



**Report of the Internal Working Group to Review Extant
Ownership Guidelines and Corporate Structure for Indian
Private Sector Banks**

RESERVE BANK OF INDIA

October 2020

Letter of Transmittal

Shri Shaktikanta Das
Governor
Reserve Bank of India
Mumbai

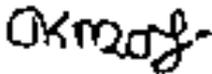
October 26, 2020

Dear Sir,

It gives us immense pleasure in submitting the Report of the Internal Working Group set up to Review extant Ownership Guidelines and Corporate Structure for Indian Private Sector Banks.

Thank you for the confidence reposed in the Group to look into the various dimensions of such a matter of enormous importance. The Group has approached the entire gamut of issues with an open mind and the final recommendations reflect a practical approach while being cognisant of the prudential concerns.

Yours sincerely,



(P. K. Mohanty)
Member



Lily Vadera
Member



Sachin Chaturvedi
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Shrimohan Yadav
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Acknowledgements

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The IWG greatly benefited from the inputs received during the discussions held with various experts. The IWG would like to express its gratitude to former Deputy Governors Smt. Shyamala Gopinath, Smt. Usha Thorat, Shri Anand Sinha and Shri N. S. Vishwanathan for sharing their deep insights with the group. The IWG also acknowledges the valuable inputs shared by Shri Bahram Vakil (Partner, AZB & Partners); Shri Abizer Diwanji (Partner and National Leader - Financial Services EY India), Shri Sanjay Nayar (CEO, KKR India), Shri Uday Kotak (MD & CEO, Kotak Mahindra Bank.), Shri Chandra Shekhar Ghosh (MD & CEO, Bandhan Bank) and Shri P. N. Vasudevan (MD & CEO, Equitas Small Finance Bank).

The Group places on record its appreciation for the excellent support and assistance provided by Shri Vaibhav Chaturvedi, Ms. Beena Abdulrahiman and Shri N. Ramasubramanian all General Managers, Reserve Bank of India, for preparing excellent background notes, providing valuable inputs during deliberations and final drafting of the Report. The able assistance from Shri Sooraj Menon and Shri R. Sakthivel, both Assistant General Managers, RBI is also sincerely acknowledged.

Executive Summary

1. Banking sector is a vital cog of any healthy economy. While the sector contributes significantly to the welfare in an economy by providing intermediation through maturity and risk transformations to balance the utility preferences of the economic agents, it is tightly regulated considering the social externalities of the negative spillovers. One of the channels through which regulations ensure that the incentives of the banking companies align with that of the larger society is through having a say in the market structure and organisation of banking business. Licensing regimes, which aim to ensure that only those participants with the right amount of ability and willingness to do banking business in line with the social and economic preferences of a financial system are permitted to organise such businesses, have been a key component of the regulatory arsenal of prudential regulators, including Reserve Bank of India.

2. Prior to nationalisation of banks, Indian banking sector had been organised in the private sector. The sector was opened up again post liberalisation with the first round of licensing of private banks that was done in 1993. Since then there have been two more rounds of licensing of banks in the private sector – in 2001 and 2013 – culminating with the on-tap licensing regime of universal banks since 2016. This period has been interspersed with licensing of differentiated and specialised banks such as Local Area Banks (LABs), Small Finance Banks (SFBs) and Payments Banks (PBs).

3. The provisions and requirements of the various rounds of licensing have not been uniform; in fact, it reflected the regulatory preference and the generally accepted prudential principles as existed at each time. As a result, presently, India has a number of banks working under differing regulatory regimes when it comes to organisation of business. This has the potential to raise concerns about uneven playing field as well as scope for regulatory arbitrage. Moreover, various structural changes have occurred over the years both in the Indian economy as well as the body of banking regulation. For instance, the financial intermediation by banks have come down in relative relevance when compared to the early years of liberalisation – more intermediation is being carried out these days by non-banking intermediaries including capital markets. The prudential regulation has also shifted its preference to a widespread disaggregated shareholding structure for banks as enshrined as Pillar III of the Basel guidelines. Further, the aspirations of the Indian economy for the future also requires a strong and vibrant banking sector to be in place to adequately support the investment demands of such growth, which may require a fundamental

rethink of current regulatory stance towards the question of how a banking business should be organised.

4. With the above backdrop, the Internal Working Group (**'the IWG'**) was constituted by the Reserve Bank on June 12, 2020 to examine and review the extant licensing and regulatory guidelines relating to ownership and control, corporate structure and other related issues. The IWG, under the leadership of Dr. P.K.Mohanty, senior Director in the Group, focused on the major issues that need to be addressed based on the current experiences of the Reserve Bank and examined the various statutory provisions underpinning the extant norms governing licensing of banks, manner in which the banking and para-banking activities are organised, organisational structure of banks, and those governing ownership and control of the banks. The IWG also interacted with certain serving and retired officials of Reserve Bank, bankers, legal experts, and other professionals and experts in the field of banking and finance to understand their insights and views on the subject. The IWG also studied the international practices followed in some major jurisdictions.

5. After detailed deliberations, the IWG has made the following major recommendations on the various issues that were considered for deliberations:

I. Lock-in period for promoters' initial shareholding, limits on shareholding in long run, dilution requirement and voting rights

- (i) **No change may be required in the extant instructions related to initial lock-in requirements**, which may continue as minimum 40 per cent of the paid-up voting equity share capital of the bank for first five years.
- (ii) **The cap on promoters' stake in long run of 15 years may be raised from the current levels of 15 per cent to 26 per cent** of the paid-up voting equity share capital of the bank. This stipulation should be uniform for all types of promoters and would mean that promoters, who have already diluted their holdings to below 26 per cent, will be permitted to raise it to 26 per cent of the paid-up voting equity share capital of the bank. **The promoter, if he/she so desires, can choose to bring down holding to even below 26 per cent, any time after the lock-in period of five years.**
- (iii) **No intermediate sub-targets between 5-15 years may be required. However, at the time of issue of licences**, the promoters may submit a dilution schedule which may be examined and approved by the Reserve Bank. The progress in achieving these agreed milestones must be

periodically reported by the banks and shall be monitored by the Reserve Bank.

- (iv) **As regards non-promoter shareholding, current long-run shareholding guidelines may be replaced by a simple cap of 15 per cent of the paid-up voting equity share capital of the bank, for all types of shareholders.**

II. Pledge of Shares

- (i) **Pledge of shares by promoters during the lock-in period, which amounts to bringing the unencumbered promoters' shares below the prescribed minimum threshold, should be disallowed.**
- (ii) In case invoking the pledge results in purchase/transfer of shares of such bank beyond 5 per cent of the total shareholding of the bank, without prior approval of Reserve Bank, it may restrict the voting rights of such pledgee till the pledgee applies to Reserve Bank for regularisation of acquisition of these shares.
- (iii) The Reserve Bank may introduce a reporting mechanism for pledging of shares by promoters of private sector banks.

III. ADR/GDR issued by banks

The Reserve Bank may legally examine the issue and make suitable regulations so that this conduit is not used by dominant shareholders to indirectly enhance their voting power. The options may include prior approval of the Reserve Bank before entering into agreements with depositories, with a provision to modify the Depository Agreement to assign no voting rights to depositories; and a mechanism for disclosure of the details of ultimate depository receipt holders so that indirect holding may be reckoned along with direct holding.

IV. Eligibility of Promoters

- (i) **Large corporate/industrial houses may be allowed as promoters of banks only after necessary amendments to the Banking Regulations Act, 1949** to deal with connected lending and exposures between the banks and other financial and non-financial group entities; and strengthening of the supervisory mechanism for large conglomerates, including consolidated supervision. RBI may examine the necessary legal provisions that may be required to deal with all concerns in this regard.
- (ii) **Well run large Non-banking Financial Companies (NBFCs, with an asset size of ₹50,000 crore and above, including those which are owned by a corporate house, may be considered for conversion into**

banks provided they have completed 10 years of operations and meet the due diligence criteria and satisfy the additional conditions specified in this regard.

- (iii) With regard to individuals and entities/groups, the provisions of the extant on-tap licensing on universal banks and SFBs are appropriate and do not warrant any change. However, for **Payments Banks intending to convert to a Small Finance Bank, track record of 3 years of experience as Payments Bank may be sufficient.**

V. Initial Capital

- (i) The minimum initial capital requirement for licensing new banks should be enhanced as below:
 - a. **For Universal banks: The initial paid-up voting equity share capital/ net worth required to set up a new universal bank, may be increased to ₹1000 crore.**
 - b. **For Small Finance Banks: The initial paid-up voting equity share capital/ net worth required to set up a new SFB, may be increased to ₹300 crore.**
 - c. **For UCBs transiting to SFBs: The initial paid-up voting equity share capital/ net worth should be ₹150 crore which has to be increased to ₹300 crore in five years.**
- (ii) As the licensing guidelines are now on continuing basis (on-tap), the Reserve Bank may put a system to review the initial paid up voting equity share capital/net-worth requirement for each category of banks, once in five years.

VI. Corporate Structure – Non-operative Financial Holding Company (NOFHC)

- (i) **NOFHCs should continue to be the preferred structure for all new licenses to be issued for Universal Banks. However, NOFHC may be mandatory only in cases where the individual promoters / promoting entities / converting entities have other group entities.**
- (ii) **Banks currently under NOFHC structure may be allowed to exit from such a structure if they do not have other group entities in their fold.**
- (iii) **While banks licensed before 2013 may move to an NOFHC structure at their discretion, once the NOFHC structure attains a tax-neutral status, all banks licensed before 2013 shall move to the NOFHC structure within 5 years from announcement of tax-neutrality.**
- (iv) The Reserve Bank should engage with the Government to ensure that the tax provisions treat the NOFHC as a pass-through structure.

- (v) **The concerns with regard to banks undertaking different activities through subsidiaries/Joint Ventures (JVs)/associates need to be addressed through suitable regulations till the NOFHC structure is made feasible and operational.** The Reserve Bank may frame suitable regulations in this regard *inter alia* incorporating the following and the banks must be required to fully comply with these regulations within a period of two years.
- a. The bank and its existing subsidiaries/JVs/associates should not be allowed to engage in similar activity that a bank is permitted to undertake departmentally. The term ‘similar activity’ to be defined clearly.
 - b. **If a group entity desires to continue undertaking any lending activity, the same shall not be undertaken by the bank departmentally and the group entity shall be subject to the prudential norms as applicable to banks for the respective business activity.**
 - c. Banks should not be permitted to form/acquire/associate with any new entity [subsidiary, JV or Associate (>20% stake – signifying significant influence or control)] or make fresh investments in existing subsidiary/JV/associate for any financial activity. Investments in ARCs may be as per extant norms.
 - d. However, banks may be permitted to make total investments in financial or non-financial services company which is not a subsidiary/JV/associate upto 20 per cent of the bank’s paid up share capital and reserves.

VII. Listing Requirements

- (i) **SFBs to be set up in future:** Such banks should be listed within ‘six years from the date of reaching net worth equivalent to prevalent entry capital requirement prescribed for universal banks’ or ‘ten years from the date of commencement of operations’, whichever is earlier.
- (ii) For **existing small finance banks and payments banks:** Such banks should be listed ‘within six years from the date of reaching net worth of ₹500 crore’ or ‘ten years from the date of commencement of operations’, whichever is earlier.
- (iii) **Universal banks:** Such banks shall continue to be listed within six years of commencement of operations.

VIII. Harmonisation of Various Licensing Guidelines

- (i) Whenever a new licensing guideline is issued, if new rules are more relaxed, benefit should be given to existing banks, immediately. If new rules are

tougher, legacy banks should also confirm to new tighter regulations, but transition path may be finalised in consultation with affected banks to ensure compliance with new norms in a non-disruptive manner.

- (ii) As and when the changes in certain norms, as recommended by the Group in this report are accepted by Reserve Bank, these should be made applicable to existing banks also, in the manner as prescribed in previous paragraph.
- (iii) As the licensing is now on-tap, Reserve Bank may prepare a comprehensive document encompassing all licensing and ownership guidelines at one place, with as much as possible harmonisation and uniformity, providing clear definition of all major terms. These guidelines may be equally applicable on legacy or new banks. This may be updated from time to time depending on emerging requirements.

6. The detailed rationale underpinning the above recommendations and the details of the various deliberations undertaken and the viewpoints that were considered during the process of finalising the above recommendations are discussed in the ensuing chapters.

Chapter 1 : Introduction

1.1 The banking sector in India has evolved over the past three decades into a more diverse, competitive sector with the entry of several new players at various points, reflecting the policy orientations at specific times. The key turning point was in 1993 when, as part of the broader reforms in the financial sector, fresh licences were issued for a few private sector banks as part of the new licensing policy. The process has continued, with the fresh licences being granted for universal banks in terms of the guidelines issued in 2001 and 2013.

1.2 The broad policy relating to ownership and control in Indian private sector banks is guided by the framework issued in February 2005. Though the overarching principle that the ownership and control of private sector banks should be well diversified and that the major shareholders are 'fit and proper', have remained unchanged, the specific contours have evolved over the years with specific prescriptions given as part of licensing guidelines issued at various points in the past. The guidelines for on-tap licensing of universal banks, issued in 2016 and the for small finance banks (SFBs), issued in 2019, capture the extant norms.

1.3 However, the fast changing macroeconomic, financial market and technological developments portend newer opportunities to transform the banking landscape. In alignment with the agenda set for the economic growth of the country to become a \$5 trillion economy, there are heightened expectations for the banking sector to scale up for a greater play in the global financial system. It was in this context that, in order to leverage these developments for engendering competition through entry of new players, the Reserve Bank initiated the process for a comprehensive review of the extant guidelines on licensing and ownership for private sector banks. This exercise would also provide an opportunity to harmonise the norms applicable to banks set up under different licensing guidelines to ensure a level playing field and foster competition among these banks.

1.4 Accordingly, on June 12, 2020, an Internal Working Group (**the IWG**) was set up by the Reserve Bank to examine and review the extant licensing and regulatory guidelines relating to ownership and control, corporate structure and other related issues, with the following members:

- (i) Dr. Prasanna Kumar Mohanty, Director, Central Board of RBI
- (ii) Prof. Sachin Chaturvedi, Director Central Board of RBI
- (iii) Smt. Lily Vadera, Executive Director, RBI
- (iv) Shri S. C. Murmu, Executive Director, RBI
- (v) Shri Shrimohan Yadav, Chief General Manager, RBI – Convener

1.5 The Terms of Reference (TOR) of the IWG were as under:

- (i) To review the extant licensing guidelines and regulations relating to ownership and control in Indian private sector banks and suggest appropriate norms, keeping in mind the issue of excessive concentration of ownership and control, and having regard to international practices as well as domestic requirements;
- (ii) To examine and review the eligibility criteria for individuals/ entities to apply for banking licence and make recommendations on all related issues;
- (iii) To study the current regulations on holding of financial subsidiaries through non-operative financial holding company (NOFHC) and suggest the manner of migrating all banks to a uniform regulation in the matter, including providing a transition path;
- (iv) To examine and review the norms for promoter shareholding at the initial/licensing stage and subsequently, along with the timelines for dilution of the shareholding; and,
- (v) To identify any other issue germane to the subject matter and make recommendations thereon.

Approach of the Committee

1.6. The IWG was led by Dr. P.K.Mohanty, as the senior Central Board Director in the Group. The IWG was cognisant of the enormity of the task at hand and went about its work in a structured manner, identifying the key issues that needed detailed examination. The IWG also examined the relevant statutory norms contained in Banking Regulation Act, 1949 [particularly amendments carried out through Banking Laws (Amendment) Act, 2012], Companies Act, 2013, Securities and Exchange Board of India (SEBI) regulations, etc. to understand the legality and remit of certain provisions contained in guidelines/regulations issued by the Reserve Bank from time to time.

1.7. The IWG interacted with certain serving and retired Deputy Governors of Reserve Bank, serving bankers, legal experts, and other professional and experts in the field of banking to get their insights on the subject. A summary of views of experts on various issues is furnished in *Annex I*. The IWG also studied the international practices followed in some major jurisdictions. These interactions and research greatly helped the IWG to frame its views.

Structure of the Report

1.8. The Report is structured into four key chapters, apart from the Introduction. Chapter 2 discusses the broader context for the need for review of the licensing and ownership guidelines. Chapter 3 traces the evolution of the licensing framework for private banks. Chapter 4 provides an overview of international experience. Chapter 5 contains discussions on the diverse perspectives regarding each of the identified issues and the final recommendations of the IWG.

Chapter 2 : Macroeconomic Environment and the Structure of Banking System

2.1 India has been one of the fastest growing economies over the past two decades, notwithstanding the severe shocks during the period. Average Gross Domestic Product (GDP) growth of India, which slumped after the Global Financial Crisis from 8.2 per cent in 2009-11 to 5.3 per cent in 2011-13, moved upward from 2013-14, reaching 8.3 per cent in 2016-17, which is considered to be one of the longest cyclical upswing in the post-independence period. Though the fundamentals of economy remained strong, India's real GDP growth showed signs of slowdown since 2017, accentuated by cyclical global downturn which commenced in 2018, with the GDP growth slowing down to 4.2 per cent in 2019-20. The current financial year has been marred by the impact of Covid19 pandemic and the IMF has projected the global growth at -4.4 percent in 2020. For India, the Monetary Policy Committee (MPC) estimates the real GDP growth in 2020-21 to be negative at (-)9.5 per cent. However, the recovery process has commenced and as per MPC estimates, the real GDP growth for Q1:2021-22 is expected to be 20.6 per cent. The IMF, as part of its latest World Economic Outlook (October 2020) has projected India to register a growth of 8.8 per cent in 2021, which would be the highest among all major economies.¹

2.2 Looking beyond the recovery phase over the near term, it may now even be a greater imperative to review and address any structural issues in the financial sector to ensure that it is in a position to provide the necessary growth momentum to the economy. Undoubtedly it will require many other pieces to come together for a sustained growth push, but given the criticality of the banking sector it may be an important determinant in this regard. To support its growth and to fulfil its aspirations, India needs an efficient banking sector.

2.3 This chapter provides an analytical overview of the present structure of the banking system in India.

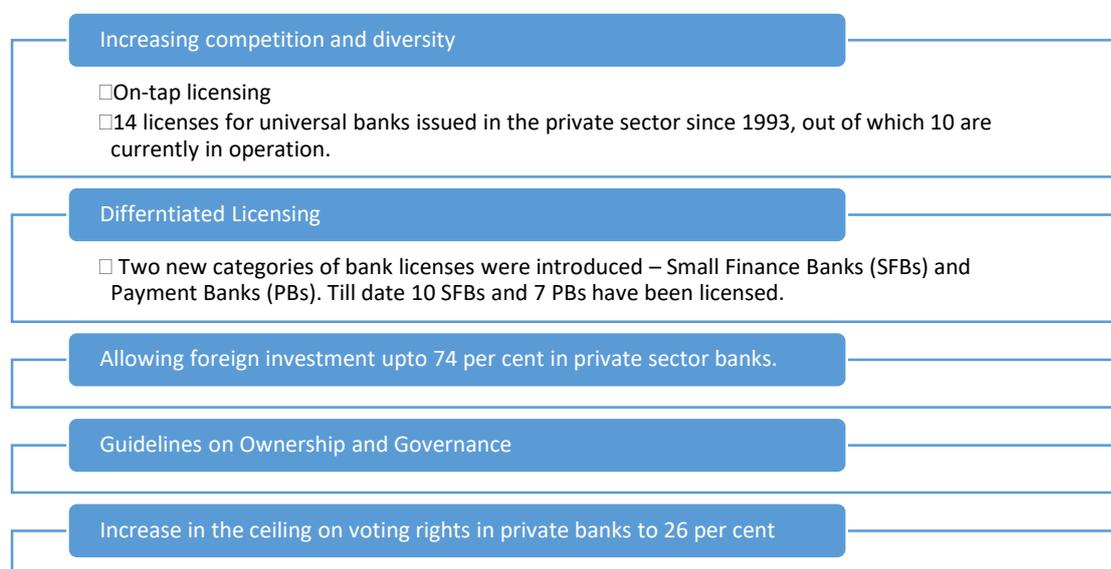
Structure of the Banking System

2.4 The evolution of Indian banking has been dotted with many discontinuities that reflect quite conspicuously in the structure of the sector today. The sector is

¹ IMF World Economic Outlook, October 2020

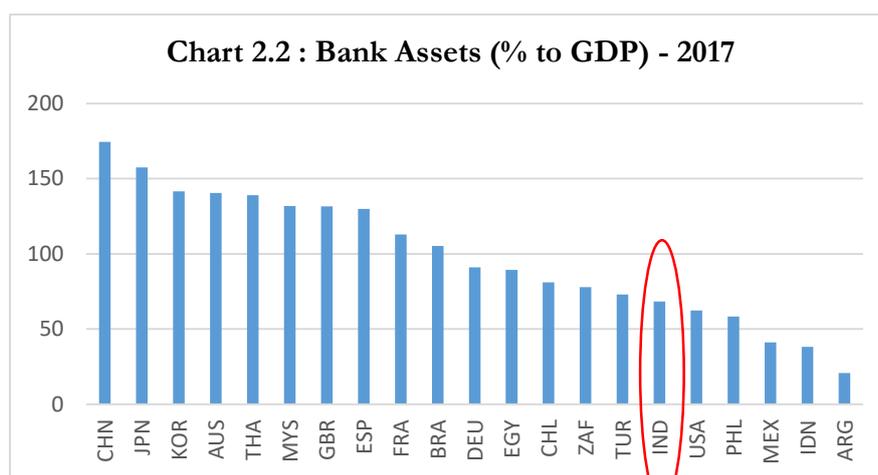
today characterised by a fragmented market composition with different categories of banks in existence with varying ownership patterns. Reforms in various areas have altered the market structure, ownership patterns, and the domain of operations of institutions, and infused competition in the financial sector. The gradual liberalisation over the last few years has allowed private participation in the sector and eased entry of foreign banks. The existing banking structure in India is multi-layered with various types of banks catering to the specific and varied requirements of different sections of society and economy. Chart 2.1 captures the key transformative reforms in this regard:

Chart 2.1 – Key Reforms Relating to Ownership and Governance of Private Sector Banks



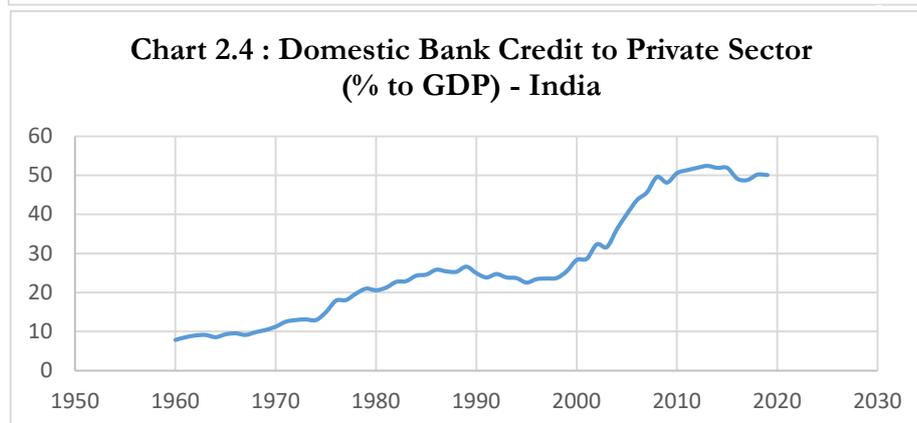
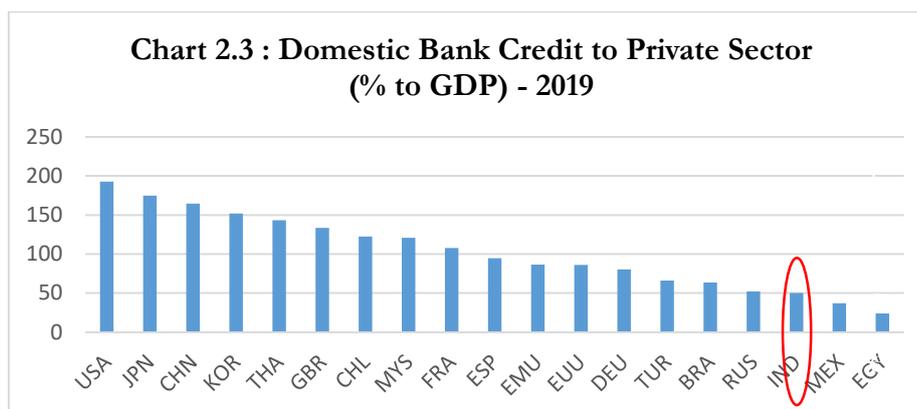
An Assessment – Global Comparison

2.5 The banking sector has grown significantly over the years but the total balance sheet of banks in India still constitutes less than 70 per cent of the GDP, which is much less compared to global peers, particularly for a bank-dominated financial system (Chart 2.2).



(Source: World Bank)

2.6 An important indicator of bank-based financial deepening, that is, private sector credit, has expanded rapidly in the past five decades thereby supporting the growth momentum. However, the domestic credit provided by Indian banks still remains low compared with major emerging market and developing economies (EMDEs), and advanced economies (Charts 2.3 and 2.4).



