

## Two new banking licences awarded by central bank

By Sawant Singh and  
Aditya Bhargava,  
Phoenix Legal



### New Delhi

Second Floor,  
254, Okhla Industrial Estate  
Phase III  
New Delhi – 110 020, India  
Tel +91 11 4983 0000  
Fax: +91 11 4983 0099  
Email: delhi@phoenixlegal.in

### Mumbai

Vaswani Mansion, 3rd Floor  
120 Dinshaw Vachha Road  
Churchgate  
Mumbai – 400 020, India  
Tel: +91 22 4340 8500  
Fax: +91 22 4340 8501  
Email: mumbai@phoenixlegal.in

On 1 July 2013, the Reserve Bank of India (RBI) disclosed that it had received 26 applications from private sector entities for licences to establish new banks. The applicants included prominent financial and industrial concerns such as Edelweiss, L&T Finance, Reliance Capital, Videocon Group and Tata Sons, although Tata Sons and the Videocon Group later withdrew their applications. After an initial screening of applications by the RBI, the applications were further scrutinized by the High Level Advisory Committee (HLAC) established by the RBI.

### The winners

Based on the recommendations of the HLAC, the RBI on 2 April 2014 granted “in-principle” approval to two applicants, namely, IDFC Limited and Bandhan Financial Services Private Limited, to establish new banks. The application of the Department of Posts was reserved for further consultation with the central government.

The “in-principle” approval is valid for 18 months, and the successful applicants are to be granted a licence to commence banking business in India based on their compliance with the conditions mentioned in the “in-principle” approval.

### Legislative progression

In his budget speech for the financial year 2010-11, on 26 February 2010, India’s then finance minister, Pranab Mukherjee, announced that to “extend the geographic coverage of banks and improve access to banking services” the RBI would consider granting licences to private sector entities to establish new banks. On 11 August 2010, the RBI placed a discussion paper on guidelines for the entry of new banks in the private sector on its website for comments.

Taking into account the comments received on the discussion paper, the RBI placed draft guidelines on its website for comments on 29 August 2011. The guidelines for licensing of new banks in the private sector were finalized and issued on 22 February 2013, after taking into account the amendments to the Banking Regulation Act, 1949, brought about by the enactment of the Banking Laws Amendment Act, 2012, and the comments received on the draft guidelines.

The amendments to the Banking Regulation Act were crucial to the issuance of new licences as, among the measures they introduced, they allowed an increase in the restriction in voting rights from 10% to 26% (subject to the RBI’s guidelines), allowed banks to issue preference shares (subject to the RBI’s guidelines), and empowered the RBI to “supersede” the board of directors of a bank for a period of six to 12 months if the RBI is of the view that the board of the bank is not working in the interests of the depositors and the shareholders.

Notably, the passage of the Banking Laws Amendment Act was one of the RBI’s specific requirements to commence the process of accepting applications for the issuance of licences for new banks.

### Factors considered

In its press release on “in-principle” approvals, the RBI stated that the applications had been assessed on the basis of factors such as the financial statements of group entities, proposed business plan, and demonstrated capability for running a bank. The RBI also left the door open for unsuccessful applicants to apply again in the future for licences to establish banks.

There has been a sense that the RBI would be reluctant to grant licences to

industrial concerns so as to avoid the possibility of banks set up by them using money from the public for the benefit of the group. Certain requirements prescribed by the guidelines for the establishment of new banks may also have discouraged industrial concerns from applying for licences. These include: the establishment of a wholly owned non-operative financial holding company (NOFHC) to own the bank; the bank and the NOFHC having no credit and investment exposure to the promoter group; the NOFHC not having any equity, debt or credit exposure to any entity outside the promoter group; the bank not having any equity exposure to any other NOFHC; and the board of the bank having a majority of independent directors.

### What’s next?

In a progressive move, the RBI also announced that it intends to modify the new bank licensing guidelines so that the issuance of licences is on an “on tap” basis, i.e. applications for establishing banks can be submitted at any time. The RBI also intends to move towards granting “differentiated licences”, which will broaden the pool of applicants for banking licences. This ties in with one of the recommendations of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households, which was chaired by Nachiket Mor (incidentally also a member of the HLAC): to have separate banks for separate functions such as payment processing, wholesale investment banking (which would lend only to niche sectors like infrastructure), wholesale consumer banking, and full-service banking.

*Sawant Singh is a partner and Aditya Bhargava is a principal associate at the Mumbai office of Phoenix Legal.*