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### **How will RBI select entities for new bank licence?**

The long wait for banking licences ended last week and now all eyes on how the Reserve Bank of India will select candidates for new banking licences. The market is rife with guesses. The stock market has been playing stocks up and down.

[26 candidates](#), comprising Non Banking Finance Companies (NBFCs), corporate house, government entities and broking companies have applied for banking licences. Most experts are pinning hopes on NBFCs and government entities with significant penetration in rural areas to win the banking licences.

CNBC-TV18's Latha Venkatesh in conversation with three independent experts R Jagannathan, the Editor Firstpost, Haseeb Drabu former chairman J&K Bank and former editor Business Standard and a columnist with Livemint, and B D Narang former chairman of Oriental Bank of Commerce and now director of many companies discusses these different categories of candidates that have applied for bank licence and who among them are most likely to achieve it.

While NBFCs were preferred by all three experts as it would be a natural evolution for them, Narang preferred government entities like India Post and LIC Housing Finance due to their extensive reach and inclusive work across India.

Drabu gave the least priority to corporate due to conflict of interest. "Big businesses should be kept out. There is always a conflict of business. Howsoever Chinese walls you create, they know how to break it and pierce through them," Narang commented.

***Below is the verbatim transcript of the discussion between these three experts.***

**Q: Let me start with you Haseeb Drabu, there are 26 candidates instead of asking you how they will be selected let me put the question on its head, on what grounds will you eliminate from this group of 26?**

**Drabu:** I don't know how they will do it, but I think the logical way for any process to operate is not to go by names, but to go by category. So, if you look at the 26 entities that have applied, there are five basic buckets of categories that have applied. The first one is corporates. There are four corporate, then there are NBFCs, 15 of them; then there are broking firms and government entities and others. So, you will have these five buckets within which the government has to take a view. Now corporate, there are two straight front-end corporate, but there are two others which are backed by corporate. Similarly, NBFCs, there are pure play NBFCs, then there are corporate-backed NBFCs and then there is government-backed NBFCs. So, you have three categories within NBFCs. Then you have broking firms of a certain kind and government department undertaking, which is like department of post. So, ideally one would want a mix of these candidates. Now what exact things they will look at would depend on let us say the lineage, the ownership and the business model. But prima facie, things would be based on categories and not so much on individual.

**Q: So what are you saying? Would you like one from each category to be selected or would you take only some categories and eliminate other categories altogether?**

**Drabu:** No, of course one should look at it in a much more granule and serious manner. The most important category for me is the NBFC pure play. It is in a financial services sector and making an NBFC into a bank is a natural process of evolution, of a firm from one stage of existence to the other. So, government, Reserve Bank of India (RBI) should help these firms get into a higher form of organisation as it were.

Second would be NBFCs with corporate banking. So, again I would prefer that, but one level lower than, so if I were to have a caste system of thinking, the highest, the Brahminical level really is the NBFC pure play. The second level is NBFC backed by corporates. Third I would look at government department undertaking and there is a specific reason for that. I would otherwise not want government because government does not need a license, government like they did in the Mahila Bank, can announce a bank on its own. But there are a specific reason, which is the inclusion programme and there is nothing more inclusive widespread as the department of post, so that should be done. Fourth would be the corporates and fifth in my hierarchy would be the broking firms. So, I would really stop at three, I would not look at corporates, I would not look at broking firms, I would look at NBFCs pure play, NBFCs corporate-backed and department of post.

**Q: Haseeb wants to eliminate categories like corporates and broking which he has placed lowest, if I were to ask you to eliminate from this 26, on what principles will you eliminate?**

**Jagannathan:** I think people who have no connection whatsoever of the business of taking money or lending money that means broking houses and also say real estate firms or people allied to that, those people should certainly be excluded.

And certainly if you have been involved in any kind of major scandalous activity or you have been in that kind of a thing, which will not meet 'the fit and proper' criteria, I think those people should automatically be eliminated.

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**Q: That brings me directly to a question which the RBI and the committee will face. We are living in days of right to information (RTI) and clearly all the reasons will have to be spelt upfront and at some point, even if the RBI were to hide initially behind a cloak of confidentiality, it could have to be brought out. At least in cases like coal licences and telecom spectrum, the bidder is eliminated on grounds of money. Here it has to be qualitative. So do you think the RBI or the committee will be able to tide through this? You have to call someone names and not call someone names and really everybody would have had a brush with the regulator of some kind at some point. Do you think the RBI will be able to tide through this?**

**Jagannathan:** I think so because, I think it is possible to take a call and say this is my judgement call today on this entity and this is why I have rejected it now. It doesn't mean that the person you have chosen will finally not turn out to be crook because that can happen in the process of becoming a bank and trying to be competitive and all kind of things. After all banks were nationalised because they were lending to each other and doing all kinds of things in 1969. They were all crooks which were once nationalised so there is no guarantee that some of them will not start doing circular lending and all kind of things but that's post facto. When you are taking a judgement call, as long as you document it, I think the RBI will be safe even if it makes a wrong choice.

