

THIRTEENTH LOK SABHA

MINISTRY OF FINANCE
(DEPARTMENT OF ECONOMIC AFFAIRS)

THE BANKING REGULATION (AMENDMENT) BILL, 2003

FORTY SEVENTH REPORT



Presented to Lok Sabha on 19 August, 2003
Laid in Rajya Sabha on 19 August, 2003

LOK SABHA SECRETARIAT
NEW DELHI

August, 2003/Sravana, 1925 (Saka)

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COMPOSITION OF STANDING COMMITTEE ON FINANCE – 2003

Shri. N. Janardhana Reddy – Chairman

MEMBERS

LOK SABHA

2. Shri Omar Abdullah
3. Shri Raashid Alvi
4. Shri Sudip Bandyopadhyay
5. Shri Surender Singh Barwala
6. Shri Ramesh Chennithala
7. Smt. Renuka Chowdhury
8. Dr. Daggubati Ramanaidu
9. Shri Kamal Nath
10. Shri Trilochan Kanungo
11. Shri Rattan Lal Kataria
12. Dr. C. Krishnan
13. Shri M.V.V.S. Murthi
14. Shri Sudarsana E.M. Natchiappan
15. Capt. Jai Narain Prasad Nishad
16. Shri Rupchand Pal
17. Shri Prabodh Panda
18. Shri Prakash Paranjpe
19. Shri Raj Narain Passi
20. Shri Sharad Pawar
21. Shri Pravin Rashtrapal
22. Shri Ramsinh Rathwa
23. Shri Chada Suresh Reddy
24. Shri S. Jaipal Reddy
25. Shri Jyotiraditya Madhavrao Scindia
26. Shri T.M. Selvaganapathi
27. Shri Lakshman Seth
28. Shri Kirit Somaiya
29. Shri Kharabela Swain
30. Shri P.D. Elangovan **

RAJYA SABHA

31. Dr. Manmohan Singh
32. Dr. T. Subbarami Reddy
33. Shri Murli Deora
34. Shri Prithviraj Chavan
35. Shri S.S. Ahluwalia
36. Shri Swaraj Kaushal *
37. Shri M. Rajasekara Murthy
38. Dr. Biplab Dasgupta
39. Shri P. Prabhakar Reddy
40. Shri Amar Singh
41. Shri Prem Chand Gupta
42. Shri Palden Tsering Gyamtso
43. Shri Raj Kumar Dhoot
44. Shri Praful Patel
45. Shri Dinesh Trivedi

*Nominated to this Committee vice Sh. Mukhtar Abbas Naqvi w.e.f. 26.3.2003

** Nominated to this Committee w.e.f. 07.04.2003

SECRETARIAT

- | | | | |
|----|------------------------|---|----------------------|
| 1. | Shri P.D.T. Achary | - | Additional Secretary |
| 2. | Dr. (Smt.) P.K. Sandhu | - | Joint Secretary |
| 3. | Shri R.K. Jain | - | Deputy Secretary |
| 4. | Shri S.B. Arora | - | Under Secretary |

INTRODUCTION

I, the Chairman, Standing Committee on Finance having been authorised by the Committee to submit the Report on their behalf present this Forty-Seventh Report on the Banking Regulation (Amendment) Bill, 2003.

2. The Banking Regulation (Amendment) Bill, 2003 introduced in Lok Sabha on 21 April, 2003 was referred to the Committee on 02 May, 2003 for examination and report thereon, by the Hon'ble Speaker, Lok Sabha under Rule 331E of the Rules of Procedure and Conduct of Business in Lok Sabha.

3. The Committee sought the views and suggestions from (i) Indian Banks' Association, (ii) Oriental Bank of Commerce, (iii) Punjab National Bank, (iv) ICICI Bank Ltd., (v) HDFC Bank Ltd., (vi) Federation of Indian Chamber of Commerce and Industry (FICCI) and (vii) Confederation of Indian Industry (CII).

4. The Standing Committee on Finance at their sitting held on 28 July, 2003 heard the views of representatives of the (i) Oriental Bank of Commerce, (ii) Punjab National Bank, (iii) ICICI Bank Ltd., and (iv) HDFC Bank Ltd.

5. At their sitting held on 29 July, 2003 the Committee first took the oral evidence of the Ministry of Finance and Reserve Bank of India. The Committee then heard the views of the representatives of the (i) Indian Banks' Association (IBA), (ii) Federation of Indian Chamber of Commerce and Industry (FICCI) and (iii) Confederation of Indian Industry (CII).

6. The Committee considered and adopted the draft report at their sitting held on 13 August, 2003.

7. The Committee wish to express their thanks to the representatives of (i) Oriental Bank of Commerce, (ii) Punjab National Bank, (iii) ICICI Bank Ltd., (iv) HDFC Bank Ltd., (v) Indian Banks' Association, (vi) Federation of Indian Chamber of Commerce and Industry and (vii) Confederation of Indian Industry, (viii) Ministry of Finance and (ix) Reserve Bank of India for the co-operation extended in placing before them their considered views and perceptions on the subject and for furnishing written notes and information that the Committee had desired in connection with the examination of the Bill.

8. For facility of reference, recommendations/observations of the Committee have been printed in thick type.

**NEW DELHI;
18 August, 2003
27 Sravana, 1925 (Saka)**

**(N. JANARDHANA REDDY)
Chairman,
Standing Committee on Finance**

REPORT

Introductory

Prior to the enactment of Banking Regulation Act, 1949 which aims to consolidate the law relating to banking and to provide for the nature of transactions which can be carried on by banks in India, the provisions of law relating to banking companies formed a subsidiary portion of the general law applicable to companies and were contained in Part XA of the Indian Companies Act, 1913. These provisions, which were first introduced in 1936, and which have undergone two subsequent modifications, have proved inadequate and difficult to administer. Moreover, while the primary objective of company law is to safeguard the interests of the stock-holder, that of banking legislation should be the protection of the interests of the depositor. It has therefore been felt for some time that separate legislation was necessary for the regulation of banking in India.

