

Banking roadmap leads to a dark tunnel

WITHOUT CONTEMPT

Somasekhar Sundaresan / New Delhi March 14, 2005

In his Budget speech last fortnight, the finance minister heralded a new "roadmap" for banking to be announced by the RBI. The same evening, the RBI published its roadmap.

Together, they had raised a lot of expectations of a visionary policy framework. But a closer read of the two-page document makes it appear less like a roadmap and more like the design of one long heavily guarded tunnel.

More than a year ago, the government had announced to the world that foreign ownership of banks in India could go up to 74 per cent regardless of whether the investment was in the form of financial investment by foreign institutional investors (FIIs) or foreign direct investment (FDI).

The same model was also being proposed for all sectors across industries. However, the roadmap has set the clock back, at first blush by four years, and on detailed scrutiny, by a few decades.

In a nutshell, the roadmap provides for a control raj for the RBI in the banking sector "with a lot of jargon. The stated purpose of the roadmap is that the RBI would enable a "consolidation of the domestic banking system", but would adopt a "gradualist approach" that would provide for "enhancement of foreign presence" in a "synchronised manner".

The RBI has simply stated that until March 2009, in order to enable Indian banks to prepare themselves for global competition, it does not intend to permit free corporate activity in the banking sector. Every material corporate move would require permission of the RBI.

Any acquisition of shares of 5 per cent or more in any private sector bank would be allowed only in banks that the RBI identifies as candidates for restructuring, and such acquisition too would require the permission of the RBI before the shares are acquired.

One wonders how the RBI intends to notify that certain banks are due for restructuring, without setting off panic among the bank's depositors.

Of course, foreign banks entering India for the first time may set up shop afresh. This is proposed to be permitted in the form of new branches or new wholly-owned subsidiaries (in direct conflict with the government's policy of 74 per cent cap on foreign holding) or conversion of existing branches into a wholly owned subsidiary. The RBI may prescribe the time-frame for which such subsidiaries ought to be wholly owned.

Clearly, the gradualist approach of the RBI speaks of consolidation through merger and acquisitions only in the second phase, that is after April 2009.

The RBI has said it would propose a law to remove the current cap on voting rights in banks at 10 per cent, but such a law would also provide regulatory approvals that would be required from the RBI.

At the core of the new policy is the RBI's emphasis that "banks are special". On this basis, the RBI has reiterated all the guidelines that are currently in place for regulating this sector.

These include the impractical guidelines for acknowledgement (read "prior approval") of transfer or allotment of shares in private sector banks resulting in 5 per cent of more being acquired.

The guidelines require aggregation of direct and indirect holding across affiliates and "associated enterprises" (a term adopted from the transfer pricing provisions in the Income-tax laws).

Should one have to comply with these guidelines, every financial institution has to break up their existing Chinese Walls (often created for sound reasons of propriety, confidentiality, prudence, and regulatory compliance) to ensure that the aggregate purchases of all associated enterprises together does not exceed 5 per cent.

For instance, every time a fund manager of a mutual fund promoted by ICICI wants to purchase any banking stock, he has to know the extent of holding in the same stock held by ICICI itself, its broking subsidiary, investment banking subsidiary, insurance joint venture, and other such companies.

If the fund manager has to ensure he is not breaching the RBI's guidelines, either the Chinese Walls across these institutions have to be broken giving him access to the books of all companies in the group, or he ought to play safe and not trade in banking stocks at all. From all counts, it appears that it is the latter that the RBI has in mind.

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