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ARGUING IN FAVOUR OF BANKING SECTOR REFORMS

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INTRODUCTION

Bank of England and Bank of Japan both agreed to help India tackle its dwindling balance of payment crisis in 1991 but at the cost of our pride. Around 50 metric tonnes of gold was shipped out in four tranches and a sum 405 mil-lion dollars was secured. Amid the economic chaos and a defanged banking sector came the Narasimhan Committee reports. The landmark legislation aimed for a complete overhaul of the banking hierarchy in India. One of the key thrust area was the transition of big PSBs from national banks to international banks. The aspiration was to break in the top 50 banks by asset size and develop shock resilient agencies. Its' been three decades now but apart from SBI we have failed miserably in achieving that scale. 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; the only bank that can break into the list (SBI with asset size of 39 lakh crore is already in top 100) is HDFC bank with an asset size of 15 lakh crore. The HDFC story has been a fascinating one. The bank has a market cap of 129 billion dollars and has given a whooping 500% return in last 10 years. Theoretically, HDFC bank has achieved things that SBI could not in 70 years. This does present a compelling case for more corporate partici-pation in Indian banking sector.

CREDIT SCENARIO IN INDIA:

One of the prime reasons leading of rapid industrialization of China was a very strong GDP ratio. As per Bank of International Settlement (BIS) Credit to GDP ratio of China in 1991 was 83.3 where as that of India was mere 21. This effectively translated into credit deficiency in the economy which dampened business activity, made capital rela-tively expensive and stunted economic growth. This number currently stands at 60 for India where as it is 221 for China. For

per unit of value added to GDP Chinese bankers have almost 3.5 more capital than Indian bankers. An extension of this argument is the macro-level data provided by World Bank which shows that real interest rates in India went up to 6.2% in 2017 from 2.5% in 2012, while real rates fell in many other Asian countries, including Chi-na. The Indian banking sector cannot be said to be highly concentrated. Though Herfindahl Hirschman Index (HHI) for India is around 0.08 for both credit and deposit, market competitiveness is very weak. The overall debt supply to the MSME sector, through informal and formal sources, is estimated at INR 69.3 trillion (USD 1.1 trillion) . Informal sources cater to INR 58.4 trillion of that the debt demand, while formal sources account for INR 10.9 trillion of the MSME demand. Banking institutions account for INR 9.4 trillion (14%) of the overall formal finance supply, where commercial banks are the largest formal institutions contributing INR 8.8 trillion. Informal sources include both insti-tutional sources such as money lenders and chit funds and non-institutional sources such as family, friends, and family businesses.

NEEDS FOR PRIVATE SECTOR BANKS:

From the data generated over the years it can be safely established that business models adopted by private sector banks are far superior to their public sector counterparts. As per RBI's own admission; 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. However, a much lower gross NPA ratio and smaller pool of writ-ten-off accounts gives them a much cleaner balance sheet for more productive utilisation of capital. In layman terms; private banks know how to do business and more importantly they know how to do it profitably. This has translated into better business performance and a much higher price to book value for private sector banks. There-fore, 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.

THE POLICY CHANGE:

Let us begin by taking a cue from Raguram Rajan's criticism to the IWG suggestion. In one of his article published on linkedIn Rajan argued that the corporate entry into banking will further "exacerbate the concentration of economic (and political) power in certain business houses and create conflict of interest on lending to certain businesses". Unfortunately, though the concern might be appropriate the claim is unfounded. The RBI paper explicitly states that the large corporate/industrial houses may be permitted to promote banks only after necessary amendments have been made 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 strength-ening of the supervisory mechanism for large conglomerates, including consolidated supervision. 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; licenses may not be issued until these mechanisms are in place.

An effective redressal to the corporate governance issue can be achieved though the NOFHC structure which will be mandatory for all new banks. Not just new banks even the legacy banks will be asked to convert to NOFHC to create a level playing field. 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 necessari-ly held outside the NOFHC. Simply put if Mr. X bids for a bank license and he is a promoter of other 10 companies; 4 of which are related to financing business in some way or the other then all the 4 companies will be held under one NOFHC & the rest 6 will be outside the NOFHC. Under no circumstances can the bank or lending organization take exposure to the other companies held by the promoter. This helps us negate faulty exposures and prevent "phone banking". This helps the NOFHC achieve the necessary ring fencing to prevent biased business decisions. Moreover, this 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 stringent listing guidelines have also been prescribed by RBI.

- https://www.bloombergquint.com/bq-blue-exclusive/corporate-ownership-of-banks-ask-how-not-if

	India	Singapore	USA
Philosophy of holding a bank	The ultimate ownership and control of private sector banks should be well diversified. 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.	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.	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.
Threshold for Prior approval	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.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 of 'fit and proper' status of its major shareholders. A fresh acquisition, resulting in a person exceeding 10 per cent or more, requires the prior approval of RBI. Public Sector Banks: 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	MAS has following approval thresholds for acquisition of shareholding or voting rights in banks: 5 percent - Susbtantial Sharehlder 12 percent - Contorller 20 percent : Contoller/ indirect controller	For a company that is subject to the BHC Act to directly or indirectly acquire control of a bank or BHC. Authorisation required before a BHC can acquire, >5 per cent voting shares of another bank. 'Control' means the power to vote >25 per cent in a bank or BHC or control over the election of a majority of directors or the power to exercise controlling influence over the management or policies of the bank or BHC. Under limited circumstances a rebuttable presumption of control arises when a person, would own, control, or hold with the power to vote >10 per cent.

	entitled to exercise voting rights in excess of 10 per cent.		
Share Holding Limits	Limits are prescribed, depending on category of shareholders: Promoter: Individuals and Non-financial entities: 15 per cent Non-Promoter: Individuals and Non-financial entities: 10 per cent of paid-up capital Promoter or Non-Promoter: (i) Non-regulated or non-diversified or non-listed financial entities: 15 per cent. (ii) Listed, regulated, and well diversified financial entities or supranational institutions or PSU or Govt. – 40 per cent (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.	No specific limits for different types of owners is prescribed With an objective to liberalise commercial banking in Singapore	There are no quantitative limits on shareholding by natural persons, or entities, in a bank in the United States.

Global bank ownership guidelines vis-a vis India

CONCLUSION:

Overall, this reform is a welcome step towards reforming the banking sector in India. There is always an argument that private participation may give rise to the next Yes bank but that by no way means we should indulge in restric-tive banking practices. Effective corporate governance is the only way from preventing banks from going bust. India has indulged in restrictive banking practices for far too long. If we want to move towards the goal of 5 trillion economy, it is only prudent to implement this landmark reform and bring in fresh capital to meet the requirements of a growth hungry economy.

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