RBI guidelines for setting up of Wholly Owned Subsidiaries by foreign banks in India

Opportunities and Challenges

November 2013

Executive Summary

- Foreign banks play an important role in the development of the Indian Banking industry with a market share of 6.5% of total banking assets in FY 13.
- In 2005, Foreign banks operating in India were allowed to convert their existing branches to Wholly Owned Subsidiaries (WOS) while following the 'one-mode presence' criterion and the WOS was to be treated at par with the existing branches of foreign banks for branch expansion in India. Even though RBI allowed the banks to operate either in Branch form or a WOS form, all the foreign banks are currently operating in India as Branch mode
- The framework for setting up of WOS has now been finalized by RBI which favors a subsidiary mode of presence from financial stability perspective. It provides incentives in the form of 'Near National Treatment' to WOS of foreign banks which will enable them to open branches anywhere in the country at par with Indian banks
- The framework has laid down certain parameters for which a WOS mode of presence may be mandated for banks established post Aug 2010. To provide safeguards against the possibility of the Indian banking system being dominated by foreign banks, the framework has certain measures to contain their expansion if the share of foreign banks exceeds a critical size. Certain measures from corporate governance perspective have also been built in so as to ensure that the public interest is safeguarded.
- The framework also allows WOSs to dilute their stake to 74 per cent or less in accordance with the existing FDI policy. The WOS may also be permitted to enter into M&A transactions with any private sector bank in India. For banks who wish to convert themselves from Branch mode to WOS mode, a well defined process has been laid out. This includes an amalgamation scheme that will have to be approved by the RBI. Given the attractiveness of the Indian market, foreign banks planning to enter in India will have to evaluate both the entry options and will have to submit a detailed business plan to RBI.
- Existing banks will also have to evaluate the benefits of conversion to WOS i.e. non-restrictive branch expansion, ability to raise rupee based non-equity capital, possibility of entering into M&A with private sector Indian banks etc., against the cost of complying with the Priority Sector Lending (PSL) requirements, corporate governance guidelines, etc. Foreign Banks will also need to consider how the proposed India structure fits within the regional and global corporate structure of its parent organization.
- The framework provides the Foreign Bank with an opportunity to refresh their India market plans in terms of capital and management commitments to size the growth opportunities in form of both organic as well as inorganic options.

Key Highlights of the framework (1/2)

Form of Presence	• Foreign banks which commenced banking business in India before August 2010 shall have the option to continue their banking business through the branch mode. However, they will be incentivized to convert into WOS because of the attractiveness of the near national treatment afforded to WOS. • Banks with complex structures, banks which do not provide adequate disclosure in their home jurisdiction, banks which are not widely held, banks from jurisdictions having legislation giving a preferential claim to depositors of home country in a winding up proceedings, etc., would be mandated entry into India only in the WOS mode. • Foreign banks in whose case the above conditions do not apply can opt for a branch or WOS form of presence. • A foreign bank opting for branch form of presence shall convert into a WOS as and when the above conditions become applicable to it or it becomes systemically important on account of its balance sheet size in India.
Capital	• The initial minimum paid-up voting equity capital for a WOS shall be Rs.5 billion for new entrants. Existing branches of foreign banks desiring to convert into WOS shall have a minimum net worth of Rs.5 billion. • The WOS shall meet the Basel III requirements on a continuous basis from the time of its entry / conversion5. WOS shall, however, maintain a minimum capital adequacy ratio, on a continuous basis for an initial period of 3 years from the commencement of its operations, at 10 per cent. • WOS of foreign banks may raise rupee resources through issue of non-equity capital instruments
Branch Expansion	• WOS would be permitted to open branches in Tier 1 to 6 centres (except at certain sensitive locations) without having the need to take prior permission from RBI. • The branch expansion guidelines as applicable to domestic scheduled commercial banks would generally be applicable to WOSs of foreign banks.
Corporate Governance	▪ The composition of the board of directors of WOS should meet the following requirements – not less than two-third of the directors should be non-executive directors; – a minimum of one-third of the directors should be independent of the management of the subsidiary in India, its parent or associates; – not less than fifty per cent of the directors should be Indian nationals /NRIs/PIOs subject to the condition that not less than 1/3rd of the directors are Indian nationals resident in India.

Key Highlights of the framework (2/2)

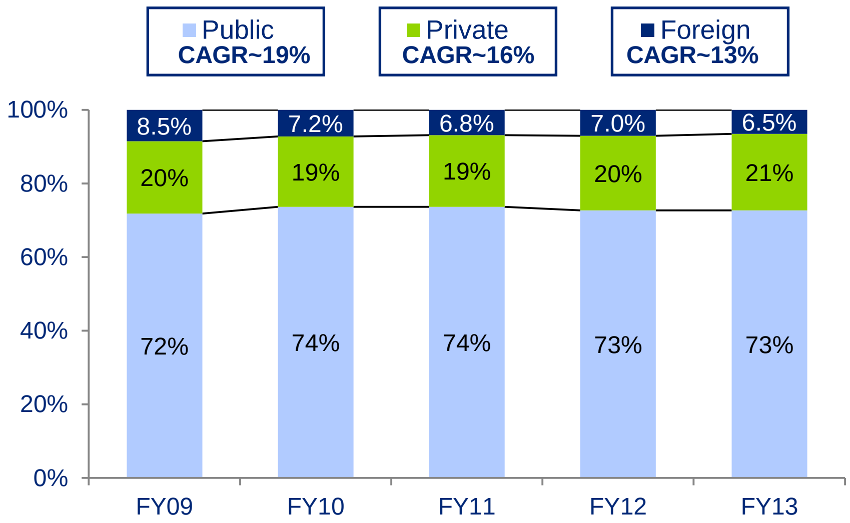
Investment in Subsidiaries and M&A Activity	• Investment by a WOS bank in a subsidiary company, financial services company, financial institution, stock and other exchanges and non-financial service companies should not exceed 10 per cent of the bank's paid-up share capital and reserves and the investments in all such companies, financial institutions, stock and other exchanges put together should not exceed 20 per cent of the bank's paid-up share capital and reserves. • WOSs may, at their option, dilute their stake to 74 per cent or less in accordance with the existing FDI policy. In the event of dilution, they will have to list themselves. • The issue of permitting WOS to enter into M&A transactions with any private sector bank in India subject to the overall investment limit of 74 per cent would be considered after a review is made with regard to the extent of penetration of foreign investment in Indian banks and functioning of foreign banks (branch mode and WOS).
Priority Sector Lending	• Priority Sector lending requirement would be 40 per cent for WOS like domestic scheduled commercial banks with adequate transition period for existing foreign bank branches converting into WOS.
Entry Restriction	• To prevent domination by foreign banks, restrictions would be placed on further entry of new WOSs of foreign banks/ capital infusion, when the capital and reserves of the WOSs and foreign bank branches in India exceed 20 per cent of the capital and reserves of the banking system.
Parental Support	• The parent of the WOS would be required to issue a letter of comfort to the RBI for meeting the liabilities of the WOS. • On arm's length basis, WOS would be permitted to use parental guarantee/ credit rating only for the purpose of providing custodial services in India and for their international operations. However, WOS should not provide counter guarantee to its parent for such support.

