ENTRY OF NEW BANKS IN THE PRIVATE SECTOR – DISCUSSION PAPER

1. INTRODUCTION

1.1 The Union Finance Minister, in his budget speech for the year 2010-11 had announced that '*The Indian banking system has emerged unscathed from the crisis. We need to ensure that the banking system grows in size and sophistication to meet the needs of a modern economy. Besides, there is a need to extend the geographic coverage of banks and improve access to banking services. In this context, I am happy to inform the Honourable Members that the RBI is considering giving some additional banking licences to private sector players. Non Banking Financial Companies could also be considered, if they meet the RBI's eligibility criteria*.'

1.2 Subsequently, in line with the above announcement, the Governor, Reserve Bank of India indicated in the Annual Policy Statement for the year 2010-11 that the Reserve Bank will prepare a discussion paper marshalling the international practices, the Indian experience as well as the extant ownership and governance (O&G) guidelines and place it on the Reserve Bank's website by end-July 2010 for wider comments and feedback. The Reserve Bank also noted that detailed discussions will be held with all stakeholders on the discussion paper and guidelines will be finalised based on the feedback. All applications received in this regard would be referred to an external expert group for examination and recommendations to the Reserve Bank for granting licenses.

2. WHY NEW BANKS IN INDIA

2.1 It is generally accepted that greater financial system depth, stability and soundness contribute to economic growth. But beyond that, for growth to be truly inclusive requires broadening and deepening the reach of banking. A wider distribution and access of financial services helps both consumers and producers raise their welfare and productivity. Such access is especially powerful for the poor as it provides them opportunities to build savings, make investments, avail credit, and more important, insure themselves against income shocks and emergencies.

2.2 As of March 31, 2009, the Indian banking system comprised 27 public sector banks, 7 new private sector banks, 15 old private sector banks, 31 foreign banks, 86 Regional Rural Banks (RRBs), 4 Local Area Banks (LABs), 1,721 urban cooperative banks, 31 state co-operative banks and 371 district central co-operative banks.

2.3 The average population coverage by a commercial bank branch in urban areas improved from 12,300 as on June 30, 2005 to 9,400 as on June 30, 2010 and in rural and semi urban areas from 17,200 as on June 30, 2005 to 15,900 as on June 30, 2010. The all India weighted average during the same period improved from 15,500 to 13,400.

2.4 Though the Indian financial system has made impressive strides in resource mobilization, geographical and functional reach, financial viability, profitability and competitiveness, vast segments of the population, especially the underprivileged sections of the society, have still no access to formal banking services.

2.5 The Reserve Bank is therefore considering providing licences to a limited number of new banks. A larger number of banks would foster greater competition, and thereby reduce costs, and improve the quality of service. More importantly, it would promote financial inclusion, and ultimately support inclusive economic growth, which is a key focus of public policy.

2.6 This discussion paper outlines past approaches, international experience, and considers the various costs and benefits of increasing the number of new banks as well as the pros and cons of various policy parameters in licensing new banks.

3. PAST APPROACH TO NEW BANKS

3.1 Reserve Bank's approach

3.1.1 When financial sector reforms were initiated in India in the early nineties, guidelines for licensing of new banks in the private sector were issued in January 1993 and subsequently revised in January 2001; the objective was to instill greater competition in the banking system to increase productivity and efficiency.

3.1.2 The revised 2001 guidelines by and large were still cautious in nature. Large industrial houses were not permitted to promote new banks. However, individual companies, directly or indirectly connected with large industrial houses were permitted to own 10 percent of the equity of a bank, but without any controlling interest.

3.1.3 An NBFC with good track records was considered eligible to convert into a bank, provided it was not promoted by a large industrial house and satisfied the prescribed minimum capital requirements, a triple A (AAA) or its equivalent, credit rating in the previous year, capital adequacy of not less than 12 percent and net Non Performing Assets (NPA) ratio of not more than 5 percent.

3.1.4 The initial minimum paid up capital was prescribed at Rs. 200 crore to be raised to Rs.300 crore within three years of commencement of business.

3.1.5 Promoters were required to contribute a minimum of 40 percent of the paid up capital of the bank at any point of time, with a lock-in period of five years. However, if the promoter's contribution to the initial capital was more than the minimum 40 percent, they were required to dilute their excess stake after one year of the bank's operations.

3.1.6 Non Resident Indians (NRIs) were permitted to participate in the primary equity of a new bank to the maximum extent of 40 percent. However, the equity participation was restricted to 20 percent within the above ceiling of 40 percent, in the case of a foreign banking company or finance company (including multilateral institutions) acting as a technical collaborator or a co-promoter.

3.1.7 Banks were required to maintain an arm’s length relationship with business entities in the promoter group and individual company/ies investing upto 10 percent of the equity. They could not extend any credit facilities to the promoters and company / ies investing up to 10 percent of the equity. The relationship between business entities in a promoter group and the bank had to be of a similar nature as between two independent and unconnected entities.

3.1.8 The shares of the bank had to be listed on a stock exchange.

3.1.9 Capital adequacy ratio of the bank had to be 10 percent on a continuous basis from the commencement of operations.

3.1.10 Banks were obliged to maintain upto 40 percent of their net bank credit as loans to the priority sector.

3.1.11 Banks were obliged to open at least 25 percent of their total number of branches in rural and semi urban centers.

3.2 Reserve Bank’s experience

3.2.1 10 new banks were set up in the private sector after the 1993 guidelines and 2 new banks after the 2001 revised guidelines. Out of these, four were promoted by financial institutions, one each by conversion of co-operative bank and NBFC into commercial banks, and the remaining six by individual banking professionals and an established media house.

3.2.2 Out of the four banks promoted by individuals in 1993, only one has survived with muted growth. One bank has been compulsorily merged with a nationalized bank due to erosion of networth on account of large capital market exposure. The other two banks have voluntarily amalgamated with other private sector banks over a period of 10 to 13 years due to the decisions of the majority shareholders arising out of poor governance and lack of financial strength.

3.2.3 Out of the remaining six banks that were licensed in 1993, one bank promoted by a media group has voluntarily amalgamated itself with another private sector bank within five years of operations and four banks promoted by financial institutions have either merged with the parent or rebranded and achieved growth over a period of time. The bank that was converted from a Cooperative bank has taken some time in aligning itself to the commercial banking and is endeavoring to stabilize itself.

3.2.4 The two banks licensed in the second phase have been functioning for less than 10 years and their transition from the settling stage has been fairly smooth.

3.2.5 The experience of the Reserve Bank over these 17 years has been that banks promoted by individuals, though banking professionals, either failed or merged with other banks or had muted growth.

3.2.6 Only those banks that had adequate experience in broad financial sector, financial resources, trustworthy people, strong and competent managerial support could withstand the rigorous demands of promoting and managing a bank.

3.2.7 The experience with small banks has not been encouraging, Out of the six Local Area Banks licensed, only four remain. The license of one has been cancelled due to serious misrepresentation / concealment of facts at the time of granting of licence and another has been merged with a bank on account of bad governance and unfit management. Of the remaining four, two though continuing to maintain minimum capital, liquidity and profitability, have not progressed much. The remaining two are functioning satisfactorily but their growth has been restrained due to inadequacies of the small bank model.

3.2.8 The Local Area Bank model has inherent weakness such as unviable and uncompetitive cost structures which are a result of its small size and concentration risk. Local Area banks are required to confine their operations to a small area of three districts. This concentration exposes the banks to the risk of adverse selection. Further, the size of operations and also the locational disadvantage of these banks act as a constraint to attracting and retaining professional staff as well as competent management. Corporate governance standards in these banks are also found wanting partly because of their concentrated ownership.

3.2.9 The experience with other small banks i.e. urban co-operative banks, and small deposit taking NBFCs is similar. Low capital base, lack of professional management, poor credit management, and diversion of funds have led to multi-faceted problems.

3.2.10 As such, in the interest of the depositors and the financial system as a whole, and also due to the thrust on the financial inclusion, banks should be required to start with sufficient initial capital. Further, strong capital base would also ensure that the banks withstand any adverse conditions in the financial sector as well as the economy.

4. RECOMMENDATIONS OF EXPERT COMMITTEES AND LESSONS FROM THE GLOBAL CRISIS

4.1 High Level Investment Commission

The February 2006 report of The High Level Investment Commission, constituted by the Government of India in December 2004 with the objective of enhancing both foreign and domestic investment levels in India, has, among other things, recommended permitting ownership in Indian banks of up to 15 percent by Indian corporates, and also to increase limits of holdings by any one foreign bank up to 15 percent in private banks.

4.2 High Level Committee on Fuller Capital Account Convertibility

The July 2006 report of The High Level Committee on Fuller Capital Account Convertibility, constituted by the Reserve Bank of India in March 2006 under the chairmanship of Shri S. S. Tarapore, has recommended that RBI should evolve policies to allow, on a case by case basis, industrial houses to have a stake in Indian banks or promote new banks. The policy may also encourage non-banking finance companies to convert into banks. It has also recommended that after exploring these avenues until 2009, foreign banks may be allowed to enhance their presence in the banking system.

4.3 Committee on Financial Sector Reforms

The September 2008 report of The High Level Committee on Financial Sector Reforms, constituted by the Government of India in August 2007 under the chairmanship of Dr. Raghuram G. Rajan, has recommended allowing more entry to private well-governed deposit-taking small finance banks with stipulation of higher capital adequacy norms, a strict prohibition on related party transactions, and lower allowable concentration norms (loans as a share of capital that can be made to one party). Such measures would also increase financial inclusion by reaching out to poorer households and local small and medium enterprises.

4.4 Lessons from the recent global financial crisis

4.4.1 A constellation of regulatory practices, accounting rules and incentives magnified the credit boom ahead of the recent global financial crisis. The same factors accelerated the downturn in markets and intensified the crisis. Macroeconomic stability and financial stability were generally treated as separate and unrelated constructs with the former focusing on preserving low and stable inflation, while the latter dealing with the firm-level supervision of the formal banking sector. In this process, not only was the growing shadow financial sector ignored, but also factors such as the interconnectedness within the complex financial system, especially between banks and the financial institutions, the systemic risk arising out of too-big-to-fail entities and system-wide liquidity needs.

4.4.2 Though the epicentre of the crisis lay in the sub-prime mortgage market in the US, it was transmitted rapidly throughout the globe, destabilizing financial markets and banking systems. The crisis eventually impacted the broader macro-economy, affecting economic growth and employment throughout the world.

4.4.3 The magnitude of this crisis has clearly signaled the need for major overhaul of the global financial regulatory architecture, the importance and need for improving quality and level of capital, risk management and governance standards, having strong domestic (indigenous) banks, avoiding large and complex banking structures as well as strengthening banks' transparency and disclosures.

5. <u>ISSUES FOR CONSIDERATION</u>

Various opinion makers have expressed views about the desirability of permitting new banks (including local area banks), allowing conversion of NBFCs into banks and whether large industrial and business houses should be allowed to set up banks. A number of issues, however, bear consideration. These include:

⇒ **Minimum capital requirements for new banks and promoters contribution**

⇒ **Minimum and maximum caps on promoter shareholding and other shareholders**

⇒ **Foreign shareholding in the new banks**

⇒ **Eligible Promoters**

(A) Whether industrial and business houses could be allowed to promote banks

(B) Should Non-Banking Financial Companies be allowed conversion into banks or to promote a bank

⇒ **Business Model**

This paper reviews the international and Indian experience on all these aspects together with possible approaches with discussion on the pros and cons of each of the approaches. Annexures I, II and III indicating the country-wise experience in respect of licensing of banks, as indicated by the international banking regulators, are also annexed to the discussion paper. Based on the feedback, comments, suggestions received on the possible approaches discussed in this paper and detailed discussions with the stakeholders, the RBI will frame detailed guidelines for licensing of new banks and invite applications for setting up new banks. All applications received would then be examined by an external group, who would then make recommendations to the RBI with regard to granting licences to the applicants. However, the intention is to grant a limited number of licences.

6. Minimum capital requirements for new banks and promoters contribution

6.1 International Experience

6.1.1 Internationally, the bank regulators either insist on certain initial minimum capital to be brought by the applicant/applicants (e.g., European Union, Germany, France, United Kingdom, Japan, Canada, Hong Kong, Malaysia, Singapore) to obtain a banking license, or assess the required start-up capital to be brought by the proposed bank based on the scale, nature, complexity and inherent risks of the operations as proposed in the business plan (e.g., Australia, USA).

6.1.2 Minimum capital requirements range between USD 1.6 million (INR 8 crore) in Argentina to USD 1077.8 million (INR 5389 crore) in Singapore.

6.1.3 Out of the statistics available for 21 countries, four countries have minimum capital requirements exceeding USD 100 million (INR 470 crore) viz. Malaysia – USD 618.8 million (INR 3094 crore), Kuwait – USD 257.3 million (INR 1286 crore), Indonesia – USD 331 million (INR 1655 crore) and Singapore – USD 1077.8 million (INR 5389 crore).

6.1.4 However, in Australia and USA the capital requirements are prescribed on a case to case basis depending on the business plan, scale, nature and complexity of operations. Further, in Hong Kong and Argentina, minimum capital is determined in accordance with the type of financial institution being established.

6.2 Indian Approach

6.2.1 The guidelines issued in 1993 for licensing of new banks in the private sector had prescribed Rs. 100 crore as minimum capital and the 2001 guidelines raised this to Rs. 200 crore to be increased to Rs.300 crore over three years from commencement of business.

6.2.2 In India, as there are only full-fledged bank licenses with no restricted licenses being given, the minimum capital requirement has been kept reasonably high.

6.2.3 Taking into account the lapse of time since the last guidelines issued in January 2001 and inflation since then, there is a case to have the minimum capital requirement at more than Rs. 300 crore.

6.2.4 Possible Options/Solutions

(a) Having a low minimum capital requirement (but more than Rs.300 crore) for new banks

PROS

- This may attract those who are serious about participating in financial inclusion to set up banks.
- This may result in optimum utilization of capital from the beginning.

CONS

- It may result in many non-serious entities with inadequate financial backing seeking banking licenses.
- Small banks suffer from disadvantages in scale and scope and also face concentration risk making them more vulnerable.
- A low capital requirement could lead banks to run out of capital early, leading to increased risk taking for showing higher profit to attract more capital.
- Even serious parties with limited financial backing entering the banking space may not be able to participate meaningfully in financial inclusion as investment in technology would be a major requirement.
- Ensuring fit and proper shareholding and directors of large number of small banks is quite onerous.
- Large number of small banks lead to weakening of supervision in the sector by putting pressure on supervisory resources.

(b) Having a high (say Rs.1000 crore) minimum capital requirement for new banks

PROS

- In India, since licenses are given to only full-fledged bank, adequate minimum capital requirement may be necessary to ensure that the banks operate on a strong capital base.
- Higher minimum capital requirement would evince interest from serious parties with sufficient financial backing.
- Such banks would be able to play a more meaningful role in financial inclusion, as they are able to invest resources in technology and partnerships for financial inclusion.

CONS

- Promoters may not be seriously committed to financial inclusion as they are likely to be focused on more profitable large ticket size commercial banking.

(c) Initial minimum capital may be prescribed at say Rs.500 crore with a condition to raise the amount to say Rs.1000 crore within a period of say 5 years.

PROS

- It will enable applicants from a wider spectrum, i.e. those willing to focus on financial inclusion as well as those interested in more sophisticated commercial banking, to seek a banking licence.
- It would be easier to dilute the promoters' stake to a lower percentage of the total capital of the new bank as the bank grows.

CONS

- This could invite the not very serious applicants to set up a new bank.
- Some of the newly licenced banks may not be able to fulfill this condition of scaling up the capital and level of operations.

7. <u>Minimum and maximum caps on promoter shareholding and other shareholders</u>

7.1 International Experience

7.1.1 Internationally, most banking jurisdictions require banks to be widely held. There are no separate limits or caps for the promoters, but the same rule applies to other shareholders. Hence the promoters are required to seek approval from appropriate authorities if they desire to hold, directly or indirectly, or cross the general threshold limits ranging from 5 percent in Japan to 50 percent in European Union**.**

7.1.2 The general threshold limits in various countries that require approval from the competent authorities are - Germany (20%, 30%, 50%), Australia (15%), Canada (10%, 20%, 30%), European Union (20%, 30%, 50%), France (10%), Japan (5%).

7.1.3 In Hong Kong, for instance, there is no restriction on the maximum percentage of shares that an individual can hold in an Authorised Institution (AI). However, a person who intends to hold 50 percent or more of the share capital of an AI should be a well established bank or other supervised financial institution in good standing in the financial community and with appropriate experience.

7.1.4 In Canada, the approval thresholds are 10 percent, 20 percent and 30 percent where Ministerial approvals are required for acquiring such shareholding. Further, there is differential treatment with respect to maximum permitted shareholding in banks depending on whether the banks are small, medium or large sized banks. In case of small bank (with equity less than $ 2 billion) shareholding could be permitted beyond 10 percent and up to 100 percent with the permission of the Minister. In case of medium sized bank (with equity more than $ 2 billion but less than $ 8 billion), shareholding could be permitted beyond 10 percent and up to 65 percent with the permission of the Minister, subject to the condition that at least 35 percent of voting shares should be listed in the stock exchanges. Further, in case of large banks (with equity of $ 8 billion or more), shareholding could be permitted beyond 10 percent of any class of shares and up to 20 percent of any class of voting shares or up to 30 percent of any class of non-voting shares with the approval of the Minister, provided the person does not control the bank and is not a major shareholder (holding more than 20 percent of shares). The exceptions to the bar on being major shareholders in such large banks are bank holding companies and certain eligible institutions (e.g. widely held insurance holding companies, widely held Canadian financial institutions, eligible foreign institutions). However, widely held bank holding companies are permitted to own 100 percent of the shares of the subsidiary banks in Canada. Thus, Canada has tighter norms for ownership and control with respect to large banks and has relaxed norms for the small and medium sized banks.

