FOREIGN INVESTMENT POLICY FOR BANKING SECTOR IN INDIA-PRESENT STATUS

A Presentation by

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FDI POLICY

FDI is permitted through 4 distinct Channels in the Banking Sector-

- In Public Sector Banks FDI is permitted with a cap of 20% of equity.

- In Private Sector Banks FDI is permitted with a cap of 74% of equity.

- Branches of Foreign Banks
- Wholly Owned Subsidiaries of Foreign Banks

FDI- Recent Developments

- **RBI Governor on April 20, 2010, in his Annual Policy Statement for 2010-2011 announced "Drawing lessons from the crisis, it is proposed to prepare a discussion paper on the mode of presence of foreign banks through branch or WOS by September 2010".**

Regulatory Control Perspective

- The post-crisis lessons support domestic incorporation of foreign banks i.e. subsidiarization.
- Following are the main advantages of local incorporation:

  (i) it ensures that there is a clear delineation between the assets and liabilities of the domestic bank and those of its foreign parent

  (ii) it is easier to define laws of which jurisdiction applies

  (iii) local incorporation provides more effective control in a banking crisis

Proposed Framework for Presence of Foreign Banks in India

Eligibility of the Parent Bank

- **Foreign Banks must satisfy RBI that they are subject to adequate prudential supervision in their home country.**
- **The setting up of WOS/branches in India should have the approval of the home country regulator.**
- **Other factors that will be taken into account while considering the application ,are;**

I. Economic and political relations between India and the country of incorporation of the foreign bank

II. Financial soundness of the foreign bank

III. Ownership pattern of the foreign bank

IV. International and home country ranking of the foreign bank

V. Rating of the foreign bank by international rating agencies

VI. International presence of the foreign bank

Entry Norms

Following category of banks may be mandated entry in India only by way of setting up a Wholly Owned Subsidiary (WOS):

i) Banks incorporated in a jurisdiction that has legislation which gives deposits made/ credit conferred, in that jurisdiction a preferential claim in a winding up.

ii) Banks which do not provide adequate disclosure in the home jurisdiction.

iii) Banks with complex structures,

iv) Banks which are not widely held, and

v) if the Reserve Bank of India is not satisfied that supervisory arrangements and market discipline in the country of their incorporation are adequate.

Existing Bank Branches

It would be mandatory for Banks which opt for branch mode of presence to convert themselves into WOS, if:

- They meet the parameters set out in the previous slide

OR

- They become systemically important by virtue of their balance sheet size, i.e. once their assets become 0.25% of the total assets of all Scheduled Commercial Banks in India.

Full National Treatment

- A consolidation of the domestic banks both in private and public sectors is yet to take place.
- Allowing full national treatment could lead to unintended consequences for the banking sector.
- It would, therefore, not be possible nor desirable to provide full national treatment to WOSs of foreign banks.
- However, they would be placed in a much better position than the foreign bank branches operating in India.
- The extent of full national treatment and limitations thereon in matters like branch expansion, raising non-equity capital in India, priority sector lending, etc. are given in the subsequent slides.

Capital Requirement

- WOS of foreign banks would be treated at par with the new private sector banks in regard to minimum capital requirement (i.e. initial minimum capital of Rs.300 crore)
- The WOS shall be required to maintain a minimum capital adequacy ratio of 10 per cent of the risk weighted assets.
- For foreign banks with branch mode of presence - capital requirements will continue for the present i.e USD 25 million.

Corporate Governance

- Not less than 50 percent of the directors should be Indian nationals resident in India,
- Not less than 50 percent of the directors should be non-executive directors,
- A minimum of one-third of the directors should be totally independent of the management of the subsidiary in India, its parent or associates and
- The directors shall conform to the ‘Fit and Proper’ criteria as laid down in our extant guidelines contained in RBI circular dated June 25, 2004, as amended from time to time. This would be in line with the roadmap released in February 2005.

Branch Expansion

- **WOS would be enabled to open branches in Tier 3 to 6 centres except at a few locations considered sensitive on security considerations (New concession).**
- **Their application for setting up branches in Tier 1 and Tier 2 centres would also be dealt with in a manner and on criteria similar to those applied to domestic banks (New concession).**
- **The expansion of the branch net work of foreign banks in India - both existing and new entrants - who are present in branch mode would be strictly under the WTO commitments of 12 branches per year.**

Measures to Contain Dominance of Foreign Banks

It is proposed that when the capital and reserves of the foreign banks in India including WOS and branches exceed 25% of the capital of the banking system, restrictions would be placed on

(i) further entry of new foreign banks,

(ii) branch expansion in Tier I and Tier II centres of WOS , and

(iii) capital infusion into the WOS - this will require RBI's prior approval.

- Under present WTO commitment, licenses may be denied to new foreign banks if the assets of foreign bank branches exceed 15% of the total assets in India.

Use of Credit Rating and Parent / Head Office Support

- **The parent bank may be required to issue a Letter of Comfort to the Reserve Bank, as is required in many jurisdictions today, for meeting the liabilities of the WOS.**

Declaration of Dividends

Wholly owned subsidiaries of foreign banks, being banks incorporated in India, may declare dividends subject to criteria laid down.

* CRAR of at least 9% for preceding two completed years
* Net NPA less than 7%.

Mergers / Acquisitions and Dilution of WOS to 74 %

The issue of dilution or listing of WOS of foreign banks in India and allowing mergers and acquisitions of Indian private sector banks by foreign banks or their WOS may be considered after a review is made of experience gained on the functioning of WOS of foreign banks in India.

Differential Licensing

- **As a policy RBI has not so far encouraged banks which do not support financial inclusion in general.**

- **Reserve Bank of India would not consider granting differential license to foreign banks seeking entry in 'niche markets'.**

Thank You