A comparison of the regulatory framework for New Private Sector Banks, Branch operations of Foreign Banks and WOS of Foreign Banks have been provided in Appendix to this Note

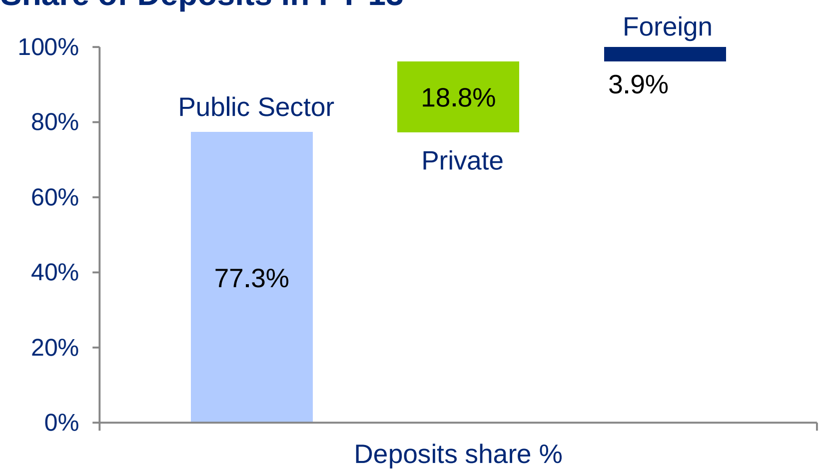
Existing Footprint of Foreign Banks in India

Foreign banks have to play a significant role in expanding coverage and increasing delivery efficiency for banking services in India

Composition Banking Assets %



Share of Deposits in FY 13



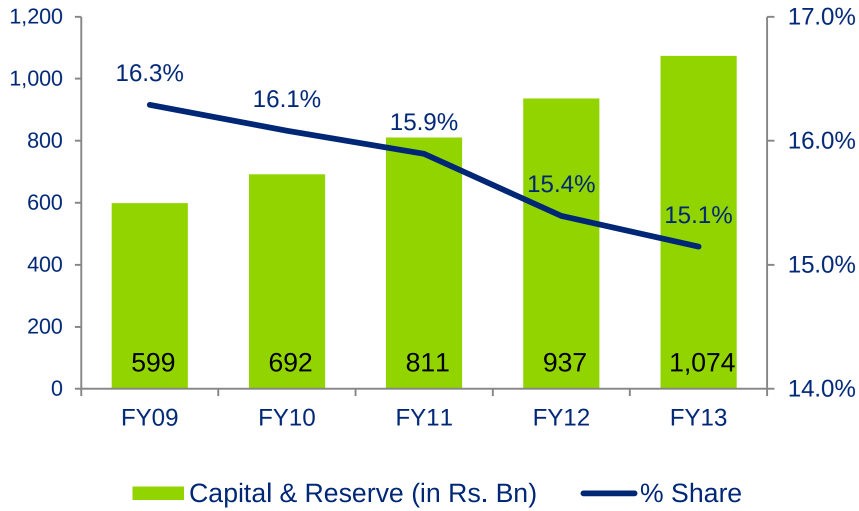
Observations

- Public sector banks have dominated Indian banking and accounted for 73% of the assets at the end of FY 13
- Foreign banks have witnessed a stable asset share though it decreased marginally from 7.0% in FY 12 to 6.5% in FY 13
- Though 44 foreign banks are currently operating in India, three banks i.e. Citibank, Standard Chartered and HSBC account for 60% of total business
- Foreign banks contributed around 3.9% of the aggregate deposits in FY 13
- However, Foreign banks face considerable regulatory restrictions on the expansion of branches as well as overall business
- Most of the Foreign Banks have sub-optimum branch network due to regulatory restriction and with Government’s thrust to increase penetration of banking services , Foreign banks have to play a significant role in expanding coverage and increasing delivery efficiency

Source: “Profile of Banks 2013”, RBI website, www.rbi.org.in, Indian Banks Association http://www.iba.org.in/glance.asp

Foreign banks have increased their capital base and enjoy healthy NIM

Capital and Reserves for Foreign Banks



- Foreign Banks enjoy the lowest cost of funds and have the highest spreads as compared to the other categories of banks
- The capital and reserves of foreign banks have grown at a CAGR of 16% between FY 09 and FY13
- However, the % of capital and reserve of foreign banks to total SCBs have declined to 15% by FY13

Cost of Funds and Returns on funds

		Public Sector Banks		Old Private Banks		New Private Banks		Foreign Banks		All Banks	
		FY 13	FY 12	FY 13	FY 12	FY 13	FY 12	FY 13	FY 12	FY 13	FY 12
A	Net Interest Margin	2.57	2.76	2.94	2.95	3.30	3.13	3.89	3.89	2.79	2.90
B	Cost of Funds (Cove)	6.27	6.06	7.27	7.10	5.77	5.45	4.05	3.88	6.12	5.90
C	Return on Advances adjusted to Cove	3.81	4.25	4.88	4.88	5.57	5.32	5.50	5.72	4.21	4.51
D	Return on Equity	13.24	15.33	16.22	15.18	16.51	15.27	11.52	10.79	13.84	14.60
E	Return on Assets	0.78	0.88	1.26	1.20	1.74	1.63	1.94	1.76	1.03	1.08

Denote best in group

Source: "Report on trend and progress of banking in India 2011–12", RBI website, www.rbi.org.in
"A Profile of Banks", RBI Website, 2013

Foreign banks have focused on the urban/ metro markets (1/2)

Sr. No.	Name of the Bank	Year of Establishment in India	Capital (in Rs Mn)	Assets (in Rs Mn)	% of total Assets	Branches		
						Rural/ Semi-urban	Urban/ Metro	Total
Established Prior to August 2010								
1	Citibank N.A.	Nov-1963	173,794	128,381	1.34%	2	41	43
2	Standard Chartered Bank	Jan-1854	191,531	119,758	1.25%	-	100	100
3	HSBC Ltd.	Jan-1853	151,958	106,170	1.11%	2	48	50
4	DBS Bank Ltd.	Mar-1995	29,303	40,708	0.43%	6	6	12
5	Deutsche Bank AG	Oct-1980	78,913	40,492	0.42%	1	16	17
6	The Royal Bank of Scotland N.V.	Oct-1920	28,319	26,360	0.28%	2	29	31
7	JPMorgan Chase Bank N.A.	Sep-1994	57,535	25,339	0.26%	-	1	1
8	Barclays Bank PLC	Oct-1990	55,410	24,582	0.26%	1	8	9
9	Bank of America NA	May-1964	7,604	18,437	0.19%	-	5	5
10	Bank of Nova Scotia	May-1984	17,850	13,908	0.15%	-	5	5
11	BNP Paribas	Jan-1862	22,819	13,679	0.14%	-	9	9
12	The Bank of Tokyo-Mitsubishi UFJ, Ltd.	Dec-1953	34,023	13,167	0.14%	1	3	4
13	Mizuho Corporate Bank Ltd.	May-1996	35,877	7,623	0.08%	-	2	2
14	UBS AG	Jan-2009	20,675	6,824	0.07%	-	1	1
15	Credit Agricole Corporate & Investment Bank	Sep-1981	17,593	6,033	0.06%	-	5	5
16	Societe Generale	Apr-1985	8,571	3,179	0.03%	1	2	3
17	American Express Banking Corporation	May-2008	7,604	2,540	0.03%	-	2	2
18	Shinhan Bank	May-1996	5,725	2,473	0.03%	1	2	3
19	Abu Dhabi Commercial Bank Ltd.	Dec-1980	3,274	1,638	0.02%	-	2	2
20	State Bank of Mauritius Ltd.	Nov-1994	6,062	1,472	0.02%	-	3	3
21	Bank of Bahrain and Kuwait B.S.C.	Aug-1986	2,886	1,168	0.01%	-	2	2
22	FirstRand Bank Ltd.	Apr-2009	3,033	1,143	0.01%	-	1	1
23	Antwerp Diamond Bank N.V.	Jun-2002	2,302	1,016	0.01%	-	1	1
24	Chinatrust Commercial Bank	Apr-1996	1,603	433	0.00%	1	1	2
25	HSBC Bank Oman S.A.O.G.	Oct-1985	2,229	377	0.00%	-	2	2