7.1.5 In USA, there are no conditions relating to dilution of stake of promoters / shareholders because of other conditions relating to control.

7.2 Indian approach

7.2.1 Modern banking in India started with the establishment of a limited number of banks by British agency houses, which were largely confined to port centres, for financing of trade in the raw materials needed for British industries. The Indian enterprises made significant entry into banking business only during the early twenties, which got strengthened by the growing nationalist sentiment and the spread of the Swadeshi movement. The economic power in the Indian joint stock banks was concentrated in the hands of a few families, who managed to make the bulk of its finance available to themselves, favoured groups and their concerns. Moreover, the bulk of the bank advances were diverted to industry, particularly to large and medium-scale industries and big and established business houses, while the needs of vital sectors like small-scale industry, agriculture and exports tended to be neglected. It was only due to the impact of the diversification and growth of Indian industry during the Second World War as also the Five Year Plans on industrial development in the fifties that Indian banks changed their banking policies and stance to a certain extent.

7.2.2 The banking system, being an important intermediary through which the savings of the community got channelized and served as a key constituent of country's basic social and economic objective, the Government of India introduced a scheme of '*social control*' over banks in 1967 with the main objective of achieving a wider spread of bank credit, preventing its misuse, directing a larger volume of credit flow to priority sectors and making it a more effective instrument of economic development.

7.2.3 Subsequently, in July 1969, 14 major commercial banks were nationalized, the basic objective of which was to ensure that credit was channeled to various priority sectors of the economy, which were hitherto neglected, and in accordance with the national planning priorities. The nationalization of commercial banks marked a paradigm shift in the focus of banking as it sought a shift from class banking to mass banking and a thrust to branch expansion in the rural and semi-urban areas as also stepping up of lending to the so called priority sectors. Additional statutory powers were conferred upon the Reserve Bank, not only with the objective of protecting the depositors' interest, but also to ensure that particular clients or groups of clients are not favoured in the matter of distribution of credit and whatever the character of the shareholding, its influence is neutralized in the constitution of the board of directors and in the actual credit decision taken at different levels of bank management.

7.2.4 To avoid problems arising out of possible conflict of interests, such as connected lending, the 1993 and 2001 guidelines on entry of new private sector banks sought to reduce the control of functions of banks by the promoters.

7.2.5 In India, the promoters have been allowed to bring in higher stake (minimum of 40 percent of the paid-up capital of the bank) at the time of licensing of banks with a lock-in period of 5 years. The main intention was to have a stable capital base, and strong professional management, but without any interference or control of management by the promoters.

7.2.6 The February 2005 Ownership and Governance (O & G) guidelines require promoters and other shareholders of the banks to divest/dilute their shareholding to a level of 10 percent or below of the bank's share capital within a specified time frame. However, under exceptional circumstances and where the ownership is that of a financial entity, that is well established, well regulated, widely held, publicly listed and enjoying good standing in the financial community, higher shareholding is permitted to a level of more than 10 percent up to 30 percent. A level exceeding 30 percent is subject to higher due diligence standards prescribed in the February 2004 guidelines for acknowledgement of transfer / allotment of shares in private sector banks.

7.2.7 Any acquisition or transfer of shares of private sector banks, taking the aggregate shareholding of an individual or group, either directly or indirectly to 5 percent or more of share capital, requires acknowledgement from the Reserve Bank of India which is aimed at ensuring that the significant shareholders are fit and proper.

7.2.8 Banks (including foreign banks having branch presence in India) and financial Institutions are not permitted to acquire any fresh stake in a bank's equity shares, rendering its holding to exceed 5 percent of the investee bank's equity capital. This is with a view to limit interlocking of capital within the banking system.

7.2.9 Possible Options/Solutions

(a) Retaining the current approach of requiring promoters to bring in a minimum of 40 percent of capital with lock-in clause for 5 years and the threshold for other significant shareholders to be restricted to maximum of 10 percent with the requirement to seek acknowledgement from Reserve Bank of India on reaching 5 percent threshold and above. Promoters too would have to dilute to the extent required in a time bound manner say, 5 years after the lock in period.

PROS

- Large shareholding by promoters in the initial stage would ensure that the bank has promoters' stake in the development of the bank in the initial stages while the dilution requirement would lead to diversified holding without significant control on the functions of bank.
- Requiring dilution of shareholding upfront at the time of licensing would ensure that only promoters having no interest in exercising control over the banks would seek bank license.
- The bank would be run professionally in the long run in the absence of any significant influence.

CONS

- Serious promoters may find the dilution requirement to a very low level unattractive and could deter them from setting up a bank.

- In the absence of any serious promoter, the bank may lack the vision and direction a new bank may require.
- In the absence of a serious promoter, there would be difficulty in fixing accountability and responsibility for the affairs of the bank.

(b) Retain the general threshold for the shareholders at 5 percent of the capital but raise the threshold for promoters and other significant shareholders to say 20 percent in the long run. Higher shareholding could be considered exceptionally subject to increasingly stringent criteria.

PROS

- This could invite serious promoters as well as serve the purpose of diversified shareholding.
- Due to the long term interest, the promoters would be interested in formulating long term vision and goals, provide direction, take keen interest in improving business and profitability in order to protect their reputation.
- The promoters would be interested in infusing capital into the bank in times of distress to protect their reputation.
- For the regulator, fixing responsibility and accountability becomes easier.

CONS

- Any change would also have to be implemented for other existing banks.
- The promoters and other shareholders may not consider the level of shareholding significant enough for committing resources and energies. Alternatively, this level may not be low enough to ensure there is no significant influence. As such there may be neither a totally professional organization nor one that has a strategic driving force.

(c) Allow promoters to hold their initial shareholding of 40 percent

PROS

- This would ensure continuing stake of promoters in the bank with all the attendant benefits of providing direction, commitment and resources.

CONS

- This would lead to concentrated shareholding in banks, which in the Indian context is found to be detrimental to depositors' interests in the long run.

- The promoters would gain control on the functioning of banks, which may lead to diversion of depositors' funds, lending within the group on non-commercial terms, connected lending, etc.

(d) Follow the Canadian Model (para 7.1.4) of shareholding pattern

Schematically a model for India could be : no restriction on ownership up to 5 / 10 percent with permission to hold up to 40 percent of capital in banks with shareholders' equity up to say Rs. 1000 crore, 30 percent of capital in banks with shareholders' equity more than say Rs. 1000 crore and up to say Rs. 2000 crore, and permitted maximum holding (10 percent or 20 percent) in banks with shareholders' equity of more than say Rs. 2000 crore.

PROS

- The promoters' support and direction would be available to the bank in the formative years, with the advantage of ensuring long term vision, goals and direction for the bank.
- Once the bank grows to a substantial size and has the potential of creating an impact in the financial system, this model ensures that the bank is run professionally and that there is no controlling shareholder influencing the functions of the bank.
- After achieving sufficient experience and growth in size, the bank would be performing professionally and on its own strength.
- The bank will have the option to decide its business model and size consistent with promoters' interest in the extent of shareholding.

CONS

- This would lead to concentrated shareholding for smaller banks with the attendant disadvantages.
- This could induce the promoters to expand their business very slowly so as to have control for a longer period and thus underperform from the economy's perspective.
- Once the promoters help establish the bank in the financial sector and achieve substantial growth, there may be some resistance to giving up their control and shareholding, leading to possible non transparent shareholding.

8. <u>Foreign shareholding in the new banks</u>

8.1 Indian Approach

8.1.1 The 2001 guidelines on entry of new banks permitted NRIs to participate in the primary equity of a new bank to the maximum extent of 40 percent. However, the equity participation was restricted to 20 percent within the above ceiling of 40 percent, in the case of a foreign banking company or finance company (including multilateral institutions) acting as a technical collaborator or a co-promoter.

8.1.2 Subsequently, based on the March 5, 2004 Press Note 2 of the Government of India's (Ministry of Commerce and Industry), the aggregate foreign investment from all sources (FDI, FII, NRI) in private sector banks was not to exceed 74 percent of the paid-up capital of the bank, under the automatic route. This included FDI, investment under Portfolio Investment Scheme (PIS) by FIIs and NRIs, and also included IPOs, Private Placements, GDRs/ADRs and acquisition of shares from existing shareholders.

8.1.3 Further, the FDI policy prescribes that at all times, at least 26 percent of the paid up capital of private sector bank will have to be held by residents, except for wholly-owned subsidiary of a foreign bank.

8.1.4 The sub caps for individual FII and NRI holding is restricted to 10 percent with the aggregate limit for all FIIs and NRIs capped at 24 percent and 10 percent respectively, with a possibility to raise cap with the approval of the Board/General Body to 49 percent and 24 percent respectively.

8.1.5 Transfer of shares under FDI from residents to non-residents requires approval of Foreign Investment Promotion Board (FIPB) under Foreign Exchange Management Act (FEMA).

8.1.6 The February 3, 2004 RBI guidelines on grant of acknowledgement of transfer/allotment of shares in private sector banks is also applicable to acquisition of shares by foreign investors, if such acquisition results in any person owning or controlling 5 percent or more of the paid up capital of the private bank.

8.1.7 However, the Press Notes 2, 3 & 4 issued by Government of India in February 2009 indicate that banks with foreign shareholding of more than 50 percent would be treated as nonresident owned banks. In the event of the foreign shareholders having the right to appoint majority of directors on the Board, the bank would be treated as nonresident controlled bank.

Since the objective is to create strong domestic banking entities and a diversified banking sector which includes public sector banks, domestically owned private banks and foreign owned banks, aggregate non-resident investment including FDI, NRI and FII in these banks could be capped at a suitable level below 50 percent and locked at that level for the initial 10 years.

PROS

- This would enable foreign capital to be used in the promotion of domestic banks.
- This would allow for foreign technical collaboration in setting up domestic banks.
- The downstream investment of banks for monitoring indirect foreign investment would not be an issue.

CONS

- Foreign capital willing to invest in banking or promote banks in India will be constrained.
- Raising of additional capital predominantly from domestic sources may pose a problem;
- This would be in contrast to the present FDI policy which allows 74 percent foreign equity in private sector banking.
- Banks may not be able to use the innovative approaches brought in by foreign promoters.

9. Eligible Promoters

9.1 (A) Whether industrial and business houses could be allowed to promote banks

9.1.1 International Experience

9.1.1.1 Although commercial business ownership of banks by non-financial firms is not legally prohibited in most of the countries, the concerned home countries' laws and regulations typically limit the percentage of voting rights and controlling positions that any shareholder could obtain with prior approval of the regulatory authorities. This regulates the influencing power of the commercial shareholders in bank decision banking.

9.1.1.2 Further, most developed country's banking regulators/jurisdictions such as, Australia, Canada, European Union, Germany, France and United Kingdom do not specifically restrict industrial companies from setting up banks, but limit the percentage of voting rights and controlling positions that any shareholder can obtain, with the prior approval of the regulatory authorities.

9.1.1.3 In Canada, small banks can be owned by single owners and commercial enterprises.

9.1.1.4 United Kingdom has allowed industrial groups to participate in banking. Tesco Bank is a prime example.

9.1.1.5 In South Africa, there are no regulations or broader concerns about industrial houses or families owning banks, and the regulator is more focused on the quality and reputation of the shareholders.

9.1.1.6 Taiwan and Hong Kong do not have any restrictions on ownership of banks by industrial houses/families. However, there are standard restrictions on related party transactions [such as limits on percentage of total loans that can be made to private sector (including industrial houses) companies and intra-group lending be made on an arms-length basis].

9.1.1.7 In Japan, the banking regulator has strict and conservative standards for granting banking license. While there are no specific restrictions on granting of banking licenses to conglomerates/industrial houses, the regulator places certain restrictions on governance and disclosure based on shareholding levels, i.e. a shareholder has to report to the banking regulator on crossing 5 percent ownership, and any increase in ownership above 5 percent requires specific permission from the banking regulator. This automatically limits control by industrial houses as far as new banks are concerned.

9.1.1.8 However, the Keiretsu Model adopted in Japan earlier is somewhat different, in the sense that loose-knit groups of firms (called keiretsu), organized around a lead bank, are allowed to hold shares in each other. For most of the large keiretsu, such as Mitsubishi and Sumitomo, internal group holdings can account for as much as 25 percent of the total group equity. It may, therefore, be possible that a bank can informally control a much larger stake than 5 percent through the crossholding structure.

9.1.1.9 In USA, industrial houses are not allowed to own banks. The regulatory framework is designed to protect a bank from the risks posed by the activities or conditions of its parent company and the parent's non-bank subsidiaries and maintain the general separation of banking and commerce. This has been done by way of GLB Act, 1999 by authorizing financial holding companies to affiliate only with companies that were engaged in activities determined to be financial in nature or incidental to financial activities. Further, the Act requires the corporate owners of full service banks to be supervised on a consolidated basis. However, certain exceptions were allowed to industrial loan companies chartered in certain States in 1987. Several large international companies such as General Motors, General Electric, BMW, Volkswagen and Volvo own industrial loan companies under the exception and use these companies to support various aspects of their global operations.

9.1.1.10 In Brazil, industrial houses are permitted to set up banks. However, ownership limits beyond certain percentage require regulatory approval so as to manage the moral hazard of intra-group lending and also prevent regulatory capture.

9.1.1.11 In Korea, subsequent to Asian crisis, the industrial houses (*chaebol)* are barred from promoting new banks as they believe in keeping banking and commerce separate from each other.

9.1.1.12 Twelve percent of countries including the USA restrict the mixing of banking and commerce (Page – 107, Rethinking Banking Regulation : Till Angels Govern by James R. Barth, Gerard Caprio Jr. and Ross Levine)

9.1.2 Indian Approach

9.1.2.1 Prior to nationalization of major commercial banks in 1969, the industrial and business houses, having control of the banks, diverted bulk of the bank advances to industry, particularly to large and medium-scale industries and big and established business houses, while the needs of vital sectors like small-scale industry, agriculture and exports were neglected. The main objective of nationalization of commercial banks was to make a shift in the focus of banking from class banking to mass banking and provide a thrust to branch expansion in the rural and semi-urban areas as also stepping up of lending to the so called priority sectors.

9.1.2.2 The 2001 licensing guidelines prohibited promotion of new banks by industrial houses. However, individual companies, directly or indirectly connected with large industrial houses were permitted to acquire by way of strategic investment shares not exceeding 10 percent of the paid-up capital of the bank, subject to RBI's prior approval.

9.1.3 View Points

<u>I. In Support</u>

i. Industrial and business houses can be an important source of capital and can provide management expertise and strategic direction to banks as they have done to a broad range of non-banking companies and other financial companies.

ii. Large industrial and business houses have already been permitted to operate in other financial services sectors, such as insurance companies, asset management companies and other non-banking finance companies including loan and leasing companies. Many of the largest private sector companies in these segments are fully or partially owned by industrial and business houses. Thus, the industrial and business houses with their presence in the above sectors, are already competing with banks both on the assets and liabilities side.

iii. Industrial and business houses have a long history of building and nurturing new businesses in highly regulated sectors such as Telecom, Power, Automobiles, Defence, infrastructure projects like Airports, Highways, Dams, Ports.

iv. Equity of large industrial and business houses is widely held and all are listed on the stock exchanges and are accordingly subject to Companies laws, SEBI laws and regulations on transparency, disclosure and corporate governance.

v. An Industrial and business house with presence across various sectors would face a higher reputational risk compared to a pure individual promoter or financial services player.

vi. Strengthening banking regulation & supervision, stronger corporate governance norms, a more competitive banking market and stringent prudential regulations and disclosure requirements could mitigate the risks of affiliations of banks with the industrial and business houses.

vii. Permitting industrial and business houses to own a limited number of banks should not lead to undue concentration of control of banking activities as the Indian banking system is largely composed of public sector and private sector banks.

II. Potential risks

Even though Industrial and business houses are already permitted in other areas of financial services, banks are special as they are highly leveraged fiduciary entities central to the monetary and payment system. There are several deep rooted fears in allowing industrial and business houses to own banks. Mainly these relate to the fact that such an affiliation tends to undermine the independence and neutrality of banks as arbiters of the allocation of credit to the real sectors of economy. Conflicts of interest, concentration of economic power, likely political affiliations, potential for regulatory capture, governance and safety net issues are the main concerns. The Japanese experience with Keiretsu, the Korean experience with *Chaebols* and the Indian experience prior to nationalization are strong reminders of the pitfalls of commercial interests promoting / controlling banks.

