SHOULD CORPORATES BE ALLOWED TO OWN BANKS?

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ABSTRACT

The Reserve Bank of India is a regulator of the banking system in India. Post-liberalization of the banking sector, various banks were given licenses in 1993, 2001, and 2013 in 3 phases. Later since 2016, on tap licensing regime has been started by RBI. On Tap Licensing means one can apply for a banking license throughout the year, unlike the old regime where RBI used to invite applications within a specified timeframe. As a result, there are various banks that are established under different sets of provisions and requirements. Hence the banking business is organized under different regulatory regimes. Hence Internal Working Group was constituted by RBI to examine and review the extant licensing and regulatory guidelines relating to ownership, control, corporate structure, and other related issues. The IWG has stated in its report various changes which were accepted by RBI but one point on which RBI is cautious is allowing corporates to own banks. RBI has not accepted to allow large industrial houses to own/promote banks because of a history of Indian banks prior nationalization period. There are various risks and benefits related to this but here risks overweigh the benefits of allowing corporates to own banks. In 2014, RBI issued licenses to IDFC and Bandhan Bank to promote banking business, although their promoters were large corporate houses. The license was provided under RBI's guidelines of promoting banks under the NOFHC route. This was justified by RBI as "At a time when there is public concern about governance, and when it comes to licenses for entities that are intimately trusted by the Indian public, this may well be the most appropriate stance."

Keywords: Banks, Large Industrial Houses, Corporates, RBI.

INTRODUCTION

If we talk about any modern or healthy economy, then Banking Sector is its lifeline. It plays a vital role in the functioning of an economy. According to Banking Regulation Act 1949, banking means accepting deposits from the public, which are repayable on demand or

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otherwise, for the purpose of lending or investments and withdrawal by cheque, draft, order, or otherwise. They play an important role in the mobilization of deposits and disbursement of credit to various sectors of the economy.[1] Before nationalization of banks in 1969, the banks were in the hands of the private sector. The need to nationalise the banks arose because of practices of connected lendings, imprudent lendings, and hence bank failures increased in those times. During 1947-58, for instance, 361 banks of varying sizes failed in India. The failed banks were amalgamated or ceased to exist.[2]

HISTORY

Earlier in 1917, Tatas set up their bank known as Tata Industrial Bank and Birlas controlled United Commercial Bank (now UCO). In India, even Central Bank was earlier a Private sector bank. Later in 1949, it was nationalised through the RBI (Transfer of Public Ownership) Act. Similarly, the Imperial Bank of India was nationalised in 1955 and named as State Bank of India. Later in 1969, 14 major commercial banks functioning in India were nationalised such as Allahabad Bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Canara Bank, Punjab National Bank, UCO Bank, Union Bank of India, etc. And then in the year 1980, another 6 banks underwent nationalization like Punjab and Sind Bank, Oriental Bank of Commerce, Corporation Bank, Andhra Bank, New Bank of India and Vijaya Bank.[3]

After this, almost 20 banks were nationalised and the government controlled 91% of the banking industry of the country. After 1990, the liberalisation of the banking sector started and a lot of private banks came into the business. These banks came to be known as new generation tech-savvy banks. These banks were HDFC Bank, Axis Bank, IndusInd Bank, Oriental Bank of Commerce.[4] No new licenses were awarded till 1991 when 12 were given and 2 more in 2015. But none were awarded to corporates. Hinduja Group, the multi-industry conglomerate, was involved with banking since 1978 when they established Hinduja Bank, which operates in

[1] 'An Introduction to Indian Banking System' http://www.drbrambedkarcollege.ac.in/sites/default/files/AN%20INTRODUCTION%20TO%20INDIAN%20BANKING%20SYSTEM.pdf accessed 16 January 2022.

[2] Kavaljit Singh 'Why This Is Not the Right Time to Allow Corporate Ownership in Indian Banks' (30 Nov 2020) https://thewire.in/banking/indian-banks-nbfcs-corporate-ownership-rbi accessed 17 January 2022.

