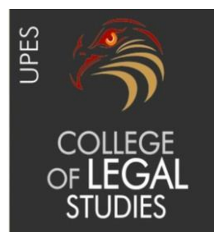
FDI IN BANKING SECTOR IN INDIA

Ayush Srivastava

Submitted under the guidance of: Dr. Sujata Bali

This dissertation is submitted in partial fulfillment of the degree of B.B.A., LL.B. (Hons)



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University of Petroleum and Energy Studies

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CERTIFICATE

This is to certify that the research work entitled **"FDI in Banking Sector in India"** is the work done by Ayush Srivastava under my guidance and supervision for the partial fulfillment of the requirement of B.B.A., LL.B. (Hons) degree at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

Signature & Name of Supervisor:

Designation:

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DECLARATION

I declare that the dissertation entitled **"FDI in Banking Sector in India"** is the outcome of my own work conducted under the supervision of Dr. Sujata Bali, at College of Legal Studies, University of Petroleum and Energy Studies, Dehradun.

I declare that the dissertation comprises only of my original work and due acknowledgement has been made in the text to all other material used.

Signature & Name of Student:

Date:

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ABBREVIATIONS

AD: Authorised Depository

BCSB: Basel Committee on Banking Supervision

CBRG: Cross Border Resolution Group

CG: Central Government

CRR: Cash Reserve Ratio

CRAR: Capital to Risk Weighted Ratio

DFI: Development Finance Institution

DIPP: Department of Industrial Promotion and Policy

ECD: Exchange Control Department

FCNR: Foreign Currency Non-Repatriable

FDI: Foreign Direct Investment

FII: Foreign Institutional Investment

FEMA: Foreign Exchange Management Act

FERA: Foreign Exchange Regulation Act

FIPB: Foreign Investment Promotion Board

FPI: Foreign Portfolio Investment

GOI: Government of India

IMF: International Monetary Fund

IPDI: Innovative Perpetual Debt Instruments

LPG: Liberalisation, Privatisation and Globalisation

LOC: Letter of Comfort

NPA: Non Performing Assets

NRO: Non –Resident Ordinary

OCB: Overseas Corporate Bodies

PSB: Public Sector Banking

PSU: Public Sector Undertaking

QFI: Qualified Institutional Investors

RBI: Reserve Bank of India

RRB: Regional Rural Banks

SEBI: Securities Exchange Board of India

SLR: Statutory Liquidity Ratio

TBTF: Too Big To Fail

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TCTF: Too Connected To Fail

UNCTAD: United Nations Conference on Trade and Development

WTO: World Trade Organisation

WOS: Wholly Owned Subsidiary

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OVERVIEW OF THE FDI SECTOR IN INDIA

Historical Background

Post Independence India, which was striving to establish basic framework for growth and prosperity so as to outreach benefit to its large population strictly adhered to socialist policies as modus for development. The key element of such policies was to reach self sufficiency. The liberalization of the Indian economy refers to ongoing economic reforms that started through launch on Statement on Industrial Policy on 24 July 1991.

Attempts to liberalize economy were made earlier also in the year 1966 and 1985. The first attempt failed leading to adoption of stricter version of socialism. The then Prime Minister Rajiv Gandhi made another attempt in 1985. In the year 1991 due to the economic turmoil resulting from balance of payments crisis, India in respect of its obligation to the IMF had to pledge 20 tons of gold to Union Bank of Switzerland and another 47 tons to Bank of England. The IMF also mandated India to undergo series of structural economic reforms.

As a result of IMF requirements, the government under the leadership of the then Prime Minister of P. V. Narasimha Rao and the then finance minister Manmohan Singh started introduction of certain reforms in the economy regulation though not completely in tandem with the IMF requirements. The policies so introduced included opportunity for foreign trade and investment, deregulation of the market, privatization and inflation-controlling measures. The reformative policy advocated in 1991 is popularly touted as LPG. Generally speaking liberalization regime has in essence has remained somewhat same irrespective of the political ideaology. The reforms of 1991 proved to be sustainable in nature and resulting in far reaching positive consequences. The new industrial policy which was proclaimed in 1991 contained big volume of incentives and concession for the flow of foreign capital to India.

Post liberalisation Reforms were introduced in the banking sector to strengthen the Indian banks and make them internationally competitive as banks play vital role in furthering the economic development of the nation. The domestic banking sector was opened up for private participation with a view that entry of new private banks would accentuate the existing competition. Analysts suggest that the efficiency of the banking sector is deemed to be improved due to the effect of liberalization policy resulting in gradual in cost of intermediation and decline in nonperforming loans. The liberalization caused upgradtion of the sector through improved technology and competition.

Banking Sector Reforms

Banking sector reforms as pointed out below help us in understanding firstly the state of affairs of the banking market before reforms secondly the recommendations and their adoption reflects the intention behind requesting such changes and thirdly the ideaology employing which the reforms are framed in the country.

In August 1991, GOI constituted a committee under the chairmanship of M. Narasimham. The Committee was constituted to suggest ways by which "operational flexibility" and "functional autonomy" can be brought about to the ailing banking sector which was crippled under the strict socialistic and non reformative regulatory regime. Such was sought so as to enhance efficiency, productivity and profitability of banks. The Narsimham committee was the first step towards liberalization of banking sector as it saw liberalization as tool for gaining economic prosperity and worked in this sphere. FDI at that time was a far fetched aspirations. But if we carefully anlayse the recommendations, these hint on obtaining overseas influence in terms of services and business practice, capital etc. The recommendations were directed to achieve certain basic requirements what we today seek to obtain through FDI infusion though now in more advanced form. The Narsimham Committee submitted its report in November 1991. Following listed are its key recommendations:

a. Constitution and setting up of a atleast a four-tier hierarchy structure which consists of few i.e. atleast three to four large banks. SBI being at the foremost level. The major public sector banks today are due to this robust empowerment drive under the Narsimham recommendations.
b. Imparting equal treatment to both public as well as private sector bank so that an an amicable level playing field is maintained which shall give rise to a healthy competitive market.

c. Removal of the ban on opening of private sector banks along with removal of the restrictions and amendment to the branch licensing policy.
d. The govt. has to be more liberal in the expansion of foreign bank branches and foreign operations of Indian banks should be rationalized.

e. It was recommended that the SLR and the CRR need to be progressively brought down from 1991-92 so as to give to the banks greater operational flexibility.
f. The committee stressed upon re-examinaion and re-formulation of the credit program and further one of the major recommendation was to re-define priority sector so as to extend benefit to a greater class, it was recommended to enlarge the ambit of the term so as to include small and marginal farmers, small and medium scale industrial sector, comparatively small individual businesses and weaker sections.
g. Realising the importance of the Basel norms and the necessity to adhere to it, the committee recommended that within the time frame of three years the Banking institutions in India should comply and adhere to the BIS/Basel norms for capital adequacy.
h. The committee called for de-regulation of Interest rates and required that Interest rates should be determined by the forces of the market.
i. Stress was laid down upon the need to provide for prudential norms for commercial banks.
j. The committee closely observed the working of the banks in the country and suggested that the competition between DFIs and banks needs to be increased and a shift from consortium lending to syndicated lending should be made.
k. Dealing with doubtful debts the committee called upon governmental agencies to make provisions to the extent of 100 percent of the security shortfall.
l. The govt. share of public sector banks should be disinvested to a certain percentage like in case of any other PSU
m. Each public sector banks should setup at least one rural banking subsidiary and they should be treated at par with RRBs.

The first phase reforms that hinted on key factors of the banking industry such as competition, prudential norms, de regulation of interest rates, better customer services, induction of professionalism etc. in a nutshell indicated that through liberalization the industry should develop as that of its western counterparts. The recommendations of the committee along with the governmental scheme were instrumental in bringing new private banks in the country, better customer service and induction of healthy competition so as to enable the banking industry to develop free from strict governmental ties.

After somewhat positive success of the first generation reforms the next step towards the policy of LPG was to be taken. For the purpose of initiating second generation or phase of financial sector reforms, another committee on Banking Sector Reforms (BIS), again under the Chairmanship of M. Narasimham submitted was appointed. The committee submitted its report on April 23, 1998 to the Finance Ministry and was referred to as Narsimham Committee II report. The recommendations addressed some of the concerns that were raised due to a relatively free operation of the banking sector. The major recommendations of the Narasimham Committee II report were mentioned below:

1. One of the most important recommendation was that the RBI should separate its role from being monetary authority to that of regulator of the banking sector. It was observed by the Committee that the RBI was maintaining a stricter control over the banking sector in order to comply with its fiscal policies. It was realized that the sector though needs to be under the scrutiny and supervision of the governmental agency but certain amount of freedom needs to be given so as to let it thrive satisfactorily.
2. By that time many banking corporations both private and public were incorporated, howsoever most of them had dwindling business. The committee in order to strengthen these banks advocated the merger of strong public sector banks and if rehabilitation was not possible insisted on their closure.

3. It recommended corrective measures like recapitalization is undertaken for weak banks and if required such banks should be closed down.

4. The committee put forth the 'golden handshake scheme' surplus banking sector staff. It was realized that in order to provide better services large scale employment of efficient staff is to be done. Further training was also necessary for bank employees.

5. A short term possible solution for weak banks was suggested as the report observed that the narrow banks could be allowed as a mean of facilitating their rehabilitation.
6. The committee realized the problem regarding large NPA. Expressing concern over rising NPAs, the committee furthered an idea of setting up an asset reconstruction

fund to tackle the problem of huge non-performing assets (NPAs) of banks under public sector.

7. The committee focused on the issue that a healthy competition between the private and public sector banks needs to be instituted and encouraged for the healthy development of the sector.
8. The report envisaged flow of capital to meet higher and unspecified levels of capital adequacy and reduction of targeted credit.

The positive effect of the Narsimham committee reports on banking sector reforms were that the government concentrated through reformative process on enhancing the role of market forces in evolution of the sector. Government undertook steps such as making sharp reduction in pre-emption through reserve requirement, market determined pricing for government securities, disbanding of administered interest rates and enhanced transparency and disclosure norms to facilitate market discipline. Introduction of pure inter-bank call money market, auction-based repos-reverse repos for short-term liquidity management, facilitation of improved payments and settlement mechanism, and requirement of significant advancement in dematerialization and markets for securitized assets were among some other measure that the government took as a result of the committee reports.