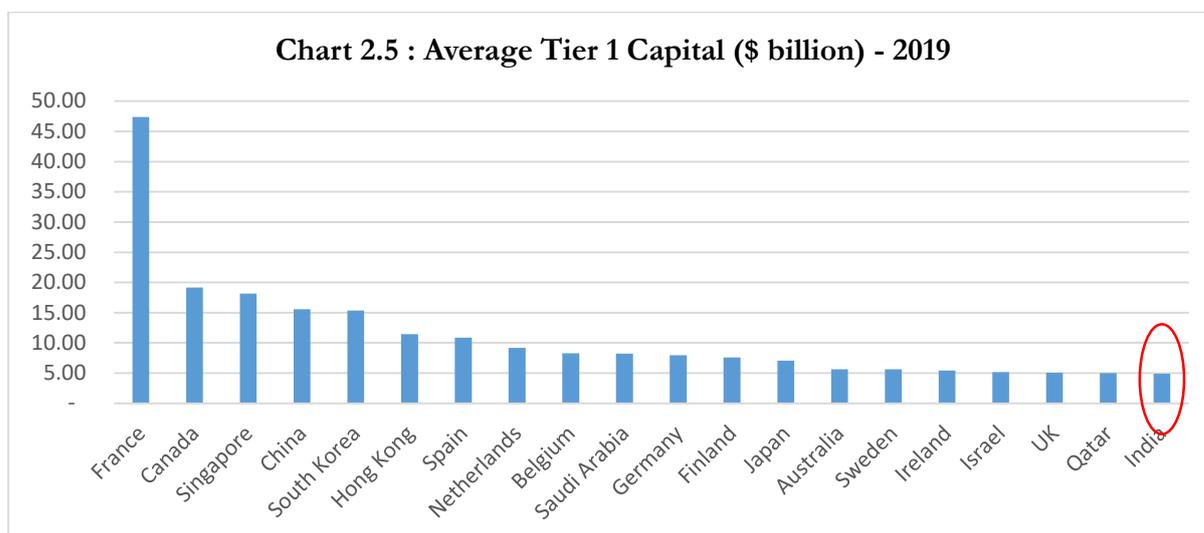
(Source: World Bank)

2.7 At present only one Indian bank is in the top-100 global banks by size. As on December 31, 2019, in the list of top-100 global banks by asset size, Banco de Sabadell, a Spanish bank, with total assets of \$251,408.59 million (approx. ₹18 lakh crore) was at the hundredth position. In comparison, the top five Indian banks had the asset size as depicted in Table 2.1:

Bank	Total Assets (₹ Crore) (as on March 31, 2020)
State Bank of India	39,51,394
HDFC Bank Ltd.	15,31,498
Bank of Baroda	11,61,648
ICICI Bank Limited	11,04,168
Axis Bank Limited	9,19,303

(Source: RBI)

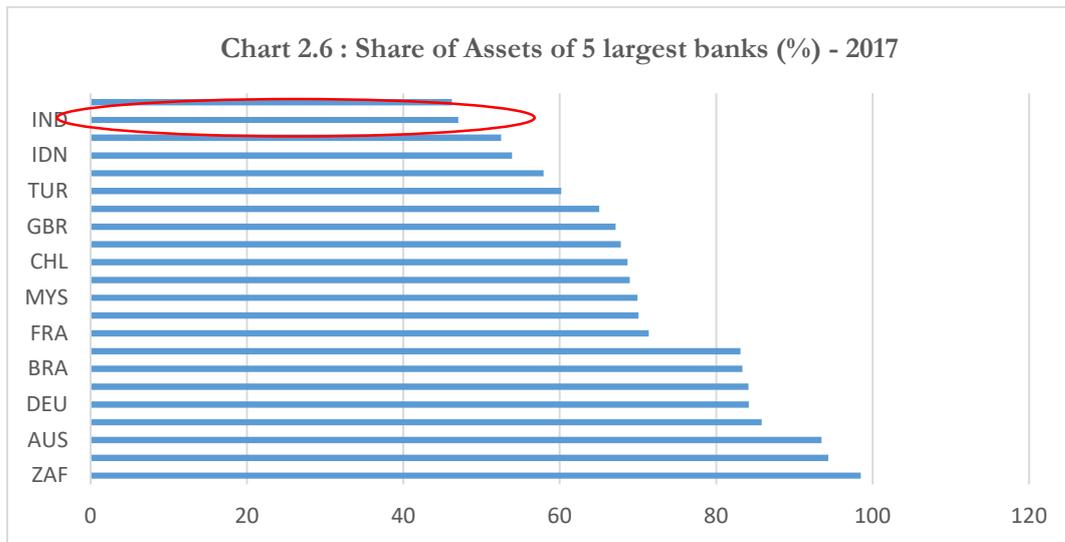
2.8 It may be instructive to note that in terms of number of banks, as well as the total size of the banking system, India ranks in the top decile globally among the 158 banking systems tracked as part of *The Banker* database. However, the average Tier 1 capital of banks in India at \$ 4.92 billion (approx. ₹37,000 crore) as of March, 2019 is less than most of the global peers (Chart 2.5).



(Source: *The Banker Database*)

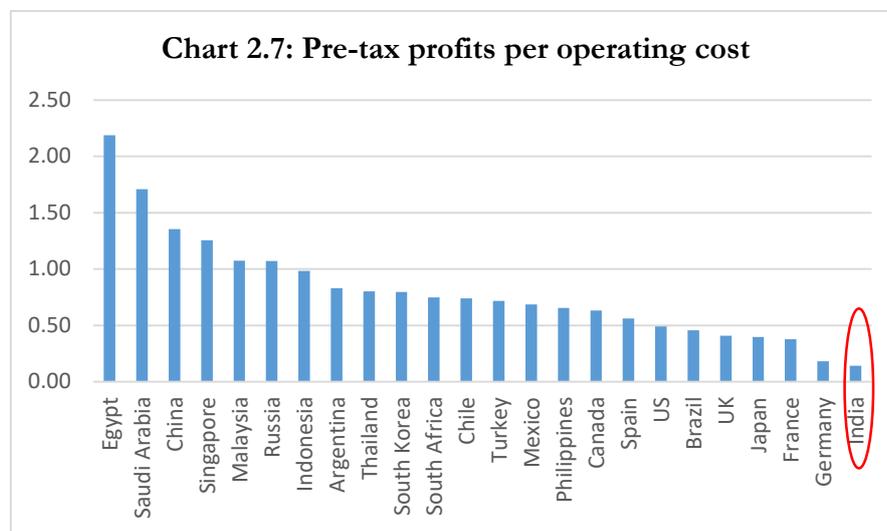
2.9 The Indian banking sector cannot be said to be highly concentrated. The Herfindahl Hirschman Index (HHI) for India is around 0.08 for both credit and

deposits which indicates an unconcentrated industry. The share of five largest banks in India is one of the lowest as compared to other jurisdictions. (Chart 2.6).



(Source: World Bank)

2.10 However, in terms of cost efficiencies, Indian banks are just at the bottom of the list, primarily on account of large staff costs. The net pre-tax profit generated by the Indian banks per unit of operating costs is just around \$ 0.14 million (approx. ₹1 crore) as against a global average of \$ 1 million (Chart 2.7).



(Source: The Banker Database)

2.11 While there may be multiple reasons for the relatively small size of the banking system in India as compared to other countries, which may be a matter of separate study, it does seem that part of it has to do with the structural economic setting in which the banks operate. The confluence of various factors over the past decades including inefficient credit allocation; high interest rates; weak credit enforcement mechanisms; absence of viable resolution mechanisms; operational

inefficiencies of several banks, etc. can be said to have contributed to the stunted growth of the banking system. The problem of scale is not something unique to the banking system. As reported in a recent Bloomberg article, “*As much as 40 per cent of the country’s listed nonfinancial firms have revenue of less than \$15 million. They’re tiny even by emerging-market standards, and the ratio hasn’t increased at all over the past decade.*”² The two may in fact be closely interlinked.

2.12 The experience after the 2008 global financial crisis also highlights the problems of forced credit expansion. The huge credit allocation to the infrastructure sector, with its attendant structural problems, is considered prime reason for the accumulation of large, unresolved stressed assets on banks’ balance sheets. This was one of the major factors constraining the credit creation capacity of banks in the ensuing years. While the enactment of Insolvency and Bankruptcy Code (IBC) in 2016 and the new resolution paradigm pursued by the Reserve Bank can be said to be game changers in this regard, it may be a while before these structural changes translate into a sustained positive impact on lending.

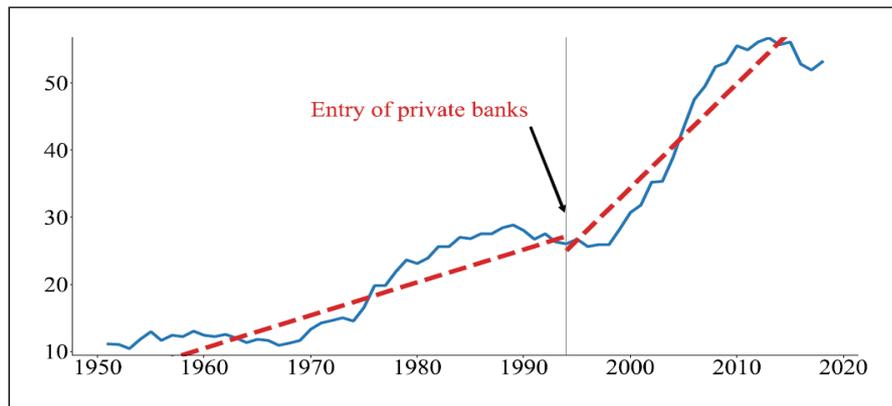
2.13 While select private banks have been able to buck the trend and have shown healthy, sustained growth over the years, they have some way to break into the global top-100. Thus, in order for the banking sector to play a greater role in the economic growth, it would be imperative for the underlying ecosystem to also change. Several policy measures taken/being taken in this direction are undoubtedly a huge positive and much will depend on how these changes play out over the coming years. The role of the private banks will, though, be crucial.

Domestic Context - Increasing role of Private Sector Banks

2.14 The private sector banks have evolved since 1990s and play a major role in the banking business in India. As may be observed from the following chart, credit in the banking sector registered higher growth after the banking sector was opened for competition through licences granted to private sector banks in 1994. It establishes the important role being played by private sector banks in the growth of the economy.

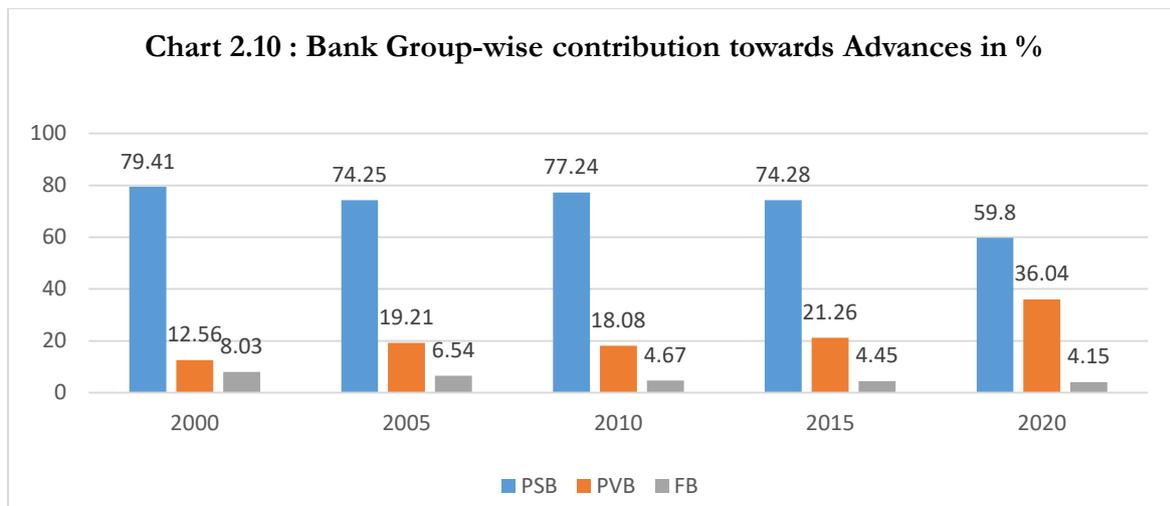
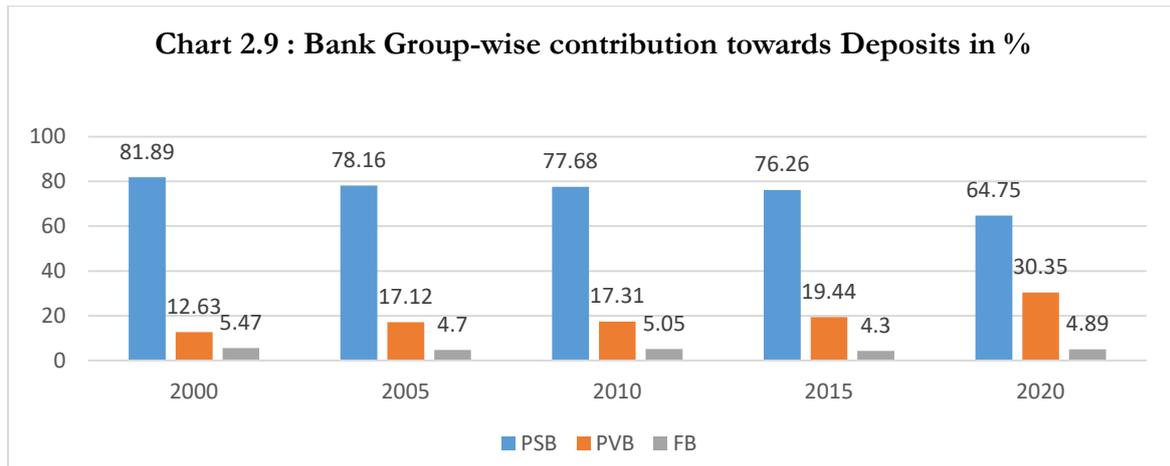
² <https://www.bloomberg.com/opinion/articles/2020-09-20/india-needs-to-choose-the-economy-it-wants-toyota-or-pakora>

Chart 2.8 : Banking Sector Credit (% to GDP)



Source: Economic Survey -2019-20

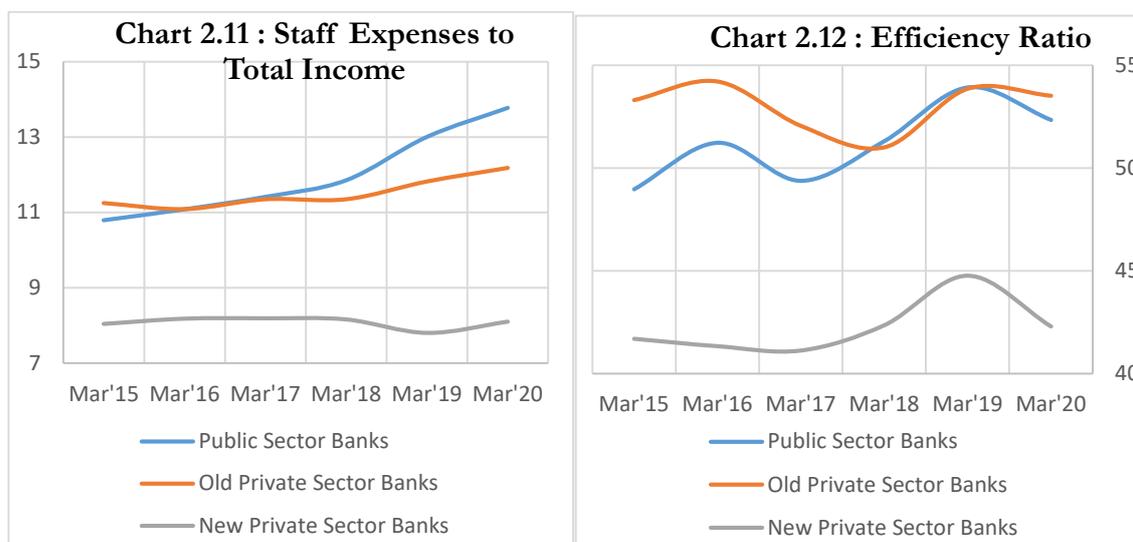
2.15 A comparative position of private sector banks, PSBs and foreign banks (FBs) on certain important parameters since 2000 is given in Charts 2.9 and 2.10 which show the growing importance of private sector banks.



(Source: RBI)

2.16 As may be seen, the contribution of private sector banks towards deposits and advances of Scheduled Commercial Banks³ has increased from 12.63 per cent and 12.56 per cent in 2000 to 30.35 per cent and 36.04 per cent respectively in 2020. The PSBs have been consistently losing market share to the private banks, a process which has markedly hastened over the past five years. The primary reason for this has been the beleaguered balance sheets of PSBs on account of the non-performing asset (NPA) overhang of post-global financial crisis years.

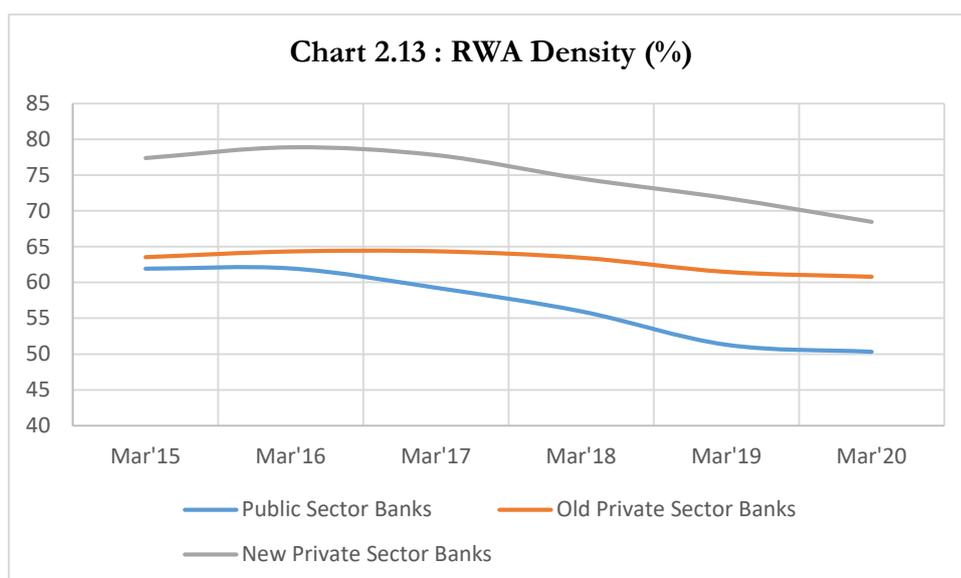
2.17 Private banks, particularly new generation private banks, also score over the PSBs in terms of the operational efficiencies.



(Source: RBI)

2.18 This may also be a reflection of the difference in their business models. The risk-weight density of private banks is discernibly higher than PSBs, at the same size of loan book relative to total assets, which indicates higher risk appetite on the part of private banks (Chart 2.13). However, a much lower gross NPA ratio and smaller pool of written-off accounts gives them a much cleaner balance sheet for more productive utilisation of capital.

³Source: Report on Trend and Progress of Banking in India, Database on Indian Economy and submissions of Small Finance Banks



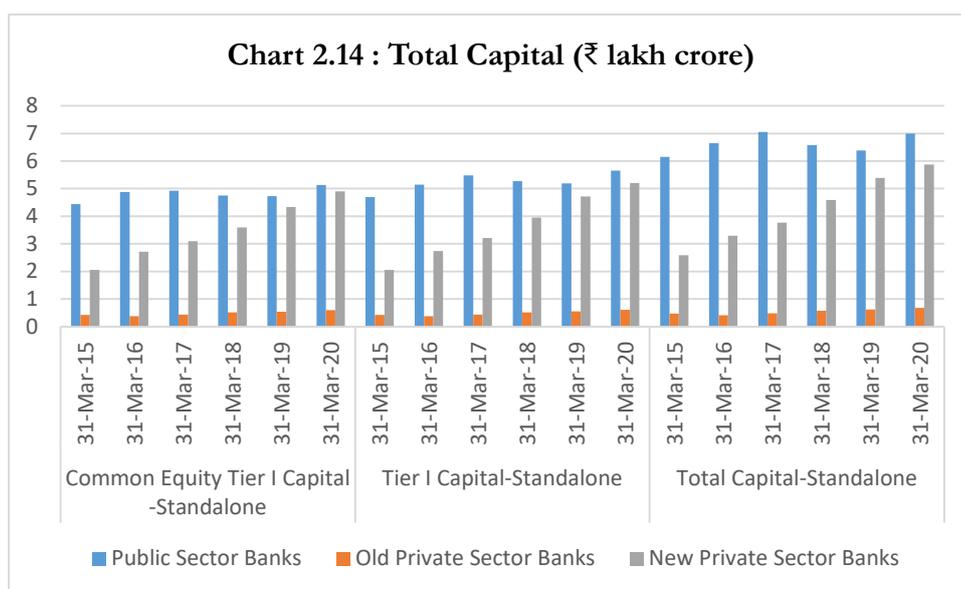
(Source: RBI)

2.19 The above differences also reflect in the market valuations of the two sets of banks. Most of the big private banks enjoy a Price (P)/Book Value (BV) of more than 1, which indicates their attractiveness for fresh market raising (Table 2.2)

Table 2.2 Price to Book Value of major banks (as on October 20, 2020)			
Banks having P/BV > 1	P/BV	Banks having P/BV > 1	P/BV
Bandhan Bank	3.3	Axis Bank	1.55
Kotak Mahindra	4.7	ICICI Bank	2.1
HDFC Bank	3.6	Yes Bank	1.33
IndusInd Bank	1.27	IDFC First Bank	1.03
RBL Bank	0.85	SBI	0.83

(Source: Financial Express)

2.20 Therefore, capital has really not been a problem for private banks. During the last five years, private banks have been able to raise an aggregate capital of ₹1,15,328 crore from the market (through follow-on public offers, qualified institutional placements, American depository receipts/global depository receipts, employee stock option scheme, etc.) as compared to ₹70,823 by PSBs, which needed a massive infusion of another ₹3,18,997 crore from the GOI (Chart 2.14).



(Source: RBI)

2.21 As may be seen, the total capital held by private banks has reached almost par with PSBs at a much lower balance sheet size.

Conclusion

2.22 As is evident from the analysis above, the increasing share of private banks has provided the system with a requisite robustness. The recent merger of PSBs as part of the Government’s plan to have a few large banks have given size to some of the PSBs. While private banks have had their share of problems, some of them have grown significantly. Going forward, there may be space for both PSBs as well as private banks, existing as well as new, to make space for themselves.

2.23 At a broader level, for enabling a reasonable level playing field, there would have to be a gradual convergence in terms of the operating space and flexibility available to each segment. In terms of regulatory and prudential norms governing the banking operations, there is already a significant amount of convergence. In fact, this equitable application of regulatory policies across ownership groups has been one of the cornerstones of the regulatory regime. However, the same would have to be extended to managerial and operational flexibility based on good governance standards, specifically in case of PSBs.

Chapter 3 : Evolution of Bank Licensing Norms in India

3.1. Historically, till some banks were nationalised in 1969, commercial banks in India were privately held. The private sector banks played a crucial role in the growth of joint stock banking in India. At the time of independence in 1947, India had 97 scheduled private banks, 557 non-scheduled private banks and 395 cooperative banks. The commercial banks, many of which were controlled by business houses at that time, lagged in attaining the social objectives. Therefore, the Government of India nationalised 14 major commercial banks in 1969 and 6 more commercial banks in 1980. Thus about 91 per cent of the banking business in India was brought under PSBs. Since first phase of nationalisation, during next two decades, no banking licence was granted in private sector except Bharat Overseas Bank Ltd.

3.2. However, with the onset of economic reforms in the early nineties, the role of private banks has increasingly been recognised. From 1993 to end of September 2020, eight licensing guidelines have been issued by the Reserve Bank, of which four are for universal banks and four pertain to Differentiated Banks. The Reserve Bank has generally adopted consultative approach in framing these licensing guidelines. During this journey spanning almost three decades, certain specific guidelines/instructions/Master Directions and Discussion Papers have also been issued.

A. 1993 Licensing Guidelines for new Private Sector Bank

3.3. The Committee on Financial Sector Reforms under Shri M. Narasimham, set up in 1991 for financial sector reforms, *inter alia* advocated opening up of the banking sector to the private entrepreneurs to bring in competition and efficiency in the banking industry, and made unequivocal recommendation to allow more private and foreign banks into the banking industry. It paved the way for licensing of new commercial banks in the private sector. Accordingly, in 1993, with increasing recognition of the need for competition, growing process of globalisation and adoption of more liberal policies, the Reserve Bank issued 'Guidelines on Entry of New private sector banks-1993'.

