

Discussion Paper- Presence of foreign banks in India

1. Introduction

1.1 In 2005, the Reserve Bank released the “Road map for presence of foreign banks in India” laying out a two track and gradualist approach aimed at increasing the efficiency and stability of the banking sector in India. One track was the consolidation of the domestic banking system, both in private and public sectors, and the second track was the gradual enhancement of foreign banks in a synchronised manner. The Road map was divided into two phases, the first phase spanning the period March 2005 – March 2009, and the second phase beginning after a review of the experience gained in the first phase. However, when the time came to review the experience gained in the first phase, global financial markets were in turmoil and there were uncertainties surrounding the financial strength of banks around the world. At that time it was considered advisable to continue with the current policy and procedures governing the presence of foreign banks in India.

1.2 Governor on April 20, 2010, in his Annual Policy Statement for 2010-2011 indicated that while global financial markets have been improving, various international fora have been engaged in setting out policy frameworks incorporating the lessons learnt from the crisis. Furthermore, there was a realisation that as international agreement on cross-border resolution mechanism for internationally active banks was not likely to be reached in the near future, there was considerable merit in subsidiarisation of significant cross-border presence. Apart from easing the resolution process, this would also provide greater regulatory control and comfort to the host jurisdictions. In the Policy Statement it was announced “Drawing lessons from the crisis, it is proposed to prepare a discussion paper on the mode of presence of foreign banks through branch or WOS by September 2010” (paragraph 100).

1.3 Accordingly, this discussion paper on the form of presence of foreign banks in India has been prepared taking into account, inter-alia, the lessons learnt from the recent global financial crisis and the practices followed in other countries. Based on the feedback received on the approach outlined in the discussion

paper, the Reserve Bank will frame detailed guidelines on the presence of foreign banks in India.

2. Existing framework

The road map unveiled in 2005 comprised two phases – Phase I (March 2005 to March 2009) and Phase II (April 2009 onwards).

A copy of the “Roadmap for presence of foreign banks in India” released with the Press Release dated February 28, 2005 is attached as Annex 1.

During the first phase, foreign banks were permitted to establish presence by way of setting up a wholly owned banking subsidiary (WOS) or conversion of the existing branches into a WOS. The guidelines covered, inter alia, the eligibility criteria of the applicant foreign banks such as ownership pattern, financial soundness, supervisory rating and the international ranking. The WOS was to have a minimum capital requirement of Rs.300 crore i.e. Rs.3 billion and would need to ensure sound corporate governance. The WOS was to be treated on par with the existing branches of foreign banks for branch expansion with flexibility to go beyond the existing WTO commitments of 12 branches in a year and preference for branch expansion in under-banked areas. The Reserve Bank had indicated that it may also prescribe market access and national treatment limitation consistent with WTO as also other appropriate limitations to the operations of WOS, consistent with international practices and the country’s requirements.

3. Branches vs Subsidiaries

3.1 Regulatory control perspective

3.1.1 Recent global financial crisis have brought out that (a) complex structures (b) too big to fail (TBTF) and (c) too connected to fail (TCTF) have exacerbated the crisis. The post-crisis lessons support domestic incorporation of foreign banks i.e. subsidiarisation.

3.1.2 Branches are not separate legal entities whereas subsidiaries are locally incorporated separate legal entities. Subsidiaries being locally incorporated have

their own capital base and their own local board of directors. In the case of branches, parent banks are, in principle, responsible for their liabilities.

3.1.3 The main benefits associated with branches are (i) greater operational flexibility, (ii) increased lending capacity (loan size limits based on the parent bank's capital) and (iii) reduced corporate governance requirements. Branches are generally not allowed to take retail deposits or enjoy deposit insurance. (The position in this regard in some countries is given in the Annex 2). While the branch form of presence can have its own advantages such as stronger support from the parent could be forthcoming in situations of local adversity of the branch, internationally it is generally understood that with a branch it may be 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. As branches are part of the head office, assets attributable to it can easily be transferred by the branch to the foreign head office. Further the 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 times of crisis, the distinction between the branch and the rest of the bank, and the legal location of assets and liabilities, may well become very important.

3.1.4 Cross Border Resolution Issues with branches

Insolvency procedures may differ by the approach taken by each country. Some countries follow a "separate-entity" doctrine and thus are able to place their depositors and creditors before those of other countries. For example, Australia and USA have enacted rules under which home country depositors or creditors are senior claimants over depositors from branches located overseas during bankruptcy proceedings. Other countries follow "single-entity" doctrine and consider a bank and its foreign branches as a whole and give an equal treatment to all creditors irrespective of domicile unlike Canadian and American legislations that allow the authorities to separate the branch from its parent and use the assets to cover the liabilities under the host country regulations. During liquidation of a foreign bank's branch, US authorities can collect all the assets of the foreign bank in their jurisdiction, even when those assets do not belong to the branch;

hence, more assets will be available to reimburse the claimants of an ailing foreign bank's branch. Moreover, in the case of a bank failure the FDIC is authorized to bill the cost of the failure to affiliate or sister banks.

In order to overcome these limitations the Cross Border Bank Resolution Group (CBRG) of BCBS has come out with its recommendations based on the lessons from the crisis, delineating two approaches viz. ring fencing or territorial approach and universal approach. The CBRG recommends a "middle ground" approach that recognises strong possibility of ring-fencing in a crisis. This approach entails certain changes to national laws and resolution frameworks. An alternative approach would be establishing a universal framework for the resolution of cross border financial groups, which puts all creditors on same footing. Though some jurisdictions including India stipulate locally assigned capital for branch mode of presence which serves the purpose of ring fencing, setting up subsidiaries clearly provides for ring fenced capital within the country.

3.1.5 In view of the above mentioned facts a number of jurisdictions therefore impose a local incorporation requirement for foreign banks mainly for two reasons (i) to protect retail depositors and (ii) to limit operations of systemically important banks.

3.1.6 In general, following are the main advantages of local incorporation:

- (i) it ensures that there is a clear delineation between the assets and liabilities of the domestic bank and those of its foreign parent and clearly provides for ring fenced capital within the host country.
- (ii) it is easier to define laws of which jurisdiction applies since laws characterize a subsidiary as a locally incorporated entity with its own capital.
- (iii) a locally incorporated bank has its own board of directors and these directors are required to act in the best interests of the bank, to prevent the bank from carrying on business in a manner likely to create a substantial risk of serious loss to the bank's 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.