9.1.4 Possible Options/Solutions

(a) **Industrial and business houses may be permitted to promote banks**

PROS

- Apart from industrial and business houses, there may not be many entities / parties that could bring in the capital required for banks, particularly if the threshold levels are kept high. In view of the large developmental needs of the economy, there is need for large capital investment in the banking sector.
- The entrepreneurial and managerial talent amply demonstrated by industrial and business houses in Telecom, Power, Automobiles, Defence, important infrastructure projects, Life Insurance, General Insurance, Asset Management Companies and NBFCs which could be gainfully harnessed in the banking sector with suitable safeguards would be lost.
- Further, as per the International Monetary Fund (IMF) paper on selected Issues on the Republic of Korea, while earnings of industrial companies/commercial groups are not necessarily negatively correlated with bank earnings, the financial groups' earnings may be positively correlated with bank earnings over a wide range of financial shocks. Thus, the industrial companies could act as a source of contingent capital for banks.

CONS

- Banking being highly leveraged business and dealing with public money, it makes sense to keep Industry / business and banking separate.
- When banks are flush with liquidity, there is a great risk of diverting the funds to liquidity constrained operations of the group. Further, as industrial and business groups are involved in various types of activities they may be able to rotate funds from one entity to another, which makes it difficult for the supervisors / regulators to trace source and utilisation of funds, especially when all the entities in the group are not regulated by one regulator.
- Preventing industrial and business houses to promote banks would automatically eliminate any conflicts of interest situations as well as situations similar to the pre 1969, when banking was monopolised in the hands of few individuals and where bank's funds were used for connected lending.
- Allowing industrial and business houses to promote banks creates conflicts of interest through self dealing at the expense of bank clients. Conflicts of interest could also arise from transactions between the bank and its affiliates. A bank affiliated to a commercial firm may deny loans to its affiliate's competitors, and instead favour its commercial affiliates in granting loans on preferential terms. Further, there may be risk of connected lending to companies within the group or to customers or suppliers of such companies on preferential terms. This would transfer the resulting risks to the minority shareholders, relatively uninformed depositors and the Deposit Insurance Fund. Commercial affiliates are likely to provide a captive market for an affiliated bank, thus foreclosing a substantial amount of competition in banking markets.
- As large industrial and business conglomerates have cross holding among their group entities engaged in diverse activities in India and abroad, dealing with complex structures of the industrial / business houses poses difficulties in supervision and regulation.
- Major operations of the industrial and business group may not be well regulated which makes it difficult to assess the 'fit and proper' status of the industrial / business group.
- In the absence of statutory provisions that impose strong penalties for violations, dealing very strongly with conflict of interest situations and

connected lending as available in Hong Kong where the violations of provisions would lead to penalty and imprisonment, allowing industrial / business houses to set up banks and allowing them access to bank's funds may be risky.

- Linking banking with commercial activities may tend to undermine the neutrality and independence of banks in deciding allocation of credit to the real sectors of the economy. Such distortion in allocation of credit may have substantial adverse effect on the overall productivity of the economy.
- The complex web of relationships of commercial firms with their customers or suppliers and proper monitoring of preferential access to credit would be very difficult. Further, the Industrial and business houses could engage in cross-shareholding in equity of group companies, which would make it difficult to assess the true capital structure of the bank. Supervision of banking conglomerate groups having non-financial entities within them could also be a challenge for the supervisors. The above issues could also lead to overburdening of the supervisory resources of the Reserve Bank.
- The industrial and business houses may not be committed to attaining broader objectives of financial development particularly ensuring financial inclusion and providing services to all sections of society.
- If the Industrial houses / business groups come under stress especially in a prolonged downturn, it may undermine confidence in the banks promoted by industrial and business houses which could be a threat to financial stability.

(b) **Industrial and business houses that have predominant presence and experience in the financial sector could be allowed to set up banks subject to other due diligence process**

PROS

- Track record of the industrial and business houses in the financial sector is available from other regulators and authorities to ensure that only those with sufficiently long and sound track record promote banks.
- Professional skills and expertise in the group's financial companies would add value to the bank.

CONS

- Possible concentration of economic power in all major areas of business and finance could be a potential threat to financial stability

9.1.5 Possible safeguards to address the downside risks of Industrial and business houses promoting banks

i. Strengthening the governance guidelines of 'fit and proper' criteria on a continuing basis.

ii. Fit and proper criteria 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.

iii. Further, other parameters such as corporate governance standards in the corporate entity, extent of financial activities carried out by the industrial / business house, comfort with the corporate structure within the group, whether ownership is diversified and separate from management and the source of promoters’ equity, should also be specially verified.

iv. The structure proposed for promoting banks should be such that the bank can be ring fenced from other financial and commercial entities in the group. RBI should be satisfied about its ability to supervise the bank and obtain all required information from the Group relevant for this purpose smoothly and promptly.

v. Industrial and business houses promoting banks must have diversified ownership. However, Industrial and business houses engaged in real estate activities either directly or indirectly, should not be allowed to promote banks; given the sensitivity of the real estate sector, any sub-version of the Chinese walls between the bank and the rest of the Group could have extremely negative consequences for financial stability.

vi. There could be stringent limits on transactions between the bank and other entities in the Group to minimize the prospect of direct or indirect lending to other entities in the Group. Internationally, there are various means through which the connected lending is checked – e.g., - Brazil and Japan do not permit intra-group lending, Taiwan doesn’t allow unsecured lending and allows secured lending only if approved by the Board and Australia requires all intra-group lending to be cleared by the Board. Other countries, like USA and Hong Kong, however, do not have specific restrictions for industrial / business groups. It may be better to be ultra cautious and ban any intra group exposure.

vii. The Board could be mandated to have a majority of independent Directors and the Chairman should be a part time Chairman

viii. To guard against the possibility of Independent Directors not being truly independent, with consequences for corporate governance, legislative changes should be made to empower RBI to supersede the Board where it is felt that the functioning of the Board / bank is not in the interest of depositors or financial stability, as a pre condition for considering allowing Industrial or business houses to promote banks.

ix. To contain the possibility of “holding out” if an industrial / business house comes under severe stress, industrial and business houses may not be allowed to use the brand name and logo of the Group.

x. To ensure transparency of the processes and to assess the ability of the promoters to meet the 'fit and proper' criteria, all applications for setting up new banks by business houses could be put in public domain for comments from the general public.

Some of the issues raised above would require amendments to various Acts/statutes and it would not be possible to address these issues until and unless the amendments are in place.

(c) As an intermediate step, industrial and business houses could be allowed to take over RRB’s, before considering allowing them to set up banks.

PROS

Apart from all the pros discussed in the context of allowing industrial and business houses to promote banks, the following additional advantages will accrue :

- This will give industrial and business houses an opportunity to prove their suitability for promoting banks.
- If on balance there is a net downside in allowing Industrial or business Houses to promote banks, the negative externalities would be limited.

- This has the potential to provide an immediate impetus to financial inclusion and revitalize RRBs especially those in underbanked regions.
- The decision or otherwise to allow Industrial and business houses to promote banks would be a much more measured and balanced one due to the experience gained.

CONS

- Apart from all the cons discussed in the context of allowing industrial and business houses to promote banks, this option would also require legislative changes which would need to be expedited.

In this eventuality, all the possible safeguards discussed in para 9.1.5 would also be applicable.

9.2. (B) Should Non-Banking Financial Companies be allowed conversion into banks or to promote a bank

9.2.1 International Experience

9.2.1.1 In some countries, the financial institutions that are already well regulated are favoured for conversion into banks.

9.2.1.2 In Hong Kong, the entry level criterion for an applicant is that it should already have been a Deposit Taking Company (DTC) or Restricted Licence Bank (RLB) for not less than three continuous years.

9.2.1.3 In USA, certain types of depository institutions (state commercial banks, state savings associations, state savings banks, state trust companies, federal savings banks and federal savings associations) are allowed to convert into national banks, provided they demonstrate the ability to operate safely and soundly and are in compliance with applicable laws, regulations and policies, and are consistent with the National Bank Act and applicable OCC regulations and policies.

9.2.1.4 In determining action on a conversion application in USA, the OCC normally considers the applicant’s condition and management. This includes compliance with regulatory capital requirements and conforms to the statutory criteria, including many of the same standards applicable to chartering a de novo national bank; adequacy of policies, practices, and procedures; CRA record of performance, etc. The OCC may impose special conditions for approvals to protect the safety and soundness of the bank; prevent conflicts of interest; provide customer protections; ensure that approval is consistent with the statutes and regulations; or provide for other supervisory or policy considerations.

9.2.1.5 A converting institution is also allowed to retain existing branches as a national bank, if such retention is consistent with applicable law.

9.2.2 Indian Approach

9.2.2.1 The Non Banking Financial Sector in India comprises various types of financial institutions including All-India financial institutions, development finance institutions, non banking finance companies (NBFC), etc. While the All-India financial institutions (AIFIs) and development finance institutions (DFIs), are largely an offshoot of development planning in India, the NBFCs are mostly private sector institutions, which have carved their niche in the Indian financial system.

9.2.2.2 Unlike the banking sector, the NBFC sector is heterogeneous in nature functionally as well as in terms of size, nature of activities and sophistication of operations. NBFCs include not only entities that are part of large multinational groups or Indian business groups, but also small players at district towns, with net owned fund (NOF) hovering at the statutory minimum of Rs 200 lakh.

9.2.2.3 Initially, with a view to protect the interests of depositors, regulatory attention was mainly focused on NBFCs accepting public deposits (NBFCs-D). Over the years, however, this regulatory framework has been widened to include issues of systemic significance. The sector is being consolidated and while deposit taking NBFCs have decreased both in size as well as in terms of the quantum of deposits held by them, NBFCs-ND have increased in terms of number and asset size. NBFCs-ND-SI (NBFCs- ND with asset size of Rs.100 crore and above) are subject to CRAR and exposure norms prescribed by the Reserve Bank.

9.2.2.4 As at the end of financial year of 2008-2009, the total assets of NBFCs were at Rs. 95,727 crore and Public deposits were at Rs. 21,548 crore.

9.2.2.5 The 2001 guidelines on entry of new banks in the private sector permitted NBFCs with a good track record for conversion into a bank, provided it satisfied the specific criteria relating to minimum net worth, not promoted by a large industrial house, AAA (or its equivalent) credit rating in the previous year, capital adequacy of not less than 12 percent and net NPA ratio of not more than 5 percent.

9.2.2.6 So far, only one NBFC has been converted into a bank, and the transition has been fairly smooth.

9.2.3 Possible Options

a) Permitting conversion of NBFCs into banks

PROS

- Since NBFCs are already regulated by RBI and have a track record, the 'fit and proper' concerns could be addressed more easily.
- NBFC model particularly those in lending activities has been successful in expanding the reach of financial system and thus by converting to banks, this model could be scaled up to better leverage the benefits and achieve the objective of financial inclusion.
- Some of the sectoral credit issues, such as infrastructure and microfinance, could be better addressed if NBFCs specializing in the specified sectors can better leverage their competence by converting to banks and having access to low-cost funds.

CONS

- Though a prudential framework has been put in place for systemically important non-deposit taking NBFCs, these are minimal in their scope and cover limited areas. Further, such NBFCs are not, as yet, subject to regular onsite inspections.
- There has been a light-touch regulatory framework for non-deposit taking NBFCs. As such, the ability of the NBFC to run a bank under a heavier regulation cannot be extrapolated from this experience.
- The initial capital requirement for NBFCs is a miniscule Rs. 2 crore and the due diligence and 'fit & proper' assessment exercise of promoters/directors is minimal both in terms of scope and rigour, as compared to banks. The NBFC model and the bank model are entirely different as NBFC model provides financial access to excluded categories without the same regulation as applicable to banks. On the other hand, the banking license gives the institution full scope to carry out full-fledged banking activities, with stricter regulatory requirements. Therefore the NBFCs may not fulfill the 'well established and well regulated' criteria and hence the 'track record' of an NBFC cannot be taken as an automatic eligibility criterion for conversion into banks.

- Conversion of NBFCs into bank would require folding up of large number of branches and withdrawal from many segments of businesses as well as disinvestment from subsidiaries/affiliates not engaged in businesses permitted to banks.
- Conversion could also lead to demand for regulatory forbearance in the initial stage.
- NBFCs have niche space in the financial system and there is a need to strengthen them. Migration of stronger NBFCs will not strengthen the banking space while the NBFCs space will be weakened.
- The maturity mix of the asset portfolio is also skewed towards long term and the asset mix may not be compatible to the banking liabilities. If NBFCs are converted into banks they may take a long time to align themselves to banking.
- Moreover, the NBFC's continued dependence on wholesale deposits and short term borrowings to sustain even their existing business operations would raise financial stability issues.

Note :In the case of conversion of NBFCs promoted by large industrial and business houses, the pros & cons of permitting industrial / Business houses to promote banks as well as the requirement that the industrial / Business house should not be engaged in real estate activity directly or indirectly will also apply.

b) Permitting standalone (i.e. those not promoted by Industrial / Business Houses) NBFCs (including those regulated by SEBI, IRDA & NHB) to promote banks

In addition to the *PROS* and *CONS* under (a) above, the following are also relevant under this option.

PROS

- The expertise of the NBFC in the financial sector (as set out for the pros of permitting NBFCs to convert into banks) could flow into the bank if NBFCs are allowed to promote banks.
- The NBFCs could retain their niche space and yet contribute to the financial sector through the bank they would set up.

- NBFCs already being regulated would have a verifiable track record for ‘fit and proper’ assessment.
- The operations of the NBFCs may not be liquidity constrained and hence possibilities of diversion of funds may be less.
- Possibility of improved governance in banks due to ownership by entities experienced in the financial sector.

CONS

- Due to the maturity differences of the assets and liabilities of the NBFCs and banks, there may be possibilities of the bank funds being utilized to meet the NBFC liabilities and also of indulgence in regulatory arbitrage.
- NBFC Groups engaged in activities that are not permitted to banks would be a source of concern and contagion.
- Their experience in the financial sector would not be adequate enough to be a source of strength in promoting banks. (Please see cons in para 9.2.3 (a) in the context of permitting NBFCs to convert into banks).
- NBFCs may not have the financial strength or parentage to support bank’s capital needs particularly in periods of stress.

Note :NBFCs or its subsidiaries / Associates should not be engaged directly or indirectly in real estate activities for being considered eligible to promote banks.

10. <u>Business Model</u>

10.1 International Experience

10.1.1 Internationally, a 3-year business plan incorporating its goals, business structure, financial projections of balance sheets, cash flow and earnings, key financial and prudential ratios for the proposed bank and its subsidiaries on a consolidated basis.

10.1.2 The business plan is also required to address the adequate and appropriate risk management and internal control systems, compliance processes and systems, information and accounting systems, external and internal audit arrangements, and sensitivity analysis showing the results of changes in key assumptions under the worst case scenario.

10.1.3 In Hong Kong, the applicants are not expected to depart radically from their business plans in the first years of operation as an authorized institution, and if such a departure is proposed, the authorized institution is required to consult with the Monetary Authority in advance.

10.1.4 In USA, any change in business plan after the bank has started operations would require approval from the OCC. Further, each national bank has a responsibility under the Community Reinvestment Act (CRA) to help meet the credit needs of its entire community, consistent with the safe and sound operations of such institution. The CRA regulation requires each bank to delineate at least one assessment area, comprising of one or more metropolitan statistical area or areas or one or more contiguous political subdivisions (such as countries, cities or towns).

10.2 Indian Approach

10.2.1 The 2001 guidelines on entry of new banks stipulated that the applicants should furnish a project report covering business potential and viability of the proposed bank, the business focus, the product lines, proposed regional or locational spread, level of information technology capability and any other information that they consider relevant.

10.2.2 Applications are also supported by detailed information on the background of the promoters, their expertise, track record of business and financial worth, details of promoters' direct and indirect interests in various companies/industries, details of credit/other facilities availed by the promoters/promoter companies/other group companies with banks/financial institutions, and details of proposed participation by foreign banks/NRI/OCBs.

10.2.3 The guidelines also stipulated that the new bank will have to observe priority sector lending target of 40 percent of net bank credit as applicable to other domestic banks. A new bank was also required to open 25 percent of its branches in rural and semi-urban areas to avoid over concentration of their branches in metropolitan areas and cities. Other conditions such as use of modern infrastructural facilities in office equipments, computer, telecommunications, etc. were also specified in order to ensure provision cost-effective customer service.

10.3 Possible Options/Approaches

(a) Status- quo could be maintained where new banks could be licensed under the usual conditions.

PROS

- This would enable the new banks to compete in a level playing field.
- This could avoid having differential supervision and regulation for the new banks.
- Uniform norms could be applied to all banks, old and new, for their compliance.

CONS

- This approach would not further the objective of licensing new banks for achieving accelerated financial inclusion.

(b) Considering the thrust on financial inclusion, a business model oriented towards this objective could be preferred. The business model could be required to clearly articulate the strategy and the targets for achieving significant outreach to clientele in Tier 3 to 6 centers (i.e. in populations less than 50000) especially in the underbanked regions of the country either through branches or branchless models.

PROS

- This would induce the new banks to participate in financial inclusion in a big way.
- This would also encourage banks to adopt latest and innovative methods and leverage information technology, BC / BF models in reaching the unreached.
- As the micro finance companies have already proved that the financial inclusion business model is viable, banks may not face problems relating to viability of the models.