3.4. **Major provisions:** Initial minimum required paid-up capital for such banks was set at ₹100 crore. The promoters' contribution for such a bank was to be determined by the Reserve Bank. Though it was stated that the shares of the bank should be listed on stock exchanges, no specific time line was prescribed. There was no explicit ban on setting up banks by large commercial/industrial houses. However, it was to be ensured at the time of licensing that they avoid the shortcomings, such

as, unfair pre-emption and concentration of credit, monopolisation of economic power, cross holdings with industrial groups, etc., which beset the private sector banks prior to nationalisation.

3.5 Out of ten licences granted under these Guidelines during 1993-1994, four were promoted by financial institutions, one each by conversion of co-operative bank and NBFC into commercial banks, three by individual banking professionals and one by an established media house. Out of the three banks promoted by individual banking professionals, none has survived; while one has been compulsorily merged with a nationalised bank, the other two have voluntarily amalgamated with other private sector banks. Out of the remaining seven banks, one bank promoted by a media group has voluntarily amalgamated itself with another private sector bank. Thus, out of 10 banks licenced, only six are in existence at present.

B. 2001- Licensing Guidelines for new banks in Private Sector

3.6 The Committee on Banking Sector Reforms (Narasimham Committee II), in 1998 recommended that the policy of licensing new private banks [other than local area banks (LABs)] may continue. The Committee also recommended that there should be well defined criteria and a transparent mechanism for deciding the ability of promoters to professionally manage the banks and no category should be excluded on a priori grounds.

3.7 After a review of the experience gained on the functioning of the new banks in the private sector, in consultation with the Government, the Reserve Bank issued revised licensing guidelines in 2001.

3.8 **Major provisions:** The initial minimum paid-up capital was raised from ₹100 crore to ₹200 crore, which was required to be raised further to ₹300 crore within three years of commencement of business. The promoters' contribution was required to be a minimum of 40 per cent of the paid-up capital of the bank and it was to be locked in for a period of five years from the date of licensing of the bank. Promoters' contribution in excess of the 40 per cent, was required to be diluted after one year of the bank's operations. These banks were not allowed to be promoted by a large corporate/industrial house. However, individual companies, directly or indirectly connected with large corporate/industrial houses were permitted to participate in the equity of these banks up to a maximum of 10 per cent but were not allowed to have controlling interest in the bank. Conversion of an NBFC into private sector bank was permitted if it had impeccable track record. However, the

NBFCs promoted by a large corporate/industrial house or owned/controlled by public authorities, including Local, State or Central Governments, were not eligible. The promoters, their group companies and the proposed bank were to accept the system of consolidated supervision by the Reserve Bank. These banks were not to be allowed to set up a subsidiary or mutual fund for at least three years from the date of commencement of business. In June 2002, the maximum limit of shareholding of Indian promoters in these banks was raised to 49 per cent of their paid up capital.

3.9 Two banks licenced under these guidelines were set up by individual banking professionals.

C. 2004 - Guidelines for acknowledgement of transfer/allotment of shares in private sector banks

3.10 With a view to streamline the procedure for obtaining acknowledgement and removing uncertainties for investors including foreign investors [Foreign Direct Investment (FDI), Financial Institutional Investment (FII) and Non-resident Indian (NRI)] in regard to the allotment or transfer of shares and indicate in a transparent manner the broad criteria followed by Reserve Bank for the purpose, in February 2004, Reserve Bank issued detailed guidelines. Private sector banks were advised to ensure through an amendment to the Articles of Association (AoA) that no transfer takes place of any acquisition of shares to a level of 5 per cent or more of the total paid-up capital of the bank unless there is a prior acknowledgement by the Reserve Bank.

3.11 To ensure that ownership and control of private sector banks remains in the hands of fit and proper persons, these guidelines also prescribed illustrative criteria for acknowledgement which *inter alia* included integrity, reputation and track record of applicant. Where acquisition or investment were to take the shareholding of the applicant to a level of 10 per cent or more and up to 30 per cent, the Reserve Bank prescribed certain additional stringent criteria.

3.12 Acknowledgement for transfer of acquisition or investment exceeding the level of 30 per cent were to be considered subject to meeting all the prescribed criteria and only in certain specified situations such as in public interest, desirability of diversified ownership of banks, soundness and feasibility of the plans of the applicant for the future conduct and development of the business of the bank; and shareholder agreements and their impact on control and management of the bank.

D. 2005 - Guidelines on Ownership and Governance in private sector banks

3.13 In February 2005 the Reserve Bank issued detailed guidelines on ownership and governance of private sector banks. The broad principles underlying the framework of this policy was to ensure that the ultimate ownership and control of private sector banks is well diversified. While diversified ownership minimises the risk of misuse or imprudent use of leveraged funds, the fit and proper criteria, were viewed as over-riding consideration in the path of ensuring adequate investments, appropriate restructuring and consolidation in the banking sector.

3.14 Some of the major areas these guidelines covered included norms on shareholding in private sector banks, acquisition and acknowledgement related norms, dispensations permitting a higher level of shareholding in case of restructuring of problem/weak banks or in the interest of consolidation in the banking sector. These guidelines also prescribed that where ownership is that of a corporate entity, it is to be ensured that no single individual/entity has ownership and control in excess of 10 per cent of that entity. Large corporate/industrial houses were allowed to acquire, by way of strategic investment, upto 10 per cent holding subject to the prior approval of the Reserve Bank. Shareholder with other commercial affiliations were also placed under same restriction.

3.15 These guidelines prescribed that the aggregate foreign investment in private banks from all sources (FDI/FII/NRI) could not exceed 74 per cent. If any FDI/FII/NRI shareholding reaches and exceeds 5 per cent, either individually or as a group, it will have to comply with the criteria indicated in the '2004- Guidelines for acknowledgement'. Arrangements for continuous monitoring were also introduced in these guidelines putting the onus on the banks to ensure continuing compliance of the 'fit and proper' criteria and provide an annual certificate to the Reserve Bank.

3.16 All the instructions relating to acquisition of shares in private sector banks and shareholding/voting rights limits in private sector banks, were later consolidated in the form of Master Directions, issued in 2015 and 2016 respectively.

E. Discussion Paper on Entry of New Banks in the Private Sector (2010) & the Guidelines for Licensing of New Banks in the Private Sector (2013)

3.17 In August 2010 the Reserve Bank released a Discussion Paper on "Entry of New Banks in the Private Sector" to seek views/comments of various stakeholders on following aspects delineated in the Discussion Paper:

- (a) Minimum capital requirements for new banks and promoters' contribution

- (b) Minimum and maximum caps on promoters' shareholding and other shareholders
- (c) Foreign shareholding in the new banks
- (d) Whether industrial and business houses could be allowed to promote banks
- (e) Should NBFCs be allowed conversion into banks or to promote a bank
- (f) Business model for the new banks.

3.18 Taking into account the feedback received on the Discussion Paper the draft guidelines on 'Licensing of New Banks in the Private Sector' were framed. The draft guidelines were placed on the website of the Reserve Bank in August 2011 for comments. The final guidelines for "Licensing of New Banks in the Private Sector" were issued in February 2013.

3.19 **Major provisions:** These banks were to be mandatorily set up through a wholly-owned Non-Operative Financial Holding Company (NOFHC). There was no bar on large corporate/industrial houses to be promoters. Individuals were not allowed to promote a bank. The NOFHC was to initially hold a minimum of 40 per cent of the paid-up voting equity share capital of the bank which would remain locked in for a period of 5 years from the date of commencement of business. Shareholding by NOFHC in excess of 40 per cent was to be brought down to 40 per cent of paid-up voting equity share capital within 3 years from the commencement of operations. Further, it has to be brought down to 20 per cent in 10 years and to 15 per cent within 12 years. Shares were required to be listed within 3 years from the date of commencement of business. The aggregate non-resident shareholding could not exceed 49 per cent for first 5 years from commencement of operations. No non-resident shareholder could acquire more than 5 per cent in the bank for first 5 years from commencement of operations. After 5 years extant FDI policy would be applicable. Initial minimum paid-up voting equity capital/net worth for converting NBFC was raised to ₹500 crore. Bank was required to maintain 13 per cent CRAR for first 3 years from commencement of operations. No entity other than the NOFHC can have shareholding or control in excess of 10 per cent of the paid-up voting equity capital of the bank.

3.20 Two banks were set up under these guidelines.

F. Discussion Paper (2013) and the Guidelines issued thereafter for Small Finance Banks (2014) and Payments Banks (2014)

3.21 Immediately thereafter, the Reserve Bank released another comprehensive Discussion Paper in 2013, identifying certain building blocks for the reorientation of the banking structure with a view to addressing various issues such as enhancing competition, financing higher growth, providing specialised services and furthering financial inclusion. The overall thrust of the reorientation was to impart dynamism and flexibility to the evolving banking structure, while ensuring that the structure remains resilient and promotes financial stability. These discussions shaped contours of licensing policies and guidelines framed thereafter, and continue to do so even now.

Small Finance Banks

3.22 Considering that small local banks can play an important role in the supply of credit to micro and small enterprises, agriculture and banking services in unbanked and under-banked regions in the country, the Reserve Bank decided to allow new “small banks” in the private sector. The final licensing guidelines were issued in November 2014. In terms of the activity scope, the SFBs are required to extend 75 per cent of Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL) by the Reserve Bank. At least 50 per cent of its loan portfolio should constitute loans and advances of upto ₹25 lakh.

3.23 Resident individuals/professionals with 10 years of experience in banking and finance; and companies and societies owned and controlled by residents were eligible to set up SFBs. Existing NBFCs, Micro Finance Institutions (MFIs), and LABs that were owned and controlled by residents could also opt for conversion into SFB. Large public sector entities and industrial and business houses, including NBFCs promoted by them were not eligible. The minimum paid-up equity capital for SFBs was kept at ₹100 crore. An NBFC/MFI/LAB converting into a SFB was required to have a minimum net worth of ₹100 crore.

3.24 The promoters’ minimum initial contribution to the paid-up equity capital of such bank shall at least be 40 per cent and gradually brought down to 30 per cent in 10 years and 26 per cent within 12 years from the date of commencement of business of the bank. If the existing NBFCs/MFIs/LABs converted into bank have diluted the promoters’ shareholding to below 40 per cent, but above 26 per cent, due to regulatory requirements or otherwise, then the minimum shareholding requirement is 26 per cent. Voluntary listing for SFBs with net worth less than ₹500

crore and mandatory listing for SFBs within 3 years of reaching net worth of ₹500 crore was prescribed. SFBs cannot establish subsidiaries to undertake para-banking activities. NOFHC structure is mandatory in case a promoter setting up an SFB also desires to start a Payments Bank.

3.25 If the SFB aspires to transit into a universal bank, such transition will not be automatic, but would be subject to fulfilling minimum paid-up capital / net worth requirement as applicable to universal banks; its satisfactory track record of performance as a SFB and the outcome of the Reserve Bank's due diligence exercise.

3.26 Ten SFBs were licenced under these guidelines.

Payments Banks (PBs)

3.27 The licensing guidelines for PBs were issued in November 2014. The objective of setting up of PBs was to further financial inclusion by providing small savings accounts and payments/remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users.

3.28 Scope of their activities includes acceptance of demand deposits (initially restricted to holding a maximum balance of ₹1 lakh per individual customer); issuance of ATM/debit cards (cannot issue credit cards); payments and remittance services through various channels; distribution of non-risk sharing simple financial products like mutual fund units and insurance products, etc. The PBs can not undertake lending activities.

3.29 Eligible promoters included existing non-bank Pre-paid Payment Instrument (PPI) issuers; individuals/professionals; NBFCs, corporate Business Correspondents (BCs), mobile telephone companies, super-market chains, companies, real sector cooperatives that are owned and controlled by residents; and public sector entities. A promoter/promoter group could have a joint venture with an existing scheduled commercial bank to set up a PB. Promoter/promoter groups had to be 'fit and proper' with a sound track record of professional experience or running their businesses for at least a period of five years in order to be eligible to promote PBs. The minimum paid-up equity capital for PBs was fixed at ₹100 crore. The promoters' minimum initial contribution to the paid-up equity capital of such PBs shall at least be 40 per cent, which is to be kept locked in for the first five years from the commencement of its business. No dilution schedule was prescribed. Voluntary listing with net worth less than ₹500 crore and mandatory listing within 3

years of reaching net worth ₹500 crore was prescribed. These banks cannot establish subsidiaries to undertake para-banking activities.

3.30 The Reserve Bank had announced its decision to grant ‘in principle’ approvals to 11 entities to set up PBs. Subsequently, licences were issued to seven PBs and all the banks were set up. Later, in 2020 one bank has decided for voluntary winding up of its business, and surrendered its licence.

G. 2016- Guidelines for ‘on tap’ Licensing of Universal Banks in the Private Sector

3.31 After a thorough examination of the pros and cons, the discussion paper on ‘Banking Structure in India – The Way Forward’, issued in 2013 made out a case for reviewing the current ‘Stop and Go’ licensing policy and for considering a ‘continuous authorisation’ policy on the grounds that such a policy would increase the level of competition and bring new ideas into the system. The feedback on the Discussion Paper broadly endorsed the proposal of continuous authorisation with adequate safeguards. Building on the Discussion Paper and after carefully examining the views/comments received on the draft guidelines from various stakeholders, as also, using the learning from the recent licensing process, such as, the experience of licensing two universal banks in 2014 and granting in-principle approvals for SFBs and PBs, the Reserve Bank worked out the framework for granting licences to universal banks on a continuous basis. These guidelines were issued on August 1, 2016.

3.32 **Major provisions:** Some of the key aspects of the Guidelines include: (i) resident individuals and professionals having 10 years of experience in banking and finance at a senior level are also eligible to promote universal banks; (ii) large corporate/industrial houses are excluded as eligible entities but are permitted to invest in the banks up to 10 per cent; (iii) NOFHC has been made non-mandatory in case of promoters being individuals or standalone promoting/converting entities who/which do not have other group entities; (iv) Not less than 51 per cent of the total paid-up equity capital of the NOFHC shall be owned by the promoter/promoter group, instead being wholly owned by the promoter group; and (v) Existing specialised activities have been permitted to be continued from a separate entity proposed to be held under the NOFHC subject to prior approval from the Reserve Bank and subject to it being ensured that similar activities are not conducted through the bank as well.

3.33 The listing time line was raised to 6 years from commencement of business by the bank as against earlier prescription of 3 years. The time for bringing down the shareholding in excess of 40 per cent by Promoters/NOFHC to 40 per cent was increased from 3 to 5 years. Further, longer time was given for dilution of shareholding i.e. 30 per cent in 10 years and to 15 per cent within 15 years.

H. 2018- Voluntary Transition of Primary (Urban) Co-operative Banks (UCBs) into Small Finance Banks (SFBs)

3.34 Over the years, a few UCBs along with high rate of growth, have expanded their area of operation to multiple States thus acquiring the size and complexities of a small commercial bank. Discussion Paper on 'Banking Structure in India - The Way Forward' issued in 2013 envisaged conversion of UCBs into commercial banks and exploring the possibilities of converting some UCBs into commercial banks or small banks. The High Powered Committee (HPC) on UCBs recommended voluntary conversion of large Multi-State UCBs into Joint Stock Companies and other UCBs, which meet certain criteria, into SFBs.

3.35 In keeping with the fast paced changes in the banking space and in order to facilitate growth, a scheme for voluntary transition of UCBs into SFB is considered a step forward to provide full suite of products / services, sustain competition, raise capital, etc. Accordingly, this scheme was introduced for voluntary transition of eligible UCB into SFB by way of transfer of assets and liabilities. The detailed scheme was announced on September 27, 2018.

3.36 Major provisions of the scheme are as given below:

- (i) Eligible applicants: UCBs with a minimum net worth of ₹50 crore and CRAR of 9 per cent and above.
- (ii) Promoters: A group of individuals/professionals, having an association with UCB as regular members for a period of not less than three years and approved by General Body with 2/3rd majority of members present and voting. The promoters must be residents and shall have ten years of experience in banking and finance.
- (iii) Capital requirement: Minimum net worth of ₹100 crore from the date of commencement of business and the Promoters shall maintain at least 26 per cent of the paid-up equity capital.
- (iv) The eligible UCBs can apply for conversion to SFBs under 2019 'on tap' SFB licensing guidelines.

I. 2019 - “Guidelines for ‘on tap’ Licensing of Small Finance Banks in the Private Sector”

3.37 It was mentioned in the licensing guidelines for SFBs issued in 2014 that after gaining experience in dealing with these banks, the Reserve Bank would consider receiving applications on a continuous basis. Accordingly, the draft guidelines were published on the website of the Reserve Bank on September 13, 2019 inviting comments from the stakeholders and members of the public. Taking into consideration the responses received, the final guidelines were issued on December 5, 2019.

3.38 Major changes in these Guidelines, when compared with earlier Guidelines on SFBs dated November 27, 2014, are: (i) The licensing window will be open on-tap; (ii) minimum paid-up voting equity capital / net worth requirement shall be ₹200 crore; (iii) for UCBs, desirous of voluntarily transiting into SFBs initial requirement of net worth shall be at ₹100 crore, which will have to be increased to ₹200 crore within five years from the date of commencement of business. Incidentally, the net-worth of all SFBs currently in operation is in excess of ₹200 crore; (iv) SFBs will be given scheduled bank status immediately upon commencement of operations; (v) SFBs will have general permission to open banking outlets from the date of commencement of operations; (vi) PBs can apply for conversion into SFB after five years of operations, if they are otherwise eligible as per these guidelines.

3.39 As may be seen with above, guidelines for licensing of banks have kept pace with changing ecosystem; various developments in the area of technology, economy, capital markets; legislative reforms and developments; increasing needs of customers (particularly marginalised section of the society); need to extend reach of banks upto last mile; international practices; improving governance standards; etc. A comparative position of all major licensing guidelines for private sector banks is furnished in *Annex II*. Summary of all licensing guidelines is furnished in *Annex III*.

Chapter 4 : International Experience

4.1 Internationally, most banking jurisdictions require banks to be widely held to avoid concentration of control in the interest of governance and financial stability. A survey of the regulatory regimes in major countries brings out that most of the regimes address the concerns relating to bank ownership through a set of restrictions on the ownership of bank stock on the following parameters:

- (a) level of ownership by single person/related entities
- (b) requirements on ultimate beneficial ownership and control
- (c) ownership restrictions for domestic entities based on nature of entity
 - non-bank financial entities
 - non-financial entities
 - other banks
- (d) ownership restrictions for foreign entities

4.2 A comparative position of international practices and regulatory guidelines in respect of bank ownership in some advanced jurisdictions vis-à-vis India, is furnished in *Annex IV*. The major inferences that may be drawn from these practices/statutory provisions prevalent in other jurisdictions are enumerated below.

- (i) Most of these countries do not have an explicit cap on the maximum shareholding by a single person/entity. Australia seems to be an exception among the major developed countries, with prohibition on acquiring voting rights of more than 20 per cent.

In this regard, Canada has a unique regime which requires banks with equity greater than \$ 12 billion to be widely held, with no one entity in control; in banks with equity \$2 - \$12 billion a person is permitted to have aggregate shareholding upto 65 per cent with at least 35 per cent being publicly held; and no restrictions for smaller banks.

- (ii) Ownership concentration is regulated through a layered threshold structure as per which any person wishing to acquire/increase shareholding in a bank beyond those thresholds would be required to seek regulatory approval for the same. The qualifying threshold level is mostly 10 per cent with subsequent triggers at 20 per cent, 30 per cent and 50 per cent (Malaysia and Singapore have 5 per cent, apart from India). Many of these jurisdictions also have reporting requirements within specified timeframes upto certain thresholds by the acquirer as well as the bank particularly for listed banks.

- (iii) While there is a concept of ‘promoter’ in India with separate limits prescribed for shareholding, the same is not found in other jurisdictions. Persons are classified as major shareholders (e.g. Canada), controllers (e.g. Singapore), principal shareholder (e.g. USA) depending on their shareholding, voting rights, etc.
- (iv) The basis for the thresholds include an ability of the person to exercise control directly or indirectly by virtue of having ‘significant interest’ (e.g. Canada) or ‘significant influence’ (e.g. New Zealand, UK, Sweden) or ‘relevant interest’ (e.g. Australia), ‘material influence’ (e.g. Japan) through shareholding, voting rights, power to issue directions etc.
- (v) The above structure applies to direct as well as indirect control by a person singly or jointly through a group of associates or related parties.
- (vi) The regulators give approvals on a case to case basis subject to a number of considerations including the overall sectoral impact of the transaction and the satisfaction of ‘fit and proper’ principles by the person/s acquiring the stake, which may inter alia include reputation, financial soundness, credit standing etc. In case of acquirers being non-individuals, the due diligence may extend even to the parent institution or major shareholders.
- (vii) Acquirers of shares beyond thresholds need to provide comprehensive information to the authorities for their approval including the intent of purchase, terms and conditions, if any, manner of acquisition, source of funds, etc.
- (viii) In terms of the nature of the entity, non-banking financial firms and non-financial firms are permitted to acquire shares in banks subject to the overall ceilings in respect of single entity in most countries albeit with regulatory approval.
- (ix) In most of the countries, the FDI entry is subject to fulfilment of set of entry norms and licences are accorded on a case to case basis within the overall policy framework. Foreign portfolio investment, on the other hand, is treated similar to domestic portfolio investment and is subject to the guidelines in place in respect of shareholding by a single person/entity on a non-discriminative basis.

4.3 As regards ownership of banks by non-financial firms, including corporate/industrial houses, most countries do not have an explicit restriction, except a few as discussed below. However, the entry is restricted through an authorisation framework. Even in some of these countries where there is no explicit restriction, the actual ownership of the banking system by such non-financial firms is not too high.⁴

4.4 Some of the key jurisdictions which have explicit limits on shareholding by non-financial firms include, apart from India, the United States, Australia, South Korea, Philippines, Indonesia and Malaysia. In the United States, commercial enterprises are not allowed to own a bank due to the concept of separation of banking and commerce. Though the limitation in the 1933 Glass-Steagall Act (GSA), strictly separating banking from securities and insurance activities, has been rolled back to a large degree as a result of the 1999 Gramm-Leach-Bliley Act (GLBA), the concept of the separation of banking and commerce still exists. This has been a contentious issue over the years and has been debated from time to time.

4.5 Many jurisdictions also have in place comprehensive frameworks for regulation of transactions within large conglomerates. In the US, sections 23A and 23B of the Federal Reserve Act specify the statutory restrictions on transactions between a member bank and its affiliates. In the European Union (EU), the Financial Conglomerates Directive provides a framework for supplementary layer of prudential supervision of financial conglomerates addressing the concerns behind such transactions.

⁴ Bank Regulation and Supervision Survey (2019), World Bank

Chapter 5 : Issues and Perspectives

5.1 Lock-in period for promoters' initial shareholding, limits on shareholding in long run, dilution requirement and voting rights

5.1.1 As mentioned previously, banking regulation prefers wider shareholding in banks to concentrated shareholding. Towards this end, apart from prescribing timelines for mandatory listing of the shares of the banks, shareholding ceilings have been prescribed along with the dilution schedule for shareholding of promoters of the banks.

5.1.2 The limits on shareholding, lock-in requirements and dilution schedule for promoters prescribed in various guidelines issued by the Reserve Bank are summarised in the following table:

Licensing Guidelines→	2001	2013	2014 SFB	2016 On-tap Universal	2019 On-tap SFB
Min initial holding	40% of paid up (voting) equity capital				
Lock in for this	5 years				
Dilution schedule for excess above minimum required capital (40 %) (from date of commencement of business)	After 1 year - 40% (raised to 49 % in 2002) (Bank to seek RBI approval if extra time required)	Within 3 years - 40%	Within 5 years- 40%	Within 5 years- 40%	Within 5 years- 40%
		Within 10 years 20 %	Within 10 years 30%	Within 10 years 30%	Within 10 years 30 %
		Within 12 years 15%	Within 12 years 26%	Within 15 years 15%	Within 15 years 15%

5.1.3 As regards non-promoters, the extant Master Directions on Ownership in Private Sector Banks, 2016 provide for a three-tier long run shareholding limits for investors in a bank: Individuals and Non-financial institution/ entities – 10 per cent; Non-regulated or non-diversified and non-listed financial institutions – 15 per cent; and, Regulated, well diversified, and listed/ supranational institution/ public sector undertaking / Government financial institutions – 40 per cent.

5.1.4 The issue of subsequent changes in the shareholding of the promoting entity has also been recognised as an important consideration in the recent past. In respect of licences issued to PBs, SFBs, IDFC First Bank and Bandhan Bank, the Reserve Bank had mandated that any change of shareholding by way of fresh issue or transfer of shares to the extent of 5 per cent or more in their respective promoting entities also shall be with the prior approval of the Reserve Bank. This condition was not part of the respective licensing guidelines but was incorporated subsequently either in the 'Terms and Conditions' of the licence or the 'in-principle approval' or the banks were separately advised to amend their memorandum of association/article of association suitably.

