RBI Press Release

Guidelines on Entry of New Banks in the Private Sector (January 3, 2001)

The guidelines for licensing of new banks in the private sector were issued by the Reserve Bank of India (RBI) on January 22, 1993. Out of various applications received, the RBI had granted licences to 10 banks. After a review of the experience gained on the functioning of the new banks in the private sector, in consultation with the Government, it has now been decided to revise the licensing guidelines.

The revised guidelines for entry of new banks in private sector are given below. The guidelines are indicative and any other relevant factor or circumstances would be kept in view while considering an application. With the issue of revised guidelines, applications pending with the RBI would be treated as lapsed.

2. Guidelines

(i) The initial minimum paid-up capital for a new bank shall be Rs. 200 crore. The initial capital will be raised to Rs. 300 crore within three years of commencement of business. The overall capital structure of the proposed bank including the authorised capital shall be approved by the RBI.

(ii) The promoters' contribution shall be a minimum of 40 per cent of the paid-up capital of the bank at any point of time. The initial capital, other than the promoters' contribution, could be raised through public issue or private placement. In case the promoters' contribution to the initial capital is in excess of the minimum proportion of 40 per cent, they shall dilute their excess stake after one year of the bank's operations. (In case divestment after one year is proposed to be spread over a period of time, this would require specific approval of the RBI) Promoters' contribution of 40 per cent of the intial capital shall be locked in for a period of five years from the date of licensing of the bank.

(iii) While augmenting capital to Rs. 300 crore within three years of commencement of business, the promoters will have to bring in additional capital, which would be at least 40 per cent of the fresh capital raised. The remaining portion could be raised through public issue or private placement. The promoters' contribution of a minimum of 40 per cent of additional capital will also be locked in for a minimum period of 5 years from the date of receipt of capital by the bank.

(iv) NRI participation in the primary equity of a new bank shall be to the maximum extent of 40 per cent. In the case of a foreign banking company or finance company (including multilateral institutions) as a technical collaborator or a co-promoter, equity participation shall be restricted to 20 per cent within the above ceiling of 40 per cent. In cases of shortfall in foreign equity contributions by NRIs, designated multilateral institutions would be allowed to contribute foreign equity to the extent of the shortfall in NRI

contribution to the equity. The proposed bank shall obtain necessary approval of Foreign Investment Promotion Board of the Government of India and Exchange Control Department of the RBI.

(v) The new bank should not be promoted by a large industrial house. However, individual companies, directly or indirectly connected with large industrial houses may be permitted to participate in the equity of a new private sector bank up to a maximum of 10 per cent but will not have controlling interest in the bank. The 10 per cent limit would apply to all inter-connected companies belonging to the concerned large industrial houses. In taking a view on whether the companies, either as promoters or investors, belong to a large industrial house or to a company connectecd to a large industrial house, the decision of the RBI will be final.

(vi) The Proposed bank shall maintain an arms length relationship with business entities in the promoter group and the individual company/ies investing upto 10 per cent of the equity as stipulated above. It shall not extend any credit facilities to the promoters and company/ies investing up to 10 per cent of the equity. The relationship between business entities in the promoter group and the proposed bank shall be of a similar nature as between two independent and unconnected entities. In taking view on whether a company belongs to a particular Promoter Group or not, the decision of the RBI shall be final.

(vii) Conversion of NBFCs into Private Sector Banks

An NBFC with a good track record desiring conversion into a bank should satisfy the following criteria :

- The NBFC should have a minimum net worth of Rs. 200 crore in its latest balance sheet which will stand increased to Rs. 300 crore within three years from the date of conversion.
- The NBFC should not have been promoted by a large Industrial House or owned/controlled by public authorities, including Local, State or Central Governments.
- The NBFC should have acquired a credit rating of not less than AAA rating (or its equivalent) in the previous year.
- The NBFC should have an impeccable track record in compliance with the RBI regulations/directions and in repayment of public deposits and no default should have been reported.
- The NBFC desiring conversion into bank should have capital adequacy of **not less than 12 per cent** and net NPAs of **not more than 5 per cent.**
- The NBFC on conversion to a bank will have to comply with Capital Adequacy Ratio and all other requirements such as lending to priority sector, promoters' contribution, lock-in period

for promoters' stake, dilution of promoters' stake beyond the minimum, NRI and foreign equity participation, arms length relationship, etc. as applicable to banks.

3. *Other Requirements*

(i) The bank shall be required to maintain a minimum capital adequacy ratio of 10 per cent on a continuous basis from the commencement of its operations.

(ii) In order to ensure level playing field,

a) the new bank will have to observe priority sector lending target of 40 per cent of net bank credit as applicable to other domestic banks, and
b) the new bank will be required to open 25 per cent of its branches in rural and semi-urban areas to avoid over concentration of their branches in metropolitan areas and cities on the same lines as new private sector banks established under guidelines laid down by the RBI in January 1993,

(iii) The promoters, their group companies and the proposed bank shall accept the system of consolidated supervision by the Reserve Bank of India.