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Privatization of Banks

The gradual privatization of public sector banks has been an important component of banking sector reforms in India. This has been prompted more by the need to raise capital to meet there vise capital adequacy norms, rather than a conscious policy decision on the part of the govt. to withdraw from banking operations (Kohli, 2006). In 1994, the committee on Banking Sector Reforms (CBSR) suggested to dilute the govt. shareholding in public sector banks to 51 percent. Still the govt. has to recapitalize public sector banks to large extent through budgetary support. In 2001, govt. ownership in banks was further reduced to 33 percent with the condition that no individual shareholder can hold more than1 percent of the shares. However, the privatization of public sector banks in India is not yielding the expected result. By1998, only 9 public banks (out of 20) had gone for public equity to strengthen their capital base. The dismal performance of these banks in raising capital from the market could be gauged from the fact that in 1998-99 the minimum shareholding of govt. was 66 percent. By March 2001, 11 public sector banks were listed at the National Stock Exchange, but the share of top 5 bank saccounted for 95 percent of the total traded shares of them.

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FDI and India

The Indian banking market is different from the other developed and developing nations because of India's peculiar social and economical condition. The Indian economy in the time of critical economic crisis was uplifted by the government of India (GOI) with the help of World Bank and IMF employed macro-economic stabilization and structural adjustment program. These reforms opened doors for FDI inflows and for a more liberal foreign policy in order to restore the confidence of foreign investors. Later Foreign Investment Promotion Board (FIPB) was created whose main function was to invite and facilitate foreign investment.

It should be noted that from a initial amount of less than USD 1 billion in 1990, a UNCTAD survey projected that during 2010-2012 India emerged as the second most important FDI destination (after China) for multinational financial institutions. As per the mentioned survey, following sectors attracted higher inflows; services, telecommunication, construction activities and computer software and hardware. The primary jurisdictions from where the foreign inflow was directed were Mauritius, Singapore, the US and the UK. FDI for 2009-10 at US$ 25.88 billion was lower by five per cent from US$ 27.33 billion in the previous fiscal[1]. Foreign direct investment in August dipped by about 60 per cent to approx. US$ 34 billion, the lowest in 2010 fiscal, industry department data released showed. In the first two months of 2010-11 fiscal. FDI inflow into India was at an all-time high of $7.78 billion up 77%from $4.4 billion during the corresponding period in the previous year.

In the process of economic development in India FDI helps in achieving independence in different areas of the economy. In 2013, FDI norms for several sectors were further relaxed several sectors, including telecom, defence, PSU oil refineries, power exchanges and stock exchanges, among others. For instance UK-based Tesco applied to initially invest US$ 110 million for starting supermarket chain in collaboration with Tata Group's Trent. In civil aviation sector, Malaysia based Air Asia and Singapore Airlines teamed up with Tata Group to launch two new airline services.

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[1] GYANPRATHA – ACCMAN (Journal of Management, Volume 5 Issue 1, 2013)

FDI is a tool for economic growth by due to power of local capital, power of generating productivity and employment. It also helps upgradation of skills, technology and capabilities of management in various sectors of the economy. FDI has a long term bonding with banking, services business and economic growth of the country[2]. Well known authors and economists such as Laghane.K.B (2007) have suggested that FDI should be seen as a mode to reduce poverty, unemployment and as instrument for upgrading priority sector banking[3].

The last decade has shown that fast rate of economic growth and progressive policy has made India as a preferable destination for foreign investments. U.S.A has been at the head-front position in terms of foreign investments in India and constructing and amicable partnership between the two largest democracies in the world.

Apart from all the above, since the capital raising capacity in India is very less to take the Indian banking sector to worldwide we require investment from abroad. RBI should make such policies that are beneficial both for the foreign investor as well as the Indian economy.[4]

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[2] Bhattacharyya Jita, Bhattacharyya Mousumi (2012), “Impact of FDI and Merchandise and Services Trade of the Economic growth in India: an Empirical study”

[3] Singh J. (2010), “Economic Reforms and Foreign Direct Investment in India: Policy, Trends and Patterns”.

[4] http://www.ijoart.org/docs/Role-of-FDI-in-Banking-in-generating-wealth-to-Indian-Economy.pdf

Key Takeaways on FDI in India

FDI investment in India is done in accordance with and pursuant to the FDI Policy formulated by the GOI. The DIPP, which works under the aegis of Ministry of Commerce and Industry issues a "Consolidated FDI Policy Circular " on an annual basis on March 31st of each year (since 2010) elaborating upon the policy and the process in respect of FDI infusion in Indian markets. The latest policy is "Consolidated FDI Policy Circular"[5] dated April 17, 2014. The FEMA Regulations[6] issued by the RBI, which are amended and updated from time to time, also play a pivotal role as these prescribe amongst other things the mode of investments i.e. issue or acquisition of shares / convertible debentures and preference shares, process regarding of receipt of funds, pricing and reporting guidelines. The Reserve Bank has issued which contains the Regulations in this regard.

Entry routes for investments in India

Pursuant to the FDI framework investments can be made in shares, mandatorily and fully convertible debentures and mandatorily and fully convertible preference shares of a company incorporated in India by non-residents through the following two ways or routes:

- Automatic Route: for investment upto a prescribed limit neither the foreign investor nor the Indian company in which the investment is being made requires any approval from the RBI or the GOI or any other authority for making such foreign investment.
- Government Route: Under Government Route where the investment is to be made above a prescribed limit, the foreign investor or the Indian company has to obtain prior FIPB or DIPP approval for the proposed FDI investment.

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[5] http://dipp.nic.in/English/Policies/FDI_Circular_2014.pdf

[6] Notification No. FEMA 20 /2000-RB dated May 3, 2000

Eligibility for FDI in India

i. A foreign resident or an entity not incorporated in India may invest in India, subject to the FDI Policy as declared by the Government of India. Where a person is a citizen of Bangladesh or an entity incorporated in Bangladesh such person or entity may with the prior FIPB approval invest in India under the FDI Scheme. Further, a person being citizen of Pakistan or an entity incorporated in Pakistan may invest in an Indian company under FDI Scheme pursuant to a prior FIPB approval and subject to the prohibitions applicable to all foreign investors and the Indian company, receiving such foreign direct investment.

ii. NRIs, residents as well as citizens of Nepal and Bhutan are also permitted to invest in shares and convertible debentures of Indian companies under extant FDI Scheme on repatriation basis, subject to the condition that the amount of consideration for such investment shall be paid-up only by way of inward remittance in free foreign exchange through normal banking channels.

iii. Since September 16, 2003 OCB are no longer allowed to participate in FDI process. Erstwhile OCBs incorporated outside India and which are not under adverse notice of the RBI may make participate in the FDI infusion of investment as an incorporated non-resident entity with prior governmental approval in case of government route and with the prior RBI approval wherein the investment is being made through the Automatic Route. However, before participating in the FDI process, such erstwhile OCB should obtain a onetime certification from RBI that it is not in the adverse list being maintained with the Reserve Bank of India.

With respect to the OCB stricter surveillance has been put into place. All the ADs have been made responsible to ensure that OCBs do not maintain and operate any account other than NRO current account in compliance with the relevant guidelines[7] issued by the RBI. The RBI also places further restriction by providing that the NRO account so being operated by the OCB cannot be utilised for making any fresh investments in India. All fresh requests for opening of NRO current account for the purpose of liquidating previous investment which is being held on non-repatriation basis is to be forwarded by the AD bank to the RBI. Other category of accounts such as the NRE or FCNR or NRO shall be remain available for the OCBs which are in the

[7] A.P. (DIR Series) Circular No. 14 dated September 16, 2003

adverse list maintained by the RBI. The AD banks shall maintain such accounts in the frozen status.

Type of instruments

Companies incorporated in India may issue any of the following securities; equity shares, fully and mandatorily convertible debentures, fully and mandatorily convertible preference shares.and warrants. Such instruments shall be issued subject to the pricing guidelines / valuation norms and reporting requirements and all other applicable guidelines, policies, notifications and criteria as prescribed under FEMA Regulations.

Before December 30, 2013, issue of various types of preference shares for example non-convertible, optionally convertible or partially convertible, had to be done in accordance with the relevant guidelines applicable for ECB. From 30, 2013 onwards the RBI had allowed that an that optionality clauses may henceforth can be provided for in equity shares and compulsorily and mandatorily convertible preference shares/debentures which are proposed to be issued to a person resident outside India under the FDI policy framework. The function of inducing optionality clause is that it will oblige the buy-back of securities from the investor at the price prevailing/value determined at the time of exercise of the optionality so as to enable the investor to exit without any assured return. The provision of optionality clause has been made be subject to the certain conditions which have been laid down as below:

(a) a minimum lock-in period of one year or a minimum lock-in period as prescribed under FDI Regulations;

(b) Post the lock-in period the foreign investor who exercised the option/right will become eligible to exit without any assured return, as under:

(i) where the shares allotted to the foreign investor are of a listed company, such foreign investor may exit at the market price prevailing at the recognised stock exchanges;

(ii) where the shares allotted to the foreign investor are of an unlisted company, the foreign investor shall be eligible to exit from the investment made in equity shares of the investee company at a price which shall be determined on arm's length basis in accordance with

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universally accepted pricing methodology which is duly certified by a Chartered Accountant or a SEBI registered Merchant Banker.

The key guiding principle is that the foreign investor does not have access to any assured exit price at the time of making such investment, however he has right to exit at the fair price computed asper criteria stated above at the time of exit, subject to conditions as applicable.

Guidelines on Pricing Policy

• IPO: Pricing of fresh issue of shares to a foreign investor under the FDI Scheme shall be determined on the basis of:

- Relevant SEBI guidelines where the investee institution is a listed company.
- Price so determined is not to be less than the fair value of shares which is determined by a SEBI registered Merchant Banker or a Chartered Accountant according to any universally accepted pricing methodology on arm's length basis.

The aforesaid pricing policy shall also find its application in determining prices for issue of shares against payment of lump sum technical know how fee / royalty due for payment/repayment or conversion of ECB into equity or capitalization of pre incorporation expenses/import payables.

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In case of partly paid-up equity shares, the prices shall be determined upfront along with 25% of the total consideration amount, shall also be received upfront; Any balance consideration towards fully paid-up equity shares is to be received within a period of 12 months. Where issue size is greater than rupees five hundred crore and the issuer has complied with the relevant ICDR regulation the 12 months period for receiving the consideration amount is not to be pressed upon. Also incase of an unlisted Indian company the time period of 12 months for receiving the balance consideration amount is not mandatory where the issue size is greater than rupees five hundred crores.

The policy regarding pricing of the warrants and price/ conversion formula in substance shall remain as that of equity shares with one minor deviation that in case of share warrants the period within which balance consideration towards fully paid-up up equity is to be received shall be 18 months. Further the at the time of conversion price can not stoop below the fair market value which existed at the time of issuance of such share warrants and he relevant

regulations, notifications etc of FEMA as issued and amended from time to time by the RBi shall be applicable.

