प्रेस प्रकाशनी PRESS RELEASE

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RBI releases Framework for setting up of Wholly Owned Subsidiaries by Foreign Banks in India

The Reserve Bank of India (RBI) today released on its website, the framework for setting up of Wholly Owned Subsidiaries (WOS) by foreign banks in India. The policy is released in pursuance of the announcement made in the Second Quarter Review of Monetary Policy 2013-14 (para 26).

The policy is guided by the two cardinal principles of (i) reciprocity and (ii) single mode of presence. As a locally incorporated bank, the WOSs will be given near national treatment which will enable them to open branches anywhere in the country at par with Indian banks (except in certain sensitive areas where the Reserve Bank's prior approval would be required). They would also be able to participate fully in the development of the Indian financial sector. The policy incentivises the existing foreign bank branches which operate within the framework of India's commitment to the World Trade organisation (WTO) to convert into WOS due to the attractiveness of near national treatment. Such conversion is also desirable from the financial stability perspective. To provide safeguards against the possibility of the Indian banking system being dominated by foreign banks, the framework has certain measures to contain their expansion if the share of foreign banks exceeds a critical size. Certain measures from corporate governance perspective have also been built in so as to ensure that the public interest is safeguarded.

Background

In 2004, Government of India with a view to liberalising foreign direct investments (FDI) in private sector banks raised the FDI limit to 74 per cent in the private sector banks under the automatic route and also permitted foreign banks, regulated by a banking supervisory authority in the home country and meeting the Reserve Bank's licensing criteria to hold 100 per cent paid up capital, to set up a WOS in India.

To operationalise the FDI guidelines, the Reserve Bank released the roadmap for presence of foreign banks in India in consultation with the Government of India on February 28, 2005. The roadmap was divided into two phases – the first phase spanning the period March 2005 to March 2009 and the second phase beginning after a review of experience gained in the first phase.

In the first phase, foreign banks already operating in India were allowed to convert their existing branches to WOS while following the 'one-mode presence' criterion and the WOS was to be treated at par with the existing branches of foreign banks for branch expansion in India. The second phase of the roadmap which was to commence in April 2009 envisaged removal of limitations on the operations of WOS and treating them on par with the domestic banks to the extent appropriate. During the first phase no foreign bank came forward to set up or convert their branches into WOS in the absence of adequate incentives.

As a sequel to the roadmap of 2005 and pursuant to the announcements made in the Annual Policy Statement for 2010-11, the Reserve Bank issued a Discussion Paper in January 2011 on the mode of presence of foreign banks in India. The framework for setting up of WOS by foreign banks in India has now been finalised taking into account the feedback received on the Discussion Paper and factoring in the lessons from the crisis which favours a subsidiary mode of presence from financial stability perspective.

Key features of the Framework

- Banks with complex structures, banks which do not provide adequate disclosure in their home jurisdiction, banks which are not widely held, banks from jurisdictions having legislation giving a preferential claim to depositors of home country in a winding up proceedings, etc., would be mandated entry into India only in the WOS mode.

- Foreign banks in whose case the above conditions do not apply can opt for a branch or WOS form of presence.

- A foreign bank opting for branch form of presence shall convert into a WOS as and when the above conditions become applicable to it or it becomes systemically important on account of its balance sheet size in India.

- Foreign banks which commenced banking business in India before August 2010 shall have the option to continue their banking business through the branch mode. However, they will be incentivised to convert into WOS because of the attractiveness of the near national treatment afforded to WOS.

- To prevent domination by foreign banks, restrictions would be placed on further entry of new WOSs of foreign banks/ capital infusion, when the capital and reserves of the WOSs and foreign bank branches in India exceed 20 per cent of the capital and reserves of the banking system.

- The initial minimum paid-up voting equity capital for a WOS shall be ₹ 5 billion for new entrants. Existing branches of foreign banks desiring to convert into WOS shall have a minimum net worth of ₹ 5 billion.

- The parent of the WOS would be required to issue a letter of comfort to the RBI for meeting the liabilities of the WOS.

- Corporate Governance – (i) not less than two-third of the directors should be non-executive directors; (ii) a minimum of one-third of the directors should be independent of the management of the subsidiary in India, its parent or associates; (iii) not less than fifty per cent of the directors should be Indian nationals /NRIs/PIOs subject to the condition that not less than 1/3rd of the directors are Indian nationals resident in India.

- The branch expansion guidelines as applicable to domestic scheduled commercial banks would generally be applicable to WOSs of foreign banks except that they will require prior approval of RBI for opening branches at certain locations that are sensitive from the perspective of national security.

- Priority Sector lending requirement would be 40 per cent for WOS like domestic scheduled commercial banks with adequate transition period for existing foreign bank branches converting into WOS.

- On arm’s length basis, WOS would be permitted to use parental guarantee/ credit rating only for the purpose of providing custodial services and for their international operations. However, WOS should not provide counter guarantee to its parent for such support.

- WOSs may, at their option, dilute their stake to 74 per cent or less in accordance with the existing FDI policy. In the event of dilution, they will have to list themselves.

The issue of permitting WOS to enter into M&A transactions with any private sector bank in India subject to the overall investment limit of 74 per cent would be considered after a review is made with regard to the extent of penetration of foreign investment in Indian banks and functioning of foreign banks (branch mode and WOS).

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