Guidelines set for issuing of licences for new banks

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The The Reserve Bank of India (RBI) recently issued guidelines on the licensing of new banks in the private sector and invited applications by 1 July 2013. While the guidelines have been on the anvil since 2010, it is understood that the RBI was keen for certain amendments to be made to the Banking Regulation Act, 1949 – which were brought about by the Banking Laws (Amendment) Act, 2012 – before releasing the guidelines. This article discusses some key features of the guidelines.

Eligibility criteria

All private sector entities that are "owned and controlled by residents" and promoters/promoter groups with an existing non-banking financial company (NBFC) are eligible to apply to the RBI for a licence to establish a bank through a wholly owned non-operative financial holding company (NOFHC). The guidelines also require that a promoter/promoter group must be "fit and proper" in accordance with the criteria prescribed in the guidelines. This entails displaying not just financial soundness and a decade-long track record of business success, but also requires a reputation for integrity.

The NOFHC, a concept introduced in the guidelines and to be governed by a distinct set of (yet to be issued) directions, must be registered as an NBFC with the RBI.

The promoters can only hold shares in the NOFHC, while the NOFHC will hold shares in the bank and other entities of the promoter group engaged in financial services. No member of the promoter group engaged in financial services activities can hold shares in the NOFHC.

The objective of the NOFHC structure is to ring-fence the regulated financial services entities (including the bank) from the other activities of the promoter group, and to ring-fence the bank from other regulated financial services activities of the promoter group.

Shareholding in bank

The initial minimum paid-up equity capital of the bank must be ₹5 billion (US$92 million). However, promoters are free to bring in additional equity capital as per their business plan.

While the NOFHC must hold at least 40% of the paid-up voting equity capital of the bank for a period of five years from the commencement of banking business, the guidelines require that the NOFHC's shareholding in the bank be reduced a graded manner – to 20% within 10 years, to 15% within 12 years, and any shareholding exceeding 40% must be brought down to 40% within three years from the commencement of business. Additionally, the bank's shares must be listed within three years of the commencement of business.

In contrast to the prescribed ceiling on foreign direct investment in banks of 74%, the guidelines prescribe that for the first five years, non-resident shareholding in banks cannot exceed 49% of the paid-up voting equity capital of the bank. Further, a non-resident investor, either by itself or in concert with any subsidiary or affiliate, cannot hold more than 5% of the paid-up voting equity capital of a bank for the first five years from the commencement of business of the bank.

Exposure norms

The guidelines prescribe stringent exposure norms for both NOFHCs and banks. For example, an NOFHC cannot have credit or investment exposure to any entity that is part of its promoter group (other than the entities held by it), nor can it have equity, debt or capital exposure to any entity outside its promoter group.

Similarly, a bank cannot have credit or investment exposure to any entity that is part of its promoter group or any individual associated with the promoter group or the NOFHC. Banks also cannot invest in equity or debt capital instruments of financial entities under its NOFHC, or other NOFHCs – which is in contrast with the shareholding limits currently applicable to banks. Additionally, restrictions are placed on lending and investment activity by financial institutions held by an NOFHC (other than the bank), with the objective of avoiding round-tripping or circular movement of funds.

Across the finish line?

After multiple rounds of vetting, applicants may be granted in-principle approval by the RBI to establish a bank. The successful candidates would then be required to establish the bank within one year of receipt of such approval.

The guidelines give the impression that only established groups, having one or more listed companies and committed to long-term participation in the banking sector, would be allowed to establish new banks in the private sector. Judging by media reports and the RBI's recent notification on queries on the guidelines, there already appears to be some interest from prominent business groups. However, the overall impact of the guidelines will only be seen post-July 2013, when the RBI assesses the applications and grants approvals for the establishment of new banks.

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