2. The Banking Regulation (Amendment) Bill, 2003 seeks to remove sub-section (2) of Section 12 of Banking Regulation Act, 1949. This sub-section provides that no person holding shares in a banking company is entitled, in respect of any shares held by him, to exercise voting rights on poll in excess of ten percent of total voting rights of all the shareholders of the banking company.

3. Earlier the Select Committee on the Banking Companies Bill, 1946 considered it undesirable that the affairs of a banking company should be allowed to fall under the control of a small cable. Accordingly, it had suggested limiting the voting rights of any one shareholder to a certain percentage ($1/10^{\text{th}}$ or $1/20^{\text{th}}$) of the total voting powers. Otherwise, the small group of individuals could control activities of banking companies thereby facilitating the undertaking of unsafe and speculative business to the detriment of the interests of the depositors. However, this restriction on voting rights is confined to 'poll' only and not in case of voting by show of hands of members present at the meeting in which case each member has one vote only. In terms of para 56 of the schedule-I to the Companies Act, 1956, it had been provided that subject to any rights or restrictions for the time being attached to any class or classes of shares (a) on show of hands, every member present in person shall have one vote, and (b) on a poll, the voting right of members shall be as laid down in Section 87 i.e. in proportion to his share of the paid-up equity capital of the company. Further, in order to prevent circumvention of this prohibition by group shareholding, besides reducing the percentage of voting right from five per cent to one per cent in 1964 the sub section (3) was added at a later

stage, to discourage benami purchase of shares in a banking company and to compel the registration of such shares in the names of the real owners, however this may have no practical effect so long as the benamidar does not seek to repudiate the right of the real owner. Similarly, sub-section (4) was also incorporated to require Chairman, etc. to furnish to the Reserve Bank periodical returns giving particulars as to their shareholding in their banks directly or indirectly. In 1994 the voting right was raised to 10 per cent.

Scope of the Bill

4. It has been stated in the statement of objects and reasons of the Bill that with a view to encouraging foreign banks to set up their subsidiaries and attracting foreign investors, it has become necessary to remove the said restriction on voting rights of a person holding shares in a banking company. It is, therefore, proposed to omit sub-section (2) of section 12 of the Banking Regulation Act, 1949, to remove the said restriction on the voting rights of shareholders of a banking company.

5. During the oral evidence of the representatives of the Ministry of Finance and Reserve Bank of India, it was informed that in 1994 the limit for voting right was raised to 10 percent and now in 2003 it is proposed to remove this ceiling altogether. When they were asked about the reasons for the same, a representative of RBI stated as follows:-

“Prior to 1994, in 1993 as a part of the Financial Sector Reforms – when we were framing the guidelines for the entry of new Private Sector Banks – it was felt that this restriction on voting rights needs to be removed, and there was a move to do so. But, instead of relaxing it and removing it fully, the wiser counsels at that time relaxed it to 10 per cent. So, it was much stricter prior to 1994, and in 1994, instead of doing away with it, they took a half hearted measure and relaxed it to 10 percent. The Reserve Bank had even then desired that it should be removed because we have to send a signal to the outside world that Indian and the Indian Banking System is moving towards the best international practices. Nowhere in the world; no Central Bank has introduced this kind of voting right restrictions. We are the only one who have it. So, we would like to send this signal that India is moving forward towards the best international practices.

6. In this regard a representative of the Ministry of Finance had further clarified the Government’s stand as stated below:-

“Sir, in 1994 when this restriction of 10 per cent was imposed, it was still the beginning of the reform process and perhaps we did not feel confident enough to face competition from the foreign banks. So, we imposed this restriction to restrict their presence here. But, now 10 years down the line our banks have become strong enough, and I do not think

that now the problem exists because we are much stronger, and our banking system is much better. We are now in a position to face the competition.”

7. When it was asked how the removal of this sub-clause would attract foreign capital in public sector banks, private sector banks and foreign banks operating in India, the Ministry of Finance in their written reply stated as follows:

“The voting rights of shareholders of Public Sector Banks are governed by the relevant provisions of Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970, Banking Companies (Acquisition and Transfer of Undertakings) Act, 1980, State Bank of India Act 1955 and State Bank of India (Subsidiary Banks) Act, 1959. Therefore removal of the ceiling of 10% prescribed in BR Act shall not have any impact on Public Sector banks. This will also not have any impact on foreign banks operating in India through a branch presence.

However, in respect of private sector banks of Indian subsidiaries of foreign banks, when allowed, the foreign promoters/investors would be better inclined to invest higher amounts if they are allowed to exercise voting rights in accordance with the extent of their shareholding. To this extent, the proposed amendment can attract foreign capital.

8. On a query being made as to how much FDI Government expect by virtue of removal of this ceiling of 10% on voting rights, the Government in their post evidence reply stated:-

“Some banks operating as branches or having representative offices in India have been approaching RBI and Government and inquiring about removal of ceiling on voting rights. While it cannot be estimated at this stage as to how many out of them would actually set up subsidiaries, it is expected that removal of ceiling in voting rights will definitely encourage foreign direct investment in this sector. It may be mentioned that as a subsidiary foreign banks would be required to bring in capital of US\$ 60 million instead of \$ 10 million required for a branch.”

