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DANGEROUS SUGGESTION: THE HINDU EDITORIAL ON RBI SUGGESTION TO ALLOW CORPORATE HOUSES TO SET UP BANKS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

Most often, reports prepared by the RBI's internal working groups barely draw much attention beyond the relevant circles in the banking and financial services industries and rarely ever evoke protest. But the strong reactions to an internal panel's report on November 20, almost a full month since the group of central bank officials had submitted their recommendations on October 26, come as no surprise. The panel, which was tasked with reviewing ownership norms and corporate structure for private sector banks, has made worthwhile suggestions including ways to harmonise licensing norms for all banks including older legacy lenders and newer entrants. While the panel's appointment in June — at a time when the country was in the throes of coping with the severe economic fallout of the COVID-19 lockdown — got little attention, its suggestion that corporate or industrial houses be allowed to promote banks has triggered widespread concern. And among those with reservations are at least three former senior central bankers and a global credit rating agency. Most intriguing is that the panel, which consulted with experts ranging from former RBI officials to legal and finance professionals, clearly acknowledges that all but one of these outside experts were unequivocal in their opinion that given the prevailing far-from-ideal corporate governance culture, corporates ought to be barred from promoting banks.

The difficulty in ring-fencing "the non-financial activities of the promoters with that of the bank", was flagged by these experts as the central concern, a fear that was echoed by S&P Global Ratings too. Former RBI Governor Raghuram Rajan and former Deputy Governor Viral Acharya — who was appointed by the Modi government after Mr. Rajan had left the central bank — in a joint article on LinkedIn have termed the proposal a 'bad idea' and questioned its rationale. Acknowledging the RBI group's caveats including its assertion that corporates only be allowed as promoters after "necessary amendments to the Banking Regulation Act, 1949" are enacted to safeguard against connected lending, the two economists have, however, pointed to the bailouts of Yes Bank and Lakshmi Vilas Bank as examples of the heightened risk posed by any move to loosen bank licensing norms. For all its regulatory powers and supervisory capabilities, the RBI failed to spot the build-up of troubled exposures at Yes Bank in time. The dangers posed to overall financial stability by letting industrial houses have access to relatively inexpensive capital in the form of household savings through banks, howsoever legally regulated, are far too great to risk at the altar of liberalisation of ownership norms. The RBI's decision makers need to reject this suggestion outright and place it where it belongs — the shelf.

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