SOUTH INDIAN Bank

STUDENTS' ECONOMIC FORUM

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December 2011

Theme 241

ENTRY OF NEW BANKS IN THE PRIVATE SECTOR: DRAFT GUIDELINES

A monthly publication from South Indian Bank

19th Year of Publication

SOUTH INDIAN Bank
Experience Next Generation Banking
The South Indian Bank Ltd., H.O. : 'S.I.B. House', Thrissur, Kerala

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DECEMBER 2011

THEME 241 : ENTRY OF NEW BANKS IN THE PRIVATE SECTOR:DRAFT GUIDELINES

A well informed customer will make the policy makers as well as organisations which produce goods and services more responsive to the customer needs. This will also result in healthy competition among organisations and improve the quality of goods and services produced.

The "SIB Students' Economic Forum" is designed to kindle interest in economic affairs in the minds of our younger generation. We highlight one theme in every monthly meeting of the "Forum". We discuss this month the draft guidelines on "Entry of New Banks in the Private sector" based on the discussion paper released by RBI in the Annual Policy statement for the year 2010-11.

What do you know about the draft guidelines for entry of new banks?

Our Country is rated as the world's second fastest growing major economy. In a recent move, RBI has paved the way for the big industrial houses to enter the country's Rs.64 trillion banking sector, by releasing the draft guidelines for entry of new banks in the private sector. RBI is now in the process of receiving feed backs, comments and suggestions on these guidelines. The final guidelines will be issued only after incorporating certain amendments to the Banking Regulation Act 1949. According to the draft, groups or entities with diversified ownership in the private sector, having sound credentials and successful track record of minimum 10 years are eligible to apply for the new banking license.

What was the announcement made by Union Finance Minister in his budget speech for 2010-11?

The Finance Minister views that the Indian Banking System has emerged unscathed from the global financial crisis and the need of the hour is to facilitate speedy growth of the sector in terms of size and sophistication to cater to the needs of the economy. He has reiterated the importance of extending geographic coverage of banks and providing the common man easy access to banking services. The words of Finance Minister provide a clear indication that the Government is considering favourably, granting licenses to new banks in the private sector. In this context, RBI indicates that the guidelines will be finalised based on feed backs from all stakeholders and all the applications for new licenses would be referred to an expert group for recommendations.

What is the rationale behind granting license to new banks in India?

According to RBI, the pace of growth in an economy largely depends on the depth, stability and soundness of the financial system. The country needs a vibrant banking system with broader and deeper roots to reach the rural mass. The distribution of financial services and products, across the length and breadth of the country benefits both the producers and consumers resulting in increased productivity to the producers and improved savings to the consumers. The concept of financial inclusion is a powerful initiative as far as the common man is concerned, to practise savings and investments of their surplus as well as to avail credit for their essential requirements. The average population coverage by a commercial bank branch in urban centres is 9400 whereas in rural and semi urban centres it is 17200 as on 30 June, 2010. The all India weighted average has improved from 15,500 in 2005 to 13,400 in 2010.The Indian Financial System has been very stable in terms of financial viability, profitability and competitiveness. RBI is of the view that large number of banks would foster greater competition resulting in reduced costs and improved quality of service. Above all the new initiative would promote financial inclusion and support faster economic growth as envisaged by the Government and the Regulator.

What is the experience of RBI in this context?

The guidelines for licensing of new banks in the private sector were first issued in 1993 and revised subsequently in 2001. Under the 1993 guidelines, 10 new banks were set up and in 2001 the revised guidelines witnessed entry of 2 more new banks. Of the above, four were promoted by financial institutions, one each by conversion of a co-operative bank and an NBFC and the remaining six by individual banking professionals and an established media house. Out of the four banks by individual promoters, two were amalgamated with other private sector banks, one merged with a nationalised bank and the remaining survived. The major reasons for the merger and amalgamation were erosion of net worth on account of large capital market exposure and poor governance and lack of financial strength. It is seen that only those banks with adequate resources, trustworthy people, competent and experienced management could survive. The local area bank model suffered due to the inherent weaknesses in governance and incompetency of the management.

What are the key features of the draft guidelines?

The discussion paper describes in order the international practices, Indian experience as well as the extant ownership and governance guidelines. RBI has now released the draft guidelines for licensing of new banks in the private sector.

