Wholesale and Long-term Finance bank

What is the issue?

\n\n

After having issued licences for new-age payments and small finance banks, the RBI has now published a discussion paper on the need for wholesale and long-term finance (WLTF) banks.

\n\n

What is WLTF?

\n\n

\n
- The idea is that as the financial sector grows, apart from a number of universal banks, it may be **useful to have differentiated banks** focusing on different areas and developing competence.
\n
- This will reduce the cost of intermediation and lead to better economic outcomes.
\n
- The WLTF banks will focus on lending to the corporate sector, small and medium businesses, and the infrastructure sector.
\n
- They may also offer services in the area of foreign exchange and trade finance.
\n
- Further, they can act as market makers in instruments like corporate bonds and credit derivatives.
\n
- WLTF banks can raise funds through issuance of debt and equity. They may also be allowed to accept term deposits above a threshold.
\n

\n\n

What are the advantages?

\n\n

\n

- As specialized institutions, they will be in a much better position compared with commercial banks in **evaluating and funding long-term projects.**
\n
- It's not easy for companies to get long-term financing because of the underdeveloped corporate bond market and possible asset liability mismatch in the banking system.
\n
- With specialized banks, **NPA risks could possibly be avoided** in the future.
\n
- It may also help the rest of the banking sector in the case of joint lending, or by simply getting the project evaluation from these banks.
\n
- Establishment of WLTF banks will also enhance competition, which will **lead to more efficient allocation of financial resources.**
\n

\n\n

Does India have prior experience?

\n\n

\n
- India has tried the **development finance institution (DFI) model** in the past with limited success.
\n
- After independence, DFIs were established to increase the level of investment in the economy.
\n
- **Industrial Finance Corp. of India (IFCI)** was the first such institution to be established in 1948.
\n
- This was followed by the establishment of state finance corporations.
\n
- In later years, other institutions like the Industrial Credit and Investment Corporation of India (ICICI) and Industrial Development Bank of India (IDBI) were established.
\n
- However, DFIs **struggled with government interference and changes in the economy,** and accumulated high levels of NPAs.
\n
- One of the biggest problems facing long-term finance institutions is competing for funds in the marketplace and being able to lend at competitive rates.
\n

\n\n

What are the factors to be considered?

\n\n

\n
- As the banking regulator mulls over issuing licences for new-age WLTF banks, there are at least **three aspects** that will need greater attention.
\n
- **First, government participation** in setting up WLTF banks should be avoided as it could end up defeating the purpose.
\n
- Government ownership would lead to the same problems that public sector banks are facing at the moment.
\n
- Further, these banks will be highly specialized and will need operational freedom, which is not possible with government ownership.
\n
- **Second,** licences should only be issued to entities that are able to demonstrate the ability to build such a highly specialized bank, and are in a position to bring in capital to both meet regulatory requirements and run the business on a sustainable basis.
\n
- The central bank may allow industrial houses to participate to the extent that they are not in a position to influence business decisions.
\n
- **Third,** the RBI will need to design a regulatory architecture that will enable growth with adequate safeguards.
\n
- For example, the regulator may choose to exempt these banks from cash reserve ratio and statutory liquidity ratio requirements.
\n
- These banks will compete directly with the bond market.
\n

\n\n

\n\n

Source: Live Mint

\n