

Banking on transformative banking regulations

The recent changes in India's banking regulations remind us of the landmark moment in 1993 when the Reserve Bank of India (RBI), following the Narasimham Committee's recommendations, granted licences to private sector banks for the first time since nationalisation. That single decision sparked an extraordinary wave of value creation, leading to today's thriving private banking sector with a market capitalisation of about Rs. 40 lakh crore (around USD 460 billion).

India's banking system has always been tightly regulated, though there have been attempts over time to loosen the framework. The recent decisions by the RBI seem to mark a genuine effort to bring long-awaited reforms that could set off another phase of strong growth and value creation for the banking sector.

After almost a decade, the RBI has issued a new universal banking licence, allowing a small finance bank to transition into a universal bank. This is a pivotal step that sets a new benchmark for other banks to strengthen their governance and operational standards.

Another significant milestone is the RBI's approval for a foreign bank to acquire a sizeable minority stake in a mid-sized Indian bank, along with board representation and proportionate voting rights. This development signals growing global investor interest in Indian mid-sized banks. It could allow these banks to scale up meaningfully, challenge larger incumbents, and drive innovation through the infusion of international capital and expertise. By tapping into their global investors' networks, these banks could also enhance cross-border trade finance and corporate banking services, unlocking new growth opportunities.

For the first time since the RBI introduced the wholly owned subsidiary framework for foreign banks 12 years ago, we are seeing a real merger materialise. The RBI's approval of a foreign bank subsidiary merging with a local listed bank signals a deeper stage of consolidation and global integration within the Indian banking sector. Such mergers usually bring in new capital and technology, reduce operational costs through synergies, and improve asset quality through shared risk management practices. Together, these changes reflect a more mature, open, and globally competitive Indian banking landscape, with mid-sized banks increasingly playing an important national and international role.

The RBI has also made a groundbreaking move by allowing banks to finance corporate mergers and acquisitions for the first time since 1992. This reform opens a regulated and transparent channel for acquisition financing, shifting credit flow from expensive private markets back to banks. With banks now able to fund up to 70% of acquisition values, companies will have easier and cheaper access to financing for growth through acquisitions. This policy is expected to transform the domestic M&A environment by widening funding options and encouraging consolidation and expansion. *Please refer to my article dated Oct 4, 2025 on this “ <https://economictimes.indiatimes.com/markets/stocks/news/how-rbis-nod-puts-banks-at-the-centre-of-corporate-deals/articleshow/124304470.cms> ”*

Alongside these major reforms, the RBI has introduced several measures to boost credit growth and make financing more accessible to Indian corporates. It has increased lending limits against listed debt securities and shares, raised the cap on IPO financing to bring banks on par with NBFCs, and relaxed lending restrictions on large corporates by replacing them with more sophisticated risk management tools. The reduction of risk weights on infrastructure loans releases additional capital for priority sectors, while the simplification of External Commercial Borrowing rules gives banks more flexibility in foreign currency funding.

Our Views

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Operationally, the RBI's most recent credit policy announced 21 measures aimed at streamlining banking operations. A key change relates to how banks organise their business and corporate structures. The new framework strikes a balance between maintaining regulatory control and providing banks with greater flexibility. This allows them to move faster, pursue market opportunities, and diversify revenue streams without unnecessary bureaucratic hurdles.

Overall, these developments mark the beginning of another golden era for Indian banking. The transformation from a time when the sector was almost entirely government-controlled, with approvals needed even to open a small extension branch, to today's liberalised and dynamic environment is remarkable. Reduced red tape lowers costs for banks, which in turn leads to more affordable loans and better services for customers.

What stands out most is the coordination between the government and the RBI. Both are working in sync to promote sustainable growth, balancing reform with stability. This alignment of policy and regulation is a powerful combination that is accelerating the momentum of change and setting the stage for the next phase of India's banking evolution.

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