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GUIDELINES ON ENTRY OF NEW PRIVATE SECTOR BANKS

For well over two decades, after the nationalisation of 14 larger banks in 1969, no banks have been allowed to be set up in the private sector. Progressively, over this period, public sector banks have expanded their branch network considerably and catered to the socio-economic needs of large masses of the population, especially the weaker section and those in the rural areas. The public sector banks now have 91 per cent of the total bank branches and handle 85 per cent of the total banking business in the country. While recognising the importance and the role of public sector banks, there is increasing recognition of the need to introduce greater competition which can lead to higher productivity and efficiency of the banking system. A stage has now been reached when new private sector banks may be allowed to be set up.

It is necessary that while permitting the entry of new private sector banks the following considerations have to be kept in view:

(a) they sub-serve the underlying goals of financial sector reforms which are to provide competitive, efficient and low cost financial intermediation services for the society at large;

(b) they are financially viable;

(c) they should result in upgradation of technology in the banking sector;

(d) they avoid the shortcomings, such as, unfair preemption and concentration of credit, monopolisation of economic power, corss holdings with industrial groups, etc., which beset the private sector banks prior to nationalisation;

(e) freedom of entry in the banking sector may have to be managed carefully and judiciously.

Based on these considerations, the Reserve Bank has formulated the following guidelines for establishment of new banks in the private sector :-

(a) Such a bank shall be registered as a public limited company under the Companies Act, 1956.

(b) The RBI may, on merits, grant a licence under the Banking Regulation Act, 1949 for such a bank. The bank may also be included in the Second Schedule of the Reserve Bank of India Act, 1934 at the appropriate time. The decision of the RBI in these matters shall be final.

(c) The bank will be governed by the provisions of the Banking Regulation Act, 1949 in regard to its authorised, subscribed and paid-up capital. The minimum paid-up capital for such a bank shall be Rs.100 crores. The promoters' contribution for such a bank shall be determined by the RBI and will also be subject to other applicable regulations.

(d) The shares of the bank should be listed on stock exchanges.

(e) To avoid concentration of the headquarters of new banks in metropolitan cities and other overbanked areas, while granting a licence, preference may be given to those, the headquarters of which, are proposed to be located in a centre which does not have the headquarters of any other bank.

(f) Voting rights of an individual shareholder shall be governed by the ceiling of 1 per cent of the total voting rights as stipulated by Section 12 (2) of the Banking Regulation Act. However, expemption from this ceiling may be granted under Section 53 of the said Act, to public financial institutions.

(g) The new bank shall not be allowed to have as a director any person who is a director of any other banking company, or of companies which among themselves are entitled to exercise voting rights in excess of twenty per cent of the total voting rights of all the shareholders of the banking company, as laid down in the Banking Regulation Act, 1949.

(h) The bank will be governed by the provisions of the Reserve Bank of India Act, 1934, the Banking Regulation Act, 1949 and other relevant statues, in regard to its management, set-up, liquidity requirements and the scope of its activities. The directives, instructions, guidelines and advices given by the RBI, shall be applicable to such a bank as in the case of other banks. It would be ensured that a new bank would concentrate on core banking activities initially.

(i) Such a bank shall be subject to prudential norms in respect of banking operations, accounting policies and other policies as are laid down by RBI. The bank will have to achieve capital adequacy of 8 per cent of the risk weighted assets from the very beginning. Similarly, norms for income recognition, asset classification and provisioning will also be applicable to it from the beginning. So will be the single borrower and group borrowers exposure limits that will be in force from time to time.

(j) The bank shall have to observe priority sector lending targets as applicable to other domestic banks. However, in recognition of the fact that new entrants may require some time to lend to all categories of the priority sector, some modifications in the composition of the priority sector lending may be considered by RBI for the initial period of three years.

(k) Such a bank will also have to comply with such directions of the RBI as are applicable to existing banks in the matter or export credit. As a facilitation of this it may be issued an authorised dealer's licence to deal in foreign exchange, when applied for.

(l) A new bank shall not be allowed to set up a subsidiary or mutual fund for at least three years after its establishment. The holding of such a bank in the equity of other companies shall be governed by the existing provisions applicable to other banks, viz. -

(i) 30 per cent of the bank's or the investee company's capital funds, whichever is less, as set out under the Banking Regulation Act, 1949, and

(ii) 1.5 per cent of the bank's incremental deposits during a year as per RBI guidelines.

The aggregate of such investments in the subsidiaries and Mutual Fund (if and when set up) and portfolio investments in other companies shall not exceed 20 per cent of the bank's own paid-up capital and reserves.

(m) In regard to branch opening, it shall be governed by the existing policy that banks are free to open branches at various centres including urban/metropolitan centres without the prior approval of the RBI once they satisfy the capital adequacy and prudential accounting norms. However, to avoid over-concentration of their branches in metropolitan areas and cities, a new bank will be required to open rural and semi-urban branches also, as may be laid down by RBI.

(n) Such a bank shall have to lay down its loan policy within the overall policy guidelines of RBI. While doing so, it shall specifically provide prudential norms covering related party transactions.

(o) Such a bank shall make full use of modern infrastructural facilities in office equipments, computer, telecommunications, etc. in order to provide good customer service. The bank should have a high powered customer grievances cell to handle customer complaints.

(p) Such other conditions as RBI may prescribe from time to time.

(V.L.Patil)

Press Release : 1992-93/233 Relations Officer

Related Press Releases	
Aug 11, 2010	RBI releases Discussion Paper on Entry of New Banks in the Private Sector
Jan 03, 2001	Guidelines on entry of new banks in the private sector