SURVEY ON NEW BANK LICENSES

June 2013

FICCI

Federation House, Tansen Marg
New Delhi - 110 001

Key Highlights

- 96% of the respondents felt that **India needs new banks**
- 88% of the respondents felt that RBI condition for an applicant applying for a banking license to set up at least 25% of its branches in unbanked rural centres with a population of less than 9,999 **will play a significant role in expansion of banking services to mid cities and rural India and hence help in increasing financial inclusion in India**
- 75% of the respondents felt that **new banks will help in consolidating the banking sector.**
- Irrespective of the fact that the new banks will help in consolidation of the banking sector, 58% of the total respondents felt that new banks **should start afresh completely** while only 42% of the respondents felt that new banks **should acquire existing smaller banks and grow (Figure 4)**
- 69% of the respondents felt that **corporate/ industrial houses should be given licenses** while the remaining 31% felt that they should not be allowed to operate as banks
- On being asked to provide **any other parameters** that the respondents felt were **significant and should be therefore considered by RBI before issuing the license**, the top three parameters that emerged are Sound financial position and financial track record of promoters and all the group companies (53%); Deep understanding and experience in financial services including fiduciary financial services (29%); Binding all compulsions such as opening up of branches in unbanked areas, PSL targets, Basel norms and limited exposure to sensitive sectors (29%) **(Figure 7)**
- 59% of the respondents felt that the **process of issuing bank licenses** to new players should be an ongoing process **(Figure 8)**
- 30% of the respondents felt that the **time line for reviewing a new bank application** should be 6-12 months **(Figure 10)**
- 72% of the respondents felt that the **recommendations of the advisory committee** after its review of a new application should be considered seriously by RBI Board in granting license to an applicant rather than it being binding on the RBI Board **(Figure 12)**
- 64% of the respondents felt that other regulators should be a part of the Advisory Committee
- When asked about who should be **part of the Advisory Committee that will be formed by RBI,** an overwhelming 69 per cent of the respondents wanted to have public policy experts and financial sector experts on the committee **(Figure 13)**

Introduction

The recent guidelines on New Bank Licenses by RBI have opened the doors for the entry of third set of private banks into the Rs. 73 trillion banking sector. The guidelines have been issued after a gap of three years when the government first announced its plan to issue new bank licenses in the year 2010.

RBI has so far issued licenses to just 12 banks in two phases. It granted licenses to first 10 and then to 2 private sector banks in the years 1993-94 and 2003-04 respectively.

The primary objective of granting licenses to private sector banks in the first phase was to open up the Indian banking sector to private players. The main focus of issuing licenses this time is to foster financial inclusion.

The Indian banking sector predominantly comprises of public sector banks in which the government has a majority stake. According to RBI estimates, the government will have to infuse Rs. 70,000 crore – Rs. 90,000 crore capital in the public sector banks over the next five years to enable them to meet the capital requirements as stipulated under the Basel III norms. The new norms would be applicable from January, 2018.

Therefore, an expansion of banking services in terms of coverage by PSBs will entail huge investments from the government. Thus, allowing new banks in the system may help ease the burden of financial inclusion away from the public sector banks.

Extent of financial exclusion in India

- Only 35% of Indian population have formal bank accounts as compared to an average of 41% in developing economies
- Nearly 70% of India's population lives in villages. However, a vast majority of approximately 6,50,000 villages in India do not have a single bank branch thus leaving a huge chunk of rural population in the hands of money lenders. The total number of branches in rural India stood at 37,471 and the total banking outlets in villages after taking into account the Branches, Business Correspondents and other modes was just 1,81,753 (as on March, 2012)
- 80% of the Indian population is without life insurance, while 90% are excluded from the non – life insurance category

Table 1: Select Indicators of Financial Inclusion – Cross Country Comparison

Country	Number of branches (per 0.1 million adults)	Number of ATMs (per 0.1 million adults)	Bank loan as per cent of GDP	Bank deposits as per cent of GDP
1	2	3	4	5
India	10.64	8.90	51.75	68.43
Australia	46.15	119.63	40.28	53.26
Brazil	46.15	119.63	40.28	53.26
France	41.58	109.80	42.85	34.77
Mexico	14.86	45.77	18.81	22.65
United States	35.43	-	46.83	57.78
Korea	18.80	-	90.65	80.82
Philippines	8.01	17.70	21.39	41.93

All data pertain to 2011 Source: Trends and Progress of Banking in India

Apart from improving financial inclusion in India, new banks can potentially be the game changers in the following ways:

1. They can bring in the new processes and technology and will play a significant role in driving competition. It will also encourage existing players to improve efficiency
2. New players with sound financial base will bring in the much needed capital that is required to support the credit needs of the economy
3. Last but not least, they will generate huge employment opportunities

