BANK LICENSING: PRE AND POST BANK LICENSING POLICY 2013 OF THE RESERVE BANK, WAS THERE A NEED FOR CHANGE?

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ABSTRACT

The RBI issued specific guidelines, "Licensing of New Banks in the Private Sector," in February, 2013 take into account the existing economic environment, RBI's objective regarding banking sector reforms, and its past experience with banking licenses issued in 1993 and 2003. Apart from stringent entry-level guidelines, RBI expects new banks to take the lead in achieving greater financial inclusion, enhancing rural banking facilities, reaching priority-sector lending targets, and ushering in technology innovations in the banking industry. The focus of the committee was to recommend innovative solutions to the RBI to accelerate financial inclusion in unbanked and under-banked sections of the society in sustainable and cost effective way. The committee submitted its report to the RBI report in January 2014. One of the key recommendations of the committee was to introduce specialized banks ('Payments Bank') to cater to the lower income groups and small businesses. The report also provided high level criteria to assess 'Fit and Proper' status of the Payments bank license aspirants.

INTRODUCTION

The Reserve Bank of India (RBI) on February 22, 2013 issued the final guidelines for licensing of new private sector banks wherein entities both from private and public sector shall be eligible to set up a bank through a wholly-owned non-operative financial holding company (NOFHC). The NOFHC shall be wholly owned by the promoter / promoter group. The NOFHC shall hold the bank as well as all the other financial services entities of the group. Entities / groups should have a past record of sound credentials and integrity, be financially sound with a successful

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record of accomplishment of 10 years. For this purpose, RBI may seek feedback from other regulators and enforcement and investigative agencies.[2]

The new guidelines take into account the existing economic environment, RBI's objective regarding banking sector reforms, and its past experience with banking licenses issued in 1993 and 2003. Apart from stringent entry-level guidelines, RBI expects new banks to take the lead in achieving greater financial inclusion, enhancing rural banking facilities, reaching priority-sector lending targets, and ushering in technology innovations in the banking industry. Applicants that were issued licenses in the earlier two stages have reached a certain degree of success in some, but not all, of the above. It will be a tough task for the beneficiaries of the new banking licenses to meet RBI's expectations while ensuring they establish and run a financially strong entity.

NEED FOR NEW BANK LICENSES: FINANCIAL INCLUSION

The prime motive of reopening the window for licenses by the RBI was to "achieve financial Inclusion".[3] The inclusion targets come from three broad policy stances:

- Coverage—monitored by number of no-frills accounts and other such products
- Outreach—branches in different categories of habitation, and
- Deployment—priority sector, agriculture and weaker sections[4]

The need for the inclusion focus comes from the fact that India is home to the world's largest unbanked population. Just 1 in 2 Indians have a savings account and 1 in 7 Indians have access to bank credit. CRISIL's financial inclusion index called "Inclusix" (which measures financial inclusion on three parameters: branch penetration, deposit penetration and credit penetration) recorded an all India score of 42.8 on a scale of 100 (2012) which, although reflecting a healthy upward trend, points towards an under penetration of formal banking. Wide disparities in access

[2] *Guidelines for Licensing of New Banks in the Private Sector*, Reserve Bank of India. February, 2013

[3] Aditi Khanna, *New Banking Licensees – How Will They Change The Landscape?*, A CRISIL Young Thought Leader 2013 Dissertation.

[4] http://www.livemint.com/Industry/bGJ4YBT2GraAIJxW1DaT3H/New-bank-licences-the-meaning-ofinclusion.html

to financial services were recorded as well. While India's six largest cities were found to have 10% of all bank branches, the bottom 50 districts merely have 2%.[5]This is confirmed an IMF study from 2011 which finds India way short of its next door neighbor in this regard. The objective of the policy therefore, is spot on.