CONS

- The business model heavily oriented towards financial inclusion may not be able to provide commensurate returns to banks to enable them to compete with other private sector banks in the country.
- With heavy orientation towards financial inclusion involving high cost, cross subsidization of the financial inclusion activities with other gains is not possible.

- It will create uneven playing field vis-à-vis the existing banks with its attendant negative consequences for such banks.
- In case the bank deviates substantially from its proposed business model particularly if its earnings are low threatening its viability, there may not be any regulatory remedy. The thrust on financial inclusion will thus be lost in such cases.

11. ISSUES FOR DISCUSSION

This paper attempted to give a broad overview of the issues and concerns regarding entry of new banks. Given the pros and cons discussed above, the Reserve Bank would welcome broader discussion and debate on the following aspects :

- ⇒ **Minimum capital requirements for new banks and promoters contribution**
- ⇒ **Minimum and maximum caps on promoter shareholding and other shareholders**
- ⇒ **Foreign shareholding in the new banks**
- ⇒ **Whether industrial and business houses could be allowed to promote banks**
- ⇒ **Should Non-Banking Financial Companies be allowed conversion into banks or to promote a bank**
- ⇒ **The business model for the new banks**

August 11, 2010

ANNEX I

Synopsis of select country practices on licensing of new banks in the private sector as per information obtained from the respective regulators

CANADA

I. Institutional and Legal Framework

The Office of the Superintendent of Financial Institutions (OFSI) is the authority to assess applications for incorporation of banks or a federal trust or loan company [collectively referred to as federally regulated financial institution (FRFI)] in Canada and makes recommendations to the Minister of Finance (called as the Minister) who has the ultimate responsibility for approving the incorporation of financial institutions under the Bank Act, 1991.

The applicants for incorporation of FRFIs that intend to take deposits are also required to become members of the Canada Deposit Insurance Corporation (CDIC). However, if the proposed FRFI is a bank that will only be taking wholesale deposits (deposits greater than $ 1,50,000), it may apply to CDIC for authorisation to accept deposits in Canada without being a CDIC member. The banks on incorporation are also required to register with the Canadian Payments Association (CPA) for membership.

For establishing a FRFI in Canada, there are two parts to the application process. The first part deals with requirements to obtain "letters patent of incorporation", which are issued by the Minister upon recommendation of the Superintendent of Financial Institutions (the Superintendent). The second part sets out the requirements to obtain an "Order to Commence and Carry on Business". This Order is issued by the Superintendent after letters patent of incorporation have been issued.

II. Criteria for Issuance of Letters Patent of Incorporation

(1) Eligible Applicants: Any entity or person is eligible to own a FRFI. However, applicants who do not meet the following statutory criteria and those who fall in the ineligible category as mentioned below, are not eligible to apply:

Statutory criteria

i. the nature and sufficiency of the financial resources of the applicant/s as a source of continuing financial support for the FRFI;
ii. the soundness and feasibility of the plans of the applicant/s for future conduct and development of the business of the FRFI;
iii. the business record and experiences of the applicant/s;
iv. the character and integrity of the applicant/s or, if the applicant or any of the applicants is a body corporate, its reputation of character and integrity;
v. whether the FRFI will be operated responsibly by persons with the competence and experience suitable for involvement in the operation of a financial institution;

vi. the impact of any integration of businesses and operations of the applicant/s with those of FRFI;

vii. the opinion of the Superintendent regarding the extent to which the proposed corporate structure of the applicant/s and their affiliates may affect the supervision and regulation of the bank, having regard to nature and extent of the proposed financial services activities to be carried out by the bank and its affiliates, as also the nature and degree of supervision and regulation applying to the proposed financial services activities to be carried out by the affiliates of the bank; and

viii. the best interest of the financial system in Canada.

<u>**Category not eligible to apply:**</u>

(a) Her Majesty in right of Canada or in right of a province, an agency of Her Majesty in either of those rights or an entity controlled by Her Majesty in either of those rights;

(b) government of a foreign country or any political subdivision thereof;

(c) an agency of the government of a foreign country or any political subdivision thereof;

(d) an entity that is controlled by the government of a foreign country or any political subdivision thereof, other than an entity that is a foreign bank or a foreign institutions or its subsidiaries.

(2) Minimum initial capital requirement:

Subsection 485(1) of the *Bank Act* (BA), 1991 of Canada requires banks to maintain adequate capital. For this purpose, the OSFI has established two minimum standards: assets to capital multiple, and risk-based capital ratio. The first test provides an overall measure of the adequacy of an institution's capital. The second measure focuses on risk faced by the institution. Under Assets to capital multiple, total assets should not be greater than 20 times capital, although this multiple can be exceeded with the Superintendent's prior approval to an amount not greater than 23 times. Institutions are expected to meet minimum risk-based capital requirements for exposure to credit risk, operational risk and, where they have significant trading activity, market risk. The minimum capital requirements, which must be maintained on a continuous basis, are a tier 1 capital ratio of 4% and a total capital ratio of 8%.

(3) Ownership Criteria: The ownership criterion is based on the size of the FRFI, i.e. Small Bank, Medium Bank, Large Bank and Trust or Loan Company. If a financial services group wishes to establish a FRFI, it is required to select, as the applicant, through which most of the group's banking business or financial activities is conducted.

(a) In case of a **Small Bank**, the shareholders' equity is less than $ 2 billion and there is no restriction on ownership other than (i) the requirement for Ministerial approval to own more than 10% and up to 100% of any class of shares, and (ii) if the bank is controlled by a large

Canadian bank or by a Canadian bank holding company[1] and the bank has equity in excess of $ 250 million, no other person may be a major shareholder[2] of the bank.

(b) In case of a **Medium Bank**, the shareholders' equity is more than $ 2 billion but less than $ 8 billion and there is no restriction on ownership other than (i) the requirement for Ministerial approval to own more than 10% of any class of shares, (ii) at least 35% of the voting shares must be listed on a recognized Canadian Stock Exchange and owned by persons who are not major shareholders, and (iii) if the bank is controlled by a large Canadian bank or by a widely held Canadian bank holding company, no other person may be a major shareholder of the bank.

(c) In case of a **Large Bank**, the shareholders' equity is $ 8 billion or more, which is required to be widely held. While any person can own less than 10% of any class of shares without any approval, for owning more than 10% of any class of shares and up to 20% of any class of voting shares or up to 30% of any class of non-voting shares, approval of the Minister is required, provided the person does not control the bank. However, if a large bank is a subsidiary of a widely held bank holding company, the bank holding company may own 100% of the shares of the large bank. Certain eligible institutions (e.g. widely held insurance holding companies, widely held Canadian financial institutions, eligible foreign institutions), which control banks with shareholders' equity of less than $ 8 billion, will be able to continue to closely hold those banks as the equity grows through the $ 8 billion threshold.

(4) Limitation on shareholding: No person can be a major shareholder of a bank with equity of $ 8 billion or more, except for cases mentioned above. However, if a person is a major shareholder of a bank with equity of less than eight billion dollars and the bank's equity reaches eight billion dollars or more, the person is required to reduce the same within a period of three years from the date of bank's equity reaching eight billion dollars so as to ensure that he is not a major shareholder of the bank.

(5) Information requirements: The applicant is required to submit various types of information for assessing the principal shareholders' commitment to the FRFI and in ensuring that the new FRFI has, and will continue to have sufficient capital, and that it has adequate risk management controls in place to support its operations thereby reducing the likelihood of failure. These, inter-alia, include current organization chart (with percentages owned) for the applicant and its ultimate parent, if any, and all entities in the corporate group; entities in which the applicant beneficially owns 10% or more of the voting rights; names and details of all persons owning more than 10% of any class of shares or ownership interest in the applicant and the percentage of shares or ownership interest held; summary of the financial and other activities carried on by the applicant and its affiliates; etc. OSFI also required

[1] bank holding company" means a body corporate that is incorporated or formed under Part XV of Bank Act, 1991.
[2] Major shareholder is generally defined as a person who beneficially owns more than 20% of any class of voting shares or 30% of any class of non-voting shares.

personal information from each of those individuals that demonstrates clearly that they have, or have access to, the necessary financial resources to provide ongoing financial support to the FRFI. Each individual is also required to provide details of any material regulatory actions, criminal convictions or breaches of statutory or other administrative/regulatory enactments against the individual.

Business Plan: The applicant is required to submit a three-year business plan indicating the reasons for establishing FRFI, analysis of target markets and opportunities that the FRFI will pursue in Canada, analysis of competitors showing both threats and opportunities and plans to address them. The business plan should address the reasons as to why the applicant believes that the FRFI would be successful and the overall strategy to achieve this success. It should also give an overview of each line of business to be conducted by the FRFI and the products and services to be offered as well as a summary of the FRFI's businesses as a whole and how they interrelate, pro-forma initial base financial statement and balance sheet & income statement for the first three years of operations, contingency plans resulting from variations associated with key assumptions used in developing the plan and also provide sensitivity analysis showing the results of changes in key assumptions under the worst case scenario. The applicant is also required to submit a break-up of all elements used to calculate the risk based tier I and total capital ratios, and the assets to capital multiple including a description of any off-balance sheet activities, as also source of initial and future capital provided for in the base case and the worst case scenarios in the form of a capital plan and funding policies. The business plan must also address the risks that the use of information technology could pose upon the customers, employees and vendors, etc.

Governance: As part of the incorporation process, applicants are required to provide a description of the major risk management and control processes and policies for the new FRFI. A review of these processes would enable OSFI to assess the FRFI's ability to manage and mitigate the risks inherent in its business activities and comply with the governing statutes, regulations and OSFI guidelines. Accordingly, the applicant is required to submit an overview of the investment and lending policies and standards and procedures adopted; draft policies and procedures in respect of FRFI's funding and liquidity risk management; detailed provisioning policies and description of general allowances anticipated in executing the FRFI's business plan; capital management policy giving outline of the targeted levels of capital and describing on-going monitoring procedures to ensure compliance with OSFI's minimum capital requirements; major risk areas and policies and control procedures to monitor risk tolerance and risk management; details of any risk management and control processes that would be integrated with those of other entities in the applicant's group.

OSFI's framework for assessing the effectiveness of governance is based on a two-fold approach: 1) an assessment of the governance process against a range of characteristics, and 2) an assessment of the institution's performance or effectiveness in carrying out its governance responsibilities. The board characteristics are assessed and rated on the following elements:

- composition of the board;
- the board's role and responsibilities;

• the nature and operations of board committees;
• board practices; and
• board self-assessment programs.

OSFI looks not only for evidence that institutions have appropriate policies and processes in place but also for indicators that these policies and processes are understood, are being followed and that, as a result, they are effective. In OSFI's view, the hallmarks of effective corporate governance by the board and its members include:

(a) **Judgement:** decisions that strike a reasonable balance between business objectives and risk management and control functions.

(b) **Initiative:**

i. proactive exercise of responsibilities by members, while respecting the responsibility of the CEO and senior management to manage the institution;
ii. readiness to both advise and challenge management;
iii. an adequate commitment of time by members for board responsibilities;
iv. involvement in determination and review of the institution's business objectives and strategies.

(c) **Responsiveness:**

i. responsiveness to issues or deficiencies identified by management, the independent oversight functions and regulators;
ii. involvement in management's response to regulatory recommendations and requirements;
iii. responsiveness to issues identified in board evaluations of itself or management.

(d) **Operational Excellence:**

i. processes and ways of operating that permit discussion and advance consideration of important matters and transactions, based on appropriate and timely information and analysis;
ii. periodic review of the adequacy and frequency of information the board needs to fulfill its responsibilities.

As a part of assessing the quality of risk management, OSFI has identified six Oversight Functions that should exist in a bank. They are Board of Directors, Senior Management, Risk Management, Internal Audit, Compliance, and Financial Analysis. These functions provide an independent review of the management of business activities. The purpose of this oversight is to ensure that Operational Management is effective in managing and controlling the risks for a given significant activity on a day-to-day basis. OSFI's primary objective in assessing the Oversight Functions is to determine the extent to which it can use the work of these functions to ensure that appropriate controls are in place and are being followed at the operational level. This allows OSFI to focus its own resources on reviewing areas that are likely to affect the risk profile of the institution.

III. Requirements for Making of an Order to Commence and Carry on Business by the Superintendent

In terms of Bank Act, 1991 of Canada, a bank cannot carry on any business until the Superintendent has, by order, approved the commencement and carrying on of business by the bank. Before issuing an Order to Commence and Carry on Business, OSFI must be satisfied that the FRFI has the necessary systems, management structure, control processes and compliance managements systems in place. An on-site review is also done to assess the control processes and management systems and to ensure that the FRFI is capable of producing the required statutory and supervisory information in an accurate and timely fashion as soon as it starts operations.

IV. Limiting asset size

On considering the Superintendent's opinion on the nature and extent of the financial services activities carried out by entities affiliated with the bank and its impact on the supervision and regulation of the bank, the Minister may, in the best interests of the financial system in Canada, could stipulate additional restrictions on the Assets to capital multiple in the order of Commencing and Carrying on Business. (Please refer para II (2) on Minimum initial capital requirement).

V. Can Industrial Companies own banks

Any entity or person is eligible to own a FRFI, provided they satisfy the statutory criteria.

AUSTRALIA

I. Institutional and Legal Framework

In terms of Section 9 (3) of Banking Act, 1959, the Australian Prudential Regulation Authority (APRA) is the designated authority to grant authorisation to a body corporate to carry on banking business in Australia. Institutions granted an authority to carry on banking business in Australia are referred to as 'authorised deposit-taking institutions' or 'ADIs'. The fact that a body corporate is granted an authority to carry on banking business in Australia does not entitle the ADI to call itself a bank, except consent is granted by APRA under Section 66 of the Banking Act. The Banking Act only allows corporations to carry on banking business in Australia, which means APRA cannot consider applications from partnerships or unincorporated entities.

APRA may refuse an application for authority to carry on banking business in Australia where an applicant is a subsidiary of a non-operating holding company (NOHC) that does not hold a NOHC authority under the Act. Where relevant, an applicant should submit to APRA a written application by its NOHC for a NOHC authority under Section 11AA of the Act concurrently with its application for authority to carry on banking business.

Foreign banks can also apply to establish locally incorporated subsidiaries or branches to carry on banking business in Australia. A foreign bank may simultaneously hold an authority to operate as a foreign ADI and be the parent of a locally incorporated subsidiary authorised as an ADI.

II. Criteria for granting authorisation to carry on banking business

APRA only authorises suitable applicants with the capacity and commitment to conduct banking business with integrity, prudence and competence on a continuing basis. APRA may refuse an application on, in addition to non-fulfilment of the minimum criteria required, other prudential grounds.

(1) Minimum start-up capital requirements: The minimum start-up capital for applying for authorisation to carry on banking business is fixed by APRA after assessing the adequacy for an applicant on a case-by-case basis based on the scale, nature and complexity of the operations as proposed in the business plan. However, applicants proposing to operate as banks are required to have a minimum of $ 50 million in Tier 1 capital. Otherwise, no fixed amount of capital is required for an authority to carry on banking business. Foreign ADIs are not required to maintain endowed capital in Australia and are not subject to any capital-based large exposure limits.

Applicants must satisfy APRA that they are able to comply with APRA's capital adequacy requirements for the commencement of their banking operations. All locally incorporated ADIs are required to maintain, at all times, a prudential capital ratio (PCR) of 8 per cent (as set by APRA in accordance with Prudential Standard APS 110 Capital Adequacy) of total risk weighted assets, of which at least half must be made up of Tier 1 capital (a minimum tier 1 capital ratio of 4%). Further, an ADI is, at all times, required to maintain a risk-based capital ratio in excess of its PCR.

Newly established ADIs may be subjected to a higher minimum capital ratio in their formative years, depending on the risk profile of the proposed operations. Mutually owned ADIs are permitted to have start-up capital made up entirely or mostly of Tier 2 capital.

(2) Ownership criteria: Ownership of ADIs *[governed by the Financial Sector (Shareholdings) Act (FSSA), 1998]* is limited to the extent that the shareholdings of an individual shareholder or group of associated shareholders in an ADI cannot exceed 15 per cent of the ADI's voting shares. A higher percentage limit may be approved by the Treasurer on national interest grounds. Non-Operating Holding Companies (NOHCs) with a 100 per cent shareholding in the proposed ADI and foreign bank parents must also have a wide spread of ownership unless exempted from the provisions of FSSA.

(3) Governance: Applicants are required to satisfy the requirements set out in *Prudential Standard APS 510 Governance* in respect to composition and functioning of the Board. Applicants must also satisfy APRA that they have policies in place to ensure that persons who hold the key positions within the proposed ADI are fit and proper, in accordance with *Prudential Standard APS 520 Fit and Proper*.

All substantial shareholders of an applicant are required to demonstrate to APRA that they are 'fit and proper' in the sense of being well established and financially sound entities of standing and substance.

The proposed ADIs are also required to have adequate and appropriate risk management and internal control systems, compliance processes and systems, information and accounting systems, and external and internal audit arrangements to enable APRA.

(4) Business Plan: The applicant is required to submit a business plan incorporating the goals of first three years of operations of the ADI and its group including all controlled entities. The Plan should include business structure (outline of proposed activities and scale of operations, borrowing and lending activities, off-balance sheet activities, etc.); financial projections of balance sheets, cash flow and earnings, key financial and prudential ratios for the proposed ADI and its subsidiaries on a consolidated basis.

