Internal Working Group Recommendations: RBI

Why in News

Recently, an **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.

- The IWG, **headed by PK Mohanty,** was constituted by the RBI in **June 2020,** to **review the extant ownership guidelines** and **corporate structure for private sector banks** in India.

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.

Way Forward

- 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