Source: "Profile of Banks 2013", RBI website, www.rbi.org.in, Indian Banks Association http://www.iba.org.in/glance.asp

Foreign banks have focused on the urban/ metro markets (2/2)

Sr. No.	Name of the Bank	Year of Establishment in India	Capital (in Rs Mn)	Assets (in Rs Mn)	% of total Assets	Branches Rural /Semi-urban	Branches Urban/ Metro-	Branches Total
Established Prior to August 2010								
26	Bank of Ceylon	Oct-1995	1,757	309	0.00%	-	1	1
27	Commonwealth Bank of Australia	Feb-2010	1,692	304	0.00%	-	1	1
28	Mashreqbank psc	Dec-1980	1,208	247	0.00%	-	1	1
29	Krung Thai Bank Public Company Ltd.	Jan-1997	491	238	0.00%	-	1	1
30	Bank Internasional Indonesia	Apr-1996	2,138	217	0.00%	-	1	1
31	United Overseas Bank Ltd.	Dec-2009	1,559	207	0.00%	-	1	1
32	AB Bank Limited	Jun-1996	751	198	0.00%	-	1	1
33	JSC VTB Bank	Apr-2008	1,114	131	0.00%	-	1	1
34	Sonali Bank Ltd.	Sep-1974	98	56	0.00%	-	2	2
Established Post August 2010								
35	Australia & New Zealand Banking Group Ltd	Jun-2011	11,324	4,908	0.05%	-	1	1
36	Credit Suisse AG	Feb-2011	13,066	3,414	0.04%	-	1	1
37	Sumitomo Mitsui Banking Corporation	Dec-2012	10,834	1,093	0.01%	-	1	1
38	Rabobank International	Jul-2011	6,139	852	0.01%	-	1	1
39	Westpac Banking Corporation	Oct-2012	8,172	823	0.01%	-	1	1
40	Industrial & Commercial Bank of China Ltd. (ICBC)	Sep-2011	4,818	779	0.01%	-	1	1
41	Woori Bank	Dec-2011	1,636	384	0.00%	-	1	1
42	National Australia Bank Ltd.	Jan-2012	1,530	321	0.00%	-	1	1
43	Sberbank	Jan-2011	1,443	178	0.00%	-	1	1
	Total		**1,036,263**	**621,559**	**6.5%**	**18**	**316**	**334**

Note: All Data noted above is as on March 2013
Year of incorporation is taken as the year their first branch was established in India
Source: "Profile of Banks 2013", RBI website, www.rbi.org.in, Indian Banks Association http://www.iba.org.in/glance.asp

Roadmap for existing and new Foreign Banks

RBI has permitted both Branch and WOS model but encourages WOS structure for existing and new foreign banks in India

Entry roadmap for new banks

A#. Following category of banks would be mandated entry in India only by way of setting up a Wholly Owned Subsidiary (WOS):

- Banks incorporated in a jurisdiction that has legislation which gives deposits made/ credit conferred, in that jurisdiction a preferential claim in a winding up
- Banks which do not provide adequate disclosure in the home jurisdiction
- Banks with complex structures
- Banks which are not widely held
- If the RBI is not satisfied with supervisory arrangements (including disclosure arrangements) and market discipline in the country of their incorporation are not adequate, and
- For any other reason that RBI considers that subsidiary form of presence of the bank would be desirable on financial stability considerations or if a foreign bank has set up a branch in India after August 2010 is considered systemically important by virtue of the balance sheet size by RBI

B. All other banks can opt for a branch or WOS on entry. However, it would be mandatory for banks which opt for branch mode of presence to convert themselves into WOS if:

- Any of the conditions mentioned in section A materialize in the judgment of RBI

Roadmap for existing banks

- Foreign banks which commenced their operations in India from August 2010 would convert their branches into WOS, if required by RBI
- Such banks will convert into WOS, if they meet the conditions mentioned in Section A
- RBI would not mandate conversion of existing branches to WOS for foreign banks which commenced their operations before August 2010 They can either covert to WOS or can continue to operate as branches
- The branch expansion of both the existing foreign banks and the new entrants present in the branch mode would be subject to the WTO commitments
- The conversion of branches to WOS shall be carried out in accordance with scheme mandated in the public interest to be approved by RBI under Section 44A of the Banking Regulation (BR) Act 1949
- The banks (new or existing) that want to set up a WOS would be required to submit Form III prescribed in Rule 11(a) of the BR Act 1949 together with additional information to the Principal Chief Manager, RBI

Referred to as Para 4(a) clauses
(Foreign bank branches would be considered to be systemically important once their assets (on balance sheet and credit equivalent of off-balance sheet items) become 0.25% of the total assets (inclusive of the credit equivalent of off-balance sheet items) of all scheduled commercial banks in India as on March 31 of the preceding year)

RBI guidelines would have positive implications on WOS' business, governance and growth prospects (1/3)

Business

Support from Parent Company required	• The parent of the WOS would be required to issue a letter of comfort (LOC) to RBI for meeting the liabilities of the WOS. • WOSs would be permitted to use parental guarantees/credit rating only for providing custodial services and for international operations, on an arm's length basis • However, WOS should not provide counter guarantee to its parent for such support
Public Listing possible	• WOS of foreign banks at their option dilute their stake to 74% or less in accordance with the extant FDI policy and list on stock exchanges in India
Investment by WOS in subsidiaries and other companies permitted	• The investment by WOS in other companies would be in accordance with RBI guidelines which ensures independence functioning of the WOS • The WOS should maintain arm's length relationship with parent's group entities • Prior approval of RBI would be required to set up subsidiaries
Capital and reserves of WOSs	• RBI could restrict entry of new WOSs of foreign banks when the capital and reserves of the foreign banks in India exceed 20% of the Indian banking system
Repatriation Of Profits permitted	• WOS of foreign banks are allowed to pay dividend to the parent bank, like the domestic banks

RBI guidelines would have positive implications on WOS' business, governance and growth prospects (2/3)

