inspection in the Bank naturally imposed on it the necessity of maintaining a large establishment for the purpose. The Central Government suggested in February 1946 the levy of a licence fee on the banks inspected, since the cost of inspection would have to be borne by the Government. The Bank was, however, of a different view. It wrote back to the Government in the same month thus:

> The protection of depositors and the development of banking in India on sound lines are a national interest and any administration costs that may be incurred by the Reserve Bank in the course of inspection and in fulfilment of its duties as the mentor of the Indian Banks should, in our opinion, be borne by the Reserve Bank, i.e., indirectly by the State. Moreover, the inclusion of a provision for the levy of fees on banks to cover the cost of inspection would only increase the opposition of banks to the Bill. The amount of licence fees obtained from the banks would also be only a small percentage of the costs the Reserve Bank will have to incur. In view of these considerations, we are inclined to think that it would not be either justifiable or desirable to levy a licence fee at this stage.

The Government dropped the proposal.

The Bank carried out the inspection of 41 banks under the Inspection Ordinance, as of the end of June 1949**.** In some cases, the affairs were found to be conducted so badly that the Bank recommended to the Government drastic remedial action such as prohibition of acceptance of fresh deposits or removal from the Second Schedule. On the public coming to know, in a few recalcitrant cases, that Government had taken or contemplated taking serious steps, there were heavy withdrawals of deposits from the banks concerned and they had to suspend payment. The events leading to the failure of two banks, viz., the Exchange Bank of India and Africa and the Nath Bank are discussed briefly later in this chapter, since the Reserve Bank was directly affected by their liquidation, having granted emergency advances to them in a futile attempt to rescue them.

Banking Companies (Restriction of Branches) Act, 1946

The second important interim regulatory measure taken was the passing of the Banking Companies (Restriction of Branches) Act, 1946. From its inspections the Bank found that most of the banks which failed had embarked, soon after their scheduling, on a spree of expansion by opening several branches, which ultimately proved uneconomical to maintain. Also, during the war years, many of the offices had been opened in places already having adequate banking facilities. The Governor took a serious view of the lop-sided opening of branches and suggested to the Central Board in December 1945 that a new

clause should be inserted in the proposed Banking Bill, requiring banks to obtain Reserve Bank's sanction for the opening of a new branch and providing that, before granting any such permission, the Bank be required to satisfy itself that the interest of the public would be served by the opening of the branch. The Central Board approved the Governor's proposal but watered it down by resolving that ' should it be found that this clause provoked strong opposition, the provision may be dropped if pressure from non-official members is brought to bear upon Government'. However, in July 1946, the Board, on reviewing the position, felt the need for urgent action and decided that Government should be addressed to consider the desirability of passing an Ordinance, giving the Reserve Bank the pokier to license branches of banks.

The Bank's proposals for the Ordinance enlarged the scope of the branch licensing provisions envisaged previously, inasmuch as its approval was to be obtained even for changes in the location of existing branches. The Bank also recommended that, besides public interest to be served by the proposed branch, the other factors to be taken into account before issue of licence should be the financial history and condition of the bank concerned, the general character of its management, the adequacy of the bank's capital structure and its future earning prospects. The Government signified to the Bank in September 1946 their opposition to legislation by Ordinance 'save in the most exceptional circumstances'. Government were, however, agreeable to introduce a bill in the next session of the Assembly if more factual evidence was produced in support of the measure.

In October 1946, the Bank furnished the Government with a comprehensive note on the subject, giving facts and figures of the unhealthy trends prevalent in branch banking. The Bank's reasoning convinced the Government, which introduced the Bill in the Legislative Assembly immediately. The Banking Companies (Restriction of Branches) Bill was passed without practically any discussion or any adverse public comment as apprehended by the Board of the Bank and by the Government and the Act came into force in November 1946.

The drafting inadvertence that had crept in the Inspection Ordinance was repeated in the Restriction of Branches Act, as it was made applicable to banking companies incorporated under the Indian Companies Act, i.e., to banks registered in British India. An anomalous position arose in that a British Indian bank had to take permission to open a branch in British India, while a bank incorporated in an Indian State or an exchange bank could open a branch in British India without any such permission. Further, any bank -British Indian or otherwise - could open a branch outside British India without the Reserve Bank's permission. The Bank issued a circular to all banks in

December 1946 explaining the legal position, whereupon the Government remarked in their letter of. January 2, 1947, as follows:

> As you are aware, the exclusion of banks incorporated outside British India and of branches of British Indian Companies outside British India was inadvertent. It was not, therefore, desirable to bring this fact specially to the notice of all banks. It is true that in view of the lack of legal power you cannot refuse permission in such cases but it would have been as well to allow the banks to apply where they thought such permission necessary.

However, the position was rectified with the promulgation of the Banking Companies (Control) Ordinance in 1948, in terms of which all banks were required to obtain the Reserve Bank's permission for opening new branches and changing the location of existing branches in India. As a result, the pace of branch expansion slowed down. This is evident from the progressive decline in the number of applications received by the Reserve Bank for permission to open new branches or change the location of existing .branches, as may be seen below:

	Number of applications Received	Allowed	Rejected
1947	487	370	117
1948	352	272	80
1949	173	125	48
1950	120	92(6)*	29

* For opening offices in places outside India.

The following table gives a picture of the progress of branch banking during the years 1946-50.

Year (End of)	All banks	Total scheduled banks	Imperial Banks of India	Exchange banks	other scheduled banks	Non scheduled banks
1946@ ….	4,886	2,857	358	58	2,441	2,029
1947@ ….	4,819	2,987	362	60	2,565	1,832
1948.. ….	4,674	2,963	367	62	2,534	1,711
1949 .. ….	4,441	2,852	377	64	2,411	1,589
1950 .. ….	4,353	2,779	382	62	2,335	1,574

@ Figures relate to Indian Union.

In contrast to the continuous and substantial growth in the number of offices during the war period, there was a steady fall from the middle of 1948. While the decline was partly due to the effects of partition, the

restrictions imposed by banking legislation restrained a mushroom growth of branches and also compelled banks to close some of their unremunerative branches.
There was also a decline in the number of offices of Indian banks abroad, mainly in Pakistan, as shown below:

End of		Scheduled banks	Non-scheduled banks
1946	....	628	153
1947	....	463	68
1948	....	226	46
1949	....	144	31
1950	....	125	26

Notwithstanding the operation of statutory control over branch banking for about four years, there was no significant change in the matter of regional imbalances in banking offices. For one thing, as already mentioned, there was a net decline in the number of branches in the postwar years. For another, in the initial years of branch control the Reserve Bank's policy was not so much one of bringing about a balanced branch expansion regionally as that of curbing large scale expansion generally, with a view to consolidating the substantial growth that had occurred during the war years. At the end of 1950, out of a total of 2,478 towns in the Indian Union, as many as 1,015 towns were not served by an office of any bank. Again out of the aggregate of 5,077 banking offices in the Indian Union (including 724 offices of co-operative banks), 2,896 offices (47 per cent of the total) were concentrated in 175 towns with a population of 50,000 or more (according to the 1941 census). The offices of scheduled banks were concentrated in the States of Madras, Bombay, Uttar Pradesh, the Punjab and West Bengal and those of the non-scheduled banks in Madras, Bombay, West Bengal, and Travancore-Cochin.

Banking Trends, 1945-51

At this stage, it may be useful to refer to the trend of bank deposits, advances, etc., in the post-war period, up to March 1951. In analysing the banking trends, three broad phases may be discerned, viz., (a) from the close of the war till June 1948, when both deposits and advances registered a more or less continuous rise, (b) July 1948 to December 1949, which witnessed a steep fall in deposits and a moderate decline in advances barring seasonal expansion, and (c) from the beginning of 1950 onwards when the earlier uptrend in deposits and advances reappeared.

The consolidated position of scheduled banks for (i) undivided India for 1945 through June 1948 and (ii) the Indian Union for 1947 through March 1951 are presented in the following page. Since, for purposes of analysis, it would be more convenient to take the post-war period up to June 1948 as a whole, the figures for undivided India for 1947 and June 1948 have been derived from the totals for the Indian Union and Pakistan. From July 1948, the analysis is based on figures relating to the Indian Union.

During the first phase, i.e., from the end of the war till June 1948, the war-time uptrend in deposit liabilities continued; total demand and time liabilities rose from Rs. 865 crores at the end of June 1945 to Rs.1,112 crores by the last week of June 1948, a rise of 28.6 per cent over the three-year period. There was some decline in the proportion of demand liabilities to total deposit liabilities but, around 70 per cent, it was still substantially higher than in the pre-war period. With the gradual adaptation of trade and industry to peace-time conditions, advances and bills rose sharply by almost Rs.200 crores in the three-year period, from Rs. 292 crores to Rs. 487 crores, the advances-deposits ratio rising from 33.8 to 43.8 per cent. On the other hand, investments in Government securities, which had risen sharply and approximated to about one-half of the deposit liabilities in December 1945, recorded some decline. Scheduled banks' borrowings from the Reserve Bank remained insignificant throughout the period; excepting a few weeks during January and August-October 1946 and January 1947, the weekly outstandings were less than a crore of rupees.

During the second phase, July 1948 to December 1949, aggregate deposits* registered a steep fall of Rs.139 crores, from Rs. 974 crores to Rs. 835 crores. This was the combined result of a number of factors, in particular the heavy adverse balance of trade and the repatriation of some foreign capital. During the same period, advances and bills also recorded a net decline, though there was substantial expansion in the busy season. The large decline in deposits was met by the disinvestment of Government securities; the decline in this item was from Rs. 467 crores in October 1948 to Rs. 357 crores by the end of 1949. Scheduled banks' borrowings from the Reserve Bank were higher during the greater part of the period, moving between Rs. 4 crores and Rs.22 crores.