III. Can Industrial Companies Own Banks

Notwithstanding that there are no statutory provisions governing who may or may not own an ADI in Australia (i.e. there are no statutory provisions excluding ownership of an ADI by an industrial company), Government policy had until 1998 precluded the ownership of ADIs other than by widely diversified shareholders or by other approved financial institutions (including foreign banks). Similarly, ADIs were precluded from having any substantial ownership interest in non-financial institutions. With the passage of amendments to the Banking Act in 1998 extending APRA’s prudential powers, in particular, providing for the authorisation of NOHCs, policy now permits ADIs to be owned by a wider range of institutions (including potentially industrial companies), provided that the ultimate holding company for the group including the ADI is an authorised NOHC. In addition, ADIs may now own substantial interests in non-financial companies.

Thus, whilst an industrial company might be the dominant company in a group including an ADI, such an industrial company can only be a sister company of the ADI (and not its holding company) or a subsidiary of an ADI. As a member of a group headed by an ADI or authorised NOHC, the industrial company would be subject to the provisions in the Banking Act (see above) dealing with ADIs, authorised NOHCS, their subsidiaries and groups headed by an ADI or authorised NOHC.

Although it is possible for ADIs to belong to groups which include dominant non-financial entities (such as industrial companies) no such groups currently exist in Australia.

APRA has recently, vide a discussion paper, made proposals to extend its current prudential supervision framework to conglomerate groups (containing APRA-regulated entities) that have material operations in more than one APRA-regulated industry and/or have one or more material unregulated entities. APRA is already supervising banking and general insurance groups on a group basis. APRA’s proposed Level 3 supervision framework aims to ensure that prudential supervision adequately captures the risks to which APRA-regulated entities within a conglomerate group are exposed and which, because of the operations or structures of the group, are not adequately captured by the existing prudential frameworks at Level 1 (Supervision that applies to individual operating entities authorised by APRA) and (where it applies) Level 2 (Group supervision that applies to groups headed by an ADI, general insurer or authorised NOHC). Group supervision at Level 3 will involve not only assessing both capital adequacy and compliance with governance and risk management requirements, but also ensuring that the structure of the group does not give rise to excessive unmitigated risks. Supervision will take into account the individual structure and character of each group.

HONG KONG

I. Institutional and Legal Framework

Hong Kong Monetary Authority (HKMA) is, in terms of Section 16 (1) (a) of the Banking (Amendment) Ordinance, 1997, authorized to issue authorizations to a company to carry on banking business[1] or business of taking deposits as a deposit-taking company; or business of taking deposits as a restricted licence bank, in Hong Kong. An applicant must be a body corporate. As such, the HKMA cannot consider applications from partnerships or unincorporated entities.

Hong Kong maintains a three-tier system of authorized institutions, namely, banks, restricted licence banks (RLBs) or deposit-taking companies (DTCs). Only banks can carry on "banking business" in terms of Section 11(1) of Banking Ordinance and thus can operate current and saving accounts, accept deposits of any size and maturity from the public and pay or collect cheques drawn by or paid in by customers. Banks are, therefore, permitted to engage in the full range of retail and wholesale banking business. RLBs are not eligible to carry on "banking business", but may take call, notice or time deposits from the public in amounts of HK$ 5,00,000 and above without restriction on maturity. RLBs generally engage in activities such as merchant banking and capital market operations. DTCs are restricted to taking deposits of HK$ 1,00,000 or above with an original term to maturity, or call or notice period, of at least three months. They are generally engaged in a range of specialized activities, including consumer finance, trade finance, or securities business.

As per the extant policy followed by HKMA since 1981, the applicants for RLB and DTC status for incorporation in Hong Kong should have at least 50% owned by a bank (or, exceptionally, another financial institution) which is adequately supervised.

An overseas applicant seeking a banking licence in Hong Kong can in practice enter only in the form of a branch. An RLB presence may be in the form of either a branch or a subsidiary. Since 1977, it has been the practice to grant DTC registrations only in respect of locally incorporated subsidiaries. However, subject to the MA's approval, an overseas incorporated bank may convert its branch operations in Hong Kong into a subsidiary provided that it has been authorized to conduct banking business in Hong Kong for not less than three continuous years and its Hong Kong operations meet the balance sheet criteria for local bank applicant.

II. Criteria for grant of authorisation for conducting banking business

Under section 16(2) of the Banking Ordinance, the MA is required to refuse to authorize if any one or more of the criteria specified in the Seventh Schedule of the Ordinance ("the Schedule") are

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[1] "banking business" is defined in section 2 of Banking Ordinance as the business of either or both of the following - (a) receiving from the general public money on current, deposit, savings or other similar account repayable on demand or within less than 3 months or at call or notice of less than 3 months; or (b) paying or collecting cheques drawn by or paid in by customers.

not fulfilled with respect to the applicant. The criteria apply to institutions not only at the time of authorization but also thereafter. It follows that failure to meet the criteria by existing authorized institutions would be a ground for revocation of authorization.

(1) Minimum Start-up capital requirements:

In terms of Section 6 of Schedule VII of the Banking Ordinance, the applicant company, seeking authorisation to carry on banking business in Hong Kong, is required to have a start-up capital with the aggregate amount of its paid-up share capital and the balance of its share premium account not less than HK$ 300 million[1]. In the case of a company seeking authorization to carry on a deposit-taking business as a deposit-taking company, the aggregate amount of its paid-up share capital and the balance of its share premium account should not be less than HK$ 25 million. However, in the case of a company seeking authorization to carry on a deposit-taking business as a restricted licence bank, the aggregate amount of its paid-up share capital and the balance of its share premium account should not be less than HK$ 100 million.

It is also necessary that the Monetary Authority should be satisfied that the applicant company will, on authorisation, continue to have adequate financial resources (whether actual or contingent) depending on the nature and scale of its operations.

Further, in the case of a company incorporated in Hong Kong, the company, on and after authorization, is also required to have and maintain a capital adequacy ratio which complies with the provisions of Part XVII of the Banking Ordinance. Under section 98, an authorized institution incorporated in Hong Kong must maintain a minimum capital adequacy ratio of 8%; while under section 101, the MA can raise this statutory minimum for particular institutions to not more than 12% in the case of banks and not more than 16% in the case of RLBs and DTCs. At present, the minimum capital adequacy ratios to be observed by all authorized institutions incorporated in Hong Kong have been raised to 10% or above. In addition to the statutory minimum ratio, the MA has set a non-statutory trigger ratio generally at least 1% above the minimum ratio. The trigger ratio is intended to provide a cushion to reduce the risk of breaches of the minimum ratio and to provide an early warning signal of deterioration in capital adequacy. If the capital ratio of a locally incorporated institution falls below the statutory minimum set for it, the institution is immediately asked to take remedial action. Locally incorporated institutions are generally required to meet the minimum and trigger ratio requirements on both an unconsolidated and consolidated basis.

(2) Balance Sheet size:

The applicant institution, whether incorporated in or outside Hong Kong, applying for authorisation to carry on banking business, must have total customer deposits (subject to certain specified exclusions) and total assets (less contra items) of not less than HK$ 3 billion and HK$ 4 billion, respectively, only at the time of authorisation. Thus, the institution incorporated in Hong Kong should have been a DTC or RLB (or any combination thereof) for not less than three continuous

[1] The minimum capital requirement for banks was increased from HK$150 million to the present level in May 2002. Existing banks have been given a grace period of two years to comply with the increased requirement.

years; or a subsidiary of a bank incorporated outside Hong Kong or a subsidiary of a holding company of such bank, and that the bank has been authorized to carry on banking business in Hong Kong for not less than three continuous years, with the MA being satisfied that the bank will transfer from its Hong Kong operations to the subsidiary amounts of customer deposits and assets not less than the respective amounts mentioned above.

(3) Governance:

The HKMA must be satisfied that each person who is, or is to be, a director, controller, chief executive or executive officer of the company incorporated in Hong Kong, is a fit and proper person to hold the particular position which he holds or is to hold. If the company is incorporated outside Hong Kong, the HKMA must be satisfied that each person who is, or is to be a chief executive, or executive officer, of the business in Hong Kong of the company; as also the director, controller or chief executive of the business of the company in the place where it is incorporated, is a fit and proper person to hold the particular position which he holds or is to hold. The Monetary Authority should also be satisfied that the company has, and will if it is authorized, continue to have adequate systems of control to ensure that each person who is, or is to be, a manager of the company is a fit and proper person to hold the particular position which he holds or is to hold.

The MA must be satisfied that the institution presently maintains, and will on authorization continue to maintain, adequate liquidity, i.e. a minimum liquidity ratio of not less than 25% on average during each calendar month. The institution should also comply with necessary control systems to guard against concentration risks (large exposures and risk concentration), maintain adequate provision for depreciation or diminution in the value of its assets (including provision for bad and doubtful debts), for liabilities which will or may fall to be discharged by it and for losses which will or may occur. The institution should show that it presently has, and will if authorized continue to have, adequate accounting systems and adequate systems of control, disclosure of adequate information about the state of its affairs and profit and loss account in its audited annual accounts and in other parts of its annual report, and carryon the business (which includes any business that is not banking business or the business of taking deposits) with integrity, prudence and the appropriate degree of professional competence and in a manner which is not detrimental to the interests of depositors or potential depositors.

Regarding RLBs and DTCs incorporated in Hong Kong, the MA also expects that an appropriate number of independent, or at least non-executive, directors should be included in their boards. With regard to a person who is, or is to be a director or chief executive, the relevant considerations include whether he has sufficient skills, knowledge, experience, and soundness of judgement properly to undertake and fulfil his particular duties and responsibilities. The MA also takes into account the factors such as, the person's reputation and character, the person’s knowledge and experience, competence, soundness of judgement and diligence, person's record of non-compliance with various non-statutory codes or has been reprimanded or disqualified by professional or regulatory bodies, the person's business record and other business interests, and his financial soundness and strength, etc.

Further, the MA must be satisfied in respect of the identity of each controller[1] of the institution. If necessary, the MA will seek the assistance of the home supervisor of an institution incorporated outside Hong Kong.

If, for example, the applicant is a part of a financial conglomerate, the MA may require information to enable him to assess any risks arising from the operations of other companies within the group.

(4) Business Plan:

Applicants are required to submit a business plan for the first three years of operation of the proposed branch or subsidiary in Hong Kong. The business plan should describe the nature and scale of business to be undertaken and business strategies to be adopted, as well as details of the proposed management, organizational structure and control systems. It should also include financial projections for the first three years of the operation, including the projected balance sheet, capital adequacy and liquidity ratios and profitability. While the financial projections are not intended to be precise forecasts, they should give a realistic picture of the proposed scale of business of the applicant and the expected financial performance. In general, applicants are not expected to depart radically from their business plans in the first years of operation as an authorized institution; if such a departure is proposed, the authorized institution should consult with the MA in advance.

III. Fees payable by authorised institutions:

An authorized institution is required to pay banking licence fee (HK$ 0.47 million) /registration fee (HK$ 0.11 million) / restricted banking licence fee (HK$ 0.38 million) depending on the type of licence received, i.e. bank, deposit taking company, or restricted licence bank respectively, to the Director of Accounting Services. These institutions are also required to pay renewal fee on an annual basis.

IV. Maximum percentage of shares a promoter/individual can hold in an AI

There is no restriction on the maximum percentage of shares that an individual can hold in an Authorised Institution. However, the HKMA's policy indicate that a person who intends to hold 50% or more of the share capital of an AI *incorporated in Hong Kong* should be a well established bank or other supervised financial institution in good standing in the financial community and with appropriate experience.

[1] "Controller" is defined as: (a) indirect controller - a person in accordance with whose directions or instructions, the directors of the institution or of another company of which it is a subsidiary are accustomed to act; (b) minority shareholder controller - a person who either alone or with associates controls 10% or more, but not more than 50%, of the voting rights of the institution or of another company of which it is a subsidiary; and (c) majority shareholder controller - a person who either alone or with associates controls over 50% of the voting rights of the institution or of another company of which it is a subsidiary.

There is no concept of promoter in Hong Kong. However, HKMA has a statutory responsibility to approve each prospective controller of an institution under Section 70 of the Banking Ordinance.

V. Dilution of shareholding of the promoters:

There is no such condition in the Banking Ordinance.

VI. Can Industrial Companies Own Banks

No specific restrictions on ownership of banks by industrial houses.

MALAYSIA

I. Institutional and Legal Framework

The Minister of Finance of Government of Malaysia is the authority, in terms of Section 6 (4) of Banking and Financial Institutions Act (BAFIA), 1989, to grant licence to a person to carry on business of banking, finance company, merchant banking, or discount house business. The applicant is required to be a public company. However, before granting the licence, the Minister takes into consideration the recommendations of the Bank Negara Malaysia in respect of whether the licence should be granted or refused and the conditions, if any, to be imposed on the licence. A bank or a finance company licensed under subsection 6(4) is deemed to be a member institution under the Malaysia Deposit Insurance Corporation Act 2005.

II. Criteria for grant of licence to carry on banking business

The Bank Negara Malaysia provides recommendation to the Minister for grant of banking licence only if the applicant satisfies the criteria set out in the Second Schedule of BAFIA Act, 1989.

(1) Minimum Start-up capital requirements:

All banking institutions are required to maintain, in terms of Section 14 of the BAFIA Act, 1989, a certain amount of capital funds unimpaired by losses as a condition for granting and continuing a licence. The minimum capital funds requirement for domestic banking groups is RM 2 billion and in cases of locally incorporated foreign banks and stand alone investment banks, it is RM 300 million and RM 500 million respectively.

Capital funds for domestic banking groups are calculated based on the aggregate capital funds of the commercial bank and investment bank in each group. These banking groups are given the flexibility to determine the relative size of each entity within their groups as long as the aggregate capital funds of all the entities amounts to at least RM2 billion. In addition to this minimum capital requirement, each banking institution within the banking group is also required to comply with the minimum regulatory capital requirement as a part of “Capital Adequacy Requirement Risk-Weighted Capital Ratio”.

(2) Governance:

Bank Negara Malaysia ensures that every person who is, or is to be, a director, controller or manager of the applicant institution is a fit and proper person to hold the particular position which he holds or is to hold. In determining whether a person is a fit and proper person to hold any particular position, focus is given to his probity, competence and soundness of judgement for fulfilling the responsibilities of that position, as also to the diligence with which he is fulfilling or likely to fulfil those responsibilities and to whether the interests of depositors or potential depositors, if any, of the institution are, or are likely to be, in any way threatened by his holding that position. Reliance on the previous conduct and activities in business or financial matters of the person in question and, in particular, to any adverse evidence, are also taken into account for granting licence to the institution.

For grant of licence, it is required that the business of the applicant institution should be directed by at least two individuals.

III. Fees payable by licensed institutions:

Every licensed institution is required to pay a certain amount of licence fee upon being licensed, a fee for opening any office in Malaysia other than the office at the principal place of business; and an annual fee for continuance, to the Minister.

IV. Maximum percentage of shares a promoter/individual can hold in an AI

There is no restriction on the maximum percentage of shares that an individual can hold in a licensed bank or licensed finance company.

V. Dilution of shareholding of the promoters:

There is no such condition in the BAFIA 1989.

VI. Can Industrial Companies Own Banks

No information is available.

GERMANY

I. Institutional and Legal Framework

The responsibilities for German banking supervision are shouldered commonly by the Deutsche Bundesbank and the Bafin (Federal Financial Supervisory Authority (FFSA)). The Deutsche Bundesbank and the Bafin have spelled out the details of their respective roles in day-to-day supervision, as laid down by Parliament, in an agreement. Under the agreement, the Bundesbank is assigned most of the operational tasks in banking supervision. In the ongoing monitoring process, the Bundesbank's responsibilities notably include evaluating the documents, reports, annual accounts and auditors' reports submitted by the institutions as well as regular audits of banking operations. It holds both routine and ad-hoc prudential discussions with the institutions. On the other hand, the Bafin is responsible for all sovereign measures. Bafin carries out audits of banking operations, either together with the Bundesbank or on its own only in exceptional cases.

The Bafin is the authority to issue licence to anyone wishing to conduct banking business or to provide financial services in Germany commercially or on a scale which requires a commercially organised business undertaking, in terms of Sections 32 and 33 of the Banking Act, 1989. Credit institutions requiring a licence in accordance with section 32 (1) may not be operated in the form of a sole proprietorship.

II. Criteria for granting licence for conduct of banking business

Anyone wishing to conduct banking business or to provide financial services in Germany requires written authorization from BaFin.

(1) Minimum initial capital requirement:

The minimum initial capital required for deposit-taking credit institutions should be at least 5 million Euros and that for investment banks, it should be at least 730,000 euros. Investment advisers, investment brokers, contract brokers and portfolio managers, as well as operators of multilateral trading facilities or companies carrying out security placement business, which are not authorized to obtain ownership or possession of funds or securities of customers and which do not trade in financial instruments for their own account must have an amount equivalent to at least 50,000 euros.

(2) Governance:

Credit and financial services institutions, which in the course of providing financial services are authorized to obtain ownership or possession of funds or securities of customers, must have at least two senior managers (executive directors), who must be "fit and proper persons". Being "fit" persons means that the persons concerned have acquired during their professional careers to date sufficient theoretical knowledge and practical experience to enable them to carry out their new jobs properly. BaFin consults the Federal Central Register for criminal offences and the Central

Commercial Register for business offences in order to verify whether they are "proper" (i.e. reliable) persons.