Governance

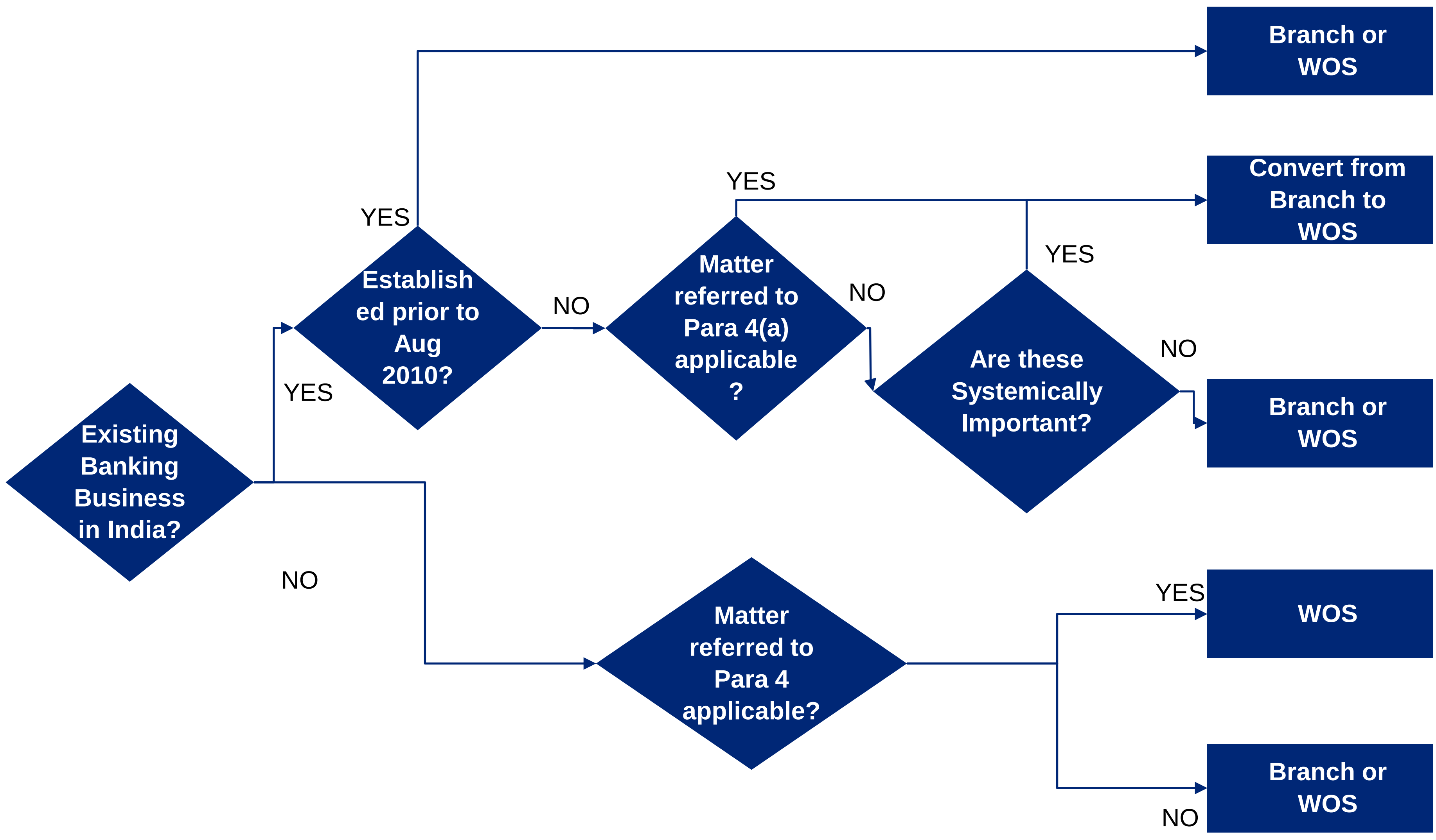
Hygiene factors for setting up WOS	• Setting up of WOS by a foreign bank in India should have the approval of the home country regulator • The foreign bank's WOS must satisfy RBI that it is subject to adequate prudential supervision as per internationally accepted standards • Other factors are: – Economic and political relations with the country of incorporation of the parent bank – Reciprocity with home country of the parent bank – Financial soundness – Ownership pattern – International and home country ranking of the parent bank by a reputed agency – Home country/parent bank rating by a rating agency of international repute such as Moody Investors Service, Standard & Poor's and Fitch Ratings – International presence of the bank – Adequate risk management and internal control systems • RBI will take the final decision to grant the license
Local incorporation leading to ring-fencing of the business	• Separates legal entities, having their own capital base and local board of directors • Clearly distinguishes assets and liabilities of domestic bank with foreign bank and ring fences the capital and assets within the host country • Clarifies the applicability of laws of the country of incorporation with gives effective control to RBI • Separate board of directors from the foreign bank itself

RBI guidelines would have positive implications on WOS' business, governance and growth prospects (3/3)

Growth

Organic Growth	**Access to cheaper resources of fund**	• WOS of foreign banks are allowed to raise rupee resources by issuing non-equity capital instruments similar to domestic banks • Current regulations allow foreign banks to raise resources only from their parent body or head office through Innovative Perpetual Debt Instruments
	Less restrictive branch expansion policy	• RBI has allowed foreign banks to operate across Tier 1 -6 cities, without taking prior permission from RBI, except at certain sensitive locations • An incentive in the form of a branch in a Tier 1 centre would be given for opening of a branch in Tier 2 to Tier 6 centres of underbanked districts of underbanked States
	National Treatment	• WOSs will be provided near national treatment
Inorganic Growth	**M&A with domestic private sector banks**	• Foreign banks are allowed to acquire domestic private sector bank subject to regulatory approval and foreign investment limit of 74%

Foreign banks established post Aug 2010 and for whom Para 4 clauses are applicable will have to be converted into WOS

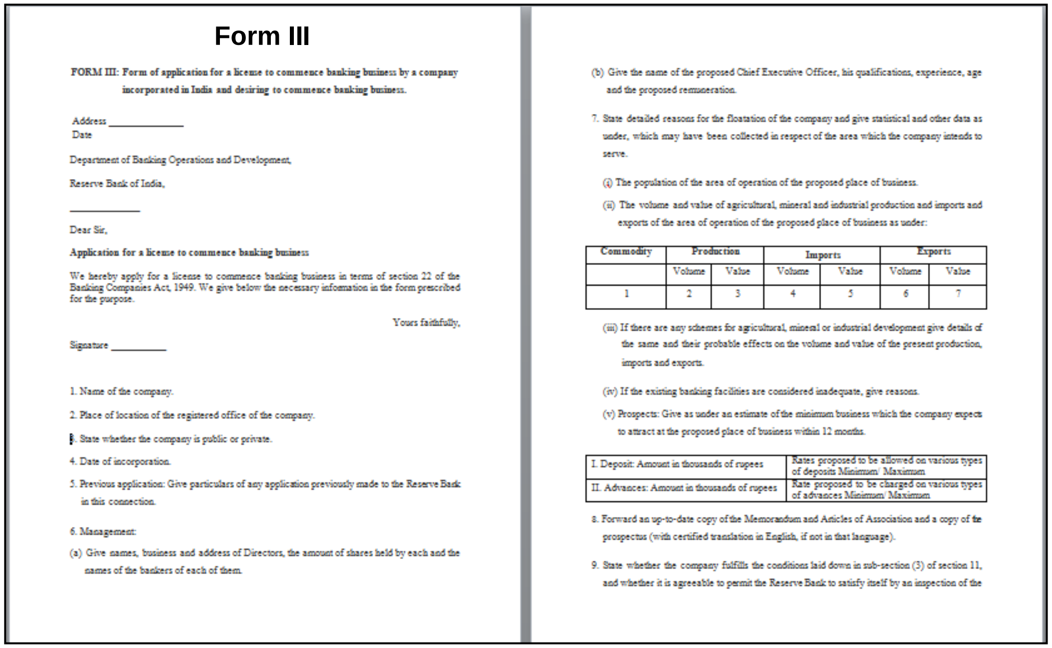


Procedure for conversion of existing branches of foreign banks into WOS has been established by RBI

