Banking Policy and Trends

Policy Measures

3.15 The major policy measures taken in the current financial year as part of the annual monetary and credit policy statement, including its mid-term review, may be seen from Box 3.1. The major policy initiatives aimed at strengthening the banking system included the following.

- Move towards consolidated supervision by incorporating the balance sheets of subsidiaries into the balance sheet of the parent bank.
- In-house arrangements by banks for collecting and collating credit and other related information required by the proposed Credit Information Bureau.
- Close monitoring of suit -filed and decreed accounts on an on-going basis.
- A simplified, non-discretionary and non-discriminatory mechanism for NPA recovery and
- Revised norms (Box 3.3) for entry of new banks in the private sector which include capital adequacy ratio of 10 per cent on continuous basis from the date of start of operations and stipulation to lend 40 per cent of net bank credit to the priority sector and to open 25 per cent of the branches in rural and semi-urban areas.

In addition to these measures, a few notable initiatives were also taken to enlarge opportunities for the relatively stronger banks in financial intermediation. These are set out in brief below.

Entry into Insurance

3.16 Keeping in view the limited actuarial and technical expertise of Indian banks in undertaking insurance business, RBI has found it necessary to restrict entry into insurance to financially sound banks. Permission to undertake insurance business through joint ventures on risk participation basis will therefore be restricted to those banks which (i) have a minimum net worth of Rs.500 crore and (ii)

BOX 3.3

Entry of New Banks in the Private Sector

As per the guidelines for licensing of new banks in the private sector issued in January 1993, RBI had granted licenses to 10 banks. Based on a review of experience gained on the functioning of new private sector banks, revised guidelines were issued in January 2001.The main provisions/requirements are listed below :—

- Initial minimum paid-up capital shall be Rs.200 crore; this will be raised to Rs.300 crore within three years of commencement of business.
- Promoters' contribution shall be a minimum of 40 percent of the paid-up capital of the bank at any point of time; their contribution of 40 percent shall be locked in for 5 years from the date of licensing of the bank and excess stake above 40 percent shall be diluted after one year of bank's operations.
- Initial capital other than promoters' contribution could be raised through public issue or private placement.
- While augmenting capital to Rs.300 crore within three years, promoters need to bring in at least 40 percent of the fresh capital, which will also be locked in for 5 years. The remaining portion of fresh capital could be raised through public issue or private placement.
- NRI participation in the primary equity of a new bank shall be to the maximum extent of 40 percent. In the case of a foreign banking company or finance company (including multilateral institutions) as a technical collaborator or a co-promoter, equity participation shall be limited to 20 percent within the 40 percent ceiling. Shortfall in NRI contribution to foreign equity can be met through contribution by designated multilateral institutions.
- No large industrial house can promote a new bank. Individual companies connected with large industrial houses can, however, contribute up to 10 percent of the equity of a new bank, which will maintain an arms length relationship with companies in the promoter group and the individual company/ies investing in equity. No credit facilities shall be extended to them.
- NBFCs with good track record can become banks, subject to specified criteria (vide paragraph 3.43 of this Chapter).
- A minimum capital adequacy ratio of 10 percent shall be maintained on a continuous basis from commencement of operations.
- Priority sector lending target is 40 percent of net bank credit, as in the case of other domestic banks; it is also necessary to open 25 percent of the branches in rural/semi-urban areas.

satisfy other criteria in regard to capital adequacy, profitability, etc. Banks which do not satisfy these criteria will be allowed as strategic investors (without risk participation) up to 10 per cent of their net worth or Rs. 50 crore, whichever is lower. However, any bank or its subsidiary can take up distribution of insurance products on fee basis as an agent of insurance company. In all cases, banks need prior approval of RBI for undertaking insurance business.

Government Shareholding

3.17 On the lines proposed in the Union Budget for 2000-2001, the Government introduced the Banking Companies (Acquisition and Transfer of Undertakings) and Financial Institutions Laws (Amendment) Bill, 2000 in Parliament which seeks to reduce the minimum shareholding by Government in nationalised banks to 33 per cent to enable them to raise fresh equity from the capital market. The Bill also seeks to empower the Central Government to supersede (based on RBI's recommendation) the Board of Directors of any nationalised bank and constitute the Financial Restructuring Authority. Other provisions in the Bill include removal of restriction on free transferability of shares held by the Central Government with a view to facilitate acquisition, merger and financial restructuring on case to case basis and requirement to annex details of subsidiaries like balance sheet and profit and loss account along with the bank's annual report.

Valuation Norms

3.18 Another major policy measure relates to valuation of banks' investments (Box 3.4). This will help those banks which have marked to market 100 per cent of the approved securities to make good the erosion in their bottom lines caused by the monetary policy measures taken by RBI to tighten liquidity in the wake of mounting pressure on the rupee in the foreign exchange market.

Exposure to Capital Market

3.19 The final guidelines circulated by RBI seek to achieve a transparent and stable system of bank financing of equities and investment in shares. Within the overall exposure to sensitive sectors, bank's total exposure to the capital market should not exceed 5 per cent of total outstanding domestic advances as on March 31 of the previous year as against the earlier ceiling of 5 per cent of incremental deposits of the previous year. Total exposure to capital market implies investment in ordinary shares, convertible debentures and units of equity-oriented mutual funds .Banks desirous of making investments in shares directly are required to build up adequate expertise in equity research, formulate transparent policy and procedure for investment in shares and ensure that exposure to investment in equities whose prices are subject to volatility, does not exceed 20 per cent of networth.