3.1.7 It must however be recognised that setting up of subsidiaries does not necessarily ensure support from the parent bank in all weathers. International experience has shown that “comfort letters” provided by the holding companies is not a source of strength as their enforceability in times of stress is very often questioned. 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.

3.1.8 A down side risk with subsidiaries may arise from financial stability perspective if they come to dominate the domestic financial system due to their being locally incorporated entities. It has come to the fore that subsidiaries promoted by foreign banks, where they had large presence, had not only acquired large share at the expense of domestic banks in the boom years but when the home countries were afflicted they had tended to substantially curtail their operations in or withdraw from the host country. Indian experience in this regard even with branch mode of presence has been no exception as the foreign banks had withdrawn substantially from the credit markets in India to the extent that y-o-y growth of credit was -7.1% (as on July 3, 2009) and -15.9% (as on October 9, 2009). However, through prudential measures, like limiting the size of the foreign bank branches and subsidiaries, it can be ensured that the domestic financial system is not dominated by foreign banks.

3.1.9. On balance however weighing the pros and cons of the branch form of presence against the subsidiary form of foreign banks, the advantages in WOS outweigh downside risks. In the light of experience gained, particularly, in the recent global crisis, subsidiary form of presence appears to be a preferred mode for the presence of foreign banks. The regulatory comfort that local incorporation

of WOS provides as compared to the branches of foreign banks would also justify a preference for WOS.

4. Proposed Framework for Presence of foreign banks in India

4.1 There are currently 34 foreign banks operating in India as branches. Their balance sheet assets, 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. In case, the credit equivalent of off balance sheet assets are included, the share of foreign banks was 10.52 per cent of the total assets of the scheduled commercial banks as on March 31, 2010, out of this, the share of top five foreign banks alone was 7.12 per cent.

4.2. The policy on presence of foreign banks in India has followed two cardinal principles of (i) Reciprocity and (ii) Single Mode of Presence. These principles are independent of the form of presence of foreign banks. Therefore, these principles should continue to guide the framework of the future policy on presence of foreign banks in India.

4.3 Following factors seem relevant for any framework for future policy on presence of foreign banks in India:

- Prima facie the branch mode of presence of foreign banks in India provides a ring-fenced structure as there is a requirement of locally assigned capital and capital adequacy requirement as per Basel Standards. Certain provisions of the BR Act¹ also delineate the separate legal identity of branches of foreign banks in India. Further, under section 584 of the Companies Act, though the company incorporated outside India is dissolved, if it has ceased to carry on the business in India, it may be

¹ Section 11(2): Banking companies incorporated outside India are required to maintain a certain amount of paid-up capital and reserves. Further, they are required to deposit with RBI, in cash or securities, an amount equal to their capital and reserves and 20 per cent of its each year's profit.

Section 11(4): Claims of all creditors of the company in India shall have first charge on the amounts kept deposited with the RBI under Section 11(2).

Section 25: Every banking company is required to maintain assets in India which shall not be less than 75 per cent of its demand and time liabilities in India.

wound up as an unregistered company. However, except for the assets specifically ring-fenced under Section 11(4) of the BR Act, the claim of domestic depositors and creditors over other assets is yet to be legally tested.

- Keeping the above in view, on balance, the subsidiary model has clear advantages over the branch model despite certain downside risks. However, under the extant policy as laid down in 2005 Roadmap, no foreign bank has approached RBI, for setting up a subsidiary, may be due to lack of incentives. Hence there may be a need to incentivise subsidiary form of presence of foreign banks.
- From financial stability perspective there would be a need to mandate at entry level itself subsidiary form of presence (i.e. wholly owned subsidiary-WOS) under certain conditions and thresholds. It would likewise be mandatory for those fresh entrants who establish as branches to convert to WOS once they meet the conditions and thresholds referred to above or which become systemically important over a period by virtue of their balance sheet size.
- While deciding the approach towards conversion of existing foreign bank branches, India's commitments to WTO will have to be kept in mind.
- It may not, therefore, be possible to mandate conversion of existing branches into subsidiaries. However, the regulatory expectation would be that those foreign banks which meet the conditions and thresholds mandated for subsidiary presence for new entrants or which become systemically important by virtue of their balance sheet size would voluntarily opt for converting their branches into WOS in view of the incentives proposed to be made available to WOS.
- The branch expansion of both the existing foreign banks and the new entrants present in the branch mode would be subject to the WTO commitments.

5. Eligibility of the parent bank

5.1 Foreign banks applying to the RBI for setting up their WOS/branches in India must satisfy RBI that they are subject to adequate prudential supervision in their

home country. In considering the standard of supervision exercised by the home country regulator, RBI will have regard to the Basel standards.

5.2 The setting up of WOS/branches in India should have the approval of the home country regulator.

5.3 Other factors (but not limited to) that will be taken into account while considering the application for setting up their presence in India are given below:

- I. Economic and political relations between India and the country of incorporation of the foreign bank
- II. Financial soundness of the foreign bank
- III. Ownership pattern of the foreign bank
- IV. International and home country ranking of the foreign bank
- V. Rating of the foreign bank by international rating agencies
- VI. International presence of the foreign bank

6. Entry norms

6.1.1 In the light of the experience gained during the recent global financial crisis, it may be advisable to mandate presence in form of subsidiaries, at least in case of certain category of banks, on prudential grounds, at the entry point itself. From financial perspective, therefore, following category of banks may be mandated entry in India only by way of setting up a Wholly Owned Subsidiary (WOS):

- i) Banks incorporated in a jurisdiction that has legislation which gives deposits made/ credit conferred, in that jurisdiction a preferential claim in a winding up.
- ii) Banks which do not provide adequate disclosure in the home jurisdiction.
- iii) Banks with complex structures,
- iv) Banks which are not widely held, and
- v) Banks other than those listed above may also be required to incorporate locally, if the Reserve Bank of India is not satisfied that supervisory arrangements (including disclosure arrangements) and market discipline in the country of their incorporation are adequate or for any other reason that the Reserve Bank of India considers that subsidiary form of presence of the bank would be desirable on financial stability considerations.