1. Foreign Bank willing to convert from Branch to WOS model has to make application to RBI
2. If eligible, in-principle approval subject to further conditions is granted by RBI
3. New entity is registered under the Companies Act to operate as WOS and approaches RBI for fresh license in its name
4. On obtaining license from RBI, the Foreign bank shall prepare a draft amalgamation scheme and get it approved by the shareholders
5. This scheme should also be approved by the shareholders of the WOS
6. The Foreign bank and WOS approach RBI with the scheme for their considerations
7. The date of effect of conversion of branches and other conditions will be specified by RBI
8. On the said date, the transfer of branches will take place from the Foreign bank to the WOS
9. On the appointed day, the WOS is entitled to carry out all or any of the businesses of the Foreign bank
10. Licenses granted to the branches of the Foreign bank stand cancelled from the appointed day

Note: If the amalgamation take more than 6 months, RBI shall cancel the license.

Application will have to be made in Form III along with a detailed business plan by a new WOS bank license applicant



Form III

FORM III: Form of application for a license to commence banking business by a company incorporated in India and desiring to commence banking business.

Address ____________
Date

Department of Banking Operations and Development,

Reserve Bank of India,

____

Dear Sir,

Application for a license to commence banking business

We hereby apply for a license to commence banking business in terms of section 22 of the Banking Companies Act, 1949. We give below the necessary information in the form prescribed for the purpose.

Yours faithfully,

Signature __________

1. Name of the company.
2. Place of location of the registered office of the company.
3. State whether the company is public or private.
4. Date of incorporation.
5. Previous application: Give particulars of any application previously made to the Reserve Bank in this connection.
6. Management:

(a) Give names, business and address of Directors, the amount of shares held by each and the names of the bankers of each of them.

(b) Give the name of the proposed Chief Executive Officer, his qualifications, experience, age and the proposed remuneration.

7. State detailed reasons for the floatation of the company and give statistical and other data as under, which may have been collected in respect of the area which the company intends to serve.

(i) The population of the area of operation of the proposed place of business.

(ii) The volume and value of agricultural, mineral and industrial production and imports and exports of the area of operation of the proposed place of business as under:

Commodity	Production		Imports		Exports	
	Volume	Value	Volume	Value	Volume	Value
1	2	3	4	5	6	7

(iii) If there are any schemes for agricultural, mineral or industrial development give details of the same and their probable effects on the volume and value of the present production, imports and exports.

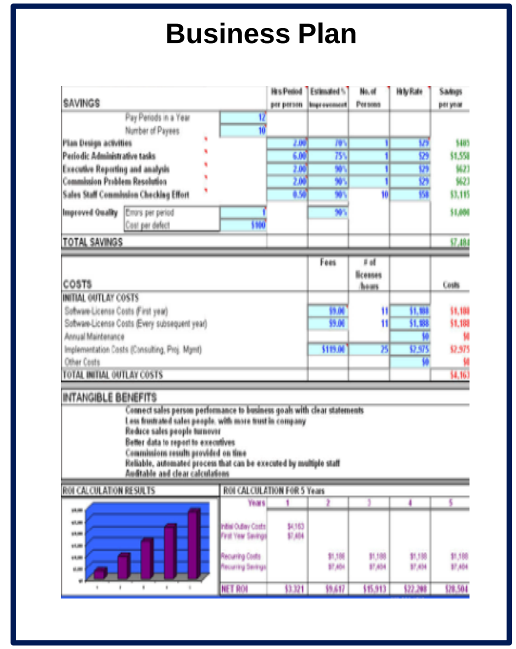
(iv) If the existing banking facilities are considered inadequate, give reasons.

(v) Prospects: Give as under an estimate of the minimum business which the company expects to attract at the proposed place of business within 12 months.

I. Deposit: Amount in thousands of rupees	Rates proposed to be allowed on various types of deposits Minimum/ Maximum
II. Advances: Amount in thousands of rupees	Rate proposed to be charged on various types of advances Minimum/ Maximum

8. Forward an up-to-date copy of the Memorandum and Articles of Association and a copy of the prospectus (with certified translation in English, if not in that language).

9. State whether the company fulfills the conditions laid down in sub-section (3) of section 11, and whether it is agreeable to permit the Reserve Bank to satisfy itself by an inspection of the



- Applicants will have to submit a viable and realistic business plan including
  - Group structure
  - Experience in retail and commercial banking
  - Branch expansion plan
  - Plans for achieving financial inclusion
  - Business case
  - Corporate governance structure
  - IT platform
- Business Plan needs to be well defined and is likely to form a part of periodic performance evaluation by RBI. As stated in the Guidelines, in case of deviation from the stated business plan after issue of license, RBI may consider restricting the bank's expansion and imposing other penal measures.

Deloitte Point of View

Foreign banks who are aspiring to actively participate in the India growth story under a WOS model shall be incentivized …however, there would be significant challenges

Opportunities

- Foreign banks can expand their footprint in a growing and attractive Indian market
- Most of the foreign bank currently operate branches in metro and tier-1 cities. With Regulator permitting banks to expand in Tier-2-6 cities foreign banks can migrate from “exclusive banking” model to more expansive “inclusive banking” both in retail and corporate banking segment
- Foreign banks can develop unique competitive proposition and further the cause of financial inclusion by increasing penetration and coverage of banking services (specially in rural areas)
  - Banks can tailor the prevalent delivery models by migrating from branch to technology led branchless model
- New products and services can be introduced in the Tier-2-3 cities by leverage experience and expertise of banks in metros and tier -1 cities
- Foreign banks can acquire upto 74% stake in private banks as this will help them expand their presence faster

Challenges

- Existing banks would also have to ensure scalability of current business models by ensuring the same quality of service in expansion mode
- In order to penetrate further, changes in the prevalent business model would be required by developing innovative and ingenious delivery models for serving unbanked
- Foreign banks would have to target newer segments (corporate banking, small-and-medium size enterprises, retail banking, SME banking, infrastructure financing, micro finance) as competition in existing segment increases
- Foreign banks will also have to comply with the ‘Priority Sector Lending (PSL)’ criteria and will have to target a new set of customers
- Foreign banks would have difficulty to comply with single borrowing limits as required by RBI in line with private banks that are not allowed to lend more than 15% of their net worth to a single company and more than 40% to a corporate group due to local subsidiarization

Foreign Banks will also need to consider how the proposed India structure fits within the regional and global corporate structure of its parent organization.

