Bank Licences: RBI should make financial inclusion an opportunity not an obligation

The wait is over; the final guidelines for new bank licences are out. The Reserve Bank of India (RBI) has buried the ghosts of crony capitalism with some tight provisions about intra-conglomerate dealing. The debate over the shadow banking system has been addressed in the paragraphs about NBFC conversion. The RBI's permission will be required before raising additional capital: this will ensure continuing good behaviour. But though the guidelines are comprehensive, I have a few quibbles.

First, there is the number of licences to be issued. There are many numbers floating around. However, if we are issuing new bank licences to promote financial deepening and inclusion, then all those who meet the RBI's criteria should get a bank licence. These licences should be given on tap, as in the insurance and mutual funds sectors, and not all at one go. The reason is simple. India has a severe shortage of banks. America still has more than 6,000 banks and we all know that bank failures were not restricted to small banks: Citi and Bank of America were perhaps the biggest recipients of bailouts.

After the crisis, we have seen a debate on the issue of banks becoming too big to fail.Simon Johnson has argued persuasively that in some parts of the world, banks essentially lobbied regulators to allow the creation of self-serving clubby environments for big banks. This should not be allowed to recur. Issuing licences in one go puts pressure on the system as all new licensees go looking for capital, people and locations at the same time. It stymies innovation, which new players will have to do and upset any clubby environment that existing banks try to create. So, we should have both the big and the new coming in with new models to spur innovation and customer service.

If licences were on tap, serious players would come in. This system would not create any scarcity rents: banking would be a value rather than valuation play. The RBI guidelines make it more favourable for people without any financial services business to create banks, rather than make it easier for large NBFCs to become banks. The rules about the statutory liquidity ratio and priority sector lending are onerous and large NBFCs will struggle to comply. The RBI should either offer concessions similar to those offered to IDBI, or it should allow NBFCs to scale down their business while building up businesses within the bank.

The RBI should let infrastructure finance to remain in NBFCs rather than bring it into the bank. Flexibility is critical to spur investments with long-tenure loans. The RBI should define what it classifies as infrastructure, that fits with rules on infrastructure funding companies.

I am disappointed that the RBI maintains the stipulation that banks need to have 25 per cent of their branches in rural areas, defining branches very rigidly. Financial inclusion will become real when it shifts from being an obligation to an opportunity. This will require

collaboration and partnerships across industry silos. We have 864 million cell phones in India and less than half that number of bank accounts. The RBI needs to spur innovative distribution solutions and partnerships with retailers and telcos to extend the last-mile reach cheaply.

On non-operating financial holding companies, the RBI has walked a tightrope with legacy issues as well as the need for a clearer structure for the future. It has also strayed into the jurisdiction of some other regulators. The attempt to create a non-operating financial holding company under which all financial businesses operate is welcome. But some practical issues need to be clarified.

The current Section 25 company guidelines require 90 per cent of the investment to be made in group companies even if they are non-operative or investment companies. A drop below this figure designates them as NBFCs. This does not make sense and the RBI will need to clarify its intent here.

The RBI should allow the recipients of new licences time to comply with the guidelines as it did to the earlier recipients of bank licences. About 18 months after starting operations should be a fair period for such compliance. Overall, I believe the guidelines deserve our praise.

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