**Q: According to you, what should be the principles of selection now? I am not asking you a negative question. I am asking you a positive question. How would you select positively? What would be your attribute?**

**Narang:** I think on your channel I have earlier, at least half a dozen times extrapolated my views. I am still of the firm view that big businesses should be kept out. There is always a conflict of business. Howsoever Chinese walls you create, they know how to break it and pierce through them.

**Q: Business here, there is Tata applying Tata Sons and Birla applying as Aditya Birla Nuvo which is really a conglomerate of which their non-bank financial company (NBFC) is a subsidiary and there are others like Bajaj Finance which is an NBFC itself backed by a corporate. There is value industry of the Videocon group; there is Smart Global which is a subsidiary of the BK Modi group, the Spice guys. Would you want all these guys eliminated, you only want pure play NBFCs or at least someone who has no relation to conglomerates?**

**Narang:** I will prefer NBFCs which are already in finance business in one way or the other. If a NBFC has insurance brokerage it is fine. If the NBFC has a factoring business it is fine. But I would prefer a NBFC to be in a pure NBFC play with no other business interest at all. That is what will be my preference number one.

Second is definitely, as Haseeb Drabu extrapolated the capacity for the inclusion. We earlier had 10 banks. Five of them have held. They just got interest in selling licences or selling a bank and moving on. They never even attempted and the others who are there have hardly been able to do anything like a financial inclusion. They are fulfilling their targets by just buying entries at the end of the closing year. So at the end of the day, my preference would have been that all these people are allowed to make an entry but they should come through the regional rural banks. After a particular stage, they should be allowed to come into the metropolitan areas so that they already have the infrastructure for financial inclusion. Now, from all these entities, I find some degree of financial inclusion is either done by Shriram or the India Post.

**Q: There are two microfinance institutions (MFIs) also.**

**Narang:** Now you have to go through their own track record and their own financial balance sheet because the balance sheet of each of them is virtually a doubtful entity. Most of them had operations in Andhra and they were totally wiped out. So I would like to go through the balance sheet very carefully before commenting upon that. So my preference would have been NBFCs who are in finance business and the group does not have any business other than that. These people have a track record of delivering because banks require a commitment of 8-10 years to flourish. You have seen in case of ICICI and in case of the HDFC, 10-15 years they have really delivered because they didn't have any diversion. They have focused and they have moved on and they became some of the best banks in the country. If we have about 8-10 such people, 5-6 of them can be granted. The second category or the last category that I will consider is NBFCs backed by strong professionals. If the NBFC has got no other business and has been by a strong professional, they have by and large delivered. They have made it a carrier for themselves. You have seen the case of the Kotak Mahindra, you have seen the case of Yes Bank, they have delivered, although not at the same level as Axis Bank or HDFC Bank or ICICI Bank but still much better than the rest of the category.

**Q: Who are your chosen licence winners of a banking licence?**

**Drabu:** I don't know how many but I would go with my own category. I would first give two Non-bank financial companies (NBFC) pure play – my bet would be with someone like Shriram Capital, I would probably go with [SREI infrastructure finance](#). Then I would move to NBFCs backed by corporate where I would certainly look at [L&T Finance](#) and [Bajaj Finserv](#).

Then I would certainly look at Department of Posts. So, I am giving five licences to these five set of people which include three categories – NBFCs pure play, NBFCs corporate and government.

**Q: What would your choice be? You had eliminated the corporate groups but I would still like to know whether you would consider Bajaj Finserv also out?**

**Narang:** My first preference will be Department of Posts. They have the largest reach as compared to anybody else in the country.

Second, I will say [LIC Housing Finance](#); they have done a tremendously good job.

Third, Infrastructure Development Finance Company ([IDFC](#)), they need CASA badly to bring a change in the country.

Fourth, Shriram Capital, fifth-SREI Infrastructure, sixth-L&T Finance and seventh Magma Finance.

**Q: Going by your own criterion of inclusion since you began your explanation or your arguments with that when I asked you about the selection criteria – you have got two micro finance institutions (MFIs) over here Bandhan Financial and Janalakshmi Financial from Bangalore. To the best of my knowledge they did not spoil their copybook when MFIs went through trying time two years ago. You don't want to include either of them or would you want it conditional on seeing their balance sheets?**

**Narang:** Number one, conditional on seeing their balance sheets. Number two, I have not been able to satisfy myself by the extent of their reach. They have been confined to too small areas and too chosen kind of a constituency to make an all India impact.