5.1.5 Even though the instructions in this regard seems to have been fairly stabilised, the IWG felt that the following aspects may require additional examination:

- (i) The extant instructions require the promoters' shareholding to be locked-in at not less than 40 per cent during the first five years of operations of a new bank. Post the lock-in period, the promoters' shareholding should not be more than 40 per cent. Whether there is a need to review the lock-in period and also whether there should be a cap on initial holding, needs to be examined.
- (ii) While the voting rights cap has been raised from 15 per cent to 26 per cent of the total voting rights of all shareholders of the banking company through notification issued by the Reserve Bank in July 2016, the extant dilution schedule requires the promoters' shareholding to be reduced to 15 per cent in the long run (i.e. in 12 or 15 years in 2013 and 2016 guidelines respectively). This necessitates review of the threshold on long term shareholdings.
- (iii) Not only the levels to which shareholding of promoters has to be brought down but also timelines to achieve the target is at variance in different guidelines. There is a need to harmonise them, including for the existing banks.
- (iv) The existing three-tier structure for long-term shareholding by non-promoters, particularly the provision to allow 40 per cent holding for well-diversified entities, is not in alignment with the norms relating to promoters and needs to be reviewed.
- (v) With regard to subsequent changes in shareholding at the promoter entity level, whether the requirement of prior approval of the Reserve Bank can be substituted with a reporting requirement.

(i) Initial lock-in requirement

5.1.6 The extant instructions require that the promoters' shareholding in the bank shall be at least 40 per cent in the initial five years of operations of a new bank. Since the licence is issued based on due diligence of the promoter group and satisfaction that the promoter group is indeed 'fit and proper' among other aspects, the stipulation of lock-in period seeks to lock in the credibility of the control of the promoter group till the business is properly established and stabilised. Further, higher holding in beginning with lock-in for five years also ensures that the promoters remain committed to the business in the formative years, providing necessary strategic direction. Majority of experts with whom the IWG interacted, were also of the view that a higher initial stake requirement makes sure that only serious and financially sound promoters come forward. Further, on the issue whether there should be upper limit/cap on the initial holding by a promoter, the IWG observed that the extant instructions do not mandate any limit in this regard and felt that status quo may continue.

5.1.7 In view of the above, the IWG recommends that no change may be required in the extant instructions related to initial lock-in requirements. Thus the 40 per cent limit would be the floor in terms of the initial holding by a promoter, with no upper ceiling, during first five years.

(ii) Maximum permitted holding in long run (Final Dilution)

5.1.8 Another issue deliberated by the IWG was whether the extant ceiling on promoters' shareholding at 15 per cent of the paid-up voting equity share capital of the bank needs a revision in view of revised ceiling for voting rights at 26 per cent of the paid-up voting equity share capital of the bank. Extant Reserve Bank Guidelines for 'on tap' Licensing of Universal Banks in the Private Sector; August 2016, inter alia, provide:

a) Shareholding by the promoter/s and the promoter group / NOHFC in the bank in excess of 40 per cent of the total paid-up voting capital shall be brought down to 40 per cent within five years from the date of commencement of business of the bank

b) The shareholding by promoter/s and promoter group / NOHFC in the bank shall be brought down to 30 per cent of the paid-up voting equity capital of the bank within a period of 10 years, and to 15 per cent of the paid-up voting equity capital of the bank within a period of 15 years from the date of commencement of business of the bank

5.1.9 During the interaction with some banks and experts it was opined that this trajectory of compulsory dilution by the promoters needs a review. The experts whom the IWG engaged with were broadly of the view that while in principle the requirement of higher shareholding in the initial years with subsequent dilution makes sense, the long-run threshold needs to be higher at 26 per cent. The group deliberated on the international practices and also the views of the experts in this regard.

International practices

- In some of the jurisdictions in Asia, like Indonesia, it was observed that a 25 per cent stake is defined as a controlling stake, requiring central bank approval. Non-controlling stakes, lower than 25 per cent, face no other constraints and are permitted without approval. This freedom is permitted for overseas investors as well.
- In Japan, the threshold is defined as applicable to a major shareholder, and is pegged at 20 per cent (15 per cent if the shareholder has material influence). Major shareholders need central bank approval, while others do not. Thus the threshold is 15 per cent if control is sought to be exercised, and 20 per cent in other situations as for instance in a purely financial investment.
- In South Korea, the norms are more nuanced, and differentiate between a non-financial business (termed NBFOs) and a financial business. NBFOs can own upto 4 per cent freely, and can go upto 9 per cent with central bank approval. Financial businesses can own upto 10 per cent freely, but can also go higher with successive approvals to get beyond 10, 25 and 33 per cent.
- In Germany, there appears to be no specific regulations limiting controlling or major shareholding in banks.

Views of experts

- Excessive focus on limits on economic ownership seems contrary to legislative intent.
- Voting control achieves the policy parameters of diversified ownership.
- Most other jurisdictions do not enforce similar limits on bank ownership, though there are due diligence thresholds.

5.1.10 In case the Reserve Bank finds any major shareholder (including promoter) not meeting ‘fit and proper’ criteria, at any point of time, it is statutorily empowered

to restrict his voting rights to 5 per cent of the paid-up voting equity capital of the bank [under Section 12B(8)], which can be a strong check.

5.1.11 The IWG also noted that it will result in harmony in various guidelines (2014 SFB guidelines allow 26 per cent holding in long run, allows NBFCs/LABs to start with 26 per cent if the entity has already diluted holding due to regulatory requirements). Permitting higher shareholding up to 26 per cent of the paid-up voting equity share capital of the bank will enable promoters to infuse higher funds which are critical for expansion of banks and work as a cushion to rescue the bank in times of distress/cyclical downturn.

5.1.12 Taking into account the feedback of experts and also looking at the international practices in this regard, the IWG felt that if India's private sector banks are to grow, it appears desirable that they be permitted to access the pool of capital available in India and elsewhere without imposing excessively narrow investment limits. While it is desirable to have widely held banks to ensure that there is no controlling stake vested in one person/entity but at the same time when individual holdings are small and shareholders are diffused, they also tend to be disengaged.

5.1.13 It was also observed that the P. J. Nayak Committee (constituted by Reserve Bank), in 2014, had recommended promoters' holding of 25 per cent recognizing that low promoters' shareholding could make banks vulnerable by weakening the alignment between management and shareholders.

5.1.14 On balance therefore, the IWG recommends that the cap on promoters' stake in the long run (i.e. 15 years) may be raised from the current levels of 15 per cent to 26 per cent of the paid-up voting equity share capital of the bank. This will balance the need for diversified ownership on the one hand and bring more skin in the game for the promoter, on the other. The 26 per cent stake would serve as the threshold for maximum holding by a promoter in long run. This stipulation would mean that promoters, who have already diluted their holdings to below 26 per cent, will be permitted to raise it to 26 per cent, subject to meeting 'fit and proper' status. The promoter, if he/she so desires, can choose to bring down holding to even below 26 per cent, any time after the lock-in period of five years.

5.1.15 As regards the long term shareholding specified for promoters being “*Regulated, well diversified, and listed/ supranational institution/ public sector undertaking / Government financial institutions*”, the IWG was of the view that in-principle there should not be any distinction in the threshold for long-term shareholding based on the nature of the promoter entity. Further, such generic qualifiers as ‘regulated, well diversified’ may dilute the rigour of the process. The IWG therefore recommends that to keep regulations simple but meaningful, **a uniform shareholding limit at 26 per cent of the paid-up voting equity share capital of the bank for all promoter categories may be stipulated.**

(iii) Sub-targets for dilution

5.1.16 Between 5-15 years, the extant guidelines provide for an intermediate threshold of 10 years, by when the shareholding has to be brought down to 30 per cent (20 per cent for banks licensed under 2013 guidelines). The IWG deliberated on the need for continuing with these intermediate thresholds and concluded that the same may not be necessary. Once the Reserve Bank has prescribed the initial lock-in requirement for 5 years and the long-term dilution schedule of 15 years, it should be left to the bank to plan out the exact path depending on economic environment and market situations. **The IWG therefore recommends that the intermediate sub-targets may be dispensed with. Instead, at the time of issue of licences, the promoters may submit a dilution schedule** which may be examined and approved by the Reserve Bank. The progress in achieving these agreed milestones must be periodically reported by the banks and shall be monitored by the Reserve Bank.

(iv) Shareholding by non-promoters

5.1.17 As regards non-promoters, the extant instructions provide for a three-tier long run shareholding limits for investors in a bank: Individuals and Non-financial institution/ entities – 10 per cent; Non-regulated or non-diversified and non-listed financial institutions – 15 per cent; Regulated, well diversified, and listed/ supranational institution/ public sector undertaking / Government financial institutions – 40 per cent. The IWG deliberated on the imperative for this three-tier stipulation and the rationale for different thresholds based on the nature of the non-promoting entity.

- The IWG was of the view that the arguments applicable for restricting the level of shareholding by promoters in the long run, equally apply to any major

shareholder in the bank as well. The concerns relating to influence over the affairs of the bank by any major shareholder, not just the promoter, need to be addressed. Therefore, there is little rationale for continuing with a higher threshold beyond 26 per cent for any shareholder.

- Further, as regards the 10 per cent limit for individuals and non-financial institutions, the IWG felt that in view of the requirement of mandatory prior clearance by the Reserve Bank for exceeding the shareholding beyond 5 per cent, in line with international norms, there may be case for increasing this threshold a notch higher upto 15 percent. The raise will also be in sync with the raise recommended for promoters' holdings. However, the due diligence process as prescribed in the Master Directions on Prior Approval, 2015, for shareholding above 10 per cent may be continued for such holding.

5.1.18 Taking into account the above, the IWG recommends that the current long-run shareholding guidelines for non-promoters may be replaced by a simple cap of 15 per cent of the paid-up voting equity share capital of the bank, for all types of non-promoter shareholders in the long run. However, the Reserve Bank should reserve the right to prescribe any lower ceiling on holding or curb voting rights of the promoters/non-promoters, if at any point of time they are found to be not meeting 'fit and proper' criteria.

5.1.19 It was also observed by the IWG that while non-promoter investors may act in concert to have control over the affairs of the bank, they may keep individual person's shareholding below 5 per cent to circumvent the requirement of 'fit and proper' test by the Reserve Bank. There is a need to have close monitoring on such efforts by banks as well as by the Reserve Bank and deterrent regulatory/supervisory actions, as may be warranted, including cancellation of bank's licence.

5.1.20 Further, the IWG is also of the view that the provisions to permit any higher holding by a promoter/investor in special circumstances as mentioned in paragraph 5 (iv) of MD on Ownership [such as relinquishment by existing promoters, rehabilitation / restructuring of problem / weak banks / entrenchment of existing promoters or in the interest of the bank or in the interest of consolidation in the banking sector, etc.] may be continued.

5.1.21 A comparative position of various type of limits on holdings, existing as well as recommended by the IWG are furnished in the following table.

Table: Limits on shareholding in long run (15 years), in percentage:

Category		Existing		Recommended (in long run)	
		Promoter group	All shareholder in long run	Promoter group	Other than promoter group
(a)	Natural person	As specified in the respective guidelines @	10	26	15
(b)	Legal person		-		
(i)	Non-financial institution/ entities,		10		
(ii)	Financial Institutions		-		
	(a) which are non-regulated or non-diversified or non-listed		15		
	(b) which are regulated, well diversified and listed / supranational institution / public sector undertaking / Government		40		
	(c) in Circumstances as mentioned in paragraph 5 (iv) of MD on ownership		As permitted on a case to case basis		

@ For all existing banks, the permitted promoter / promoter group shareholding will be in line with what has been permitted in the February 22, 2013 guidelines on licensing of universal banks viz. 15 per cent.

(v) Change in shareholding of promoting entity/major shareholders⁵ entity

5.1.22 As regards shareholding in promoting entities/major shareholder entity of the banks is concerned, it is desirable that Reserve Bank has some monitoring mechanism over the major shareholders of such entities to ensure that their control does not fall in the hands of persons which are not fit and proper. However, since

⁵ “Major shareholder” means shareholder having / likely to have an “aggregate holding” to the extent of 5 per cent or more of the paid-up share capital of the bank or 5 per cent or more of the total voting rights of the concerned bank.

Reserve Bank does not have any statutory rights over the shareholders of such entities, monitoring mechanism would have to be devised through licensing conditions, such as stipulating reporting requirements.

5.1.23 Since only large changes in shareholding of the promoting entity/entities may be cause of concern, some threshold can be considered for reporting to the Reserve Bank as and when any shareholder becomes a 'significant beneficial owner' (as defined in the Companies Act, 2013) of the promoting entity/entities.

5.1.24 In case such a shareholder is not found to be 'fit and proper' by the Reserve Bank, the Reserve Bank may take appropriate action, if warranted, such as limiting voting rights of promoting entity/major shareholder in the bank.

5.1.25 **Declassification/de-recognition of promoter(s):** No criteria, procedures or rules have been prescribed either in any of the extant licensing guidelines or Master Directions regarding de-classification/re-classification of promoter/promoter group when his holding falls below a particular threshold or when Reserve Bank's approval is required for such de-classification, etc.

5.1.26 The IWG is of the opinion that Reserve Bank may examine the issue and consider prescribing norms in this regard if considered appropriate.

Recommendations

- 1) **No change may be required in the extant instructions related to initial lock-in requirements, which may continue as minimum 40 per cent of the paid-up voting equity share capital of the bank for first five years.**
- 2) **There is no need to fix any cap on the promoters' holding in initial five years**
- 3) **The cap on promoters' stake in long run of 15 years may be raised from the current levels of 15 per cent to 26 per cent of the paid-up voting equity share capital of the bank. This stipulation should be uniform for all types of promoters and would not mean that promoters, who have already diluted their holdings to below 26 per cent, will not be permitted to raise it to 26 per cent of the paid-up voting equity share capital of the bank. The promoter, if he/she so desires, can choose to bring down holding to even below 26 per cent, any time after the lock-in period of five years.**

- 4) No intermediate sub-targets between 5-15 years may be required. However, at the time of issue of licences, the promoters may submit a dilution schedule which may be examined and approved by the Reserve Bank. The progress in achieving these agreed milestones must be periodically reported by the banks and shall be monitored by the Reserve Bank.
- 5) As regards non-promoter shareholding, current long-run shareholding guidelines may be replaced by a simple cap of 15 per cent of the paid-up voting equity share capital of the bank for all types of non-promoter shareholders.
- 6) A monitoring mechanism may be devised to ensure that control of promoting entity/ major shareholder of the bank, does not fall in the hands of persons who are not found to be fit and proper. Licensing conditions/ approvals for acquisitions may stipulate reporting requirements whenever a shareholder becomes a significant beneficial owner (as defined in the Companies Act, 2013) of the promoting entity/ major shareholder of the bank.
- 7) The Reserve Bank may examine the issue relating to declassification/derecognition of promoter and consider prescribing norms regarding de-classification/de-recognition of promoters.

5.2 Pledge of shares by promoters of private sector banks

5.2.1 The pledging of shares by promoters of Indian companies has been an old practice. The information is made publicly available since 2009 when SEBI had mandated event based disclosures. However, no reporting requirement has been prescribed by Reserve Bank to banks. Significant level of pledged shares may adversely impact the perception of the investors. In a falling market in particular, pledged shares are under pressure as diminished share prices bring down the collateral value, prompting lenders to either demand additional margins or sell the shares to protect their interests. Either of the actions can have a negative impact on stock prices, thereby eroding the wealth of the investors⁶.

⁶ [Financial Stability Report, Reserve Bank of India, June-2019](#)

Issues

5.2.2 The extant licensing conditions do not prescribe any restrictions on the pledge/encumbrance of shares held by promoters/promoter group in banks, either during or after end of lock-in period.

5.2.3 The IWG felt that in case of such banks where promoters' shareholding are under lock-in period as per the licensing conditions, there are concerns in allowing promoters to pledge shares. Hence, **during the lock-in period, the promoters should not be permitted to pledge his shares to the extent of the prescribed minimum shareholding.** The reason for this argument is that once shares are pledged for borrowing, in the event of any default in repayment by borrower or diminution in value of shares, the lender may invoke the pledge and acquire or transfer the shares. This may lead to reduction in shareholding (and consequential voting rights) of promoter/promoting entity, which would be a breach of minimum shareholding requirements during lock-in period.

5.2.4 There is one more related issue arising on account of invocation of pledge of shares of a banking company. Since share pledges may lead to share transfers on failure of the pledger to honour a pre-agreed commitment, share pledges may conflict with the Section 12B of the Banking regulation Act, 1949 which mandates prior permission from the Reserve Bank for acquisition of 5 per cent or more paid-up share capital or voting rights of a banking company. In case of default, if the lender invokes the pledge, it is possible that the lender may acquire more than 5 per cent shares of the bank.

5.2.5 The IWG took a view that since under share pledges, the collateral agreement is not for the express purpose of acquisition of shares but as a collateral for an underlying lending transaction, it may not be desirable to be too restrictive in this regard. In such an eventuality where pledgee ends up with more than 5 per cent shareholding of a bank, he may immediately apply for post-facto approval of the Reserve Bank and till the approval is obtained, the voting rights of pledgee must be restricted to 5 per cent. The voting rights may remain restricted at 5 per cent if the pledgee is not found to be 'fit and proper' by the Reserve Bank in terms of the [Master Direction on 'Prior Approval for Acquisition of Shares or Voting Rights in Private Sector Banks' dated November 19, 2015.](#)

Recommendations

- 8) **The IWG is of the view that pledge of shares by promoters during the lock-in period, which amounts to bringing the unencumbered promoters' shares below the prescribed minimum threshold, should be disallowed.**
- 9) **In case the invoking the pledge results in purchase/transfer of shares of such bank beyond 5 per cent of the total shareholding of the bank, without prior approval of Reserve Bank, it may restrict the voting rights of such pledgee till the pledgee applies to Reserve Bank for regularisation of acquisition of these shares.**
- 10) **Reporting requirement: The Reserve Bank may introduce a reporting mechanism for pledging of shares by promoters of private sector banks.**

5.3 Issues and concerns on ADR/GDR issued by banks

Introduction and background

5.3.1 Companies, including banks, can raise foreign capital without listing themselves on foreign stock exchanges by issuing shares to foreign depositories who in turn issue depository receipts (DRs) to investors who acquire indirect equity holdings in the company. These depository receipts are negotiable instruments which represent ownership of underlying shares of the destination company.

5.3.2 Depository Receipt means⁷ a foreign currency denominated instrument, whether listed on an international exchange or not, issued by a foreign depository in a permissible jurisdiction on the back of eligible securities issued or transferred to that foreign depository and deposited with a domestic custodian and includes 'global depository receipt' (GDR) as defined in the Companies Act, 2013. DRs issued by a bank or a depository in USA against underlying rupee shares of a company incorporated in India are known as American Depository Receipts (ADRs) and those issued by a bank or a depository elsewhere are known as Global Depository Receipts (GDRs).

⁷ As defined in clause 2.1(a) of ['Depository Receipt Scheme, 2014'](#); clause 2(ix) of ['Foreign Exchange Management \(Transfer or Issue of Security by a Person Resident Outside India\) Regulations, 2017'](#); Rule 2(1)(aag) of [PMLA Rules \(Maintenance of Records\) Rules, 2005](#)

5.3.3 It is essential for the Reserve Bank to have knowledge of the ownership structure of a bank. In case of DRs, the identity of the ultimate natural owner of DRs is not known, though only a Know Your Customer (KYC) compliant person can hold DRs in a FATF jurisdiction. If the DR holder has voting rights, this opacity may be misused. The IWG was apprised of the practices that have evolved in the market in relation to ADRs/GDRs, and the regulatory concerns emanating from the exercise of voting rights which depositories may exercise in issuer banks.

5.3.4 The Reserve Bank had advised the banks in 2005 that in case of issue of ADR/GDR banks will need to obtain Reserve Bank's 'acknowledgement' if the shares held by Depositories exceeded 5% of paid-up capital of the bank. Through exercising the power of 'not acknowledging the transfer', the Reserve Bank could restrict voting right of 'not fit and proper depository'. Following this, banks generally entered into an agreement with the depository to the effect that the depository would not exercise voting rights in respect of the shares held by them or they would exercise voting rights as directed by the Board of Directors of the bank.

5.3.5 In 2007, with the objective of eliminating the possibility of any interference of the depositories in the management of the bank, the Reserve Bank had advised banks to furnish to Reserve Bank a copy of the Depository Agreements entered into by banks with the depositories; and, in addition, to give an undertaking to Reserve Bank that -

- (i) they would not give cognizance to voting by the depository, should the depository vote in contravention of its agreement with the bank;
- (ii) no change would be made in terms of the Depository Agreement without prior approval of the Reserve Bank.

5.3.6 The regulatory framework governing voting rights available through holding of depository receipts are summarized below:

- According to the Companies (Issue of GDR) Rules, 2014 until the conversion of depository receipts into underlying shares, the overseas depository shall be entitled to vote on behalf of the holders of depository receipts in accordance with the provisions of the agreement entered into between the depository, holders of depository receipts and the company in this regard.⁸

⁸ Clause 6 (2) of Companies (Issue of GDR) Rules, 2014

- According to the Depository Receipts Scheme, 2014⁹ foreign depository is entitled to exercise voting rights, if any, associated with the permissible securities, whether pursuant to voting instruction from the holder of depository receipts or otherwise. Further, a holder of depository receipts issued on the back of equity shares of a company shall have the same obligations as if it is the holder of the underlying equity shares if it has the right to issue voting instruction¹⁰.
- As per 'Framework for issue of Depository Receipts' issued by SEBI on October 10, 2019, *the voting rights shall be exercised by the DR holder through the Foreign Depository pursuant to voting instruction only from such DR holder.*

5.3.7 As can be seen from above, the extant instructions to banks to enter into an agreement with the depository to the effect that the depository shall not exercise voting rights in respect of the shares held by them or they shall exercise voting rights as directed by the Board of Directors of the bank is at variance with the SEBI instructions which specify that the voting rights on Permissible Securities, if any, shall be exercised by the DR holder through the Foreign Depository pursuant to voting instruction only from such DR holder.

Issues and concerns

5.3.8 While the extant the Reserve Bank norms have attempted to address the concern regarding exercise of voting rights by the depository, the IWG acknowledged that this may also have had the unintended impact of diluting the shareholder rights by giving the Boards significant indirect influence. As the ceiling on the voting rights has been raised from 15 per cent to 26 per cent through a notification issued by the Reserve Bank in 2016, this indirect influence exercised through the depositories may be too large in certain cases. The concern may get accentuated in such situations when large number of shares of the bank are held by a dominant/major shareholder(s)/promoter(s). Though, the Reserve Bank has an option to advise such banks where promoter(s)/major shareholder(s) influence is required to be restricted, to have a clause entered in the agreement that depository would not exercise any voting rights, the extant instructions do not explicitly provide for prior consent from the Reserve Bank, before finalizing Depository Agreement.

⁹ Clause 7 of the Depository Receipts Scheme, 2014

¹⁰ 'right to issue voting instruction' means the right of a depository receipt holder to direct the foreign depository to vote in a particular manner on its behalf in respect of permissible securities. [defined in clause 2(i)]

Recommendations

- 11) In view of above, in the interest of good corporate governance, and to restrict undue influence of the bank's boards on depositories, the Reserve Bank may advise the banks to seek its prior approval before entering into agreements with depositories. Wherever promoters hold more than 15 per cent holding, one option may be to advise banks to modify the Depository Agreement to assign no voting rights to depositories. While this may not be strictly in line with the SEBI norms, it may be possible to enforce this contractually through a suitable clause in the agreement with the depositories.
- 12) The IWG also felt that it may be better to explicitly reckon the holdings by DR holders through appropriate disclosure of these holders to the investee banks. This would enable combining the direct and indirect shareholding in the bank for the purpose of compliance with the cap prescribed in Section 12B of the Banking Regulation Act, 1949 as well as for arriving at the effective voting rights of a shareholder in the bank. The banks may enter into an agreement with the depository to the effect that the depository shall disclose the list of holders of depository receipts issued by them to the bank. This will also be in compliance with the Framework for issue of Depository Receipts' issued by SEBI.
- 13) However, before proceeding, in view of complexities in various statutes/regulations involved in the matter, the Reserve Bank may examine all the legal aspects in detail for both the above options.

5.4 Eligibility of Promoters

5.4.1 Banking is like any other commercial activity, with varying levels of controls exercised by different stakeholders. However, what sets it apart is the licence to access low-cost public deposits, with deposit insurance, and their critical role as payment system operators in the economy. Any problems with banks can affect the safety of the depositors and also create frictions in the smooth liquidity transmission in the economy, which can have systemic implications. It is these distinguishing features which underpin the entire regulatory framework for the banking sector, including the financial safety nets. In the absence of these, information asymmetries and negative externalities could impact the functioning of the entire economy, including the real sector. The elaborate prudential framework for banks is aimed at

correcting the distorted incentives by regulating the activities of banks and the capital and liquidity buffers they need to maintain. However, the effectiveness of the prudential regulation can be critically contingent on the filters applied at the entry stage. The degree of onus on the bank promoters and management is several notches higher than other commercial enterprises. Therefore the eligibility requirements for the entities permitted to get into banking is one of the bedrocks of the prudential regulations.

