

Internal Working Group (IWG) recommendation

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In News: Internal Working Group (IWG) of the Reserve Bank of India (RBI) has recommended the guarded entry of corporates into the banking space, conversion of big Non-Banking Financial Companies (NBFCs) into banks, hike in promoters' stake and also a hike in minimum capital for new banks, among others.

Key Points

Entry of Corporates into Banking Space:

- Large corporates and industrial houses may be allowed as promoters of banks only after necessary amendments to the Banking Regulation Act, 1949.
- A promoter is an individual or organization that helps raise money for some type of investment activity. This is to prevent connected lending and exposures between the banks and other financial and non-financial group entities.
- Connected lending is modeled as a situation in which the bank's controlling owner extends loans of inferior quality at lower interest rates to himself or his connected parties. Credit exposure is a measurement of the maximum potential loss to a lender if the borrower defaults on payment. The RBI has been against allowing corporate houses to set up or run commercial banks due to their poor track record on governance and credit disbursement.
- Corporate houses routinely delay payments to banks and the system has no in-built incentives or disincentives for orderly debtor behaviour.

Conversion of NBFCs into Banks:

Well-run large NBFCs, with an asset size of Rs. 50,000 crore and above, including those which are owned by a corporate house, may be considered for conversion into banks subject to completion of 10 years of operations and meeting due diligence criteria and compliance with additional conditions specified in this regard.

Hike in Promoters' Stake:

- The cap on promoters' stake in the long run (15 years) may be raised from the current level of 15% to 26% of the paid-up voting equity share capital of the bank.
- On non-promoter shareholding, the panel has suggested a uniform cap of 15% of the paid-up voting equity share capital of the bank for all types of shareholders.

Hike in Minimum Capital for New Banks:

- The minimum initial capital requirement for licensing new banks should be enhanced from Rs. 500 crore to Rs. 1,000 crore for universal banks and from Rs. 200 crore to Rs. 300 crore for small finance banks.

Universal Banks combine the three main services of banking viz. wholesale banking, retail banking, and investment banking under one roof. For example, Deutsche Bank, Bank of America, HSBC, etc.

Payments Banks' Conversion into Small Finance Bank:

- For payments banks intending to convert to a Small Finance Bank (SFB), a track record of 3 years of experience as payments bank may be considered as sufficient. Payments banks (Airtel Payments Bank, India Post Payments Bank, etc.) are like any other banks, but operating on a smaller or restricted scale. Small Finance Banks are the financial institutions which provide financial services to the unserved and unbanked region of the country.

Harmonisation and Uniformity in Different Licensing Guidelines:

- The RBI should take steps to ensure harmonisation and uniformity in different licensing guidelines, to the extent possible.
- Whenever new licensing guidelines are issued, if new rules are more relaxed, the benefit should be given to existing banks, and if new rules are tougher, legacy banks should also conform to new tighter regulations, but a non-disruptive transition path may be provided to affected banks.

Non Operative Financial Holding Company:

- NOFHC should continue to be the preferred structure for all new licenses to be issued for universal banks. However, it should be mandatory only in cases where the individual promoters, promoting entities and converting entities have other group entities. NOFHC is a financial institution through which promoter/promoter groups will be permitted to set up a new bank. Entities or groups in the private sector, public sector and NBFCs can set up these wholly-owned NOFHCs.

Payments Banks

- They are like any other banks but operate on a smaller scale. For example, Airtel Payments Bank, India Post Payments Bank and so on.

Small Finance Banks (SFB)

- These are the financial institutions facilitating financial services to India's unserved and unbanked region. For example, A U Small Finance Bank, ESAF Small Finance Bank, and so forth.

Universal Banks

- Universal Banks combines three major banking services, wholesale banking, retail banking, and investment banking under one roof. For example, HSBC, Deutsche Bank, and so forth.

Internal Working Group

- The RBI has constituted a five-member Internal Working Group to review present ownership guidelines and corporate structure for Indian Private Sector Banks.

Key takeaways

- RBI Central Board Director P K Mohanty will head the committee.
- It will submit its report by 30th September, 2020.
- Terms of Reference of the Committee are:
 - To review the present licensing guidelines and regulations relating to ownership and control in Indian private sector banks and suggest appropriate norms.
 - To examine and review the eligibility criteria for individuals/ entities to apply for banking licenses.
 - To study the current regulations on holding of financial subsidiaries through non-operative financial holding company (NOFHC) and suggest the manner of migrating all banks to a uniform regulation in the matter.
 - To examine the norms for promoter shareholding at the initial/licensing stage and subsequently, along with the timelines for dilution of the shareholding