

Wholesale and Long-term Finance bank

What is the issue?

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After having issued licences for new-age payments and small finance banks, the RBI has now published a discussion paper on the need for wholesale and long-term finance (WLTF) banks.

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What is WLTF?

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- The idea is that as the financial sector grows, apart from a number of universal banks, it may be useful to have differentiated banks focusing on different areas and developing competence.
- This will reduce the cost of intermediation and lead to better economic outcomes.

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- The WLTF banks will focus on lending to the corporate sector, small and medium businesses, and the infrastructure sector. \n
- They may also offer services in the area of foreign exchange and trade finance.

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• Further, they can act as market makers in instruments like corporate bonds and credit derivatives.

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- WLTF banks can raise funds through issuance of debt and equity. They may also be allowed to accept term deposits above a threshold. \n

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What are the advantages?

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- As specialized institutions, they will be in a much better position compared with commercial banks in **evaluating and funding long-term projects.** n
- It's not easy for companies to get long-term financing because of the underdeveloped corporate bond market and possible asset liability mismatch in the banking system.
- With specialized banks, NPA risks could possibly be avoided in the future. \n
- It may also help the rest of the banking sector in the case of joint lending, or by simply getting the project evaluation from these banks. \n
- Establishment of WLTF banks will also enhance competition, which will lead to more efficient allocation of financial resources.

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Does India have prior experience?

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• India has tried the **development finance institution (DFI) model** in the past with limited success.

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• After independence, DFIs were established to increase the level of investment in the economy.

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• Industrial Finance Corp. of India (IFCI) was the first such institution to be established in 1948.

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- \bullet This was followed by the establishment of state finance corporations. $\space{\space{1.5}n}$
- In later years, other institutions like the Industrial Credit and Investment Corporation of India (ICICI) and Industrial Development Bank of India (IDBI) were established.

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- However, DFIs struggled with government interference and changes in the economy, and accumulated high levels of NPAs.
- One of the biggest problems facing long-term finance institutions is competing for funds in the marketplace and being able to lend at competitive rates.

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What are the factors to be considered?

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- As the banking regulator mulls over issuing licences for new-age WLTF banks, there are at least three aspects that will need greater attention. \n
- First, government participation in setting up WLTF banks should be avoided as it could end up defeating the purpose. \n
- Government ownership would lead to the same problems that public sector banks are facing at the moment.

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- \bullet Further, these banks will be highly specialized and will need operational freedom, which is not possible with government ownership. \n
- Second, licences should only be issued to entities that are able to demonstrate the ability to build such a highly specialized bank, and are in a position to bring in capital to both meet regulatory requirements and run the business on a sustainable basis.

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- \bullet The central bank may allow industrial houses to participate to the extent that they are not in a position to influence business decisions. \n
- Third, the RBI will need to design a regulatory architecture that will enable growth with adequate safeguards. \ln
- \bullet For example, the regulator may choose to exempt these banks from cash reserve ratio and statutory liquidity ratio requirements. \n
- These banks will compete directly with the bond market. $\slash n$

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Source: Live Mint

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