In the third phase, i.e., from the beginning of 1950, deposits registered a moderate but almost a steady rise, from Rs. 835 crores in the last week of 1949 to Rs. 881 crores by the end of March 1951 - a rise of Rs. 46 crores over the fifteen month period. Advances and bills rose substantially during the period from Rs. 412 crores to Rs. 547 crores,

* i.e., deposit liabilities excluding borrowings from banks. These data are available only from July 1948.

TRENDS IN SCHEDULED BANKS' DATA, 1945-51

(Rs. crores)

Last Friday of	Undivided India					Indian Union					
	June 1945	1945	1946	1947	*June* 1948	1947	*June* 1948	1948	1949	1950	*March* 1951
Number of Reporting Banks ..	86	91	96	99(I) 50(P)	100(I) 45(P)	99	100	95	95	93	93
Demand liabilities	626	673	730	727	782	648	664*†	637*	565*	580*	593*
Time liabilities	239	280	332	342	330	316	310*†	298*	270*	281*	288*
Total Demand and Time liabilities	865	953	1,062	1,069	1,112	965	974*†	934*	835*	861*	881*
Cash and Balances with the Reserve Bank	119	122	117	146	147	..	118†	108	114	95	93
Advances and Bills Discounted ..	292 (33·8)	327 (34·2)	465 (43·8)	445 (41·6)	487 (43·8)	406 (42·1)	452† (46·4)	443 (47·4)	412 (49·3)	445 (51·7)	547 (62·1)
Borrowings from the Reserve Bank	—	0·8	0·4	—	—	—	—	17	7	0·8	12
Investments in Government Securities	—	496 (52·0)	494 (46·5)	484 (45·3)	—	—	—	450 (48·2)	357 (42·8)	366 (42·5)	316 (34·7)

Figures in brackets are percentages to total demand and time liabilities up to June 1948 and to total demand and time deposits thereafter.
* Deposit liabilities only. † Relate to July 2, 1948.
(I) India. (P) Pakistan.

the credit-deposits ratio rising sharply from 4g to 62 per cent. The demand for credit was aggravated, apart from seasonal requirements, by the post-Korean boom. in commodity prices, speculative hoarding of commodities in short supply and liberalisation of imports. The sharp increase in bank credit was financed largely by liquidation of investments, and to some extent, by the drawing down of cash and balances with the Reserve Bank and by borrowings from the Bank.

In the post-war years, generally, the scheduled banks (and state cooperative banks) resorted to the Bank for short-term accommodation on a much larger scale than in the war or pre-war years. The following table gives the aggregate of the gross advances made to scheduled banks during the years 1937-51**;** almost the whole of such assistance was by way of advances against Government securities under Section 17(4) (a).

Year ended March	(Rs.lakhs)	Year	(Rs.lakhs)
1937	72	1945	1, 75
1938	21	1946	24, 70
1939	2, 87	1947	3, 08
1940	27	1948	22, 02
1941	59	1949	35, 61
1942	64	1950	13, 72
1943	4, 03	1951	76, 57
1944	2, 53		

The non-scheduled banks, though numerous, accounted for only a small part of the resources of the banking system. Their number had recorded considerable increase during the war with the establishment of several mushroom banks, many of them with little chance of survival. Hence, the post-war years witnessed the phenomenon of a number of these small banks going out of existence, either as a result of the operation of the natural law of survival or the coming into force of the new legal provisions for regulating banking business. The number of nonscheduled banks declined from 542 at the end of 1946 to 48 by the close of 1951**.** During the same period, deposits of these banks came down from Rs. 97 crores to Rs. 69 crores, credit extended by them from Rs. 54 crores to Rs.46 crores and their investments from Rs.34 crores to Rs. 27 crores.

Banking crises, 1946-49

The interim banking regulation measures introduced during the war and post-war years, pending the passage of the Banking Companies

Bill, were mainly designed to weed out the unsound units and generally to ensure the proper management and conduct of the affairs of banks. It was, therefore, but natural that, soon after the Inspection Ordinance and the Restriction of Branches Act had been brought into force in 1946, many of the banks-especially the less viable ones -got into difficulties, resulting in minor crises in the areas of their operations.

In this regard, the banks in Bengal presented a particularly difficult problem. There were far too many of them. The Registrar of Joint-Stock Companies, Bengal, estimated that 850 to 900 non-scheduled banks were functioning in that Province, more than half of which were only loan companies and did not do any real banking business. Nearly 75 per cent of the non-scheduled banks had paid-up capital of less than Rs. 75,000 and some even below Rs.500. The deposits of this class of banks in Bengal had risen from Rs. 5 crores to Rs.31 crores between 1940 and 1946; those of Bengali scheduled banks had increased from Rs.5 crores to Rs.70 crores during the same period. The vulnerable position of many of these banks came to a head during 1946 when 26 non-scheduled banks were black-listed by-the Calcutta Clearing Banks' Association for non-compliance with accepted banking practices. Towards the end of that year there was a run on several banks in the area, including three scheduled banks. Four non-scheduled banks suspended payment and were granted interim moratoria by the Calcutta High Court.

The Government of Bengal issued a press communique at the end of November 1946 dispelling mischievous rumours that all nonscheduled banks were in difficulty or were financially unsound and averring that a substantial number of banks were reported to be working on sound banking lines. The Government also stated that the list prepared by the Calcutta Clearing Banks' Association contained the names of some banks which had ceased working as early as 1944-45 and that there was no ground for panic. The crisis subsided after this press communique and the issue on similar lines of a press communique by the Calcutta Manager of the Reserve Bank, as also the fixing of minimum selling price of shares by the Calcutta Stock Exchange. One of the scheduled banks had to get itself affiliated to a bigger scheduled bank to ward off the crisis. In order that the situation might not get aggravated, inspections by the Reserve Bank of banks in the Eastern Area were suspended temporarily.

The unhealthy practices followed by a number of non-scheduled banks in Bengal and their tendency to open an excessively large number of branches and to grant loans without security were mainly responsible for the difficulties of the banks. Thus, for inslance, the four banks which were granted moratoria had too many branches in relation to their paid-up capital and reserves, as under:

	Capital and reserves (Rs.lakhs)	No. of branches
Bank A	2.33	23
Bank B	0.69	50
Bank C	9.36	67
Bank D	1.33	77

Lack of proper personnel at the helm of affairs of the banks was also an important contributory factor to their unsatisfactory working. In the case of some banks, there was large scale lending against speculative shares and investments in shares of associated companies. During the last quarter of 1946, owing to a combination of political and economic factors and labour troubles, there was a slump in share prices and the banks which had made large advances against shares or invested in them were adversely affected.

The conditions in the Eastern area returned to normalcy by about the end of January 1947, but-during the same month there were disturbances of a serious nature in the Punjab leading to a large scale destruction of property and loss of human life. Banks operating at centres affected by these disturbances sustained losses partly owing to the destruction of some of their offices but mainly because a sizeable portion of commodities against which they had granted advances was gutted by fire, particularly in Amritsar. The civil disturbances led to serious disruption of communications and also to some extent nervousness among the depositors of some banks. In the Western area also, a few banks experienced difficulties following the failure of the Associated Banking Corporation of India in March 1947.

A few of the affected banks made large drawings from their balances with the Reserve Bank. They also sold Government securities to the Bank on a large scale and availed themselves of advances against Government securities from the Bank, to meet the run and also as a precautionary measure. In this situation, the Bank issued a circular letter in March 1947 to all banks reminding them that they should be in close touch with the Bank's Managers at different centres and should keep the Bank posted with detailed information regarding their financial condition, so that the Bank could assist them when necessary without delay.

After the partition of the country, certain relaxations were also made in existing banking laws at the instance of the Reserve Bank, to avoid damage to the banking structure in the border areas and unnecessary distress to their depositors, many of whom were refugees. The Banking Companies (East Punjab and Delhi) Ordinance was promulgated in September 1947, empowering the Central Government to

make an order staying for a period of three months the commencement or continuance of all actions and proceedings against an applicant bank whose registered office was situated in East Punjab or Delhi. During this period the bank concerned was authorised to make payments to each depositor not exceeding ten per cent of the total amount of the current and deposit accounts at each branch in India or Rs. 250 whichever was less and was also permitted to make similar payments to the depositors who could satisfy the bank about their deposits in branches outside India. Beyond such payments and its normal running expenses, the bank was not allowed to dispose of any of its assets or accept any deposits. The Central Government were empowered to advance to the bank the amounts necessary to enable it to make payments to the depositors. In pursuance of this measure, three banks were granted interim relief by way of moratoria.

The Government of India also issued in December 1947 the Negotiable Instruments Act and the Indian Limitation Act (Temporary Amendment) Ordinance, temporarily amending the Negotiable Instruments Act, 1881, and the Indian Limitation Act, 1908. The Ordinance was intended to safeguard the interests of banks which experienced difficulties in dealing with bills drawn on firms and companies situated in the Punjab and other disturbed areas. Under the Ordinance, the banks were given powers to treat bills as dishonoured when presentment was impossible owing to the prevalence of riots or other disturbances. It was also provided that any suit, which could not be instituted within the period of limitation on account of riots or disturbances, could be admitted after the period of limitation provided the plaintiff satisfied the court that he was unable to file a suit within such period owing to disturbances.

The Reserve Bank of India (Temporary Amendment) Ordinance, promulgated by the Government in September 1947 itself, amended Section 18(3) of the Reserve Bank Act, to enable the Bank to grant emergency advances to banks against such form of security as it might consider sufficient. The genesis of this measure is described in some detail later in this chapter.

Excepting the Banking Companies (East Punjab and Delhi) Ordinance, which bristled with difficulties in implementation, the other two Ordinances remained virtually a dead letter. All these three Ordinances lapsed in March-June 1948.