5.4.2 In terms of the categories of persons which have been considered as promoters for the licence of universal banks over the years, there has been a clear preference for well-functioning financial institutions not part of any commercial group and professional individuals with proven experience in the banking and financial industry. Further, ownership and control by residents has also been a condition, though the definition of the same has varied across various guidelines. However, the formalisation of specific criteria for various categories of persons eligible for banking licence happened in 2013. The broad categories included in the 2013 guidelines provide a useful template for reviewing the approach going forward for both universal banks as well as SFBs – individuals and groups/entities. Within these, two specific sub-categories need a separate analysis, viz. large corporate/industrial houses and NBFCs.

A. Individuals

5.4.3 The IWG noted that except for the 2013 guidelines, the individuals as promoters of banks have not been disallowed. The 2016 guidelines for on-tap licensing explicitly permit individuals / professionals who are residents [as defined in FEMA Regulations, as amended from time to time] having 10 years of experience in banking and finance at a senior level to be eligible to promote banks, singly or jointly. The fit and proper status of individuals as promoters of universal banks will be based on past record of sound credentials and integrity; they should be financially sound and should have a successful track record for at least 10 years. For the SFBs, as per 2019 licensing guidelines resident individuals/professionals (Indian citizens), singly or jointly, each having at least 10 years of experience in banking and finance at a senior level are eligible. Further, the period of successful track record has been specified as 5 years for companies and societies only under the 2019 on-tap guidelines.

5.4.4 The IWG is of the view that the provisions of the extant on-tap licensing are appropriate and do not warrant any change.

5.4.5 However, the IWG also deliberated on a specific issue relating to harmonisation between the 2019 SFB guidelines, where it has been qualified that only ‘Resident individuals’ (‘Indian Citizen’) will be permitted, and the 2016 guidelines on universal banks, where only words ‘Resident individual’ have been used. In this context, the IWG noted that while the word ‘resident’ has been defined differently in Section 2(v) of FEMA as well as Section (6) of Income Tax Act; word Indian Citizen has been defined in Section 3 to 6 of Citizenship Act, 1955.

5.4.6 With the objective to bring harmony in the definition of individuals as promoters, the IWG felt it appropriate to define the eligibility criterion as, “Individuals / professionals who are residents (as defined in FEMA Regulations, as amended from time to time) and Indian Citizens (as defined in Citizenship Act, 1955) having 10 years of experience in banking and finance at a senior level would be eligible to promote banks, singly or jointly.”

B. Entities, Groups

5.4.7 Before the 2016 on-tap guidelines, the only binding condition on entities/groups intending to promote universal banks was that they have to be ‘owned and controlled’ by residents. For SFBs, though, the eligibility was limited to ‘companies and societies’ ‘owned and controlled’ by residents. The real checks, however, were exercised through the ‘fit & proper’ assessment, which looked into the financial soundness of the promoter groups and their track record of running their businesses, for an extended period.

5.4.8 The 2016 on-tap guidelines brought in a specific condition that if such promoting entity / group has total assets of ₹5000 crore or more, the non-financial business of the group should not account for 40 per cent or more in terms of total assets / in terms of gross income. A similar principle had also been applied in respect of SFBs previously. A comparative position of eligibility criteria for entities/groups/societies to promote a bank is given below.

Prior to 2013	2013 Universal	2014 SFB	2016 on-tap Universal	2019 on-tap SFB
No specific criteria prescribed	<p>Entities / groups in the private sector that are ‘owned and controlled by residents’ [as defined in Department of Industrial Policy and Promotion (DIPP) Press Note 2, 3 and 4 of 2009 / FEMA Regulations as amended from time to time] and entities in public sector....</p> <p>Fit & Proper: Promoters/ Promoter Groups should be financially sound and have a successful track record of running their business for at least 10 years.</p>	<p>Companies and Societies owned and controlled by residents.</p> <p>Fit & Proper: on the basis of their past record of sound credentials and integrity; financial soundness and successful track record of running their businesses, etc. for at least a period of five years.</p>	<p>Entities / groups in the private sector that are ‘owned and controlled by residents’ [as defined in FEMA Regulations, as amended from time to time] and have a successful track record for at least 10 years, provided that if such entity / group has total assets of ₹50 billion or more, the non-financial business of the group does not account for 40 per cent or more in terms of total assets / in terms of gross income.</p> <p>Fit & Proper: The promoting entity / promoter group should have a minimum 10 years of experience in running its / their businesses.</p>	<p>Companies and Societies in the private sector, that are owned and controlled by residents (as defined in FEMA Regulations, as amended from time to time), and having successful track record of running their businesses for at least a period of five years.</p> <p>PBs with successful track record of 5 years can promote/convert into SFB.</p> <p>Primary (Urban) UCBs can also convert into SFB under the Scheme of Voluntary Transition.</p> <p>Fit & Proper: past record of sound credentials and integrity; financial soundness and successful track record of professional experience or of running their businesses, etc. for at least a period of five years.</p>

5.4.9 The IWG reviewed the extant guidelines and discussed at length various issues. It concluded that it may not be necessary to change the broad contours. However, it did deliberate on certain specific issues, particularly the issue of the definition of ‘ownership and control’ in the context of their residency status.

5.4.10 In 2013 and 2016 Universal Bank guidelines and 2019 SFB guidelines, the eligibility criteria for Promoter Entity/Companies/Societies state that they should be “owned and controlled by residents as defined in FEMA regulations”. Further, 2016 on-tap guidelines also state that the bank should be “controlled by residents” (as per FEMA, 1999) at all times. In the 2014 SFB and PB guidelines the eligibility criteria for promoters allow companies and societies ‘owned and controlled by

residents’, without quoting FEMA or any other Act, though a subsequent clarification was issued to this effect.

5.4.11 In line with the condition applicable to individual promoters, the IWG was of the view that a corresponding change may be required even with regard to promoter groups/entities. It therefore recommends that the criterion may be modified as, “Entities / groups in the private sector that are owned and controlled by ‘resident Indian citizens’ [as defined in FEMA Regulations, as amended from time to time]”.

5.4.12 As regards the period of successful track record, just as in the case of individuals, the IWG concluded that the current stipulation of 5 and 10 years for SFB and universal banks is appropriate and no change is required. However, for those PBs intending to convert into a SFB, track record of 3 years of experience as PB may be sufficient as in any case, the promoter had experience prior to setting up PB which was taken into account while granting of licence.

C. Large Corporate/Industrial/Business Houses¹¹

5.4.13 The IWG was cognizant of the fact that the approach of the Reserve Bank regarding ownership of banks by large corporate/industrial houses has, by and large, been a cautious one in view of serious risks, governance concerns and conflicts of interest that could arise when banks are owned and controlled by large corporate and industry houses. For the first time in 2013 the Reserve Bank, in its Guidelines for Licensing of New Banks in the Private Sector, issued in February 2013, had prescribed several structural requirements of promoting a bank under an NOFHC which permitted industrial and business houses to set up banks with certain conditions. Certain large corporate houses applied for a licence under this new policy of which few entities withdrew their application. Eventually only IDFC Bank and Bandhan Bank, both from the financial services sector, were given permission to set up banks. The Reserve Bank, in its in-principle approval of these two banks in 2014, stated the following about its decision to only issue these two licences: *“At a time when there is public concern about governance, and when it comes to licences for entities that are intimately trusted by the Indian public, this may well be the most appropriate stance.”*

¹¹ A large corporate/industrial/business house in this context means a group having total assets of ₹ 5000 crore or more, where the non-financial business of the group accounts for more than 40 per cent in terms of total assets or gross income.

5.4.14 The 2014 SFB licensing conditions restored the explicit prohibition on large corporate/industrial houses from promoting banks, which has since been the consistent stance in all subsequent guidelines. Broadly, the main concerns of allowing large corporate houses to own banks relate to conflicts of interest, concentration of economic power and safety net concerns. More specifically, it heightens the risks of misallocation of credit, connected lending, extensive anti-competitive practices, and exposure of the government safety net established for banking to a broad range of risks emanating from commercial sectors of the economy. Further, all the risks relating to intra-group transactions and exposures, which are existent even otherwise, like transaction risks, moral hazard risks, risk of contagion, risk of reputation get highly magnified in case on corporate ownership of banks. The other major concern posed by the mixing of banking and commerce include overburdening the supervisory resources. It will no doubt be necessary to significantly scale up the supervision capacity before considering large corporate houses to promote banks.

5.4.15 At the same time, the IWG acknowledged the arguments in favour of allowing such entities, that they can be an important source of capital and can bring in their experience, management expertise, and strategic direction to banking. It is also a fact that many of such corporate/industrial houses have been successfully operating in other financial segments. The IWG also noted that internationally, there are very few jurisdictions which explicitly disallow large corporate houses, and even in these jurisdictions, it is not a settled issued.

5.4.16 On balance, the IWG was of the view that what may be more important in taking a conclusive view on this critical question would be the robustness of the institutional and legal setting. Notwithstanding the merits of permitting large corporate/industrial houses to own banks, certain prerequisites may be necessary before considering the same in view of valid concerns. These would include a strong legal framework for addressing connected lending and an enabling framework for consolidated supervision. These mechanisms would be imperative to deal with intra-group transactions and exposures that may be detrimental to the banking entity. For instance, though the US does not allow commercial firms to own banks, there are specific provisions in the Federal Reserve Act on regulating relations with affiliates and even putting restrictions on transactions with affiliates. In India too, the need for such an enabling legal provision was flagged by two Committees in the past - Working Group on Consolidated Accounting and Other Quantitative Methods to Facilitate Consolidated Supervision (2001) and Inter-Regulatory Working Group on

Monitoring of Financial Conglomerates (2004). While the Reserve Bank has issued guidelines in 2014 on Management of Intra-Group Transactions and Exposures, without appropriate legal backing the concerns in this regard will not be fully addressed.

5.4.17 The IWG also noted that tracking of money trail is basically an investigative function and not a supervisory function. Companies (Significant Beneficial Owners) Rules have been notified in 2018 and still evolving. Till these rules get clarity and settle down, the haze before ultimate beneficiary may continue, making it difficult to track the inter-linkages.

5.4.18 Given the various ramifications, the IWG agreed that a cautious approach needs to be adopted in this regard. As such the IWG recommends that large corporate/industrial houses may be permitted to promote banks only after necessary **amendments to the Banking Regulations Act, 1949** to deal with connected lending and exposures between the banks and other financial and non-financial group entities akin to the US Federal Reserve Act in this regard; and strengthening of the supervisory mechanism for large conglomerates, including consolidated supervision. RBI may examine the necessary legal provisions that may be required to deal with all concerns in this regard.

D. Conversion of NBFCs to banks

5.4.19 As per the On-Tap Licensing Guidelines -2016, NBFCs are permitted to convert into a universal bank, provided the promoters meet the fit and proper criteria including a 10 year track record of successful operations and those NBFCs which are part of a 'group with total assets of over ₹5000 crore' and where the non-financial business must not exceed 40 per cent of the group's total assets/ total income.

5.4.20 One of the options that the IWG explored was the possibility of allowing some of the large NBFCs, even if owned by large corporate houses, to be considered for conversion into banks, with suitable safeguards. The IWG deliberated at length on the case for permitting some of the well-run NBFCs owned by large corporate houses. The IWG agreed that the following factors may weigh in favour of this option:

- (i) Some of these NBFCs have been operating under the regulatory framework of the Reserve Bank for a considerable period of time and have managed to

develop niche expertise with strong risk management systems over the years. The Reserve Bank has a direct knowledge of the conduct of these entities over the years, which could be of great help in undertaking the required due diligence.

- (ii) Some of the concerns relating to direct ownership of banks by large corporate/industrial houses may get mitigated in respect of the NBFC route as increasingly, several elements of the prudential framework for banks have already been extended to some of the large NBFCs in view of their systemic importance.
- (iii) The IWG was also apprised of the work underway to introduce a framework for scale-based regulation with a view to identify a small set of 'systemically significant' NBFCs, which can potentially impact financial stability as also to adopt a graded regulatory framework for the NBFCs. Considering conversion of some of these entities into *de-facto* banks from *de jure* bank-like entities may be in alignment with the above approach. It may also help address the regulatory arbitrage issues arising out of systemically large NBFCs and also address the systemic risk such entities may pose given their sheer size.

5.4.21 However, the IWG also recognised that while there may be a case for relaxing the first-level entry filter, if these NBFCs owned by large industrial houses are to be considered for conversion into banks, it would be imperative for them to qualify a stricter set of criteria, as compared to other promoters, such as:

- Meeting all regulatory norms such as capital adequacy ratio, etc.
- GNPA's below and NNPA's below a prescribed threshold, etc.
- No serious regulatory concerns,
- Operating well with net profit made in past 3 years.
- Dilution of the promoter group holding in the NBFC to 49 per cent before application;
- Faster dilution schedule – Maximum promoters' holding to be brought down to 26 per cent in 10 years.

5.4.22 Certain other safeguards, as prescribed in 2013 licensing guidelines may also be suitably considered. The key safeguards suggested in 2013 were as follows:

- Promoter / Promoter Group will be permitted to set up a bank only through a wholly-owned (NOFHC). Other norms as prescribed in 2013 licensing guidelines relating to corporate structure of the NOFHC, shareholding by NOFHC, corporate governance of NOFHC, Prudential Norms for the

NOFHC and their Exposure norms, may also be made applicable, with suitable and requisite amendments.

- They should not be allowed to have their own banking operations through the bank they have promoted.
- Inherent conflict of interest could be addressed through strong regulation relating to connected lending, mutual lending to each other's sponsor groups, ring fencing of the activities, governance standards and exposures which could be clearly addressed through licensing conditions.
- Fit and proper status and background of promoter directors and top executives should be rigorously examined.
- No objection certificate of the promoters' credentials, integrity and background should be taken not only from banks and other regulatory agencies but also from investigating agencies like Central Bureau of Investigation, Enforcement Directorate, Income Tax authorities, etc.
- Large corporate/industrial houses promoting banks must have diversified ownership.
- Promoter / Promoter Groups' business model and business culture should not be misaligned with the banking model and their business 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.

5.4.23 Depending on experience gained after say 5 years, with conversion of NBFCs into banks, the Reserve Bank may review the policies in this regard to either tighten or relax policy.

Recommendations

- 14) Large corporate/industrial houses may be permitted to promote banks only after necessary amendments to the Banking Regulations Act, 1949 to deal with connected lending and exposures between the banks and other financial and non-financial group entities; and strengthening of the supervisory mechanism for large conglomerates, including consolidated supervision. RBI may examine the necessary legal provisions that may be required to deal with all concerns in this regard.**
- 15) Well run large NBFCs, with an asset size of ₹50,000 crore and above, including those which are owned by a corporate house, may be permitted to convert to banks provided they have completed 10 years of operations and meet the due diligence criterion and satisfy the conditions mentioned at para 5.4.22 and 5.4.23 above.**

- 16) In any case, as part of the framework for scale-based regulation of NBFCs, the Reserve Bank may consider putting in place a tighter, bank-like regulatory framework for such large NBFCs.
- 17) With regard to individuals and entities/groups, the provisions of the extant on-tap licensing on universal banks and SFBs are appropriate and do not warrant any change. However:
 - a. The criteria for individuals may be made consistent between universal banks and SFBs to include individuals / professionals who are residents (as defined in FEMA Regulations, as amended from time to time) and Indian Citizen (as defined in Citizenship Act, 1955).
 - b. As regards entities/groups, the eligibility criteria may explicitly specify that the entities / groups should be owned and controlled by 'resident Indian citizens' (as defined in Foreign Exchange Management Regulations, as amended from time to time).
- 18) The minimum requirement on track record of experience of promoting entity, including for a converting NBFC, may continue at 10 years for Universal banks and 5 years for SFBs, as hitherto. However, for a PB intending to convert into an SFB, track record of 3 years of experience as PB may be sufficient.

5.5 Initial Capital

5.5.1 Initial paid-up capital is one of the entry conditions for issuing a banking licence. While merely meeting the entry condition of minimum paid up capital does not guarantee a banking licence, the minimum prescription does set an important filter for the credibility of the bank as a relatively high level of financial strength of the promoters who are granted banking licences will signal the inherent strength of a new bank.

5.5.2 Ever since the Reserve Bank has considered issuing more banking licences in the past decade, the prescription of minimum capital requirement has varied depending upon the type of banking licence being issued and the occasion. A summary of the recent requirements are as follows:

- The 2013 Universal Bank licensing guidelines prescribed the initial minimum paid-up voting equity capital requirement as ₹500 crore and for the NBFCs converting into a bank, the minimum net worth requirement of ₹500 crore.

- The 2014 Small Finance Bank (SFB) licensing guidelines prescribed minimum paid-up equity capital requirement as ₹100 crore and for the NBFCs which are converting into a SFB, the minimum net worth as ₹100 crore. Subsequently in the licences that were issued to the SFBs, it was also stipulated that the minimum net worth of ₹100 crore should be maintained at all times.
- The 2014 licensing guidelines for PBs prescribed minimum paid-up equity capital as ₹100 crore. Subsequently in the licences that were issued to the PBs, it was also stipulated that the minimum net worth of ₹100 crore should be maintained at all times.
- The 2016 on-tap Universal Bank licensing guidelines retained the minimum paid-up voting equity capital requirement at the level prescribed in the 2013 Universal Bank licensing guidelines i.e. ₹500 crore and also stipulated that the bank shall maintain minimum net worth of ₹500 crore at all times. Also, in case of conversion of NBFCs into banks, the converting entity, and thereafter the bank, was required to have a minimum net worth of ₹500 crore at all times.
- The 2019 on-tap SFB licensing guidelines have increased the paid-up voting equity capital requirement to ₹200 crore as compared to ₹100 crore prescribed in 2014 SFB licensing guidelines. In case of NBFC/MFI/LAB converting into an SFB under 2019 on-tap SFB guidelines, the minimum net worth requirement of ₹200 crore should be achieved within 18 months of 'in-principle' approval or as on the date of commencement of operations. Further, for Primary UCBs converting into SFB, the initial minimum net worth requirement is ₹100 crore which should be increased to ₹200 crore within 5 years from the date of commencement of business.

5.5.3 The IWG considered whether there is a requirement to revisit the minimum capital requirements for banking licence since the last stipulation for universal banks came nearly seven years ago and 2016 guidelines merely reiterated the minimum capital requirements of the 2013 guidelines. Moreover, having shifted to an on-tap licensing regime, it was imperative that a periodic reset of minimum capital requirements may also be considered.

5.5.4 The experts with whom the IWG interacted were of the opinion that the current stipulation of capital requirement for universal banks is not very high and not a hurdle for entry of new banks. Since maintenance of minimum CRAR is prescribed, as the bank grows, it will automatically have to augment the capital.

Moreover, in a well laid business plan, capital will rise automatically over the period through internal accruals and strategic or tactical capital raising from the market. However, the minimum initial capital requirements have to be in consonance with the investment requirements for starting a new bank. The advent of cutting-edge technologies coupled with customer's demand for safe and more user-friendly banking experience has led the banks and financial services to readily adopt fintech. New banks which will be set up will, therefore, have to invest heavily in technology to provide cost effective and quick financial services.

5.5.5 It was estimated by the experts that the initial IT infrastructure alone requires investments to the tune of ₹200 to 300 crore by the banks. Apart from that the new banks will also have to invest heavily to develop their branch infrastructure. Given that public trust is the most important asset for a banking business, higher initial capital also helps in maintaining higher capital adequacy ratio in initial years, which builds confidence of all the stakeholders in bank.

5.5.6 It was also argued that high capital provides stability to the banks, and the requirement of higher capital will enable banks to diversify during initial years of operations itself. While the experts could not agree on a single ideal minimum initial capital requirement, majority of the suggestions varied from ₹600 crore to ₹2000 crore.

5.5.7 There was also a suggestion that minimum capital requirement should be reviewed every five years. It was suggested that in order to adjust for inflation, increase in the capital requirement (say 20 per cent) could be considered.

5.5.8 When it came to SFBs, most of the experts agreed that the minimum capital requirement prescription at ₹200 crore was sufficient at this point of time as it was prescribed as recently as 2019 only. However, there were also views that since the initial investment requirements in IT infrastructure and branch network for a new SFBs are comparable to that of universal banks, there could be a case for increasing the minimum capital requirement for SFBs to ₹500 crore. It was also agreed that an SFB should be permitted to convert into a universal bank only upon satisfying the minimum capital requirements prescribed for a universal bank.

5.5.9 The IWG, therefore, is of the view that the minimum initial capital requirement should be in alignment with the investment requirements for setting up a new

banking business, which varies with time. Moreover, since the last prescription for minimum capital requirements for universal banks came in 2013, it will have to be readjusted for the inflation since 2013 and to meet the enhanced capital expenditure requirements for starting a new business. This prescription also has to be sufficiently high to deter non-serious applicants from making applications for banking licences in the absence of any deterrence in the form of application fees. The CPI index has grown at a CAGR of 5.21 per cent since 2012-13. Using the same growth, ₹500 crore in 2012-13 would be equivalent to ₹714 crore in 2020. Considering the same, and to provide space for banks to start with a high capital adequacy ratio to build public trust, the IWG felt that the minimum capital requirement for universal banks should be increased to ₹1000 crore.

5.5.10 For SFBs, the IWG observed that the requirements for initial capital to set up or transform had been enhanced recently in 2019, and it could be too early to increase these prescriptions. However, the IWG observed that out of 10 SFBs set up under 2014 guidelines (where requirement for initial capital/net-worth was only ₹100 crore), seven had started with net worth of more than ₹300 crore and net worth of remaining three crossed the level of ₹300 crore within a span of one to three years from commencement of their business. It indicates that even in 2014 the applicants themselves were cognizant of higher capital requirement of around ₹300 crore. In view of above, the IWG thought it appropriate to suggest raising initial capital requirement for setting up an SFB to more realistic level of ₹300 crore as signaled by the market.

5.5.11 For UCBs converting to SFBs, the extant instructions are to permit commencement of operations at 50 per cent of the minimum capital requirement for setting up a new SFB, and to give a time period over which it has to reach 100 per cent. The increase in minimum capital requirement for setting up an SFB, thus, will increase the initial capital requirement for such converting UCBs.

5.5.12 The IWG also noted that the extant licensing guidelines use various terms for capital such as ‘equity capital’, ‘paid-up equity capital’, ‘paid-up equity shares’ and ‘paid-up voting equity capital’ while prescribing the minimum capital requirements or dilution schedules. After the amendments in B R Act in 2013, capital of banking company may consists of equity shares only (which have voting rights) or equity

shares and preference shares¹² (which have no voting rights), and considering that control by shareholders is basically exercised through voting rights, it is necessary to use a term which clearly defines such voting capital. In view of above and for greater clarity, consistency and legal certainty, the IWG felt that the term **‘paid up voting equity share capital’**, should be used in all guidelines and instructions by the Reserve Bank in this regard.

Recommendations

- 19) **The minimum initial capital requirement for licensing new banks should be enhanced as below:**
 - (i) **For Universal banks: The initial paid-up voting equity share capital/ net worth required to set up a new universal bank, may be increased to ₹1000 crore.**
 - (ii) **For Small Finance Banks: The initial paid-up voting equity share capital/ net worth required to set up a new SFB, may be increased to ₹300 crore.**
 - (iii) **For UCBs transiting to SFBs: The initial paid-up voting equity share capital/ net worth should be ₹150 crore which has to be increased to ₹300 crore in five years.**
- 20) **As the licensing guidelines are now on continuing basis (on-tap), the Reserve Bank may put a system to review the initial paid up voting equity share capital/net-worth requirement for each category of banks, once in five years.**
- 21) **The IWG also recommends uniform usage of the term ‘paid-up voting equity share capital’ in all its guidelines and instructions.**

5.6 Corporate Structure – Non-operative Financial Holding Company

5.6.1 The organisation of businesses within banking groups in India has evolved from a model in which the bank acts as a holding company with the non-banking activities undertaken through subsidiaries and associate entities to a model in which all the financial sector entities belonging to a group are held under a holding company. A decisive shift towards holding company structure happened post 2013 when the new banks were required to be held by the promoters only through a

¹² Vide Section 12(1)(ii) of the Banking Regulation Act, 1949.

NOFHC. This paradigm shift was motivated by the perceived advantages of a financial holding company structure which includes capital ring fencing, controlled contagion within a group, ring-fencing of the balance sheet of banks from other activities of the group, separation of control of banks and other entities in the group, better regulatory oversight, alleviation of regulatory arbitrage and neater resolution of financial stress within the group.

5.6.2 While the 2013 licensing guidelines required the NOFHC to be completely held by the promoter of the bank, the 2016 guidelines relaxed the requirement to majority holding by the promoters. Further, while NOFHC was mandatory under all cases in 2013 guidelines, the requirement was modified in 2016 guidelines to NOFHC being mandatory only in cases where there is at least another entity, not necessarily a financial entity, in the group apart from the bank. In all cases with NOFHCs, all regulated financial services entities, including the bank, belonging to a corporate group had to be held through the NOFHC whereas the other business had to be necessarily held outside the NOFHC. The 2016 guidelines refined the above to NOFHC holding only those financial services entities in which the individual Promoter(s) / group have significant influence or control.