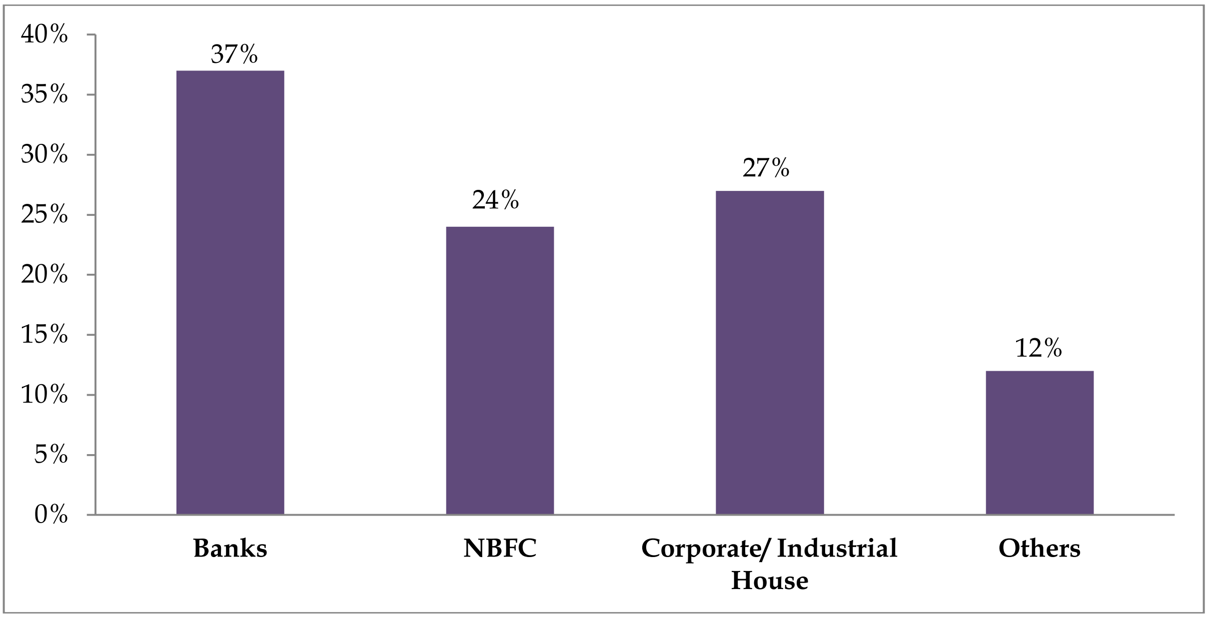
All the above will help in improving the overall efficiency level of the banking sector and in light of this, the guidelines are a welcome step in the right direction.

1. Need for New Banks

RBI's decision to allow new players in the banking industry has been very well received by the respondents of this survey.

96% of the respondents felt that India needs new banks. It was felt that allowing new players will lead to an expansion of the banking sector and will therefore help in supporting the government's agenda of financial inclusion.

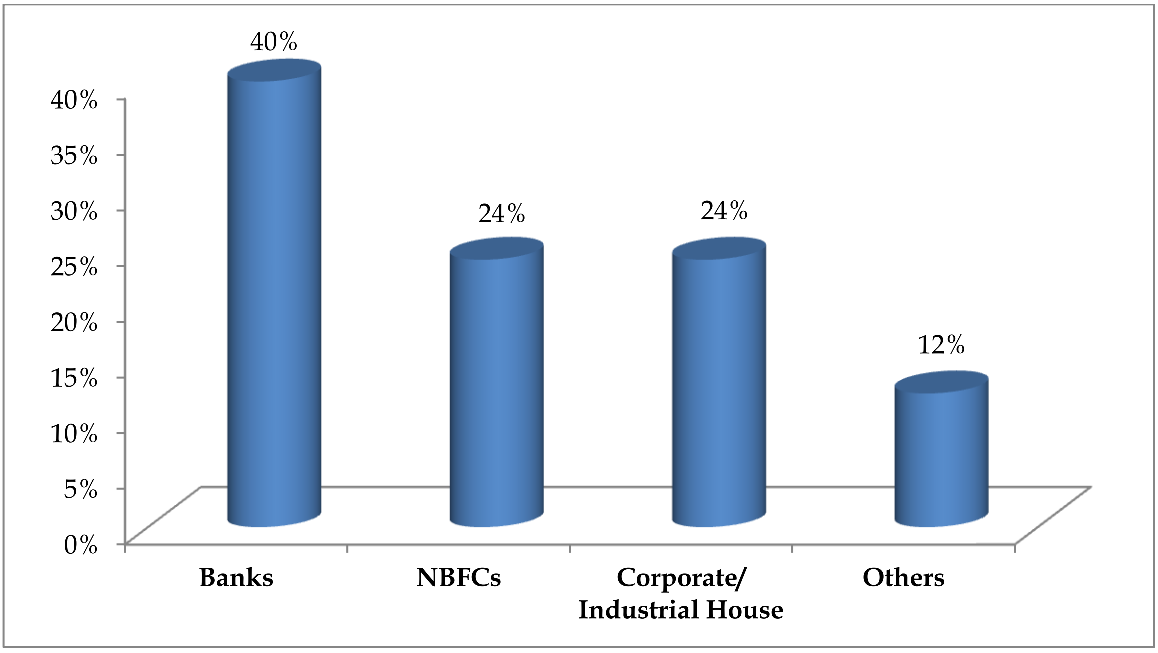
Figure 1: Category – wise segregation
Respondents in favour of new banks



RBI has also stipulated that any applicant applying for a banking license should set up at least 25% of its branches in unbanked rural centres with a population of less than 9,999.

