RBI rejects plan for 100% FDI in banks

The Reserve Bank of India (RBI) has turned down a proposal from the government to allow up to 100% foreign direct investment (FDI) in banks, a move that may come as a damper for several private sector lenders such as ICICI Bank and HDFC Bank.

Sources said the RBI has not provided a clear reason to turn down the proposal from the department of industrial policy and promotion (DIPP) that deals with FDI policy. But in the past the regulator has seen banking as a sensitive sector and opposed allowing significant shareholding by foreign institutional investors, who are seen as short-term investors and can enter or exit a stock for short durations, largely to book profits.

Private banks are particularly keen on a higher ceiling and investors are also hoping for a relaxation. In fact, HDFC Bank recently got permission for 74% foreign investment and was also found to be in breach of the norms for a short period.

A few years ago, in the draft norms for new banks, the RBI had suggested limiting FDI to 49%, against the 74% cap. The finance ministry, however, saw it as a retrograde step and got the regulator to stick to the prescribed ceiling. In fact, a few years before that, during UPAI's tenure, there had been a major battle between the finance ministry and the RBI on how the FDI norms should be applied, with North Block finally saying that setting the foreign investment rules was in its domain.

Currently, the government permits 74% FDI in private banks, with up to 49% allowed under the automatic route. Foreign holdings beyond 49% need to be cleared by the Foreign Investment Promotion Board (FIPB). Portfolio investment in the sector is capped at 49% and banking is one of the segments where the composite caps, which allow fungibility between FDI and FII flows, have not been applied as the government argued that it is a "sensitive sector".

The DIPP has moved the proposal to allow 100% FDI in the sector at a time when several new players are entering the market with the RBI offering payments and small bank licences. Easier rules for overseas investment were seen to have helped some of the new players.

In any case, there are sublimits on ownership by a group in a bank and even promoters are expected to cut their stake over a period of time to encourage wider public participation and reduce concentration of risk.

(Times of India)