UNIT – 1

History Structure Regulation of Banking

History • Indigenous Banking • Universal Banking • BR Act 1949 • Amendment 2025 • Kinds of Banks

Banking Law – Expanded Edition

SYNOPSIS

Unit Overview

This expanded unit covers the complete history of banking in India, indigenous banking system with detailed characteristics and functions, Universal Banking, key provisions of the Banking Regulation Act 1949, the Banking Laws (Amendment) Act 2025, secondary functions of commercial banks, and the structure of different types of banks including development banks.

LEARNING OBJECTIVES

What You Will Learn

01 History

Trace evolution from Vedic period to liberalization

02 Indigenous

Detail characteristics and functions of indigenous bankers

03 Universal

Explain meaning and activities of Universal Banking

04 BR Act

Master important provisions of Banking Regulation Act 1949

05 2025 Amend

Know key changes under Banking Laws Amendment Act 2025

06 Structure

Classify commercial, co-operative, RRBs and development banks

HISTORY

History of Banking in India – Overview

Banking in India is as old as the early Vedic period. Manu Smriti refers to deposits, advances, pledges and interest. Modern banking begins with Bank of Bengal (1786).

Primary Functions	Payment system, mobilization of savings, allocation of savings to investment projects
Two Broad Phases	Pre-independence (1786-1947) and Post-independence (1947 onwards)
Post-Independence	Pre-nationalization (1947-69), Nationalization (1969-91), Liberalization (1991 onwards)

PRE-INDEPENDENCE

Pre-Independence Era (1786-1947)

Early Period	Very few modern banks; many failed due to speculative trade
Presidency Banks	Bank of Bengal, Bank of Bombay, Bank of Madras
Imperial Bank	1921 – merger of Presidency Banks; later became SBI (1955)
RBI	Reserve Bank of India commenced operations in 1935
Joint Stock Banks	Introduced at the beginning of 20th century

Nationalization of Banks

1969	14 major commercial banks nationalized on 19 July 1969
List of 14	Allahabad, BoB, BoI, Bank of Maharashtra, Canara, Central Bank, Dena, Indian Bank, IOB, PNB, Syndicate, Union Bank, United Bank, UCO
1980	Six more banks nationalized (deposits above ₹200 crore)
List of 6	Andhra Bank, Corporation Bank, New Bank of India, Punjab & Sind, OBC, Vijaya Bank
Objective	Social control, priority sector lending, rural branch expansion

LIBERALIZATION

Liberalization and Entry of Private Banks

Narasimham Committee	Recommended major reforms in banking sector
New Private Banks	RBI licensed 10 new private sector banks
Major Players	ICICI Bank, HDFC Bank, Axis Bank, IndusInd, Kotak, Yes Bank
Impact	Competition, technology, better customer service, product innovation

INDIGENOUS

Indigenous Banking System – Meaning

Indigenous bankers are private firms or individuals who receive deposits, deal in hundis and lend money. They formed the bulk of the Indian financial system in ancient and medieval times.

Regional Names	Chettys (Chennai), Sahukars / Mahajans (North), Shroffs / Marwaris (Mumbai), Seths / Banias (Bengal)
Definition	Individual or private firm receiving deposits, dealing in hundis or lending money
Categories	(a) Pure banking (Multani) (b) Banking + trade (Marwaris) (c) Mainly trade with limited banking

INDIGENOUS CHAR

Detailed Characteristics of Indigenous Bankers

1	Accept deposits and deal extensively in hundis (unlike modern banks)
2	Use mainly their own capital; deposits form only a small part of working capital
3	Operations free from formalities and delays; flexible business hours
4	Establishments are small and economical; run as family concerns
5	Finance traders, artisans and small industrialists; rarely give direct loans to agriculturists
6	No formal banking education; business based on experience and personal knowledge

Detailed Functions of Indigenous Bankers

Deposits	Accept fixed and current deposits from the public
Loans	Provide loans against security of land, gold, vehicles, etc.
Hundis	Discounting of hundis is one of their most profitable activities
Remittance	Transfer money from place to place through hundis
Trade Finance	Finance internal trade and small business
Decline	Lost importance with rise of commercial and co-operative banks

Hundi – Types and Features

Definition	Unconditional order in writing directing payment of a certain sum to a named person
Darshani	Payable at sight – like a demand bill; negotiable
Muddati	Payable after a specified period mentioned on the face
Shahjog	Payable only to a Shah (respectable person) – similar to crossed cheque
Dhanijog	Payable to the owner / holder / bearer
Jawabee	Letter of recommendation to a banker for payment to a specified person

UNIVERSAL

Universal Banking / Multifunctional Banking

Universal Banking means a bank that provides a full range of financial services – commercial banking, investment banking, insurance, mutual funds, etc. under one roof.