Although the 1946 crisis subsided early, some of the Bengali banks were not able to retrieve their lost position in the succeeding years. Their efforts to prevent a debacle by impressing upon their depositors by advertisements that they were 'scheduled banks' and 'clearing banks' did not help restore much public confidence in them. The aggregate liabilities of non-scheduled banks in Bengal fell from Rs.31

crores in July 1946 to Rs. 8 crores in December r 947 ; those of scheduled banks declined from Rs. 70 crores in September 1946 to Rs. 64 crores in June 1948 and Rs. 46 crores in December 1948. The descheduling of the Bank of Commerce, Calcutta, in April 1948 gave another jolt to public confidence and resulted in steady withdrawals of deposits, including time deposits, particularly from the smaller Bengali scheduled banks. Owing to their unsound financial position and blocked advances, those banks were unable to cope even with the small demands of their depositors. Four scheduled banks, viz., the Calcutta Commercial Bank, the Pioneer Bank, the Mahaluxmi Bank and the Noakhali Union Bank, had to suspend payment in September 1948.

In the early part of 1949, there was a run on some of the foreign and Indian branches of the Exchange Bank of India and Africa and the Reserve Bank had to grant substantial assistance to it to prevent further withdrawals, as described later in this chapter. There was a widespread belief that the run would extend to other banks in the Bombay area, but luckily the scare did not last long.

In the post-war period, for all the stresses and strains, bank failures were fewer than in the war years. The post-war failures, however, involved, on an average, larger banks. The total paid-up capital of the 207 banks that failed in the period 1946-50 was Rs. 533 lakhs as compared with Rs. 68 lakhs in respect of the 365 banks that failed in the war years. Annual figures for the period 1945-51 are given in the table below.

(Rs.lakhs)

Year	No.of Banks	Capital		
		Authorised	Subscribed	Paid-up
1945	27	81	9	5
1946	27	250	12	9
1947	37	753	105	87
1948	45	1,278	245	179
1949	53	996	179	117
1950	45	737	190	140
1951	62	918	92	62

Reserve Bank's Policy regarding Special Assistance to Banks

The Bengal banking crisis of 1946 brought once again to the fore the question of the Bank's policy regarding the provision of financial assistance to banks in difficulties. In November 1946, one of the Bengali banks -a scheduled bank -affected by withdrawals requested the Reserve 'Bank for financial accommodation against the security of shares held by it in its investment and loan portfolios.

This bank was a frequent borrower from the Reserve Bank in the latter half of 1946 against Government securities; the bank did not disclose the real reason for its borrowings which, it later transpired, was the fall in its deposits. In spite of a fall in deposits by Rs. 44 lakhs between May, and November 1946 -which was not, however, revealed as the bank's demand loans from other banks offset the decline in deposits -the bank had increased its advances by Rs.1 crore. Despite the warnings of the Bank against extension of credit for speculation in shares (for which purpose the Bank issued a circular in May rg46), the bank's advances against shares formed 63 per cent of its total advances, in December 1946. In a falling market, the margins maintained by the bank were only 25 to 30 per cent. Apart from the question whether the Reserve Bank should go to the assistance of such a bank, it was doubtful whether the Bank was authorised to make advances to the bank against bills covering advances against shares, since such bills could not be considered to be drawn for bonafide trade or commercial transactions. Further, under Section 19 of the Reserve Bank of India Act, advances against shares were specifically prohibited. The request of the bank was, therefore, turned down.

The Bank, however, took up the question of amending the Act to enable it to advance on occasions of special urgency against shares or, generally speaking, against any type of security deemed suitable by it. The point to be considered was whether the amendment, if proposed, should be carried out under Section 17 or under Section 18 of the Act. No doubt, under Section 18 of the Act the Bank was authorised to grant accommodation against eligible paper to non-scheduled banks when it was satisfied that a special occasion had arisen for action under the Section; the fact was that the banking crisis in Bengal affected primarily the non-scheduled banks. However, most of the nonscheduled banks in Bengal had hardly any assets eligible for rediscount or advances under the Act; their financial position and methods of operation and the policies pursued by their managements were very unsatisfactory. In practice, therefore, it would have been impracticable for the Bank to assist any considerable number of non-scheduled banks even if the Act was amended.

The Governor, therefore, recommended to the Central Board in December 1946 the amendment of Section 17 of the Act. The Central Board agreed with the Governor and resolved:

> That, after consideration of the Governor's memorandum, the Central Board recommend that, to widen the powers of the Reserve Bank of India to enable them to extend credit to banks beyond the existing provisions of the Act by which they are governed either in a particular instance or where here is a threat to the banking structure of the country, Government should promote legislation on the lines of Section

> 10(b) of the Federal Reserve Act, * to empower the Reserve Bank of India to make advances against promissory notes which are secured to their satisfaction.

The Board resolved further:

> That, in order to enable the Reserve Bank to meet any urgent demand for assistance which might arise before the proposed legislation can been acted in the normal course, Government should prepare and hold in readiness an Ordinance to the same effect for promulgation immediately should the necessity arise.

Later in the month, the Governor submitted a memorandum to the Committee of the Central Board advising amendment to Section 18(3) †of the Act, instead of Section 17 as previously recommended by him. The reasons given by him were: (a) limitations imposed on the Bank under Section 17 of the Act, (b) the absence of the bill habit in India and (c) the inapplicability of Section 17 to non-scheduled banks which were actually the ones that had experienced the greatest strain. He felt, on a reconsideration of the problem, that for the purpose of assistance in the event of an emergency, both scheduled and non-scheduled banks should be treated on par and the Bank should be in a position to assist any bank provided it was solvent and its methods of operation were satisfactory. After all, he argued, the failure of sound nonscheduled banks might spread to scheduled banks needing larger assistance from the Bank. The Banking Bill also made no distinction between the scheduled and non-scheduled banks. Further, some of the non-scheduled banks-their number, of course, small-were run on proper lines and were rendering useful service in their own sphere.

In the memorandum to the Committee, the Governor also indicated certain guidelines for the grant of advances under Section 18 of the Act, if amended. Firstly, the powers were to be used only in case of an emergency when the assistance that could be granted under Section 17 of the Act was found to be inadequate. Secondly, the Bank had to be satisfied as to the solvency and methods of operation of the bank concerned and for this purpose a rapid inspection of its books and accounts might be required. Assistance was to be refused if the difficulties were due to over-trading or lack of normal precautions taken by well-managed banks. Stock exchange securities and immovable properties would be taboo as security for advances. However, the Bank might grant advances against bills not eligible under Section 17 by reason of their longer usance or against bills drawn by parties who

* Any Federal Reserve Bank, under Rules and Regulations prescribed by the Board of Governors of the Federal Reserve System, may make advances to any member bank on its time or demand notes having maturities of not more than four months and which are secured to the satisfaction of such Federal Reserve Bank.

† Renumbered as 18(l) (3), effective September 20, 1947.

had taken advances from banks by way of pledge of goods. All applications for advances under the new amendment had to be carefully examined by the Governor or, in his absence, by one of the Deputy Governors and the approval of the Committee obtained.

The Committee approved the Governor's proposal, and accordingly, the Government were advised to amend Section 18 of the Act.

In a subsequent memorandum placed before the February 1947 meeting of the Central Board, the Governor counselled that the greatest amount of circumspection had to be exercised in granting accommodation even if the Act was amended, in order to avoid the possibility of throwing good money after bad. He explained:

> There is already a considerable pressure on the Reserve Bank to assist banks, whether run on sound lines or not, and there is a general tendency both in the press and elsewhere to criticise the Reserve Bank for not assisting every bank which finds itself in difficulties. Sufficient attentions not, however, given to the bank's financial position and methods of operation and to the fact that it may not have been in difficulties if it had run its business on approved lines. The public has yet to realize that ultimately the progress of banks depends more on good bankers managing the institutions under their control on sound principles than on the assistance of the Reserve Bank. The present tendency of excessive reliance on and undue criticism of the Reserve Bank is likely to be accentuated when our Act has been amended on the lines proposed. It is, therefore, necessary that we should be very careful and not allow ourselves to be stampeded into hasty action by pressure from interested quarters under any circumstances and thereby hamper the development of the Indian banking system on sound lines by prolonging the existence of unsound institutions or by encouraging banks to overtrade.

Government agreed to the Bank's proposal to amend Section 18 of the Reserve Bank Act, but instead of promoting separate legislation they intended to incorporate the provision in the Banking Companies Bill itself. Meanwhile, at the request of the Indian Banks' Association and in view of the general stringency in the money market, in April 1947 the Bank abolished the seven days' minimum interest clause on loans and advances granted to scheduled banks under Section 17(4) of the Reserve Bank Act. Thus, interest was to be charged only for the actual number of days a loan or advance remained outstanding.

Apprehending delay in the enactment of the Bank Bill and having in view the coming busy season and the difficulties experienced by certain banks on account of partition of the country, the Bank recommended to Government in August 1947 the issue of an Ordinance amending Section 18(3) of the Reserve Bank Act. Accordingly, the Reserve Bank of India (Temporary Amendment) Ordinance was issued in September 1947, enabling the Bank to grant emergency advances to scheduled and non-scheduled banks against such forms of security

as might be considered sufficient by the Bank. The implementation of the Ordinance was, however, not easy since under Section 17 or Section 18 of the Act, the Bank could lend only against securities which were acceptable to the Bank. Most of the banks in difficulty had no such security to be offered to the Bank. The Ordinance was, therefore, of no practical value and it lapsed in March 1948.

However, the Bank continued to explore ways and means of helping banks in times of crises. It moved the Government to incorporate a permanent provision under Section 18(3) of the Act for enabling the Bank to advance sums of money against securities not mentioned under Section 17 of the Act, provided it was satisfied with the soundness of the concerned bank. The Bank also suggested that in cases where it advanced such monies under the amended Section 18(3) *, a stipulation might be made to enable the Bank to get a lien over the banks' general assets in preference to unsecured creditors. In anticipation of these amendments with retrospective effect, the Bank granted, in August September 1948, advances aggregating Rs. 3.69 lakhs to a Calcutta bank, against shares, gold ornaments, goods, etc. In fact, a limit exceeding Rs.10 lakhs was sanctioned to this bank, but it failed to produce eligible securities to that extent. The other three Bengali scheduled banks which had suspended payment did not approach the Reserve Bank for any assistance.