NOFHC - THE KEY FOR NEW BANKING OPERATIONS

A business group, which is keen on applying for a license should have a minimum paid up equity capital of Rs 500 crore. At the start of banking operations, NOFHC should hold a minimum of 40 per cent of the equity capital of the bank with a lock-in period of five years. Later, it has to be brought down to 15 percent within 12 year from that onwards. The NOFHC will be registered as a non-banking finance company with the RBI while the bank will be governed by the prudential regulations by RBI. The NOFHC and the bank shall not have any exposure to the Promoter Group. The bank shall not invest in the equity / debt capital instruments of any financial entities held by the NOFHC.[6]

WIDER REACH OF FINANCIAL SERVICES

However, the banking regulator put a stricter condition of having 25% of its branches in unbanked rural areas with population upto 9,999. Many believe, for a new banking entity, it will be stumbling block as the brick and mortar model especially in rural areas take time to turn profitable. In line with existing domestic norms, the new bank should also achieve priority sector lending target of 40%. Interestingly, most of the existing banks are failing to meet the target. However, the regulator seems to be committed to reach banking services in remote places of India. A back-of-the-envelope calculation suggests, 60% of the population does not have basic banking facilities.

For banking to be truly inclusive, banking and financial services must reach a large section of the general population. Consumers can then benefit from access to a wide variety of banking

[5]http://www.crisil.com/pdf/corporate/CRISIL-Inclusix.pdf
[6]*An Overview on Financial* Inclusion, Department of Financial Services, Ministry of Finance, Government of India

products and services; banks win by bringing more people into the banking fold, which reduces the cost of offering such services. Penetration of banking services also achieves the greater good of financial inclusion.

CHALLENGES FOR NEW APPLICANTS

In the past, RBI has been seen to be keen on doling out new bank licenses only once every decade. In each of the two previous occasions in 1993 and 2004, over 100 applications were filed. This time however, only 26 applications came forward initially, out of which one (Tata Sons) was subsequently withdrawn. Clearly, the amalgam of economic downturn coupled with much more stringent RBI guidelines hasn't gone down well with the Indian corporate sector.

Following could be the possible deterrents:

- Dilution of Equity: Progressive reduction of shareholding of promoter NOFHC is envisaged to restrict it to 40% for the initial 5 year period, to eventually 15% within 12 years.
- Rural branches: 25% of all branches to be opened in rural unbanked areas from the very beginning.
- Priority Sector Lending Rules: At least 40% credit to be extended to Priority Sector, which has been redefined to exclude certain SME advances.
- Ambiguous "Fit and Proper" Criterion: A financially „strong" and „successful" performance of past 10 years is a prerequisite.
- Basel III Requirements: The timing of the new banks to go public may coincide - if new banks commence operations within the next two years - with the bulk of the additional Basel III core capital requirements, which are largely back-loaded for the Indian banking

system.[7] This would be the time when existing banks will also be looking to the markets to beef up equity, making life tough for the new entrant banks.

- The indication by the central bank to give out more frequent "on tap" licenses in future.

GUIDELINES FOR LICENSING OF NEW BANKS IN THE PRIVATE SECTOR

KEY FEATURES OF GUIDELINES

a. Eligible promoters

NBFCs and entities in the public and private sectors are eligible to set up a bank through an NOFHC. The earlier restriction on large industrial houses has been removed. The financial resources and management expertise that such applicants bring has been recognized. This is relevant in light of the failure of banks promoted by individuals and banking professionals.

b. Fit and proper" criteria

Applicants should have sound credentials and a 10-year track record of running their business successfully. RBI has given due importance to the credentials and integrity of applicants. The 10-year track record criteria should ensure that only those applicants with a sound business model and those that have demonstrated the ability to run a successful business are given entry into this sector. This too seems to be largely driven by the experience from licenses given earlier, as well as by recent media reports on some banks flouting AML guidelines.

c. Corporate structure of the NOFHC

The NOFHC should be wholly owned by applicants. As a holding company, the NOFHC will hold the bank and any other financial service entities of the bank, e.g., it will be the holding company for activities conducted through a subsidiary/JV – such as insurance, broking and also

[7]Shaswat Guha, *High Barriers to Entry Stay For New Indian Bank Licences*, Available at: https://www.fitchratings.com/gws/en/fitchwire/fitchwirearticle/High-Barriers-to?pr_id=785052

the holding company – and for activities conducted internally or through subsidiaries/JV such as credit cards. The objective of the holding company is to separate the regulated financial service entities of the promoter groups from its other activities. Through such an arrangement, the RBI would be able to regulate the financial service activities of the holding company on a consolidated basis. The NOFHC is to be registered as an NBFC with the RBI.