The applicant must also declare any holders of significant participating interests[1] in the proposed institution and the size of any such interests. Any such persons must also be "proper" persons. If they are not, or if they fail to meet the standards required in the interests of sound and prudent management of the institution for any other reasons, BaFin may refuse to grant the licence.

(3) Business Plan:

The authorisation application must contain a viable business plan indicating the nature of the proposed business, the organisational structure, planned internal monitoring procedures and the proposed internal control systems, projected balance sheets and projected profit and loss accounts for the first three full financial years after the commencement of business operations. BaFin checks whether the applicant is ready and able to take the necessary organisational measures in order to be able to conduct its business in a proper manner.

III. Fees payable by licensed institutions:

Applicants are charged for the licensing procedure. The amount charged depends on the individual processing time required and on the scale of the business of the enterprise concerned. In general, the minimum amount charged is two thousand euro. Payment of a charge may also be required if the applicant withdraws the application for a licence or if the Federal Financial Supervisory Authority refuses to grant the licence.

IV. Maximum percentage of shares a promoter/individual can hold

The holder of a qualified participating interest is required to notify the Bafin and the Deutsche Bundesbank immediately if he intends to increase the amount of the qualified participating interest in such a way that the thresholds of twenty per cent, thirty-three per cent or fifty per cent of the voting rights or capital are reached or exceeded, or that the institution comes under his control. As such, there is no bar in holding of shares in a banking institution.

V. Can Industrial Companies Own Banks

Yes, industrial companies are allowed to own banks in Germany. Illustratively, Volkswagen Group has a Volkswagen Bank in its Group’s shareholdings, initially set up as finance corporation and got converted into universal bank in 1970.

[1] A qualified participating interest is deemed to exist if at least ten per cent of the capital of, or the voting rights in, an enterprise is held directly or indirectly through one or more subsidiaries or a similar relationship or through collaboration with other persons or enterprises, or if a significant influence can be exercised on the management of the enterprise in which a participating interest is held. Participating interests which are held indirectly are to be attributed in full to the persons and enterprises holding the indirect participating interest.

FRANCE

I. Institutional and Legal Framework

Under the Monetary and Financial Code, the pursuit as a regular business of activities qualifying as "banking operations" is restricted to legal entities authorised as credit institutions. Banking operations include the receipt of funds from the public, credit operations, and the banking payment services. In France, there are two broad categories of undertakings *viz*., credit institutions[1] – comprising banks, mutual or cooperative banks, municipal credit banks, financial companies and specialized financial institutions - and investment firms. Undertakings wishing to carry on a regulated banking or financial activity must be authorised as a credit institution (providing investment services or not) or as an investment firm. Under the terms of the Monetary and Financial Code and as laid down in the Banking Act and the Financial Activity Modernization Act, the Credit Institutions and Investment Firms Committee [also called the Prudential Supervision Authority (ACP)] is vested with the powers for taking the decisions and granting the individual authorisations or exemptions applying to credit institutions, with the exception of those within the competence of the *Commission Bancaire (Banking Commission)*. The ACP is a Committee which is chaired by the Governor of the Banque de France, who is also the chairman of the *Commission Bancaire*. The ACP is an independent public authority having legal personality and financial independence.

The Committee do not favour a single natural person owning a credit institution's entire share capital.

II. Criteria for Grating License for Conduct of Banking Business

(1) Minimum Initial Capital Requirement

The authorized undertakings, i.e. credit institutions and investment firms, having their registered office within the territory of French Republic are required to maintain minimum levels of paid-up capital at least equal to a sum determined by the Minister for the Economy. The minimum capital required for credit institutions (banks, mutual and cooperative banks, savings and provident institutions, specialised financial institutions, municipal credit banks that carry out all types of operations) should be 5 million euros. However, for undertakings with restricted operations, the minimum paid-up capital requirements are lower. Illustratively, Municipal Credit Banks whose Articles of Association allow them to grant loans secured by pledge or loans to natural persons but do not authorise them from receiving funds from the public should have a minimum paid-up capital of 2.2 million euro. Municipal Credit Banks which confine their activity to lending against physical collateral, financial companies whose authorisation is confined to the provision of guarantees and those financial companies whose banking activity is confined to leveraged spot foreign exchange transactions should have 1.1 million euro.

(2) Governance:

[1] Only the banks, mutual or cooperative banks and municipal credit banks are generally authorised to receive on-demand deposits or term deposits of less than two years from the public. Banks may carry out all banking transactions. Mutual or cooperative banks and municipal credit banks may carry out all banking transactions consistent with the limitations that result from the laws and regulations that govern them.

The ACP takes account of the company's activities schedule, the technical and financial facilities it intends to implement, and also the suitability of its legal form for the business of a credit institution. The committee also assesses the applicant company's ability to realise its development plans in conditions compatible with the proper functioning of the banking system and adequate customer security. In determining its approval criteria, the Committee may take the specificity of certain credit institutions in the social economic sector into account. It assesses, inter alia, the significance of their activities in regard to the public interest functions associated with combating exclusion or the effective recognition of a right to credit.

In order to assess specific suitability of persons investing capital in a credit institution, the ACP must be satisfied about the quality, identity, economic, financial, social and suitability of contributors of capital and, wherever applicable, their guarantors, and also their experience in the banking sector. Since the introduction in 1990 of various measures to increase banking safety, this information is collected for any person who holds or intends to hold, directly or indirectly, at least 10% of the voting rights. Contributors of capital are also required to send a letter to the *Banque de France* in which they undertake to provide all relevant information in the event of a change to their own situation. In addition, credit institutions are required each year to file financial information on persons who own at least 10% of their capital or incur personal unlimited liability for corporate debts. However, this obligation does not apply to shareholders or partners that are themselves credit institutions authorised in France or in another EU Member State.

The effective determination of the general orientation of a credit institution's business must be decided by at least two persons, who must at all times meet the conditions laid down in the Monetary and Financial Code. The committee may, moreover, refuse approval if the persons referred to above do not possess the necessary respectability and competence or suitable relevant experience. In particular, this concern reflects the specific responsibilities of a credit institution's shareholders, including minority shareholders.

The undertaking seeking authorization shall ensure that Headquarters of the proposed credit institution will be located on the same national territory as the registered office. Further, ACP will also verify to satisfy that assets of credit institution effectively exceed its liabilities to third parties by an amount at least equal to the required minimum capital.

(3) Viable Business Plan

The undertaking seeking authorization is required to submit a viable business plan indicating an effective direction of business policy by at least two fit and proper persons giving the main activities of the institution, nature and amount of planned transactions giving a detailed breakdown for the projected three year flow of transactions, an organisation chart, number of employees likely to be on payroll over the next three years.

III. Conversion of non-banks into Banks

No material is available.

IV. Limiting Asset Size

No details are available about *ACP* imposing an upper limit on the asset size of the proposed bank.

V. Can Industrial Companies Own Banks

a) A shareholder or several shareholders acting in concert may hold a controlling interest in a credit institution only if they have financial resources and banking and financial experience appropriate to the nature and also rated by a rating agency. If they do not satisfy both conditions, they are asked to link up in a sponsorship arrangement with an institution authorised in the European Economic Area that does.

Because of the need to protect funds received from the public, a sponsor is required when the majority shareholders are, in global terms, medium-sized or small foreign banks (i.e., banks from outside the European Economic Area). For non-bank investors that are nonetheless regulated financial institutions of considerable size and impeccable creditworthiness or situated in the European Economic Area, sponsorship is in principle not required. The same applies to very large industrial or retail groups with extensive financial experience which request banking authorisation limited to operations stemming from those of the group.

b) When the majority shareholder or shareholders are undertakings not subject to supervision by the banking authorities, the Committee also ensures that the amount of the proposed investment represents a reasonable fraction of their total fixed assets and available own funds. For group banks in particular, the Committee asks for all precautions to be taken to ensure that they have the utmost independence from their parent undertaking in all aspects of their operations and organisation. When a shareholder base of this type does not include a banking sponsor, the Committee generally makes the authorisation conditional on a letter of intent from the majority shareholder containing undertakings authorised by its senior corporate body that it will keep its shareholding in the long term, regularly monitor the institution's management, ensure that the institution can comply with banking regulations at all times, and provide financial support when called upon by the Governor of the *Banque de France*.

c) In order to avoid any ambiguity about the identity of responsible shareholders, the Committee prefers them to hold their equity interest in the credit institution directly. However, if for particular reasons one or more holding companies are interposed between the investors and the institution, they are asked to give an undertaking not to transfer control of the holding companies without first obtaining the Committee's authorisation.

UNITED STATES OF AMERICA

I. Institutional and Legal Framework

In USA new banks may be chartered for full service (as national banks) or special purpose operations (as special purpose or narrow focus banks), such as trust banks, credit card banks, bankers' banks, community development (CD) banks, and cash management banks. The Office of the Comptroller of the Currency (OCC) is the designated authority for granting approval to the organizing groups (compulsorily composed of five or more persons, normally the bank's initial board of directors) for establishing a national bank.

The OCC grants approval of charter applications in two steps: preliminary conditional approval and final charter approval. Preliminary conditional approval permits the organizers to proceed with organizing the bank. The organization phase for a national bank is the time period between the preliminary conditional approval and the day the bank opens for business. During the organization phase, the organizing bank's officers and directors start the process of hiring management team and staff, continue or begin to raise capital, establish bank premises, develop policies and procedures, test the information technology architecture, and establish management information and control systems. A national bank can begin the business of banking or engage in fiduciary activities only when the OCC grants final approval.

II. Criteria for Grating License for Conduct of Banking Business

(1) Minimum Initial Capital Requirement

The OCC does not mandate a minimum dollar level of capital for national bank charter applications because of the varying degrees of complexity of the charter proposals. Instead, consistent with the OCC's philosophy for supervising all national banks on the basis of risk, the OCC evaluates sufficiency of the proposed capital level in light of the risks present. The OCC expects projected capital for a new bank to remain at or above the "well capitalized" level as defined in 12 CFR 6.4(b)(1)[1] for the first three years of operations and until the bank is expected to achieve stable profitability. These are "minimum capital standards." The OCC may determine that higher amounts of capital from those the organizers proposed are warranted based on local market conditions or the proposed business plan.

Generally, the OCC requires higher levels of capital to support the operations of more complex bank proposals. In addition, the FDIC also has capital requirements for obtaining federal deposit insurance that are similar to the OCC's requirements. The FDIC requires that initial capital should be sufficient to provide a Tier 1 capital-to-assets leverage ratio of not less than 8 per cent throughout the first three years of operations.

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[1] In terms of Code of Federal Regulations (CFR) 6.4(b)(1), the bank shall be deemed to be well capitalized if it: (i) has a total risk-based capital ratio of 10.0 per cent or more; and (ii) has a Tier 1 risk-based capital ratio of 6.0 per cent or more; and (iii) has a leverage ratio of 5.0 per cent or more; and (iv) is not subject to any written agreement, order or capital directive, or prompt corrective action directive to meet and maintain a specific capital level for any capital measure.

An organizing group is required to complete raising capital within 12 months of the OCC's preliminary conditional approval or the approval expires. For raising capital, the organizing group is required to become a body corporate on filing the Articles of Association and Organization Certificate.

Generally national banks have only one class of common stock. National banks may not create classes of common stock with different or no voting rights. Federal banking law provides that common shareholders are entitled to one vote per share in all matters. If a bank proposes to issue more than one class of common stock, legal, supervisory, and policy issues must be considered. A bank should consult with the OCC prior to issuing more than one class of common stock. A national bank may be organized as a Subchapter S corporation, which generally has a limited number of shareholders as determined in 26 USC 1361. However, all members of a family may elect to be treated as one shareholder to determine the total number of shareholders of an S corporation.

(2) Governance:

OCC requires that the organizing groups and senior management teams must demonstrate its collective ability to establish and operate a national bank successfully in the economic and competitive conditions of the market the bank will serve. The OCC also considers whether the proposed bank (i) has organizers who are familiar with national banking laws and regulations, (ii) has competent management, including the board of directors that has ability and experience relevant to the type of products and services to be provided and the size and scope of projected risks, (iii) has capitalisation, access to liquidity and risk management systems to support the projected volume and type of business. The OCC grants a charter application only to a management team, including both the proposed management and directorate, that it considers strong in terms of experience necessary to implement the proposed business plan, exercise corrective action in response to changing internal and external factors.

OCC must be satisfied that the directors, Chief Executive Officer and Executive Officers have sufficient experience, competence, willingness and ability to be active in overseeing the safety and soundness of the bank's affairs.

The OCC requires each national bank to adopt a written insider policy addressing its code of conduct and conflicts of interest governing conduct and transactions between the bank and its directors and principal shareholders and their related interest and with its officers and employees. This policy must detail business practices the board of directors deems acceptable. The OCC requires this policy in writing for each bank, regardless of its complexity or the degree of sophistication of its systems.

The OCC expects all organizers and directors to exhibit substantial personal (contribution of time and expertise) and financial commitment (contribution of initial funding and stock subscriptions) to a new national bank.

The organizers should establish compensation plans that are in the best interest of the bank and commensurate with the services the organizers propose to offer. A new bank may include a stock benefit or compensation plan (stock benefit plan), including stock options, stock warrants, and similar stock based compensation, in its overall compensation for organizers, directors and officers, provided that it structures the plans appropriately. The OCC evaluates each proposed bank's total compensation package, including its stock benefit plan, to determine if it is reasonable considering each person's contribution of time, expertise, and financial commitment.

(3) Viable Business Plan:

Organizers of a proposed national bank must submit a business plan that adequately addresses regulatory and policy considerations. The plan must reflect sound banking principles. The organizing group's business plan, including its financial projections, analysis of risk, and planned risk management systems and controls, is critical to OCC's decision of whether to grant approval to the group's charter proposal. The plan should cover the greater of three years or the time period until the bank is expected to achieve stable profitability. It should realistically forecast market demand, customer base, competition and economic conditions. The plan should contain sufficient information to give realistic assessments of risk related to economic and competitive conditions in the market the bank will serve.

The organizing group should integrate an alternative business strategy into its business and strategic plans and bank policies, so as to manage potential scenarios prudently, efficiently, effectively when the asset or deposit mixes, interest rates, operating expenses, marketing costs, or growth rates differ significantly from the original plan.

In addition to submission of the financial information and business plan, the OCC requires each application sponsored by a holding company, including a Bank Holding Company, to provide consolidated financial projections.

(4) Responsibility under the Community Reinvestment Act (CRA):

Each national bank has a responsibility under the CRA to help meet the credit needs of its entire community, consistent with the safe and sound operations of such institution. The CRA regulation requires each bank to delineate at least one assessment area, comprising of one or more metropolitan statistical area or areas or one or more contiguous political subdivisions (such as countries, cities or towns), It must include the geographies (a census tract or block numbering area delineated by the United States Bureau of the Census in the most recent decennial census) in which the bank has its main office, branches and deposit-taking ATMs, if any, as well as the surrounding geographies in which the bank has originated or purchased a substantial portion of its loans.

The organizing group must demonstrate in the application its knowledge of and plans for serving the proposed bank's assessment area or areas. The organizing group must evaluate the banking needs of the community, including its consumer, business, nonprofit, and government sectors.

(5) Electronic Banking (e-banking) concerns:

The OCC approves proposals to establish national banks that will use and electronic delivery channel when the bank reasonably may be expected to operate successfully and in a safe and sound manner.

(6) Publication:

Each organizing group or sponsor must publish a notice of its charter application in a general circulation newspaper in the community in which the proposed bank will be located, on the date the application is filed or as soon as possible before or after submission of the filing. Any interested person may participate in the OCC licensing process by commenting in writing on any filing during the applicable public comment period (30 days from the initial date of publication). This publication process allows the public to give written comments to the OCC in support of, or in opposition to, the application or to recommend that the OCC grant approval subject only to certain conditions. Generally, public notice does not apply to conversions unless the OCC determines that the application presents a significant or novel policy, supervisory, or legal issue where a public notice is considered necessary.

III. Application Fees

An applicant is required to pay the appropriate filing fee, if any, in connection with its filing for grant of licence as a national bank charter, or for conversion to a national bank, etc. to the Comptroller of the Currency. In case of individual and non-bank holding company sponsored, the fees for a new national bank charter is $ 25,000 and in case of bank holding company sponsored, it is $ 10,000.

IV. Conversion of Non-banks into banks

Under applicable federal and state law, certain types of depository institutions (state commercial banks, state savings associations, state savings banks, state trust companies, federal savings banks and federal savings associations) may convert to become national banks, provided they demonstrate the ability to operate safely and soundly and are in compliance with applicable laws, regulations and policies, and are consistent with the National Bank Act and applicable OCC regulations and policies. A mutual depository institution may need to convert to a stock form of ownership prior to converting to a national bank. Shareholders owning not less than 51 per cent of the institution’s capital stock or a greater amount if required by applicable federal or state law, must approve the proposed conversion. The applicant should submit a list of directors and shareholders owning 10 per cent or more of capital stock (deemed to be 'controlling shareholders') with the application to convert.