The RBI through its circular brought certain clarification and explanation to the fact that where liability sought to be converted by the company is denominated in foreign currency (as generally exists in case of ECB, import of capital goods, etc.) the exchange rate prevailing at the time i.e. on the date of agreement shall be considered for conversion. No issues on part of the RBI shall be made where the borrower being a company incorporated in India, wishes to issue equity shares for a rupee amount less than amount which is arrived by mutual agreement utilising the above criteria.

The RBI through its circular brought certain clarification and explanation to the fact that the principle of calculation of rupee equivalent for payables denominated in foreign currency as aforesaid shall apply, *mutatis mutandis*, to all situations where any payables by an Indian company (for example: lump sum fees/royalties, etc.) are allowed to be converted into equity shares or other securities to be issued to a foreigner subject to the requirements and criteria stipulated under the relevant Regulations.

- However, where foreigners including non resident Indians make investments in an Indian company in compliance with the provisions of the Companies Act, 2013 through subscription to the MOA of such Company, all such investments may be made at the face value subject provided they satisfy the eligibility criteria to invest under the FDI policy.
- The RBI Circular[8] on Foreign Investment in India provides certain other conditions in addition to those already discussed with respect to issue of partly paid-up shares and warrants which are as follows:

  (a) Prior FIPB approval is required for issue of partly paid-up up shares or warrants by the company falling carrying out activity falling under the category of government route.

  (b) If any forfeiture of the amount paid-up upfront is to be done due to non-payment of call money, then it shall be done in compliance to the relevant provisions of the

[8] http://www.rbi.org.in/scripts/BS_ViewMasCirculardetails.aspx?id=9006

Companies Act, 2013;

(c) The company inviting FDI through issue of partly paid-up up shares or warrants is to bear in mind that the sectoral caps as fixed by the DIPP under the consolidated FDI policy is not to be breached. Further an obligation on the part of the foreign investors has also been placed on the foreign investor by requiring them to ensure that the partly paid-up shares or debentures or warrants to which they have subscribe on conversion to equity do not exceed the sectoral cap.

- Right Shares: Where rights issue has been made to the foreign investors under the FDI scheme the pricing has to determined upon following considerations:
  - Where the company has its shares listed on a recognized stock exchange, the price of such issue shall be determined by the company inviting FDI infusion.
  - In the case of a company which does not has its shares listed on recognized stock exchange, the pricing policy should not arrive at price which is less than the price at which the offer is made to resident shareholders.

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- Acquisition/transfer of existing shares: The acquisition or transfer of shares from a resident to a foreign entity or individual would be at a;

(a) the price for shares which are listed or to be listed on stock exchange should not be in any manner less than the price at which the preferential allotment of such shares is made in consonance with the relevant SEBI guidelines.

(b) incase of a non listed company the minimum price criteria is that the negotiated price should not be lower than the fair value determined on arm's length basis by applying universally accepted standards and duly certified by a Chartered Accountant or a SEBI registered Merchant Banker.

The price for the convertible instruments can also be a determined based on the conversion formula which has to be determined / fixed upfront, however the price at the time of conversion should not be less than the fair value worked out, at the time of issuance of these instruments, in accordance with the extant FEMA regulations.

The present research aims to analyse the FDI scheme relating to the Banking sector. The analysis involves understanding and evaluation of the policy framework as crafted, evolved and amended from time to time. Key consideration has been made to the interest of customers in determining effectiveness and profitability for the country for adapting a liberal FDI policy. The research also recognizes key concerns of the foreign investors in respect of their claims regarding low economic viability and stringent unfavourable regulatory mechanism. The conclusion aims at balancing out the pros and cons of the existing policy and put forths suggestions which may deem beneficial towards having a more efficient and effective FDI regime for the banking sector.

ANALYSIS OF EXISTING FDI POLICY in BANKING SECTOR

FDI through Wholly Owned Subsidiaries

Background

The global financial crisis of 2008 had shown that the growing complexity and interconnectivity of financial institutions around the world, along with the lack of effective cross-border resolution regimes, resulted in compromising the ability of home and host authorities to cope with the failure of too big to fail (TBTF) and too connected to fail (TCTF) institutions. The substantial interdependence of financial institutions on each other across the globe enabled occurrence of financial disaster of such a scale where the most of the economies collapsed like dominoes.

As banks and financial institutions are backbone of the world economy serious concerns were raised with object to evolve policies that help in averting such financial disasters. Consequently, numbers of policy options were proposed to including measures to restrict the negative externalities arising out of size and interconnectedness, improving the capital and liquidity buffers held by such financial bodies.

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One of the key suggestion was the principle of local incorporations. As most of the global major banking corporations were operating through branches throughout the word, ill health of the parent branch reflected on the health of the overseas branch also. Therefore, through the principle of local incorporation it was suggested to cut the entangled complex ties between foreign banks and their overseas branches by requiring the foreign banks to convert their branches to wholly owned subsidiaries or open new business with wholly owned subsidiaries only. Local incorporation gives these subsidiaries an operational freedom and on the part of the local regulatory regime they can exercise better control over such banks negating the jurisdictional issues.

The present policy regarding setting up of WOS by foreign banks which was issued on 6th November 2013 by the RBI has evolved through various precedent policy frameworks, discussions and deliberations. These are as follows:

a) Roadmap for presence of foreign banks in India[9] issued on February 28, 2005.
b) Discussion Paper on presence of foreign banks in India[10] issued in January 2011.
c) The framework for setting up of WOS by foreign banks in India[11] issued on 6 November 2013.

Analysis of the various policies

Policy 1: Roadmap for presence of foreign banks in India [2005]

In the year of 2004, the Indian Government with a view to further ease the norms relating to Foreign Direct Investments (FDI) in private sector banks apart from raising the FDI limit to 49 per cent under the automatic route also permitted foreign banks, regulated by a banking supervisory authority in the home country and operating in consonance with the Reserve Bank's licensing criteria to hold 100 per cent paid-up up capital, to set up a WOS or a Wholly-Owned-Subsidiary in India.

The RBI in consultation with the GOI on February 28, 2005 issued 'the roadmap for presence of foreign banks in India'. The roadmap consisted of two phases – the first one spanning over a term of 4years from March 2005 to March 2009 and the second phase was to begin after review of the experience gained from the first phase.

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The RBI adopted the one-mode presence criterion. During the first phase allowed foreign banks already operating in India to convert their existing branches to Wholly Owned Subsidiary and such Wholly Owned Subsidiary was to be treated at par with the existing branches of foreign banks for branch expansion in India. The second phase commencing from April 2009 envisaged removal of limitations on the operations of WOS and treating them on par with the domestic banks. Howsoever, despite the tireless efforts by the RBI no foreign bank came forward to set up or convert their branches into WOS in the absence of adequate incentives.

Key points of the two phases of the Roadmap for presence of foreign banks in India released on February 28, 2005 are as provided below:

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[9] http://www.rbi.org.in/scripts/NotificationUser.aspx?Id=2142&Mode=0

[10] http://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=2313

[11] http://www.rbi.org.in/Scripts/bs_viewcontent.aspx?Id=2758

Phase –I [March 2005-March 2009]

i) New banks – first time presence

New Foreign banks could either choose to operate through branch presence or set up a 100% wholly owned subsidiary (WOS),

ii) Existing banks – expansion policy

The existing limit of 12 branches of a foreign bank in the country as per the WTO commitment was lifted and the government was motivated towards relaxing certain criteria so as to encourage presence of the foreign banks even in places which were underbanked,

iii) Conversion of existing branches to WOS

iv) Acquisition of Shareholding in Select Indian Private Sector Banks

This was one of the key feature of the 2005 policy framework. The RBI in order to allow Indian Banks sufficient time to prepare themselves for global competition and the upgraded market dynamics, initially entry of foreign banks was permitted only in private sector banks identified by RBI for restructuring. Acquisition of controlling stake in a phased manner was allowed in such earmarked banking institutions.

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RBI decided any investment application to acquire 5% or more by a foreign bank in a private company on basis of certain key determinants and subject to the concerned guidelines and requirements. Few of such determinants were:

i) standing and reputation of the foreign bank, globally as well as in India,
ii) desired level and nature of presence of the foreign bank in India,
iii) whether such investment by the foreign bank concerned will be in the long-term interest of all the stakeholders in the investee bank.

Where an acquisition is by a foreign bank already having presence in India, a time bound not exceeding six months duration to conform to the 'one form of presence' criteria was to be submitted by the foreign bank along with the application for acquisition.

Phase II [April 2009]

i) Full National Treatment to WOS of Foreign Banks

The second phase was characterised by removal of limitations on the operations of the Wholly owned subsidiary of the foreign banks and imparting them equal treatment with domestic banks as far as practical and appropriate. Such steps were to be taken after reviewing the experience with Phase I and after due consultations with all stakeholders in the banking sector.

ii) Diluting of stake in WOS

In the second part of the second phase phase, the WOS of foreign banks on completion of a minimum prescribed period of operation were to be allowed to list and dilute their stake so as to maintain the requirement of 26 per cent of the paid-up up capital of the subsidiary to be held by Indian residents at all times consistent with para 1(b) of the Press Note 2 of March 5, 2004. The dilution of the stake could be done either by way of Initial Public Offer or as an offer for Sale.

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iii) M&A of private sector bank

In the second phase, pursuant to a review with regard to the extent of foreign investment in the domestic banks and operation of foreign banks, subject to regulatory approvals it was proposed to allow foreign banks to enter into merger and acquisition transactions with any private sector bank in India subject to the overall investment limit of 74 percent.

A. Policy Statement II : Discussion Paper on presence of foreign banks in India

Subsequent to the roadmap of 2005 and pursuant to the objectives of the Annual Policy Statement for 2010-11 made by the RBI, a Discussion Paper was issued in January 2011 on the mode of presence of foreign banks in India.

The key features of the Discussion paper are as follows:

- Branches vs Subsidiaries

i) Regulatory control perspective

Branches do not amount to being separate legal entities whereas subsidiaries are locally incorporated separate legal entities distinct from its parent institution. The subsidiaries benefit from having their own capital base and separate board of directors. In the case of branches, parent banks are, in principle, responsible for their liabilities and control the operation and management of the branches.

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The advantages of having branches are as follows:

(a) greater operational flexibility,
(b) increased lending capacity (loan size limits based on the parent bank's capital) and
(c) reduced corporate governance requirements.