d. Minimum equity capital

INR 500 crores to be put up by applicants. Bank to list itself within three years from start of operations. The minimum capital to be brought in by promoters was capped at Rs 500 crores, considering the capital outlay that would be required for setting up a new banking business. It has been raised from Rs 200 crores from the earlier cycle, taking into consideration the changed economic conditions. Additional capital may be approved if the promoters' business plans make a compelling case.

e. Foreign share-holding

Not to exceed 49% for the first five years. The current FDI policy notwithstanding, non-resident shareholding is to be kept under 49% for the first five years from the date of issuance of the license. This guideline seeks to ensure that the new bank does not become a takeover target in the initial years of its existence – a period when financials may not be very strong and valuations are likely to be cheap. This guideline may also ensure that the new bank remains classified as an "Indian" bank and is regulated accordingly.

f. Corporate governance of the NOFHC

At least 50% of directors should be independent directors. Independent directors bring with them objectivity, and are generally not susceptible to internal pressures. They also bring a different perspective to any issue, compared to the bank's own directors. They are in a better position to protect shareholders' interests and also ensure that the entity is being run effectively and ethically. The RBI has mandated that independent directors should have experience/knowledge

of one or more of the following subject areas: accounting, finance, banking, insurance, law, MSME, agriculture and rural economy, for example.

g. Exposure norms of the NOFHC

NOFHC and the bank will have no exposure to the promoter group. The bank cannot invest in capital instruments of financial entities held by the NOFHC. This should ensure that the promoter group's banking business functions separately, and is regulated apart from its other businesses.

h. Rural bank branches and priority sector lending

Bank to open at least 25% of its branches in unbanked rural centers, and also comply with PSL targets and sub-targets. This will ensure that the new banks get serious about the RBI's agenda of financial inclusion and rural banking. Unlike earlier, when the mandate was to open branches in rural and semi-urban areas, this time around the focus is on rural banking.

INTENTION OF THE RBI IN PROMULGATING THE 2013 POLICY CHANGES

The RBI's intention in the espousing the shift in stance with the banking policy in 2013 can mainly be attributed to three reasons:[8]

FINANCIAL INCLUSION

Providing affordable banking services to the lowest strata of the population is one of the primary goals that the RBI had in mind while relaxing its licensing policy. RBI has mandated that commercial banks achieve financial inclusion by offering "no-frills" savings-bank accounts and easy access to credit facilities through general-purpose credit cards (GCCs). KYC (Know Your Customer) norms have also been relaxed to achieve greater financial inclusion. One of the major

[8]White Paper on Bank License Policy, *supra* note 6.

concerns with respect to the banking sector in India, prior to 2013 was with respect to under-penetration of banking services in the country, especially in rural areas. To rectify this situation in 2013, the RBI while licensing new private banks mandated that new banks would have to open at least 25% of their branches in unbanked rural areas.

WIDER REACH OF FINANCIAL SERVICES

For banking to be truly inclusive, banking and financial services must reach a large section of the general population. Consumers can then benefit from access to a wide variety of banking products and services; banks win by bringing more people into the banking fold, which reduces the cost of offering such services. Penetration of banking services also achieves the greater good of financial inclusion. The percentage of growth in rural and urban households availing themselves of banking services can be attributed to the increasing reach of such services in rural centers.

RURAL BANKING

Penetration of banking services in rural areas is RBI's third objective regarding issuing new banking licenses. During 1993 and 1994, new banks were obligated to open branches in rural areas; between 2003 and 2004 they were required to have 25% of their branches in rural and semi-urban centers. This time around, RBI has specified that new banks must set up 25% of their branches in unbanked rural centers (having a population of up to 9,999). This guideline emphasizes RBI's focus on rural banking. Out of a total of 102,343 branches of scheduled commercial banks in India (as of March 31, 2013), 37,953 (37%) are located in rural areas. Of these, private sector banks account for just 1,937 (only 5.1%).[9] Clearly, private sector banks have lagged behind in terms of providing banking services to rural areas. By issuing the 2013 guidelines for setting up branches in those parts of the country, the RBI has strived to correct this situation.