88% of the respondents felt that this move will play a significant role in expansion of banking services to mid cities and rural India and hence help in increasing financial inclusion in India.

Figure 2: Category – wise segregation
New Banks will play a significant role in financial inclusion



2. Consolidation of Indian Banking Sector

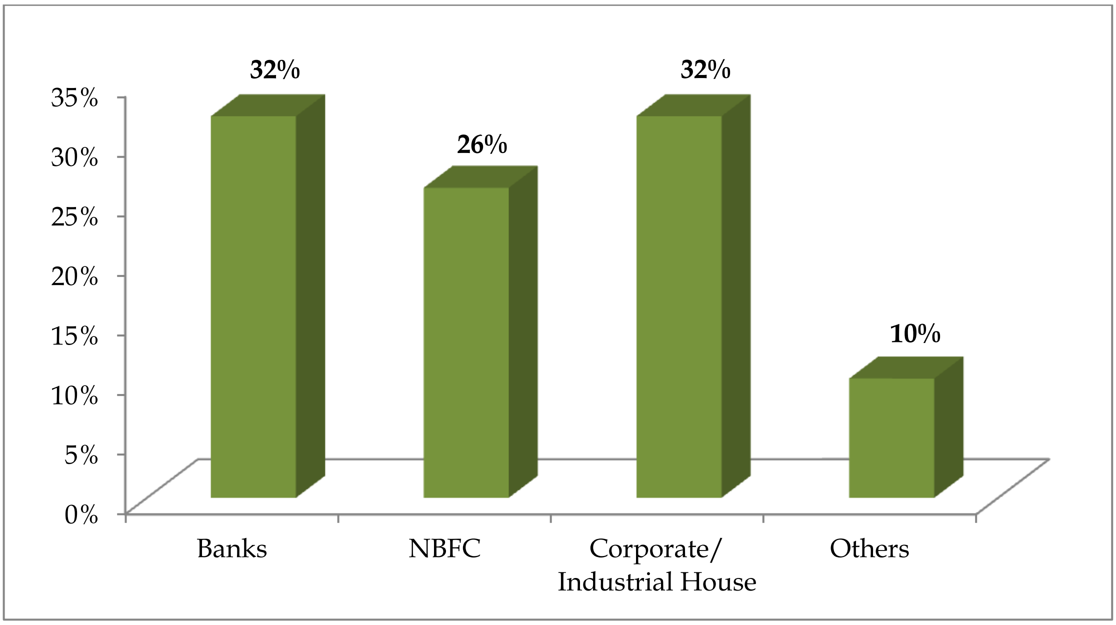
At present, there is not even a single Indian Bank which ranks amongst the top 20 banks of the world, based on market capitalisation, as compared to China which has four of its banks in the list of top 20 global banks. Furthermore, China has at least 11 banks in the list of top 100 global banks as compared to India which has only 3 banks. As of 2013, the Industrial and Commercial Bank of China (ICBC), a state owned commercial bank in China, has a market capitalisation of US$ 238 billion while the combined market capitalisation of the three Indian banks put together is just US$ 90 billion, thereby indicating a stark difference in the scale of banking operations of the two countries.

Not just the scale but the size of the Chinese banking industry sets it apart from its Indian counterparts. This is quite evident from the fact that in the year 2010, China had more than 250 commercial banks, 1,96,000 business outlets and nearly 3 million employees. On the other hand, India had just 167 commercial banks, 87,768 business outlets and around 0.8 million employees.

So while new banks are important to remain competitive, it is also evident that consolidation is also the need of the hour to match to the levels of international banks.

About 75% of the respondents felt that new banks will help in consolidating the banking sector.