Though the branch form of presence may have its own advantages such as stronger support from the parent to overcome situations of local adversity, following are its key adverse effect on the local consumer community and the economy therein:

a) with a branch it is difficult to determine the assets that would be available in the event of failure of the bank to satisfy local creditors' claims and the local liabilities that can be attributed to the branch.
b) Branches being part of the parent body, assets attributable to it can easily be transferred by the branch to the foreign head office.
c) management of a branch does not have a fiduciary responsibility to the branch's local clients. In fair weather it may not be of much relevance but in difficult times of crisis,

the distinction between the form of presence and the legal location of assets and liabilities import significance.

ii) Cross Border Resolution Issues with branches

Insolvency procedures may differ according to the legislative and judicial approach taken by each country. On one hand some countries follow a "separate-entity" doctrine and thus are able to place their depositors and creditors before those of other countries. For instance, Australia and USA have enacted rules under which home country depositors or creditors are senior claimants or have preference over depositors from branches located overseas in situation of bankruptcy. On the other hand some countries follow "single-entity" doctrine and consider a bank and its foreign branches as a single entity and hence allowing equal treatment to all creditors irrespective of domicile. Authorities at Canada and America are allowed to separate the branch from its parent and use the assets to cover the liabilities under the host country regulations.

The CBRG of BCBS has come out with its recommendations based on the lessons from the crisis of 2008, delineating both the approaches viz. ring fencing or territorial approach and universal approach. The CBRG recommended a "middle ground" approach that recognised strong possibility of ring-fencing in situations of crisis. The approach entailed certain changes to national laws and resolution frameworks. An alternative approach was establishing a universal framework for the resolution of cross border financial groups, putting all creditors at par with each other.

India stipulates locally assigned capital for branch mode of presence which serves the purpose of ring fencing.

However setting up of subsidiaries does not necessarily ensures support from the parent bank. It has been seen that enforceability of "comfort letters" is often contended and is a matter of great debate. In fact numerous examples can be cited from the Argentine crisis and banks such as from Malaysia which abandoned their subsidiaries when faced with a crisis. Similarly holding companies are not necessarily a source of support to their subsidiaries in certain circumstances. The insolvency of a parent or ring fencing of liquidity by parent's home country regulator can have same effect on subsidiaries as well as branches. In many instances international groups manage liquidity centrally and place it with various subsidiaries on a

short-term basis and in such cases the failure of parent necessarily may result in the immediate failure of the subsidiary.

In recent times it has been perceived that subsidiaries promoted by foreign bank had not only acquired large share at the expense of domestic banks in the boom years and also when the home country was afflicted by economic turmoil they had tended to substantially suspend and curtail their operations or had withdrawn from the host country.

Indian experience has not been of any exception to this no exception as many foreign banks had withdrawn substantially from the credit markets resulting in year-on-year growth to go as low as -7.1% (as on July 3, 2009) and -15.9% (as on October 9, 2009). Prudential measures, like limiting the size of the foreign bank branches and subsidiaries can be instrumental in ensuring that the domestic financial system is not dominated by foreign banks.

iii) Preventing dominance of WOS in the domestic market.

At present under the WTO commitments, there is a limit that when the assets (on balance sheet as well as off-balance sheet) of the foreign bank branches in India exceed 15% of the assets of the banking system, licences may be denied to new foreign banks. Building on this to address the issue of market dominance, it is proposed that when the capital and reserves of the foreign banks in India including WOS and branches exceed 25% of the capital of the banking system, restrictions would be placed on (i) further entry of new foreign banks, (ii) branch expansion in Tier I and Tier II centres of WOS and (iii) capital infusion into the WOS – this will require RBI's prior approval.

- Eligibility of the parent bank

Foreign banks applying to the RBI for setting up their WOS/branches in India must satisfy certain requirements some of them have been listed below:

a. such foreign banks are in compliance to adequate prudential supervision in their home country.
b. prior approval of home country regulator should be obtained for opening of the WOS.
c. economic and political relations between India and the country of incorporation of the foreign bank
d. financial soundness of the foreign bank

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e. ownership pattern of the foreign bank
f. international and home country ranking of the foreign bank
g. rating of the foreign bank by international rating agencies
h. international presence of the foreign bank

- Entry norms

In the light of the experience gained during the recent global financial crisis, it is advisable to mandate presence of foreign banks in the form of wholly owned subsidiaries. The discussion paper therefore mandated entry in India only through WOS for following category of banks:

i. Banks incorporated in a jurisdiction that gives deposits made/ credit conferred, in that jurisdiction a preferential claim in a winding up.
ii. Where adequate disclosure requirement is not present in the home jurisdiction.
iii. Banks having complex structures,
iv. Banks which do not wide presence, and
v. In any other situation as deemed to be fit by the RBI

- Corporate Governance

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In case of subsidiary an independent board plays an important role in protecting the interests of all stakeholders. Independent directors ensure separation between the board of a bank and its owners and make sure that management acts in the best interest of the local institution. It is seen internationally, that some of the important factors which are taken into account before a foreign bank is allowed to set up a subsidiary are; commitment of its parent to support the subsidiary, the ability of the subsidiary to operate on a standalone basis. The particular requirements for maintaining proper corporate governance structure have remained the same from the initial policy statement to the final framework which was released in 2009.

- Raising of Non-equity capital in India

At the time of the discussion paper there was no provision regarding access of branches of foreign bank to the domestic rupee resources to augment their non-equity capital in India. The discussion paper permitted branches of the foreign banks to raise funds from their parent head office for augmenting Tier I and Tier II capital through IPDI and debt capital instruments subject to compliance with relevant guidelines and notifications.

There can be two views regarding permitting of WOS of foreign banks to raise rupee resources through issue of non-equity capital instruments. One view may be that as WOS is a locally incorporated bank it should be given access to rupee resources in same way as has been granted to other private sector banks. Other view may be that as WOS is closely held by foreign bank it should raise long term resources from the parent foreign bank in the form of IPDI or debt capital instruments to demonstrate the parent's commitment towards the host country.

To incentivize foreign bank to set up WOS or convert their branches into WOS, the RBI may as a positive step allow these proposed WOS to raise rupee resources through issue of non-equity capital instruments in the form of IPDI, Tier I and Tier II Preference shares and subordinate debt as allowed to domestic private sector banks.

- Branch expansion

  It is necessary to create an environment for encouraging foreign banks to set up WOS, with this view the discussion paper recommended and purported an idea of a less restrictive branch expansion policy, which may not be at par with domestic banks. Accordingly, differentially favourable treatment to WOS of foreign banks as compared to the branches of other foreign banks may be put in place howsoever such was not acceptable fearing the possibility of domination of the market by the WOS of the foreign banks.

- Priority Sector lending requirements for WOS

The Raghuram Rajan Committee recommended giving WOSs same rights as private sector banks. The discussion paper in view of the extant policies did not prescribe any target or sub-target for agricultural lending for the branches of foreign banks. But, keeping in view the role of agriculture in Indian economy, WOS of foreign banks should also be required to lend to agriculture in India, as is the case with domestic banks. It is, however, proposed to prescribe a lower sub-target for lending to agriculture sector by these WOSs due to absence of full national treatment to these WOS. Thus, a lower sub-target at 10% may be fixed for these WOSs against the target of 18 % for domestic commercial banks.

- Use of Credit Rating and Parent / Head Office Support

The discussion paper proposes to treat WOS of foreign banks at par with domestic banks, this appears reasonable for the reasons stated below.

Allowing the parent foreign bank to give explicit guarantees for the liabilities of the subsidiary, it would result in strengthening the as if the subsidiary fails, the clients who have obtained the guarantees and standby letters of credit (SBLCs) from the parent foreign bank will be able to recover their dues from the parent thus leaving more assets of the subsidiary to satisfy domestic claims. This however, results in an unfair competitive advantage which a WOS shall have over domestic banks in terms of lending, raising resources from domestic and overseas market. Howsoever, the parent bank may be required to issue a letter of comfort to the Reserve Bank, as is required in many jurisdictions today, for meeting the liabilities of the WOS.

- Declaration of dividends

With respect to the declaration of dividends it was suggested that the WOS should be allowed to remit profits like a branch in India. Presently, foreign banks with branch presence in India are allowed to repatriate profits in the ordinary course of their business. However the discussion paper provided that the wholly owned subsidiaries of foreign banks may declare dividends like domestic banks subject to criteria laid down in the concerned RBI circular[12]. The circular provides for general permission to be granted for declaring dividend on compliance to following minimum prudential requirements:

a) The relevant requirement of maintenance of CRAR should have been strictly adhered to.
b) Compliance to the provisions of Sections 15 and 17 of the Banking Regulation Act, 1949.
c) Compliance to with the prevailing regulations/ guidelines issued by RBI, including creating adequate provisions for impairment of assets and staff retirement benefits, transfer of profits to Statutory Reserves etc.
d) The dividend should be payable out of the current year's profit.
e) No explicit restrictions on payment of dividend should have been placed by the RBI.

[12] DBOD.No. BP.BC. 88/ 21.02.067/2004/05 dated May 04, 2005

- Mergers / Acquisitions and Dilution of WOS to 74 %

As the operation and function of the WOS are yet to be analysed and observed, the policy regarding allowing of merger and acquisition of Indian banks by foreign banks remained unchanged and continued to be the same as stated under the 'Road map for presence of foreign banks in India'.

- Differential licensing

In the Indian Banking sector, the penetration of banking services is very low as compared to the rest of the world for instance less than 59 % of adult population has access to a bank account. The RBI does not considers granting differential licence to foreign banks seeking entry in 'niche markets, as if a positive nod is given to differential bank licence for foreign banks, it may result in a setback to the goal of financial inclusion.

Policy Statement –III Scheme for setting up wholly owned subsidiaries by foreign banks in India [November, 2013]

The RBI under Section 35A read with Section 44A of the Banking Regulation Act, 1949, in the public interest and in the interest of banking policy issued the 'Scheme for Setting up of Wholly Owned Subsidiaries (WOS) by foreign banks in India'.

The key policy decisions as contained in the aforesaid scheme are as follows:

1. Presence only through WOS if certain conditions are fulfilled

Foreign banks which shall commence business or have commenced banking business in India after August 2010 are allowed to carry on banking business in India only through a wholly owned subsidiary, if any of the following matters are applicable on them:

a. Foreign banks incorporated in a jurisdiction which gives preferential claim to deposits of home country in a winding up proceedings;
b. Foreign banks that do not have adequate and appropriate disclosure requirements in their home jurisdiction;
c. Foreign banks with complex structures;
d. Foreign banks which do not have wide presence;
e. Where the RBI is not satisfied with the adequacy of supervisory arrangements and market discipline in the home country of such banks; and
f. For any other reason that the RBI deems fit; or
g. RBI considers such bank as being systemically important by virtue of the size of its business

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2. Branch mode or wholly owned subsidiary

a) Foreign banks to which are not carrying on banking business in India but wish to wish to do so in the future and to whom the above stated conditions do not apply have the option to commence banking business in India either through a wholly owned subsidiary or a branch.
b) Any foreign bank which comes under the purview of conditions stated aforesaid shall compulsorily convert to WOS.

c) Foreign banks which are presently carrying on banking business in India and which are required to convert their branches into a wholly owned subsidiary or opt to do so, the conversion shall only be in consonance with the scheme mandated in the public interest as approved by RBI under Section 44A of the Banking Regulation Act 1949.