6.1.2 Foreign banks in whose case the above conditions do not apply can opt for a branch or WOS on entry in accordance with the single mode of presence requirement as stated in Para 4.2. However, it would be mandatory for banks which opt for branch mode of presence to convert themselves into WOS if:

- a) any of the conditionalities as mentioned in Para 6.1.1 materialise in the judgement of Reserve Bank of India or
- b) they become systemically important by virtue of their balance sheet size. Foreign bank branches would be considered to be systemically important once their assets (on balance sheet and credit equivalent of off-balance sheet items) become 0.25% of the total assets (inclusive of the credit equivalent of off-balance sheet items) of all scheduled commercial banks in India as on March 31 of the preceding year.

6.2 Existing bank branches

As regards the conversion of foreign banks that already have branch form of presence in India prior to the implementation of the new policy, the regulatory stance would be as stated in Para 4.3. This would imply that the expectation of RBI would be that existing branches of foreign banks that meet the parameters set out in paragraph 6.1.1 above, or which are or become systemically important on account of their balance sheet size exceeding a threshold limit, would voluntarily convert themselves into WOS in view of the incentives proposed to be made available to WOS. The measure of systemic importance would be as laid down in Para 6.1.2 (b) above. It may be mentioned in this context that currently, top five foreign banks account for more than 70% of total balance sheet assets of foreign banks in India.

7. Full National Treatment

7.1 For WOS, by virtue of their local incorporation, full national treatment would be expected. However, as discussed in Para 3.1.8, this could create risks from financial stability perspective if the foreign banks come to dominate the domestic banking system. Further, a consolidation of the domestic banks both in private and public sectors is yet to take place under the twin approach model articulated in the "Roadmap". Thus allowing full national treatment could lead to unintended consequences for the banking sector. It would, therefore, not be possible nor desirable to provide full national treatment to WOSs of foreign banks. However, they

would be placed in a much better position than the foreign bank branches operating in India but less than that of domestic banks. This would provide very significant incentives for the WOS mode of presence of foreign banks in India.

7.2 Government of India, Department of Industrial Policy and Promotion (DIPP) vide its press notes 2, 3 and 4 (2009 Series) has defined “foreign company” as a company with more than 50 per cent foreign holding. Therefore, under the FDI policy as set out in Circular 1 of 2010 dated 31st March 2010 issued by DIPP, WOSs of the foreign banks will be treated as foreign owned and controlled companies. Hence, WOSs of foreign banks will be treated as “foreign banks”. This would be an additional reason because of which it would not be possible to provide full national treatment to WOSs of foreign banks in India.

7.3 The extent of full national treatment and limitations thereon in matters like branch expansion, raising non-equity capital in India, priority sector lending, etc. are given in the subsequent paragraphs.

8. Capital Requirement

8.1 The minimum capital requirements for WOS on entry may generally be in line with those that would be prescribed for the new private sector banks. (RBI had issued a discussion paper on Entry of New Banks in the Private Sector on August 11, 2010 which inter alia covers the minimum capital requirement for new banks to be licensed in the private sector). Therefore, the WOS of foreign banks would be treated at par with the new private sector banks in regard to minimum capital requirement. The WOS shall be required to maintain a minimum capital adequacy ratio of 10 per cent of the risk weighted assets or as may be prescribed from time to time on a continuous basis from the commencement of operations.

8.2 The minimum net worth of the WOS on conversion from branches would not be less than the minimum capital requirement for new private sector banks. They would be required to maintain a minimum capital adequacy ratio of 10 per cent of the risk weighted assets or as may be prescribed from time to time on a continuous basis.

8.3 For foreign banks with branch mode of presence - both existing and new, the existing capital requirements will continue for the present i.e USD 25 million.

9. Corporate Governance

9.1 Any global entity would manage its investments on the basis of their assessment of the risk / return trade-off and allocate resources across various subsidiaries. The interest of the shareholders of the parent is the driving force for such decisions. Concerns may arise when the decisions taken for a subsidiary affect domestic depositors (and domestic shareholders, if the subsidiary is listed). Independent board members play an important role in protecting the interests of all stakeholders. Banks must include independent directors on their boards in order to make sure that management acts in the best interest of the local institution. Independent directors also ensure sufficient separation between the board of a bank and its owners to ensure that the board does not have unfettered ability to act in the interests of the owners where those interests diverge from those of the bank.

9.2 In some countries foreign bank subsidiaries operate like branches focussing above all on sales, with decision making powers being locally limited and risk – management being located abroad. To address these tendencies Reserve Bank of New Zealand requires locally incorporated large entities conduct substantial portion of their business in and from New Zealand.

9.3 As the international experience shows, some of the important factors to be taken into account before a foreign bank is allowed to set up a subsidiary is the commitment of its parent to support the subsidiary, the ability of the subsidiary to operate on a standalone basis even when the parent faces crisis and also that the subsidiary is managed from the host country with most of the systems and controls residing within its jurisdiction and not managed remotely from the Head Office.

9.4 In order to ensure that the board of directors of the WOS of foreign bank set up in India acts in the best interest of the local institution, RBI may, in line with the

best practices in other countries, mandate that (i) not less than 50 percent of the directors should be Indian nationals resident in India, (ii) not less than 50 percent of the directors should be non-executive directors, (iii) a minimum of one-third of the directors should be totally independent of the management of the subsidiary in India, its parent or associates and (iv) the directors shall conform to the 'Fit and Proper' criteria as laid down in our extant guidelines contained in RBI circular dated June 25, 2004, as amended from time to time. This would be in line with our roadmap released in February 2005.

10. Accounting, Prudential Norms and Other Requirements

10.1 The WOS will be subject to the licensing requirements and conditions, broadly consistent with those for new private sector banks.

10.2 The WOS will be governed by the provisions of Companies Act, 1956, Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, other relevant statutes and the directives, prudential regulations and other guidelines /instructions issued by RBI and other regulators from time to time.

11. Raising of Non-equity capital in India

11.1 In terms of the current guidelines branches of foreign bank do not have access to the domestic rupee resources to augment their non-equity capital in India. They are permitted to raise funds from their Head Office for augmenting Tier I and Tier II capital through Innovative Perpetual Debt Instruments (IPDIs) and debt capital instruments subject to terms and conditions prescribed for Indian Banks and additional terms and conditions specifically applicable to foreign banks.

11.2 As regards permitting WOS of foreign banks to raise rupee resources through issue of non-equity capital instruments there can be two views. One view would be that since WOS is a locally incorporated bank it should have access to rupee resources in line with the private sector banks. The other view could be that as WOS is a closely held foreign owned bank it should raise long term resources from the

parent foreign bank in the shape of IPDI and debt capital instruments to demonstrate the parent's commitment towards the host country.