9. Asked whether removal of restriction of 10% voting right would be applicable to domestic private sector banks, the Government have informed as under:-

“The removal of restrictions on voting rights will apply to both foreign banks as well as domestic banks. This change was, however being made with a view to attract foreign direct investment in the banking sector and it was for this reason that emphasis was laid on this aspect in the SOR. However, once foreign direct investment is permitted upto 74 per cent, making a similar change for domestic banks is also contemplated in order to provide a level playing field between foreign investors and domestic investors.”

10. In regard to granting permission to foreign banks to set up subsidiaries in India and the benefits to be accrued to India therefrom, the Ministry of Finance in a written note submitted to the Committee had stated as under:-

“At present, as a matter of policy, foreign banks are allowed to operate in India only through branches. Union Finance Minister, in his budget speech 2002-03 announced that foreign banks would be given an option to either operate as branches of their parent banks or to set up subsidiaries. A foreign bank would have to choose only one of the two options. Such subsidiaries would have to adhere to all banking regulation, including priority sector lending norms, applicable to other domestic banks. Necessary amendments would be proposed in the Banking Regulation Act, 1949 to relax the maximum ceiling of voting rights of 10% for such subsidiaries. In the Union Budget of 2003-04, the Union Finance Minister announced that FDI in banking companies would be raised to at least 74% to facilitate setting up of subsidiaries by foreign banks. The foreign bank subsidiary might feel constrained with the present provision of Section 12(2) of the B.R. Act, 1949 which stipulates a maximum ceiling of voting right of 10%. This restriction would not enable the foreign bank to have effective control over the subsidiary, unless it is 100% owned. The problem could be overcome if the above provision of the B.R. Act, 1949 is amended. The Reserve Bank, therefore, recommended amendment to Section 12(2) of the B.R. Act, 1949 to remove the restriction.”

11. Supplementing their stand, the Secretary (Financial Sector), Ministry of Finance during the oral evidence stated as follows:-

“This sub-section 2 is proposed to be dropped so that the voting right ceiling goes. It would then become commensurate with the shareholding itself. As far as the foreign investors or for that matter any investor is concerned, he would not be really interested in setting up a subsidiary bank here unless he also has a certain measure of control. With the 10 per cent shareholding why should they invest here any extra amount of shares in their subsidiaries here? Therefore, we have found that the foreign banks in India so far, have only operated certain branches. They have not really set up subsidiary in the way that we expected they would set them up”

12. During the oral evidence of the representatives of the Ministry of Finance, when it was asked whether the scope of the Bill was limited to inviting foreign banks/foreign investors, the Secretary (Financial Sector) stated as under:-

“The Bill is only limited to deletion of certain proviso which limits the voting rights of any person having a shareholding from a ceiling of 10 per cent. That ceiling is applicable to anybody, whether he is a foreigner or an Indian”

13. In regard to the scope of the Bill, a representative of CII had expressed his opinion during their appearance before the Committee as follows:-

“This is a question that was raised whether the object of removing section 12 (2) is only meant to facilitate foreign investment. It is my belief that may be one of the objectives, but the removal of section 12 (2) is not meant only for foreign investment. If you read sub-section 2 of section 12, what it says very categorically is, ‘no person holding shares in a banking company shall in respect of any shares held by him, exercise voting rights

on poll in excess of 10 per cent of the total voting rights of all the shareholders of the banking company.’ Removing this will actually allow consolidation of a whole host of smaller Indian private sector banks What the Government has stated as the objective of the Bill is the right of the Government but if you actually look at 12(2), it is much wider than that.”

14. In reply to a related query whether removal of this cap would attract foreign capital only and the investor within the country would not come forward, the Ministry of Finance in its written note stated as follows:-

“Presently, in terms of Section 12 of the Banking Regulation Act, 1949, shareholders of a banking company are not allowed to exercise voting rights in excess of 10 per cent of the total voting rights of all the shareholders of the banking company. On account of this, foreign banks/institutions are reluctant to establish subsidiaries or to invest in private banking companies in India unless they can exercise voting rights proportionate to the share held by them in the said banking company. The same is also applicable to investors within the country. As per the extant norms, a large industrial house should not promote a new bank. However, individual companies, directly or indirectly connected with large industrial houses are permitted to participate in the equity of a new private sector bank up to a maximum of 10 per cent but will not have controlling interest in the bank. In order to create a level playing field, the restrictions on domestic investors will also be reconsidered when the bill is passed in law.”

15. Advocating for the removal of 10% restriction of voting rights, the Oriental Bank of Commerce in its written submission stated as under:-

1. In view of the increasing role of Corporate governance, the policies/decisions taken by the Bank have direct bearing on various constituents including depositors, lenders, customers, employees and share holders. The banks are under obligation to follow high disclosure standards and transparency of information to the investors. In order to enhance the shareholders’ value and give them more freedom, the amendments to remove the ten percent restriction of voting right may be introduced.
2. In the present scenario of liberalization and globalisation, the FIIs form a significant component of investors in the banking system. In order to attract this community which shall pave the way for infusion of more foreign capital as well as advancement of technology, the current restriction of voting right needs to be removed.
3. The proposed removal of ten per cent restriction will benefit the major stakeholders as they would have more say in the management of the Bank. The removal of the restriction will further enable the banks to raise more capital due to the reasons enumerated above and will result in enhancing the

Capital Adequacy ratio and ultimately strengthen the Banking System as a whole.