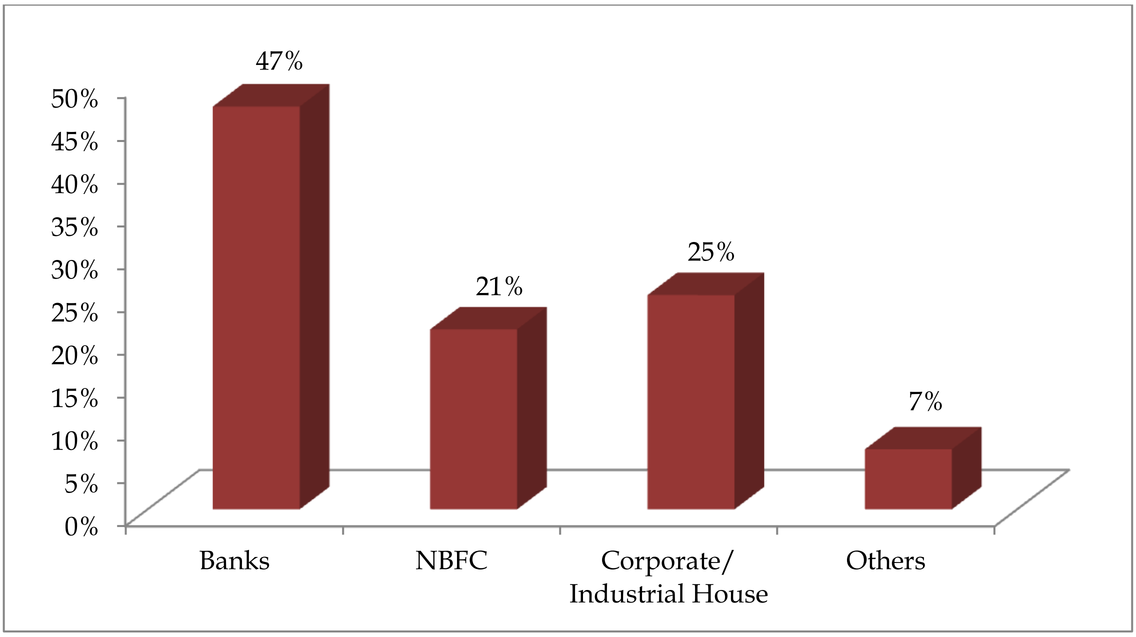
Figure 3: Category – wise segregation
New Banks will help in consolidating the Indian Banking Sector



While 75% of the respondents felt that new banks will help in consolidating the banking sector, it was quite surprising to note that only 39% of these 75% respondents felt that new banks should acquire existing smaller banks and then grow.

However, irrespective of the fact that the new banks will help in consolidation of the banking sector, 58% of the total respondents felt that new banks should start afresh completely while only 42% of the respondents felt that new banks should acquire existing smaller banks and grow.

Figure 4: Category – wise segregation
New banks should start afresh completely



3. Allowing corporate/ industrial houses to enter the banking sector

Industry has applauded RBI for adopting a balanced and a systematic approach in issuing the final guidelines. In contrast to the draft guidelines, in its final guidelines, RBI does not exclude any entity from applying for a banking license but at the same time ensures that the entity applying for a banking license meets the prudential norms and other eligibility requirements.

The public debate on allowing of corporate entities to enter into the banking sector has been diverse. Most, who are not in favour of allowing corporate entities to set up banks, expressed apprehension over possible misuse of the licenses to benefit group companies of the corporate entity and the difficulties that may arise in monitoring the flow of credit to these group companies. There have also been questions raised with regard to possible conflict of interest that may arise.

On the other hand, those in favour of allowing corporate entities into the banking sector have stated that well capitalised corporate companies can play a significant role in reaching out to unbanked population spread across India. Moreover, India has witnessed many success stories of corporate entities entering other financial sector businesses, such, as, insurance, mutual funds and even non-banking financial corporations (NBFC). Furthermore, the passing of the Banking Laws (Amendment Bill) in December, 2012 gives RBI enough powers to call for information and returns of group companies and associates of banks in order to inspect the same should it be necessary.

69% of the respondents felt that corporate/ industrial houses should be given licenses while the remaining 31% felt that they should not be allowed to operate as banks.

Figure 5: Category – wise segregation
Respondents in favour of corporate/ industrial houses to operate as banks