3. Eligibility for setting up a wholly owned subsidiary

The RBI under the new policy of 2013 has laid down certain key criteria for evaluating application for opening of WOS by foreign banks. Some of the factors include the following:

a. Approval from the home country regime,
b. the bank is subject to adequate prudential supervision as per internationally accepted standards,
c. Economic and political relations with the country of incorporation of the parent bank,
d. Reciprocity with home country of the parent bank,
e. Financial soundness,
f. Ownership pattern,
g. International and home country ranking of the parent bank by a reputed agency,
h. Home country/parent bank rating by a rating agency of international repute such as Moody Investors Service, Standard & Poor's and Fitch Ratings,
i. International presence of the bank,
j. Adequate risk management and internal control systems.

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4. National treatment

From a combined reading of the FDI policy[13] as issued by the DIPP read with circular[14] and notification[15] issued by RBI under FEMA, 1999 it is inferred that WOSs of the foreign banks though locally incorporated, being foreign owned and controlled companies, will be treated as 'foreign banks'. The DIPP circulars[16] provide that a company owned by non-residents 'means an Indian company where more than 50% of its capital is owned by non-

[13] Circular F.No. 5(2)/2013-FC-I dated April 5, 2013 (Circular 1 of 2013)

[14] A.P. (DIR Series) Circular No.1 dated July 4, 2013

[15] Notification No. FEMA. 285/2013 – RB dated August 30, 2013

[16] DIPP press notes 2, 3 and 4 (2009 Series) read with A.P. (DIR Series) Circular No. 01 dated July 4, 2013

residents and/or 'controlled' by non-residents. The term 'control'[17] has been defined in as under:

'Control' shall include the right to appoint a majority of the directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreements or voting agreements.

To prevent domination of the Indian banking sector by WOS of foreign banks, restrictions are sought to be placed on further entry of new WOSs of foreign banks, when the capital and reserves of the foreign banks (i.e. WOSs and foreign bank branches) in India exceed 20% of the capital and reserves of the banking system. On occurrence of such an event prior approval of RBI will be required for capital infusion into the existing WOSs of foreign banks.

5. Minimum capital requirement

The new policy requires the newly set up WOS of the foreign bank to bring in the entire amount of initial capital upfront funded by free foreign exchange remittance from its parent institution.

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Where a foreign bank has its presence through branch in India and desires to convert into a WOS:

- Such bank has to convert its branch capital into the entire capital of the proposed WOS. Regulations stipulated in the master circular on Basel III Capital Regulations shall be applicable.
- The bank should fulfil minimum net worth criteria.
- If the net worth upon conversion is less than the prescribed minimum capital under, the shortfall has to be brought in through equity upfront from its parent as inward remittance.
- The proposed WOS shall maintain a minimum capital adequacy ratio for a continuous period of three years at the rate of 10% (ten percent).

[17] A.P.(DIR Series) Circular No. 44 dated September 13, 2013

6. Use of group resources

As per the circular[18] of RBI and the relevant policy in this regard in the 2013 framework for setting up of WOS by foreign banks in India the core management functions cannot be outsourced by the WOS.

Also with regards to the outsourcing of IT services the relevant guidelines[19] as applicable to all scheduled commercial banks (excluding RRBs) will also be applicable to WOS.

7. Corporate governance

Special emphasis has been laid down on the corporate governance policies regulating the WOSs. Following requirements have provided for the board of directors:

a. atleast 51 percent of the total number of members of the board of directors shall consist of persons as defined under Section 10A of the Banking Regulation Act, 1949,
b. atleast two-third of the directors should be non-executive directors,
c. atleast one-third of the directors should be independent directors,
d. atleast 50 per cent directors should be Indian nationals/NRIs/PIOs subject to the condition that one-third of the directors are Indian nationals resident in India,
e. there shall be a part-time Chairman and full time CEO,
f. The WOS shall comply Section 10B(1A) of the Banking Regulation Act, 1949 as and when applicable;
g. The WOS shall comply with section 35 of the Banking Regulation Act, 1949 as and when required,

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[18] Circular DBOD.No.BP. 40 /21.04.158/2006/07 dated November 3, 2006, Circular DBOD.No.BP. 97/21.04.158/2008/09 dated December 11, 2008

[19] Circular DBS.CO.ITC.BC.No. 6/31.02.008/2010/11 titled 'Working group on Information Security, Electronic Banking, Technology Risk Management and cyber Frauds – Implementation of recommendations' dated April 29, 2011

h. The relevant guidelines[20] regarding compensation payable to the board of directors as applicable to private sector banks in India shall be applicable to the WOS also.

8. Branch Expansion/Authorisation

As per the 2013 policy no differential treatment in this respect shall be given to the WOS of the foreign bank. Thus, WOS would be permitted to open branches in Tier 1 to 6 centres subject to reporting as prescribed. Not less than 25 percent of the total number of branches opened during the financial year must be opened in unbanked rural (Tier 5 and Tier 6) centres. In any case the total number of branches opened in Tier 1 centres during a financial year cannot exceed the total number of branches opened in Tier 2 to 6 centres and all centres in the North Eastern States and Sikkim. As an incentive a branch in a Tier 1 centre can be opened for opening of a branch in Tier 2 to Tier 6 centres of underbanked districts of underbanked States. If WOS is unable to meet obligations of opening branches in Tier 2 to 6 centres in aggregate, or in unbanked rural centres (Tiers 5 to 6 centres) during a financial year, it must complete the obligation in the next financial year.

Howsoever, WOS would require prior RBI approval for opening branches at locations that are sensitive from the perspective of national security.

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9. Use of credit rating and parent / head office support

The parent of the WOS would be required to issue a letter of comfort (LOC) to the Reserve Bank for meeting the liabilities of the WOS. Reserve Bank would take into account this commitment of the parent to support the subsidiary before a foreign bank is allowed to set up a WOS in India. WOSs would be permitted on arm's length basis to use parental guarantees/credit rating only for the purpose of providing custodial services and for international operations.

10. Declaration of dividends

[20] Circular DBOD No.BC. 72/29.67.001/11-12 dated January 13, 2012 titled Compensation of Whole Time Directors /Chief Executive Officers, etc.

The WOS of a foreign bank, being a company incorporated in India, may declare dividend like domestic banks subject to extant guidelines[21] as applicable to other domestic banks.

11. Dilution of WOS to 74 per cent

WOS of foreign banks may dilute their stake upto 74 per cent in accordance with the extant FDI policy on foreign investment in banking sector and list on stock exchanges in India

12. Mergers / Acquisitions

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 WOSs), WOSs may be permitted, subject to regulatory approvals and such conditions as may be prescribed, to enter into mergers and acquisition transactions with any private sector bank in India subject to the overall foreign investment limit of 74 per cent.

[21] Circular DBOD.No. BP.BC. 88/ 21.02.067/2004/05 dated May 04, 2005

Procedure for conversion of existing branches of foreign banks into WOS

a. The undertaking of the foreign bank in India consisting of all its branches shall be amalgamated with its WOS pursuant to the directions hereby issued by RBI in the public interest under Section 35A read with Section 44A of the Banking Regulation Act, 1949;
b. A foreign bank intending to convert its branch/branches in India into WOS shall make an application in Form III prescribed vide Rule 11(a) of the Banking Regulation (Companies) Rules, 1949 to the Reserve Bank for setting up of a wholly owned subsidiary (WOS);
c. Reserve Bank, will scrutinize the application of the foreign bank and if found eligible, grant in-principle approval for setting up of a WOS in India subject to fulfilling the conditions as contained in this Scheme;
d. On completion of the formalities relating to registration as a company under the Companies Act, 1956 (Act 1 of 1956) as stipulated in paragraph 19 (e) & (f) of this Scheme, the new banking company (WOS) shall approach Reserve Bank for issuance of a fresh license in its name under Section 22 of the B.R. Act, 1949;
e. Once Reserve Bank grants licence to new banking company (WOS), the foreign bank concerned shall prepare a draft amalgamation scheme and get it approved by the shareholders of the bank by passing a resolution as required under Section 44A of the B.R. Act, 1949;
f. The shareholders of the Indian subsidiary (WOS) shall also approve the draft amalgamation scheme by passing a resolution as required under Section 44A of the B.R. Act, 1949;
g. After fulfilling all the requirements under Section 44A of B.R. Act, the foreign bank and WOS would approach RBI with the amalgamation scheme as approved by the shareholders of the foreign bank and the Indian subsidiary (WOS), for its consideration;
h. Reserve Bank will sanction the scheme of amalgamation of branch or branches, as the case may be, with WOS of the foreign bank subject to compliance with the provisions contained in Section 44A of B R Act, 1949. Conversion of branch or branches of foreign bank into WOS shall take effect from such date, and subject to such conditions, as may be specified by Reserve Bank in its order;

i. On such date as Reserve Bank may, by order, appoint, the undertakings of branch or branches of foreign bank shall be transferred to, and vest in, new banking company i.e. WOS;

j. Pursuant to the amalgamation of branches of foreign bank with the WOS, the WOS shall issue and allot shares either to the entity whose branches are being amalgamated or to the holding company of that entity;

k. From the appointed day, the new banking company will be entitled to carry on all or any of the businesses, which it was entitled or permitted to do before conversion;

l. Branch or branches as the case may be, of the foreign bank, which applies for conversion into WOS, can continue to do its usual business in India in the same name and in the same manner, and subject to such conditions as the Reserve Bank may prescribe, till the appointed day;

m. On passing of the order by the Reserve Bank under sub-section (4) of Section 44A of the B.R. Act, 1949 the licence/licences granted to branch or branches, as the case may be, of the foreign bank under Section 22 and 23 of B.R. Act 1949, shall stand cancelled;

n. While granting licence to new banking company (WOS), RBI shall specify as a licensing condition that licence is given only for the purpose of amalgamation of existing branches of the concerned bank and for functioning as a full-fledged subsidiary and in case there is failure on the part of the banking company to complete the process of amalgamation within a period of six months or such period as allowed by RBI, the licence shall be cancelled.

