

## RBI's IWG Recommendations

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### Why in news?

An Internal Working Group (IWG) of the RBI constituted to “review extant ownership guidelines and corporate structure for Indian private sector banks” recently submitted its report.

### How is the Indian banking system's performance?

- India’s banking system has changed a lot since Independence.
- Back then, banks were owned by the private sector, resulting in a “large concentration of resources in the hands of a few business families”.
- The government resorted to the nationalisation of banks in 1969 (14 banks) and again in 1980 (6 banks) to -
  1. achieve a wider spread of bank credit
  2. prevent its misuse
  3. direct a larger volume of credit flow to priority sectors
  4. make it an effective instrument of economic development
- But with economic liberalisation in the early 1990s, the economy’s credit needs grew and private banks re-entered the picture.
- This had a notable impact on credit growth.
- However, even after three decades of rapid growth, the total balance sheet of banks in India still constitutes less than 70% of the GDP.
  - This is much less compared to global peers such as China, where this ratio is closer to 175%.
- Moreover, domestic bank credit to the private sector is just 50% of GDP.
  - In economies such as China, Japan, the US and Korea it is upwards of 150%.
- In other words, India’s banking system has been struggling to meet the credit demands of a growing economy.
- There is only one Indian bank in the top 100 banks globally by size.
- Further, Indian banks are also one of the least cost-efficient.
- Clearly, India needs to strengthen its banking system to grow at a fast pace.
- In this regard, it is crucial to note that public sector banks have been steadily losing ground to private banks.
- Private Banks are not only more efficient and profitable but are also ready to

take risks.

- It was against this backdrop that the RBI constituted the IWG to suggest reforms.

### What was the IWG tasked to?

- Given the above, the IWG was asked to suggest changes that not only boost private sector banking but also make it safer.
- The terms of reference of the IWG inter alia included -
  1. a review of the eligibility criteria for individuals/entities to apply for banking license
  2. examination of preferred corporate structure for banks and harmonisation of norms in this regard
  3. review of norms for long-term shareholding in banks by the promoters and other shareholders

### What are the key recommendations?

- **Promoter's cap** - The IWG has proposed to raise the cap on promoters' stake in private banks from the current 15% to 26% in 15 years.
- As regards non-promoter shareholding, a uniform cap of 15% of the paid-up voting equity share capital of the bank is prescribed for all types of shareholders.
- **Corporates as banks** - IWG has recommended that large corporate or industrial houses may be allowed as promoters of banks.
  - Large corporates refer to business houses having total assets of Rs 5,000 crore or more.
  - Here, the non-financial business of the group accounts for more than 40% in terms of total assets or gross income.
- However, this move will be rolled out only after making amendments to the Banking Regulation Act, 1949.
  - This is to deal with connected lending and exposures between the banks and other financial and non-financial group entities.
- The IWG also made a case for strengthening of the supervisory mechanism for large conglomerates, including consolidated supervision.
- **New Banks** - IWG recommended that the minimum initial capital requirement for licensing new banks should be enhanced -
  - i. from Rs. 500 crore to Rs. 1,000 crore for universal banks
  - ii. from Rs. 200 crore to Rs. 300 crore for small finance banks
- **NBFCs** - The panel suggested well run large NBFCs with an asset size of Rs. 50,000 crore and above, including those owned by a corporate house, may be

considered for conversion into banks.

- This is however subject to completion of 10 years of operations and meeting due diligence criteria and compliance with additional conditions specified.
- **Payments Banks into SFBs** - The panel has proposed a reduction in the time-frame needed for payments banks to convert into small finance banks (SFB) to 3 years from 5 years.
- A change has also been suggested in the listing criterion for SFBs and payment banks.
- They may list -
  - i. within 6 years from the date of reaching the net worth equivalent to prevalent entry capital requirement prescribed for universal banks (or)
  - ii. 10 years from the date of commencement of operations, whichever is earlier
- **NOFHC** - Non-operative Financial Holding Company (NOFHC) should continue to be the preferred structure for all new licenses to be issued for universal banks.
  - [NOFHC is a category of non-banking finance company (NBFC), registered as an NBFC with the RBI.
  - It is governed by a separate set of directions issued by RBI.
  - The objective is to separate several financial activities carried out by the same holding company.]
- However, it should be mandatory only in cases where the individual promoters / promoting entities/ converting entities have other group entities.
- Banks licensed before 2013 may move to an NOFHC structure at their discretion.
  - However, once the NOFHC structure attains a tax-neutral status, all banks licensed before 2013 shall move to the NOFHC structure within 5 years from announcement of tax-neutrality.
- The concerns about banks undertaking different activities through subsidiaries joint ventures (JVs)/associates should be addressed through suitable regulations till the NOFHC structure is made feasible and operational.
- Banks currently under NOFHC structure may be allowed to exit from such a structure if they do not have other group entities in their fold.
- **Licensing guidelines** - The panel called for the RBI to take steps to ensure harmonisation and uniformity in different licensing guidelines, to the extent possible.

### **What are the benefits of the recommendations?**

- **Growth** - The RBI panel has suggested opening the field to new players.
- This may provide a wide choice to consumers in terms of products and

pricing.

- By initial indications, 9 private sector and 5 state owned NBFCs may get qualified to set up, or turn into, banks adding to the present strength of 143 banks (June 2020).
- This is likely to expand the banking network that should help the economy reach its growth potential.
- **NBFCs** - The IWG's recommendation to allow conversion of large NBFCs into banks could increase the size of the banking system itself.
- With at least 10 years as shadow banks, they will have a different approach to credit appraisal; risk-based pricing, monitoring and recovery strategies.
- **NOFHC** - A non-operative finance holding company (NOFHC) structure to separate ownership and management control is expected to take care of the 'conflict of interest' issues.
- This is in line with the recommendations of the PJ Nayak Committee report reviewing 'Governance of Boards of Banks in India'.
- The committee even called for Public Sector Banks (PSBs) to separate government ownership and grant autonomy in their functioning.
- The transition of the ownership structure of existing private banks licensed before 2013 is also clearly outlined.

### **What are the challenges before the RBI?**

- With expansion of number of banks and non-banks, the onus of the RBI to oversee the orderliness, sustainability and compliance standards will increase.
- Fintech companies, peer-to-peer lenders and neo-banks add to the challenges of the supervisory system.
- Cooperative banks and housing finance companies are already added to the list of regulated entities of the RBI.
- So, the RBI has to plan and reorient its human resources and draw in new talent to oversee the rapidly expanding banking system.
- It must especially track signs of stress and ensure that there is no systemic threat.

**Sources: The Indian Express, RBI, BusinessLine**