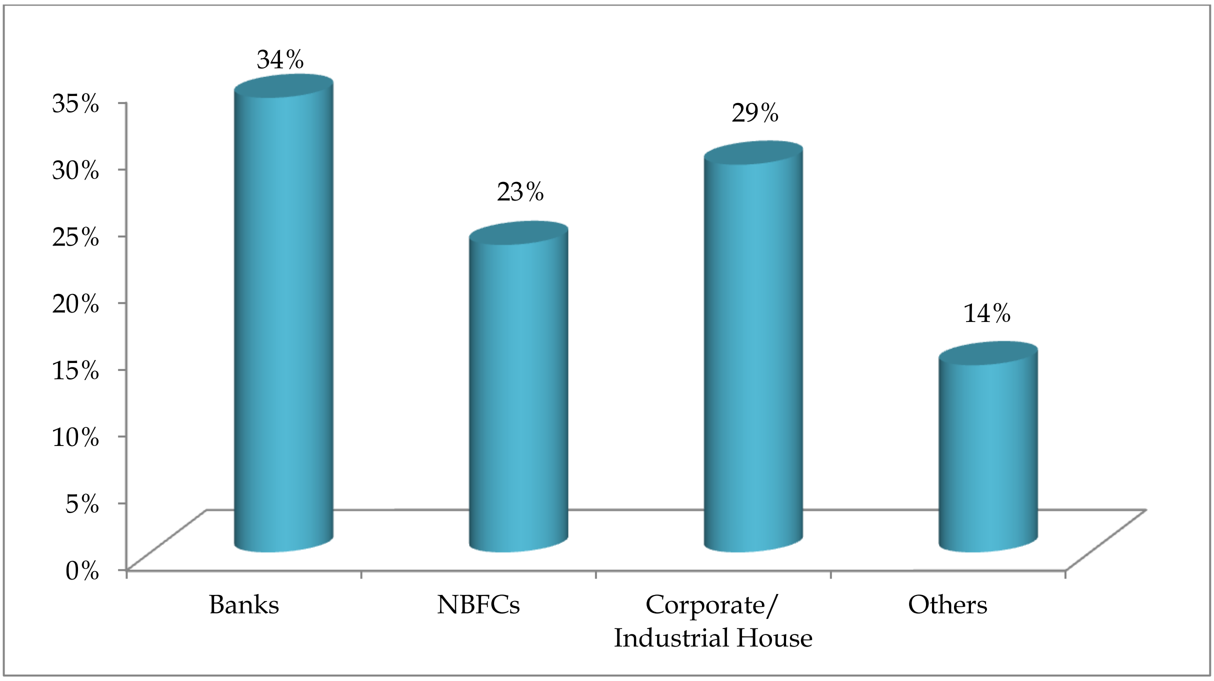
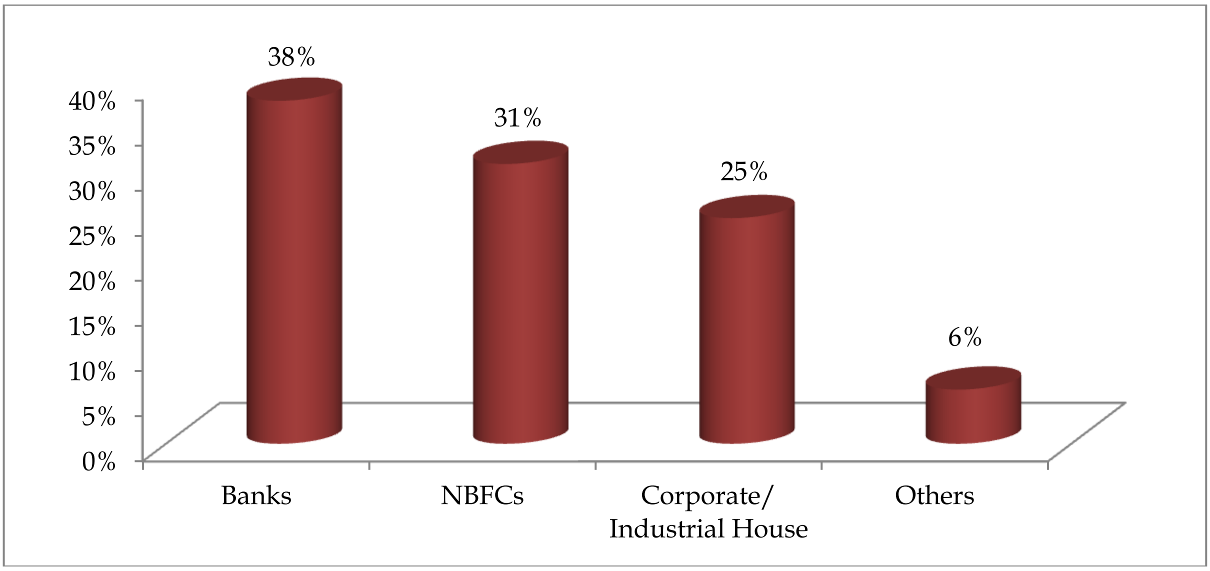


Figure 6: Category – wise segregation
Respondents not in favour of allowing corporate/ industrial houses to operate as banks