Analysis of the Policy

Foreign banks play a significant role in financing foreign trade and more importantly their main focus and principal business is to cater to trade-finance. Having expertise in handling foreign trade, foreign banks have contributed significantly in rapid rise of cross border trade. Reserve Bank may, therefore, allow WOS of foreign banks also to classify export finance as a part of their priority sector lending.

One of the basic determinants of encouraging and regulating FDI in the banking sector through foreign banks in India either by way of branch presence or through WOS presence is the economic viability. Unlike the western jurisdictions as well as the developed economies of the east the Indian banking regime is substantially guided by socialistic concerns. These socialistic concerns get absorbed in the policy making of the country and most of the time fail to appeal foreign players. For instance in and around 2011 there were about 34 foreign banks operating in branches India. The balance sheet assets of these foreign bank branches accounted for about 7.65 percent of the total assets of the scheduled commercial banks as on March 31, 2010 as against 9.03 per cent as on March 31, 2009. Further during the period of three years from 2011 to 2014 many foreign banks which were operating two to three branches in the key commercial cities of the country closed down their branches and limited I to one or two branches in the country.

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Further, the preface to the discussion paper recognized the same issue and also raised concerns over the fact that there were no takers of the 'one presence' criteria under the 2011 policy.

The initial discussions relating to various aspects of economics and competition as well regulatory affairs lead to the framing of the present policy of 2013 which continues in operation.

The present policy is guided by the two cardinal principles of (a) reciprocity and (b) single mode of presence. The WOSs being locally incorporated will be given near national treatment which will subject to certain conditions, enable them to open branches elsewhere in the country at par with other domestic. This would also encourage participation of the WOS in the development of the Indian financial sector. The policy incentivises the existing foreign bank branches which operate within the framework of India's WTO commitment to convert into WOS due to the attractiveness of near national treatment. In order to provide safeguards against the possibility of the Indian banking market being dominated by foreign banks, the

present framework has certain measures to contain their expansion if the share of foreign banks exceeds a predetermined certain critical size. Measures relating to corporate governance perspective have also been built in so as to safeguard public interest.

As pointed out earlier that local incorporation was a key step to prevent situations like the global economic crisis of 2008. Many countries imposed requirement of local incorporation for foreign banks mainly for the purpose of (i) protecting domestic customers, (ii) easier resolution process, and (iii) greater regulatory comfort. In India foreign banks are permitted by RBI to establish presence in India either through branch mode or a wholly owned subsidiary (WOS) mode. The RBI maintained its this stance in the final policy document and consequently allow foreign banks may operate in India either through branch presence or they can set up a wholly owned subsidiary (WOS) with near national treatment. The foreign banks are at their liberty to choose one of the two modes of presence.

The policies of the RBI in view of the suggestions to prevent the effect of the global economic crisis of 2008 have concentrated on local incorporation. Belowmentioned are some key advantages of local incorporation:

i) ensurance of a clear delineation between the assets and liabilities of the domestic bank and its foreign parent and clearly provides for ring fenced capital within the host country.
ii) Ease in determining jurisdiction in case of disputes and winding up procedures.
iii) locally incorporated bank has its own BOD which is required to act in the best interests of the bank and its creditors,
iv) local incorporation provides more effective control in a banking crisis and enables the host country authorities to act more independently as against branch operations.
v) ensures clear delineation between the assets and liabilities of the domestic bank and those of its foreign parent and provides for ring fenced capital and assets within the host country;
vi) local incorporation provides clarity and certainty with respect to applicability of the relevant laws;
vii) Local incorporation provides efficient and effective control to the domestic regulators.

In view of the existing market dynamics, regulatory framework following can be considered as key factors for laying down future policies:

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- The mode of presence through branch of foreign banks provides a circumscribed structure. The Banking Regulation Act, 1949, also delineates the separate legal identity of branches of foreign banks in India.
- In order to ensure financial stability there would be a need to mandate at WOS presence at the entry level itself.
- WTO commitments are also to be kept in mind.
- Mandatory conversion of existing branches into subsidiaries is not possible.

Key features of the Framework

- Banks having complex structures or not having adequate disclosure or which do not have wide presence or which are in jurisdictions which gives preferential claim to depositors of home country may enter into India only through WOS mode. Banks not falling in the aforesaid category can choose either of the two mode. Howsoever, if a foreign bank which is operating through a branch in India has to mandatorily convert into WOS as soon as it falls under the earlier defined category.
- In order to prevent domination restriction is placed on entry of new WOSs 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 domestic banking system.
- Initial minimum paid-up-up voting equity capital for a WOS shall be ` 5 billion.
- The parent bank of the WOS would issue a letter of comfort to the RBI for meeting the liabilities of the WOS.
- The branch expansion guidelines for WOS shall be same as that applicable to domestic scheduled commercial banks unless wherein specific approval is required.
- Priority Sector lending requirement for WOS shall be 40 per cent.
- WOS may on arm's length basis use parental guarantee/ credit rating for providing custodial services and overseas operations.
- Wholly owned subsidiaries if they wish then they may dilute their stake to 74 per cent or less in accordance with the extant FDI policy.

FDI through Equity

Equity Investment in Private Sector Banks

Foreign investments into the equity of private banks as well as public sector banks can be made upto the prescribed limit. The initial policy inviting FDI investment in banking sector was issued under the Press Note No.4 (2001 Series) issued by DIPP under Ministry of Commerce & Industry on May 21, 2001. The key features of the FDI policy regarding equity investment are as follows:

a. FDI upto 49 per cent from all sources is permitted in private sector banks under the automatic route and under the government route upto 74% subject to conformance with relevant rules and procedures.
b. In order to determine the above-mentioned capping of 49 per cent under the automatic route or 74% upper limit FDI under the "automatic route" in respect of private sector banks, the following category of issues are considered:
   i. IPOs,
   ii. Private Placements,
   iii. ADRs/ GDRs, and
   iv. Acquisition of shares from existing shareholders [subject to (d) below].
c. The aggregate of foreign investment that may occur in a private bank from all sources cannot exceed more than 74 per cent of the paid up capital of the domestic bank inviting FDI infusion. Resultantly at no time less than 26% (twenty six percent) of the paid up capital should be held by the domestic or resident equity holder.
d. The stipulations as above will be applicable to all investments in existing private sector banks also.
e. Separate upper limit has been set up for PIS scheme investments which occur through stock exchanges. The permissible limits for investments done by FIIs/FPIs and NRIs are as follows:
   i) individual FII/FPI equity holding has to be less than 10 per cent of the total paid-up capital. The aggregate limit for all the FIIs/FPIs/QFIs cannot exceed 24 per cent of the total paid-up capital. Howsoever the Board through a special resolution in the general meeting may extend the upper limit for all the FII/FPI/QFI investment upto 49%.

f. The issue of fresh shares by a domestic bank under automatic route is not available to foreign investors having a financial or technical collaboration in similar or allied field. Investors falling under this category need to obtain prior FIPB approval.

g. Further, investment through automatic route is not available for transferring of existing shares in a banking company from residents to non-residents. Such investment can be done through prior FIPB approval along with an "in principle" approval by ECD under the RBI. Fair Price for transfer of existing shares is on the basis of relevant SEBI and CCI guidelines as applicable by the RBI. After receipt of "in principle" approval, the resident seller can receive funds and apply to ECD, RBI for obtaining final permission for transfer of shares.

h. Foreign banks operating through branch presence in India, may invest in domestic banks under the FDI scheme upto the extent of 49% with prior approval of the RBI.

i. In the case of NRIs, as hitherto, individual holding is restricted to 5 per cent of the total paid-up capital both on repatriation and non-repatriation basis and aggregate limit cannot exceed 10 per cent of the total paid-up 69 capital both on repatriation and non-repatriation basis. However, NRI holding can be allowed up to 24 per cent of the total paid-up capital both on repatriation and non-repatriation basis provided the banking company passes a special resolution to that effect in the General Body.

j. Applications for foreign direct investment in private banks having joint venture/subsidiary in insurance sector may be addressed to the Reserve Bank of India (RBI) for consideration in consultation with the Insurance Regulatory and Development Authority (IRDA) in order to ensure that the 26 per cent limit of foreign shareholding applicable for the insurance sector is not being breached.

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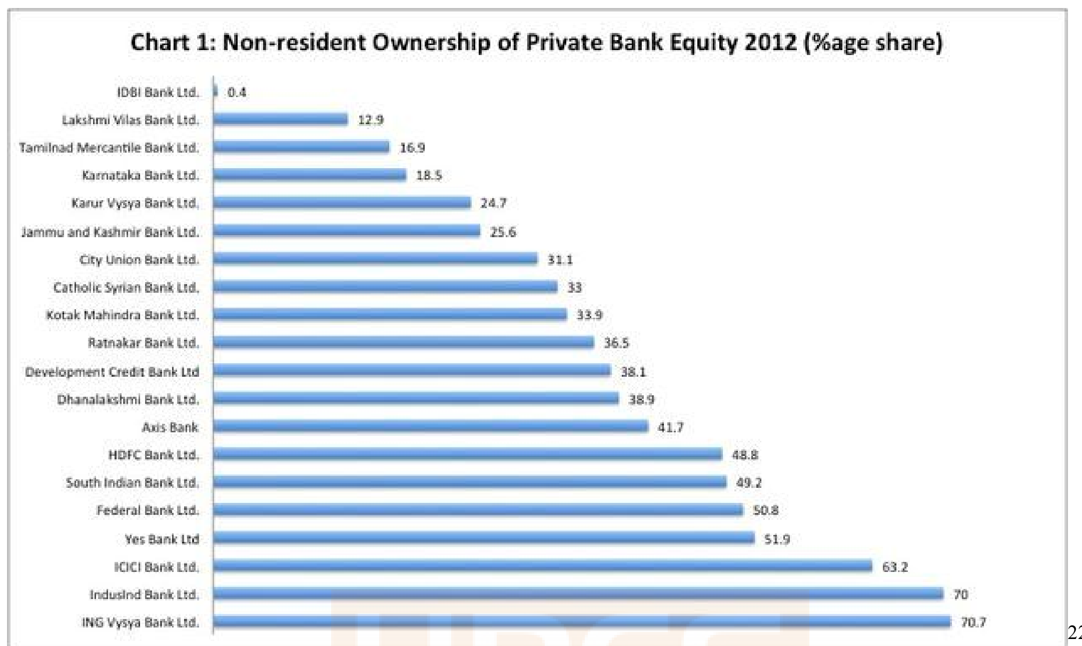
Provided below is a diagrammatic representation of the non resident ownership in domestic private bank equity. The depiction is highly helpful in understanding the viability of the policy as well as analyzing the future of FDI investments in Indian banking sector market.



