CCP

SECTION 5

BANKING LAW AND PRACTICE

What is Banking Law?

Law of Banking comprises common law, rules of equity and statements. It may be defined as the law that governs the operations of banks and banking transactions and relationships that arise therefrom. This may be common or customary law that has evolved over time in commercial world with respect to banking. It includes statutes passed by parliament to control the activities of the bank. Because of the importance of Banks to the health of the nation's economy, operations of banks are a major concern of governments the world over. This is the main reason for the existence of legislations all over the world for the licensing and monitoring of banking operations.

Evolution of Banking Institutions

There seems to be no unanimity amongst the economists about the origin of the word 'bank'. According to some economists, the word 'Bank' has been derived from the German word 'BANC' which means a joint stock firm. While others say that it has been derived from the Italian word 'BANCO' which means a heap. As a matter of fact, at the time of establishment of Bank of Venice in 1157, the Germans were influential and hence, perhaps the word 'Banc' or 'Banco' was used by Italians to denote the accumulation of securities or money with a joint stock firm which later on with the passage of time came to be known as 'Bank'.

There is still another group of people who believe that the word 'Bank' has been derived from the Greek word 'BANQUE' which means a bench. In the olden days Jews entered into money transactions sitting on benches in a market place. When a banker was not in a position to meet its obligations, the bench on which he was carrying on the money business was broken into pieces and he was taken as bankrupt.

However, the first view of the origin of the 'Bank' from the words 'Banc' or 'Banco' seems to be more convincing since it was used in the establishment of the bank of Venice which is supposed to be the most ancient bank.

The business of banking is as old as civilization itself. As early as 2000 BC, the Babylonians had developed a system of banks. They used their temples for lending at higher rates of interest against gold and silver which had been left with them for safe custody. Around the same time, the Greek temples were used as depositories for people's surplus funds and these were the centres of money lending transactions. The priests of the temples acted as agents till they lost public confidence on account of people's disbelief in religion.

The development of banking in the ancient Rome resembled the Greek pattern. After the death of Emperor Justinian in 565 A.D, the mighty Roman Empire failed resulting in severe damage to the banking business. It was only with the revival of the trade and commerce in the Middle Ages that the lessons of finance were learnt afresh from the beginning. However, during this period, banking was mainly confined to money-lending activities which were largely in the hands of the Jews. The Christians were forbidden by their religion to lend money on interest since it was considered to be sinful activity. However, with the passage of time, the hold of the church on the Christians weakened and with the development of process of trade and commerce around the 13th century, the Christians also started money lending business. They thus started giving competition to the Jews who hitherto, monopolized the business.

In the initial stages, the banking largely meant money-lending and it was restricted to selected number of families working as sole proprietary firms. The Bank of Venice founded in Italy in 1157 was the first banking institutions, followed by the Bank of Barcelona in Spain which was established in 1401. The Bank of Geneva was founded in 1407, while the Bank of Amsterdem was established in 1609. All these banks accepted the deposits which could be drawn or demand on transferred from the account of one person to another.

In England, the development of banking business can mainly be attributed to the London Goldsmiths during the reign of Queen Elizabeth I. They used to receive their customers valuables and funds for safe custody. The business of Goldsmith suffered a rude set back as a result of the ill treatment of Government of Charles II in 1640. The Goldsmiths used to deposit their funds in the exchequers with the sanction and under the care of the Government. However, King Charles II issued a directive in his regime that no payment would be made to the Goldsmiths and as a result, the Goldsmiths were ruined. The ruin of Goldsmiths proved a turning point in the history of English banking. It led to the growth of private banking and later on establishment Bank of England in 1694.