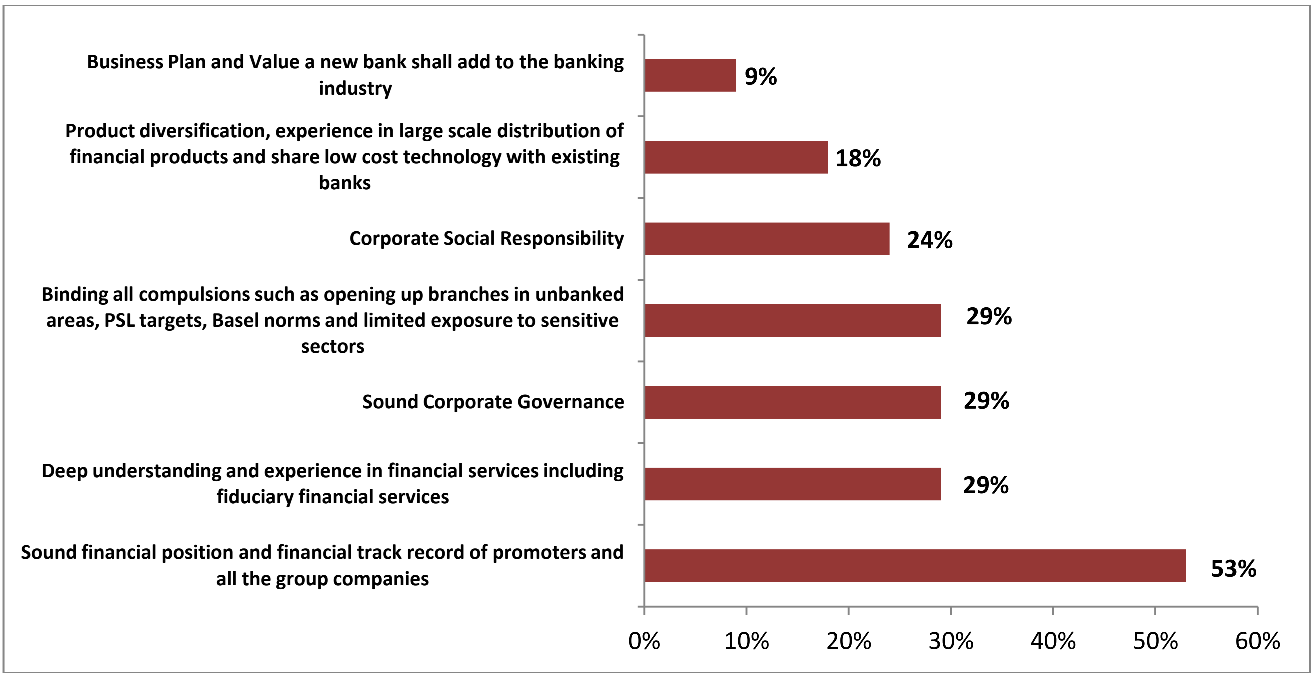
4. New Bank Licenses Issuing Process

(a) Broad Based Parameters

The RBI Guidelines on New Bank Licenses are quite comprehensive in terms of the parameters for consideration while reviewing the application of prospective entrant. Some of the criteria such as diversified ownership, sound credentials and integrity and a successful track record of atleast 10 years, besides having adequate capital, indicates the cautious approach that RBI would like to adopt before issuing the new bank license.

The survey also asked respondents to provide any other parameter that they thought were significant and should be therefore considered by RBI before issuing the license.

Figure 7: Other Parameters for evaluating new applications

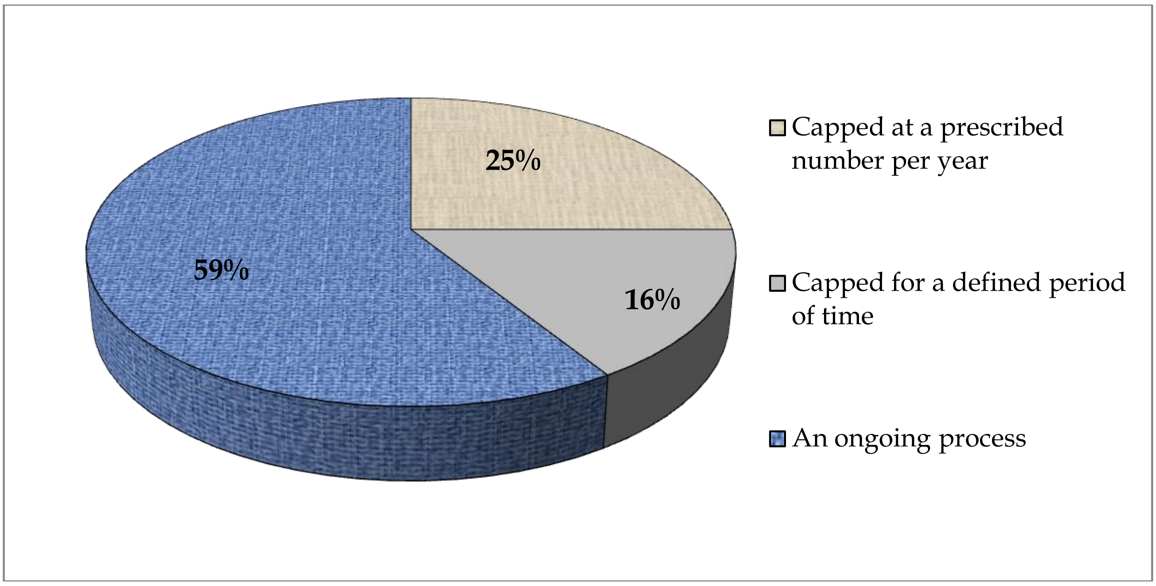


(b) Number of Licenses

Currently, RBI has not set any limit on the number of licenses that it will issue to new players. However, the final guidelines state that the licenses will be issued on a very selective basis. This is quite unlike the year 2001 when RBI had made it clear that the number of licenses to be issued over a three year period will be restricted to a maximum of two or three.

