RBI guidelines for Indian private sector banks: to bank or not to bank?

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Over the last two decades, the Reserve Bank of India (RBI) has issued banking licences under different categories. While the RBI was relatively generous when it came to the number of new licences for Small Finance Banks and Payment Banks, only a handful of players have been licensed to operate as Universal Banks. The various guidelines prescribed over the years for different sets of licences have, to an extent, created some inconsistency. Aiming to bring in uniformity and level the playing field in an evolving landscape, the RBI constituted a Working Group in June 2020 to review extant guidelines.

The Working Group's draft report, published in November 2020, has outlined a series of recommendations on the extant ownership guidelines and corporate structure for Indian private sector banks. The key proposals in its report included the following:

Eligibility of industrial/corporate houses:

The issue has been a sticky one for a long time now. Historically, by and large, RBI has prohibited this category from applying for a Bank licence except in the 2013 licensing round for Universal Banks (although none of the houses ultimately received the licence). The main apprehensions were around lending to related parties as well as conflicts of interests. The Working Group report makes a case for considering industrial/corporate houses for the banking play, giving them a foot in the door. The Working Group acknowledged that they can offer a stable source of capital and strategic thinking; and also noted that internationally, there are very few jurisdictions which explicitly disallow large corporate houses, and even in those jurisdictions, it is not a settled issued. At the same time, a suitable legal framework for supervising connected lending and non-bank entities of the group is a pre-requisite. There is also a recognition that the RBI will need to ramp up its supervisory capacity.

While the track record of some corporate houses leaves a lot to be desired, painting everyone with the same brush via a blanket prohibition would unduly close doors to groups that have an impeccable track record, strong financial standing, management pedigree and robust risk management frameworks. The RBI's final take on this matter will be keenly watched and would represent a major policy change. However, it is likely that any change will take considerable time given the complexities of ensuring the necessary legal framework is in place.

Conversion of existing Non-Banking Finance Companies (NBFCs):

At present, NBFCs with a successful track record of 10 years are eligible to apply for a Universal Bank licence whereas those with over five years can apply for a Small Finance Bank licence. Many of the larger NBFCs unsuccessfully applied in the Universal Bank licensing round of 2013. The Report, recognising the proven track record of some of these NBFCs (specifically, those with asset size greater than INR50,000 crore), has pushed the case for their conversion to a Bank model.

The Working Group has, however, suggested stricter criteria such as dilution of promoter group holding in the NBFC to 49 per cent before application as well as an accelerated dilution schedule with maximum promoters' holding to be brought down to 26 per cent in 10 years. The recommendation around 49 per cent holding from day one is a significant one and would, in some cases, require significant stake dilution before application. Fence-sitters are bound to have reservations on this requirement especially considering the lack of certainty on whether the licence would be granted even if the conditions are met. NBFCs may possibly represent a case for phased dilution from the date of principal approval, up to date of 3 years from commencement of business.

While these are important considerations, it would be critical for prospective applicants to assess the impact of moving to a bank platform on the business and the profitability in the short to medium term. Aspects such as Cash Reserve Ratio, Statutory Liquidity Ratio, branch rollout requirements, capital adequacy ratios, priority sector obligations need to be carefully evaluated.

Relaxation in timelines for existing small finance banks and payment banks

The Working Group proposes to extend the listing timeline from three years to six years after achieving the prescribed net worth threshold. This will give Small Finance Banks much needed time and flexibility. The extension would be especially welcomed by existing players with a holding company structure. This would allow these players an extended window for collapsing their structure.

For Payments Banks, the accelerated conversion to a Small Finance Bank model in three years of operations (against the extant requirement of five years) is a significant proposal. If adopted by the RBI, it will allow existing players to significantly expand their product offerings in a shorter timeframe.

Non-Operative Financial Holding Company (NOFHC)

The Working Group has recommended that legacy banks should adopt an NOFHC structure and that they should bring the bank and other entities under the NOFHC. Depending on the final shape and form, it is likely to have significant ramifications on the overall corporate structure; various aspects such as control and governance, taxation, valuation etc. would have to be duly weighed.

Overall, the Working Group recommendations are significant, both in nature and scope. There are bound to be strong views on some of its proposals and various stakeholders will likely seek to drive home their point during the window of representations (open until 15 January 2020). The RBI's final take on these recommendations will be one of the key banking developments to watch in the year ahead. The way in which the RBI ultimately channelises these changes will pave the road for the banking industry over the next decade.

(Chartered accountant Amit Phulwani contributed to this article.)