Meaning	One-stop financial supermarket offering multiple products and services
Activities in India	Commercial banking + investment banking + insurance (bancassurance) + mutual funds + merchant banking + depository services
RBI Conditions	Capital adequacy, track record, risk management systems, firewalls between banking and non-banking activities
Conversion	Financial Institutions (like IDBI) were allowed to convert into universal banks subject to RBI guidelines

Banking Regulation Act 1949 – Key Definitions

Banking (s.5(b))	Accepting deposits of money from public for lending or investment, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise
Banking Company	Any company which transacts the business of banking in India
Importance	Gives statutory definition and brings banks under comprehensive regulation

Licensing of Banking Companies (Section 22)

Requirement	No company can carry on banking business in India without a licence from RBI
Conditions for Grant	Financial condition, character of management, adequacy of capital, public interest, compliance with BR Act
Cancellation	RBI can cancel licence if conditions are breached or public interest so requires (after opportunity of hearing)
Effect of Cancellation	Company must stop banking business; may lead to liquidation or amalgamation

Board of Directors & Amalgamation

Section 10A	Board must have majority of directors with special knowledge or practical experience in accountancy, agriculture, banking, co-operation, economics, finance, law, etc.
Chairman	Whole-time Chairman or Managing Director required in certain cases
Section 44A	Amalgamation of two banking companies requires scheme approved by shareholders (2/3rd majority) and sanctioned by RBI
Returns	Banks must submit various returns (assets, liabilities, advances, etc.) to RBI periodically

AMENDMENT 2025

Banking Laws (Amendment) Act, 2025 – Key Changes

Nomination	Enhanced and simplified nomination facilities for depositors
Substantial Interest	Threshold for “substantial interest” revised for better governance
Governance & Audit	Stronger provisions on board governance, audit quality and disclosures
RBI Reporting	Streamlined and rationalised reporting requirements to RBI
Overall Aim	Modernise the regulatory framework and strengthen depositor protection

Secondary Functions of Commercial Banks – Detailed

Agent	Collect cheques, bills, dividends; pay rent, insurance premium, taxes on behalf of customers
Overdraft	Allow customers to withdraw more than balance (against security or clean)
Discounting Bills	Purchase bills of exchange at discount before maturity
Locker Facility	Provide safe deposit lockers (lessor-lessee relationship)
Traveller’s Cheques	Issue instruments that can be encashed safely while travelling
Other	Letter of Credit, Guarantees, Foreign Exchange, Merchant Banking, Depository services

COMMERCIAL

Commercial Banks – Public, Private & Foreign

Public Sector	Majority government ownership – SBI, nationalized banks, IDBI Bank, RRBs
Private – Old	Federal Bank, J&K Bank, Karur Vysya, etc.
Private – New	HDFC, ICICI, Axis, Kotak, IndusInd, Yes Bank
Foreign Banks	Registered outside India; operate via branches or wholly-owned subsidiaries
Numbers (approx)	12 PSBs, 21 private banks, 44 foreign banks

Co-operative Banking Structure

Short-term	PACS (village) → DCCB (district) → SCB (state)
Long-term	PCARDB → SCARDB
Regulation	Dual control – RBI + State Government / Central Registrar
Role	Agriculture, retail trade, small industry, self-employed

RRBs LABs

Regional Rural Banks and Local Area Banks

RRBs	1975 – joint ownership Centre + State + Sponsor Bank; serve rural population
Consolidation	“One State One RRB” policy; currently around 28 RRBs
Local Area Banks	1996 experiment; operate in max. three contiguous districts
Status	Only a few LABs commenced; limited scale-up

Development Banks – NABARD, SIDBI, NHB, EXIM

NABARD	1982 – apex for agriculture & rural development; refinance + supervision
SIDBI	1990 – exclusive focus on MSME sector
NHB	1988 – apex for housing finance; regulates HFCs
EXIM Bank	1982 – promotes and finances India’s foreign trade

STRUCTURE

Overall Banking Structure in India – Summary

Commercial	Public, Private (old & new), Foreign
Co-operative	Short-term and Long-term structures
Rural Focus	RRBs and Local Area Banks
Development	NABARD, SIDBI, NHB, EXIM Bank
Regulation	RBI primary regulator; dual regulation for co-operatives

SUMMARY POINTS

Must-Remember Points

- Banking evolved from indigenous systems and Presidency Banks to a modern multi-tier structure.
- Indigenous bankers and Hundis were the traditional backbone of finance.
- Universal Banking allows full range of financial services under one roof subject to RBI conditions.
- Banking Regulation Act 1949 is the core statute – licensing (s.22), board (s.10A), amalgamation (s.44A).
- Banking Laws (Amendment) Act 2025 strengthens nomination, governance and reporting.
- Secondary functions (agency, OD, discounting, lockers, TCs) are important revenue sources.
- Understanding the complete structure is essential for regulation and practice.