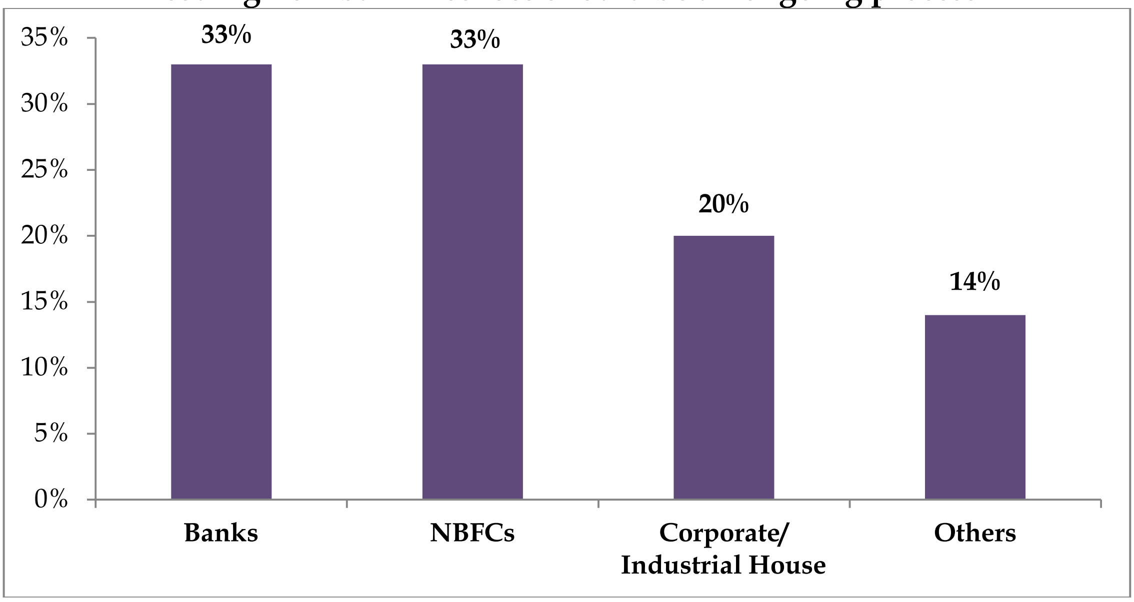
59% of the respondents felt that the process of issuing bank licenses to new players should be an ongoing process.

Figure 8: Number of New Bank Licenses



It was interesting to note that none of the respondents felt that it would be suitable for RBI to set a cap on licenses for an indefinite period of time.

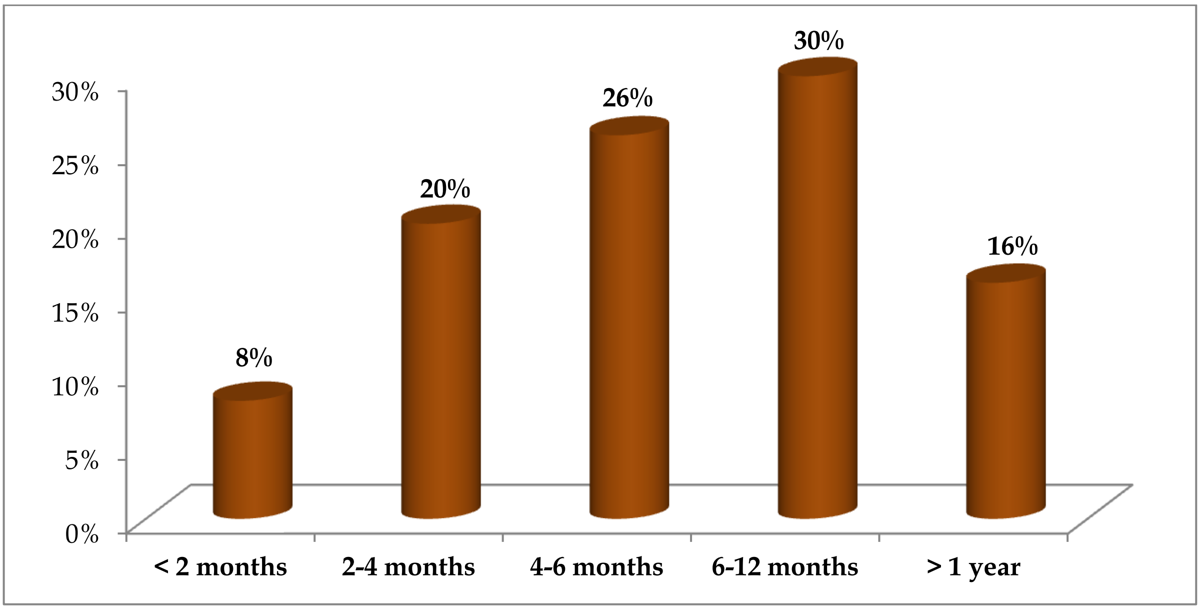
Figure 9: Category – wise segregation
Issuing new bank licenses should be an ongoing process



(c) Timeline for Reviewing an Application

30% of the respondents felt that the time line for reviewing a new bank application should be 6-12 months. Respondents felt that this was ample time for RBI to review the applications closely before coming to its final verdict on whether a banking license should be granted to any particular company.