Geoffrey Crowther, a noted economist has identified three ancestors of the present day banker; the merchant, the money-lender, and the goldsmith. The merchant because of his high and widespread reputation on credit. They were able to collect money from their customers and issue documents that were accepted as “titles of money”. The money-lender usually conducted business with his own money. Later, they also started accepting money from clients when they found it profitable to borrow at low interest rates and lend it as higher interest rates. The Goldsmiths which functioned mostly in England received gold and silver for safe custody and the receipts issued by them acknowledging the same were initially used for withdrawals of the deposits made with them. These receipts with passage of time became payable to the bearer on demand and enjoyed considerable circulation. In this way, the ‘goldsmith’ note becomes the fore-runner of modern bank note. Later on when the goldsmiths started transferring the deposits made with them on the basis of letter issued by the depositors, it led to the origin of modern cheque currency. Thus, in a way the goldsmiths can rightly be termed as the fore-runners of the modern banking institutions.

Though the banking business in its naïve form was in operation since ancient times the banking in its present form is of recent origin. It was only in the 19th century that the modern joint stock commercial banking system developed in most of the leading countries, including enactment of laws and regulations to govern the Banking business.

Evolution of Banking in Kenya

Prior to the establishment of colonial rule in Kenya, there were four different items used as currency

- Indian rupee and its coins
- The Maria Teresa dollar
- Cowrie shells
- Beads and cloth

Currency was introduced by colonialists because of trade along the East African coast with Arabs, Indians and Europeans. With the establishment of colonial government however, the need arose for a more convenient and standardized form of currency because the major objective of colonialism was the exploitation of the resources in the territory for the advancement of the home country.

In 1888 the Imperial British East Africa began its plans to administer Kenya and Uganda and it introduced currency for the two territories. They introduced a silver rupee coin and the continuation of the Indian rupee that was already in circulation. The Indian Rupee was most widely used because of the trade along the coast with British India.

In 1922 the East African shilling convertible with the British shilling was introduced as the primary unit of exchange which remained the currency for Kenya till independence.

The establishment of the currency system for Kenya had a direct bearing on how banking would evolve. British commercial banks started operating in Kenya in the 1890s and until the attainment of independence these banks had principally the following characteristics:

- There was a high degree of concentration in the major towns
- There was an exclusive concern with the financing of trade
- There was an elaborate system of branch banking
- There was a virtual lack of interest in or involvement with the African population.

Throughout the advanced period and into the first half of the 1960s Kenya's banking sector was dominated by the British Banks.

The first bank was the National Bank of India which was established in 1896. The bank later changed its name to National Grindlays Bank which is now known as Kenya Commercial Bank. It was joined by Standard Bank of South Africa in 1950 which later became the Standard Bank now the Standard Chartered Bank.

Thereafter the National Bank of South Africa came into the country and later merged with two other British Banks to form Barclays Bank which later became Barclays Bank of Kenya.
Additional new banks started coming to Kenya, for instance;

- In 1951 Nedelandsche
- In 1953 the Bank of India and the Bank of Baroda
- In 1956 Habib Bank –from Pakistan
- In 1958 Ottoman Bank – from Turkey
- In 1962 commercial Bank of Africa.

Most of these banks had little business with the nature population of Kenya and even when they went into deposit banking they would concentrate on the settler immigrant community. Thus up to 1963 the only institution that helped mobilized African savings was the Post Office Savings Bank which accepted African Savings from 1910. Even when the Commercial Banks started dealing with Africans, these dealings were limited to the acceptance of savings. They did not advance any credit to Africans thus the expansion of credit to Africans would become the major aims for intervention by the independence government in this sector.

At independence, the monetary and financial system in place served the colonial interest and hence on independence emphasis was on ensuring that there was proper control of the financial and monetary system to facilitate the attainment of economic, social and political objectives. Thus the independence government set out to rectify the situation in the following ways:

(a) By establishing a Kenyan Central Bank to take over the control of monetary and financial policy
(b) The introduction of Kenyan currency separate and distinct from the colonial currency and not shared with any other country.
(c) Entering into the community banking sector by establishing state owned community banks or buying shares in existing banks.

Banking Legislation in Kenya.