5.6.3 Various controls were also prescribed for cross-investments and exposures between the financial entities held through the NOFHC as well as between the entities held under the NOFHC and those held outside. For instance, the NOFHC and the entities held under it shall not have any exposure to the Promoter Group except for the exposure of NOFHC to the entities held under it. Also, the bank shall not take any exposure on the Promoters / Promoter Group entities or individuals associated with the Promoter Group or the NOFHC, including any financial entities held by the NOFHC. Further, banks had to undertake all activities which can be undertaken departmentally, from within the bank. All other activities, which were required to be conducted only through a separate subsidiary/associate/JV, should be conducted through a separate entity held under the NOFHC. However, if the promoters desired to continue existing specialized activities from a separate entity proposed to be held under the NOFHC, prior approval from the Reserve Bank would be required and it should be ensured that similar activities are not conducted through the bank. Further, entities under the NOFHC would not be permitted to engage in activities that the bank is not permitted to engage in. As regards SFBs and PBs, NOFHC is not mandatory even though they could adopt the holding company structure at their discretion.

Issues considered

5.6.4 Most of the experts with whom the IWG interacted with were of the view that a holding company structure is a desired format to achieve the necessary ring-fencing objectives and hence may be sustained. Regarding applicability of NOFHC structure for legacy cases, some were of the view that, to create a level playing field, even these banks should also be brought under NOFHC structure. However, this requirement must be imposed after resolving the issue of concessions such as waiver of stamp duty, tax exemptions from government, relaxations from other hurdles such as SEBI/other statutory requirements, etc. Sufficient time also need to be provided for transition in a non-disruptive manner. Some other experts were of the view that existing bank set up under licensing guidelines prior to 2013 guidelines should not be forced to be move to NOFHC structure as it involves several disruptive issues; it could lead to legal and constitutional complexities; it could seriously impair their market capitalisation, which would impact their capital raising ability; it could take a very long time and would involve a complex process of restructuring; it would be an unnecessary diversion of managerial bandwidth; it will burden these banks and financial companies with expensive and unnecessary costs; there is no such mandatory requirement in several developed countries. Some experts opined that Reserve Bank should also allow reverse merger of NOFHC, in case a bank does not have any other business entity and wants to do so. It was also suggested that to address issue of regulatory arbitrage, the term ‘similar activity’ should clearly be defined.

5.6.5 The IWG observed that even under the NOFHC structure, there are significant differences in the way corporate structure could be organized in 2013 and 2016 licensing guidelines. The issue of harmonisation between the two sets of NOFHC guidelines was the first issue for review. The IWG agreed that the 2016 guidelines provide a nuanced and much better template and should be the preferred approach going forward. **As regards the banks set up under the 2013 guidelines, they may be given an opportunity, at their discretion, to reorient their structures in compliance with the 2016 guidelines.**

5.6.6 Another key issue deliberated by the IWG was the harmonisation of corporate structures of legacy banks set up before 2013. As also opined by various experts, while harmonisation may be desirable, the costs of the same must be recognised. Restructuring of a sufficiently diversified group to fit into an NOFHC structure may involve substantial legal costs and tax implications.

5.6.7 The IWG considered the above views and concluded that convergence of corporate structures of the banking companies may be desirable in the long run for a level playing field and efficiency in regulation and supervision. However, given the large number of banks (20) and their existing subsidiaries (88), the perfect alignment of the regulatory framework and migration of existing banks from ‘bank-subsidiary’ model to ‘holding company’ structure may appear challenging as it would entail a long drawn out process of reorganisation of existing activities and significant changes in the holding structure which would cause significant disruptions for banks. Further, the enabling tax-neutral transition framework is absent.

5.6.8 The IWG felt that the Reserve Bank should first engage with the Government to ensure that the tax provisions treat the NOFHC as a pass-through structure, thus removing taxation on dividends by the bank at two levels before reaching the ultimate investors. Only once the tax neutral structure is in place should a convergence of all banks towards a holding company structure be considered. Till then, the convergence could be at the discretion of a bank. The corporate structure of the NOFHC may be modelled broadly on the lines suggested by Reserve Bank in the Guidelines for Licensing of New Banks in the private sector dated February 2013.

5.6.9 Even after the tax neutral status for NOFHC, considering the differential complexities in each case, a hard deadline specified by the Reserve Bank towards the convergence may not be feasible. Rather, each bank may be asked to draw up transition plans with a 5-year horizon.

5.6.10 Till such time the bank converts to a NOFHC structure, the issues relating to regulatory arbitrage and spill over risks that are sought to be addressed through the NOFHC structure may be enforced through regulations.

Regulations for legacy banks till conversion to NOFHC

5.6.11 The IWG observed that the general principle in this regard should be that no existing subsidiary/JV/associate of a bank should be allowed to engage in similar activity that a bank is permitted to undertake departmentally. The term ‘similar activity’ may be defined clearly. Further, banks should not be permitted to form/acquire/associate with any new entity [subsidiary, JV or Associate (>20% stake – signifying significant influence or control)] for any financial activity. However, investments in Asset Reconstruction Companies (ARCs) may be as per extant norms. During this period, banks should also not be allowed to invest in the

equity / debt capital instruments of any of its existing subsidiary/JV/associate of a bank. However, they may be allowed to make total investments in financial or non-financial services company which is not a subsidiary/JV/associate upto 20 per cent of the bank's paid up share capital and reserves, subject to all other conditions of the Reserve Bank guidelines on para-banking.

5.6.12 Considering the above principles, the Reserve Bank may frame suitable regulations, also drawing from the principles laid down in the 2013 NOFHC guidelines. A reasonable timeline of two years may be provided to banks to review and reorganize their subsidiaries/JVs/associates in line with these principles.

5.6.13 In this context, the IWG also weighed the necessity of having a formal legal framework for regulation of NOFHCs and the intra-group activities within an NOFHC. The Group noted that the Working Group on Introduction of Financial Holding Company Structure in India (Chair: Smt. Shyamala Gopinath, 2011) had recommended a new law laying down a separate regulatory and supervisory framework for holding companies. After detailed deliberations, the IWG took a view that the NOFHC structure has been introduced for all new licences issued after 2014, with the NOFHC being regulated as a separate class of NBFC. This structure has been working fine and the absence of a separate law has not been perceived to be a hindrance. However, the IWG stressed on the recommendation made earlier regarding a legal framework for addressing concerns regarding intra-group transactions and exposures, which would be relevant here as well.

5.4.14 The IWG also agreed with the recommendation made by the Working Group on Introduction of Financial Holding Company Structure in India that the PSBs also need to be brought under the NOFHC model which will require suitable amendments to various Acts, including the State Bank of India Act, 1955 and the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/1980.

Recommendations

- 22) NOFHCs should continue to be the preferred structure for all new licenses to be issued for Universal Banks. However, NOFHC may be mandatory only in cases where the individual promoters / promoting entities / converting entities have other group entities.**
- 23) Banks currently under NOFHC structure may be allowed to exit from such a structure if they do not have other group entities in their fold.**

- 24) While banks licensed before 2013 may move to an NOFHC structure at their discretion, once the NOFHC structure attains a tax-neutral status, all banks licensed before 2013 shall move to the NOFHC structure within 5 years from announcement of tax-neutrality.
- 25) The Reserve Bank should engage with the Government to ensure that the tax provisions treat the NOFHC as a pass-through structure.
- 26) The concerns with regard to banks undertaking different activities through subsidiaries/JVs/associates need to be addressed through suitable regulations till the NOFHC structure is made feasible and operational. The Reserve Bank may frame suitable regulations in this regard *inter alia* incorporating the following and the banks must be required to fully comply with these regulations within a period of two years.
- The bank and its existing subsidiaries/JVs/associates should not be allowed to engage in similar activity that a bank is permitted to undertake departmentally. The term ‘similar activity’ may be defined clearly.
 - If a group entity desires to continue undertaking any lending activity, the same shall not be undertaken by the bank departmentally and the group entity shall be subject to the prudential norms as applicable to banks for the respective business activity.
 - Banks should not be permitted to form/acquire/associate with any new entity [subsidiary, JV or Associate (>20% stake – signifying significant influence or control)] or make fresh investments in existing subsidiary/JV/associate for any financial activity. Investments in ARCs may be as per extant norms.
 - However, banks may be permitted to make total investments in financial or non-financial services company which is not a subsidiary/JV/associate upto 20 per cent of the bank’s paid up share capital and reserves, subject to all other conditions of the Reserve Bank guidelines on para-banking.
 - Banks should put in place group-wide capital management policy with respect to risks faced by its subsidiaries/JVs/associates, subject to supervisory review.

5.7 Listing Requirements

5.7.1 Banking regulation prefers wider shareholding in banks to concentrated shareholding. This preference has been enshrined in Pillar III of the Basel guidelines which focuses on market discipline that requires distributed shareholding in the banks to be effective. In this line, the previous licensing guidelines required that the newly licensed bank should be mandatorily listed after operating for a certain number of years.

5.7.2 By end of September 2020, out of 22 universal banks in the private sector, 20 are listed and two (Tamilnad Mercantile Bank and Nainital Bank) are yet to be listed. Out of 10 SFBs, two are listed (AU SFB and Ujjivan SFB). No Local Area Banks and PBs is listed so far.

5.7.3 While the earlier guidelines did not prescribe any norms for listing timelines, the 2013 universal bank licensing guidelines (which required ₹500 crore as initial capital/net worth) prescribed that the banks shall get their shares listed on the stock exchanges within 3 years of commencement of business. On the similar lines, the 2014 SFB and PBs licensing guidelines mandated listing within 3 years from the date of reaching net worth of ₹500 crore (i.e. the then entry level capital requirement for universal banks).

5.7.4 The 2016 on-tap Universal Bank licensing guidelines relaxed the listing time to 6 years to eliminate the inconsistency between the mandatory lock-in period of 5 years for promoters' shareholding and the listing requirement. However, 2014 SFBs/PBs guidelines were not relaxed and even 2019 on-tap SFB guidelines prescribed norm of 3 years, though these banks also had a mandatory lock-in period of 5 years.

5.7.5 A newly set up bank may need the initial two to three years to focus on building its business and expansion of customer base. It takes another two to three years to gain investor's confidence in the market before listing. Hence, period of six years from the commencement of operations may give sufficient time for a bank to stabilize its performance and gain the investors' confidence. Further, as per SEBI (Listing Obligations and Disclosure Requirements) norms, there is a requirement for listing of certain average pre-tax operating profit for preceding three years for listing which may be challenging for new banks trying to build their businesses. Thus the

listing requirements for universal banks should provide reasonable time for a new bank to consolidate its operations before inviting public shareholding.

5.7.6 However, for SFBs the listing timeline appeared too short to the IWG. Majority of the experts with whom the IWG met were also of the opinion that the listing requirements for the SFBs should be harmonised with that for the universal banks. The experts suggested that SFBs may be required to list 'within three years upon achieving a net worth of ₹500 crore' or 'six years of date of commencement of operations', whichever is later. The experts generally agreed that rushing the listing timelines will result in the management of the new banks having to devote disproportionate attention to listing requirements during the initial years of operations rather than the operations of the bank itself.

5.7.7 While it is true that the three years' timeline for listing for SFBs and PBs is from the date of achieving net worth of ₹500 crore, and not from the commencement of operations, the IWG observed that 80 per cent SFBs were set up either with net worth above ₹500 crore or crossed this benchmark within a short period of one to two years from commencement of business, and thus effectively such SFBs were required to get listed much before 6 years (within 3 to 5 years).

5.7.8 If the capital is taken as benchmark, and the harmony in listing norms is to be provided, the SFBs and PBs should be listed within 6 years after crossing the level of initial capital prescribed for universal banks. However, such existing SFBs and PBs which are much below this benchmark, have already got sufficient time for consolidation, expansion and stabilisation. If they are provided time of 6 years from crossing benchmark of ₹500 crore (or proposed ₹1000 crore), it will provide them an unduly long time for listing. It is also possible that some of them intentionally may not cross this benchmark to avoid listing. Such a situation does not auger well for transparency and good governance standards, which are expected from banks. Further, listing also provides a way for the promoters to comply with the requirements for dilution of their shareholding. Hence, the IWG is of the view that an upper limit of 10 years is required for listing of such banks, which do not cross the benchmark.

Recommendations

27) SFBs to be set up in future: Such banks should be listed within 'six years from the date of reaching net worth equivalent to prevalent entry

capital requirement prescribed for universal banks' or 'ten years from the date of commencement of operations', whichever is earlier.

- 28) For existing SFBs and PBs : Such banks should be listed 'within six years from the date of reaching net worth of ₹500 crore' or 'ten years from the date of commencement of operations', whichever is earlier.
- 29) Universal banks: Such banks shall continue to be listed within six years of commencement of operations.

5.8 Fit and Proper Criteria

5.8.1 One of the major concerns that arise in context of corporate governance in banks is the type of people who control the bank. As the major shareholders/promoters, act as trustees, it is necessary that they must be 'fit and proper' for the deployment of funds entrusted to them. The various guidelines issued by the Reserve Bank refer to the 'fit and proper' status of the persons holding shares of banks and also prescribed illustrative/broad criteria to check their 'fit and proper' status, as illustrated below:

- [Guidelines for Acknowledgement of Transfer/Allotment of Shares in private sector banks dated February 3, 2004](#): The guidelines have provided illustrative criteria to determine whether the person is 'fit and proper' to acquire (i) more than 5 per cent but less than 10 per cent (ii) between 10 per cent to 30 per cent; and (iii) more than 30 per cent in private sector banks.
- [Master Direction on 'Prior Approval for Acquisition of Shares or Voting Rights in private sector banks' dated November 19, 2015](#): The Chapter V of the Master Direction has prescribed illustrative criteria for determining whether a person is 'fit and proper' to acquire (i) more than 5 per cent but up to 10 per cent (ii) more than 10 per cent in a private sector bank. Further, in terms of Chapter VI of the said MD, it is the responsibility of the concerned bank to continuously monitor and ensure that all its major shareholders are 'fit and proper' through the declarations provided by major shareholder (as defined in MD on Prior Approval) and its own investigations.
- [Guidelines for 'on tap' Licensing of Universal Banks in the Private Sector – 2016](#): Separate criteria have been prescribed for individuals and entities / NBFCs, being promoters.
- [Guidelines for 'on tap' Licensing of Small Finance Banks in the Private Sector-2019](#): Though specific criteria to assess 'fit and proper' status have not been prescribed, it has been stated in these guidelines that the Reserve Bank

would assess the ‘fit and proper’ status of the applicants on the basis of their past record of sound credentials and integrity; financial soundness and successful track record of professional experience or of running their businesses, etc. for at least a period of five years.

5.8.2 Thus, the ‘fit and proper’ criteria have been laid down in different guidelines.

5.8.3 The Standing Committee of Finance (SCF) on Banking Regulation (Amendment) Bill, 2005 had noted that necessity to meet ‘fit and proper criteria’ by the person who intends to acquire more than 5 per cent holding in a bank is with the view that the ownership is in the hands of fit and proper persons, who can be trusted to judiciously exercise their voting rights in respect of matters involving public funds, and elect fit and proper persons to manage the affairs of a bank. The Committee was further informed by the Ministry that criteria for ‘fit and proper’ was not included in Section 12B amendment proposal because Ministry wants the Reserve Bank to have the flexibility in case they want to add something to it later, they can do so. Thus, the legislative intent also has been to give flexibility to the Reserve Bank for prescribing rules for assessment of ‘fit and proper’ status, and hard coding the same may reduce the available flexibility.

5.8.4 The IWG noted that the Reserve Bank has already provided illustrative criteria for determining ‘fit and proper’ status of applicants in [Master Direction on Prior Approval for Acquisition of Shares or Voting Rights in private sector banks – 2015](#) and suggests no change in the extant norms. It also felt that discretion may be with the Reserve Bank for prescribing rules for assessment of ‘fit and proper’ status, and not hard coding the same as it may reduce the available flexibility.

Recommendations

30) **The criteria to assess ‘fit and proper’ status of promoters/major shareholders as prescribed in the ‘Guidelines for on tap Licensing of Universal Banks in the Private Sector – 2016’ and in ‘[Master Directions on Prior Approval for Acquisition of Shares or Voting Rights in private sector banks - dated November 19, 2015](#)’ are appropriate and may be continued. Going forward, a harmonised approach may be adopted in various guidelines.**

5.9 Issue of harmonisation of various licensing guidelines

5.9.1 Since beginning of licensing guidelines for private sector banks in 1993 to end of September 2020, eight licensing guidelines have been issued by Reserve Bank, of which four are for universal banks and four pertain to Differentiated Banks. As the environment in which the banks operate has been dynamic and the specific contours keep evolving in the area of banking, economy, regulatory norms and statutory provisions, certain specific prescriptions in each licensing guidelines also have been altered or fine-tuned or adjusted to keep pace with emerging requirements.

5.9.2 While for differentiated bank certain prescriptions had to differ on account of variances in nature and scope of their work, differences in prescription in licensing of universal banks which have been issued at different points of time, have sometime led to difficulties in applying uniform/harmonized approach to achieve the objective of level playing field. Certain provisions of a new licensing guidelines may be more relaxed/tighter than the existing licensing guidelines. The issue which arises is that whether all the new norms may be imposed on existing banks or existing banks should be allowed to be governed by provisions laid down under the licensing guideline under which they were set up.

5.9.3 After considering the opinion furnished by the experts on this issue and further deliberations, the IWG is of the view that existing banks also have to be covered with provisions of new licensing guidelines because new provisions generally seek to plug lacunae in the existing system. Further, harmonisation of all guidelines is desirable to create a level playing field.

5.9.4 While the some of the new norms may be more relaxed, some may be tougher than the existing norms. If new rules are more relaxed, benefit should be given to existing banks, immediately. If new rules are tougher, legacy banks should also confirm to new tighter regulations, but timelines/ graduated smooth transition path should be finalized in consultation with affected banks to ensure implementation in non-disruptive manner. Inclusion of a condition in the T&C of licence, that as and when new guidelines are issued and if there is any change in any existing prescription/norm, the bank will have to adhere to the modified prescription/norm, in the manner defined by Reserve Bank and in the time-line prescribed by Reserve Bank, would be helpful to bring clarity.

Recommendations

- 31) Whenever a new licensing guideline is issued, if new rules are more relaxed, benefit should be given to existing banks, immediately. If new rules are tougher, legacy banks should also confirm to new tighter regulations, but transition path may be finalised in consultation with affected banks to ensure compliance with new norms in a non-disruptive manner.
- 32) As and when the changes in certain norms, as recommended by the IWG in this report are accepted by Reserve Bank, these should be made applicable to existing banks also, in the manner as prescribed in previous paragraph.
- 33) As the licensing is now on-tap, Reserve Bank may prepare a comprehensive document encompassing all licensing and ownership guidelines at one place, with as much harmonisation and uniformity as possible, providing clear definition of all major terms. These may be equally applicable to legacy and new banks. This may be updated from time to time depending on emerging requirements. It will also provide flexibility to Reserve Bank to fine tune the instructions, at a short notice, through small relevant amendment in this document.

Annex I : Summary of Experts' Views

The IWG interacted with selected experts from the field of accountancy and legal, practitioners, MD & CEOs of certain banks and a few senior retired regulators. The views expressed by them are summarised in the following paragraphs.

1. Initial Capital:

Most of the experts were of the view that the initial capital to be increased for all types of banks. For universal banks the range of suggestions varied from ₹600 crore to ₹2,000 crore. One felt that there is no need to raise it as prescription for maintenance of CRAR may take care of capital requirement. For SFBs, while one opined that it may be raised to ₹500 crore, one felt that it may be half of the requirement fixed for universal banks, many had a view that it may continue at existing level. The experts felt that the higher initial capital will help the bank in the initial days when the management can concentrate on the business instead of raising resources for capital. Further, the initial cost in developing IT and branch network, etc. is huge even for SFBs and for such expenditures about ₹200 crore capital is required in the beginning. For transition of SFB to universal bank SFB should meet minimum capital requirement of universal bank. Experts also had a view that licensing guidelines now being on-tap, minimum capital requirement should be reviewed every five years.

2. Eligibility criteria:

All the experts except one were of the opinion that large corporate/industrial houses should not be allowed to promote a bank. The main reason being the prevailing corporate governance culture in corporate houses is not up to the international standard and it will be difficult to ring fence the non-financial activities of the promoters with that of the bank. Stress in non-financial activity may spill over to bank. The corporate houses may either provide undue credit to their own businesses or may favour lending to their close business associates. They may influence lending by the bank, to finance the supply and distribution chains and customers of the group's non-financial businesses, thereby creating unreported risk to the bank. There are various ways of circumventing the regulations on connected lending and due to complex structures of entities, cross holding of capital, the disbursement/diversion of funds to group concerns is difficult to check. It is difficult to prevent influence of corporate houses on the Board in such banks. Assessing 'fit and proper' status of the promoters and its large number of group entities is very difficult. As far as fulfilling need of capital is concerned, it is not difficult to attract capital from sources other than corporate houses, for well governed banks. With well-developed equity market in India, well governed banks have been successful in raising capital from public. There is also a need to significantly scale up regulatory and supervision capacity before permitting corporate/ industrial houses to promote banks.

On the issue of large NBFCs to promote or convert into banks, almost all the experts were of the view that large NBFCs, with good track record should be encouraged to convert into a bank as this will result in better regulation of these entities. Large NBFCs beyond a certain size need to be regulated like banks. It will also reduce chances of regulatory arbitrage. The criteria to determine large NBFC can be based on minimum asset size which varied from ₹5,000 crore to ₹10,000 crore, and good track record for minimum 10 years. On conversion to banks, they may be given a glide path for compliance with norms as applicable to banks. Some of the experts were of the view that in case corporate promoted large NBFCs are allowed to be converted into bank, either the corporate should bring down their stake to 10 per cent (which is presently being allowed) or bank should be properly ring fenced with the non-financial activities of the promoter group, through prescription of group exposure limits, etc. Almost all the experts stated that promoting entities

of the bank should be owned and controlled by residents, while in the bank the foreign shareholding can be up to the present permissible FDI limit of 74 per cent.

3. Promoters' shareholding:

The views of the experts were wide ranging with some agreeing to the present prescription, while other had divergent views. The divergent views are summarised as under:

- (i) Promoters' shareholding cap can be up to 26 per cent in the long run (15 years) with initial capital 40% being locked in for 5 years. The P. J. Nayak Committee, in 2014, recommended promoter holding of 25% recognising that low promoter shareholding could make banks vulnerable by weakening the alignment between management and shareholders. There is no need to have a wide divergence between economic interest and voting rights. As voting rights are capped at 26% through statute, shareholding of promoters could also be permitted between 20 to 25%. Both shareholding and voting rights should be aligned in long run. Diversified ownership in banks may not be an effective tool to enforce good governance. Excessive focus on limits on economic ownership seems contrary to legislative intent. Voting control achieves the policy parameters of diversified ownership. International practices do not enforce similar limits on bank ownership
- (ii) Reserve Bank may allow two types of new banks to be set up – one by promoters and another by non-promoters. Present dilution schedule can continue for the banks set up by promoters. In case of banks set up by several non-promoters investors, where since inception the equity may be held widely, without having any major shareholder - none of the investors may be allowed to have more than 5 per cent stake. If any institutional investor is allowed to have maximum 10 per cent stake, voting rights may be restricted to 5 per cent.
- (iii) Promoter group can be defined more broadly. Group of individuals/entities with good track record can be allowed to promote a bank and the shareholding can be well diversified right from the beginning.
- (iv) For well diversified and regulated financial institutions the cap on shareholding in long run can be up to 40 per cent as allowed presently.
- (v) Some experts opined that present dilution schedule prescribed for 'on-tap' universal bank guidelines is appropriate. However, some were of view that dilution schedule can be without smaller milestones i.e. 5/10/15 years. If the objective of Reserve Bank is to achieve well diversified shareholding in the bank in long run, and if some banks achieves the diversification through dilution of promoters' holding much before the prescribed timeline, Reserve Bank should consider and allow such dilution.
- (vi) The initial minimum promoters' shareholding requirement may be reduced to 26 per cent from existing requirement of 40 per cent as there may be good professional bankers who want to set up a bank but individually they cannot meet high initial capital requirements.
- (vii) Lock in of should be for first 5 years to ensure promoters' interest in the bank.
- (viii) On voting rights, some experts suggested that differential limits for shareholding and voting rights are not required. If it is decided to have differential prescriptions for shareholding and voting rights, there should not be too much deviation between the two. Effective voting right must be kept in mind (in case of higher holding, effectively voting right is more). Beneficial ownership of shares should also be taken into account, while examining the control. Some experts opined that in long run, there should not be differential limits for shareholding and voting rights. Even if voting rights are curtailed to 10%, it is the higher shareholding which allows investors to wield informal influence over management and the bank.