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The above pictorial depiction shows the extent of foreign holding in the private banks in India. The statistics depicted above are of 2012. Oflate many escalations have occurred in the foreign holdings. For instance Yes bank gained approval from RBI in 2014 to increase is the FDI limit to 74%. South India Bank has also been under the scanner of the RBI for inviting foreign investment greater than the prescribed limit of 49%. From the above stats it can be reasonably be inferred that the participation through FDI in domestic private banks is popular among foreign investors. Equity investments limit the risk factor as compared to the risk involved in opening of branches or wholly owned subsidiaries. Further it is greatly beneficial for the domestic banks as it helps them to receive the much needed capital so as to increase their operations. Benefits and issues relating to FDI through equity investment has been discussed further in the chapter of Conclusion.

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[22] http://www.thehindu.com/business/Economy/fdi-in-banking/article4101872.ece titled 'FDI in Banking" dated November 16, 2013

Equity Investment in Public Sector Banks

Infusion through FDI and PIS in nationalised banks or the public sector banks has been fixed at an overall statutory[23] limits of 20%(twenty per cent) as provided under. The same ceiling has been fixed in respect of foreign investment in equity of State Bank of India and its associate banks. Since 2000 the FDI limits for other sectors as well as for private banks have been amended many times. But in case of public sector banks the limit has been set at 20%. Further no scope for increased investment has been left through governmental approval in case of public sector banks unlike their private sector banks.

Voting rights of foreign investors

Category of Banking Institution	Statutory Provision	Corresponding Right
Private Sector Bank	Section 12(2) of Banking Regulation Act,1949	Any person holding shares, in respect of any share held by him, shall not exercise voting rights in excess of 10%(ten percent) of the total voting rights of all the shareholders.
Nationalised Banks	Section 3(2E) of Banking Companies (Acquisition and Transfer of Undertakings) Acts, 1970/80]	Any shareholder, other than the C G, shall not be entitled to exercise voting rights in respect of any shares held by him in excess of 1%(one percent) of the total voting rights of all the shareholders of the nationalised bank.
State Bank of India (SBI)	Section 11 of State Bank of India Act,1955	Any shareholder, except shall not be entitled to exercise voting rights in excess of 10%(ten percent) of the issued capital,

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[23] Section 3 (2D) of the Banking Companies (Acquisition & Transfer of Undertakings) Acts, 1970/80

		(Government, in consultation with RBI can raise the above voting right to more than ten percent).
Associate Banks of SBI.	Section 19(1) and (2) of SBI (Subsidiary Bank) Act, 1959	No one shall be registered as a shareholder in respect of any shares held by him in excess of 200(two hundred) shares. Any shareholder, other than SBI, shall not be entitled to exercise voting rights in excess of 1%(one percent) of the issued capital of the subsidiary bank concerned.

Approval of RBI and reporting requirements

i. Under existing regulations and guidelines transfer of shares of 5%(five per cent) and more of the paid-up capital of a private sector banking company has to be done with prior intimation to RBI. For FDI of 5%(five per cent) and more of the paid-up capital the private sector banking company has to make application to the DBOD of RBI.

ii. FEMA 1999 provides that issue of equity of a domestic banking company whether done through the automatic route or trough prior approval of FIPB, does not require further approval of ECD of RBI. The process regarding ECD reporting is a two stage process which is as follows:

a. First stage: The Indian company inviting equity investment from foreign investors has to submit a report within 30 days of the date of receipt of amount of consideration which shall contain details such as name and address of foreign investors, date of receipt of funds, mode, channel and intermediary to payment of funds.

b. Second stage: a report in the Form FC-GPR along with certificate from the Company Secretary certifying compliance with that various regulations is to be filed within 30 days from the date of issue of shares.

Disinvestment by Foreign Investors

In terms of Regulations 10 and 11 of RBI Notification No. FEMA 20/2000-RB dated May 3, 2000 issued under FEMA 1999, disinvestments by foreign investors would be governed by the following:

(i) Sale of shares by non-residents on a stock exchange and remittance of the proceeds thereof through an authorized dealer does not require RBI approval.

(ii) Sale of shares by private arrangement requires RBI's prior approval. RBI grants permission for sale of shares at a price that is market related and is arrived at in terms of guidelines indicated in Regulation 10 above.

FDI and CUSTOMER BENFIT

FDI and Protection of Consumer Interest

Present are the times when neither an individual nor an economy can sustain being isolated from the rest of the world. Since its independence in order to achieve India's primary objective to obtain self sufficiency and self dependency the economic policy was always pro socialistic. As the domestic players in the market were not capable enough to put up against global competition entry to foreign players was restricted. The inhibitions regarding negative effect of an amicable FDI policy was for long being weighted over the plethora of benefits an effective well regulated FDI policy could bring to the nation. The economic reformation that took as an effect of the aftermath of the economic crisis of 1990 recognised the benefits and necessity of the FDI in India.

At first FDI was seen as means to provide greater capital benefits to the domestic markets and the RBI stressed upon it as a means to bring the domestic market at par with the global market. Consumer benefits though inferred as a positive outcome of the FDI have never been brought to the forefront.

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The banking sector institutions of the developed economies have in order to increase profitability have employed as a means of greater competitive tactic, igneous customer service policies which have been benefitting both the market players and the customers. For instance, policy of zero liability credit cards which is presently followed in India only by three banks being HDFC, ICICI and Axis Banks is a matter of gone days for the banking customer of western world. FDI is to be perceived to bring greater and better technology capabilities, further the foreign banks which mark their presence in the domestic market either through WOS or equity inflow shall bring in their developed and incentivizing policies so as to attract more and more customers as to earn greater return on investments. As a matter of fact the system of White Label ATM has also been adopted from the west. Customers whether in rural or urban areas of the Company are bound to get benefitted from the FDI infusion. FDI not only stirs up the stagnant market that is characterized by one hand lethargic public sector banks and on the other side by few commercial banks resulting to low level of competition.

The various facets of consumer benefits can be analysed through following points:

Competition:

Competition plays a key role in determining whether a particular economic policy such as FDI has resulted in positive manner or not. The effect on existing competition in the market by foreign banking institutions is yardstick for determining the extent of penetration into the domestic market is to be given to the foreign players. For instance, if the foreign players are too strong in comparison to the domestic banks these foreign banks irrespective of their mode of presence i.e. branch or WOS shall be able to dominate the market and resulting in reduced competition. Howsoever, if a level playing field is maintained the competition would increase which would be benefitting for the economy.

If we talk about in terms of consumer benefits and competition, the greater is the competition the greater is accrual of positive benefits to the customers. As the number of players increase in order to maintain their competitiveness and profitability these strive to outdo each other by giving better services. It is pertinent to note that banking being service industry institutions can gain and maintain their profitability only by providing better services. Further, the new foreign banks which operate through either branches or wholly owned subsidiaries whose sole objective is to increase and obtain large profits bring with them new policies which they employ globally. Such induction of global policies shall invoke the domestic players to also employ policies of customer service in tandem with the services offered by the foreign banks. This shall also not be different even incase of foreign equity infusion, the limit of FDI through equity infusion has been raised to 74% this means that the foreign investors in lieu of their investment shall require and also oversee that the affairs and management of the domestic bank are run in the most appropriate way that looks after their interest.
Further an efficient competitive market provides the customers with large number of service providers to choose from.

Technological up-gradation:

Technology plays a key role in today's life. From the use of plastic money to the services of mobile banking technology has made it all. The RBI has in recognition of the need of bringing technological advancements into the domestic banking industry has allowed outsourcing of IT requirements by the WOS to their home country. The RBI has also stressed upon the need of establishing a nationwide proper structure to provide access and application so as to encourage use of plastic money, internet banking facilities etc.

Both of the Narsimham Committiee reports stressed upon the necessity of technological advancement of the Indian banking sector. In terms of policy the western jurisdictions and their markets are far ahead of their east-asian counterparts and specifically India. The positive effect of FDI is that the WOS of the foreign banks bring and employ these better technologies which help in providing greater and efficient facilities both for the banks as well as the customers. Incase of the equity infusion and opening of JV the sharing of technical know how shall contribute immensely to accentuate technological capabilities of the Indian banking sector. Technology is utilized from honoring plastic cards demands, to mobile internet to maintaining appropriate security covers for the customers. Better technology shall ease out the process of customer verification, day to day banking transfers and processes etc.

Public Sector Banks

The FDI Limit in public sector banks has been fixed at 20% as against the cap of 74% in case of private sector banks. Presently many of Public Sector Banks as well as the government has been voicing about possibility of decreasing the government stake in these banks and opening of greater opportunity to the general public as well as foreign investors for equity investments. It is believed that such shall enable the Public sector banks to gain access to larger capital which would in turn facilitate them to provide better and more efficient services which reach to greater section of the population. The present government under the leadership of Prime Minister Mr. Narendra Modi can be perceived to aim at balancing capitalist and socialistic attitude towards the banking sector. As in his tenure only the talks regarding reducing of government stake have gained momentum and at the same time the socialistic policies such as Jan dhan yojna aims to extend banking services to the entire

population. The further FDI infusion into the Public sector banks shall encourage them to participate in the global competition in form of providing better customer services.

Analysis

While determining the customer benefits which accrue through FDI investments in the banking sector one important thing which is to be kept in mind is that most of the foreign banks as well as majority of the domestic commercial banks cater to and focus on providing banking facilities in terms of trade finance or commercial lending. Very few of these banks indulge in providing services to the majority of the population. As financing of commercial contracts is very profitable and hassle free as against the socialistic policies governing banking services to local population, the entities which invest through FDI seek to obtain the cream business as against the domestic banks which have to bear reduce profitability due to socialistic pattern of customer services in India. The pertinent point remains that whether the main customers that is the public in general is gaining any benefit out of FDI infusion, that whether these foreign institutions are contributing to the development of the country in general. In the year 2012 some of the reputed banks closed down their branches in India due to low business.

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Also, one of the reasons for low response to the policy for setting up WOS by foreign banks in India was the socialistic policies. Policies regarding providing banking facilities compulsorily in underbanked areas and states. Though this activity was incentivized howsoever most of the foreign banks remained un-interested.

It is pertinent to point out that when our domestic banks hesitate and resist to comply and seem disinterest by various customer specific policies such as providing ATM facilities in large scale throughout the country, operating White Label ATMs at low cost, restriction on interest rates etc. to what extent the foreign banks which have sole motive of profit gaining shall comply with these policies. For instance, in 2013 the NBFCs operating the White Label ATM services revolted to increase the per transaction cost by atleast 3 to 5 rupees from 10 Rupees. Such was not accepted by the RBI and was later on amicably settled.