Foreign banks will have to evaluate the business case for the most appropriate legal structure

Key Drivers for the business case

Availability of Capital	• The initial minimum paid-up voting equity capital for a WOS is Rs. 5 billion or USD 80 million – 12-15 Tier 1 foreign banks (including Citi Bank, HSBC, Standard Chartered, etc.) already have capital base of over Rs.150 billion and are well-capitalized – 8-10 Tier 2 foreign banks (including ICBC, FirstRand Bank, Bank of Bahrain and Kuwait B.S.C., etc.) have capital base close to Rs. 5 billion • Foreign banks may need to evaluate their risk appetite for the Indian market and enjoy benefits of higher ROE/ ROI
Long term vision and Aspirations	• WOS model could provide opportunities for Foreign Banks to grow both organically as well as inorganically through M&A • Foreign Banks who have long term growth aspirations for the India markets have been provided with an opportunity to convert into a WOS and also explore the opportunity of listing in the Indian capital market
Business Case & Market Attractiveness	• Indian banking sector is expected to grow at over 15% which presents a significant growth opportunity for foreign banks to grow in a emerging country like India • RBI has allowed foreign banks' WOS to open branches across tier 1 to 6 centres which could lead to increased retail presence by foreign banks in India • There is a huge potential to tap the underpenetrated and unbanked semi-urban and rural markets
Other Requirements	• Similar to domestic private banks, larger foreign banks' (banks with over 20 branches) WOS are required to meet PSL requirements • Foreign banks' WOS need to set-up at least 25% branches in rural areas to align with RBI's objective of financial inclusion • The WOS need to adhere with corporate governance requirements (Indian CEO, Part-time Chairman, 50% directors of Indian Origin/ Indian /NRI)

Key considerations in tailoring the business model (1/2)

Priority Sector Lending

- As per the Framework, WOSs will comply with the Priority Sector Lending (PSL) requirements (agriculture, small and medium enterprises, exports and home loans up to Rs15 lacs. The overall target is 40 percent of Adjusted Net Bank Credit (ANBC) or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. Foreign banks have limited capabilities and reach to target all these segments
- Sub target for lending to agriculture sector is also mandated at 18 percent of ANBC or credit equivalent amount of Off-Balance Sheet Exposure, whichever is higher. Foreign banks with their urban focus would have to devise a mechanism to strengthen its capabilities to appraise, grant and disburse credit for agriculture / agriculture related sectors
  - Currently more than 60% credit off-take for foreign banks is for export financing and there is negligible agriculture financing
  - Banks can consider partnering with Business Correspondents (BC), NBFCs or Micro Finance companies to achieve this
- Foreign banks have been recording higher net NPA ratio compared to private sector banks in FY 12 and FY 13. With increased PSL and lack of required capabilities to cater to PSL , NPA management would be a key imperative
- Foreign banks have the highest sensitive sector lending (capital markets, real estate and commodities) with 30% compared with 18.5 % for all the SCBs in FY 12 and accordingly would require highest capital buffering. With subsidiarization, banks would not be in position to transfer excessive capital buffers from parent and other subsidiaries and have to recapitalize either by equity dilution or issuing non- equity instruments and thereby increasing the interest charge

Key considerations in tailoring the business model (2/2)

Liquidity Management

- Currently, interest rate risk in the banking books is effectively transferred to the Asset and Liability Management ("ALM") desk of global / regional market. With subsidiarization, Banks need to setup a local ALM Desk
- Bank not only have to measure the liquidity positions of bank subsidiary on an ongoing basis but also examine how liquidity requirements are likely to evolve under crisis scenarios for local operations
- Currently, centralized treasury desks distribute funding around the various regional branches, monitor compliance with strict centrally mandated mismatch limits and manage pools of liquid assets. With WOS structure, banks have to locally determine limits on maturity and currency mismatches and liquid asset requirements

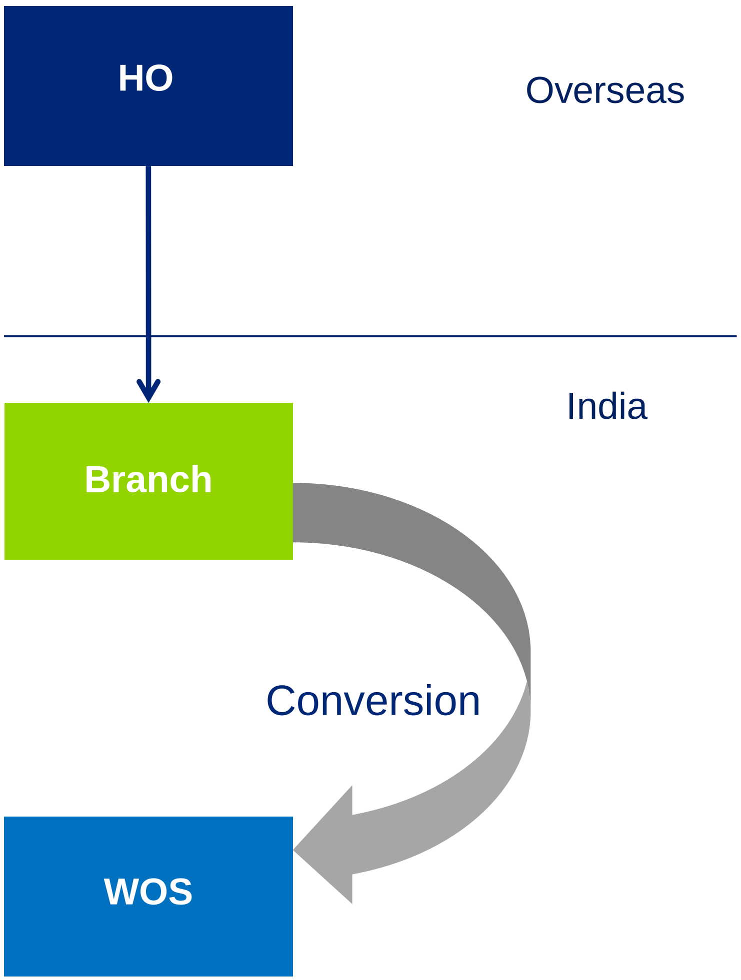
Risk Management

- Banks have to measure, monitor and control any counterparty risk arising out of any transactions with parent or any other subsidiary
- The risk assessment for the branches is largely based on the parent's risk management framework. However, local customization has to be been incorporated to align with the RBI requirements
- Foreign banks have to put in place an exhaustive risk governance framework covering asset liability management, portfolio management and operational risk group

Corporate Governance

- With RBI incentivizing foreign banks to move from a branch-led to a WOS business model, there will be a number of Corporate Governance (CG) concerns that will have to be addressed by the foreign banks in making the shift:
  - Parent group would have to ensure that while adopting a ring fenced structure , its capabilities are transferred and its strategy for the domestic market is aligned with its global strategy
  - Banks may find recommended CG practices too restrictive and would face challenges to constitute the appropriate composition of the boards in terms of foreign directors, Independent directors, Indian Directors etc.