The key features are

- Minimum Capital Requirements
- Minimum and maximum caps on shareholdings
- Foreign shareholding
- Eligible Promoters
- Business Model
- Corporate Structure
- Corporate Governance

Explain the key features in the draft guidelines?

Minimum Capital Requirements: As per the guidelines, the minimum capital requirement is fixed at Rs.500 crores. The Non–operative Holding Company (NOHC)shall hold a minimum 40% of the paid up capital for a minimum period of five years from the date of licensing. The NOHC holding shall be brought down to 20% and 15% within 10 and 12 years respectively from the date of licensing.

Minimum and Maximum caps on shareholdings: RBI favours a lower cap of 49% in the initial few years. The Government is of the view that a higher cap of 74% may attract more foreign funds.

Foreign shareholding: The aggregate foreign (non resident)shareholding from FDIs,NRIs and FIIs in a new bank shall not exceed 49% for the first five years from the date of licensing. No non resident shareholder, directly or indirectly, individually or in groups, will be permitted to hold 5% or more of the paid up capital of the bank. Currently foreign shareholding in private sector banks is allowed up to 74% of the paid up capital.

Eligible Promoters: The draft suggests that any entity /group in the private sector, owned and controlled by residents, with diversified ownership, sound credentials having successful track record of 10 years is eligible for a license to promote a new bank. The entities / groups having significant income /assets (10% or more) from real estate or capital market activities in the last three years either individually or otherwise are not eligible.

Business Model: The business model should be realistic, viable and capable of achieving the ultimate goal of financial inclusion. The applicant for a new license shall forward the business plan for the new bank along with the application. In case of any deviation from the model, after issue of license, RBI may impose penal measures.

Corporate Structure: The draft proposes setting up of new banks only through a wholly owned Non-operative Holding Company (NOHC) to be registered with RBI as an NBFC. The objective is that the NOHC should clearly demarcate the regulated financial services or activities of the group including the new bank from other activities of the group. It means that only non-financial companies or entities and individuals belonging to the promoter group will be allowed to hold shares in the NOHC.

Corporate Governance: It is proposed that the NOHC director board should have a minimum 50% of directors, totally independent of the promoter, associates and customers of the entity. No financial service entity under the NOHC would be allowed to engage in any activity that a bank is permitted to undertake. RBI insists that the group shall provide all required information in this context smoothly and promptly to the regulators.

What are the other conditions in the draft guidelines?

1. Shareholding of 5% or more of the paid up capital of the bank by individuals / entities/groups will be subject to approval of RBI.
2. The bank shall get its shares listed on the stock exchanges within two years of licensing.
3. The bank shall open at least 25% of its branches in unbanked rural centres with population up to 9,999 as per 2001 census.
4. Existing NBFCs, if considered eligible, may be permitted to either promote a new bank or convert themselves into banks.
5. The top management of the bank shall have expertise in the financial sector, preferably.
6. The bank should operate on Core Banking solution from the beginning.
7. The bank shall make full use of modern infrastructural facilities in telecommunication, technology and other fields to provide cost effective service to the customers.
8. The bank shall be required to maintain a minimum Capital Adequacy Ratio of 12% for a minimum period of 3 years and as prescribed by RBI subsequently.
9. The bank shall comply with the priority sector lending targets and sub targets as applicable.
10. The promoters, the group entities, NOHC and the new bank shall be subject to the system of consolidated supervision by RBI.
11. The NOHC shall not be permitted to set up any new financial services entity for at least 3 years from the date of licensing.
12. The bank will be governed by the provisions of Banking Regulation Act 1949, RBI Act 1934.

What are the additional considerations in respect of promoter groups having 40% or more assets/ income from non financial business?

- The board of the bank should have a majority of independent directors.
- The exposure of bank to any entity in the promoter group shall not exceed 10% and the aggregate exposure to all the entities in the group shall not exceed 20% of the paid-up capital and reserves of the bank.
- The board should seek prior approval of RBI for raising the paid up capital beyond Rs.1000 crore for every block of Rs.500 crore.

What is the role of the High Level Advisory Committee to be set up by RBI?

All the applications for license will be initially screened by RBI to ensure *prima facie* eligibility of the applicants.The applications are then referred to the committee comprising eminent personalities with experience in banking and other relevant areas. The committee will set up its own procedures for screening the applications .The committee will reserve the right to either call for additional information or seek clarifications on any point. The committee submits the recommendation to RBI for issue of an in-principle approval.

