



Corporates Houses & Banking

Why in News

Recently, the [Reserve Bank of India \(RBI\)](#) has put on hold the recommendations from its **Internal Working Committee (IWG)**, that said large corporate and industrial houses may be allowed to promote banks after amendments to the [Banking Regulations Act, 1949](#).

- The RBI has **accepted 21 out of 33 recommendations of the IWG** on ownership of private banks, but kept silent on giving banking licence to big business groups.

// **Promoter cap:** Cap for promoters may be raised to 26% and for non-promoters to 15% at central bank's discretion

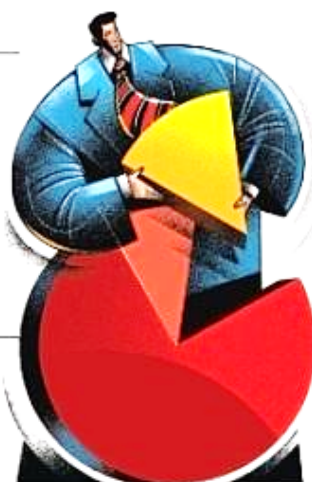
NBFCs: Non-banking financial firms with an asset size of ₹50,000 cr or more can aspire for a banking license

SFBs: Time-frame for payments banks to convert to a small finance bank to be three years from five years

- ▶ Provision for SFBs and payment banks to list within six years

Bank licensing: Capital level for licensing new universal banks may be doubled to ₹1,000 cr; raised to ₹300 cr for SFBs from ₹200 cr

BIG BANK REFORMS



NOFHC: Non-operative financial holding company must for promoters, promoting entities, converting entities with other group entities

- ▶ NBFCs wanting to convert into universal banks with interests across financial services will have to set up NOFHCs

- ▶ Banks licensed before 2013 may move to an NOFHC structure. Have to shift within 5 years of attaining tax-neutral status

- ▶ Banks under NOFHC structure may be allowed to exit from it if they do not have other group entities in their fold

Key Points

▪ About:

- Corporate Houses (CH) were active in the banking sector till five decades ago when the banks **promoted by them were nationalised in the late sixties** amid allegations of connected lending and misuse of depositors' money.
- The Banking sector was opened up again for the **CHs Post Liberalisation (1991)** with the first round of licensing of private banks **that was done in 1993**.
- Since then, there were two more rounds of licensing of banks in the private **sector - in**

2003-04 and 2013-14 - culminating with the [on-tap licensing regime](#) of universal banks in 2016.

- However, even some prominent business houses were not considered in 2013-14.

▪ **Pros of Allowing Corporations To Own Bank:**

◦ **Plugging Capital Gap:**

- Currently, the government keeps picking money from the taxpayers pocket and funding the [public sector banks](#).
- Hence, by allowing the big corporates into the banking sector the capital requirement can be fulfilled.

◦ **Financial Inclusion:**

- Even today a significant population do not have access to banking in the country, the corporates' entry would mean the **opening of more branches and subsequently bringing more people into the banking net.**

◦ **Improving Competition:**

- Privatization of banks has been a long-proposed reform in the Indian banking industry. Allowing corporations into the banking sector **will further pressurize Public sector banks to become competitive.**

▪ **Concerns of Allowing Corporates To Own Bank:**

◦ **Connected Lending & Moral Hazard:**

- There are apprehensions that it would not be easy for supervisors to **prevent or detect self-dealing or connected lending** as banks could hide connected party or related party lending behind complex company structures and subsidiaries or through lending to suppliers of promoters and their group companies.
 - Connected lending **involves the controlling owner of a bank giving loans to himself or his related parties** and group companies at favourable terms and conditions.
- Big business groups already account for a major chunk of [Non-Performing Assets \(NPAs\)](#) in the banking system even without becoming promoters of a bank.
- In ethical terms, this will **erode the bank's role as an effective financial and create a moral hazard** or conflict of interest situation.

◦ **Circular Lending & Difficulty In Regulation:**

- Under circular lending, corporate bank X funding projects of an industry group, which owns corporate bank Y, and corporate bank Y funding projects of an industry group owning bank Z, and finally, corporate bank Z funding projects of industry group owning bank X.
- With available legal structures and the proliferation of [shell companies](#), makes it hard to track such lending on a real-time basis.

◦ **Inequality & Concentration of Wealth:**

- Corporations owning banks will add more muscle to big industry groups, **which already dominate many important sectors** of the economy, including telecom, organised retail, aviation, software and e-commerce.
- This will further **accelerate the concentration of wealth** and [increase inequalities](#).

◦ **Contradicting the Previous Ruling:**

- The banking sector in India has been in trouble for the last few years, keeping that in mind **the RBI in 2016 had created new guidelines** on the limit of lending to a single company.
- The rationale behind this ruling was that if a bank lends too much to one company

only then it risks losing that money if the company sinks.

- Therefore, the recommendation of allowing the entry of industry groups in the banking sector is **in contradiction with the above-said ruling in 2016.**

Way Forward

- Before granting much economic power in the hands of corporations, it is imperative to carry out the **long-pending banking reforms and strengthen the functional autonomy of RBI.**
- The recent failures on internal and external controls like in the case of **PNB leading to an alarming fraud**, the **failures of bank and NBFCs** like **Lakshmi Vilas Bank, Yes Bank**, etc. where all stakeholders lost money and credibility have given rise to the need of new regulations with a very high degree of supervisory mechanism and corporate governance which has strong Information Technology (IT) and **Artificial Intelligence (AI)** enabled platform.
- Where a corporate house is a promoter, **strict regulations on the use of funds held with the bank and monitoring of related party transactions will be essential.**
- Fit and proper **criterion needs to be foolproof** and the common citizens should become the beneficiaries in the process.

Source: IE

PDF Reference URL: <https://www.drishtias.com/printpdf/corporates-houses-banking>