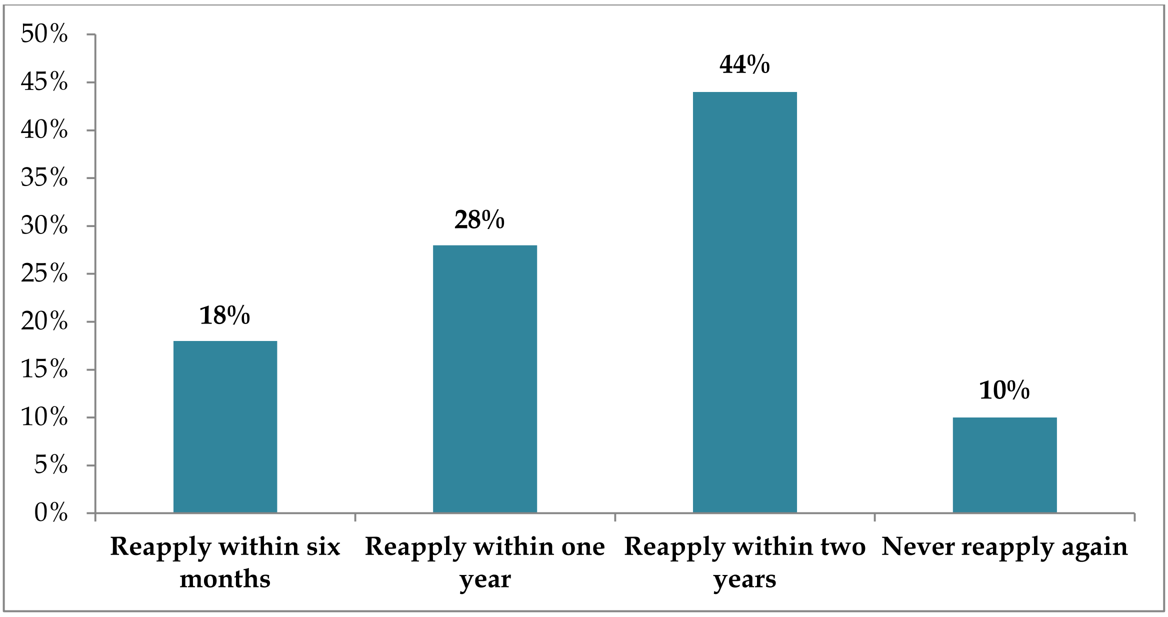
Figure 10: Timeline for reviewing a new bank application



(d) Reapplication in case of a rejection

In the case of an application being rejected, 44% of the respondents felt that the applicant should be allowed to reapply within two years.

Figure 11: Re-application in case of a rejection

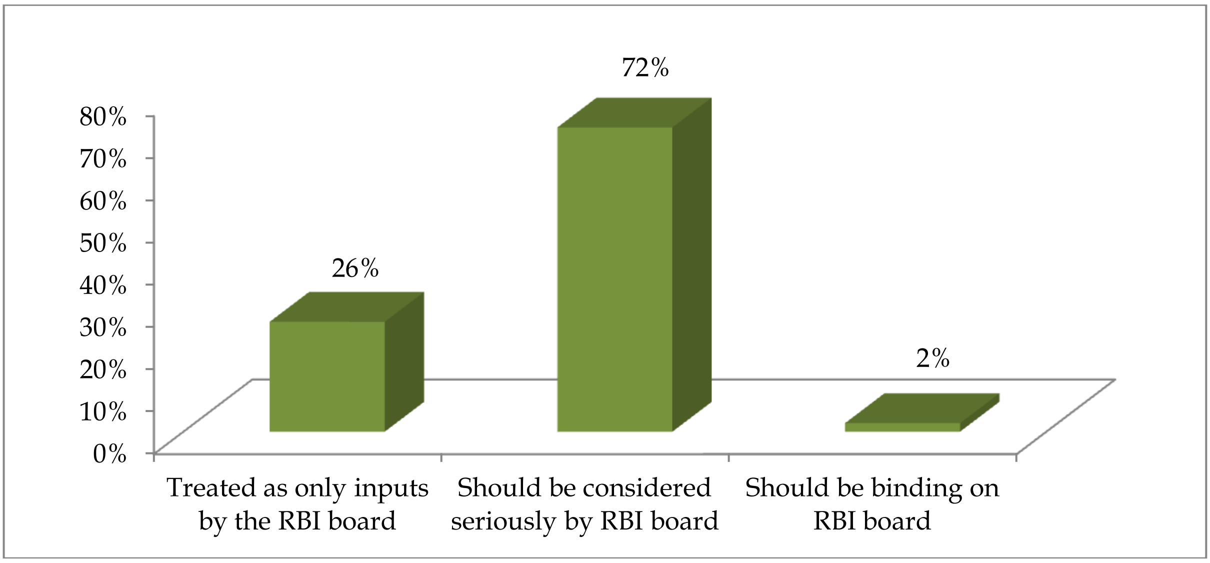


5. **Role of Advisory Committee**

Once RBI receives all applications by July 1, 2013, it will undertake an in- depth examination of all applications. Thereafter, all the applications will be referred to a High level Advisory Committee, the composition of which will be decided by RBI shortly.

72% of the respondents felt that the recommendations of the advisory committee after its review of a new application should be considered seriously by RBI Board in granting license to an applicant rather than it being binding on the RBI Board.

Figure 12: Recommendations of the Advisory Committee



Also, 64% of the respondents felt that other regulators should be a part of the Advisory Committee.

When asked about who should be part of the Advisory Committee that will be formed by RBI, an **overwhelming 69 per cent of the respondents wanted to have public policy experts and financial sector experts on the committee.** Other suggestions were to have other regulators from the financial sector and prominent bankers (retired and working) as part of the Committee.

Figure 13: Members of the Advisory Committee