# Framework for presence of foreign banks in India

*By Sawant Singh and Aditya Bhargava, Phoenix Legal*

PHOENIX LEGAL

**New Delhi**
Second Floor,
254, Okhla Industrial Estate
Phase III
New Delhi – 110 020, India
Tel +91 11 4983 0000
Fax: +91 11 4983 0099
Email: delhi@phoenixlegal.in

**Mumbai**
Vaswani Mansion, 3rd Floor
120 Dinshaw Vachha Road
Churchgate
Mumbai – 400 020, India
Tel: +91 22 4340 8500
Fax: +91 22 4340 8501
Email: mumbai@phoenixlegal.in

On 6 November, the Reserve Bank of India (RBI) issued its much awaited framework for the presence of foreign banks in India. The framework envisages that foreign banks will be present in India preferably through wholly owned subsidiaries (WOS) rather than branches, and such WOS will enjoy "near national treatment".

## Background

To implement the Indian government's measure of permitting 74% foreign direct investment in Indian banks, the RBI issued a "roadmap" for the presence of foreign banks in India in 2005. While this roadmap contemplated banks incorporating locally in India, no foreign banks converted their Indian branches into WOS. Subsequently, in 2011, the RBI released a discussion paper on the presence of foreign banks in India. Based on public comments on the discussion paper, the RBI has now issued the framework.

The lessons learned in the global financial crisis of 2008 were the driving force for the issuance of the framework. A key imperative for the framework's issuance was to require foreign banks to incorporate locally to conduct business in India, so as to ensure greater control of foreign banks' Indian operations. As local incorporation requires separate legal entities, this is also expected to ensure that the assets of the Indian WOS are separated from those of the parent foreign bank. Local incorporation would also ensure that a board of directors based in India would manage the affairs of the Indian WOS keeping in mind the best interests of the WOS.

## Mode of presence

Foreign banks that commenced business in India prior to August 2010 have the option to continue business through branches. However, foreign banks that commenced business in India after August 2010 through branches, as well as foreign banks that are not already present in India, will have to establish a WOS to conduct business in India, if any of the following conditions apply to them: (a) the foreign bank is incorporated in a jurisdiction that gives preferential treatment to local depositors in a winding up; (b) the RBI is not satisfied with the level of supervision exercised over the foreign bank; (c) the bank is not subject to adequate disclosures in its jurisdiction of incorporation; or (d) the foreign bank is not widely held or has a complex structure.

Foreign banks to which the above conditions do not apply can enter India through branches but would be required to convert to WOS if these conditions later become applicable to them.

## Capital requirements

The minimum paid-up capital required for the WOS of a foreign bank in India is ₹5 billion (US$82 million). In case of a foreign bank entering India, this minimum capital would be required to be infused in the WOS up front by the parent foreign bank. Where a foreign bank is already present in India through branches and is converting to a WOS, the shortfall in the minimum capital after conversion of the branches into the WOS will have to be infused in the WOS by the parent foreign bank.

To ensure that the foreign banks present in India – both through WOS and through branches – do not dominate the Indian financial system, the framework contemplates placing certain restrictions on foreign banks in India. For instance, where the aggregate of the capital and reserves of foreign banks' WOS and branches exceed 20% of the aggregate of the capital and reserves of the Indian banking system, prior RBI approval would be required for the infusion of capital into foreign banks' WOS.

## National treatment

The guidelines for branch expansion applicable to domestic Indian scheduled commercial banks would also apply to WOS of foreign banks. Additionally, subject to relaxations that the RBI may allow on a case-to-case basis, such WOS would also need to comply with the priority sector lending requirements that are applicable to domestic banks.

While the framework contemplates mergers and acquisitions between Indian private sector banks and WOS of foreign banks, these transactions are subject to guidelines that the RBI may prescribe after considering factors such as foreign investment in Indian banks and the functioning of foreign banks in India.

## Conclusion

The issuance of the framework is welcome from an investment perspective, and will provide much needed direction to foreign banks seeking to enter India as well as foreign banks that are already present in India. Reportedly, some foreign banks have already approached the RBI for further clarifications on the framework. However, factors such as stringent corporate governance and priority sector lending requirements, and lack of clarity on mergers and acquisitions of banks, may discourage foreign banks from establishing WOS in India.

*Sawant Singh is a partner and Aditya Bhargava is a senior associate at the Mumbai office of Phoenix Legal.*