16. The Punjab National Bank welcoming the proposal, expressed its views as follows:-

1. Till date, the legal regime governing the voting rights in a Banking Company is different from framework of legal provisions relating to other Companies.
2. The proposed Amendment to remove the restriction on exercise of voting rights in excess of 10% of total voting rights, as provided in Section 12(2) of the Banking Regulation Act, 1949 is a welcome proposal. The provision, in its present shape, is a deterrent for investment in shares of private banks.
3. As per the Prudential norms prescribed by Reserve Bank of India, the capital adequacy ratio is to be maintained at a minimum of 9% on an ongoing basis. However, keeping in view the international standards, the New Basel Capital Accord as well as the requirement of capital for business growth, there is a need for improving the capital adequacy ratio & the capital base of the Banking system.
4. The increase of capital can take place either by fresh issue of capital or plough back of profits or subordinated debts. Owing to the limitations of plough back of profits and raising subordinated debts, issue of fresh capital is a necessity. The removal of restrictions as mentioned above would attract capital to the banking system from Indian & foreign investors.
5. As regards the possible concentration of the share holding/voting rights in a few persons/groups, the Takeover Regulations of SEBI provide enough checks.

17. ICICI Bank Ltd. and HDFC Bank Ltd. have also welcomed the Bill

18. The Indian Banks' Association summarized its views as under:-

The proposed amendment would lead to greater investment in private banking in the country. This would help to improve professionalism in management, risk-management practices and also accelerate the process of technology assimilation in banking operations in the country. Hence banking industry would welcome the proposed amendment.

19. The Federation of Indian Chamber of Commerce and Industry (FICCI) has listed a number of benefits that were likely to accrue with the removal of existing restriction of 10% voting rights which are summarised below:-

“FICCI is of the opinion that the Banking Regulation (Amendment) Bill, 2003 which aims at removing the existing restriction of 10% on voting

rights of a person holding shares in a banking company is a step in the right direction. The move is a progressive step towards the liberalization of the banking sector as it aims at aligning ownership with voting rights. Moreover, it would incentivize existing foreign banks operating through the branch structure to convert to a locally incorporated subsidiary and also explore listing more actively thus making the Indian Banking sector more attractive to foreign investors. The amendments will thus bring in greater competition in the banking sector, more investments, better and sophisticated technology and would push Indian Banks strive for global standards.”

20. During the oral evidence when it was asked whether the Government made any study regarding removal of 10 percent limitation on the voting rights, a representative of Reserve Bank of India replied as follows :-

“May I just submit that the only study which we have in support of removal of this restriction is the Narasimhan Committee Report, which has recommended this after much study”

21. The Committee on Banking Sector Reforms (Narasimham Committee II) in its report submitted in April 1998 had *inter-alia* made the following recommendations regarding voting rights and permission to foreign banks to set up subsidiaries in India :-

“The Committee would recommend there should be well defined criteria and a transparent mechanism for deciding the ability of promoters to professionally manage the banks and no category should be excluded on priority grounds. The question of a minimum threshold capital for old private banks also deserves attention and mergers could be one of the options available for reaching the required capital thresholds. The Committee would also, in this connection suggest that as long as it is laid down (as now) that any particular promoter group cannot hold more than 40% of the equity of a bank, any further restriction on voting rights by limiting it to 10% may be done away.”

“Foreign banks are allowed to operate only as branches. Government also allows foreign banks/finance companies to invest upto 20% in a private sector bank as technical partner/collaborator. The Committee reiterates the view of the CFS that in addition foreign banks may be allowed to set up subsidiaries or joint ventures in India. Such subsidiaries or joint ventures should be treated on par with other private banks and be subject to the same conditions with regard to branches and directed credit as these banks. Only reputed foreign commercial banks with a well-diversified ownership pattern should be eligible to set up subsidiaries or majority owned subsidiaries.”

22. The Performance of Foreign Banks Branches in India for the year ended March, 2003 is given below:-

1. Business Size and Growth

- Asset size increased by 2.80% to Rs. 1,15,018 crore.
- Fifteen banks registered negative growth during the year.

- Total deposits increased by 8.74% to Rs. 70, 164 crore.
- SLR investments increased by 27.53% to Rs. 30, 978 crore.
- Non-SLR investments declined by 8.31% to Rs. 10,009 crore.
- Total gross advances went up by 7.73 to Rs. 54,419 crore.
- Twenty-one banks showed decline in gross advances.

2. Capital Adequacy

- Combined Capital to Risk-weighted Asset Ratio (CRAR) increased to 15.21%.
- Core CRAR of the group increased to 12.17%.
- All Foreign Banks complied with minimum CRAR requirements

3. Asset Quality

- Gross Non Performing Loans (NPL) ratio declined to 5.24%.
- New NPL ratio declined to 1.62%
- Net NPL ratio below 5% for 23 out of 36 banks.
- Substandard advances increased by 9.07% to Rs. 938 crore.

4. Profitability

- Profit after tax went up by 20.72% to Rs. 1,782 crore owing to decrease in interest expenses and staff expenses and lower provisions and taxes.
- Net interest income increased by 7.0%.
- Income from securities trading declined by 50.9% to Rs. 484 crore.
- Staff expenses declines by 7.09%
- Provisions including tax declined by 8.31%
- Ten banks incurred net losses during the year.
- Return on Assets (ROA) went up to 1.6%
- Efficiency (Cost-Income) ratio improved to 46.5%.
- Interest spread further increased to 3.5%

Large Foreign Banks- Share in Total Assets

Bank Name	Share in total Assets (%) 9As on 31 st March, 03)
Standard Chartered Bank	23.62

Citibank N.A.	21.92
Hongkong & Shanghai Banking Corp Ltd.	18.18
ABN AMRO Bank N.V.	9.09
All others (32 banks)	27.19
All Foreign Bank	100.00

23. In regard to the performance of foreign banks in India, a representative of Reserve Bank of India, stated as follows during the oral evidence :-

“At present, I just want to share some figures relating to the branches of foreign banks. Their total assets in the banking system as a whole, as on 31st March, forms only 6.9 per cent of the entire banking system. This figure is so low. And we have a rule which says that if it exceeds 15 per cent, we can stop licensing. We are far far below that percentage. How much do the foreign banks control deposits? Now, even as branches, they are accepting deposits from the public. The deposits accepted by branches of foreign banks constitute only 5 per cent at present and foreign banks have been in existence since 1941.”