11.3 As an incentive to foreign banks to set up WOS or convert their branches into WOS, RBI may allow them 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.

12. Branch expansion

12.1 With a view to creating an environment for encouraging foreign banks to set up WOS, a less restrictive branch expansion policy, though not at par with domestic banks may be envisaged. Accordingly, differentially favourable treatment to WOS of foreign banks as compared to the branches of other foreign banks may be put in place on the grounds of regulatory comfort that subsidiaries would provide.

12.2 Therefore, with a view to incentivise setting up of WOS/conversion of foreign bank branches into WOS, it is proposed that the branch expansion policy as applicable to domestic banks as on January 1, 2010, may be extended to WOS of foreign banks also. This would mean that the WOS would be enabled to open branches in Tier 3 to 6 centres except at a few locations considered sensitive on security considerations. Their application for setting up branches in Tier 1 and Tier 2 centres would also be dealt with in a manner and on criteria similar to those applied to domestic banks.

12.3 The expansion of the branch net work of foreign banks in India – both existing and new entrants – who are present in branch mode would be strictly under the WTO commitments of 12 branches or as may be modified from time to time. The withdrawal of the current stance of permitting larger number of branches than the commitment under WTO of 12 branches each year is to incentivise the foreign banks with branch mode of presence to move to WOS structure.

13. Measures to contain dominance of foreign banks

13.1 As discussed in Para 3.1.8, there is a downside risk to financial stability of the dominance of foreign banks over the domestic banking system on account of the near-national treatment proposed in several respects to WOSs. Therefore, in order to ensure that such a situation does not come about, certain restrictive measures would have to be put in place. 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.

14. Priority Sector lending requirements for WOS

14.1 Since the WOS of foreign banks will be locally incorporated banks they should not be treated very differently from domestic banks in respect of Priority Sector Lending norm. Priority sector obligations on WOS have, therefore, to be more onerous than for branches of foreign banks but less than those for domestic banks since they would not get full national treatment.

14.2 Further, Raghuram Rajan Committee has also recommended giving WOSs same rights as private sector banks together with requirement to fulfil priority sector lending norms at par with domestic banks viz. 40% as against 32%.

14.3 In terms of extant priority sector lending norms foreign banks are required to extend lending to the priority sector (total) to the extent of 32% (against 40% for domestic banks) of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of off-balance sheet exposure, whichever is higher.

14.4 Foreign banks play a significant role in financing foreign trade and as a matter of fact, most of the foreign banks have opened branches 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.

14.5 At present, no target or sub-target for agricultural lending has been prescribed for the branches of foreign banks. However, 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, since the branch spread of these banks will be limited due to their not being given full national treatment. Accordingly, a lower sub-target at 10% may be fixed for these WOSs against the target of 18 % for domestic commercial banks.

Analogous to domestic banks, not more than 2.5% out of sub-target of 10% should relate to indirect agriculture finance. As regards any shortfall in achieving PSL norms, the extant instructions applicable to the branches of foreign banks may be made equally applicable to WOSs of foreign banks.

14.6 Following norms are proposed for WOS of foreign banks towards lending to Priority Sector:

Newly set up WOS of foreign banks may be required to comply with the Priority Sector Lending (PSL) norms as given below from day one.

Sr.No.	Particulars	Target
1.	Total Priority Sector Lending target	40% of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of off-balance sheet exposure whichever is higher
2.	Sub-target for Export credit	12% of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of off-balance sheet exposure whichever is higher
3.	Sub-target for agricultural advances	10% of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of off-balance sheet exposure whichever is higher [Not more than 25% of above 10% i.e. 2.5% of

		Adjusted Net Bank Credit (ANBC) or credit equivalent amount of off-balance sheet exposure whichever is higher should relate to indirect agriculture advances]
4.	Small enterprise advances	10% of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of off-balance sheet exposure whichever is higher

14.7 WOSs set up by conversion of existing branches of foreign banks

14.7.1 WOS set up by conversion of existing branches may be allowed a transition period of five years from the year in which they incorporate in India for meeting priority sector lending norms. The following table lays down the proposed roadmap for achieving 40% PSL target, sub-target of 10% towards agriculture sector by WOSs:

Year	Increase in PSL	Total target PSL	Sub-target for agriculture lending
1 st	2%	34%	2%
2 nd	2%	36%	4%
3 rd	2%	38%	6%
4 th	2%	40%	8%
5 th	-	40%	10%

15. Use of Credit Rating and Parent / Head Office Support

15.1 If the parent is allowed to give explicit guarantees to the creditors for the liabilities of the subsidiary, it would strengthen the subsidiary structure. In case the subsidiary fails, the clients who have the guarantees and standby letters of credit (SBLCs) from the parent bank may be able to recover their dues from the parent thus leaving more assets of the subsidiary to satisfy domestic claims. However, on the other hand if such a support is permitted the WOSs would have an unfair competitive advantage over domestic banks in terms of lending, raising resources from domestic and overseas markets as well as providing certain niche services like

custodial business to FIs etc. It is, therefore, proposed to treat WOS of foreign banks at par with domestic banks in this regard.

15.2 Nevertheless, 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.

16. Tax treatment

16.1 It appears that for any Capital Gains Tax arising out of transfer of property, goodwill and other assets of capital nature to its own newly incorporated subsidiary in India the provisions of Section 47(iv) of Income Tax Act, 1961 would be applicable to foreign banks converting their branches into subsidiaries. Foreign banks may approach the appropriate authority for suitable clarification.

17. Declaration of dividends

17.1 A suggestion has been made that in the initial years of its formation, the WOS should be allowed to remit profits like a branch in India. Foreign banks with branch presence in India are allowed to repatriate profits in the ordinary course of their business. However the wholly owned subsidiaries of foreign banks, being banks incorporated in India, may declare dividends like domestic banks subject to criteria laid down in RBI circular DBOD.No. BP.BC. 88/ 21.02.067/2004/05 dated May 04, 2005. In terms of the said circular general permission has been granted for declaring dividends only to those banks, which comply with the following minimum prudential requirements.

(i) The bank should have :

- * CRAR of at least 9% for preceding two completed years and the accounting year for which it proposes to declare dividend.
- * Net NPA less than 7%.

In case any bank does not meet the above CRAR norm, but is having a CRAR of at least 9% for the accounting year for which it proposes to declare dividend, it would be eligible to declare dividend provided its Net NPA ratio is less than 5%.