[9]Sujoy Kumar Dhar & Kumar Satyaki Ray, *Banking Reform in India: Can it Support a Sustainable Economy*, IBS Business School, Kolkata.

SPECIFIC CATEGORIES OF APPLICANTS UNDER THE 2013 LICENSING REQUIREMENTS

Some of the specific institutions that are the likely applicants after the RBI's licensing policy change in 2013 belong to the following categories broadly[10]:

PUBLIC SECTOR UNDERTAKINGS

Government support is the biggest advantage that a PSU has. The Department of Posts has a network of approximately 1.55 lakh post offices across the country, of which around 1.39 lakh offices are in rural areas.11 (In comparison, SBI has around 13,000 branches across the country). Thus, a PSU is better placed than most other applicants to satisfy the RBI's guidelines on financial inclusion and rural banking. The IT modernization project, undertaken by the Department of Posts, can be enhanced to include the implementation of core banking solutions (CBS) and other IT requirements. Its large workforce, including "feet-on-the-street," can be an advantage in reaching out to potential customers. However, it can also be a liability, since most of the project's workforce is untrained in the specific skills required for banking and selling financial products. Also, a bank promoted by the postal department may not find many takers in the urban areas, where usage and dependency on the post has been on the decline.[11]

CORPORATE HOUSES

Corporate houses benefit from prior experience in financial services, availability of capital, experienced and trained manpower, updated IT and other infrastructure assets, and acceptability in urban areas (which is vital in the initial stages of setting up a bank). However, RBI norms on financial inclusion, rural banking and priority sector lending may involve substantial expenditures, which in turn would put pressure on the parent entities' balance sheet. For a

[10]White Paper on Bank License Policy, *supra* note 6.

[11]Umakanth Varottil, RBI Guidelines for Licensing of New Private Sector Banks, available at http://indiacorplaw.blogspot.in/2013/02/rbi-guidelines-for-licensing-of-new.html

corporate, this may not be an ideal situation, as there are too many stakeholders to answer to.[12] Corporate houses can also suffer from adverse corporate governance issues, including ongoing investigations from regulatory agencies and unflattering media reports.

CAPITAL MARKET ENTITIES

Most of the advantages – as well as the challenges – that a corporate entity is likely to face are also applicable to broking houses. Such institutions are at an additional disadvantage due to the RBI guideline, which states that "*promoter/promoter groups should not potentially put the bank and the banking system at risk on account of group activities such as those which are speculative in nature or subject to high asset price volatility*."

MICROFINANCE INSTITUTIONS AND OTHER NBFCS

The business model of MFIs in India makes them ideal vehicles for achieving the RBI's objective of financial inclusion. Such entities are concentrated in rural areas, and provide loans where banks are unable or unwilling to do so. Their network in unbanked areas and their customer base can help them reach the targets of opening rural branches and financial inclusion. The kind of loans they offer can also go a long way in meeting PSL requirements. On the flip side, such entities can be hampered by low profitability and inferior asset quality (most of their loan portfolio is unsecured). NBFCs such as Muthoot Finance (4,200 outlets, of which 60% are in tier II, II and IV cities) and Shriram Capital can benefit from their rural reach and lending, as well as from a client base that can be tapped for banking services. However, applicants whose other group activities are "subject to high asset price volatility" (e.g., gold loans in the case of Muthoot Finance) may not be encouraged by RBI.

[12] White Paper on Bank License Policy, *supra* note 6.

PRE AND POST BANK LICENSING POLICY 2013: COMPARATIVE ANALYSIS

The Indian enterprises made significant entry into banking business in the early twenties and strengthened further during the growing nationalist sentiment and freedom movement in the country. In the process, major banks were concentrated in the hands of few business houses and the resources mobilized by these banks were diverted to favored groups neglecting the vital segments of the economy. In order to channelize the bank funds to the neglected sectors, 14 banks were nationalized in the year 1969 followed by another 6 in the year 1980. The initiatives taken by the government, commercial banks marked a paradigm shift in branch expansion and credit delivery mechanism thereby paved the way to Mass Banking from Class Banking.[13]

Till pre-reform era, the Indian Banking industry was dominated by Public Sector Banks (PSB) and majority of their operations including pricing of products, were governed by the regulator i.e. Reserve Bank of India. During this period, banks were tuned to operate under regulated environment, especially in the areas of lending and pricing of products. In the process, the PSBs have become inactive/reactive entities while customers expected a proactive approach from banks.