Key considerations in taxation (1/2)



- Tax Rate arbitrage (40% for branches of Foreign banks vis-à-vis 30% for Indian WOS bank) restricted if Dividends declared by Indian company as Dividends suffer DDT.
- Conversion of branches of foreign banks in India into WOS made income-tax neutral.
  - Exemption from Capital Gains Tax: provided it is in accordance with the scheme framed by the RBI and subject to notified conditions.
  - Exemption from Stamp Duty: Banking Laws (Amendment) Act 2012 ~ Indian Stamp Act 1889 amended - Conversion of a branch of a bank into a wholly owned subsidiary of the Bank or transfer of shareholding of a bank to a holding company in terms of the scheme of RBI shall not be liable to stamp duty.

Key considerations in taxation (2/2)

Source Country Taxation (India)

- Present Tax disputes on payment to self, specific treaty provisions
- Transfer pricing implications on conversion, capital infusion, guarantees and LOC to WOS, and parent –subsidiary cross recharges and expenses
- Composition of capital of WOS; Issue of capital to bank or its holding company?
- Benefits of Deferred Tax Assets of the branch - whether would be transitioned to WOS
- Tax allowance of cost incurred on conversion of branch to WOS
- Credit for taxes withheld relating to branch; Open tax assessments, tax liabilities and refund due for years prior to conversion
- Indirect tax implications (VAT, service tax) on conversion and credit for input tax paid by branch
- Assignment of rent agreements/ employees – retirement benefits
- Tax implications on repatriations / remittances from branch vis-à-vis WOS
- Exit Tax in India from branch vis-à-vis WOS

Home Country Taxation

- Foreign Tax implications of conversion of branch into wholly owned subsidiary in home country of the foreign banks including Foreign Tax Credit

Foreign banks considering a long term investment for India market may have to reconfigure some business dimensions to support the WOS model

	Dimension	Requirement	Key Capabilities	
Value Creation	Business Strategy	Set direction and vision for the organization	• Strategic / Business Planning	• Organization Design
Value Creation	Product & Services	Define the targeted consumer and the go-to-market strategy	• Market / Cultural Knowledge	• Product / Service Strategy
Value Protection	Risk Management	Identify risks associated with local market and mitigate those challenges	• IP Protection	• Crisis Planning / Mitigation
Value Protection	Regulatory	Understand impact on business of local regulations and influence changes	• Government Relations	• Legal / Regulatory Mgt
Value Enablement: Product Offering Focused	Sales & Customer Service	Develop the channels by which products will be sold and serviced	• Marketing • Pricing & Profitability Mgt	• Sales & Channel Strategy • Customer Service
Value Enablement: Product Offering Focused	Operations & Logistics	Provide the infrastructure, capacity and quality required to achieve service level and cost targets	• Supply Chain Planning • Sourcing / Procurement • Production / Execution	• Distribution/Transportation • Quality Management
Value Enablement: Product Offering Focused	Product Development	Develop new product, process and business model innovations	• Marker Research & Pricing (Product Innovation)	• Development • Commercialization (Process Innovation)
Value Enablement: Supporting Function	Finance	Understand cost structure and profitability, as well as how to identify / invest in high-potential opportunities	• Product Costing • Treasury Strategy	• Budget Management • Performance Management • Tax Strategy
Value Enablement: Supporting Function	Talent Management	Develop required processes to attract, develop, and retain talent	• Talent Strategies	• Talent Solutions
Value Enablement: Supporting Function	Technology	Provide infrastructure required to enable operations	• Application Architecture • Data Architecture	• IT Operations

Business Dimension requiring reconfigurations

Summary

- Foreign banks have played an important role in Indian banking sector by increasing the efficiency of the local banking system and bringing in more sophisticated financial services despite various regulatory restrictions imposed
- Considering the capital required to fuel the economic growth, foreign banks have to play a significant role along with new private sector banks to cater to growing credit demand. RBI has initiated the process of granting licenses to new private sector banks
- RBI has adopted a gradual and a calibrated approach to expand presence of foreign banks, subject to measures to contain the "downside risk to financial stability”. Though, RBI has permitted both branch and WOS model, it clearly favors WOS structure and is incentivizing banks to incorporate locally
- Going forward foreign banks who have significant India growth plans would need to develop unique competitive proposition and further the cause of financial inclusion by increasing penetration and coverage of banking services (specially in unbanked rural areas)
- Though banks have few downsides by adopting WOS model in short term, WOS structure can highlight foreign bank’s commitment to India and can eventually lead to National Treatment after alleviating regulatory concerns
- It is important that the transition from branch to wholly owned subsidiary should be seamless and less disruptive and less costly to be effective
- Foreign Banks have the advantages of developing a Rupee balance sheet as well as look at faster organic as well as inorganic growth besides getting an opportunity of getting listed on Indian exchanges
- This framework provides an opportunity for Foreign Banks to evaluate their preferred structure of doing business based on their capital commitment, business plan and long term aspirations for the Indian market

Appendix

Comparative snapshot of regulatory considerations -1/6

Parameter	New Private Sector Banks	Branches of Foreign Banks	WOS of Foreign Banks
Form of Presence	• Entities / groups in the private sector that are 'owned and controlled by residents', entities in the public sector and promoters / promoter groups with an existing non-banking financial company (NBFC	• Banking branches in India of the parent foreign bank	• WOS of the parent bank incorporated in India under Companies Act
Ownership Pattern	• Promoters will be permitted to set up a new bank only through a wholly owned NOFHC, which will hold the bank, as well as all other regulated financial sector entities • Capital structure of the wholly-owned NOFHC set up by Promoter / Promoter Groups in Private Sector shall consist of − voting equity shares not exceeding 10% to held by any individual belonging to the Promoter Group, along with his relatives (as defined in Section 6 of the Companies Act 1956) and along with entities in which he and / or his relatives hold not less than 50 % of the voting equity shares, and − companies forming part of the Promoter Group whereof companies in which the public hold not less than 51% of the voting equity shares shall hold not less than 51 % of the total voting equity shares of the NOFHC	• Foreign parent bank	• Parent foreign bank may be permitted to hold 100% equity in the subsidiary • WOS of foreign banks on completion of a minimum prescribed period of operation will be allowed to list and dilute their stake upto 74%

Comparative snapshot of regulatory considerations -2/6

Parameter	New Private Sector Banks	Branches of Foreign Banks	WOS of Foreign Banks
Minimum Capital Requirement	• Initial minimum paid-up capital for a new bank shall be Rs. 5 billion and the NOFHC shall hold at least a 40% stake of the bank, which shall be locked in for a period of five years from the date of commencement of the business of the bank • NBFCs that are converted into banks shall have a minimum net worth of Rs. 5 billion • Any shareholding by NOFHC beyond 40% shall be brought down to 40% within three years from the date of commencement of business of the bank	• Foreign banks are required to bring an assigned capital of US$25 million upfront at the time of opening the first branch in India	• The initial minimum paid-up voting equity capital for a WOS shall be Rs. 5 billion to be brought upfront • For foreign bank branches, which want to convert into WOS should have minimum net worth of Rs.5 billion
Branch Expansion	• Required to open 25% of its branches in unbanked rural centres to avoid over concentration of their branches in metropolitan areas and cities • Require RBI approval for opening branches in Tier-1 centers	• Branch expansion under the WTO commitments of 12 branches per year and on the principles of reciprocity, though RBI has been granting permissions of more than 12 branches in the past	• Regulation for setting-up branches similar to that for Private banks • The WOS may open branches in Tier 1 to 6 centres subject to certain requirements • WOS would require RBI's approval on setting up branches at certain sensitive locations
Local Market Access (raising non-equity capital)	• Allowed to raise non-equity capital for the purpose of capital adequacy (Tier I & II)	• No access to rupee resources to augment non-equity capital • Permitted to raise funds from their Head Office for augmenting Tier I and Tier II capital through IPDIs and debt capital instruments	• WOS may raise rupee resources through issue of non-equity capital instruments as allowed to domestic private sector banks