In determining action on a conversion application, the OCC normally considers the applicant's condition and management, including compliance with regulatory capital requirements; conformance with statutory criteria, including many of the same standards applicable to chartering a de novo national bank; adequacy of policies, practices, and procedures; CRA record of performance, etc. The OCC may impose special conditions for approvals to protect the safety and soundness of the bank; prevent conflicts of interest; provide customer protections; ensure that approval is consistent with the statutes and regulations; or provide for other supervisory or policy considerations.

Special supervisory conditions may be used depending on whether the particular circumstances warrant it. The OCC tailors special supervisory conditions to specific situations, such as:

(a) Maintaining a specified minimum capital floor;
(b) Executing a written agreement between the proposed bank and its holding company that provides for capital maintenance, liquidity support, or other assurances to the bank, if and when necessary;
(c) Developing a contingency business plan agreement between the proposed bank and the OCC setting forth certain actions that the bank will take if the bank does not achieve the business plan results; and
(d) Requiring all final third-party relationship contracts to stipulate that the performance of services provided by the vendors to the bank are subject to the OCC's examination and regulatory authority.

A converting institution may retain existing branches as a national bank, if such retention is consistent with applicable law. The applicant must identify all branches that will be retained following the conversion. The applicant should certify that the resulting branch structure complies with applicable state and federal branching laws. Certification of the institution's compliance with law, where applicable, must include consideration of geographic limitations and any quantitative and qualitative factors.

V. Can Industrial Companies own banks

A new bank may be owned directly by individuals or a holding company. A new bank may be affiliated with another organization, called a sponsor, rather than choose to operate independently. A sponsor is usually an existing holding company, regardless of whether it is a bank holding company (BHC). However, the OCC does not consider as a sponsor a new BHC that is established at the same time as the new national bank.

When a new bank proposal has a sponsor, the OCC considers primarily the financial and managerial resources of the sponsor and the sponsor's record of performance, rather than the financial and managerial resources of the organizing group. When the sponsor serves as a substantial source of strength, the OCC may approve an application, even in a market in which economic conditions are marginal or competitive conditions are intense. However, in such cases, the OCC may require the bank to execute a written agreement with its holding company that provides for capital maintenance and liquidity support from the holding company. Conversely, the OCC may deny a sponsored new bank application, if the condition of the parent company or any affiliate is subject to supervisory concern or otherwise detracts from the application.

To enhance the corporate separateness of the organizations, the sponsor should evaluate the bank's activities and operations closely and address on the need for bank directors to act primarily in the best interest of the bank rather than the bank's sponsor and to exercise objective judgement in carrying out their duties, independent of undue influence from sponsor management and affiliates.

UNITED KINGDOM

I. Institutional and Legal Framework

Firms (partnerships or unincorporated associations) seeking authorization to carry on banking business are required to apply for Part IV permission by the Financial Services Authority in terms of Financial Services and Markets Act, 2000. Section 40(1) of the Act (Application for permission) allows an application to be made to the FSA for Part IV permission by an individual, a body corporate, a partnership or an unincorporated association. However, in the case of the regulated activities of accepting deposits, the applicant seeking Part IV permission can be a body corporate or a partnership.

II. Criteria for granting license for conduct of banking business

Before carrying on a regulated activity by a firm, the FSA must be satisfied that the firm can meet and continue to meet the minimum standards, called Threshold Conditions, and that the persons running the firm are fit and proper. There are essentially five threshold conditions, which are related to legal status of the applicants, location of offices, applicant's close links with other firms or individuals, adequate resources and suitability of the applicants.

(1) Adequate Resources

The applicant must demonstrate to the FSA that it has adequate resources in relation to the specific regulated activity or regulated activities that it seeks to carry on, or carries on. In this context, the *FSA* interprets the term 'adequate' as sufficient in terms of quantity, quality and availability, and 'resources' as including all financial resources, non-financial resources and means of managing its resources; for example, capital, provisions against liabilities, holdings of or access to cash and other liquid assets, human resources and effective means by which to manage risks.

When assessing this threshold condition, the FSA may consider any person appearing to it to be in a relevant relationship with the firm, in terms of section 49 of the Act; for example, a firm's controllers, its directors or partners, other persons with close links to the firm, and other persons that exert influence on the firm. The FSA may also take into consideration the impact of other members of the firm's group on the adequacy of its resources. For example, the FSA may assess the consolidated solvency of the group.

While assessing the firm's compliance for adequate resources, the FSA will also consider other relevant matters, such as:

(a) whether the firm may have difficulties if the application is granted, at the time of the grant or in the future, in complying with any of the FSA's prudential rules;

(b) whether the firm will not be able to meet its debts as they fall due;

(c) whether there are any implications for the adequacy of the firm's resources arising from the history of the firm;

(d) whether the firm has taken reasonable steps to identify and measure any risks of regulatory concern that it may encounter in conducting its business and has installed appropriate systems and controls and appointed appropriate human resources to measure them prudently at all times; and

(e) whether the firm has conducted enquiries into the financial services sector in which it intends to conduct business that are sufficient to satisfy itself that:

(i) it has access to adequate capital to support the business including any losses which may be expected during its start-up period; and

(ii) Client money, deposits, custody assets and policyholders' rights will not be placed at risk if the business fails.

The applicant seeking authorization for carrying on banking business is required to have an initial capital of not less than 5 million euro. The bank is also required to maintain, at all times, capital resources equal to or in excess of the sum of the credit risk capital requirement, market risk capital requirement and the operations risk capital requirement.

(2) Governance:

The proposed firm must satisfy the FSA that it is fit and proper to have Part IV permission having regard to all circumstances, including its connection with other persons, the range and nature of its proposed or current regulated activities that it carries on or seeks to carry on, and the overall need to ensure that its affairs are and will be conducted soundly and prudently.

The FSA assesses all relevant matters relating to firm's commitment to conduct business with integrity and in compliance with proper standards, competence and ability of management, and conduct of affairs with due skill, care and diligence. The FSA expects the firm's business plan or strategy plan to take into account the interests of consumers and demonstrate that it is ready, willing and organized to comply with the relevant requirements. In this context, the FSA assesses the business integrity of the firm in terms of (i) whether the firm or any person connected with the firm has been convicted of any criminal offence including offences of dishonesty, fraud, financial crime, insider dealing, market manipulation, money laundering, etc.; (ii) whether the firm has been subject to any investigation or enforcement proceedings; (iii) whether the firm has contravened, or is connected with a person who has contravened any provisions of the Act or any preceding financial services legislation, regulatory system or the rules, regulations, principles of code or practice, etc.; (iv) whether the firm or a person connected with the firm has been refused registration, authorisation, membership or licence to carry out a trade, business or profession; (v) whether the firm or a person connected with the firm has been dismissed from employment or a position of trust, or a fiduciary relationship, or has been disqualified from acting as a director.

As regards having competent and prudent management and exercising due skill, care and diligence, relevant matters for assessment by FSA include (i) whether the governing body of the firm is made up of individuals with an appropriate range of skills and experience to understand, operate and manage the firm's regulated activities; (ii) whether the firm has made arrangements for an adequate system of internal control to manage the financial and other risks in a prudent manner; (iii) whether the firm has developed human resources policies and procedures that are reasonably designed to ensure that only honest individuals, which are committed to high standards of integrity in conduct of their activities, are employed;

(3) Viable Business Plan:

The firm seeking Part IV permission must satisfy itself and the FSA that (a) it has a well constructed business plan or strategy plan for its product or service which demonstrates that it is ready, willing and organised to comply with the relevant requirements; (b) its business plan or strategy plan has been sufficiently tested; and (c) the financial and other resources of the firm are commensurate with the likely risks it will face. The plan should also detail the complexity of the firm's proposed regulated activities and unregulated activities and the risks of regulatory concern it is likely to face. Notes on the contents of a business plan are given in the business plan section of the application pack for Part IV permission.

III. Can Industrial Companies own banks

The Threshold Condition with regard to close links is somewhat relevant in this context. According to this condition, the applicant firm, having close links with another person[1], must satisfy the FSA that those links are not likely to prevent its effective supervision. The FSA takes into consideration the structure and geographical spread of the applicant firm, the group to which it belongs and other persons with whom it has close links. The FSA also examines whether the firm and the group to which it belongs will be subject to supervision on a consolidated basis and whether it is possible to assess the overall financial position of the group at any particular time.

[1] the applicant firm is considered to have close links with another person, if the another person is a parent undertaking/subsidiary undertaking/ parent undertaking of a subsidiary undertaking/ subsidiary undertaking of a parent undertaking/ owns or controls 20% or more of the voting rights or capital, of the applicant firm. If the applicant firm owns or controls 20% or more of the voting rights or capital of the another person, it is considered to have close links.

European Union

I. Institutional and Legal Framework

The Capital Requirements Directive (CRD), set out by the European Parliament and the Council of the European Union, deals comprehensively with the taking up and pursuit of the business of credit institutions *(an undertaking the business of which is to receive deposits or other repayable funds from the public and to grant credits for its own account)* and their prudential supervision in the Member States of the European Union. In terms of Article 6 of the Directive, the Member States are required to issue authorisation to the credit institutions for commencing their business activities. The Member States are also required lay down the requirements for such authorisation and notify them to the European Commission.

II. Criteria for Granting License for Conduct of Banking Business

Without prejudice to other general conditions laid down by the national law of the Member States of the European Union, the competent authorities can grant authorisation to the credit institutions before commencing their activities, only on the credit institutions satisfying certain minimum conditions.

(1) Minimum Initial Capital Requirement

The applicant credit institution should possess separate own funds and initial capital (capital and reserves) should be 5 million euro or more. However, the Member States can grant authorisation to particular categories of credit institutions whose initial capital is less than 5 million euro, provided their initial capital is not less than 1 million euro, the concerned Member States notifies the Commission the names of such credit institutions and their reasons for exercising this option.

(2) Governance

An authorisation will be granted for taking up the business of credit institution only when there are at least two persons who effectively direct the business of the credit institution. In other words, authorisation will not be granted if these persons are not of sufficiently good repute or lack sufficient experience to perform such duties.

The competent authorities must be informed, on a continuous basis, about the identities of the shareholders or members, whether direct or indirect, natural or legal persons, that have qualifying holdings (a direct or indirect holding in an undertaking which represents 10% or more of the capital or of the voting rights or which makes it possible to exercise a significance influence over the management of that undertaking), and of the amounts of those holdings. The shareholders or members must be suitable, so as to ensure the sound and prudent management of the credit institution.

Where "close links"[1] exist between the credit institutions and other natural or legal persons, the competent authorities must be satisfied that such relationships would not prevent the effective exercise of their supervisory functions.

The competent authority, before granting authorisation to a credit institution, also consults the competent authorities of the other Member States in cases where (a) the credit institution concerned is a subsidiary[2] of a credit institution authorised in another Member State; (b) the credit institution concerned is a subsidiary of the 'parent undertaking'[3] of a credit institution authorised in another Member State; or (c) the credit institution concerned is controlled by the same persons, whether natural or legal, that are controlling a credit institution authorised in another Member State.

The relevant competent authorities also consult each other when assessing the suitability of the shareholders and the reputation and experience of directors involved in the management of another entity of the same group.

The Home Member State competent authorities are required to ensure that every credit institution has robust governance arrangements, which include a clear organisation structure with well defined, transparent and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks it is exposed to, and adequate internal control mechanisms, including sound administrative and accounting procedures.

III. Publication

The Member States are required to notify the details of every authorisation granted to the credit institutions or withdrawal of the same, to the Commission, which will publish the list in the Official Journal of the European Union and keep it up to date.

IV. Limiting Asset Size

No details are available about CRD imposing an upper limit on the asset size of the proposed credit institution.

V. Can Industrial Companies own banks

There is nothing specific in CRD to prevent credit institutions being owned or controlled by another industrial undertaking or another kind of financial institution (including a hedge fund). The EU rules do not prohibit particular classes of institution from controlling or owning a bank.

[1] "Close Links" means a situation in which two or more natural or legal persons are linked in any of the following ways: (a) participation in the form of ownership, direct or by way of control, of 20 % or more of the voting rights or capital of an undertaking; (b) control; or (c) the fact that both or all are permanently linked to one and the same third person by a control relationship.

[2] a subsidiary undertaking is any undertaking over which, in the opinion of the competent authorities, a parent undertaking effectively exercises a dominant influence.

[3] a parent undertaking is any undertaking which, in the opinion of the competent authorities, effectively exercises a dominant influence over another undertaking.

The relevant provisions in this case are the conditions relating to the suitability of owners and to close links. A supervisory assessment must be made in each individual case, taking into account the specific characteristics of the relevant shareholders or controllers, their ability to ensure the sound and prudent management of the bank, and their impact on the ability of the authorising authority to supervise the bank effectively. Nevertheless, in this context, a mention needs to be made with regard to change of control. Any natural or legal person or such persons desirous of acquiring, directly or indirectly, a qualifying holding in a credit institution or to further increase such holding so as to reach 20%, 30% or 50% or more of the total voting rights or of the capital held, which would render it to become a subsidiary of the credit institution, are required to seek and obtain supervisory approval from the competent authority of the concerned Member State. In approving such acquisition, the competent authorities assess the suitability of the proposed acquirer and the financial soundness of the proposed acquisition, in order to ensure the sound and prudent management of the credit institution. The Member States should neither impose any prior conditions in respect of the level of holding that is proposed to be acquired nor allow their competent authorities to examine the proposed acquisition in terms of the economic needs of the market.

JAPAN

I. Institutional and Legal Framework

The Banking Law of Japan, 1981 provides that any person seeking permission to carry on business of banking is required to take a licence from the Prime Minister. The Prime Minister reviews the application for bank licence in terms of compliance of certain criteria.

II. Criteria for Granting License for Conduct of Banking Business

(1) Minimum Initial Capital Requirement

The bank should be a joint-stock corporation and the minimum capital should be 1 billion yen or more.

(2) Governance

The Prime Minister must be satisfied that the applicant has the financial basis sufficiently to perform the business of bank soundly and effectively, and a prospect for income and expenditure relating to the business is good. The applicant, in its personal composition, should be possessing knowledge and experience capable of performing accurately, fairly and effectively the business of bank, and the person having sufficient social credit.

A person owning voting rights, which exceed five-hundreds of voting rights of all the shareholders of a bank or of all the shareholders of a bank holding company (considered to be the person holding large-scale voting rights of bank), is required to furnish information regarding the ratios of retained voting rights, matters concerning funds to obtain, the purpose of retention, etc., to the Prime Minister.

Any person who intends to acquire voting rights equal to or more than standard value of main shareholders of a bank, should seek prior approval in advance from the Prime Minister.

III. Can Industrial Companies own banks

There is no specific information on this aspect. However, the Banking Law specifies that a bank holding company cannot perform any other business than administration of operations of banks which are its subsidiaries and of companies, such as long-term credit bank, securities specialising company, insurance company, foreign company engaged in banking business, securities business or insurance business, companies engaged in financial related business.

ANNEX II

Select Country Practices on licensing of new banks in the private sector – Table I

Country	Legal framework	Authority granting license/authorization	Types of banks authorized/licensed	Eligible applicants	Criteria for granting licenses	
					Minimum start-up capital	Limit on ownership
Germany	Sections 32 and 33 of the Banking Act, 1989	Bafin [Federal Financial Services Authority (FFSA)]	Deposit-taking credit Institutions, investment banks, and financial services institutions		5 million euro for deposit-taking credit institutions and 0.73 million euro for investment banks	The holder of a qualified participating interest[i] is required to notify Bafin and Deutsche Bundesbank if he intends to increase the amount of qualified participating interest in such a way that the threshold of 20%, 33% or 50% of the voting rights or capital are reached or exceeded, or that the institution comes under his control.
Australia	Section 9(3) of the Banking Act 1959	Australian Prudential Regulation Authority (APRA) grants authorization to carry on banking business. The applicant can call itself a bank only when consent is also granted by APRA under Section 66 of the Banking Act.	Institutions authorized to carry on banking business are referred to as 'Authorized Deposit-Taking Institutions'.	Only corporations (i.e. excluding partnerships or unincorporated entities) are permitted. A non-operating holding company (NOHC) that does not hold a NOHC authority under the Act, are not permitted.	- Fixed by APRA based on the scale, nature and complexity of operations of the applicant. - However, applicants required to have a minimum of $ 50 million in Tier 1 capital. - Prudential Capital Ratio (PCR) of 8% of which at least half of it being made up of Tier 1 capital. - Foreign ADIs not required to maintain endowed capital in Australia.	- shareholding of individual or group of associated shareholders cannot exceed 15 % of the ADI's voting shares. - The Treasurer may allow higher percentage limit. - NOHCs with 100% shareholding in ADI must have wide spread of ownership unless exempted.
Canada	Bank Act, 1991	There are 2 parts to the process. The Minister of Finance on	Schedule I: allowed to accept deposits and are not subsidiaries of a	Any entity or person	- $ 5 million since 2002. - Minimum capital of 4%	Ownership is based on size of Federally Regulated Financial Institution (FRFI) (banks, federal trust or loan company).