(iv) The new bank shall not be allowed to set up a subsidiary or mutual fund for at least three years from the date of commencement of business.

(v) The headquarters of the proposed new bank could be in any location in India as decided by the promoters.

(vi) The new bank shall make full use of modern infrastructural facilities in office equipments, computer, telecommunications, etc. in order to provide cost-effective customer service. It should have a high powered Customer Grievances Cell to handle customer complaints.

(vii) The new bank will be governed by the provisions of the Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, other relevant Statutes and the Directives, Prudential regulations and other Guidelines/Instructions issued by the RBI and the regulations of SEBI regarding public issues and other guidelines applicable to listed banking companies.

4. *Procedure for Applications*

i) In terms of Rule 11 of the Banking Regulation (Companies) Rules, 1949 applications shall be submitted in the prescribed form (Form III). In addition, the applications 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. The project report should give as much concrete details as feasible, based on adequate ground level information and avoid unrealistic or unduly ambitious projections.

Applications should also be supported by detailed information on the background of 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 company(ies)/other Group company(ies) with banks/ financial institutions, and details of proposed participation by foreign banks/ NRI/OCBs.

ii) Applications for setting up new banks in the private sector, along with other details as mentioned above, should reach the following address before **March 31, 2001**.

The Chief General Manager-in-Charge, Department of Banking Operations and Development, Reserve Bank of India, World Trade Centre, Centre I, Cuffe Parade, Colaba, Mumbai 400 005.

5. Procedure for the RBI Decisions

i) In view of the increasing emphasis on stringent prudential norms, transparency, disclosure requirements and modern technology, the new banks need to have strength and effeciency to work profitably in a highly competitive environment. As a number of banks are already functioning, licences will be issued on a very selective basis to those who conform to the above requirements and who are likely to conform to the best international and domestic standards of customer service and efficiency. Preference will, however, be given to promoters with expertise of financing priority areas and in setting up banks specialising in the financing of rural and agro-based industries. The number of licences to be issued in the next three years may be restricted to two or three of the best acceptable proposals. This number would also include permission granted to any NBFC for conversion into bank. [If the number of acceptable proposals of the highest standards are more than three, this limit may be relaxed on recommendation of the Advisory Committee (see below). In that case the period for issuing new licences may be stretched to four or five years].

ii) At the first stage, the applications will be screened by the RBI to ensure prima facie eligibility of the applicants.Thereafter, the applications will be referred to a high-level Advisory Committee to be set up by the RBI comprising

Dr. I.G. Patel, - Chairman
former Governor of the Reserve Bank of India
Shri C.G. Somiah, - Member
former Comptroller and Auditor General of India
Shri Dipankar Basu,- Member
former Chairman of State Bank of India

Chief General Manager of the Department of Banking Operations and Development of the RBI will be the Secretary of the Advisory Committee.

(iii) The Committee will set up its own procedures for screening the applications. The

Committee will reserve the right to call for more information as well as have discussions with any applicant/s and seek clarification on any issue as required by it. The Committee will submit its recommendations to the RBI for consideration within three months after the last date of receipt of applications by the RBI (i.e. June 30, 2001). The decision to issue an in-principle approval for setting up of a bank will be taken by the RBI. The RBI's decision will be final.

(iv) The validity of the in-principle approval issued by the RBI will be one year from the date of granting in-principle approval and would thereafter lapse automatically.

v) After issue of the in-principle approval for setting up of a bank in the private sector, if any adverse features are noticed subsequently regarding the promoters or the companies/firms with which the promoters are associated and the group in which they have interest, the Reserve Bank of India may impose additional conditions and if warranted, it may withdraw the in-principle approval.

RBI Withdraws Interest Rate Surcharge on Import Finance and Minimum Interest Rate Prescription on Overdue Export Bills (January 5, 2001)

On a review of the current situation, the Reserve Bank, has decided to withdraw the interest rate surcharge on imports as also the prescribed minimum interest rate in respect of overdue export bills :

a) Withdrawal of Interest Rate Surcharge on Import Finance

The Interest Rate Surcharge of 50 per cent on import finance, which has been in force since May 26, 2000 is being withdrawn with effect from January 6, 2001.

b) Interest Rate on Overdue Export Bills

Since May 26, 2000, banks are required to charge a minimum rate of 25 per cent interest on overdue export bills. This stipulation is also being withdrawn with effect from January 6, 2001 and banks will henceforth have the freedom to decide the appropriate rate of interest on overdue export bills. However, the present procedures for ensuring that there is no deliberate attempt to delay repatriation of export receipts will remain in force.

