Corporates Houses & Banking

Why in News

Recently, the **Reserve Bank of India (RBI)** has put on hold the recommendations from its **Internal Working Committee** (IWG), that said large corporate and industrial houses may be allowed to promote banks after amendments to the **Banking Regulations Act, 1949.**

- The RBI has **accepted 21 out of 33 recommendations of the IWG** on ownership of private banks, but kept silent on giving banking licence to big business groups.

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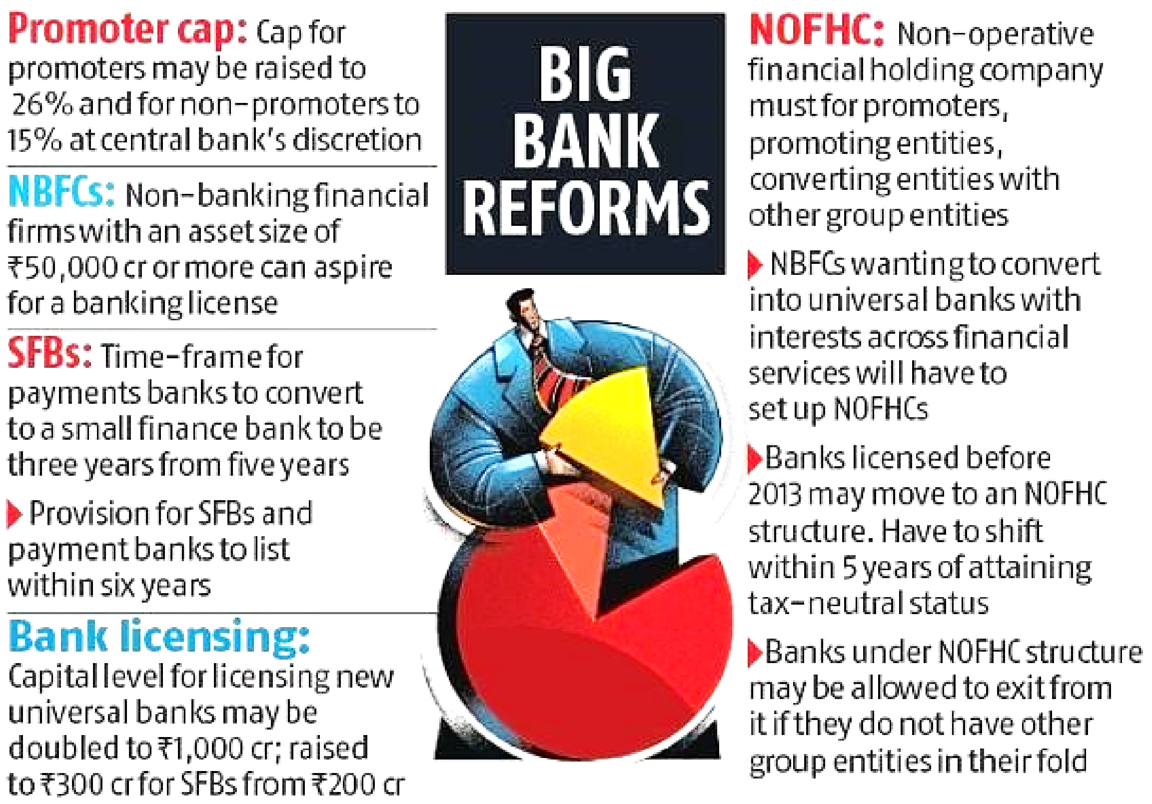

Key Points

- **About:**
    - Corporate Houses (CH) were active in the banking sector till five decades ago when the banks **promoted by them were nationalised in the late sixties** amid allegations of connected lending and misuse of depositors' money.
    - The Banking sector was opened up again for the **CHs Post Liberalisation (1991)** with the first round of licensing of private banks **that was done in 1993.**
    - Since then, there were two more rounds of licensing of banks in the private **sector – in**

2003-04 and 2013-14 – culminating with the on-tap licensing regime of universal banks in 2016.

        - However, even some prominent business houses were not considered in 2013-14.
- **Pros of Allowing Corporations To Own Bank:**
    - **Plugging Capital Gap:**
        - Currently, the government keeps picking money from the taxpayers pocket and funding the **public sector banks**.
        - Hence, by allowing the big corporates into the banking sector the capital requirement can be fulfilled.
    - **Financial Inclusion:**
        - Even today a significant population do not have access to banking in the country, the corporates' entry would mean the **opening of more branches and subsequently bringing more people into the banking net.**
    - **Improving Competition:**
        - Privatization of banks has been a long-proposed reform in the Indian banking industry. Allowing corporations into the banking sector **will further pressurize Public sector banks to become competitive.**
- **Concerns of Allowing Corporates To Own Bank:**
    - **Connected Lending & Moral Hazard:**
        - There are apprehensions that it would not be easy for supervisors to **prevent or detect self-dealing or connected lending** as banks could hide connected party or related party lending behind complex company structures and subsidiaries or through lending to suppliers of promoters and their group companies.
            - Connected lending **involves the controlling owner of a bank giving loans to himself or his related parties** and group companies at favourable terms and conditions.
        - Big business groups already account for a major chunk of **Non-Performing Assets (NPAs)** in the banking system even without becoming promoters of a bank.
        - In ethical terms, this will **erode the bank's role as an effective financial and create a moral hazard** or conflict of interest situation.
    - **Circular Lending & Difficulty In Regulation:**
        - Under circular lending, corporate bank X funding projects of an industry group, which owns corporate bank Y, and corporate bank Y funding projects of an industry group owning bank Z, and finally, corporate bank Z funding projects of industry group owning bank X.
        - With available legal structures and the proliferation of **shell companies**, makes it hard to track such lending on a real-time basis.
    - **Inequality & Concentration of Wealth:**
        - Corporations owning banks will add more muscle to big industry groups, **which already dominate many important sectors** of the economy, including telecom, organised retail, aviation, software and e-commerce.
        - This will further **accelerate the concentration of wealth** and **increase inequalities.**
    - **Contradicting the Previous Ruling:**
        - The banking sector in India has been in trouble for the last few years, keeping that in mind **the RBI in 2016 had created new guidelines** on the limit of lending to a single company.
        - The rationale behind this ruling was that if a bank lends too much to one company

    only then it risks losing that money if the company sinks.
    - Therefore, the recommendation of allowing the entry of industry groups in the banking sector is **in contradiction with the above-said ruling in 2016.**

Way Forward

- Before granting much economic power in the hands of corporations, it is imperative to carry out the **long-pending banking reforms and strengthen the functional autonomy of RBI.**
- The recent failures on internal and external controls like in the case of **PNB leading to an alarming fraud**, the **failures of bank and NBFCs** like **Lakshmi Vilas Bank**, **Yes Bank**, etc. where all stakeholders lost money and credibility have given rise to the need of new regulations with a very high degree of supervisory mechanism and corporate governance which has strong Information Technology (IT) and Artificial Intelligence **(AI)** enabled platform.
- Where a corporate house is a promoter, **strict regulations on the use of funds held with the bank and monitoring of related party transactions will be essential.**
- Fit and proper **criterion needs to be foolproof** and the common citizens should become the beneficiaries in the process.

Source: IE