Subsidiaries vis-à-vis Branches of foreign banks

24. At present foreign banks are allowed to operate in India only through branches. The Ministry of Finance in a written note, informed the Committee that branches of foreign banks operating in India enjoy certain special facilities vis-a-vis other scheduled commercial banks operating in India. Two of these are of particular interest. First, the priority sector lending target for branches of foreign banks is 32 percent of the net bank credit as opposed to 40 per cent of the net bank credit for all other scheduled commercial banks. Furthermore, export credit granted by branches of foreign banks is considered as a part of priority sector lending but the same facility is not applicable for other scheduled commercial banks. Secondly, branches of foreign banks do not have any restriction in terms of place of location of their branches. All other scheduled commercial banks, however, need to locate at least 25 percent of their branches in the rural and semi-urban centers. Subsidiaries of foreign banks would not, however, enjoy these special treatments, which are extended to the branches of foreign banks.

25. The Ministry of Finance in their written note to the Committee have enumerated the following as the advantages of wholly owned subsidiaries:-

- (a) Wholly owned subsidiary is the outcome of host country regulatory requirement. It is incorporated locally and is subject to laws/regulations of the host country. Further expansion in the host

country is relatively easy from the view point of approvals and provision of capital.

- (b) Capital is funded by the parent bank. Profits are repatriable after payment of applicable withholding taxes.
- (c) Wholly owned subsidiary need not disclose the financial position of the parent bank. A subsidiary is a separate legal entity. As such, parent bank is not legally liable for the business done by a subsidiary.
- (d) Subsidiary is set up where future expansion is permitted only through a subsidiary,
- (e) A subsidiary is insulated from the effect of insolvency of the parent bank. Its assets cannot be attached if parent bank become insolvent. Subsidiary will be subject to liquidation/insolvency procedures of host country.
- (f) A subsidiary is subject to the control of Board of Directors located in the host country.

26. Indian Banks' Association have stated in their note submitted to the Committee which was also endorsed by the representatives of Oriental Bank of Commerce, Punjab National Bank, ICICI Bank Ltd. and HDFC Bank Ltd. that in their view establishment of subsidiaries by foreign banks could have the following beneficial effects:-

- a. Presently foreign banks have lower priority sector lending targets (32% inclusive of export credit as against 40% with export credit not being treated as priority sector for other private banks and public sector banks). The subsidiaries of foreign banks would however not be entitled to this concession.
- b. Capital adequacy requirements are limiting factors for growth in domestic credit. Higher capital inflow through this route could augment credit flow to various sectors.
- c. Foreign banks would be able to bring into the country their expertise in the area of risk management and other key functional areas. Banking industry would also benefit from the technology edge some of the global banks have.
- d. The change would increase competition in the field, which would improve efficiency and customer service.

27. In their post evidence reply on the setting up of subsidiaries in lieu of opening up of branches, the Government have stated as under:-

“This is an option. Both alternatives of branch route and subsidiary route would be available to foreign banks. Depending on their strategy and

objective and degree of presence required in India, some foreign banks may prefer to operate as branches and others may prefer the subsidiary route. Subsidiaries have more freedom in opening branches. On the other hand, subsidiaries will be required to meet higher priority sector obligations.”

28. The Ministry of Finance in a written reply on the likely impact of the proposed amendment on the public sector banks, has stated that the proposed amendment regarding voting rights in the BR Act was not likely to have any impact on Public Sector. In terms of the provisions under Section 3 (2 D) of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970/80 the overall statutory limits of Foreign Direct Investment and Portfolio investment was 20 percent. Though the SBI Act did not have a similar provision, the limit applicable to nationalized banks was extended to SBI also with a view to ensure level playing field among Public Sector banks on the basis of understanding with the Standing Committee on Finance in 1996.

29. In this regard Indian Banks’ Association has also stated that the proposed amendment would not have any impact on the working of Public Sector Banks. The Association has further stated that the voting rights of shareholders (other than government) in these entities were governed by the clauses in the respective legislations. For example - the voting rights of a shareholder in State Bank of India was limited to 10%. In Nationalised banks and Associate banks of SBI the cap was fixed at 1%. The proposed amendment would not therefore impact the capital structure or working of public sector banks.

30. When it was asked whether this Bill is applicable to public sector banks, the Secretary (Financial Sector), Ministry of Finance replied as under:-

“The Government has very carefully considered this aspect and taken a view that this is not the appropriate time for opening up the entire sector. Let us open the private sector first and then, after learning some experience, the Government could take another view later on. It is also to keep in view what is the general opinion. In this hon. House also there are various shades of opinion. If there is so much concern about investment even in the private sector, you can imagine the magnitude of concern that will arise in relation to the public sector banks.”

31. In regard to competition of foreign banks with the public sector banks, the Chairman, IBA has stated as below during his oral evidence before the Committee:-

“As far as the competition of foreign banks with the existing banks are concerned, foreign banks are functioning in the country even today. A number of foreign banks are there, may be with the limited branches. So, their coming and opening some subsidiaries and all that, I think, the Indian banking system is capable of having a competition. There is no problem even today because for so many years of their existence, still today the

public sector banks are doing more than 85 per cent of the business as far as banking is concerned. And may be because of our spread, may be because of our total working, may be because of our domestic retail, etc. they may be doing a larger volume of business, etc. But we are still the largest percentage in terms of all that. So, I personally do not feel that any competition can deter us, rather we can be more competitive. If better technology is brought in, you can be more wiser so that we will be compelled to improve our technology which will give a better customer service, and the customers will be having a better service available to them.”