The Committee of the Central Board also decided in August 1948, that in an emergency the Governor should be authorised to make advances on suitable security at 2 per cent interest with a margin of 5 per cent of the market value against Government promissory notes and at reasonable margin against other securities. Such advances were to be subject to the conditions that the banks assisted agreed to furnish details of their assets to the Reserve Bank from time to time as directed (whether or not there was a statutory provision for furnishing such information) and also accepted the Bank as the final authority to decide whether the emergency existed or had ceased.

In accordance with the Bank's proposal for amendment of Section 18 of the Act, the Central Government included under the Banking Companies (Control) Ordinance, promulgated by them in September 1948, a clause amending Section 18(3) * by adding the following words in that Section :

> or, when the loan or advance is made to a banking company, as defined in the Banking Companies (Control) Ordinance, 1948, against such other form of security as the Bank may consider sufficient.

The Ordinance also inserted the following additional provision as a new sub-section(2) under Section 18 **:**

* Renumbered as 18(l)(3).

Where a banking company to which a loan or advance has been made under the provisions of clause (3) of sub-section (I) is wound up, any sums due to the Bank shah, subject only to the claims, if any, of any other banking company in respect of any prior loan or advance made by such company against any security, be a first charge on the assets of the banking company.

These amendments were given retrospective effect from September 20**,** 1947**.** The amendments were later placed on a permanent basis in the Banking Companies Act.

These provisions were of immediate significance. For, in the same month that they were first brought into force, i.e., September 1948, on panic appeals for assistance by the Bengali banks in trouble and the West Bengal Government, the Deputy Governor (Mr. Mehkri) visited Calcutta and conferred with the officers of the Bank and some of the local banks, including the Nath Bank which was facing a closure if urgent financial assistance were not forthcoming. The Deputy Governor sanctioned limits to the Nath Bank aggregating Rs. 72.50 lakhs initially against its over-all assets. The limit was almost fully utilised and the advances were subsequently secured by repledge of shares and sub-mortgage of immovable properties belonging to the bank's constituents.

The advances to the Nath Bank were ratified by the Committee of the Central Board soon after they were granted. Still, the Reserve Bank had misgivings about the validity of the securities created in its favour, since there was a technical difficulty that the advances had been made without a definite expression by the Central Board that a special occasion had arisen 'making it necessary or expedient that action should be taken under this section for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture '. The Nath Bank went into liquidation in May 1950 and after protracted legal proceedings lasting for eight years, the Official Liquidator of the bank admitted, bf way of compromise, the Reserve Bank's first charge on the securities pledged to it. The Bank was able to realise most of the money due to it.

A similar difficulty cropped up, in February 1949**,** in the case of the Exchange Bank of India and Africa (Exchange Bank, to be brief) also. This bank experienced a run on some of its foreign branches and it was feared that the panic would have repercussions on the bank's branches at Colombo, Madras and Bombay. Since a major portion of its advances was locked up in airline interests, the bank was unable to meet the withdrawals and frantically appealed to the Reserve Bank for assistance. Advances aggregating Rs. 85 lakhs were sanctioned to it by the Bank under Section 18(1)(3) of the Act, during February-April 1949, against deposit of title deeds of immovable properties

belonging to the bank, the sub-mortgage of properties belonging to its constituents and against the rehypothecation/repledge of other securities in its possession. The advances sanctioned by the Governor/Deputy Governor were ratified by the Committee of the Central Board and the Central Board itself between March and June 1949. Despite the assistance given by the Bank, the Exchange Bank had to suspend payment in May 1949 and was ordered to be wound up in July 1949. The failure of this bank did not, however, cause a run on any other bank in the Western area.

In the liquidation proceedings of the Exchange Bank, the Reserve Bank, being the largest single creditor, claimed the first charge on the assets of the bank, under Section 18(2) of the Act. The Official Liquidator of the bank challenged the Reserve Bank's claim contending that, in order to admit or deny the validity of the Reserve Bank's first charge, it would be necessary for the Bank to prove that the advances were made in accordance with the formalities laid down under Section 18(1) of the Act. The position was, as in the Nath Bank's case, that the advances had been granted without a previous expression of opinion by the Central Board that a special occasion had arisen making it necessary or expedient that the advances had to be granted. The Bank consulted its Counsel who held:

> The matter 'is not free from difficulty. I take the view, not without considerable hesitation, that the Governor is competent under section 7(3) to form the opinion which the Central Board is empowered to form under sub-section (1) of section 18.

Another difficulty was that the particulars of the mortgages or charges had not been registered by the Reserve Bank with the Registrar of Companies as required by Section 18 of the Indian Companies Act. These issues were raised by the Official Liquidator while filing a petition in the Bombay High Court in March 1450 disputing the claims of the Reserve Bank. The Official Liquidator's contentions against the Bank were supported by another creditor of the Exchange Bank who had a charge on the same goods, securities and assets which had been offered to the Reserve Bank as security and who had, besides, taken the precaution of registering his charge with the Registrar of Companies. In January 1951, at the initiative of the High Court and the Official Liquidator, a suggestion was made to the Reserve Bank's solicitors and Counsel that, since the legal position regarding the validity of the Reserve Bank's claims was not beyond doubt, the Liquidator would be agreeable to a compromise in the interest of all creditors, subject to the sanction of the Court. The Governor of the Bank (Rama Rau) obtained the approval of the Finance Minister (Deshmukh) for the compromise under which the Reserve Bank was

entitled to 50 per cent of the net assets realised by the Official Liquidator after deduction of trust monies, preferential claims payable under Section 230 of the Indian Companies Act and costs of liquidation. The recoveries of assets in the liquidation proceedings of the bank were effected at a slow pace spread over a number of years and the Reserve Bank, ultimately, had to forgo a good part of its dues.

Ever since the crash of the TNQBank there was criticism that the Reserve Bank was not helping banks in difficulties and was needlessly insisting on eligible securities, but in 1949-50 the tide of comments turned against the Bank for its large advances to the Exchange Bank. In the Union Parliament, Mr. R. K. Sidhva, in particular, raised the above issue, time and again. The Finance Minister, replying on March 22, 1950 to the questions asked by Mr. Sidhva, was clear in his mind that in exercising its discretion as it did, the Reserve Bank was perfectly justified; its action had been in the best interests of the country.

In view of the compromise arrived at between the creditors and the Official Liquidator of the Exchange Bank, the main points at issue (viz., whether the Governor had the powers of the Central Board in regard to declaration of emergency under Section 18 of the Act and granting of advances under that Section) were not determined by the Court. It was, however, considered necessary by the Bank to clarify the intention of the Act so as to save the Governor from any possible embarrassment in the future caused by a judicial decision regarding his powers. Since the inception of the liquidation proceedings of the Exchange Bank, both the Government and the Bank were considering the manner in which the Reserve Bank Act should be amended to protect the official acts of the Governor under Section 18 from being impugned in a court of iaw. Further, it was recognised that, in the emergency of the kind contemplated in Section 18, it might be detrimental to the general banking business to hold over action until after a meeting of the Board could be convened for prior consultation. The object was achieved in May 1951 when the Reserve Bank Act was amended making it clear under Section 18 read with Section 7(3) that the Governor (or in his absence, the Deputy Governor nominated by him) or the Central Board could validly grant the emergency advances. The amendment was made retrospective from January 1, 1949.

EFFORTS FOR A COMPREHENSIVE BANK ACT

The Bank's efforts for a comprehensive banking legislation continued all through with undiminished vigour. The Banking Companies Bill

which, it may be recalled, lapsed in October 1945 with the dissolution of the Legislative Assembly, was reintroduced in the new Assembly in March 1946. The intervening period gave an opportunity to the Government for considering the amendments suggested by the Bank in May 1945 as also certain additional provisions recommended by it in December 1945.

In October 1945, the Government conveyed their approval of all the amendments suggested by the Bank in May 1945, except the one recommending reduction in minimum capital requirements for banks operating outside the State or Province of their incorporation, from Rs.20 lakhs to Rs.10 lakhs. The Bank's Board, however, reiterated at its meeting in December 1945 the earlier recommendation that the limit should be lowered to Rs.10 lakhs, if strongly pressed by nonofficial members in the Legislature.

The Board also considered at this meeting a memorandum prepared by the Governor suggesting amendments to the Banking Companies Bill to provide for a ' comprehensive ' system of licensing of banks and for licensing of branches of banks too. In the Bill as it then stood, only banks incorporated outside British India or the United Kingdom were required to obtain licences to start banking business in British India. The Governor recommended that the clause should be altered so as to require all banks other than the then existing scheduled banks to obtain licences from the Bank within a period of five years after the provision came into force. The Board approved the Governor's recommendation with the addition of a further stipulation that a bank incorporated in a country the Government or law of which discriminated in any way against banks registered in British India should also be required to take out a licence. In effect, the Bank's revised recommendation could hardly be called comprehensive since, among the then existing banks, licences had to be taken out by only (a) non-scheduled banks and (b) the National City Bank of New York and the American Express Company. The licensing provision was to be applicable to these two American banks, as there were a few States in the U.S.A. which either prohibited the acceptance of deposits by branches of foreign banks or made such acceptance dependent on special permission from the State banking authorities.

The Governor thought it essential to introduce a comprehensive licensing system in the context of a provision under the Banking Companies Bill in terms of which the work of liquidation of banks was to be entrusted to the Bank. The Governor's view was that by enforcing the licensing provisions, a number of petty banks, whose assets had been dissipated by mismanagement, would go out of existence, thereby lessening the Bank's responsibility for undertaking liquidation proceedings. Indeed, the Governor's preference was for deletion of the

provision appointing the Reserve Bank as the Official Liquidator, as the task might prove to be beyond the Bank's administrative capacity. The Board did not, however, consent to this.