In order to instill greater competition in the banking system and to enhance the productivity & efficiency further, RBI adopted a liberalized policy and allowed Private players to enter into banking in the post reforms era. Broadly, the developments can be classified in to three important phases. First Phase (1993 to 2003) - RBI had granted licenses to ICICI Bank, HDFC Bank, UTI Bank (now Axis Bank), Global Trust Bank, IDBI Bank, Times Bank, Centurion Bank, Bank of Punjab and IndusInd Bank to setup banks in India. Majority of these banks pertain to financial institutions of the country.

Second Phase (2004 to 2010) – Though the performance of the New Generation Private Sector Banks was quite satisfactory, the episode of Global Trust Bank has sent alarming signs to the

[13] NSN Reddy, *Banks & New Licensing Policy - Are we heading to "U" turn?,* October, 2010, Available at: http://www.allbankingsolutions.com/Articles/Articles-NSNR-Banks-and-New-Licensing-Policy.shtml

banking industry. Thus, making the regulator cautious and judicious while allowing licenses to new players and while monitoring the performance of the existing players. In the above backdrop, RBI gave permission only to two banks viz., Kotak Mahindra Bank and Yes Bank.

The entry level capital requirement for new private sector banks as prescribed in 2001 was initially Rs.200 crore with a commitment to increase it to Rs.300 crores within three years. Large industrial houses were not permitted to promote new banks. However, individual companies, directly or indirectly connected with large industrial houses were permitted to own 10% of equity, without any controlling interest.

RBI allowed licenses to 10 New Private sector Banks since 1993 of which 4 were promoted by financial institutions and the remaining 6 by individual banking professionals. Ironically, the banks promoted by individuals either failed or merged with other banks viz., GTB with OBC and Times Bank, Bank of Punjab and Centurion Banks with HDFC Bank.

Third Phase (Beyond 2013) - The Finance Minister has announced in the recent Budget (2010) that the RBI is considering some additional banking licenses to private sector, including Non Banking Finance Companies (NBFCs) with an objective to extend the geographic coverage of and improve access to banking services, to promote financial inclusion. On Friday, RBI released a new set of norms to allow creation of more banks. Here is a brief comparison of the guidelines issued in 1993, 2001 and 2013.

ELIGIBLE PROMOTERS

1993: Individuals, corporate groups, financial institutions were eligible to set up banks.

2001: Individuals and financial institutions were allowed, but large industrial houses were not permitted to open banks.

2013: Everyone is welcome. Corporate groups, financial institutions and public sector entities can apply for a banking license.

CORPORATE STRUCTURE

1993: New banks were formed as public limited companies.

2001: The guidelines did not mention any change in the corporate structure.

2013: Promoters must set up banks only through wholly owned non operative financial holding companies.

PROMOTERS' CONTROL

1993: The guidelines did not mention any cap on promoters' holdings in the bank.

2001: Promoters had to maintain 40% stake in the bank for at least five years.

2013: Promoters through a holding company must hold 40% share in the bank for five years. The stake must be cut.

FOREIGN SHAREHOLDING

1993: The guidelines did not mention any cap on foreign shareholding in the bank.

2001: Non-residents were allowed to hold up to 40% in the bank. Foreign banks acting as co promoters were allowed 20% stake within the 40% ceiling.

2013: Aggregate non-resident shareholding will be capped at 49% for five years.

VOTING RIGHT

1993: Individual shareholder's voting right was capped at 1 per cent of the total voting right.

2001: The guidelines did not mention any change in the rules pertaining to voting right.

2013: An individual belonging to the promoter group along with his relatives can hold up to 10% of the total voting equity shares of the holding company.