[3] Finology Blog, 'Nationalization of Banks: History of Indian Banks' (15 Dec 2020) https://blog.finology.in/recent-updates/nationalization-of-banks accessed 24 January 2022.

[4] Finology Blog, 'Nationalization of Banks: History of Indian Banks' (15 Dec 2020) https://blog.finology.in/recent-updates/nationalization-of-banks accessed 24 January 2022.

many countries. In India, it operates as IndusInd Bank which was one of the first to get a license after RBI allowed new banks to be set up.

However, RBI has restricted promoter stakeholding in private banks to 15% along with further restrictions on its management and voting rights. Those who got licenses were asked to reduce their promoter stake to this level gradually over 10-15 years. But the regulations around promoter holding in the private banks have gone through many changes and have been contested. Even in courts as in the case of Kotak Mahindra Bank, which was always in financial business. In the case of KMB, the promoters have reduced their stake to 26% after reaching a deal with RBI in 2020. There are other such cases as well, for example, Bandhan Bank where promoter holding was up to 80% and has now been reduced to 40%. Last year, RBI allowed the promoters to hold up to 26%, and banks like IndusInd have welcomed the move and shown intent to increase their stake.

ALLOWING CORPORATES TO OWN BANKS

Recently Internal Working Group (IWG) of the Reserve Bank of India (RBI) has in its report titled "Extant Ownership Guidelines and Corporate Structure for Indian Private Sector Banks" suggested that large Corporate Houses be allowed to enter Indian Banking System by making necessary amendments to Banking Regulation Act, 1949. IWG was aware of RBI's view to not allow Corporates to enter the banking sector in view of serious risks, governance concerns, and conflict of interests.[5] These recommendations came in accordance with the RBI's 'Guidelines for Licensing of New Banks in the Private Sector' which provided the opening of the banking sector to other entities such as Non- Banking Financial Companies.

BENEFITS AND RISKS OF ALLOWING CORPORATES TO OWN BANKS

There are many benefits of allowing Corporates to enter the banking sector, but it comes with risks too. Hence it has both pros and cons.

BENEFITS

[5] RBI, 'Report of the Internal Working Group to Review Extant Ownership Guidelines and Corporate Structure for Indian Private Sector Banks', (20 November 2020) https://rbi.org.in/Scripts/PublicationReportDetails.aspx?UrlPage=&ID=1160#CPA4 accessed 16 January 2022.

1. Source of Capital: Many Indian Banks are Public Sector banks and are owned by the Government. And Government just uses the taxpayer's deposits for maintaining and funding such banks. Hence we can say Indian Banking System deals with a lack of capital and Infrastructure. Hence if Corporates are allowed to own banks, the lack of capital requirements can be fulfilled.

2. Expertise: If big businesses are allowed in the banking sector then they can bring in their experience, management expertise, strategic decision making, and strategic direction, which is lacking in government-owned banks.

3. Fostering Competition: If the Privatisation of Banks is allowed, then it will foster competition in banking industries. As currently there are not many banks in the public sector and hence there is a kind of monopoly. Hence if it is allowed then it will enhance competition and efficiency of banks and thereby protect the interests of the consumers.

RISKS

1. Connected Lending and Moral Hazard: A bank that doesn't have a large business backing can unanimously provide lending services to authentic borrowers without any bias thus ensuring efficient allocation of funds to spur the overall growth of the economy. Whereas, a large corporate-owned bank, can be biased when providing loans to the group companies at the expense of more deserving ones. If banks start providing loans at such expense, then the risks associated with the projects of companies will get transferred from companies to the banks hence affecting other shareholders of the bank and putting them in jeopardy. In other terms, the efficiency of the bank will be questioned and it will collapse. This is a case of conflict of interest where businesses need a huge chunk of money for their projects and they borrow it from banks. If such banks will be held by them then they will be able to take personal benefit which is morally hazardous for the economy.

