Update

Much Awaited RBI Guidelines for Licensing of Private Sector Banks Are Finally Out

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Update

Reserve Bank of India ("RBI") on Friday, the 22nd day of February, 2013, has issued much awaited final guidelines on licensing of new banks in private sector (the "Guidelines")[1] and thereby paving way for all corporates in private sector to enter into banking sector of the country. Accordingly, the private and public sector will now be eligible to set up a bank through a wholly-owned non-operative financial holding company.

In its press release issued on February 22, 2013[2], RBI mentioned that the new application for the license can be made on or before July 1, 2013 by any corporate fulfilling the eligibility criteria in the Guidelines and such applications shall be reviewed by high-level committee based on recommendations of which the RBI shall be granting 'in-principle' approval to the applicants. It is pertinent to note that in its draft guidelines placed on RBI site on August 29, 2011, RBI had excluded companies in the property and brokerage industries from applying for new bank licenses. However, the final Guidelines have opened the gate for all corporates without any exclusion provided they fulfill the specified conditions.

Background

As on date, there are 22 private sector banks registered with RBI. Out of these, eight were licensed pursuant to the RBI guidelines issued in 1993 and two were registered under the guidelines issued in 2001. The Union Finance Minister had made an announcement in his budget speech for 2010-11 that the RBI was considering giving some additional banking licenses to private sector players. Non-Banking Financial Companies could also be considered, if they meet the RBI's eligibility criteria.

In pursuant to the said announcement, a Discussion Paper was placed on its site by RBI in 2010 and after receiving feedbacks from the general public, consultants, existing banks, industrial and business houses, Non-Banking Financial Companies, Micro Finance Institutions etc and based on the experience of 1993 and 2001 guidelines, RBI placed on its website the draft guidelines for granting license to private sector in banking sector on August 29, 2011 inviting public comments.

Keeping in view the recommendations of the Narasimham Committee, Raghuram Rajan Committee and general public comments from the industry, RBI finally has released final guidelines for licensing the private players for setting up banks. Sources

[1] Text of the Guidelines are available at http://rbi.org.in/scripts/bs_viewcontent.aspx?Id=2651
[2] Text of press release is available at: http://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=28191

says that the RBI is likely to issue four to five licenses and the process is expected to be completed by the end of this calendar year[3].

Highlights of the Guidelines

1) **Eligible Promoters:** Entities / groups in the private sector, entities in public sector and Non-Banking Financial Companies (NBFCs) shall be eligible to set up a bank through a wholly-owned Non-Operative Financial Holding Company (NOFHC).

2) **'Fit and Proper' criteria:** Entities / groups should have a past record of sound credentials and integrity, be financially sound with a successful track record of 10 years. For this purpose, RBI may seek feedback from other regulators and enforcement and investigative agencies.

3) **Corporate structure of the NOFHC:** The NOFHC shall be wholly owned by the Promoter / Promoter Group. The NOFHC shall hold the bank as well as all the other financial services entities of the group.

4) **Minimum voting equity capital requirements for banks and shareholding by NOFHC:** The initial minimum paid-up voting equity capital for a bank shall be Rs. 5 billion. The NOFHC shall initially hold a minimum of 40 per cent of the paid-up voting equity capital of the bank which shall be locked in for a period of five years and which shall be brought down to 15 per cent within 12 years. The bank shall get its shares listed on the stock exchanges within three years of the commencement of business by the bank.

5) **Regulatory framework:** The bank will be governed by the provisions of the relevant Acts, relevant Statutes and the Directives, prudential regulations and other Guidelines/Instructions issued by RBI and other regulators. The NOFHC shall be registered as a non-banking finance company (NBFC) with the RBI and will be governed by a separate set of directions issued by RBI.

6) **Foreign shareholding in the bank:** The aggregate non-resident shareholding in the new bank shall not exceed 49% for the first 5 years after which it will be as per the extant policy.

[3] Source: NDTV News

7) **Corporate governance of NOFHC:** At least 50% of the Directors of the NOFHC should be independent directors. The corporate structure should not impede effective supervision of the bank and the NOFHC on a consolidated basis by RBI.

8) **Prudential norms for the NOFHC:** The prudential norms will be applied to NOFHC both on stand-alone as well as on a consolidated basis and the norms would be on similar lines as that of the bank.

9) **Exposure norms:** The NOFHC and the bank shall not have any exposure to the Promoter Group. The bank shall not invest in the equity / debt capital instruments of any financial entities held by the NOFHC.

10) **Business Plan for the bank:** The business plan should be realistic and viable and should address how the bank proposes to achieve financial inclusion.

11) **Other conditions for the bank :**
    a) The Board of the bank should have a majority of independent directors.
    b) The bank shall open at least 25 per cent of its branches in unbanked rural centres (population up to 9,999 as per the latest census)
    c) The bank shall comply with the priority sector lending targets and sub-targets as applicable to the existing domestic banks.
    d) Banks promoted by groups having 40 per cent or more assets/income from non-financial business will require RBI's prior approval for raising paid-up voting equity capital beyond Rs. 10 billion for every block of Rs. 5 billion.
    e) Any non-compliance of terms and conditions will attract penal measures including cancellation of license of the bank.

12) **Additional conditions for NBFCs promoting / converting into a bank:** Existing NBFCs, if considered eligible, may be permitted to promote a new bank or convert themselves into banks.

How can one make application for license?

In terms of Rule 11 of the Banking Regulation (Companies) Rules, 1949 all applications are required to be submitted to Department of Banking Operations and Development of RBI on or before July 1, 2013 in Form III as annexed in the Guidelines.

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How the RBI will be considering the applications?

All Applications shall first be screened by RBI to ensure prima facie eligibility of applicant and then the application shall be referred to High Level Advisory Committee to be set up by RBI. Based on the recommendations of the said Committee, RBI shall be giving its final decision on the application and RBI's decision in this regard shall be final. While evaluating the applications, both the RBI and the High Level Committee may ask for more information as well as have discussions with any applicant/s and seek clarification on any issue as may be required by it. In order to ensure transparency, the names of the applicants for bank licenses will be placed on the RBI website after the last date of receipt of the applications.

Conditions after obtaining 'in-principle' approval

The validity of the in-principle approval issued by RBI will be one year from the date of granting in-principle approval and would thereafter lapse automatically. Therefore, the bank will have to be set up within one year of granting the in-principle approval. RBI reserves the right to impose additional conditions and if warranted, to withdraw the in-principle approval if any adverse features are noticed after grant of approval to the applicant.

Conclusion

The Guidelines issued by the RBI is the culmination of three-year process after issue of Discussion Paper in this regard. The strict conditions of having 25% branches in rural area and FDI limited up to 49% for the first five years may make the cake a little bitter. In addition, RBI seems not to grant any relief to these new banks on achieving priority sector lending criteria as compared to existing banks.

At present, there are 26 public sector banks and 22 private sector banks. Only 35 per cent of India's adult population has accounts with banks and other financial institutions as compared to a global average of 50 per cent. Opportunity to private sector to open up banks will surely make the sector more attractive. At the same time, banking being a highly leveraged business, RBI will be very cautious while granting any 'in-principle' approval to private sector.