Banking Companies Bill, 1946

The recommendations of the Board (excepting those relating to the reduction of minimum capital requirements for banks operating outside their Province or State from Rs.20 lakhs to Rs.10 lakhs and reduction of the percentage of minimum liquid assets from 25 to 20 and some other minor amendments) were incorporated in the Banking Companies Bill which was reintroduced in the Legislative Assembly in March 1946. This Bill also contained important amendments, mooted by the Bank, to the provisions of Section 42(6) of the Reserve Bank Act ; the amendments sought to confer on the Bank the power of inclusion in or exclusion from the Second Schedule, whereas previously the decision in this regard rested with the Central Government. The Bank was also to be given the necessary powers to satisfy itself that the real or exchangeable value of the paid-up capital and reserves of the bank concerned was not less than Rs. 5 lakhs and the bank's affairs were not being conducted to the detriment of the interests of the depositors.

A motion to refer the Bill to a Select Committee was adopted by the House in April 1946, but, owing to constitutional developments, the Committee could not meet until November 1946. In the meantime, as already mentioned, at the Bank's instance, the Government promulgated the Banking Companies (Inspection) Ordinance and secured the passage of the Banking Companies (Restriction of Branches) Bill.

The respite afforded by the delay in the meeting of the Select Committee till November 1946 gave the Bank the chance of having yet another look at the Banking Companies Bill and recommending to the Government fundamental changes in the provisions relating to inspection. The relevant clause, as it stood in the Bill, provided for inspection by the Reserve Bank only when the Central Government. had misgivings about the condition of a bank. The point had been made that the commencement of an inspection of a bank under such circumstances might cause a run on it and impair its credit irretrievably. To avoid such untoward consequences, a system of regular inspections was suggested by the Bank's management in a memorandum to the Central Board in July 1946. The clause was to be altered on the lines of the provisions of the Inspection Ordinance which provided that the Central Government could at any time direct the Bank to cause an inspection to be made and make report thereon to the Central Government. The Bank's Board, at its meeting in August 1946, not only agreed with this recommendation but also resolved that the authority

to inspect a bank should vest in the Reserve Bank itself without requiring it to obtain a direction from the Central Government. This was, indeed, a far cry from the 1939 proposals which had deliberately by-passed inspection as not practicable nor desirable ! This also underlined the flexible approach adopted by the Bank's Board in the light of war-time banking developments.

The Select Committee, which examined a number of expert witnesses, held meetings in November 1946 and January and February 1947. In the discussions among the members, several interesting suggestions, and some radical ones too, were made. For instance, Mr. Manu Subedar brought up the question of the abolition of the many distinctions that existed in the Bank Bill among banks- scheduled and non-scheduled, those registered earlier and those registered later, Indian and foreign, British Indian and those of Indian States and so on. The suggestion found general support. Mr. Subedar also suggested the appointment of a Curator, an official of the Reserve Bank, to take over from the Registrar of Companies the functions relating to banks and ' be a guide and friend and not always a schoolmaster with a rod '. This suggestion was opposed by members as ' a mere detail ' of how the Reserve Bank had to implement its powers. The third suggestion of Mr. Subedar was the constitution of a bank rehabilitation fund of Rs. 5 crores, out of the Reserve Bank's profits, for helping banks in trouble. While this suggestion was opposed by many other 'members, they expressed the view that the Bank came in at the last minute in a crisis and gave only advice without any prompt help. Despite the strenuous efforts made by the Bank's representative (Mr. Ram Nath) to explain the role of the Bank in a crisis, the general trend of opinion among the members was that the Bill should contain provisions spelling out the powers and responsibilities of the Reserve Bank.

Regarding the scope of the Bill, Mr. M. Ananthasayanam Ayyangar wanted it to be extended to nidhis and indigenous bankers and the definition of 'banking' to be elaborated so as to include acceptance of time deposits. Sir Cowasjee Jehangir did not see why the Imperial Bank had to have an Act of its own and could not be brought under the new Act, so as to be within the control of the Reserve Bank. These suggestions found general acceptance. Mr. Sasanka Sekhar Sanyal made several interesting observations concerning the responsibility of big banks in financing agriculture, the need for a central advisory board and the proper attitude of the Reserve Bank. He observed:

> you cannot expect the small bank alone to invest in agriculture. The big Banks should be made to help rural industries more and more. Otherwise it would be a competition between a giant and adward. The responsibility of the Reserve Bank should not be whittled down to any extent. We must have a central advisory body consisting

> of officials, with provincial branches and provincial legislatures must be represented therein and the centre also must be represented. We must have good non-official spokesmen having direct day to day voice in the matter of administration. The Reserve Bank looks at things more or less as a paper proposition. It is neither responsible nor responsive.Within the present framework of the Reserve Bank we must have provisions which will keep the non-official spokesmen alert and vigilant on the one hand to see that operations are made according to law and at the same time see that the central authority namely the Reserve Bank is not lukewarm, and does not show favouritism between one bank and another.

Besides the above suggestions emanating from the members of the Select Committee, there were several changes and additions suggested by the representatives of the banking industry -Indian scheduled and non-scheduled banks, exchange banks and nidhti-and the Bombay Shareholders' Association.

The report of the Select Committee was presented to the Legislative Assembly in February 1947. The Committee observed:

> . . . . 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 examined with a view to introducing subsequent legislation extending so far as possible the provisions of the Bill to other banking concerns.

The ' constitutional reasons ' the Committee had in view were that this sector of banking lay within the Provincial sphere and not of the Central Legislature and that there were also practical difficulties of extending the provisions of the Indian Companies Act, which were primarily intended for joint-stock companies, to individuals and partnership firms.

Since the amendments and additions recommended by the Select Committee were of a fundamental nature and formed the basis for the Banking Companies 'Act, 1949**,** they are briefly recounted below:

(i) DEFINITION OF BANKING

The Committee elaborated the definition of ' banking ' to include acceptance of time deposits and added a new clause prohibiting companies other than banking companies from accepting deposits repayable on demand. The new definition read as follows: '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 '. This definition was incorporated in the Banking Companies Act and has withstood the test of time to this day.

(ii) M INIMUM CAPITAL REQUIREM ENTS

In the Bill referred to the Select Committee, the minimum capital requirements were based on population. The Committee introduced a more workable basis, viz., the territorial range of a bank's activities. It introduced the conception of ' regions ' or ' areas ' of operation, the overriding minimum for a bank incorporated in India being Rs.15 lakhs and for banks incorporated outside India Rs. 20 lakhs. The absolute minimum for a unit bank was, however, suggested at Rs. 50,000. Exchange banks had to deposit cash or approved securities with the Reserve Bank of an amount equivalent to the minimum capital requirements. These provisions have remained practically unaltered save for the additional provision, introduced in 1962, that no new unit bank could start business with less than minimum capital and reserves of Rs. 5 lakhs, as compared with the earlier minimum of Rs. 50,000.

(iii) CASH RESERVE

The Select Committee did away with the difference between scheduled and non-scheduled banks in the matter of maintenance of cash reserve. All banks were to maintain minimum cash reserve amounting to 5 per cent and 2 per cent of their demand and time liabilities, respectively; previously the percentages were 5 and 2 for scheduled banks and 5 and 1 ½ for non-scheduled banks.

(iv) PROHIBITION OF PREMATURE PAYMENT OF DIVIDEND

The Select Committee introduced a new clause prohibiting banks from paying dividends on their shares unless all the capitalised expenses (including preliminary expenses, organization expenses, share-selling commission, brokerage, amount of losses incurred and any other item of expenditure not represented by tangible assets) were completely written off. This provision has remained unchanged till now.

(v) RESERVE FUND

In the Bill referred to the Select Committee, only non-scheduled banks were required to build up and maintain a reserve fund out of their profits till the fund equalled paid-up capital. The Committee extended the obligation to all Indian banks, scheduled and non-scheduled.

(vi) PROHIBITION OF COMMON DIRECTORS

With a view to preventing interlocking of bank directorates, the Select Committee added a new clause debarring a bank from

taking on its Board any person who was a Director of another bank. This provision has remained unaltered.

(vii) RESTRICTIONS ON LOANS AND ADVANCES

In the earlier version of the Bill, grant of unsecured loans and advances to Directors and to firms or companies in which the bank or its Directors were interested as partner, Director or managing agent was prohibited. It was represented that this prohibition would seriously interfere with established practices. The Select Committee felt that the only relaxation that could be justifiably made was to exclude from the scope of the section the grant of unsecured loans and advances to public companies in which the bank or its Directors were interested in the manner as mentioned above. However, a provision was inserted requiring returns to be furnished of such advances, which would enable the Bank to know whether excessive advances were granted to such companies.

(viii) LICENSING OF BANKS

The Select Committee extended the licensing provisions to all banks except the Imperial Bank; All new banks were to be required to apply for licence before starting business. Existing banks had to apply for licence within six months of the coming into force of the Section but could carry on business until the Reserve Bank conveyed its decision regarding the issue of licence. Before granting licence, the Reserve Bank could inspect a bank to find out whether it would be able to repay the depositors in full as their claims fell due, and its affairs were being properly conducted, In the case of banks incorporated abroad, the Bank was required to ensure that the Government or the law of the foreign country did not discriminate against Indian banks.

(ix) MAINTENANCE OF LIQUID ASSETS

The percentage of approved liquid assets to total demand and time liabilities to be maintained by each bank was reduced from 25 to 20**.** This had been proposed by the Bank, but was not incorporated in the Bill by the Government. Later, in 1964, the percentage was raised to 25.

(x) INSPECTION

The clause was redrafted somewhat on the lines of the Banking Companies (Inspection) Ordinance, 1946**.** The Reserve Bank was given full discretion to inspect a bank at any time so that the public might

have no ground for drawing any unfavourable inference from the fact that a bank was inspected. Other important features of the new clause were that the Reserve Bank should employ only its own officers to conduct the inspections and that a copy of the Bank's report on the inspection should in all cases be sent to the inspected bank.