Checks and Balances

32. In regard to possible implications of the Bill on the Banking Sector, when it was asked whether removal of this sub-clause would open a Pandora Box for the unscrupulous investors who can misuse the provisions of the Bill for their narrow interests, the Ministry of Finance stated in their written reply that although it was proposed to remove the cap on the voting rights in respect of the shares held by any person in any banking company, the regulatory and supervisory provision as contained in the Banking Regulation Act, 1949 would take care of the concern expressed by the Standing Committee on Finance. The subsidiary floated by a foreign banking company would be a banking company incorporated in India and like any Indian banking company, would be governed by the Banking Regulation Act, 1949.

33. In regard to the kind of regulatory control that RBI would be able to exercise on subsidiaries of foreign banks, the Secretary (Financial Sector), Ministry of Finance stated as follows during the oral evidence:-

“This is covered under Section 10(A), Section 10(B)(6), Section 20(A), Section 21, Section 35(A), Section 36, Section 35(1), Section 27 and many others (of Banking Regulation Act, 1949). If this is not considered efficient, we can amend this further. But they will be subject to the same law as the Indian banks are. If the Indian banks are responsible for any mischief, they can be held responsible under the same law. If the foreign subsidiaries do certain mischief, they would also be responsible under the same law. As of today the situation is different. They are only branches of foreign banks. Therefore, what the Reserve Bank of India can look at is the mechanism of the regulatory agency of the original country in the country which is exporting the investment, and whether the regulatory mechanism is adequate and satisfactory or not. That is what they can look at. After this change occurs, we will be able to subject them to our own regulatory control. If it is imposed, I think, it is really a greater degree of discipline on foreign investors.

34. In regard to a query on the mutual responsibility and the relationship between the parent foreign bank and its subsidiary in India, a representative of Reserve Bank of India had stated during their oral evidence as below :-

“If a subsidiary is permitted to be set up in India, we, as the Central Bank, would feel that there is a greater degree of prudential supervision over the subsidiary than over a branch of a foreign bank in India. That is because the host country regulator will, under the system of consolidated supervision, also see the books of the subsidiary. So, to that extent, we have a greater degree of comfort about the running of a foreign subsidiary rather than running of the foreign banks’ branches in India.”

35. When it was asked whether a parent foreign bank will be legally liable for the business done by a subsidiary, a representative of RBI replied as follows during the oral evidence:-

“So far as the subsidiaries of foreign banks are concerned, not only they will be subject to Indian laws, but also the provisions under the Banking Regulation Act, and the provisions of the Companies Act will be equally applicable. Under the Basel Convention, the consolidated supervision of accounts will be increasingly done by the Central Bank in India. When the accounts are prepared, the accounts of not only the subsidiaries but also of the holding company are seen.”

36. In regard to a query whether the parent foreign banks are legally liable for any fault or any irregularity committed by the subsidiary, a representative of ICICI Bank Ltd. replied as follows during their oral evidence as follows:-

“As a matter of law, the parent banks will not be responsible for any fault or irregularity committed by a subsidiary. However, at the time of giving approval for acquisition up to 74%, the regulator can ask the parent bank to commit the necessary capital so as to ensure that the Indian banking operation, if at all it needs, gets more capital. This is an experience that we have been having. When we go for overseas branches, they ask for such a commitment from our side, that is, the parent organization, that we would bring it in. I might just complement what Mr. Kohli said on level playing field between foreign banks and all other banks, private or public sector banks. It is because the regulatory requirement for private and public banks is identical for priority sector lending and for rural branches. It is slightly different for foreign banks. “

37. In regard to RBI control over the transfer of shares, the Ministry of Finance informed the Committee that as per the extant instructions, banks are required to obtain prior acknowledgement from Reserve Bank of India before effecting transfer of shares when the transfer makes the shareholding of the individual/group equivalent to five per cent or more of the total paid up capital of the bank. It is, now, proposed to place this

arrangement in the Act itself based on the Sections 108 A to 108 H of the Companies Act, 1956.

38. The Ministry of Finance in their post evidence replies have stated that the above instructions serves the following purposes:-

- (i) This will put the banks on guard against attempts by individuals/groups who acquire a controlling interest in the bank by manipulating acquisition of shares and consequential adverse influence on the functioning of the bank.
- (ii) Before acknowledging of the transfer of shares RBI ensures that
 - a) Individuals or group of individuals do not corner shares of bank through back door. Besides, there should be no destabilizing effect on the working of the bank.
 - b) the transfer of shares must be within the framework of banking policy
 - c) the persons/companies acquiring the shares must be 'fit' and proper'
 - d) the transfer must be in public interest.

39. The Committee, after having examined the provision of the Bill and after having considered the material placed and evidence tendered before them by the Government, Public Sector and Private Sector Banks etc. are convinced of the objects and reasons of the Bill. They are of the view that this Bill will not only provide for setting up of subsidiaries of foreign banks but it will also pave the way for consolidation process in Indian Private Banks. They feel that once this sub-section (2) of section 12 of the Banking Regulation Act, 1949 goes, the opportunities will be available to all investors and the investment will not remain confined to foreign banks only. They are constrained to observe that this vital information should have been mentioned in the Statement of Objects and Reasons of the Bill. They want the government to make suitable amendments in this regard.

