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RBI releases Discussion Paper on 'Banking Structure in India - The Way Forward'

The Reserve Bank of India today released on its website a [Discussion Paper](#) on 'Banking Structure in India – The Way Forward'.

The Discussion paper has identified certain building blocks for the reorientation of the banking structure with a view to addressing various issues such as enhancing competition, financing higher growth, providing specialised services and furthering financial inclusion. It has also emphasised the need to address the concerns arising out of such changes with a view to managing the trade off for ensuring financial stability. The envisaged policy will have to be in the backdrop of a strong regulatory and supervisory regime with increased intensity of supervision for the systemically important banks. The overall thrust of the reorientation is to impart dynamism and flexibility to the evolving banking structure, while ensuring that the structure remains resilient and promotes financial stability.

The important issues covered in the Discussion Paper are:

- i) **Small banks vs. large banks** : Small local banks play an important role in the supply of credit to small enterprises and agriculture and banking services in unbanked and under-banked regions in the country. While permitting large number of small banks, however, the issues relating to their size, numbers, capital requirements, exposure norms, regulatory prescriptions, corporate governance and resolution need to be suitably addressed.
- ii) **Universal Banking**: Universal banking model remains the dominant and preferred model in most of the post crisis world, given the failure of many investment banks during the crisis. Under the universal banking model, the Financial Holding Company (FHC) structure has distinct advantages and may be a preferred model. Additionally, in a changing economic environment, there is a need for niche banking and differentiated licensing could be a desirable step in this direction, particularly for infrastructure financing, wholesale banking and retail banking. There is also a need to promote investment banks/investment banking activities.
- iii) **Continuous Authorisation**: There is a case for reviewing the current 'Stop and Go' licensing policy and consider adopting a 'continuous authorisation' policy, as continuous authorisation keeps the competitive pressure on the existing banks and also does not strain the banking system as the 'block' licensing may do. However, it is important that the entry norms should be stringent so as to encourage entry by only well-qualified entities in order to improve the quality of the banking system and promote competition.

- iv) **Conversion of UCBs into commercial banks:** There is a case of exploring the possibilities of converting some UCBs into commercial banks or small banks as these banks, freed from dual control and with more avenues to raise capital, could extend banking services in the regions characterised by poor banking outreach.
- v) **Consolidation:** The issue of consolidation in the banking sector has assumed significance, considering the need for a few Indian banks to cater to global needs by becoming global players and the growing corporate and infrastructure funding needs. Taking into account the pros and cons of consolidation, it has to be borne in mind that while consolidation of commercial banks with established synergies and on the basis of voluntary initiatives is welcome, it cannot be imposed on banks. A measured approach is to be made both on consolidation and global presence even if attaining global size is not imminent.
- vi) **Presence of Foreign Banks in India:** The significance and need for foreign banks' participation in India arises primarily to increase competition, promote efficiency of the local banking system and also to bring in sophisticated financial services and risk management methodologies which can be adopted by the domestic banks. Post crisis, domestic incorporation of foreign banks through the subsidiarisation route has acquired importance.
- vii) **Indian banks' presence overseas:** Given the highly competitive environment overseas coupled with enhanced regulation, the way forward for the Indian banks could be, apart from Representative Office and branch form of presence overseas, local incorporation by large banks either individually or in joint venture mode with other banks or with overseas banks. This will enable the large Indian banks to engage in a much wider range of activities and have greater potential for growth. Eventually, this may facilitate banks increasing their global reach.
- viii) **Government Ownership:** An optimal ownership mix in the banking sector is required to promote a balance between efficiency, equity and financial stability. Going forward, there is a better pay-off in enabling PSBs to improve their performance while promoting private sector banks. As regards the reduction in fiscal burden on account of recapitalisation of the Public Sector Banks (PSBs), Government may consider options from menu of choices available such as issue of non-voting equity shares or differential voting equity shares, adopting FHC structure or diluting stake in PSBs.
- ix) **Deposit Insurance and resolution:** The existence of an effective resolution regime is essential for any type of banking structure India may pursue. The FSB key attributes could be the guiding principles for setting up a resolution framework in India.
- x) **Indicative reorientation of the banking structure:** The reoriented banking structure would comprise four tiers. The first tier may consist of three or four large Indian banks with domestic and international presence along with branches of foreign banks in India. The second tier is likely to comprise several mid-sized banking institutions including niche banks with economy-wide presence. The third tier may encompass old private sector banks, Regional Rural Banks, and multi state Urban Cooperative Banks. The fourth tier may embrace many small privately owned local banks and cooperative banks.

Comments on the issues raised in the Discussion Paper may be forwarded by September 30, 2013 to the Principal Chief General Manager, Department of Banking Operations and Development, Reserve Bank of India, Central Office, 12/13 Floor, Shahid Bhagat Sing Marg, Mumbai 400 001 ([email](#))

Background

Exercises to review the banking systems have been taken up by many jurisdictions especially in the aftermath of the global financial crisis incorporating lessons learnt from the crisis. While the primary motivation of the current exercise in reviewing the banking structure in India is to put forth various options to enable the banking system to cater to the needs of a growing and increasingly globalising economy, providing specialised services and deepening financial inclusion, the lessons learnt from the crisis are suitably taken into consideration, despite Indian banking system coming out relatively unscathed from the crisis.

A number of studies have sought to examine whether the nature of the banking structure matters for the economic growth of a country. While there is no broad consensus on the issue, it can be reasonably agreed that a dynamic and flexible banking system would be more equipped to address the requirements of a dynamic economy.

Against this background the Reserve Bank of India issued guidelines for licensing of new banks in the private sector, vide its [press release dated February 22, 2013](#). It was stated in the guidelines that there was a need for an explicit policy on banking structure in India, keeping in view the recommendations of the Narasimham Committee, Raghuram Rajan Committee and other viewpoints. Accordingly, it was announced in the Monetary Policy Statement 2013-14 on May 03, 2013 that the Discussion Paper on 'Banking Structure in India – The Way Forward' would be issued.

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