**Q: But [Karur Vysya Bank](#) has been doing a great job in a very small area as well we have seen perhaps some decent performances by other regional entities like may be [Karnataka Bank](#) or [Lakshmi Vilas Bank](#) which definitely has a higher reach than Karur. But aren't small regional banks also serving a purpose and perhaps serving a better purpose by going to tier-VI and tier-V areas, which the big national banks are not – that's not an argument for you?**

**Narang:** Both [Dhanlaxmi](#) and Lakshmi Vilas Bank need a serious revisit by Reserve Bank of India (RBI). I strongly think they are candidates for timely merger. I don't want to comment on other banks other than Karur Vysya.

Karur Vysya is a very healthy bank, but I feel sometimes RBI should act on time to save situation. Dhanlaxmi Bank and Lakshmi Vilas Bank are two such classic cases.

**Q: At the moment you have the last word. Whom would you choose and why?**

**Jagannathan:** As far as the NBFC category is concerned I would broadly go with what Haseeb mentioned, except for one thing. He mentioned India Posts on the criterion of inclusion. I think the ability to manage, just because you are there in several thousand villages does not make you eligible to become a bank. You can manage liabilities but a bank has to manage assets. India Posts has no such qualification and if it is a government owned bank, it can be as vulnerable to pressure as any corporate bank. I would not exclude corporates. Given that Tata's and Birla's largely have a good name, I would say that Tata Bank and a Birla Bank should be given licence. Certainly names like L&T Finance, Bajaj Finserv should be getting in. All the categories that Haseeb mentioned I agree with. So, it all depends on how many you want to give.

My guess is that if you are giving about 6 or 8 in the first round, you will probably give Tata and Birla the top two, three NBFCs and probably one or two semi-private public thing like IDFC which need to get out of very narrow infrastructure areas and widen their liability base so that they have a access to more resources. So, I would eliminate those complete categories of real estate fellows and brokerages and all, those make no sense whatsoever.

**Q: I also wanted to ask you among the NBFCs Shriram and SREI were chosen by both the other judges. Would you go with those two in terms of your NBFC or would your choice be different? Who would be your NBFCs? I want actual names? I don't want categories?**

**Jagannathan:** I am very clear that Shriram definitely qualifies, as far as the other categories, I would basically look at NBFCs backed by corporate houses because I think they would not have a problem with capital or managing that. So, I think Bajaj Finserv or for that matter Larsen and Toubro (L&T), these people should easily get it.

**Q: Does SREI come in your list?**

**Jagannathan:** No.

**Q: And then we have categories like Industrial Finance Corporation of India (IFCI) and Tourism Finance Corporation of India (TFCI), the government-backed entities, are they in your list?**

**Jagannathan:** No, they should never be in the list.

**Q: Alright, then I think now we have a fairly substantial number of names. Suppose you don't have a cap of 7 or 8, sometime back the Reserve Bank governor even said that quite a few licenses will be given, but not more than the number of existing private players already, that really leaves you open for all 26. So, suppose I weren't to give you a cap at all, would you want to include any more?**

**Jagannathan:** I would suspect about 12-14 can easily be given. It is only the very lesser known NBFCs on whom you don't have enough information and you have not done due diligence, those are the ones I would exclude and also the brokerage houses and people with strong real estate links and those kind of people where I think you have to be more careful.

**Q: How long do you think the process will take? When may the licence be given?**

**Jagannathan:** I think the governor mentioned that it can happen in three months, but he is going in two months, so I don't think it is happening during his term.

**Q: He said in the next three months RBI will finalise its recommendations and then appoint the committee, the committee has to make its recommendations, so that is still a distance away. I don't know if the coming of the elections will delay the process because that would amount to a policy give away or a policymaking. So what is your realistic timeframe? When are the lists of the licensees announced?**

**Jagannathan:** I think it will be announced only by the new governor, though the preliminary processes and the short-list will be ready by the time this governor goes.

**Q: I want the date from you, December 31, March 31?**

**Jagannathan:** I think by December certainly the first licenses will be given.

**Q: What is your likely date, by when the licenses will be given?**

**Narang:** I feel the list will be definitely out by December, maybe a little earlier than that.

Experts have given a fairly comprehensive list, but clearly all of them are entirely excluding brokerages. The common candidates chosen are L&T Finance and Shriram. But there is wide variation in terms of the attitude to corporate, 2:1, so two people have preferred that corporates be kept out, but Jagannathan prefers that corporate come in. Also, where two experts preferred department of post, one clearly opposed it. These lead us to conclusion that there is going to be a fair amount of contentious debate when that final list is made.