(xi) FURTHER POWERS AND FUNCTIONS OF THE RESERVE BANK

In view of the much publicised criticism regarding the aloofness of the Bank, a new clause was added enlarging the Bank's powers and functions in relation to banks. The clause empowered the Bank to caution and advise banks, to assist them as intermediary or otherwise in proposals for amalgamation and to grant loans to them [under amendment proposed by the Select Committee to Section 18(3) of the Reserve Bank Act referred to later] against any security the Bank might consider sufficient. The Bank could also call upon an inspected bank to hold a meeting for considering matters relating to the inspection and to make such changes in its management as might be necessary thereupon. The Bank was also placed under a statutory obligation to submit an annual report to the 'Central Government on the trend and progress of banking in the country.

(xii) APPLICATION OF CERTAIN PROVISIONS TO THE IMPERIAL BANK

The Select Committee considered that, although the constitution of the Imperial Bank was regulated by a separate Act, all the major provisions of the Bank Act excepting those pertaining to minimum capital requirements, licensing, submission of balance-sheet and exercise of powers of advice, caution and help by the Reserve Bank should be extended to the Imperial Bank. This was designed to meet one of the main criticisms levelled against the earlier proposals for banking legislation.

(xiii) AMENDMENT OF SECTION 18(3) OFTHE RESERVE BANK ACT

The Select Committee proposed an amendment to Section 18(3) of the Reserve Bank Act, to enable the Bank to come to the aid of a bank through granting a loan secured to the Reserve Bank's satisfaction by forms of security other than those permitted by that Act as it then stood.

In the minutes of dissent appended to the Select Committee Report, some of the suggestions made were: (a) a statutory maximum should be fixed for the dividend for all banks at 9 per cent; the savings thus effected should be utilised to increase the rate of interest paid on

deposits and to reduce the rate of interest charged on loans given by banks up to a maximum rate of not more than 3 per cent over the discount rate of the Reserve Bank; (b) a provision should be made for representation of depositors on the directorate of a bank; (c) a statutory limit might be fixed in respect of salary or remuneration for the manager, managing director, or other employees of a bank; and (d) all banks should be nationalised at an early date and that as a first step, the Reserve Bank and the Imperial Bank might be made State Banks.

The Bank considered the Select Committee's recommendations in detail and was agreeable to many of the changes.

Postponement of the Bill

The 1946 Bill, as amended by the Select Committee, could not be taken up for final consideration during the Budget Session of the Assembly in 1947 owing to very heavy legislative programme; a motion for continuance of the Bill from the old Assembly was adopted by the Constituent Assembly (Legislative) in November 1947. However, the constitutional changes necessitated a number of formal amendments. In addition to these, several further amendments, albeit of a minor nature, were proposed by the Bank. Government, therefore, considered that the passage of the measure would be facilitated if the Bill as reported by the Select Committee were withdrawn and a fresh Bill incorporating all the amendments were introduced and referred to another Select Committee. Accordingly, the Bill was withdrawn from the Constituent Assembly (Legislative) in January 1948, and a new Bill, called the Banking Companies Bill, 1948, was introduced in March 1948. The only important new amendment incorporated in the new Bill was the insertion of a clause providing for a ceiling of 9 per cent on bank dividends.

The Bill was, once again, subjected to delay due to pressure of legislative and other business and could be referred to a Select Committee only in August 1948. In order, however, to deal with certain features in the banking situation requiring urgent attention and in particular to enable the Reserve Bank to assist banks in difficulties, the Government promulgated, in September 1948, an Ordinance, viz., the Banking Companies (Control) Ordinance, containing some of the important provisions of the Banking Companies Bill.

Select Committee on the Banking Companies Bill, 1948

The new Select Committee on the Bill held meetings between November 1948 and January 1949. The witnesses examined by the Committee included representatives of some of the leading commercial banks

headed by Sir Homi Mody, Chairman of the Indian Banks' Association. The bankers also submitted a memorandum to the Select Committee containing their views. The amendments recommended by them included (i) raising the minimum capital requirements in respect of unit banks from Rs. 50,000 to Rs.2 lakhs, (ii) removing the ceiling in respect of dividend payment and (iii) exempting banks having paid-up capital and reserves of more than Rs. 50 lakhs from the restrictions on opening of branches. An important suggestion made by the bankers was the setting up of an Advisory Board for the Reserve Bank. Sir Homi argued:

> Large powers are sought to be conferred on the Reserve Bank and some provision should be made by which the Reserve Bank which is not a commercial bank may be advised by a board of commercial bankers say, people representing the Indian Banks' Association which includes all the largest scheduled banks in India. The Advisory Board may consist of three members appointed by the Banks' Association, one appointed by Government and one appointed by the Reserve Bank itself. The overriding powers would be with the Reserve Bank but the Advisory Board would submit advice and criticism from time to time.

The example of the U.S.A., Brazil and Pakistan where there were provisions for the appointment of Advisory Boards or Councils was cited. The Bank was not in favour of such an Advisory Board. Its view was that, if banks were so represented, they might not agree to adverse action being taken by the Bank against some among them. They might also come to know the secrets of other banks' affairs. Moreover, under the Reserve Bank Act, there was already a Central Board of Directors and representative Local Boards composed of men of wide experience and knowledge of banking, trade and agriculture. Later, in the course of the debate in the Legislature, an amendment was moved by Mr. Lakshminarayan Sahu, for the constitution of an Advisory Committee for the Reserve Bank. The Reserve Bank was to exercise control over banking companies under the guidance of this Committee, which was to consist of five members, three nominated by the Indian Banks' Association, and one each by the Central Government and the Reserve Bank. The meetings of the Committee were to be presided over by the Governor or in his absence by a Deputy Governor. The amendment was rejected.

The report of the Select Committee was presented to the Legislative Assembly in February 1949**.** The Committee, at the outset, mentioned that it had 'considered the possibility of extending the scope of the Bill to cover partnership or individuals carrying on banking business but found the same constitutional objections as were present before the previous Select Committee '. The Committee dropped the clause added by the previous Select Committee prohibiting companies

other than banks from accepting deposits repayable on demand, as it was considered ' unnecessary to include in a Bill for the regulation of banking companies, a prohibition in respect of demand deposits on companies which to the knowledge of the lender are not banking companies and of the nature of business of which he is aware '. Another clause omitted was that limiting bank dividends to g per cent. The Select Committee was of the view that this issue had to be considered with reference to companies generally and that it was not desirable to make a provision for banks alone in that matter in anticipation of any general decision that might be arrived at. Yet another relaxation recommended by the Committee was the restoration of the percentage for a bank's shareholding in another company to a maximum of 40 per cent (as against 20 per cent suggested in the 1945 Bill). An important clause redrafted by the Committee concerned the appointment of the Reserve Bank as official liquidator. In the opinion of the Committee, it would be impracticable for the Bank to undertake the liquidation of all banks ordered to be wound up, although there was no doubt that the Bank would be willing to undertake the task where large public funds were involved. The discretion in this matter was therefore left to the Bank. Two important clauses added by the Select Committee were those (a) empowering the Reserve Bank to give directions to banks in regard to their lending policies so that credit facilities might be controlled, if necessary, with a view to checking speculation or rising prices and (b) giving the Government powers to exempt from the provisions of the Act any bank or class of banks either generally or for such period, as might be specified, on the recommendation of the Reserve Bank.

A comment on these changes is provided by the Hindu in its issue of February 12, 1949

The Select Committee's amendments to the Banking Companies Billare all mainly in favour of the banks rather than the depositors. The Finance Minister, in his speech on the Bill on Tuesday, defended these changes on the ground of expediency.

Three separate minutes of dissent signed by Mr. T. T. Krishnamachari, Mr. M. Ananthasayanam Ayyangar and Professor K. T. Shah were appended to the Select Committee's Report. Messrs. Krishnamachari and Ananthasayanam Ayyangar wanted the clause relating to limitation of dividends to be retained. Mr. Krishnamachari, later participating in the debate on the Bill, made the important point that control of banks was needed not so much for the protection of depositors (' an erroneous idea which has been given the go-by long time back ' he said) but as a corollary to Government's monetary policy.

Professor K. T. Shah, in his minute of dissent, observed that his differences with the majority report were fundamental; notwithstanding this statement, he signed the majority report! The main points of differences he had were: (i) the Bill was not comprehensive enough to include the indigenous bankers. ; (ii) there was no provision to ensure that only those persons who were properly qualified by knowledge, experience and training were placed in responsible posts of management (including Directors) in banks ; (ii;) agricultural financing had been wholly ignored ; and (iv) the Bill showed no conception of banking as an integral and important public utility and social service, a part of the aggregate national economy, which had a vital role to play in the material development of the country, its resources and also its potentialities. Professor Shah suggested (a) giving right to depositors to appoint their own directors, (b) making provision for appointment of a Director by the Reserve Bank on the Board of Directors of every bank and (6) insertion of a new clause to facilitate acquisition by the State of any or all banking concerns.

The Bill as amended by the Select Committee was introduced in the Legislative Assembly on February 8, 1949; it was passed by the Assembly on February 17, the debate lasting 7 days. While a large number of amendments were moved, most of them by two members, namely, Professor K. T. Shah and Mr. Naziruddin Ahmad, less than a third of them were accepted, these being relatively unimportant. The Bill received the assent of the Governor General on March 10 and came into force on March 16.

Commenting on the powers and responsibilities vested in the Bank under the Act, The Eastern Economist* stated:

> This detailed narration of the duties and powers of the Reserve Bank have been given deliberately to impress upon the public the colossal burden that a single institution is being called upon to have in policy-making as well as day-to-day administration of the country's banking system. It is a responsibility, which may not weigh on the Old Lady of the Threadneedle Street. But the Reserve Bank is by no means an old lady or even an elderly one. It is, in fact, a very young maiden just fifteen years old -possibly sure of its ability, as young things usually are, but not yet very sure of its experience in a difficult world.

The Banking Companies Act, 1949

The main provisions of the Banking Companies Act and their legislative history have been surveyed in detail in this and earlier chapters. It should be useful to list the principal sections below:

* February 18, 1949.