- (ii) The bank should comply with the provisions of Sections 15 and 17 of the Banking Regulation Act, 1949.
- (iii) The bank should comply 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.
- (iv) The proposed dividend should be payable out of the current year's profit.
- (v) The Reserve Bank should not have placed any explicit restrictions on the bank for declaration of dividends.

18. Setting up of NBFCs by the WOS of foreign banks

18.1 Under the provisions of Section 19(2) of the Banking Regulation Act, 1949, a banking company cannot hold shares in any company whether as a pledgee or mortgagee or absolute owner of an amount exceeding 30 per cent of the paid-up share capital of that company or 30 per cent of its own paid-up share capital and reserves, whichever is less.

18.2 In terms of the extant RBI instructions, which are more restrictive, the investment by a bank in a subsidiary company, financial services company, financial institution, stock and other exchanges should not exceed 10 per cent of the bank's paid-up share capital and reserves and the investments in all such companies, financial institutions, stock and other exchanges put together should not exceed 20 per cent of the bank's paid-up share capital and reserves. Investments which are made as part of the treasury operations of banks purely for the purpose of trading can be excluded for the purpose of the 20 percent cap. Banks cannot also participate in the equity of financial services ventures including stock exchanges, depositories, etc. without obtaining the prior specific approval of the Reserve Bank of India notwithstanding the fact that such investments may be within the ceiling prescribed under Section 19(2) of the Banking Regulation Act.

18.3 RBI does not view favourably setting up of subsidiaries or significant investment in associates for activities that can be undertaken within the bank.

18.4 The WOS being a locally incorporated bank may be subjected to the regulations as applicable to Indian banks detailed above. In the case of WOS approval for setting up subsidiaries or significant investment in associates will also factor in whether there are NBFCs set up by the parent banking group under FDI rules for undertaking same or similar activity.

19. Regulatory framework for consolidated prudential accounting and supervision

19.1 The regulatory framework for consolidated prudential reporting and supervision, currently applicable to branches of foreign banks as laid down in circular DBOD No.FSD.BC. 46/24.01.028/2006-07 dated December 12, 2006 may also be made applicable to WOS in all cases where NBFCs are promoted by the foreign bank parent/group of the WOS in India .

20. Mergers / Acquisitions and Dilution of WOS to 74 %

20.1 In February 2005, the 'Road map for presence of foreign banks in India' indicated that:

i) Foreign banks may be permitted to invest in private sector banks that are identified by RBI for restructuring. In such cases foreign banks would be allowed to acquire a controlling stake in a phased manner.

ii) The WOS of foreign banks on completion of a minimum prescribed period of operation will be allowed to list and dilute their stake so that at least 26 per cent of the paid up capital of the subsidiary is held by resident Indians at all times. The dilution may be either by way of Initial Public Offer or as an offer for sale.

iii) After a review is made with regard to the extent of penetration of foreign investment in Indian banks and functioning of foreign banks, foreign banks 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 investment limit of 74 per cent.

20.2 The issue of dilution or listing of WOS of foreign banks in India and allowing mergers and acquisitions of Indian private sector banks by foreign banks or their WOS may be considered after a review is made of experience gained on the functioning of WOS of foreign banks in India.

21. Differential licensing

21.1 In India, the penetration of banking services is very low. Less than 59 % of adult population has access to a bank account and less than 14 % of adult population has a loan account with a bank and priority sector provides an avenue for financial inclusion. Further, as a policy RBI has not so far encouraged banks that do not subscribe to a business model that supports financial inclusion in general. Reserve Bank of India would not consider granting differential licence to foreign banks seeking entry in 'niche markets, since if at this stage it is decided to go in for differential bank licence for foreign banks, it may be a setback to the goal of Financial Inclusion which is being vigorously pursued by RBI.

22. This discussion paper gives broad contours of the proposed policy on the mode of presence of foreign banks in India. Reserve Bank hereby invites feedback/suggestions on the proposals from all stakeholders. Feed back/suggestions may be furnished within a period of 45 days from the date of publication of the Discussion Paper on RBI website. The guidelines delineating the Road Map for presence of foreign banks in India would be finalised after taking into account the feedback/suggestions received from the stakeholders.

PRESS RELEASE



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**RBI unveils Roadmap for Presence of Foreign Banks in India
And Guidelines on Ownership and Governance in Private Banks**

The Reserve Bank of India (RBI) today released the roadmap for presence of foreign banks in India and guidelines on ownership and governance in private sector banks. Shri P Chidambaram, Minister of Finance, Government of India, in his speech announcing the Union Budget for 2005-2006 today, stated that the “RBI has prepared a roadmap for banking sector reforms and will unveil the same.”

Accordingly, the following three documents have been released:

- (a) Roadmap for presence of foreign banks in India along with
- (b) Annex for setting up of wholly owned banking subsidiaries and
- (c) Guidelines on ownership and governance in private sector banks

Roadmap for Presence of Foreign Banks in India

It may be recalled that the Ministry of Commerce and Industry, Government of India had, on March 5, 2004 revised the existing guidelines on foreign direct investment (FDI) in the banking sector. These guidelines also included investment by non-resident Indians (NRIs) and FIIs in the banking sector.

As per the guidelines the aggregate foreign investment from all sources was allowed up to a maximum of 74 per cent of the paid up capital of the bank while the resident Indian holding of the capital was to be at least 26 per cent. It was also provided that foreign banks may operate in India through only one of the three channels, namely (i) branch/es (ii) a Wholly owned Subsidiary or (iii) a subsidiary with an aggregate foreign investment up to a maximum of 74 per cent in a private bank. In consultation with the Government of India, RBI has released the road map for presence of foreign banks in India to operationalise the guidelines.

The roadmap is divided into two phases. During the first phase, between March 2005 and March 2009, foreign banks will be permitted to establish presence by way of

setting up a wholly owned banking subsidiary (WOS) or conversion of the existing branches into a WOS.

To facilitate this, RBI has also issued detailed guidelines. The guidelines cover, *inter alia*, the eligibility criteria of the applicant foreign banks such as ownership pattern, financial soundness, supervisory rating and the international ranking. The WOS will have a minimum capital requirement of Rs. 300 crore, i.e., Rs 3 billion and would need to ensure sound corporate governance. The WOS will be treated on par with the existing branches of foreign banks for branch expansion with flexibility to go beyond the existing WTO commitments of 12 branches in a year and preference for branch expansion in under-banked areas. The Reserve Bank may also prescribe market access and national treatment limitation consistent with WTO as also other appropriate limitations to the operations of WOS, consistent with international practices and the country's requirements.