Comparative snapshot of regulatory considerations -3/6

Parameter	New Private Sector Banks	Branches of Foreign Banks	WOS of Foreign Banks
National Treatment	• Banks are accorded national treatment by the regulator	• Branches are not accorded national treatment by regulator	• It will be provided near national treatment
Financial Inclusion	• Business plan will have to address how the bank proposes to achieve financial inclusion	• Foreign bank branches with 20 or more branches are mandated to have priority sector lending as applicable to domestic commercial bank. Foreign banks with less than 20 branches enjoy certain relaxations	• Similar to new private sector banks, at least 25% of the branches should be opened in rural areas. • The total number of branches opened in Tier 1 cannot exceed the total number of branches opened in Tier 2 to 6 centres and all centres in the North Eastern States and Sikkim • An incentive in the form of a branch in a Tier 1 centre would be given for opening of a branch in Tier 2 to Tier 6 centres of under-banked districts of under-banked States
Dividend Distribution Flexibility	• The dividend payout ratio shall not exceed 40 % with the eligibility of NBFC dependent on CRAR and Net NPA levels	• Foreign banks with branch presence in India are allowed to repatriate profits in the ordinary course of their business	• May declare dividends similar to domestic banks

Comparative snapshot of regulatory considerations -4/6

Parameter	New Private Sector Banks	Branches of Foreign Banks	WOS of Foreign Banks
Statutory, regulatory, prudential and other requirements	• The bank will be governed by the provisions of: – Banking Regulation Act, 1949,Reserve Bank of India Act, 1934, Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007, other relevant Statutes and the Directives, Prudential regulations and other guidelines /Instructions issued by RBI – and other regulators from time to time, including the regulations of SEBI regarding public issues and other guidelines applicable to listed banking companies • The NOFHC will be registered as a non-banking financial company (NBFC) with the RBI and will be governed by a separate set of directions issued by RBI. • The financial entities held by the NOFHC will be governed by the applicable Statutes and regulations prescribed by the respective financial sector regulators.	• Foreign banks' branches will be governed by provisions of the Companies Act, Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007 and other relevant guidelines issued by RBI	• The WOS will be governed by the provisions of the Companies Act, ~~1956,~~ Banking Regulation Act, 1949, Reserve Bank of India Act, 1934, Foreign Exchange Management Act, 1999, Payment and Settlement Systems Act, 2007 and other relevant guidelines issued by RBI • If foreign bank parent/group of the WOS has NBFCs, the regulatory framework for consolidated prudential reporting and supervision, currently applicable to branches of foreign banks will also be applicable to WOS • If deficiencies are found in Know Your Customer (KYC)/Anti Money Laundering (AML)/Combating the Financing of Terrorism (CFT) policies, WOS would be subjected to enhanced prudential requirements.
Capital Adequacy	• The bank shall be required to maintain a minimum capital adequacy ratio of 13% of its risk weighted assets for a minimum period of three years after the commencement of its operations subject to such higher percentage, as may be prescribed by the RBI from time to time	• Foreign banks with branch presence will have to meet capital adequacy requirement as per Basel standards	• The WOS should meet Basel III requirements and maintain a minimum capital adequacy ratio of 10% for an initial period of 3 years and other conditions as prescribed under capital adequacy framework

Comparative snapshot of regulatory considerations -5/6

Parameter	New Private Sector Banks	Branches of Foreign Banks	WOS of Foreign Banks
Corporate Governance	• The NOFHC shall not have a Director in its Board of Directors, who is a Director in any other NOFHC or a bank other than a banking company under it • The NOFHC shall not be managed by any person: – who is a Director in any other company not being a subsidiary of the NOFHC or a company registered under Section 25 of the Companies Act, 1956 or – who is engaged in any other business or vocation • At least 50% of the directors of the NOFHC should be totally independent of the promoter/promoter group entities, their major customers and major suppliers • Ownership and management should be separate and distinct in the NOFHC, the bank and entities regulated by RBI and the source of promoters' / promoter groups' equity in the NOFHC should be transparent and verifiable • NOFHC shall obtain from Directors a Deed of Covenant, a declaration and undertaking in its favor, as may be specified by RBI, and an annual declaration • NOFHC shall have a Nomination Committee to perform due diligence in respect of its Directors. • NOFHC shall have a Remuneration Committee of the Board to decide on the compensation payable to the key management executives of NOFHC		• The composition of the board should adhere with following guidelines: – not less than 51% of the directors should belong to Section 10A of the Banking Regulation Act 1949 – not less than two-third of the directors should be non-executive directors – not less than one-third of the directors should be totally independent of the management of the subsidiary in India, its parent or associates – not less than 50% of the directors should be Indian nationals /NRIs/PIOs and one-third of the directors are Indian nationals resident in India; – the directors shall conform to the 'Fit and Proper' criteria as laid down in RBI guidelines – Board to constitute of Part-time Chairman and full time CEO, who should be resident of India – RBI to approve (re) appointment, etc. of the Part-time Chairman (non-executive director) and CEO/Other Directors based on Section 10B and Section 35B of the BR Act, 1949 respectively – All other provisions as applicable to private sector banks in India

Comparative snapshot of regulatory considerations -6/6

Parameter	New Private Sector Banks	Branches of Foreign Banks	WOS of Foreign Banks
Setting up of NBFCs	• NOFHC shall not be allowed to set up any new financial services entity for at least 3 years from the date of commencement of business	• Similar process as that for domestic banks • However, head offices of foreign banks having branches in India may, under the automatic route for FDI, commence the business of NBFI after obtaining a Certificate of Registration from the Reserve Bank	• The WOS being a locally incorporated bank is subjected to the regulations as applicable to Indian banks • In the case of WOS, approval for setting up subsidiaries or significant investment in associates will also factor in whether there are NBFCs set up by the parent banking group under FDI rules for undertaking same or similar activity
Priority Sector Lending (PSL)	• The new private sector banks are required to extend lending to the priority sector (total) to the extent of 40% of net bank credit with the minimum contribution of agriculture and advances to weaker section of 18% and 10% respectively	• Foreign banks with more than 20 branches are required to extend lending to the priority sector (total) to the extent of 40% of net bank credit with the minimum contribution of agriculture and advances to weaker section of 18% and 10% respectively • Foreign banks with less than 20 branches are required to extend lending to the priority sector (total) to the extent of 32% of net bank credit	• WOS to comply with PSL targets as mentioned in RBI's guidelines • Total priority sector lending target of 40% of adjusted net bank credit • WOS would be given a period of 5 years to achieve PSL targets from the date of conversion to WOS for existing bank with less than 20 branches • For a foreign bank with more than 20 branches, the 5 years time frame will begin starting April 1, 2013 onwards

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