(I) Application of the Act to all banking companies, except cooperative banks, transacting banking business in India (including the acceding States) (Sections 1 and 3) ;

(2) definition of ' banking ', ' banking company' and ' company ' and forms of business in which banks may engage [Sections 5 and 6(1)] **;**
(3) prohibition of a bank from engaging in trade or business other than banking and requiring it to dispose of non-banking assets, except such as are required for its own use, within the prescribed period (Sections 8 and 9) ;
(4) prohibition of employment, among others, of managing agents or any person whose remuneration is on a commission or profit-sharing basis or is excessive (Section 10**) ;**
(5) requirement as to minimum paid-up capital and reserves (Section 11) ;
(6) regulation of the proportion,inter se, of authorised, subscribed and paid-up capital and voting rights of shareholders (Section 12) **;**
(7) restriction on commission, brokerage, discount; etc., on sale of shares ; prohibition of creation of charge on any unpaid capital of the bank ; and prohibition of payment of dividends unless the capitalised expenses are completely written off (Sections 13 to 15) ;
(8) prohibition of common directors among banks (Section 16) ;
(9) provision for building up the reserve fund (Section 17) **;**
(10) maintenance of minimum cash reserve by non-scheduled banks either with themselves or with the Reserve Bank similar to that prescribed for scheduled banks to be kept with the Reserve Bank under the Reserve Bank Act (Section 18) ;
(11) restriction on formation of subsidiary companies except for
certain purposes and on holding of shares in other companies (Section 19) ;
(12) prohibition of loans and advances on the security of a bank's own shares or unsecured loans and advances to its directors or firms or private companies where it or any of its directors is interested as partner, director, managing agent or guarantor (Section 20) **;**
(13) empowering the Reserve Bank to determine policy regarding advances to be followed by banks and to give directions to banks as to purposes for which advances may or may not be made, margins on secured advances and rates of interest to be charged on advances (Section 21) ;
(14) comprehensive system of licensing of banks by the Reserve Bank (Section 22) **;**
(I 5) licensing of new branches and of transfer of existing branches (Section 23) ;
(16) stipulation as to maintenance. of sufficient liquid assets in India to meet liabilities in India (Sections 24 and 25) ;

(17) empowering the Reserve Bank to call for periodical returns and to publish consolidated information about banks (Sections 27 and 28) ;
(18) provisions as to balance-sheet, its audit and publication (Sections 29 to 32) ;
(19) conferment of powers on the Reserve Bank to inspect the books and accounts of banks and on the Central Government to take drastic action, if considered necessary, on the basis of inspection reports (Section 35) ;
(20) (a) empowering the Reserve Bank:

(i) to caution or prohibit banks generally or any bank in particular against entering into any particular transaction or class of transactions, and generally give advice to them,
(ii) to assist as intermediary or otherwise, in proposals for the amalgamation of banks,
(iii) to grant 1oans and advances to any bank under Section 18(1) (3) of the Reserve Bank Act,
(iv) to require a bank, during the course, or after the completion, of its inspection, to make such changes in its management as the Reserve Bank considers necessary;

(b) requiring the Reserve Bank to make an annual report to the Government on trend and progress of banking in India (Section 36) ;
(21) provisions as to grant of moratorium to a bank temporarily unable to meet its obligations; procedure for winding up by court; and restrictions on voluntary winding up and on amalgamations (Sections 37 to 45) ;
(22) provisions prescribing penalties for contravention of the provisions of the Act (Sections 46 to 48) ;
(23) application of certain provisions of the Act to the Imperial Bank (Section 51) **;**
(24) amendment of Section 18 of the Reserve Bank Act to enable the Bank to make loans and advances to a bank in an emergency against such form of security as the Bank might consider sufficient, and entitling the Reserve Bank to a first charge on the general assets of the bank concerned, in the event of its being wound up, subject only to the claims, if any, of any other banking company, in respect of any prior loan (Section 55) ; these amendments were deemed to have had effect from September 20**,** 1947 (Section 55); and
(25) amendment of Section 42(6) of the Reserve Bank Act detailing the conditions for inclusion or exclusion of banks from the Second Schedule (Section 55).

The Banking Companies Act repealed Part XA of the Indian Companies Act, 1913, and the whole of the Banking Companies

(Restriction of Branches) Act, 1946, the Banking Companies (Inspection) Ordinance, 1946, and the Banking Companies (Control) Ordinance, 1948.

1950 Amendment of the Act

Soon after the enactment of the Act, the Bank found that the provisions of the Act relating to amalgamation and liquidation of banks did not lay down the procedure to be followed by the banks, the liquidator or the Court, as the case might be, for expeditious disposal of the proceedings. As the Legislature was not in session, the Bank moved the Government to issue an Ordinance in September 1949 to give effect to the additional provisions. Subsequently, in March 1950, the Ordinance was replaced by the Banking Companies (Amendments Act, 1950, According to the amending Act, any scheme of amalgamation of banks, before its submission to the Reserve Bank for sanction, had to be approved by the shareholder of each of the banking companies by a resolution passed by a majority in number representing two-thirds of the shareholders of each of the banks, present either in person or by proxy, at a meeting called for the purpose. The scheme, when sanctioned by the Reserve Bank, would be binding on the concerned banks, A dissenting shareholder was entitled to such compensation from the amalgamated bank as might be determined by the Reserve Bank when sanctioning the scheme. The Act also provided for automatic transfer of all assets and liabilities of the amalgamated bank to the transferee bank. A compromise or arrangement between a bank and its creditors become effective only if certified by the Reserve Bank as not being detrimental to the interests of the depositors.

In the matter of liquidation of banks, besides prescribing special provisions for speedy disposal of winding up proceedings of banks, the Act empowered the Court to try in a summary way any offence committed by any person who had taken part in the formation or promotion of the bank, which was being wound up, provided the offence was one punishable under the Indian Companies Act, 1913. The Reserve Bank was authorised to examine the records of any liquidation proceeding where its advice was solicited by the official liquidator on direction of the Court and to tender such advice as it might think fit.

The amending Act also contained an important provision extending the Reserve Bank's powers of licensing to the opening of branches outside India.

The salutary effects of the Banking Companies Act were in evidence fairly soon after it came into effect. There was a tendency amongst banks to put their house in order and the beginnings of bank mergers

were also noticed. Two notable mergers took place, in the Eastern and Northern area, respectively, thereby averting a possible banking crisis. In December 1950, four scheduled banks in West Bengal, viz., the Bengal Central Bank, the Comilla Union Bank, the Comilla Banking Corporation and the Hooghly Bank, which had all been subject to a run after the failure of the Nath Bank, were amalgamated into the United Bunk of India, the Reserve Bank playing an important role in this. In March 1951, the Punjab National Bank took over the entire liabilities in respect of deposits in the Indian Union of the Bharat Bank against the transfer of equivalent assets.

Administrative Arrangements for Banking Regulation

In an earlier chapter, reference was made to the establishment, with effect from August 1, 1945, of the Department of Banking Operations, to provide the administrative machinery for discharging the several duties and responsibilities of the Bank under the proposed Banking Companies Bill. The Chief Officer of the Department was deputed in September 1945 to the U.S.A. for making a study of bank supervision and inspection in that country so that the machinery for banking regulation in India could be organised on sound lines. The functions of the Department in the initial stages related mainly to inspection of banks for inclusion or retention in the Second Schedule, fixing of credit limits for scheduled banks, scrutiny of balance-sheets and other returns submitted by banking companies, rendering of advice on banking and financial matters to banks as well as Governments and banking legislation. Its activities steadily expanded with the additional responsibilities vested in the Bank under the various interim or transitional banking measures.

With the increase in work, branches of the Department were established in other places such as Calcutta, Madras and Kanpur. The work at the Central Office of the Department at Bombay came to be organised in three Divisions, dealing respectively with operations, inspection and liquidation. The staff of the Department was augmented from time to time. Arrangements were also made to recruit staff from outside, especially persons with practical banking experience. Thus, when Banking Companies Act came into effect, the Department was reasonably equipped to take up the duties devolving on it under the Act.

Shortly after the Banking Companies Act came into force, the Bank decided to institute a system of periodic inspection of all banks covered by the Act. Besides general inspection of banks, special inspections were undertaken for specific purposes under the Act, namely, issue of a licence under Section 22, grant of moratoria, inclusion in the Second

Schedule of the Reserve Bank of India Act and examination of schemes of arrangement and, amalgamation.

RESERVE BANK AND INDUSTRIAL FINANCING

The vastly expanded role which the Bank has played in the field of financing of industries is an interesting facet of the Bank's post-war career. In this sphere, as in others, the Bank's approach underwent a change in response to the needs of the economy.

It will be recalled that the Central Banking Enquiry Committee recommended the creation of provincial Industrial Credit Corpprations and an all-India institution for the purpose of meeting the requirements of industries of regional and national importance, respectively. It also advocated 'mixed banking' for the Imperial Bank and other well established commercial banks. For a long time, very little was done in the direction of these recommendations. In fact, hardly any thought was bestowed on these matters till the early forties.

With the prospects of the war drawing to a close, the problem of industrial development in India on organised lines gained increasing attention of the Central Government. Interest in the question was stimulated by the publication of the *Bombay Plan* for the economic development of the country and by the setting up of a special department by the Central Government, in charge of Sir Ardeshir Dalal, to study and plan post-war industrial development. The rapid growth of indigenous industries during the war period and the necessity of protecting them against foreign competition, the problem of preventing indiscriminate utilisation of the large accruals of sterling balances and the enthusiastic popular support for a national plan for industrial progress were some of the factors which necessitated thinking on the subject of finance for industry.