Country	Legal framework	Authority granting license/authorization	Types of banks authorized/licensed	Eligible applicants	Criteria for granting licenses	
					Minimum start-up capital	Limit on ownership
		recommendations of the Office of the Superintendent of Financial Institutions (OFSI) issues 'letters patent of incorporation'. The second part is to issue an 'Order to Commence and Carry on Business' by the Superintendent after 'letters of patent of incorporation' has been issued.	foreign bank. Schedule II: allowed to accept deposits and are subsidiaries of a foreign bank. Schedule III: foreign banks but not incorporated under the Bank Act and operate only in large cities, with certain restrictions. Banks intending to take deposits also required to become member of Canada Deposit Insurance Corporation (CDIC).		Tier I capital ratio and 8% total capital ratio to be maintained on a continuous basis.	**Small Bank** – shareholders' equity is less than $ 2 billion and no restriction on ownership other than permission of Minister required to own more than 10% and up to 100% of any class of shares; and if the bank is controlled by a large Canadian bank or by a Canadian bank holding company and the bank has equity of more than $ 250 million, no other person can be a major shareholder of the bank. **Medium Bank** – shareholders' equity is more than $ 2 billion but less than $ 8 million, and no restriction on ownership other than permission of Minister required to own more than 10% of any class of shares; at least 35% of voting shares to be listed on Canadian Stock Exchanges and owned by persons who are not major shareholders; and if the bank is controlled by a large Canadian bank or by a widely held Canadian bank holding company, no other person can be a major shareholder of the bank. **Large bank** – shareholders' equity is $ 8 billion or more and widely held. No permission for holding 10% of any class of shares, but permission of the Minister is required for holding more than 10% of any class of shares and up to 20% of any class of voting shares or up to 30% of any class of non-voting shares, provided the person does not control the bank. If large bank is subsidiary of a widely held bank holding company, it may own 100% of the shares of large

Country	Legal framework	Authority granting license/authorization	Types of banks authorized/licensed	Eligible applicants	Criteria for granting licenses	
					Minimum start-up capital	Limit on ownership
						bank. Certain eligible institutions (e.g. widely held insurance holding companies, widely held Canadian financial institutions, eligible foreign institutions), which control banks with shareholders' equity of less than $ 8 billion, can continue to closely hold those banks as the equity grows through the $ 8 billion threshold. - No person can be a major shareholder of a bank with equity of $ 8 billion or more, except for above cases.
Hong Kong	Section 16(1) (a) of the Banking (Amendment) Ordinance, 1997	Hong Kong Monetary Authority (HKMA)	Three-tier system of authorized institutions - banks (permitted to engage in full range of retail and wholesale banking business) - Restricted License Banks (RLBs) not eligible to carry on banking business but may take call, notice or time deposits from public in amounts of HK$ 5 lakh and above without restriction on maturity, - Deposit-Taking Companies (DTCs) engaged in specialized activities, including consumer finance, trade finance or	Only body corporates are permitted.	Banks - HK$ 300 million or more. DTCs - HK$ 25 million or more. RLBs - HK$ 100 million or more. An authorized institution is also required to maintain a minimum CAR of 10% and HKMA can raise it to 12% in the case of banks and up to 16% in the case of RLBs and DTCs. A non-statutory trigger ratio of 1% has also been stipulated.	No restriction on maximum percentage of shares that an individual can hold. However, a person intending to hold 50% or more of share capital of an authorized institution, can do only in well established bank or other supervised financial institution in good standing and with appropriate experience.

Country	Legal framework	Authority granting license/authorization	Types of banks authorized/licensed	Eligible applicants	Criteria for granting licenses	
					Minimum start-up capital	**Limit on ownership**
			securities business, but are restricted to take deposits of HK$ 1 lakh or above with an original term to maturity, or call or notice period, of at least 3 months.			
MALAYSIA	Section 6 (4) of Banking and Financial Institutions Act (BAFIA), 1989	Minister of Finance, Government of Malaysia on recommendations of the Bank Negara Malaysia	Banks, finance company, merchant banking, discount house business	Public company	RM 2 billion for domestic banking groups (capital funds for domestic banking groups are calculated based on aggregate capital funds of the commercial banks and investment bank in each group). Each banking institution within the banking group is also required to comply with the minimum regulatory capital requirement as a part of Capital Adequacy requirement. RM 300 million for locally incorporated foreign banks RM 500 million for stand-alone investment banks	There is no restriction on the maximum percentage of shares that an individual can hold in a licensed bank or licensed finance company.
EUROPEAN UNION	Article 6 of The Capital	Competent authorities of Member States			5 million euro or more.	Any person desirous of acquiring, directly or indirectly, a qualifying holding in a credit

Country	Legal framework	Authority granting license/authorization	Types of banks authorized/licensed	Eligible applicants	Criteria for granting licenses	
					Minimum start-up capital	Limit on ownership
	Requirements Directive (CRD) issued by the European Parliament and the Council of European Union				However, the Member States can grant authorizations to particular categories of credit institutions whose initial capital is less than 5 million euro, provided their initial capital is not less than 1 million euro.	institution or to further increase such holding so as to reach 20%, 30% or 50% or more of the total voting rights or of the capital held, rendering it to become a subsidiary of the credit institution, are required to obtain supervisory approval from the competent authority of the concerned Member State.
FRANCE	Monetary and Financial Code, the Banking Act and the Financial Activity Modernisation Act	The Prudential Supervision Authority (ACP) (the Credit Institutions and Investment Firms Committee)	Two broad categories - credit institutions comprising banks, mutual or cooperative banks, municipal credit banks, financial companies and specialized financial institutions - and investment firms		5 million euro for credit institutions, that carries out all types of operations. 2.2 million euro for municipal credit banks which grant loans secured by pledge or loans to natural persons but are not authorized to receive funds from public 1.1 million euro for municipal credit banks which confine to lending against physical collateral, financial companies that provide either guarantees or confine to leveraged spot foreign exchange transactions. Required to maintain a	A single natural person is not permitted to own a credit institution's entire share capital. A shareholder or several shareholders acting in concert may hold a controlling interest in a credit institution.

Country	Legal framework	Authority granting license/authorization	Types of banks authorized/licensed	Eligible applicants	Criteria for granting licenses	
					Minimum start-up capital	**Limit on ownership**
					solvency ratio of at least 8% at all times.	
UNITED KINGDOM	Section 40(1) of Financial Services and Markets Act, 2000	Part IV permission by Financial Services Authority (FSA)		Individual, body corporate, partnership or unincorporated association	5 million euro. The bank is also required to maintain, at all times, capital resources equal to or in excess of the sum of credit risk capital requirement, market risk capital requirement and operation risk capital requirement.	No information is available. However, the applicant firm can have close links with another person (i.e. owns or controls 20% or more of voting rights or capital of the applicant firm), provided FSA is satisfied that such links are not likely to prevent its effective supervision.
USA	National Bank Act	The Office of the Comptroller of the Currency (OCC) is designated authority. OCC grants approval in two steps: preliminary conditional approval and final charter approval.	National Banks for full services, special purpose or narrow focus banks (trust banks, credit card banks, bankers' banks, community development banks, cash management banks) for special operations.	Organizing groups compulsorily composed of five or more persons (normally the bank's initial board of directors). It should be a body corporate.	No minimum dollar level of capital for national bank charter applications. OCC evaluates sufficiency of the proposed capital level in light of the risks present. It expects projected capital to remain at or above the "well capitalized" level for the first three years of operation, which is considered to be the minimum capital standards. For more complex bank proposals, higher levels of	No restriction on maximum percentage of shares that an individual can hold. New national bank may be owned by individuals or a holding company.

Country	Legal framework	Authority granting license/authorization	Types of banks authorized/licensed	Eligible applicants	Criteria for granting licenses	
					Minimum start-up capital	**Limit on ownership**
					minimum capital are stipulated.	
JAPAN	The Banking Law of Japan, 1981	The Prime Minister		Any person	1 billion yen or more	No restriction on maximum percentage of shares that an individual can hold. However, any person who intends to acquire voting rights equal to or more than standard value of main shareholders of a bank, should seek prior approval in advance from the Prime Minister

[i] A qualified participating interest exist if at least ten per cent of the capital of, or the voting rights in, an enterprise is held directly or indirectly through one or more subsidiaries or a similar relationship or through collaboration with other persons or enterprises, or if a significant influence can be exercised on the management of the enterprise in which a participating interest is held.

ANNEX III

Select Country Practices on licensing of new banks in the private sector – Table II

Country	Criteria for granting licenses		Limiting asset size	Publication	License Fees	Can corporates own banks?
	Governance	Business Plan				
Germany	At least 2 senior managers (executive directors) who are Fit & Proper persons with sufficient theoretical knowledge, practical experience and reliability. Applicant should declare any holders of significant participating interest in the proposed institution and the size of any such interest. Such persons must also be proper persons.	3-year viable business plan indicating the nature of proposed business, organisational structure, planned internal monitoring procedures and proposed internal control systems, projected balance sheets and profit & loss accounts.			Minimum license fee is 2000 euro. However, the amount actually charged depends on the individual processing time required and on the scale of business of the enterprise concerned.	Yes
Australia	Applicants to show that persons who hold key positions within the ADI, and all substantial shareholders are 'Fit & Proper' in accordance with Prudential Standard APS 520 Fit and Proper criteria.	- 3-year business plan incorporating its goals, business structure, financial projections of balance sheets, cash flow and earnings, key financial and prudential ratios for the proposed ADI and its subsidiaries on a consolidated basis. - Adequate and appropriate risk management and internal control systems, compliance processes and systems,		Authorisations are published on APRA's website and in the Government Gazette.		Yes, ADIs can be owned by industrial companies provided the ultimate holding company of the group is a banking company (authorized NOHC) subject to the provisions in the Banking Act. The ADIs can also own substantial interest in non-financial

		information and accounting systems, and external and internal audit arrangements				companies. An industrial company which is a dominant company in a group including an ADI, can only be a sister company of the ADI (and not its holding company) or a subsidiary of ADI.
Canada	- submit details on current organization chart with names and details of persons owning > 10% of any class of shares or ownership interest in the applicant - entities in which applicant owns 10% or more of voting rights - summary of financial and other activities carried on by the applicant and its affiliates - personal information from all individuals which demonstrate that they have access to financial resources to provide continuous financial support to FRFI - each individual to provide details of any regulatory actions, criminal convictions or breaches of statutory or other administrative/regulatory enactments against him - description of risk management and control processes and policies for FRFI - overview of investment and lending policies and standards and procedures adopted in respect of funding, liquidity risk management, capital management policy Based on two-fold approach: range of characteristics (judgment capacity,	- 3-year business plan indicating the reasons for establishing FRFI, analysis of target markets, opportunities and competitors - overview of each line of business and product and services to be offered - initial base financial statement and balance sheet & income statement for first three years and contingency plans resulting from variations associated with key assumptions in worst case scenarios - address the risks that information technology could pose upon the customers, employees, vendors, etc.	On Superintendent's opinion, the Minister may stipulate the bank not to exceed its average total assets as on the last day of the month immediately before the month specified in the order.			Yes. Any entity or person is eligible to own a FRFI provided they satisfy the statutory critiera.

	initiative, responsiveness and operational excellence of the board and its members) and institution's performance or effectiveness in carrying out its governance responsibilities.					
Hong Kong	- Each person who is, or is to be, a director, controller, chief executive or executive officer or manager is a 'fit and proper' person. - Maintain adequate liquidity (minimum liquidity ratio of not less than 25% during each month), comply with control systems, adequate provision for depreciation and losses, adequate accounting and control systems, disclosure of adequate information about the state of its affairs and profit and loss account in its audited annual accounts. - Carry on the business with integrity, prudence and the appropriate degree of professional competence and in a manner not detrimental to the interests of depositors or potential depositors. - HKMA takes into account the persons' reputation and character, knowledge and experience, competence, soundness of judgment and diligence, person's record of non-compliance with various non-statutory codes. - Identity of each controller of the institution.	3-year business plan describing the nature and scale of business to be undertaken and business strategies to be adopted, details of the proposed management. organisational structure and control systems, and financial projections	Applicant institution applying for carrying on banking business must have total customer deposits and total assets of not less than HK$ 3 billion and HK$ 4 billion respectively, only at the time of authorization. The applicant institution should have been a DTC or RLB for not less than 3 continuous years, or a subsidiary of a bank incorporated outside Hong Kong or a subsidiary of a holding company of such bank.		Banking license fee - HK$ 0.47 million Registration fee - HK$ 0.11 million RLB license fee - HK$ 0.38 million	No information
MALAYSIA	Every person who is, or is to be, a director, controller or manager of the applicant institution should be fit and proper person in respect of probity, competence and soundness of judgment, diligence and protecting the depositors or potential		Bank Negara Malaysia stipulates a certain amount, depending on the nature and scale of operations, to be maintained as net assets.		Certain amount of license fee upon being licensed, for opening any	No information is available.

	depositors' interest. Business should be directed by at least two individuals.				office in Malaysia other than the office at principal place of business, and for continuance, is levied.	
EUROPEAN UNION	At least 2 persons, who are fit and proper and have sufficiently good repute and sufficient experience, should effectively direct the business of the credit institution. Information on identities of shareholders or members (direct or indirect, natural or legal persons) that have qualifying holdings (10% or more of capital or of voting rights) should be furnished to competent authorities. Fit and Proper criteria for shareholders or members. Where "close links"[1] exist between the credit institutions and other natural or legal persons, the competent authorities must be satisfied that such relationships would not prevent the effective exercise of their supervisory functions.		No details are available.	Member States are required to notify the details of every authorization granted to the credit institutions or withdrawal of the same, to the Commission, which publishes the list in the Official Journal of the European Union.		There is nothing specific in CRD to prevent credit institutions being owned or controlled by another industrial undertaking or another kind of financial institution (including a hedge fund). The EU rules do not prohibit particular classes of institution from controlling or owning a bank.
FRANCE	Assesses the quality, identity, economic, financial, social and suitability of contributors of capital, and also their guarantors and their experience in banking sector. Information is also sought for from persons who hold at least 10% of voting rights.	3-year viable business plan indicating an effective direction of business policy, nature and amount of planned transactions giving a detailed breakdown, an organisation chart, number of employees likely to be on payroll.	No details are available about ACP imposing an upper limit on the asset size. However, assets of credit institution should exceed its liabilities to third parties by an amount at least equal to			The Monetary and Financial Code does not specifically restrict the industrial companies to own banks. The proposed credit

	Institution must be handled by at least two persons who must at all times be fit and proper and also meet the conditions laid down in Monetary and Financial Code. ACP assesses the applicant company's ability to realise its development plans in line with proper functioning of the banking system and adequate customer security.		the required minimum capital.			institution can be sponsored when the majority shareholders are medium sized. In case of large industrial or retail groups with extensive financial experience, which applied for banking authorisation limited to operations stemming from those of the group, do not require sponsorship.
UNITED KINGDOM	Fit and Proper in all circumstances, including the applicant's connection with other persons. Compliance with proper standards, competence and ability of management, conduct of affairs with due skill, care and diligence. FSA assesses the business integrity of firm and persons connected with the firm.	Well constructed business plan or strategy plan indicating firm's products or services, complexity of the firm's regulated and unregulated activities and the risks of regulatory concern.				Financial Services and Markets Act does not specifically restrict industrial groups to own banks. FSA, while examining the application, takes into consideration the structure and geographical spread of the applicant firm, the group to which it belongs and other persons with whom it has close links.
USA	Organizing groups and senior management teams must demonstrate its collective ability to establish and operate a national bank successfully.	More than 3-year business plan that addresses regulatory and policy considerations and indicates sound banking principles, financial projections,		Each organising group or sponsor must publish a notice of its charter	$ 25000 for a new national bank charter in case of individual	Certain types of depository institutions (state commercial banks, state savings

	Directors, CEOs and Executive Officers should have sufficient experience, competence, willingness and ability to be active in overseeing the safety and soundness of bank's affairs. Fit and Proper criteria for the organizers groups and management. Each national bank has to adopt a written insider policy addressing its code of conduct and conflicts of interest between the bank and its directors and principal shareholders and also with its officers and employees. Organizers to establish compensation plans that are in the best interest of the bank and commensurate with the proposed services.	risk analysis and risk management systems and controls. It should realistically forecast market demand, customer base, competition and economic conditions. The plan should also incorporate an alternative business strategy so as to manage potential scenarios prudently, efficiently and effectively. Each national bank has a responsibility under the CRA to help meet the credit needs of its entire community, consistent with the safe and sound operations of such institution.		application in a general circulation newspaper in the place of its location, which allows the public to give written complaints to the OCC in support of or in opposition to the application.	and non-bank holding company sponsored. $ 10,000 in case of bank holding company sponsored.	associations, state savings banks, state trust companies, federal savings banks and federal savings associations) can convert to become national banks, provided they demonstrate the ability to operate safely and soundly and comply with applicable laws, regulations and policies. A new bank may be affiliated with another organization called a sponsor, rather than choose to operate independently. A sponsor is usually an existing holding company, not necessarily bank holding company.
JAPAN	- Applicant must indicate that it has the financial basis sufficiently to perform the bank business soundly and effectively, and a prospect for income and expenditure relating to the business is good. - Applicant should possess knowledge and experience capable of performing accurately, fairly and effectively the					No specific information is available.

	business of bank. - A person owning voting rights, which exceed five-hundreds of voting rights of all the shareholders of a bank or of all the shareholders of a bank holding company, is required to furnish information regarding the ratios of voting rights, matters concerning funds, purpose of retention to the Prime Minister.					