2. Difficulty in Regulation: Due to various shell companies, subsidiaries, and complex legal structures of companies, it will get impossible to track and regulate the transactions made by such banks.

3. Concentration of Wealth: If new banking licenses are provided to Corporates, it will only add more power to these large groups thereby dominating other important sectors of the economy. It will only jeopardize the interest of small companies. This will create inequality and concentration of wealth into the hands of some.

4. Poor Corporate Governance: Another reason why RBI don't want to give license to corporates is Poor Corporate Governance. The IWG stated that "the prevailing corporate governance culture in corporate houses is not up to the international standard and it will be difficult to ring-fence the non-financial activities of the promoters with that of the bank." India's biggest accounting fraud 'Satyam Scam' held in 2009 just came 5 months after the company won the Golden Peacock Global Award for Excellence in Corporate Governance, instituted by the Institute of Directors (UK).

Former Governor Raghuram Rajan and Deputy Governor Viral Acharya have opposed the move of allowing business houses in banking. They said "The history of such connected lending is invariably disastrous – how can the bank make good loans when it is owned by the borrower? Even an independent committed regulator, with all the information in the world, finds it difficult to be in every nook and corner of the financial system to stop poor lending," they said in a joint article. In August 2011, the then RBI Governor D. Subbarao said in one of his speeches, "By far the biggest apprehension is about self-dealing — that companies will use the bank as a private pool of readily available funds."

BHARATPE'S ACQUISITION OF PMC BANK

Recently in June 2021, RBI has allowed Fintech startup BharatPe along with Centrum Financial Services (an NBFC) to acquire a crisis hit Punjab and Maharashtra Co-operative Bank (PMC) and form a Small Finance Bank (SFB). In this arrangement, BharatPe will be a 'joint investor' and CFS will be a promoter for the bank. The SFB is known as Unity SFB and started its operations on November 1, 2021. Small Finance Bank are niche banks that provide banking services of deposit and lending to small and marginal farmers, small business units, micro and small enterprise, and unorganized sector entities. According to RBI's Guidelines for 'on tap' Licensing of Small Finance Banks in the Private Sector, "an NBFC which has a sufficient track record of at least 5 years can convert into SFB. However, joint ventures by different promoter groups for the purpose of setting up small finance banks would not be permitted.

Proposals from Government-owned / public sector entities and large industrial house/business groups, including from NBFCs and PBs promoted by them, autonomous boards/bodies set up under enactment of a state legislature, state financial corporations, subsidiaries of development financial institutions, will not be entertained. For the purpose of these guidelines, a group with assets of ₹ 5,000 crores or more with the non-financial business of the group accounting for 40 percent or more in terms of total assets / gross income, will be treated as a large industrial house/business group." In the case of BharatPe and Centrum Financial Services, the former one is not a Large Industrial House and the latter is an NBFC that fulfills the criteria of promoting an SFB. Still, it is believed that RBI did not give the license to this Joint Venture out of choice. It was because PMC bank which was involved in a scam and on the verge of shutting down was being acquired by this JV. A draft scheme for amalgamation was released by RBI, according to which Unity's takeover of assets and Liabilities of PMC will provide greater protection to the depositors.

CONCLUSION

As we have covered all the benefits and risks associated with allowing Corporates to own banks, we can say that risks overweighs the benefits. It means Corporate Houses should not be allowed to promote banks. Or if they are allowed then proper guidelines and policies should be drafted. Such as a cap/limit can be set while providing loans to the promoters, promoter (corporate promoters) shareholding to be reduced in case of joint ventures, etc. Otherwise, Yes Bank fraud case can also be taken into consideration, wherein even if it is not a Corporate bank, still it got involved in such a big blunder. So we can conclude that no law, regulation, audit, policy, or guideline can stop these corporates from committing malpractices.