During this phase, permission for acquisition of share holding in Indian private sector banks by eligible foreign banks will be limited to banks identified by RBI for restructuring. RBI may if it is satisfied that such investment by the foreign bank concerned will be in the long term interest of all the stakeholders in the investee bank, permit such acquisition. Where such acquisition is by a foreign bank having presence in India, a maximum period of six months will be given for conforming to the 'one form of presence' concept.

The second phase will commence in April 2009 after a review of the experience gained and after due consultation with all the stakeholders in the banking sector. The review would examine issues concerning extension of national treatment to WOS, dilution of stake and permitting mergers/acquisitions of any private sector banks in India by a foreign bank in the second phase.

Guidelines on Ownership and Governance For Private Banks

It may be recalled that the Reserve Bank had released a draft policy framework for ownership and governance in private sector banks on July 2, 2004 for discussion and feed back. These guidelines emphasised desirability of diversified ownership in banks, 'fit and proper' status of important shareholders, directors and the CEO and the need for a minimum capital / net worth criteria. Suitable transition arrangements had been provided while keeping the policy and the processes transparent and fair. The guidelines have remained in the public domain for a sufficient length of time and have been widely debated. There is a general consensus on the need for good governance and management in the banking system and desirability of diversified ownership to the extent possible while keeping the overriding objective of ensuring fit and proper status of owners and directors. Certain issues were also raised on the application of the framework to existing banks and the need for enabling shareholding higher than 10 per cent to facilitate restructuring in the banking system and consolidation.

Based on the feedback received and in consultation with the Government of India, the Reserve bank has now finalized the guidelines on ownership and governance. The guidelines provide for higher levels of shareholding, *inter alia*, for ensuring restructuring and consolidation simultaneous with compliance of fit and proper criteria. The present policy of acknowledgement for acquisition / transfer of shares by FIIs will continue based upon the guidelines on acknowledgement of acquisition / transfer of shares issued on February 3, 2004 and RBI may seek certification from the concerned FII of all beneficial interest.

While implementing the above policies it will be ensured by RBI that the approach is consultative, processes are transparent and fair, and a non-disruptive path is followed.

Alpana Killawala
Chief General Manager

Press Release: 2004-05/910

Annexure to Roadmap for Presence of Foreign Banks in India

The guidelines for setting up of WOS by foreign banks and conversion of existing branches of foreign banks into WOS are given hereunder:

Eligibility of the parent bank

1. Foreign banks applying to the RBI for setting up a WOS in India must satisfy RBI that they are subject to adequate prudential supervision in their home country. In considering the standard of supervision exercised by the home country regulator, the RBI will have regard to the Basel standards.
2. The setting up of a wholly-owned banking subsidiary in India should have the approval of the home country regulator.
3. Other factors (but not limited to) that will be taken into account while considering the application are given below:
 - i. Economic and political relations between India and the country of incorporation of the foreign bank
 - ii. Financial soundness of the foreign bank
 - iii. Ownership pattern of the foreign bank
 - iv. International and home country ranking of the foreign bank
 - v. Rating of the foreign bank by international rating agencies
 - vi. International presence of the foreign bank

Capital

- 4 The minimum start-up capital requirement for a WOS would be Rs. 3 billion and the WOS shall be required to maintain a capital adequacy ratio of 10 per cent or as may be prescribed from time to time on a continuous basis, from the commencement of its operations.
- 5 The parent foreign bank will continue to hold 100 per cent equity in the Indian subsidiary for a minimum prescribed period of operation.

Corporate Governance

6. The composition of the Board of directors should meet the following requirements:
 - Not less than 50 per cent of the directors should be Indian nationals resident in India.
 - Not less than 50 per cent of the Directors should be non-executive directors

- A minimum of one-third of the directors should be totally independent of the management of the subsidiary in India, its parent or associates.
- The directors shall conform to the 'Fit and Proper' criteria as laid down in RBI's extant guidelines dated June 25, 2004.
- RBI's approval for the directors may be obtained as per the procedure adopted in the case of the erstwhile Local Advisory Boards of foreign bank branches.

7. Accounting, Prudential Norms and other requirements

- i. The WOS will be subject to the licensing requirements and conditions, broadly consistent with those for new private sector banks
- ii. The WOS will be treated on par with the existing branches of foreign banks for branch expansion. The Reserve Bank may also prescribe market access and national treatment limitation consistent with WTO as also other appropriate limitations to the operations of WOS, consistent with international practices and the country's requirements.
- iii. The banking subsidiary will be governed by the provisions of the Companies Act, 1956, Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, other relevant statutes and the directives, prudential regulations and other guidelines/instructions issued by RBI and other regulators from time to time.

8. Conversion of existing branches into a WOS

All the above requirements prescribed for setting up a WOS will be applicable to existing foreign bank branches converting into a WOS. **In addition** they would have to satisfy the following requirements.

Supervisory Comfort

Permission for conversion of existing branches of a foreign bank into a WOS will *inter alia* be guided by the manner in which the affairs of the branches of the bank are conducted, compliance with the statutory and other prudential requirements and the over all supervisory comfort of the Reserve Bank.

Capital Requirements

The minimum net worth of the WOS on conversion would not be less than Rs. 3 billion and the WOS will be required to maintain a minimum capital adequacy ratio of 10 per cent of the risk weighted assets or as may be prescribed from time to time on a continuous basis. While reckoning the minimum net worth the local available capital including remittable surplus retained in India, as assessed by the RBI, will qualify. Reserve Bank will cause an inspection/ audit to assess the financial position of the branches operating in

India and arrive at the aggregate net worth of the branches. RBI's assessment of the net worth will be final.

9. Acquisition of holding in select private sector banks

Foreign banks may apply to the Reserve Bank for making investment in private sector banks that are identified by RBI for restructuring. Reserve Bank will examine the application with regard to the eligibility criteria prescribed for foreign banks to set up a WOS vide paragraphs 1 to 4 above as well as their track record in restructuring banks.

While permitting foreign banks to acquire stake in the identified private sector banks, RBI may undertake enhanced due diligence on the major shareholders to determine their 'Fit and Proper' status. Reserve Bank may also prescribe additional conditions in this regard as may be considered appropriate.

