

Standing Committee Report Summary

Policy on New Licences in the Banking Sector

- The Standing Committee on Finance (Chairperson: Mr. Yashwant Sinha) presented its report on “Policy on New Licences in the Banking Sector” on October 18, 2013. It reviewed the performance of new banks and the guidelines for setting up of new banks while keeping in mind the objective of financial inclusion. The key observations and recommendations are mentioned below:
- **Issue of licences for establishment of new banks:** The Committee noted that the Narasimhan Committee (1991) had recommended that the Reserve Bank of India (RBI) permit establishment of new banks in the private sector. Following the recommendations, guidelines for licensing of new banks were issued by RBI in 1993 and revised guidelines were issued in January 2001 and February 2013.
- Out of the four banks established by individuals in 1993, just one has survived while three have either voluntarily merged or have been compulsorily merged due to a decline in their financial health. The Committee opined that the 1993 guidelines may not have been adequate to check such decline in financial health of the new banks.
- **Banking licences to large industrial houses:** The Committee observed that the 2013 guidelines for banking licences have permitted large industrial houses to apply for banking licenses, contrary to the 2001 guidelines. It disapproved of RBI’s reasoning for issuing licences to large industrial houses that: (i) capital requirement can be easily provided by them, (ii) they had already been allowed entry into other financial service sectors, and (iii) they have nurtured industrial growth in various highly regulated sectors including telecom, power and highways. It stated that it would be prudent to keep industry and banking separate since banking is a highly leveraged business involving public money and public welfare. It expressed concern that industrial houses may not be geared to achieve the objectives of financial inclusion.
- **Fit and proper criteria:** At present, under the “fit and proper” criteria, entities applying for a banking licence should have sound credentials and integrity, and should have a successful track record of 10 years. The Committee opined that a more precise, coherent and objective yardstick should be formulated to assess the credentials of various applicants.
- **Paid up capital:** The Committee recommended raising the minimum paid-up capital requirement for new banks from the current Rs 500 crore to Rs 1000 crore. It opined that starting a bank with Rs 500 crore as capital could limit operations of the bank and that increasing the minimum requirement would also screen out less serious players.
- **Lending norms:** The Committee noted that there are no lending norms prescribed in the guidelines with regard to lending to entities associated with the promoters of the banks. It expressed the need to have clear guidelines regarding the same in order to prevent appropriation of funds to serve the interests of the promoter group.
- **Financial inclusion:** The 2013 guidelines require new banks to open at least 25% of their branches in unbanked rural areas. The Committee noted that the existing private sector banks have less than 20% of their branches in such areas. It recommended that RBI have a mechanism to incentivise expansion of banking in unbanked rural areas. Further, it proposed that permission for opening new branches be given in lots of four - three branches in urban areas and one in a rural area.
- **Issues related to applications:** The Committee proposed that: (i) RBI execute screening and evaluation of applicants in a transparent manner, (ii) RBI respond to applications promptly and inform rejected candidates about the reason for the same within a stipulated time period, and (ii) there be a mechanism to enable aggrieved applicants to seek review of decisions of RBI.

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