In pursuance of the suggestion of the General Purposes Sub-Committee appointed by the Department of Planning and Development of the Central Government, that the urgent question of adequate arrangements for the provision of industrial finance be examined by the Finance Department in consultation with the Reserve Bank (referred to in Chapter 15) a detailed note was drawn up on the subject, in May 1945, by the Secretary, Mr. Ram Nath, under the direction of the Governor. The note analysed the problem of industrial finance and reviewed the institutional arrangements in this behalf in other countries. The note proceeded on the basis that specialised institutions should be set up both at the all-India and the regional levels; it also indicated, fairly

elaborately, the respective fields of operations of the all-India and the provincial institutions. In considering these issues, the note, ab initio, excluded public sector projects from the scope of assistance from the proposed specialised institutions. Provision for those enterprises, said the note, was a matter for the Governments to arrange and fell within the scope of such general budgetary and borrowing programmes as might be drawn up by Governments for the purpose of implementing their reconstruction and development plans.

As regards the type of all-India institution which was the most proper in the prevailing conditions, the Bank management rejected alternatives such as a wholly private-owned corporation or a wholly State-owned corporation. It favoured an arrangement whereby there was shareholding of 20 per cent each by Government and the Reserve Bank and 60 per cent by institutional and other investors. Such an institution would enjoy the advantage of having available to it the intimate knowledge of industry and wide business experience. At the same time, the presence on its Board of Directors and probably on its executive of nominees of Government and the .Reserve Bank would serve as a guarantee that the policies pursued by the institution were conceived in the broad national interest.

Coming to the field of operations of the all-India institution, the Bank's study was of the view that it would be undesirable for the corporation to participate directly in industry by purchasing shares of industrial concerns. It was, however, considered all right for the proposed institution to participate in the underwriting of shares issued by industrial concerns. On the whole, the stress was on the provision of loan capital rather than equity capital.

To finance its operations, the corporation could be permitted to raise foreign currency loans, when necessary, through the International Bank proposed to be set up, or directly in foreign markets through the issue of bonds and debentures secured against the various assets mortgaged to the corporation by the industrial concerns which had borrowed from it. According to the note, a provision permitting the institution to borrow from the Government was undesirable; Government assistance, if any, could only take the form of either a share in the capital or guarantee of principal and interest, the corporation's other resources being derived from the issue of debentures and, if necessary, from long-term deposits received from the public.

About the types of provincial corporations to be set up, the note took the view that they could be owned jointly by Government and private investors, the proportion of share capital held by the former being limited to, say, 40 per cent. Such a corporation could raise funds through issue of debentures and proceed on lines somewhat similar to those proposed for the all-India institution, except that in the case of

the provincial body, no borrowing power outside India was presumably necessary. The type of industry to be financed by a provincial corporation varied with local conditions, but it would be desirable to restrict the operations of the corporation to small and medium sized businesses that required finance, say, up to Rs. 50,000.

The note was forwarded by the Bank to the Finance Department, Government of India, for their comments. The Finance Department, while generally concurring with the Bank's views, was of the opinion that, having regard to the investible funds then in existence, Government guarantee of principal and interest in respect of share and debenture capital of the corporation seemed hardly necessary and might be avoided if possible. The Government had also doubts whether it was necessary to confer underwriting powers on the proposed all-India institution and whether the corporation should be empowered to accept deposits. In their view, underwriting powers, if conferred, should be exercised only for special reasons and should be confined to issue of debentures and possibly of preference shares. The minimum period of acceptance of deposits, if any, by the corporation should be fixed substantially in excess of five years.

In considering these views of the Government, the Governor was firm that a Government guarantee was an integral part of the proposals as envisaged by him and that, as a concomitant, there should also be a limitation on the dividend payable to the shareholders. In his view, being a quasi-Government institution with Government guarantee, its surplus profits, after payment of dividends, would have to be transferred to the Government. About Government's opinion on the underwriting powers of the corporation, the Governor thought it was a question of the latitude to be allowed to the proposed institution in its character and would depend in practice on the degree of discrimination exercised by it in the selection of ventures it was prepared to assist.

The subject was placed before the Central Board at the July 1945 meeting. The Board generally agreed with the scheme as outlined by the Bank's management and endorsed the Governor's remarks regarding Government guarantee. It was also of the unanimous opinion that the power of underwriting should not be circumscribed and that the discretion in this matter should be left to the Board of the institution, since the industries which would approach the institution were mostly those failing to raise capital in the ordinary way but which, nevertheless, required development in the larger interests of the country. The Board was also of the view that the corporation should be given latitude to accept fixed deposits at attractive rates for periods not less than five years. The Board differed from the Governor on one point, viz., about the transfer of surplus profits to Government; it thought it more desirable that such surplus should be transferred to the reserves. It

resolved that a detailed scheme including the necessary proposals for legislation for submission to Government should be taken in hand. Accordingly, in January 1946, the Bank forwarded to the Government a draft Bill for giving effect to the proposals for the establishment of an Industrial Finance Corporation. After detailed examination by the Government of India, the Bill was introduced in the Legislative Assembly in November 1946.

The salient features of the Bill may now be briefly touched upon. These were:

(i) The Corporation's share capital was to be Rs. 5 crores, divided into 2,000 shares of. 25,000 each, of which 20 per cent each was to be held by the Central Government and the Reserve Bank and the balance of 60 per cent by scheduled banks, insurance companies, investment trusts, and other like financial institutions;
(ii) the Board of Directors of the Corporation was to consist of 12 members, of whom six, including the Managing Director, were to be nominated/appointed by the Government/Reserve Bank;
(iii) the Corporation was to be authorised to issue bonds and debentures to the extent of four times the share capital, guaranteed by the Government as to principal and interest;
(iv) acceptance of fixed deposits was to be permitted, with a minimum maturity of ten years, and up to a maximum outstanding of Rs.10 crores;
(v) as regards types of assistance, the Corporation could grant secured loans (rupee as well as foreign currency), subscribe to debentures, underwrite the issue of securities and also provide guarantees; the aggregate accommodation to a single party was not to exceed 10 per cent of the share capital of the Corporation; and
(vi) the Corporation was required to establish a reserve fund out of profits. The dividend payable was limited to 2 ½ per cent per annum until the reserve fund equalled or exceeded share capital; thereafter, the balance of profit, after payment of dividend up to a maximum limit of 5 per cent, had to be transferred to Government.

The Bill could not be proceeded with, owing to constitutional changes, till November 1947, when the Constituent Assembly (Legislative) adopted a motion to refer the Bill to a Select Committee. Replying to the debate in the Assembly, the Finance Minister, Mr. Shanmukham Chetty, explained that the proposed Corporation was not intended to supply all the finance or even a substantial part of the finance necessary for the large scale industrialization of the country. The Corporation was only intended to help, to a limited extent, the large scale industries started by private entrepreneurs. The Finance Minister was not in favour of enlarging the categories of shareholders

of the Corporation. He said: 'By deliberately restricting the shareholding to certain specified institutions, it was the intention of this Bill to bring to the service of the State under the control of the State the experience gained by-private captains of industry '.

The Select Committee which met in December 1947 and January 1948 adopted several amendments and its report was presented to the House by the Finance Minister in the latter month. A minute of dissent was recorded by Professor K. T. Shah and Mr. Diwan Chaman Lall, who tried to make out a strong case for the Corporation to be owned, controlled and managed by the State. The Bill was taken up for consideration in February 1948 and after lengthy discussion was passed in the same month. The original Bill underwent the following changes, as passed by the Legislature:

(a) The authorised capital of the Corporation was fixed at Rs.10 crores consisting of 20,000 shares of Rs. 5,000 each, while retaining the issued capital at Rs. 5 crores with power to increase it from time to time after obtaining the sanction of the Central Government and providing for guarantee of share capital by the Central Government as to the repayment of the principal;
(b) 10 per cent of the share capital of the Corporation was to be set apart for subscription by co-operative banks; this proved to be a very controversial matter; the Reserve Bank had not favoured shareholding by co-operative institutions;
(c) discretion was to be allowed to the Central Government in the matter of fixing the minimum rate of dividend to be declared by the Corporation and the rate to be offered on bond issues of the Corporation to be guaranteed by Government;
(d) in discharging the functions the Board of Directors was to act on business principles; it was to be guided on questions of policy by such instructions as might be given to it by the Central Government;
(e) two places on the Board of Directors were to be reserved for the co-operative interests;
(f) the Corporation was empowered to appoint Advisory Committees and Advisers in order to secure the efficient discharge of its functions ;
(g) the Corporation was authorised to invest in Government securities -an omission in the original measure -, to issue debentures to the extent of five times the paid-up share capital and reserve fund (as against four times share capital), to accept fixed deposits repayable after a period of five years (as against ten years previously) and to provide assistance to any single industrial concern up to a maximum of Rs. 50 lakhs. The Corporation's assistance was to be confined to only public limited companies or co-operative societies.

The Industrial Finance Corporation of India came into being on July 1, 1948, with its Central Office at Delhi. Mr. Ram Nath, who was closely connected with the formulation of the proposals and the piloting of the legislation, was appointed as the first Managing Director of the Corporation, on the recommendation of the Central Board of the Reserve Bank, as provided in the Statute.

In 1951, the Parliament passed the State Financial Corporations Act, with a view to enabling the State Governments to set up similar corporations for providing long-term finance to medium and small scale industries. Under this Act, nearly all the States have established their own financial corporations.

Concluding Observations

From the foregoing pages, it will be seen that the post-war period was an eventful one for Indian banking, the outstanding development being the passing of the Banking Companies Act, about a decade after the proposals in this behalf were originally formulated. Despite periods of stress and strain, the Indian banking system as a whole displayed resilience and strength. There remained, however, the task of weeding out the weak elements and streamlining the banking system so as to full3 its role in the economic development of the country, a task that necessarily required years to accomplish. The foundation for this was partially laid in the post-war period.

Over the years, the Reserve Bank's vigilance came to be increasingly felt, with improvement in the operations of banks taking place steadily, though silently. Simultaneously, the Bank began giving increasing attention to developmental matters such as rapid and balanced expansion of bank branches, training of bank personnel, development of the banking habit and creation of adequate institutional facilities for the provision of finance for the development of the private sector.