40. The Committee, however, feel that removal of restriction on voting rights is a step in the right direction and it will facilitate the inflow of foreign capital and expertise etc. in the country's banking sector. They further want that the regulatory mechanism should be made foolproof and strong enough so that any unscrupulous investor (foreign or Indian) does not misuse the provisions. In this regard the Committee have noted the existing instructions according to which banks are required to obtain prior acknowledgement from Reserve Bank of India before effecting transfer of shares when the transfer makes the shareholding of the individual/group equivalent to 5% or more of the paid up capital of the bank. The Committee expect that Reserve Bank of India will ensure strict compliance of these instructions.

41. With these suggestions, the Committee approve the Bill for enactment.

NEW DELHI;
18 August, 2003
27 Sravana, 1925(Saka)

N. JANARDHANA REDDY
Chairman,
Standing Committee on Finance

MINUTES OF THE FOURTEENTH SITTING OF STANDING COMMITTEE ON FINANCE

The Committee sat on Monday, 28 July, 2003 from 1500 to 1620 hours.

PRESENT

Shri. N. Janardhana Reddy – Chairman

MEMBERS

LOK SABHA

2. Dr. Daggubati Ramanaidu
3. Shri Rattan Lal Kataria
4. Dr. C. Krishnan
5. Shri Sudarsana E.M. Natchiappan
6. Shri Rupchand Pal
7. Shri Prabodh Panda
8. Shri Chada Suresh Reddy
9. Shri Kharbela Swain

RAJYA SABHA

10. Dr. T. Subbarami Reddy
11. Shri Murli Deora
12. Shri S.S. Ahluwalia
13. Shri Swaraj Kaushal
14. Shri Palden Tsering Gyamtso
15. Shri Raj Kumar Dhoot

SECRETARIAT

- | | | |
|---------------------------|---|----------------------|
| 1. Shri P.D.T. Achary | - | Additional Secretary |
| 2. Dr. (Smt.) P.K. Sandhu | - | Joint Secretary |
| 3. Shri R.K. Jain | - | Deputy Secretary |
| 4. Shri S.B. Arora | - | Under Secretary |

WITNESSES

ORIENTAL BANK OF COMMERCE

1. Shri B.D. Narang, Chairman & Managing Director
2. Shri Rajiv Madhok, General Manager

PUNJAB NATIONAL BANK

1. Shri S.S. Kohli, Chairman & Managing Director
2. Shri S. Vishvanathan, Asstt. Manager (Law)

ICICI BANK

1. Shri K.V. Kamath, Managing Director
2. Ms. Kalpana Morparia, Executive Director

HDFC BANK

Shri Paresh Sukdhankar, Head - Marketing & Risk

2. At the outset, the Chairman welcomed the representatives of the Oriental Bank of Commerce (OBC), Punjab National Bank (PNB), ICICI Bank Ltd. and HDFC Bank Ltd. to the sitting of the Committee and invited their attention to Direction 55 of the Directions by the Speaker, Lok Sabha.

3. The Committee, then took oral evidence of the representatives of above mentioned banks and heard their views on the provisions of the Banking Regulation (Amendment) Bill, 2003.

4. Thereafter, the Members raised queries which were replied to by the witnesses.

5. The evidence was concluded.

6. A verbatim record of proceedings has been kept.

The witnesses then withdrew.

The Committee then adjourned.

MINUTES OF THE FIFTEENTH SITTING OF STANDING COMMITTEE ON FINANCE

**The Committee sat on Tuesday, 29 July, 2003 from 1600 to 1715 hours and
1715 to 1750 hours.**

PRESENT

Shri. N. Janardhana Reddy – Chairman

MEMBERS

LOK SABHA

2. Dr. Daggubati Ramanaidu
3. Shri Trilochan Kanungo
4. Dr. C. Krishnan
5. Shri Sudarsana E.M. Natchiappan
6. Capt. Jai Narain Prasad Nishad
7. Shri Rupchand Pal
8. Shri Prabodh Panda
9. Shri Prakash Paranjpe
10. Shri Pravin Rashtupal
11. Shri Ramsinh Rathwa
12. Shri Lakshman Seth
13. Shri Kirit Somaiya
14. Shri Kharbela Swain

RAJYA SABHA

15. Shri Prithviraj D. Chavan
16. Shri Palden Tsering Gyamtso
17. Shri Raj Kumar Dhoot

SECRETARIAT

- | | | |
|---------------------------|---|------------------|
| 1. Dr. (Smt.) P.K. Sandhu | - | Joint Secretary |
| 2. Shri R.K. Jain | - | Deputy Secretary |
| 3. Shri S.B. Arora | - | Under Secretary |

WITNESSES

Part – I

Ministry of Finance (Deptt. of Eco. Affairs- Banking Division)

1. Shri N.S. Sisodia, Secretary (Financial Sector)
2. Shri Shekhar Agarwal, Joint Secretary (BO)
3. Shri Sudesh Kumar, Director

Reserve Bank of India

1. Smt. K.J. Udeshi, Deputy Governor
2. Shri M.R. Srinivasan, Chief General Manager
3. Shri S.C. Gupta, Legal Adviser
4. Shri K.N. Rupani, Deputy General Manager

Part - II

Indian Banks' Association (IBA)

1. Shri Dalbir Singh, Chairman, IBA
2. Shri H.N. Sinor, Chief Executive

Confederation of Indian Industry (CII)

1. Mr. Arun Bharat Ram, Past President, CII and Vice Chairman and Senior Managing Director, SRF Ltd.
2. Dr. Omkar Goswami, Chief Economist, CII
3. Ms. Bidisha Ganguly, Senior Economist, CII
4. Shri N.B. Mathur, Advisor, CII

Federation of Indian Chambers of Commerce and Industry (FICCI)

1. Shri Gopalkrishnan, Chief General Manager, State Bank of India
2. Shri C.P. Swarnkar, General Manager (Finance), Punjab National Bank
3. Shri Vivek Bharti, Advisor, FICCI
4. Shri Sachit Gupta, Research Associate, FICCI

Part I

At the outset, the Chairman welcomed the representatives of the Ministry of Finance (Department of Economic Affairs-Banking Division) and Reserve Bank of India to the sitting of the Committee and invited their attention to Direction 55 of the Directions by the Speaker, Lok Sabha.