Ways and Means Advances Scheme, 2001 for State Governments (January 10, 2001)

The present Ways and Means Advances (WMA) Scheme to the State Governments was brought in with effect from April 1, 1999 on the basis of the recommendations of the Vithal Committee and subsequent consultations the RBI had with State Finance Secretaries and Government of India officials.

Background

Taking into account subsequent requests from several State Governments and based on the review framework indicated by Vithal committee, the matter was discussed in the latest meeting of State Finance Secretaries held on November 3 and 4, 2000 at the RBI. It was agreed in the said Conference, which was also attended by the officials of the Government of India, that an Informal Group of State Finance

Secretaries be constituted to review the existing Scheme and make recommendations and finalise its report before end December 2000. In the Conference, there was a request for immediate implementation of revised WMA and Overdraft Scheme.

The Informal Group of the State Finance Secretaries submitted its report to the RBI and the Group had the benefit of detailed discussions with the officials of the Ministry of Finance.

Decision Taken

The RBI has considered all the recommendations of the Group and the following decisions have been taken. A summary account of the decisions taken is as under.

Normal WMA Limits

As recommended by the Group, it has been decided that the normal WMA limits may be worked out taking into account the three year's average of revenue receipts and capital expenditure for fiscal years 1997-98, 1998-99 and 1999-2000 and to this base a ratio of 2.4 per cent may be applied for the non-special category States and 2.9 per cent for the special category States. Accordingly, the total revised normal WMA limits worked out to Rs. 5,296 crore as against the present limits of Rs. 3,941 crore representing an increase of Rs. 1,355 crore or about 34 per cent.

Yearly Revision

The RBI has also accepted the recommendation of the Group that the maximum ratio of 2.4 per cent and 2.9 per cent should be frozen for the next three years and every year the Reserve Bank of India will revise the normal WMA limits taking into account the moving average of revenue receipts and capital expenditure for the latest three years. However, the RBI would review this arrangements after two years.

Overdraft Regulation Scheme

Keeping in view the recommendations of the Group and the requests made by States from time to time and taking into account the problems being experienced currently in cash flow, it has been decided to increase the present 10 working days' restriction to 12 working days as an ad hoc measure subject to review.

Furthermore, as recommended by the Group, for facilitating cash flow management, it has been decided to extend the three days' restriction for bringing down the overdraft level within the level of 100 per cent normal WMA limit to five days under the Overdraft Regulation Scheme.

The Vithal Committee had recommended that no State shall be allowed to run overdraft with the RBI for more than 20 working days during a quarter in a financial year. While implementing the Vithal Committee's recommendation it had been decided to defer the decision for two years. The Group of Finance Secretaries has recommended that the decision could be deferred for one more year. The recommendation has been accepted by the RBI and it has been decided to extend the deferment of 20 days' restriction upto April 2002 under the Overdraft Regulation Scheme.

Special WMA and Minimum Balance

It has been decided that the present Seheme of special WMA and Minimum Balance would continue.

Effectiveness

It has been decided that the revised limits and above revisions would come into force from February 1, 2001.

Review

The RBI has also decided to review the entire formula for WMA in light of emerging conditions in State finances after two years with a view to bringing the revision in to effect from the third year.

WMA Scheme 2001

The revised WMA Scheme, which will be called "**WMA Scheme 2001**" will come into effect from February 1, 2001. The main features of the Scheme are as under :

(i) Taking into account the three years' average of revenue receipts and capital expenditure for fiscal years 1997-98, 1998-99 and 1999-2000 and applying to this base a ratio of 2.4 per cent for non special category States and 2.9 per cent for special category States, the total normal WMA limits work out to Rs. 5,296 crore.

(ii) The special WMA continues to be linked to the investments made by State Governments in the Government of India Securities, i.e. Dated Securities and Treasury Bills.

(iii) Overdraft Regulation Scheme which will be applicable to the State Governments with effect from February 1, 2001 is as under :

a) The RBI will allow a State to run an overdraft for 12 consecutive working days instead of 10 days at present. In case the overdraft appears in the State's account and remains beyond 12 consecutive working days as per the current practice, the RBI and its agencies

shall stop payments on behalf of the concerned State Governments. This is an ad hoc measure subject to review.

b) The overdraft shall not exceed 100 per cent of normal WMA limit. On the first occasion that this is exceeded in a financial year, the RBI shall advise the State that the overdraft amount should not exceed 100 per cent of normal WMA limit on any subsequent occasion.

c) Without prejudice to clause (a) above, if during the financial year, the amount of overdraft exceeds 100 per cent of WMA limit on a second or any subsequent occasion, the State shall be given five working days' notice instead of the present notice period of three working days to bring down the overdraft amount within the level of 100 per cent of normal WMA limit. If this is not adhered to, payments will be stopped.

The WMA Scheme 2001 is subject to review in its entirely at the end of two years with a view to bringing the revision in to effect from the third year.