RING-FENCED STRUCTURE

1993: New banks had to lay down its loan policy and make prudential norms covering related party transactions.

2001: New banks were not allowed to lend to any entity belonging to promoter group.

2013: Neither the holding company nor the bank is allowed to lend or invest in any entity belonging to the promoter group.

MINIMUM CAPITAL

1993: Minimum paid-up capital for banks was fixed at 100 crores.

2001: Initial minimum paid-up capital was fixed at 200 crores. Banks were required to increase it to 300 crore within three years.

2013: Minimum paid-up capital has been fixed at 500 crores.

CAPITAL ADEQUACY RATIO

1993: Banks had to maintain capital adequacy ratio of at least 8% from the very beginning.

2001: Banks had to maintain capital adequacy ratio of 10% on an ongoing basis.

2013: Banks must maintain capital adequacy ratio of 13% for at least three years.

BOARD COMPOSITION

1993: Any director of another banking company was not allowed to be a director in the new bank.

2001: The guidelines did not mention any change.

2013: At least 50% of the directors of the holding company must be independent. The bank's board must have a majority of independent directors.

LISTING REQUIREMENTS

1993: New banks had to get listed on stock exchanges but no deadline was given.

2001: The guidelines did not mention any change in listing requirements.

2013: New banks must get listed within three years.

NEW BUSINESSES

1993: New banks were not allowed to set up a subsidiary or mutual fund for at least three years after its establishment.

2001: New banks were not allowed to set up a subsidiary or mutual fund for at least three years after commencing business.

2013: Holding company is not permitted to set up any new financial services entity for at least three years.

LOCATION PREFERENCES

1993: Preference was given to those who proposed to have headquarters in centres that do not have headquarters of other banks.

2001: New banks were allowed to set up headquarters in any location in India but at least 25% of their branches had to be in rural and semi-urban centres.

2013: At least 25% of new banks' branches must be in unbanked rural centres.

PRIORITY SECTOR TARGET

1993: Some relaxations were allowed in meeting priority sector targets in the first three years.

2001: New banks had to meet priority sector lending target of 40 per cent of net bank credit as applicable to other domestic banks.

2013: New banks have to meet priority sector targets and build priority sector lending portfolio after commencing operations.

STANDING COMMITTEE ON FINANCE REVIEW

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 licenses 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.[14]

- 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 licenses to large industrial houses: The Committee observed that the 2013 guidelines for banking licenses have permitted large industrial houses to apply for banking licenses, contrary to the 2001 guidelines. It disapproved of RBI's reasoning for issuing licenses 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

[14] Report by Standing Committee on Finance 2013, Available at: http://www.prsindia.org/parliamenttrack/report-summaries/policy-on-new-licences-in-the-banking-sector-3036/

public money and public welfare. It expressed concern that industrial houses may not be geared to achieve the objectives of financial inclusion.[15]

- Fit and proper criteria: At present, under the "fit and proper" criteria, entities applying for a banking license 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 incentivize 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

[15] Report by Standing Committee on Finance 2013, Available at: http://www.prsindia.org/parliamenttrack/report-summaries/policy-on-new-licences-in-the-banking-sector-3036/

time period, and (ii) there be a mechanism to enable aggrieved applicants to seek review of decisions of RBI.

FUTURE DEVELOPMENTS IN THE FRAMEWORK OF BANK LICENSING

In September 2013, the RBI constituted a committee to study 'Comprehensive financial services for small businesses and low income households' headed by Dr. Nachiket Mor. The focus of the committee was to recommend innovative solutions to the *RBI to accelerate financial inclusion* in unbanked and under-banked sections of the society in sustainable and cost effective way. The committee submitted its report to the RBI report in January 2014. One of the key recommendations of the committee was to introduce specialized banks ('Payments Bank') to cater to the lower income groups and small businesses. The report also provided high level criteria to assess 'Fit and Proper' status of the Payments bank license aspirants.[16]

The Reserve Bank of India has been contemplating the issue of guidelines for differentiated bank license for Small or Payments Banks. The Reserve Bank of India has received 72 applications for Small Finance Banks and 41 for Payments Banks. The list of applicants for differentiated banking licence is full of marquee names with players like NSDL, Tech Mahindra, Dilip Shanghvi featuring in the list. Other big corporates such as Reliance Industries, Airtel, Aditya Birla Group, Videocon Industries amongst others have also applied. Department of Posts has also made an application for a Payment Bank licence.