LICENSING OF NEW BANKS: MAJOR CONTENDERS:

- **Religare Enterprises Ltd**
- **Shriram Transport Finance Co Ltd**
- **L&T Finance Ltd**
- **Bajaj Finserv Ltd**
- **Indiabulls Financial Services Ltd**
- **Birla Capital and Financial Services Ltd**
- **Tata Capital Ltd**
- **Reliance Capital Ltd**

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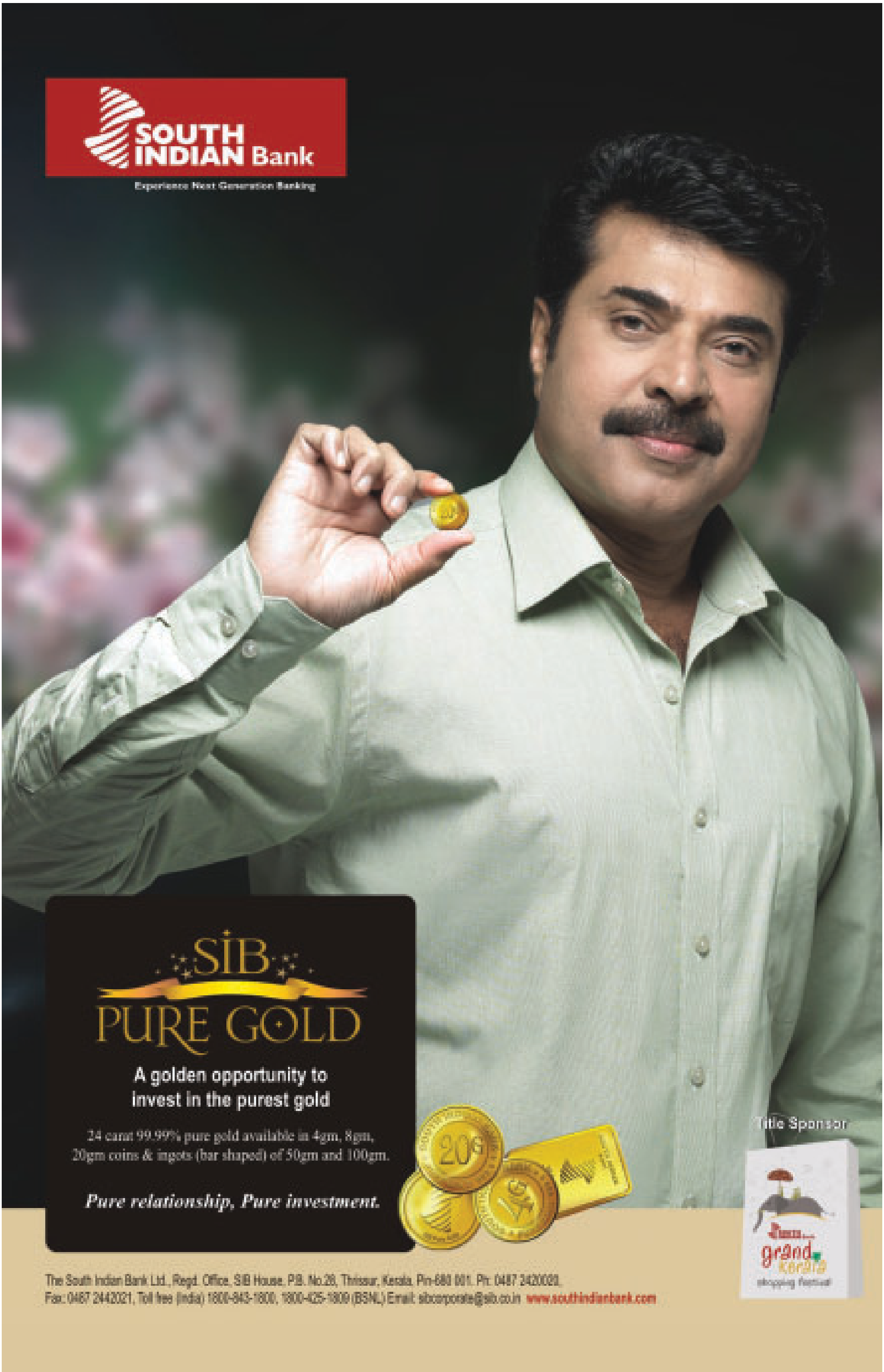
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