4. Listing requirement:

Almost all the experts were of the view that the present prescription of listing within 6 years from commencement of operations, for universal bank in the 'on-tap' licensing guidelines can be

followed uniformly including Small Finance Banks, which had been given only 3 years from reaching networth of ₹500 crore. The main arguments for the increase in minimum numbers of years is that 3 years for listing forces the banks to concentrate on listing related arrangements rather than focusing on the stabilisation and business expansion in initial years. In a period of 6 years, a new bank (Universal, SFB or PB) is expected to have matured in its experience in running banking operations, and achieved a critical size which would be ready for additional governance compliance required for listing, as well as regular and quarterly scrutiny and questioning by capital market investors.

5. Applicability of licensing guidelines and need of harmony

Most of the experts had opined that to create a level playing field, the existing and new licensing guidelines had to be harmonised. Legacy banks also have to be covered with provisions of new guidelines because new norms seek to plug lacunae in the existing system. However, any change in licensing conditions for any existing bank, which is more restrictive, could give rise to legal and constitutional complexities, unless the regulator ensures smooth transition by giving sufficient time to existing banks for achieving the tighter norms, adopting a consultative approach. Any relaxation provided in new guidelines should immediately extended to legacy banks.

6. Requirements of NOFHC structure:

- (i) Almost all the experts had a similar view that NOFHC structure is a desirable structure but need not be mandatory, if there is no other group entity, as prescribed in 2016 guidelines.
- (ii) Banks which are financial conglomerates and where various activities like insurance, pension, asset management, etc. are being undertaken by the group, NOFHC structure should be insisted.
- (iii) Regarding applicability of NOFHC structure for legacy cases, some were of the view that to create a level playing field, these banks should also be brought under NOFHC structure. However, this requirement must be imposed after resolving the issue of concessions such as waiver of stamp duty, tax exemptions from government, relaxations from other hurdles such as SEBI/other statutory requirements, etc..Sufficient time also need to be provided for transition in a non-disruptive manner.
- (iv) Some other experts were of the view that banks set up prior to 2013 guidelines should not be forced to move to NOFHC structure for following reasons:
 - a. It involves several disruptive issues
 - b. It could seriously impair their market capitalisation, which would impact their capital raising ability
 - c. It could take a very long time and would involve a complex process of restructuring through a process at the Reserve Bank and NCLT, requiring approvals of shareholders and regulators. It would be an unnecessary diversion of managerial bandwidth to try and fix something which is not broken in the first place.
 - d. It will burden these banks and financial companies with expensive and unnecessary costs arising out of taxes, stamp duties, costs of valuers and fairness opinions, lawyers, costs of taking shareholder approvals, integration costs, etc.
 - e. There is no mandatory requirement of owning banks through a holding company in several developed countries
 - f. Such a step could give rise to legal and constitutional complexities.
- (v) Reserve Bank should also allow reverse merger of NOFHC, if the bank does not have any other business entity and wants to do so.
- (vi) One expert opined that there can be non-risk participation agreement between the bank and subsidiaries with a clause that there will be no commitment for incremental capital contribution by the bank.

- (vii) To address issue of regulatory arbitrage, the term ‘similar activity’ should clearly be defined while advising banks that ‘similar activities’ may not be conducted both by bank and its subsidiary.
- (viii) The Group may identify level of threshold, which would be considered to have control of bank over these entities (subsidiary/associates/JV). Banks may be allowed to hold only up to 20% (or the level identified by the Group) in these entities. If bank want to invest more than this threshold, the bank has to move to NOFHC structure to have such entities.
- (ix) Promoter dilution and listing mandate should be either at the NOFHC level or at the bank level, as decided by the company.
- (x) If the listing is at the NOFHC level, then the caps on promoter holding at the NOFHC should be the same as the caps applicable to a standalone bank
- (xi) All governance rules applicable to a Bank should be made applicable to NOFHC

7. Need to hard coding of ‘fit and proper’ criteria:

All the experts were of the view that the current criteria/ procedure followed to check ‘fit and proper’ status is appropriate. Some of them also felt that licensing should not be a ‘tick box’ approach and the necessary flexibility and discretion should be with Reserve Bank.

8. Issue of ADR/GDR:

To address the issue of major shareholder/promoters influencing voting by depositories through the board of the bank, while one expert was of the view that Reserve Bank may prescribe that decision to advise depositories to vote in a particular fashion may be taken only by independent directors on the board of the bank, another expert was of the opinion that banning the voting by depositories (through depository agreement) may not be a good solution.. Reserve Bank may seek declaration/undertaking from the investors in ADR/GDR that they do not belong to the promoter group. The depositories are to do minimum KYC of their investors. Reserve Bank may consider restrictions such as investment in GDR should be only from FATF compliant counties.

9. Pledge of shares by promoters:

One expert suggested that the minimum holding as prescribed for promoters during lock-in period have to be clear of any encumbrances. Pledge of shares after expiry of lock-in period, should not be of any concern.

Annex II : Comparative position of Licensing Guidelines for Private Sector Banks

Licensing Guidelines →	1993	2001	2013	2014 SFB	2016 On tap Universal	2019 On tap SFB
Banks Licensed	10	2	2	10	None	None
NOFHC Requirement	No reference	No reference	Mandatory	Not mandatory	Not mandatory if promoter/ promoting entity does not have other group entities.	Not mandatory if promoter/ promoting entity does not have other group entities.
Minimum initial paid up capital / net worth	₹100 Cr	₹200 Cr To be raised to ₹300 Cr within 3 years	₹500 Cr	₹100 Cr	₹500 Cr	₹ 200 Cr¹³
Minimum shareholding of promoters (as per cent of paid up capital)	As determined by RBI	40 per cent (raised to 49 per cent in 2002)	40 per cent	40 per cent¹⁴	40 per cent¹⁵	40 per cent
Lock in for promoters' above holding	No reference	5 yr	5 yr	5 yr	5 yr	5 Yr

¹³ For Primary (Urban) Co-operative Banks (UCBs), which are desirous of voluntarily transiting into SFB, minimum net worth of such SFB shall be ₹100 crore from the date of commencement of business. However they will have to increase their minimum net worth to ₹200 crore within five years from the date of commencement of business.

¹⁴ If the existing NBFCs / MFIs / LABs have diluted the promoters' shareholding to below 40%, but above 26%, due to regulatory requirements or otherwise, RBI may not insist on the promoters' minimum initial contribution as indicated in paragraph 6 of the guidelines.

¹⁵ 26% - For NBFCs converting into / promoting a bank which have diluted promoters' shareholding below 40% but above 26% due to regulatory requirements or otherwise

Licensing Guidelines →	1993	2001	2013	2014 SFB	2016 On tap Universal	2019 On tap SFB
Dilution schedule for excess above minimum required capital (as per cent of Paid up voting equity capital) (from date of commencement of business)		After one yr, if holding is above 40 per cent → dilute to 40 per cent (raised to 49 per cent in 2002) ¹⁶	if holding is above 40 per cent → Within 3 yr, dilute to 40 per cent	if holding is above 40 per cent → Within 5 yr, dilute to 40 per cent	if holding is above 40 per cent → Within 5 yr, dilute to 40 per cent	if holding is above 40 per cent → Within 5 yr, dilute to 40 per cent
			Within 10 yr – bring down to 20 per cent	Within 10 yr – bring down to 30 per cent	Within 10 yr – bring down to 30 per cent	Within 10 yr – bring down to 30 per cent
			Within 12 yr – bring down to 15 per cent	Within 12 yr – bring down to 26 per cent	Within 15 yr – bring down to 15 per cent	Within 15 yr – bring down to 15 per cent
Listing requirements	The shares of the bank should be listed on stock exchanges	To be governed by regulations of SEBI regarding public issues and other guidelines applicable to listed banking companies	within 3 years of the commencement of business by the bank.-	within 3 years of net worth reaching to ₹500 crore,	within 6 years of the commencement of business by the bank.	within 3 years of net worth reaching to ₹500 crore,

¹⁶ If time required is more than 1 year, bank to take RBI approval

Annex III : Summary of Licensing Guidelines

(Universal Banks and Differentiated Banks)

By end of September 2020 Reserve Bank has issued eight licensing guidelines, of which four are for universal banks and four pertain to Differentiated Banks as listed below. In addition, a scheme was introduced in September 2018 for voluntary transition of Primary Urban Co-operative Banks into SFBs.

A. Universal Banks licensing guidelines:

- a. Guidelines on Entry of New Private Sector Banks dated January 22, 1993 (1993 guidelines).
- b. Guidelines on entry of new banks in the private sector dated January 3, 2001 (2001 guidelines) and an amendment dated June 7, 2002.
- c. Guidelines for Licensing of New Banks in the Private Sector dated February 22, 2013 (2013 guidelines)
- d. Guidelines for ‘on tap’ Licensing of Universal Banks in the Private Sector dated August 1, 2016 (2016 guidelines)

B. Differentiated Banks licensing guidelines:

- a. Guidelines for Setting up of Local Area Banks in the Private Sector dated August 24, 1996 (1996 guidelines).
- b. Guidelines for Licensing of “Small Finance Banks” in the Private Sector November 27, 2014 (2014 SFB guidelines)
- c. Guidelines for Licensing of “Payments Banks” dated November 27, 2014 (2014 PB guidelines)
- d. Guidelines for ‘on tap’ Licensing of Small Finance Banks in the Private Sector dated December 5, 2019 (2019 ‘on tap’ SFB guidelines)

2. Comparison of major provisions of these guidelines have been summarised below:

(A) Eligibility of Promoters:

Licensing GL	Eligibility of Promoters
Universal Banks	
1993 guidelines	<ol style="list-style-type: none"> 1. No specific eligibility criteria were prescribed. 2. Though there was no explicit ban on setting up banks by Large Industrial Houses, it was to be ensured at the time of licensing that banks avoid the shortcomings, such as, unfair pre-emption and concentration of credit, monopolisation of economic power, cross holdings with large corporate/industrial groups, etc., which beset the private sector banks prior to nationalisation.
2001 guidelines	<ol style="list-style-type: none"> 1. No specific eligibility criteria were prescribed. 2. However, these bank were not allowed to be promoted by a Large Industrial House. Individual companies, directly or indirectly connected with large industrial houses were permitted to participate in the equity of these banks up to a maximum of 10 per cent but were not allowed to have controlling interest in the bank. 3. These banks were to maintain an arms length relationship with business entities in the promoter group and the individual company/ies investing upto 10 per cent of the equity as stipulated above. Such banks were not allowed to extend any credit facilities to the promoters and company/ies investing up to 10 per cent of the equity. 4. Conversion of an NBFC into private sector bank was permitted if it had impeccable track record. The NBFC promoted by a large

Licensing GL	Eligibility of Promoters
	<p>corporate/industrial house or owned/controlled by public authorities, including Local, State or Central Governments, were not eligible. Such converting NBFC was required to have a credit rating of not less than AAA (or its equivalent) in the previous year. NBFC was required to be in compliance with RBI regulations/directions and in repayment of public deposits and no default should have been reported. Such NBFCs were to have capital adequacy of not less than 12 per cent and net NPAs of not more than 5 per cent.</p>
2013 guidelines	<ol style="list-style-type: none"> 1. Entities / groups in the private sector that are owned and controlled by residents, entities in public sector and NBFCs were eligible to set up a bank through a wholly-owned Non-Operative Financial Holding Company (NOFHC). 2. There was no bar on large corporate/industrial houses to be promoters. Banks promoted by groups having 40 per cent or more assets/income from non-financial business required RBI approval for raising capital beyond a threshold 3. Individuals were not allowed to promote a bank.
2016 'on tap' guidelines	<ol style="list-style-type: none"> 1. Resident Individuals (with 10 years of experience in banking and finance) at a senior level and Entities / groups in the private sector that are 'owned and controlled by residents'. 2. NBFCs which are 'controlled by residents' with track record for at least 10 years. <p><u>Exclusion:</u> Large Industrial Houses have been defined and are not allowed to promote a bank but are permitted to invest in the bank up to 10 per cent.</p>
Differentiated Banks	
1996 LAB guidelines	Individuals, corporate entities, trusts and societies could promote a bank.
SFB guidelines (2014)	<ol style="list-style-type: none"> 1. Resident individuals/professionals with 10 years of experience in banking and finance at a senior level; 2. Companies and societies owned and controlled by residents. 3. Existing Non-Banking Financial Companies (NBFCs), Micro Finance Institutions (MFIs), and Local Area Banks (LABs) that are owned and controlled by residents could opt for conversion into small finance banks. 4. Promoter/promoter groups was required to be 'fit and proper' with a sound track record of professional experience or of running their businesses for at least a period of five years <p>Exclusion: Large public sector entities and industrial and business houses, including NBFCs promoted by them were not eligible.</p>
Payments Banks (2014)	<ol style="list-style-type: none"> 1. Existing non-bank Pre-paid Payment Instrument (PPI) issuers; individuals / professionals; NBFCs, corporate Business Correspondents(BCs), mobile telephone companies, super-market chains, companies, real sector cooperatives; which were owned and controlled by residents; and public sector entities. 2. A promoter/promoter group could have a joint venture with an existing scheduled commercial bank to set up a payments bank. However, scheduled commercial bank could take equity stake in a payments bank to the extent permitted under Section 19 (2) of the Banking Regulation Act, 1949.

Licensing GL	Eligibility of Promoters
	3. Promoter/promoter groups was required to be 'fit and proper' with a sound track record of professional experience or running their businesses for at least a period of five years
2019 'on tap' SFB guidelines	<ol style="list-style-type: none"> 1. Resident individuals/professionals (Indian Citizens) with 10 years of experience in banking and finance. 2. Companies and Societies in the private sector that are owned and controlled by residents with track record of 5 years operations. 3. NBFCs, MFIs and LABs with track record of 5 years operations can opt for conversion into SFB. 4. Existing Payments Banks which are controlled by residents and have completed five years of operations are also eligible for conversion into small finance banks. 5. Primary (Urban) Co-operative Banks (UCBs), can opt for conversion into SFB. <p><u>Exclusion:</u> Government owned / public sector entities and large industrial house/ business groups, autonomous boards / bodies set up under enactment of a state legislature, state financial corporations and subsidiaries of development financial institutions are not allowed to promote a bank.</p>

(B) Minimum Promoters' holding and lock-in requirements:

Licensing GL	Minimum promoters' shareholding provisions	Lock-in for minimum promoters' shareholding
Universal Banks		
1993 guidelines	<p>The promoters's holding was to be determined by RBI.</p> <p>RBI had prescribed 40 per cent as minimum shareholding in the terms and conditions for some banks licensed under these guidelines.</p>	No lock-in period.
2001 guidelines	<p>The promoters' contribution was required to be a minimum of 40 per cent of the paid-up capital of the bank.</p> <p>In 2002 – It was prescribed that promoter shall hold a minimum 40 per cent (49 per cent) of the paid-up capital of the bank.</p>	5 years from the <i>date of licensing</i>
2013 guidelines	The NOFHC was to hold a minimum 40 per cent of the paid-up voting equity capital of the bank.	5 years from the <i>date of commencement of business</i>
2016 'on tap' Universal Bank guidelines	<p>The promoter/promoter group/NOFHC shall hold a minimum 40 per cent of the paid-up voting equity capital of the bank.</p> <p>If the existing NBFCs / MFIs / LABs converting into a bank have diluted the promoters' shareholding to below 40</p>	5 years from the <i>date of commencement of business.</i>

Licensing GL	Minimum promoters' shareholding provisions	Lock-in for minimum promoters' shareholding
	per cent, but above 26 per cent, due to regulatory requirements or otherwise, then the minimum shareholding requirement is 26 per cent.	
Differentiated Banks		
1996 LAB guidelines	The promoter should contribute at least ₹ 2 crore out of the minimum paid-up capital requirement of ₹5 crore (i.e. 40 per cent) <i>[Later, in 2003 LABs were advised to attain a networth of ₹25 crore within 5 to 7 years]</i>	No mention of lock-in period.
SFB guidelines (2014)	1. The promoter is to hold a minimum 40 per cent of paid-up equity capital of the SFB. 2. If the existing NBFCs / MFIs / LABs converted into bank have diluted the promoters' shareholding to below 40 per cent, but above 26 per cent, due to regulatory requirements or otherwise then the minimum shareholding requirement is 26 per cent .	5 years from the <i>date of commencement of business</i>
Payments Banks (2014)	The promoter is to hold a minimum 40 per cent of paid-up equity capital of the Payments Banks.	5 years from the <i>date of commencement of business</i>
2019 'on tap' SFB guidelines	1. The promoter shall hold a minimum 40 per cent of paid-up voting equity capital of the SFB. 2. In the case of SFBs which are converted from UCBs, the promoters shall hold a minimum of 26 per cent of paid-up voting equity capital. 3. If the existing NBFCs / MFIs / LABs converted into bank have diluted the promoters' shareholding to below 40 per cent, but above 26 per cent, due to regulatory requirements or otherwise then the minimum shareholding requirement is 26 per cent .	5 years from the <i>date of commencement of business</i>

(C) Dilution Schedule:

Licensing GL	Dilution Schedule
Universal Banks	
1993 guidelines	No dilution schedule prescribed. However, it was mentioned in the guidelines that the promoters' holding shall be determined by RBI.
2001 guidelines (amended in 2002)	Promoters' contribution in excess of the 40 per cent, was required to be diluted after one year of the bank's operations. (In case divestment after one year, it was to be spread over a period of time, with specific approval of the RBI).

Licensing GL	Dilution Schedule
	In June 2002, the maximum limit of shareholding of Indian promoters in these banks was raised to 49 per cent of their paid up capital No further dilution was prescribed in the guidelines.
2013 guidelines	Shareholding by NOFHC in excess of 40 per cent was to be brought down to <u>40 per cent</u> of paid-up voting equity capital within 3 years from the commencement of operations. Further, it is required to be brought down to <u>20 per cent in 10 years and to 15 per cent within 12 years.</u>
2016 'on tap' guidelines	The time for bringing down the shareholding in excess of 40 per cent by Promoter/NOFHC to <u>40 per cent</u> was increased to 5 years . Further, more time was given for dilution of shareholding i.e. <u>30 per cent in 10 years and to 15 per cent within 15 years.</u>
Differentiated Banks	
1996 LAB guidelines	No dilution schedule prescribed.
SFB guidelines (2014)	Shareholding in excess of 40 per cent should be brought down to 40 per cent of paid-up equity capital within 5 years from the commencement of operations. Further, it should be brought down to <u>30 per cent in 10 years and to 26 per cent within 12 years.</u>
Payments Banks (2014)	No dilution schedule prescribed.
2019 'on tap' SFB guidelines	The timeline for diluting the shareholding 'in excess of 40 per cent' to '40 per cent' is 5 years. Further holding is to be brought down to <u>30 per cent in 10 years and to 15 per cent within 15 years.</u> For the UCBs converting into a SFB the promoters' shareholding should be brought down to 15 per cent within 15 years from the date of reaching net worth of ₹200 crore.

(D) Listing requirements:

Licensing GL	Listing requirements
Universal Banks	
1993 guidelines	The shares were required to be listed but no timeframe was prescribed.
2001 guidelines	No prescription for listing of shares.
2013 guidelines	Within 3 years from the date of commencement of business by the bank.
2016 'on tap' guidelines	Within 6 years from the date of commencement of business by the bank.
Differentiated Banks	
1996 LAB guidelines	No prescription on listing of shares.

Licensing GL	Listing requirements
SFB guidelines (2014)	Voluntary listing for SFBs with net worth less than ₹500 crore and mandatory listing for SFBs within 3 years of reaching with net worth ₹500 crore
Payments Banks (2014)	Voluntary listing for PBs with net worth less than ₹500 crore and mandatory listing for PBs within 3 years of reaching with net worth ₹500 crore
2019 'on tap' SFB guidelines	Voluntary listing for SFBs with net worth less than ₹500 crore and mandatory listing for SFBs within 3 years of reaching with net worth ₹500 crore

(E) Foreign Investment norms in the bank:

Licensing GL	Norms on Foreign investment in the bank
Universal Banks	
1993 guidelines	No prescription on Foreign Investment in the bank.
2001 guidelines	NRI participation in the primary equity was capped at 40 per cent. In case of a shortfall in foreign equity by NRI, designated multilateral institutions were allowed to contribute to the shortfall amount.
2013 guidelines	The aggregate non-resident shareholding shall not exceed 49 per cent for first 5 years from commencement of operations. No non-resident shareholder can acquire more than 5 per cent in the bank for first 5 years from commencement of operations. After 5 years extant FDI policy will be applicable.
2016 'on tap' guidelines	Extant FDI policy is applicable.
Differentiated Banks	
1996 LAB guidelines	No prescription on Foreign Investment in the bank.
SFB guidelines (2014)	Extant FDI policy for Private Sector Banks as amended from time to time will be applicable.
Payments Banks (2014)	Extant FDI policy for Private Sector Banks.
2019 'on tap' SFB guidelines	Extant FDI policy for Private Sector Banks.

(F) Initial paid-up equity capital/net worth requirements, Capital Adequacy norms.

Licensing GL	Minimum Paid-up/net worth requirement	Minimum (CRAR) requirement
Universal Banks		
1993 guidelines	₹100 crore	8 per cent ¹⁷
2001 guidelines	Initial <u>paid-up capital</u> shall be ₹200 crore which shall be raised to ₹300 Crore within 3 years of commencement of business. Minimum <u>net-worth</u> of ₹200 crore for an NBFC converting into a bank which shall be increased to ₹300 crore within 3 years from the date of conversion.	10 per cent ¹⁸
2013 guidelines	Initial minimum <u>paid-up voting equity capital</u> required was ₹500 crore. For an NBFC converting into a bank minimum net worth was required to be ₹500 crore.	13 per cent for first 3 years . NOFHC on a consolidated basis to maintain 13 per cent for first 3 years .
2016 'on tap' guidelines	Initial minimum <u>paid-up voting equity capital</u> is ₹500 crore and thereafter a minimum net worth of ₹500 crore at all times, including for NBFC converted into a bank	To maintain 13 per cent for first 3 years . However, NOFHC shall maintain minimum CRAR as per applicable Basel norms.
Differentiated Banks		
1996 LAB guidelines	Minimum paid-up capital: ₹5 crore. <i>(The existing LABs were also advised by RBI in November 2003 to attain a capital of ₹25 crore and a CRAR of 15 per cent over a period of 5 to 7 years.)</i>	8 per cent
SFB guidelines (2014)	Minimum paid-up equity capital is ₹100 Cr. An NBFC/MFI/LAB converting into a SFB to have a minimum net worth of ₹100 crore.	15 per cent

¹⁷ At present, the CRAR norms for these banks are governed by RBI instructions on Basel III Capital Regulations.

¹⁸ At present, the CRAR norms for these banks are governed by RBI instructions on Basel III Capital Regulations

Licensing GL	Minimum Paid-up/net worth requirement	Minimum (CRAR) requirement
Payments Banks (2014)	Minimum paid-up equity capital was ₹100 crore.	15 per cent
2019 'on tap' SFB guidelines	<p>Minimum paid-up voting equity capital required is ₹200 crore except for UCBs converting into a bank.</p> <p>For such converting UCBs the initial requirement is ₹100 crore which should be increased to ₹200 crore within 5 years from commencing business.</p> <p>In case of NBFC/MFI/LAB/PB, converting to a SFB, the ₹200 crore net-worth requirement has to be achieved within 18 months of 'in principle' approval or date of commencement of operations, whichever is earlier.</p>	15 per cent

(G) Conditions on shareholding by non-promoters in the bank:

Licensing GL	Conditions on shareholding by non-promoters in the bank
Universal Banks	
1993 guidelines	No prescription on non-promoter shareholding in the bank.
2001 guidelines	Companies connected with large industrial houses can acquire only up to a maximum of 10 per cent but will not have controlling interest in the bank.
2013 guidelines	No entity other than the NOFHC can have shareholding or control in excess of 10 per cent of the paid-up voting equity capital of the bank.
2016 'on tap' guidelines	The restrictions on a shareholder other than an NOFHC/promoter/promoter group, to acquire more than 10 per cent in the bank, are only for the first 5 years from the commencement of business.
Differentiated Banks	
1996 LAB guidelines	No prescription on non-promoters' shareholding in the bank.
SFB guidelines (2014)	<p>No individual/entity other than promoter can hold more than 10 per cent in the bank.</p> <p>In case of NBFC/MFI/LAB converting into a SFB and if any non-promoter shareholder holds more than 10 per cent, a 3 year time period will be given for diluting it to less than 10 per cent.</p>
Payments Banks (2014)	No prescription on non-promoters' shareholding in the bank.