10. Application procedure

Applications for setting up of wholly-owned banking subsidiaries by foreign banks including conversion of existing branches should be made to the Chief General Manager-in-Charge, Department of Banking Operations and Development, Reserve Bank of India, World Trade Centre, Cuffe Parade, Colaba, Mumbai 400 005. The prescribed application form will be placed on the RBI's web site.

February 28, 2005

Guidelines on Ownership and Governance in Private Sector Banks

Introduction

Banks are “special” as they not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also leverage such funds through credit creation. The banks are also important for smooth functioning of the payment system. In view of the above, legal prescriptions for ownership and governance of banks laid down in Banking Regulation Act, 1949 have been supplemented by regulatory prescriptions issued by RBI from time to time. The existing legal framework and significant current practices in particular cover the following aspects:

- (i) The composition of Board of Directors comprising members with demonstrable professional and other experience in specific sectors like agriculture, rural economy, co-operation, SSI, law, etc., approval of Reserve Bank of India for appointment of CEO as well as terms and conditions thereof, and powers for removal of managerial personnel, CEO and directors, etc. in the interest of depositors are governed by various sections of the B.R. Act, 1949.
 - (ii) Guidelines on corporate governance covering criteria for appointment of directors, role and responsibilities of directors and the Board, signing of declaration and undertaking by directors, etc., were issued by RBI on June 20, 2002 and June 25, 2004, based on the recommendations of Ganguly Committee and a review by the BFS.
 - (iii) Guidelines for acknowledgement of transfer/allotment of shares in private sector banks were issued in the interest of transparency by RBI on February 3, 2004.
 - (iv) Foreign investment in the banking sector is governed by Press Note dated March 5, 2004 issued by the Government of India, Ministry of Commerce and Industries.
 - (v) The earlier practice of RBI nominating directors on the Boards of all private sector banks has yielded place to such nomination in select private sector banks.
2. Against this background, it is considered necessary to lay down a comprehensive framework of policy in a transparent manner relating to ownership and governance in the Indian private sector banks as described below.
3. The broad principles underlying the framework of policy relating to ownership and governance of private sector banks would have to ensure that
- (i) The ultimate ownership and control of private sector banks is well diversified. While diversified ownership minimises the risk of misuse or imprudent use of leveraged funds, it is no substitute for effective regulation.

Further, the fit and proper criteria, on a continuing basis, has to be the over-riding consideration in the path of ensuring adequate investments, appropriate restructuring and consolidation in the banking sector. The pursuit of the goal of diversified ownership will take account of these basic objectives, in a systematic manner and the process will be spread over time as appropriate.

- (ii) Important Shareholders (i.e., shareholding of 5 per cent and above) are 'fit and proper', as laid down in the guidelines dated February 3, 2004 on acknowledgement for allotment and transfer of shares.
- (iii) The directors and the CEO who manage the affairs of the bank are 'fit and proper' as indicated in circular dated June 25, 2004 and observe sound corporate governance principles.
- (iv) Private sector banks have minimum capital/net worth for optimal operations and systemic stability.
- (v) The policy and the processes are transparent and fair.

4. Minimum capital

The capital requirement of existing private sector banks should be on par with the entry capital requirement for new private sector banks prescribed in RBI guidelines of January 3, 2001, which is initially Rs.200 crore, with a commitment to increase to Rs.300 crore within three years. In order to meet with this requirement, all banks in private sector should have a net worth of Rs.300 crore at all times. The banks which are yet to achieve the required level of net worth will have to submit a time-bound programme for capital augmentation to RBI. Where the net worth declines to a level below Rs.300 crore, it should be restored to Rs. 300 crore within a reasonable time.

5. Shareholding

- (i) The RBI guidelines on acknowledgement for acquisition or transfer of shares issued on February 3, 2004 will be applicable for any acquisition of shares of 5 per cent and above of the paid up capital of the private sector bank.
- (ii) In the interest of diversified ownership of banks, the objective will be to ensure that no single entity or group of related entities has shareholding or control, directly or indirectly, in any bank in excess of 10 per cent of the paid up capital of the private sector bank. Any higher level of acquisition will be with the prior approval of RBI and in accordance with the guidelines of February 3, 2004 for grant of acknowledgement for acquisition of shares.
- (iii) Where ownership is that of a corporate entity, the objective will be to ensure that no single individual/entity has ownership and control in excess of 10 per cent of that entity. Where the ownership is that of a financial entity the objective will be to ensure that it is a well established regulated

entity, widely held, publicly listed and enjoys good standing in the financial community.

- (iv) Banks (including foreign banks having branch presence in India)/FIs should not acquire any fresh stake in a bank's equity shares, if by such acquisition, the investing bank's/FI's holding exceeds 5 per cent of the investee bank's equity capital as indicated in RBI circular dated July 6, 2004.
- (v) As per existing policy, large industrial houses will be allowed to acquire, by way of strategic investment, shares not exceeding 10 per cent of the paid up capital of the bank subject to RBI's prior approval. Furthermore, such a limitation will also be considered if appropriate, in regard to important shareholders with other commercial affiliations.
- (vi) In case of restructuring of problem/weak banks or in the interest of consolidation in the banking sector, RBI may permit a higher level of shareholding, including by a bank.

6. Directors and Corporate Governance

- (i) The recommendations of the Ganguly Committee on corporate governance in banks have highlighted the role envisaged for the Board of Directors. The Board of Directors should ensure that the responsibilities of directors are well defined and the banks should arrange need-based training for the directors in this regard. While the respective entities should perform the roles envisaged for them, private sector banks will be required to ensure that the directors on their Boards representing specific sectors as provided under the B.R. Act, are indeed representatives of those sectors in a demonstrable fashion, they fulfil the criteria under corporate governance norms provided by the Ganguly Committee and they also fulfil the criteria applicable for determining 'fit and proper' status of Important Shareholders (i.e., shareholding of 5 per cent and above) as laid down in RBI Circular dated June 25, 2004.
- (ii) As a matter of desirable practice, not more than one member of a family or a close relative (as defined under Section 6 of the Companies Act, 1956) or an associate (partner, employee, director, etc.) should be on the Board of a bank.
- (iii) Guidelines have been provided in respect of 'Fit and Proper' criteria for directors of banks by RBI circular dated June 25, 2004 in accordance with the recommendations of the Ganguly Committee on Corporate Governance. For this purpose a declaration and undertaking is required to be obtained from the proposed / existing directors
- (iv) Being a Director, the CEO should satisfy the requirements of the 'fit and proper' criteria applicable for directors. In addition, RBI may apply any additional requirements for the Chairman and CEO. The banks will be

required to provide all information that may be required while making an application to RBI for approval of appointment of Chairman/CEO.