2. The Committee then took the oral evidence of the representatives of the Ministry of Finance and Reserve Bank of India on the provisions of the Banking Regulation (Amendment) Bill, 2003.

3. Thereafter, the members raised queries which were replied to by the witnesses. The Committee directed the witnesses to send written replies to some of the queries for which replies were not readily available with them during the evidence.

4. The evidence was concluded.

5. A verbatim record of the proceedings has been kept.

The witnesses then withdrew.

Part II

2. At the outset, the Chairman welcomed the representatives of Indian Banks Association, Confederation of Indian Industry (CII), Federation of Indian Chambers of Commerce and Industry (FICCI) to the sitting of the Committee and invited their attention to Direction 55 of the Directions by the Speaker, Lok Sabha.

3. The Committee, then took oral evidence of the representatives of Indian Banks' Association, CII and FICCI and heard their views on the provisions of the Banking Regulation (Amendment) Bill, 2003.

4. Thereafter, the members raised queries which were replied to by the witnesses.

5. The evidence was concluded.

6. A verbatim record of the proceedings has been kept.

The witnesses then withdrew.

The Committee then adjourned

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MINUTES OF THE SEVENTEENTH SITTING OF STANDING
COMMITTEE ON FINANCE

The Committee sat on Wednesday, 13 August, 2003 from 1500 hrs.
to 1545 hrs.

PRESENT

Shri N. Janardhana Reddy—*Chairman*

MEMBERS

Lok Sabha

2. Dr. Daggubati Ramanaidu
3. Shri Rattan Lal Kataria
4. Dr. C. Krishnan
5. Shri Sudarsana E.M. Natchiappan
6. Capt. Jai Narain Prasad Nishad
7. Shri Prabodh Panda
8. Shri Raj Narain Passi
9. Shri T.M. Selvaganapathi
10. Shri Lakshman Seth
11. Shri Kirit Somaiya
12. Shri Kharabela Swain

Rajya Sabha

13. Shri Murli Deora
14. Shri Prithviraj D. Chavan
15. Shri Palden Tsering Gyamtso

SECRETARIAT

1. Dr. (Smt.) P.K. Sandhu — *Joint Secretary*
2. Shri R.K. Jain — *Deputy Secretary*
3. Shri S.B. Arora — *Under Secretary*

2. At the outset the Chairman, welcomed the Members to the sitting of the Committee and requested them to consider the draft Report on the Banking Regulation (Amendment) Bill, 2003.

3. The Committee thereafter took up for consideration the draft Report on the Banking Regulation (Amendment) Bill, 2003. In the meantime, a letter received from Shri Kirit Somaiya, MP and Member of the Committee, containing his suggestion on the Bill, was circulated to the Members for their consideration. After deliberation, the Committee accepted the suggestion to be added at the end of Para 40 in the following form:—

“In this regard the Committee have noted the existing instructions according to which banks are required to obtain prior acknowledgement from Reserve Bank of India before effecting transfer of shares when the transfer makes the shareholding of the individual/group equivalent to 5% or more of the paid up capital of the bank. The Committee expect that the RBI will ensure strict compliance of these instructions.”

4. The Committee then adopted the report without any other modification.

5. The Committee, thereafter, authorised the Chairman to finalise the report and present the same to the Parliament.

6. The Committee then decided to undertake a study tour to Mumbai and Goa during the first week of September, 2003.

The Committee then adjourned.

AS INTRODUCED IN LOK SABHA

21 April 2003

Bill No. 23 of 2003.

THE BANKING REGULATION (AMENDMENT) BILL, 2003

A

BILL

further to amend the Banking Regulation Act, 1949

BE it enacted by Parliament in the Fifty-fourth Year of the Republic of India as follows:—

Short title. 1. This Act may be called the Banking Regulation (Amendment) Act, 2003.

Amendment of section 12 of Act 10 of 1949. 2. In section 12 of the Banking Regulation Act, 1949 sub-section (2) shall be omitted.

STATEMENT OF OBJECTS AND REASONS

Under the existing provisions contained in sub-section (2) of section 12 of the Banking Regulation Act, 1949, no person holding shares in a banking company is entitled, in respect of any shares held by him, to exercise voting rights on poll in excess of ten per cent of total voting rights of all the shareholders of that banking company.

2. With a view to encouraging foreign banks to set up their subsidiaries and attracting foreign investors, it has become necessary to remove the said restriction on voting rights of a person holding shares in a banking company. It is, therefore, proposed to omit sub-section (2) of section 12 of the Banking Regulation Act, 1949, to remove the said restriction on the voting rights of shareholders of a banking company.

3. The Bill seeks to achieve the above object.

NEW DELHI;
The 2nd April, 2003.

JASWANT SINGH

ANNEXURE

EXTRACT FROM THE BANKING REGULATION ACT, 1949

(10 OF 1949)

	*	*	*	*	*
Regulation of paid-up capital subscribed capital and authorised capital and voting rights of shareholders.	12. (1) *	*	*	*	*
	(2) No person holding shares in a banking company shall in respect of any shares held by him, exercise voting rights on poll in excess of ten per cent of the total voting rights of all the shareholders of the banking company.				
	*	*	*	*	*

LOK SABHA

A
BILL
further to amend the Banking Regulation Act, 1949.

(Shri Jaswant Singh, Minister of Finance and Company Affairs)