Payments banks can accept deposits of up to Rs 1 lakh and can offer current and savings account deposits. They can also issue debit cards and offer internet banking. But they are not allowed to lend or issue credit cards. On the other hand Small Finance Banks will be similar to the existing commercial lenders and will undertake basic banking activities of accepting deposits and lending to un-served and under-served sections. However, the maximum loan size and investment limit

[16] RBI's Guidelines for Licensing for Payments and Small Finance Banks, Deloitte, available at:< http://www2.deloitte.com/in/en/pages/financial-services/articles/rbi-guidelines-for-licensing-of-payments-bank.html> last accessed October 13, 2015.

exposure to single and group obligors cannot be more than 10% and 15% of its capital funds, respectively. Apart from this, at least 50% of their loan portfolio has to include loans and advances of up to Rs 25 lakh, as per the RBI regulations.[17]

The underlying objective is to use these new banks to push for greater financial inclusion. Currently, almost 50% of Indians don't have a bank account and only about 30,000 of India's 5.94 lakh villages have a commercial bank branch. Much of this imbalance has to do with the inability of bigger banks to reach into the hinterland, even as other service providers, such as telecom operators, have made deep inroads. In a statement, the RBI said that it has selected entities with experience in different sectors and with different capabilities so that various models could be tried.[18]

CONCLUSION

The Reserve Bank reviewed the extant Banking Structure in India keeping in view the recommendations of, inter alia, the Committees on Financial/Banking Sector Reforms, 1991 and 1998 (Chairman: Shri M. Narasimham), the Committee on Financial Sector Reforms, 2009 (Chairman: Dr. Raghuram G. Rajan) and a few other relevant viewpoints and placed a Discussion Paper on the RBI website on August 27, 2013 for comments.

The stringent guidelines issued by RBI, including fulfillment of the "Fit and Proper" criteria, mean that eligible applicants will also find it difficult to obtain licenses. Whatever the final number, new entrants will most likely find it an uphill task to set up and run a bank, considering the challenges they are likely to face, the market and regulatory environment in which they are expected to operate and the existing level of competition. However, these issues could also translate into opportunities for consulting firms and other service providers. The beneficiaries of this latest round of issuing new banking licenses are likely to be declared by March 2014.

[17] See RBI likely to issue license for Small, Payments Banks, The Business Standard, June 2, 2015 available at:< http://www.business-standard.com/article/finance/rbi-likely-to-issue-licence-for-small-payments-banks-by-august-115060201291_1.html>.

[18] Everything you need to know about India's brand new Payments Banks, Quartz India, available at:< http://qz.com/483059/everything-you-need-to-know-about-indias-brand-new-payments-banks/> last accessed June 10, 2015.

However, the stringent guidelines issued by RBI, including fulfillment of the "Fit and Proper" criteria, mean that eligible applicants will also find it difficult to obtain licenses.

According to media reports, six to eight banking licenses are likely to be issued during this time period. Whatever the final number, new entrants will most likely find it an uphill task to set up and run a bank, considering the challenges they are likely to face, the market and regulatory environment in which they are expected to operate and the existing level of competition. However, these issues could also translate into opportunities for consulting firms and other service providers. Consulting firms with experience and expertise in core banking implementation are likely to benefit the most. Firms acting as systems integrators can offer their domain and process expertise, which would be a value proposition for new banks. Not only would a qualified SI be able to define and target the required business processes at the beginning of an engagement; it would also be in compliance with the RBI guidelines for implementing core banking solutions from day one. These consulting firms can also offer ADF consulting and implementation services to these new banks – adding even more value.

A healthy competitive banking sector that caters to all segments of the society and is deep and liquid enough to ensure efficient flow of capital to not just the most profitable ventures but also those in need of it is the need of the hour. It is of utmost importance to ensure that India achieves the coveted spot of one of the strongest and robust economies of the world.