The branch expansion policy as contained in the Scheme for setting up of WOS in India as released in November, 2013 bears a reflection of the government's intent to require the foreign banks operating through WOS or branch system to also work in the interest of the domestic market alongside their own personal interests. As per the 2013 policy no differential treatment in this respect shall be given to the WOS of the foreign bank. Thus, WOS would be permitted to open branches in Tier 1 to 6 centres subject to reporting as prescribed. Not less than 25 percent of the total number of branches opened during the financial year must be opened in unbanked rural (Tier 5 and Tier 6) centres. In any case the total number of branches opened in Tier 1 centres during a financial year cannot exceed the total number of branches opened in Tier 2 to 6 centres and all centres in the North Eastern States and Sikkim. As an incentive a branch in a Tier 1 centre can be opened for opening of a branch in Tier 2 to Tier 6 centres of underbanked districts of underbanked States. If WOS is unable to meet obligations of opening branches in Tier 2 to 6 centres in aggregate, or in unbanked rural centres (Tiers 5 to 6 centres) during a financial year, it must complete the obligation in the next financial year. Thus the policy aims at equal distribution of branches throughout the country.

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Thus, we see ideologically a regulated FDI policy is greatly benefitting to the customers. Howsoever, how well the foreign players adapt to the domestic regulatory and market dynamics exists as a determining factor for assessing the benefits that may accrue.

CONCLUSION

CONCLUSION

The appraisal of the FDI policy has most of the time been generally gauged through statistical methods depicting the amount of investment done by foreign entities in India during a particular time frame which ranges from a fiscal quarter to a decade. It is to be borne in mind that such calculated depictions are helpful to an extent to determine the credibility of the FDI policy as we are able to realize the considerable increase or decrease in the investment reflecting upon the health of the banking sector, howsoever such reports fall short of analyzing and giving a wholesome picture as to the overall effect on the various segments of economy. For instance, questions like what probable benefits have accrued to the customer segment, till what extent the foreign players have been able to contribute to the socialistic objective of the government to extend banking services to the underbanked area etc. remain unanswered until policy revision is undertaken through inviting opinion from public or robust review process undertaken by the RBI.

In case of the banking sector FDI infusion takes place through two major forms i.e. through the opening of the wholly owned subsidiaries or branches by foreign banks and equity investment in the domestic banking market. The results in relation to both the ways are distinct from each other. Where the FDI investment through the subsidiary or branch presence way has giving somewhat dwindling results, the foreign investment in case of equity has shown greater progress. For instance global major Morgan Stanley has exited from the Indian Market[24]. While Morgan Stanley is continuing with its investment banking business other banking corporations though carrying out wealth management business have exited from the Indian market reflecting upon poor viability of banking business in India. These banking institutions are Swiss Banks- EFG Group, UBS and Sarasin banks etc.

[24]http://indianexpress.com/article/business/banking-and-finance/from-ubs-to-morgan-stanley-foreign-banks-exiting-wealth-mgmt-biz-in-india/

As on September 30, 2013 there were 43[25] foreign banks operating branches in India. It is pertinent to notice that not all and infact a considerable amount of foreign banks have failed to penetrate into the Indian market and blamed lack of operational viability due to strict regulatory framework as a primary reason for the same.

While those who have performed well such as:

a) Citibank NA
b) Hong Kong Shanghai Banking Corporations(HSBC)
c) Standard Chartered Bank

On gaining systematically important status these institutions have expressed reluctance and resisted compulsory conversion of their branches into wholly owned subsidiaries[26]. As pointed out earlier in the study foreign banks operating through branches which become systematically important need to compulsorily be converted into subsidiaries. In pursuance to the policy presently 12 banks fall under this category[27].

The contribution of these banks stands mainly in the commercial and industrial lending segments wherein the overall competitiveness of the market has been enhanced by presence of these and other foreign banks. The FDI policy is always advocated by giving instances of far reaching benefits, but sadly no objective inquiry is ever made into the fact that whether these so stated benefits are accrued are not. How far the presence of foreign bank branches have contributed to the government's objective to extend banking services to the population at large has never been empirically determined.

The tryst between the foreign private banks and the domestic regulatory regime seems to be never ending. It would not be wrong to say that an inhibition regarding the regulatory regime and complexities that it involves pushes most of the foreign banks who seek to have business in India at bay.

If we observe the results of overall FDI infusion, foreign investment for 2009-10 was at US$ 25.88 billion which was lower by five per cent from US$ 27.33 billion in the previous fiscal

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[25] http://rbidocs.rbi.org.in/rdocs/Content/pdfs/71207.pdf

[26] http://www.moneycontrol.com/news/business/hsbc-evasivegoing-wholly-owned-subsidiary-way_991467.html

[27] http://www.livemint.com/Politics/jwKt9QvETehG9bJVZ2tKrJ/Citibank-StanChart-HSBC-may-have-to-become-wholly-owned-su.html

year[28]. Foreign direct investment in August dipped by about 60 per cent to approx. US$ 34 billion, the lowest in 2010 fiscal, industry department data released showed. In the first two months of 2010-11 fiscal. FDI inflow into India was at an all-time high of $7.78 billion up 77%from $4.4 billion during the corresponding period in the previous year. It shows that the FDI policy was attractive enough to invite investors around the world but was unable to retain its reputation.

If we consider the benefits which these wholly owned subsidiaries of foreign bank have are – access to a large customer base, the Indian banking sector is untapped market, as India is striving to develop into a global commercial hub the financing activities are said to increase many folds inviting greater opportunities for the banking units in India.

While what the Indian segment is gaining is from the increased competitiveness of the market. Banking incorporations whether belonging to the public or the private sector in a race to out do each other and create a position in the market have focused on providing better services. The attitude of the banks to expand in order to gain more customers along with the governmental policy requiring extention of banking services to underbanked areas seem to give positive results.

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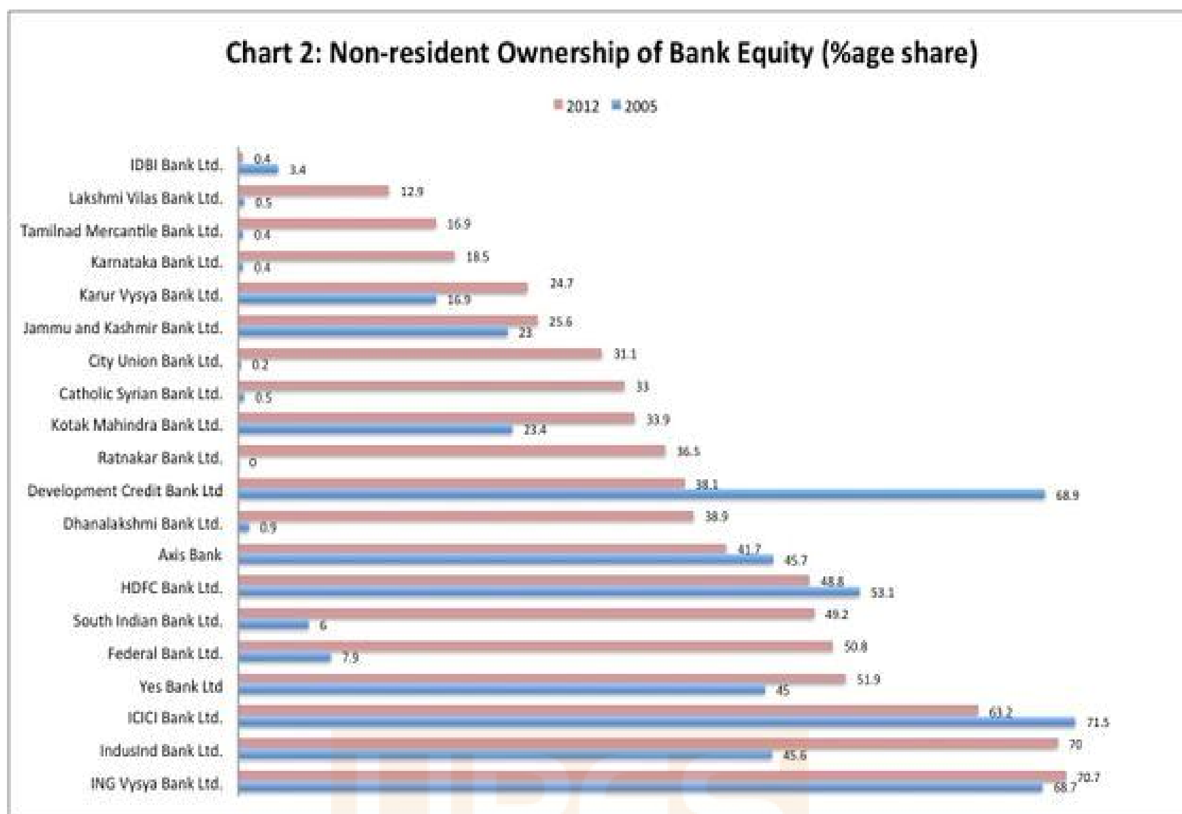
FDI thus exists as a positive mechanism to steer economic growth of the Indian Banking Sector. A balancing of interest has to be created through the FDI policy so that economic goals of the foreign banks and investors along with overall development of the domestic sector can be achieved. Further, in case of public sector banks it is highly suggestive to enunciate such policies that stir up foreign investment in these banks which are far from tasting the fruits of FDI in India.

[28] GYANPRATHA – ACCMAN (Journal of Management, Volume 5 Issue 1, 2013)



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Above is a pictorial depiction comparing the amount of FDI infusion in private sector banks in India.

The graph compares the percentage of foreign equity investment in Indian private banks as it stood in the year 2005 and then in the ear 2010. While most of the banks have had a considerable increase in the foreign equity holdings banks such as the Industrial Development Credit Bank, HDFC Bank, ICICI bank have shown a reduction in the foreign equity investment in their banks. Howsoever, the overall picture is encouraging in the terms that the equity investments have helped the banks to maintain the much needed capital adequacy for operating as well as expanding their business. It supports the claim which was advocated for FDI that private banks were in critical need of capital so as to expand their business and comply with the socialistic requirements of expansion in underbanked areas and perform other regulatory mandated businesses.

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[29] http://www.thehindu.com/business/Economy/fdi-in-banking/article4101872.ece titled 'FDI in Banking" dated November 16, 2013

As positive it seems for the private sector banks, the case is extremely different in case of the FDI in public sector banks. A recent conference which was held in January, 2015 presided over by the Prime Minister and conducted by Indian Banks Association, the discussion regarding the manner in which FDI could be used to contribute to the capital requirements of the public sector banks was highly debated. As of now in terms of assets size only State Bank of India, country's largest bank is the only Indian bank that appears in the list of top 100 banks of the World.

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