7. Foreign investment in private sector banks

In terms of the Government of India press note of March 5, 2004, the aggregate foreign investment in private banks from all sources (FDI, FII, NRI) cannot exceed 74 per cent. At all times, at least 26 per cent of the paid up capital of the private sector banks will have to be held by resident Indians.

7.1 Foreign Direct Investment (FDI) (other than by foreign banks or foreign bank group)

- (i) The policy already articulated in the February 3, 2004 guidelines for determining 'fit and proper' status of shareholding of 5 per cent and above will be equally applicable for FDI. Hence any FDI in private banks where shareholding reaches and exceeds 5 per cent either individually or as a group will have to comply with the criteria indicated in the aforesaid guidelines and get RBI acknowledgement for transfer of shares.
- (ii) To enable assessment of 'fit and proper' the information on ownership/beneficial ownership as well as other relevant aspects will be extensive.

7.2 Foreign Institutional Investors (FIIs)

- (i) Currently there is a limit of 10 per cent for individual FII investment with the aggregate limit for all FIIs restricted to 24 per cent which can be raised to 49 per cent with the approval of Board/General Body. This dispensation will continue.
- (ii) The present policy requires RBI's acknowledgement for acquisition/transfer of shares of 5 per cent and more of a private sector bank by FIIs based upon the policy guidelines on acknowledgement of acquisition/transfer of shares issued on February 3, 2004. For this purpose RBI may seek certification from the concerned FII of all beneficial interest.

7.3 Non-Resident Indians (NRIs)

Currently there is a limit of 5 per cent for individual NRI portfolio investment with the aggregate limit for all NRIs restricted to 10 per cent which can be raised to 24 per cent with the approval of Board/General Body. Further, the policy guidelines of February 3, 2004 on acknowledgement for acquisition/transfer will be applied.

8. Due diligence process

The process of due diligence in all cases of shareholders and directors as above, will involve reference to the relevant regulator, revenue authorities, investigation agencies and independent credit reference agencies as considered appropriate.

9. Transition arrangements

- (i) The current minimum capital requirements for entry of new banks is Rs.200 crore to be increased to Rs.300 crore within three years of commencement of business. A few private sector banks which have been in existence before these capital requirements were prescribed have less than Rs.200 crore net worth. In the interest of having sufficient minimum size for financial stability, all the existing private banks should also be able to fulfil the minimum net worth requirement of Rs.300 crore required for a new entry. Hence any bank with net worth below this level will be required to submit a time bound programme for capital augmentation to RBI for approval.
- (ii) Where any existing shareholding of any individual entity/group of entities is 5 per cent and above, due diligence outlined in the February 3, 2004 guidelines will be undertaken to ensure fulfilment of 'fit and proper' criteria.
- (iii) Where any existing shareholding by any individual entity/group of related entities is in excess of 10 per cent, the bank will be required to indicate a time table for reduction of holding to the permissible level. While considering such cases, RBI will also take into account the terms and conditions of the banking licences.
- (iv) Any bank having shareholding in excess of 5 per cent in any other bank in India will be required to indicate a time bound plan for reduction in such investments to the permissible limit. The parent of any foreign bank having presence in India, having shareholding directly or indirectly through any other entity in the banking group in excess of 5 per cent in any other bank in India will be similarly required to indicate a time bound plan for reduction of such holding to 5 per cent.
- (v) Banks will be required to undertake due diligence before appointment of directors and Chairman/CEO on the basis of criteria that will be separately indicated and provide all the necessary certifications/information to RBI.
- (vi) Banks having more than one member of a family, or close relatives or associates on the Board will be required to ensure compliance with these requirements at the time of considering any induction or renewal of terms of such directors.
- (vii) Action plans submitted by private sector banks outlining the milestones for compliance with the various requirements for ownership and governance will be examined by RBI for consideration and approval.

10. Continuous monitoring arrangements

- (i) Where RBI acknowledgement has already been obtained for transfer of shares of 5 per cent and above, it will be the bank's responsibility to ensure continuing compliance of the 'fit and proper' criteria and provide an annual certificate to the RBI of having undertaken such continuing due diligence.
- (ii) Similar continuing due diligence on compliance with the 'fit and proper' criteria for directors/CEO of the bank will have to be undertaken by the bank and certified to RBI annually.
- (iii) RBI may, when considered necessary, undertake independent verification of 'fit and proper' test conducted by banks through a process of due diligence as described in paragraph 8

11. On the basis of such continuous monitoring, RBI will consider appropriate measures to enforce compliance.

February 28, 2005

Annex 2

USA	Canada	Australia
<p>In order to accept or maintain domestic retail deposits of less than \$ 100,000 a foreign bank must establish an insured banking subsidiary. This requirement does not apply to a foreign bank branch that was engaged in insured deposit-taking activities on December 19, 1991.</p>	<p>To undertake the business of banking in Canada, a foreign bank must:</p> <ul style="list-style-type: none"> (i) Incorporate a bank subsidiary under the Bank Act; or (ii) Establish a bank branch under the Bank Act. <p>Full service bank branches and lending branches cannot be member institutions of the Canada Deposit Insurance Corporation.</p> <p>In order to establish a bank branch, a foreign bank must be authorised under the Bank Act and must be incorporated by or under the laws of another jurisdiction outside Canada (i.e., an authorised foreign bank).</p> <p>No one person (Canadian or foreign) may own more than 10 per cent of any class of shares of a Schedule I bank</p>	<p>Foreign banks satisfying prudential requirements and that are able to demonstrate their potential contribution to competition in Australia may conduct banking in Australia. Foreign banks may undertake banking operations in Australia through locally incorporated subsidiaries and/or an authorised branch. However, a branch may not accept "retail" deposits. A foreign bank wishing to deposits must seek authorisation as a locally incorporated subsidiary for that purpose. Foreign bank branches may accept deposits (and other funds) in any amount from incorporated entities, non-residents and their own employees. Deposits (and other funds) may only be accepted from other sources where the initial deposit (or other funds) is greater than \$A250,000. Deposit-taking outside of this is considered to be "retail" banking business.</p>