2019 'on tap' SFB guidelines	The restrictions on non-promoters' shareholding is capped at 10 per cent similar to 2014 SFB guidelines above.
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(H) Conditions on Setting up subsidiary by the bank/NOFHC

Licensing GL	Conditions on setting up subsidiary
Universal Banks	
1993 guidelines	<ol style="list-style-type: none"> 1. Not allowed to set up a subsidiary or mutual fund for at least three years after its establishment. 2. The aggregate of such investments in the subsidiaries and Mutual Fund (if and when set up) and portfolio investments in other companies were not to exceed 20 per cent of the bank's own paid-up capital and reserves. 3. The holding of a bank in the equity of other companies shall be governed by the existing provisions applicable to other banks.
2001 guidelines	Not allowed to set up a subsidiary or mutual fund for at least three years from the date of commencement of business.
2013 guidelines	The NOFHC shall hold the bank as well as all the other financial services entities of the Group regulated by RBI or other financial sector regulators. The NOFHC is not permitted to set up any new financial services entity for at least three years from the date of commencement of business of the NOFHC except in the case where it is legally required or specifically permitted by RBI.
2016 'on tap' guidelines	Apart from setting up the bank, the NOFHC shall not be permitted to set up any new financial services entity for at least three years from the date of commencement of business of the NOFHC. However, this would not preclude the bank from having a subsidiary or joint venture or associate, where it is legally required or specifically permitted by RBI.
Differentiated Banks	
1996 LAB guidelines	No prescription on setting up subsidiaries by LABs. However, as on date no LABs have established subsidiaries.
SFB guidelines (2014)	SFBs cannot establish subsidiaries to undertake para-banking activities.
Payments Banks (2014)	PB cannot establish subsidiaries to undertake para-banking activities.
2019 'on tap' SFB guidelines	SFBs will not be allowed to establish any subsidiaries.

(I) Requirement of Non-Operative Financial Holding Company (NOFHC): The concept of NOFHC was introduced for the first time in the 2013 licensing guidelines.

Universal Banks	
2013 licensing guidelines	<p>NOFHC structure is mandatory. Promoter/Promoter Group will be permitted to set up a bank only through a wholly owned NOFHC. Shares of NOFHC cannot be transferred to any other entity outside the Promoter Group.</p> <p>At least 50 per cent of the Directors of the NOFHC should be independent directors. The corporate structure should not impede effective supervision of the bank and the NOFHC on a consolidated basis by RBI. The prudential norms will be applied to NOFHC both on stand-alone as well as on a consolidated basis and the norms would be on similar lines as that of the bank.</p>
2016 ‘on tap’ Universal Bank licensing guidelines	<p>NOFHC is not mandatory if the promoter is an individual or a standalone promoting/converting entity without any other group entity. However, in case other group entities are established after the bank is incorporated the bank should move to NOFHC structure.</p> <p>Promoter/Promoter Group shall hold at least 51 per cent in NOFHC and the remaining 49 per cent can be held by non-promoters also.</p>
Differentiated Banks	
1996 LAB guidelines.	There is no requirement of NOFHC structure.
2014 SFB guidelines	NOFHC structure is mandatory in case of a promoter setting up an SFB also desires to start a Payments Bank.
2014 Payments Bank guidelines	No prescription on NOFHC structure.
2019 ‘on tap’ SFB guidelines	NOFHC structure is mandatory in case of a promoter setting up an SFB also desires to start a Payments Bank. Also, if there is an intermediate company between SFB and its promoting entity, it should be an NOFHC.

(J) Summary of Scheme for Voluntary Transition of Primary (Urban) Co-operative Banks (UCBs) into SFBs:

- (i) Eligible applicants: UCBs with a minimum net worth of ₹50 crore and CRAR of 9 per cent and above.
- (ii) Promoters: A group of individuals/professionals, having an association with UCB as regular members for a period of not less than three years and approved by General Body with 2/3rd majority of members present and voting. The promoters must be residents and shall have ten years of experience in banking and finance.
- (iii) Capital requirement: Minimum net worth of ₹100 crore from the date of commencement of business and the Promoters shall maintain at least 26 per cent of the paid-up equity capital.
- (iv) The eligible UCBs can apply for conversion to SFBs under 2019 ‘on tap’ SFB licensing guidelines.

Annex IV: International Practice and Regulatory Guidelines in respect of bank ownership

A. Philosophy underlying Ownership of Banks

India	UK	Singapore	USA	Germany	Japan
<p>The ultimate ownership and control of private sector banks should be well diversified¹⁹. Any person who holds or intends to acquire an aggregate of 5 per cent or more shares or voting rights in a private sector bank should satisfy the ‘fit and proper’ criteria of RBI.²⁰</p>	<p>Any person who wishes to acquire or increase control of a UK bank is required to apply to the Prudential Regulation Authority (PRA) for approval. The proposals are judged in line with the assessment criteria²¹.</p>	<p>To become a substantial shareholder (5 per cent), 12 per cent controller, 20 per cent controller, or indirect controller, of a locally incorporated bank, prior approval of the Minister in-charge of Monetary Authority of Singapore (MAS) is required.²² MAS must be satisfied²³ that (i) the applicant is a fit and proper person, and (ii) having regard to the likely influence of applicant, the designated financial institution will or will continue to conduct its business prudently and comply with the provisions of Banking Act. Secondly, the Minister-in-charge of MAS must be satisfied that it is in the national interest to approve this application.</p>	<p>Establishment, or acquisition of control, of a bank in USA, is subject to the review and approval of the appropriate federal banking agencies Federal Reserve Board (FRB), Office of the Comptroller of the Currency (OCC), Federal Deposit Insurance Corporation (FDIC). Companies that control banks (BHC) are subject to ongoing prudential supervision and regulation.</p>	<p>In accordance with the relevant EU directive, German law does not set limits to shareholding by natural persons or entities in credit institutions in general. However, every direct or indirect holder of a significant holding²⁴ in a bank requires an assessment.</p>	<p>Notification/authorisation requirements are imposed on large shareholders. The persons applying for authorisation are required to have understanding of public nature of the bank services and sufficient social credibility.²⁵</p>

¹⁹ Guidelines on Ownership and Governance dated February 28, 2005.

²⁰ Section 12B of Banking Regulation Act, 1949

²¹ Section 185 and 186 of Financial Markets Act, 2000 (Controllers) **Regulations 2009**

²² The definitions of “substantial shareholder”, “12% controller”, “20% controller” and “indirection controller” are set out in Singapore’s Banking Act.

²³ Section 15C of Banking Act, Singapore

²⁴ Section 2C of Germany Banking Act

²⁵ Article 52-10 of Banking Act of Japan.

B. Shareholding limits

Limits on shareholding by natural persons, entities etc. in a bank depending on category of shareholder

India	UK	Singapore	USA	Germany	Japan
<p>Limits are prescribed, depending on category of shareholders: ²⁶</p> <p>Promoter: Individuals and Non-financial entities: 15 per cent</p> <p>Non-Promoter: Individuals and Non-financial entities: 10 per cent of paid-up capital</p> <p>Promoter or Non-Promoter:</p> <p>(i) Non-regulated or non-diversified or non-listed financial entities: 15 per cent.</p> <p>(ii) Listed, regulated, and well diversified financial entities or supranational institutions or PSU or Govt. – 40 per cent</p> <p>(iii) Higher stake/strategic Higher stake / strategic investment by promoters / non-promoters through capital infusion by domestic or foreign entities / institution - permitted on a case to case basis. Rationale is to ensure that ultimate ownership and control of private sector banks is well diversified.</p>	<p>No legal limits on shareholding as any natural person or entity can hold shares in a UK Bank.</p>	<p>No specific limits for different types of owners is prescribed With an objective to liberalise commercial banking in Singapore ²⁷</p>	<p>There are no quantitative limits on shareholding by natural persons, or entities, in a bank in the United States.</p> <p>Annual submissions required of the identities of those shareholders who own or control >5 per cent in bank or holding company.</p> <p>Principal²⁸ shareholder's (generally owning >10 per cent) competence, experience, integrity, financial ability, background is checked at the time of granting approval.</p>	<p>No legal provision that set limits on shareholding or voting rights in banks exist.</p> <p>Germany adheres to the concept of free markets. Restrictions apply only for regulatory purposes as laid out by the fit and proper requirements for people/ institutions owning a bank.</p>	<p>There are no separate shareholding limits for different categories of shareholders. The Banking Act of Japan provides safeguards, such as requiring notification/ Authorisations for shareholding as mentioned above.</p>
<p>Lock in requirement: The licensing guidelines mandate higher minimum shareholding i.e. 40 per cent/26 per cent for the promoters for the first 5 years.</p>	Not applicable				
<p>Dilution requirements: The promoters have to dilute their shareholding in the bank to permissible limit within specified period, as prescribed in licensing guidelines/master direction on ownership.</p>	Not applicable				

²⁶ MD on Ownership in Private Sector Banks

²⁷ Statement by Monetary Authority of Singapore – May 17, 1999

²⁸ 12 Code for Financial Regulations (CFR) 225.13

C. Thresholds for prior approval

Need of prior approval of Regulator/Govt for acquiring shares beyond a threshold.

India	UK	Singapore	USA	Germany	Japan
<p>Yes</p> <p>Acquisition of aggregate 5 per cent or more shares or voting rights in a private sector bank by a person (major shareholder) requires prior approval of RBI.</p> <p>An incremental acquisition, by a person who has the prior approval of RBI to acquire more than 5 per cent, does not require further approval for acquisition up to 10 per cent. However, the source of funds has to be declared to the concerned bank and ‘no objection’ obtained from it before the acquisition. The bank has to report the acquisition in its annual certificate to RBI on the continuance</p>	<p>For acquisition²⁹ of 10 per cent of the shares or voting power in a UK authorised firm, or in a parent undertaking of the UK authorised firm. However, an acquisition below 10 per cent could also require prior regulatory approval if the person is able to exercise <u>significant influence</u> over the management of the UK authorised firm.</p> <p>In addition, prior approval is required for</p>	<p>MAS has following approval thresholds for acquisition of shareholding or voting rights in banks:</p> <p>5 per cent (substantial shareholder)³¹,</p> <p>12 per cent (controller)³²</p> <p>and</p> <p>20 per cent (controller)</p> <p>or</p>	<p>For a company that is subject to the BHC Act to directly or indirectly acquire <u>control</u> of a bank or BHC.</p> <p>‘Control’³⁴ means the power to vote >25 per cent in a bank or BHC or control over the <u>election of a majority of directors</u> or the power to exercise <u>controlling influence</u> over the management or policies of the bank or BHC.</p> <p>Under limited circumstances a</p>	<p>Any person intending to acquire a ³⁶qualifying holding (i.e. >10 per cent capital or voting rights) or if acquirer is able to exercise significant influence over management of the bank, requires prior approval.</p> <p>Similarly, if the holding would reach or exceed a</p>	<p>Person with ³⁸VR >5 per cent but < 20 per cent (“major holder of VR in the bank”) is required to make a notification.</p> <p>A person seeking to hold ³⁹VR >20 per cent (15 per cent in case the person is expected to have a <u>material influence</u> on decisions about company’s financial and business policies) is required to obtain an authorisation as a</p>

²⁹ Section 181 of FMA Act, 2000

³¹ Section 15A(3) of Banking Act, Singapore

³² Section 15B of Banking Act, Singapore

³⁴ 12 CFR 225.2 (e) (1)

³⁶ Article 4(1) of number 36 of EU Regulation No.575/2013

³⁸ Article 52-2-11 of Banking Act, Japan

³⁹ Article 52-9 of Banking Act, Japan

India	UK	Singapore	USA	Germany	Japan
<p>of 'fit and proper' status of its major shareholders.</p> <p>A fresh acquisition, resulting in a person exceeding 10 per cent or more, requires the prior approval of RBI.</p> <p><u>Public Sector Banks:</u> In terms of Section 3(2E) of The Banking Companies (Acquisition and Transfer of Undertakings) Act 1970/80, no shareholder other than Central Government is entitled to exercise voting rights in excess of 10 per cent.</p>	<p>increasing control at the following thresholds:</p> <p>20 per cent, 30 per cent and 50 per cent. ³⁰</p> <p>Prior approval would also be required if the increase in control would result in the person becoming a parent undertaking of the UK authorised firm.</p>	<p>an indirect controller³³.</p>	<p>rebuttable presumption of <u>control</u> arises when a person, would <u>own, control, or hold</u> with the power to vote >10 per cent.</p> <p>³⁵Authorisation required before a BHC can acquire, >5 per cent voting shares of <u>another bank</u>.</p>	<p>significant holding³⁷ 20 per cent, 30 per cent or 50 per cent of the voting rights or capital, or if the credit institution comes under its control or become the acquirer's subsidiary, approvals are required.</p>	<p>bank's <u>major shareholder</u>.</p> <p>Allowed to hold ⁴⁰VR >50 per cent when it is found especially necessary for ensuring sound and appropriate operations of bank services, the Financial Services Agency is allowed to order the relevant shareholder and the bank to take necessary measures.</p>

³⁰ Section 182 of FMA Act, 2000

³³ "Indirect controller" means a person, alone or together with other person, with or without holding shares/controlling voting power—

(a) in accordance with whose directions, instructions or wishes the directors of the financial institution are accustomed or under an obligation, to act; or
(b) who is in a position to determine the policy of the financial institution.

³⁵ 12 USC 1842 (a)(3)

³⁷ Section 2c of German Banking Act

⁴⁰ Article 52-14 of Banking Act, Japan

D. Current equity structure of top 3 to 5 banks in the jurisdiction:

Time frame over which these banks achieved the current equity structure and the applicable regulatory norms for these banks and methodology adopted by these banks to bring down the promoters' stake.

India	UK	Singapore	USA	Germany	Japan
<p>The three largest private sector banks in India in terms of net worth are HDFC Bank, ICICI Bank and Axis Bank.</p> <p>HDFC Bank: Licensed in 1995. The promoters 'HDFC Ltd' along with its group entities holds 26.10 per cent in the bank and the remaining 73.90 per cent is held by public. Achieved its current equity structure through listing and amalgamations.</p> <p>ICICI Bank: Licensed in 1994 with 100 per cent shareholding held by promoter ICICI Ltd. Presently there are no promoters in the bank and the bank is well diversified. 81.77 per cent is held by public and the remaining shareholding is held by Depository holding shares under Depository Receipts. The bank achieved its current equity structure through</p>	<p>The large banks in UK such as Barclay, Lloyds, HSBC and Standard Chartered are wholly owned by their holding companies which are well diversified with no entity holding more than 20 per cent.</p> <p>The diversified ownership in above said banks have happened over a very long timeframe and includes many mergers and acquisitions.</p>	<p>The top three Singapore banks are publicly listed with about 70 per cent (or more) of their issued ordinary shares being held by public. As such, they have a fragmented shareholder-base, with only a small number of substantial shareholders each.</p> <p>DBS Bank: wholly owned by DBS Group Holdings Ltd. 70 per cent shares of holding company are held by public and 30 per cent by Temasek Holdings Ltd, (owned by the Minister of Finance).</p> <p>OCBC: 72 per cent of the issued shares are held by public. Also, there are 2 substantial shareholders, each holding more than 5 per cent directly or indirectly in the bank.</p> <p>UOB: 76 per cent shares are held by public. (Also, there are 9 'substantial shareholders' each holding</p>	<p>The four largest bank holding companies by asset size in the U.S. as of March 31, 2020 are (i) JPMorgan Chase & Co.; (ii) Bank of America Corporation; (iii) CitiGroup Inc.; and (iv) Wells Fargo & Company.</p> <p>The shares of these firms are widely held by a combination of institutional and individual investors. Investment management companies such as The Vanguard Group, Inc., BlackRock, Inc., and Berkshire Hathaway, Inc. are the largest shareholders at each of these firms.</p> <p>All are old banks and the equity structures have evolved over a long period of time.</p>	<p>The top banks (Deutsche Bank, Commerzbank), with a broadly diversified shareholding. The Government continues to have a major stake in Commerzbank with approx. 15 per cent.</p> <p>DZ Bank AG is owned by central institute of co-operative banks. Public bank KfW - Kreditanstalt für Wiederaufbau is state owned. UniCredit Bank - now fully controlled subsidiary of Italian UniCredit Group).</p> <p>The structures evolved over a long timeframe. For the private banks like Deutsche Bank, Commerzbank and</p>	<p>The top 3 Global Systemically Important Banks in Japan (i) MUFG Mitsubishi UFJ Financial Group); (ii) SMFG (Sumitomo Mitsui Financial Group); and (iii) MHFG (Mizuho Financial Group, are held by diverse market players such as other financial institutions, overseas corporations and individuals.</p> <p>MUFG and SMFG, for example, were formed through mergers among multiple banks. Shares of some old banks, from which these FGs are originated, were already held by diverse market players as of immediately after the end of World War II.</p>

India	UK	Singapore	USA	Germany	Japan
<p>merger of the promoting entity (ICICI Ltd.) with bank and also through amalgamation of other private sector banks.</p> <p>Axis Bank: Licensed in 1994 The promoting entities SUUTI and Govt. owned insurance companies hold 15.99 per cent with the balance held by public. Achieved its current equity structure through listing and issue of new shares.</p>		<p>more than 5 per cent directly or indirectly in the bank.)</p> <p>These banks have undergone a number of corporate changes, such as capital raising, listing, mergers and acquisitions, their shareholder structures have evolved over the years.</p>		<p>UniCredit Bank, the current structure resulted out of mergers and acquisition. In case of the state owned KfW, the structure evolved in 1990 during German reunion. The structure of DZ Bank evolved by M&A activities with the latest by the merger with WGZ, a central institution of the co-operative banks.</p>	

E. International practices for shareholding limits in banks in some other major jurisdictions

Australia

In Australia, the statutory provisions in the Foreign Acquisitions and Takeovers Act 1975 and Financial Sector (Shareholdings) Act 1998 prohibit any person from holding more than 20 per cent stake in a bank without prior approval of the Treasurer of Australia. The threshold for the stake was raised from 15 per cent to 20 per cent by the 2018 amendment act *inter alia* to align it with the 20 per cent foreign shareholding threshold under the Foreign Acquisitions and Takeovers Act 1975. The Corporations Act 2001 prohibits any person (including a corporation) from acquiring a relevant interest in voting shares of a corporation if, after the acquisition, that person or any other person would be entitled to exercise more than 20 per cent of the voting power. A person will have a substantial holding if the person and person's associates have 5 per cent or more of the total voting rights.

Canada

The Bank Act does not permit any person to have 'significant interest' (aggregate holding greater than 10 per cent by the person and entities controlled by the person) in any class of shares of the bank or bank holding company except with requisite approval. A major shareholder of a body corporate is defined in the Act as a person with aggregate holding of voting shares of more than 20 per cent or non-voting shares of 30 per cent. Further, there is differential treatment with respect to maximum permitted shareholding in banks depending on size of equity of the bank. In banks with equity greater than CAD 2 billion but less than CAD 12 billion, a person is permitted to have aggregate shareholding upto 65 per cent with at least 35 per cent being publicly held. Banks with equity greater than CAD 12 billion are required to be widely held i.e. with no major shareholder except in certain circumstances.

France

Credit institutions (which include banks) must report financial information relating to 'significant shareholders' i.e. persons holding 10 per cent or more of a credit institution's voting rights to the Prudential and Resolution Control Authority (ACPR), annually. A change in the shareholding structure of a credit institution (CI) must be also be informed to the ACPR. Prior approval of ACPR and ECB, under the Single Supervisory Mechanism (SSM), are required for a transaction by which a person acting alone or in concert with other persons can acquire, increase, reduce or cease to have, directly or indirectly, a participation in a CI, when either the fraction of voting rights held by that person/persons exceeds or falls below defined thresholds or credit institution becomes or ceases to be the subsidiary of that person or persons.

Hong Kong

The principal statute governing banks in Hong Kong is the Banking Ordinance ("BO") and banks are regulated by the Hong Kong Monetary Authority ("HKMA"). Banks are within the definition of "authorised institutions" under the BO. Though the BO does not specify a maximum percentage of shares in authorised institutions which may be owned by a shareholder, controllers of authorised institutions incorporated in Hong Kong are subject to the approval of the HKMA. "Controller" is defined in the BO to include indirect controller (a person in accordance with whose instructions the directors of a company or of its parent company are accustomed to act), minority shareholder controller (a person who either alone or with associates controls 10 per cent but not more than 50 per cent of

the voting rights of the bank or of another company of which the bank is a subsidiary) and majority shareholder controller (a person who either alone or with associates controls over 50 per cent of the voting rights of the bank or of another company of which the bank is a subsidiary).

Indonesia

As per the Act of the Republic of Indonesia Number 7 of 1992 concerning Banking as Amended by Act Number 10 of 1998, a Commercial Bank in Indonesia may only be established by (i) Indonesian citizens and/or an Indonesian legal entity; or (ii) Joint venture between Indonesian citizens and/or an Indonesian legal entity with foreign citizens and/or a foreign legal entity. The OJK Regulation issued in 2016 has prescribed ownership limits in Commercial Banks based on the category of shareholders viz. for banks and non-banks financial institutions - 40%; non-financial institution – 30%; and individual shareholders – 20%. The said ownership limits are not applicable to Central Government and such institutions involved in bank's recovery. Financial institutions which intends to acquire more than 40% in a bank requires approval from Financial Services Authority, Indonesia. Controlling shareholder is an individual/entity/group that holds 25% or more of the total shares of the bank or even in case of holding less than 25%, however, proven to exercise control over the bank directly or indirectly, has to seek prior approval. Non-controlling stakes, lower than 25 per cent, face no other constraints and are permitted without approval. This freedom is permitted for overseas investors as well.

Malaysia

In terms of Financial Services Act, 2013, an individual shareholder is not allowed to hold more than 10 per cent interest in shares in a licensed financial institution in Malaysia. Under the Companies Act, 2016, substantial shareholders i.e. persons having an interest in not less than 5 per cent of the total voting shares of a company, which includes banks, are required to give notice of acquisition or change or cessation of substantial shareholding to the company within specified time frame. Prior approval of Bank Negara Malaysia (BNM) is required for acquisition of interest of in shares by way of an agreement or arrangement which would result in an aggregate interest of 5 per cent or more in the shares of the bank. Prior approval of the Minister is required, with the recommendation of BNM, for a person to acquire control of a bank. A person shall be presumed to have control if such person has an interest of more than 50 per cent of the shares of the bank or the power to elect, appoint, remove majority of the directors or the power to make or cause decisions to made and executed or is the person on whose directions or instructions the management and board are accustomed or obligated to act.

New Zealand

There are no ownership limits that are specifically applicable to registered banks in New Zealand. If a registered bank in New Zealand is subject to a change of ownership, the prior consent of the Reserve Bank of New Zealand (RBNZ) will need to be sought. Once again there is no fixed threshold but the RBNZ consent will need to be obtained before a person gains a 'significant influence' over a registered bank or increases the level of 'significant influence'. As a guideline the RBNZ considers that significant influence includes the ability to directly or indirectly appoint 25 per cent or more of the board of directors or a direct or indirect qualifying interest in 10 per cent or more of the voting shares of the registered bank.

Sweden

The rules on prudential assessments of acquisitions and increase of holdings in banks in Sweden are based on the directives of European Union Parliament and laid down in the Swedish Banking and Financing Business Act. The approval of the Swedish Supervisory Authority is necessary for a direct or indirect acquisition of a qualifying holding (direct or indirect holding of 10 per cent or more of the capital or voting rights or a holding which makes it possible to exercise a significant influence over the management) in a bank or the direct or indirect increase in such a qualifying holding whereby the holding of capital or voting rights would reach or exceed 20 per cent, 30 per cent or 50 per cent or the bank would become the acquirer's subsidiary.

Switzerland

There is no threshold limit for bank shareholding in Switzerland. Prior reporting is mandatory for all individuals and entities for directly or indirectly buying or selling 'qualified participation' in a bank. A 'qualified participation' exists when an individual or legal entity directly or indirectly owns at least 10 per cent of the capital or voting rights of a licensed institution or can otherwise influence its business activities in a significant manner. They must also report when their shareholding rises above or falls below the threshold values of 20 per cent, 33 per cent and 50 per cent. Natural persons or legal entities that directly or indirectly participate in the bank with at least 10 percent of the capital or voting rights or whose business activities are otherwise such that they may influence the bank in a significant manner (qualified participation) must guarantee that their influence will not have a negative impact on the bank's prudent and solid business activity.

South Africa:

Bank Act, 1990 mandates prior approval of Prudential Authority (PA) for a person to acquire more than 15 per cent but less than 24 per cent of shares or voting rights; and more than 24 per cent but less than 49 per cent of shares or voting rights in a bank or in a controlling company. Further, prior approval of Minister is required for acquisition of (i) more than 49 per cent but less than 74 per cent of shares or voting rights and (ii) more than 74 per cent of shares or voting rights in a bank or in a controlling company. The PA or Minister before granting permission for above said acquisition of shares or voting rights should be satisfied that the said acquisition will not be contrary to the public interest or the interest of the bank concerned or its depositors or of the controlling company. While granting such approvals, if required, PA or Minister may consult Competition Commission.

Also, the Bank Act stipulates that where the PA or Minister is of the opinion that the retention of shareholding or voting rights by a particular shareholder will be detrimental to the bank or concerned controlling company, the PA or Minister (as the case may be), may apply to the High Court requesting for an order compelling such shareholder to reduce the shareholding or voting rights to not more than 15 per cent or to limit the voting rights to 15 per cent of total voting rights. While granting such approvals, if required, PA or Minister may consult Competition Commission. Further, Financial Sector Regulation (FSR) Act, 2017 defines significant owner as the one who directly or indirectly, alone or together with a related person has the ability to control or influence materially the business or strategy of the financial institutions. The FSR Act prescribes approval requirement for such significant owner of a financial institution.