

Building Global-Scale Banks: India's Carefully Managed Liberalisation

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Summary

The Reserve Bank of India, long known for its conservative approach to bank licensing and ownership, has gradually shifted towards a more selective and strategic opening of the banking sector to foreign banks and private equity investors. This cautious liberalisation does not signify a blanket welcome to global capital. It reflects a pragmatic response to sectoral stress, the need for recapitalisation, ensure good governance and the government's ambition to build globally competitive Indian banks.

Overview

The Reserve Bank of India (RBI) has, in recent months, shown a marked shift in its policy stance by permitting private foreign financial institutions and private equity (PE) companies to not only invest but take a controlling stake in Indian banks. The latest in its policy of opening up Indian banks to foreign private investment with a controlling stake has been of the Dubai Based Emirates NBD Bank (ENBD) receiving the RBI's approval to acquire a controlling stake in RBL bank. The ENBD will pick up 60 per cent stake in RBL bank. This stake purchase will also permit the amalgamation of ENBD branches with RBL branches in India. Earlier, the RBI had permitted the Japanese Sumitomo Mitsui Banking Corporation (SMBC) to acquire a 24.22 per cent stake in Yes Bank. This was by secondary purchase of stakes from the State Bank of India (SBI) and other banks. This makes SMBC the largest shareholder in Yes Bank with a right to nominate two directors in the board of Yes Bank.

The Yes Bank crisis showed not only the RBI's preference for domestic-led reconstruction but also its willingness to invite long-term institutional capital once stability returned. Much earlier, in November 2020, the Indian subsidiary of the DBS Bank (formerly Development Bank of Singapore) merged with Lakshmi Vilas Bank (LVB). That merger marked a turning point where a foreign bank was allowed to take control of a failed Indian lender to protect depositors. Yet earlier, in February 2018, the Fairfax India Holdings Corporation (FIHC) was permitted by the RBI to take a 51 per cent stake in the Kerala-based Catholic Syrian Bank (CSB). This transaction represented a calibrated allowance for PE entry into a small private bank, balancing capital needs with local sensitivities.

In October 2025, the Kerala-based Federal Bank Limited announced that the United States-(US) based, Blackstone, probably the largest alternative asset manager, would acquire 9.99 per cent stake in it. Separately, Warburg Pincus, the US-based PE firm and Abu Dhabi Investment Authority, jointly acquired a 9.99 per cent stake in the IDFC First Bank limited.

Collectively, these cases reveal the RBI's selective liberalisation framework: 1) admit foreign or PE ownership only where it strengthens governance and financial stability; 2) enforce

stringent fit-and-proper and lock-in conditions; and 3) preserve regulatory discretion over each case rather than adopting automatic liberalisation.

As India's financial sector matures, selective foreign participation is likely to continue, especially in distressed-bank resolutions and capital augmentation. The challenge for policymakers is to deepen capital access while maintaining depositor confidence and domestic control over systemic levers.

Introduction

India's banking system has been the backbone of its economic development, channelling savings into productive sectors and supporting the growth of small businesses and industry. The system's architecture features a blend of public sector dominance, a limited number of private banks and a handful of foreign players, which has historically prioritised stability over rapid liberalisation.

However, with the increasing capital requirements under the Basel Norms, the rise of digital banking and recurring episodes of bank distress, the RBI has recognised that domestic capital alone may not suffice to sustain sectoral growth. In recent years, the RBI's approach has evolved from rigid conservatism to selective openness, particularly toward strategic foreign banks and PE funds that can bring capital, technology and good governance.

This Insights attempt to track the policy shift in the stance of the RBI in selectively permitting foreign equity participation in Indian banks to the extent of permitting them to take controlling stake.

The Concept of Selective Opening

The term 'selective opening' refers to the RBI's case-by-case approval process that allows foreign or private investors to acquire stakes in Indian banks only under specific, well-defined circumstances. It contrasts sharply with blanket liberalisation policies that permit free entry or uniform ownership caps.

The key features of selective opening include the following:

1. **Case-Specific Evaluation:** Each transaction involving foreign or PE ownership is assessed on its merits – financial soundness, governance record, systemic relevance and depositor impact.
2. **Conditional Approvals:** Approvals often come with restrictions such as lock-in periods, capital adequacy conditions or board composition requirements.
3. **Public-Interest Test:** The overriding criterion is whether the investment strengthens the stability and efficiency of the banking system.
4. **Regulatory Discretion:** The RBI retains broad discretion to approve or reject foreign participation depending on prevailing economic or political considerations.

This framework enables the RBI to harness the advantages of foreign and PE capital such as deeper funding pools, better governance and modern risk systems, without compromising financial sovereignty or depositor protection.

Factors Driving the RBI's Policy Shift

Several structural and policy imperatives have driven this cautious opening. They comprise the following:

1. **Capital and Consolidation Needs:** India's private banking system is undercapitalised relative to its growth ambitions. With Basel III norms (Basel III) tightening and loan books expanding, mid-sized banks require recurring capital infusions. Foreign strategic investors and PE firms offer a ready source of long-term capital.
2. **Emergence of Resolution Precedents:** the resolution of the CSB (2018) and the amalgamation of weak banks such as LVB demonstrated that foreign or PE participation can be structured without destabilising the system. RBI now has tested mechanisms, including reconstruction schemes and conditional approvals, for handling such transactions.
3. **Growing Foreign Investor Interest:** India's financial sector offers an attractive growth story for global capital. Strategic investors see opportunities in retail penetration, digital finance and trade-related banking. PE funds are attracted to under-priced mid-tier banks with turnaround potential.
4. **Policy Alignment with Broader Economic Reforms:** the government's *Atmanirbhar Bharat* (Self-Reliant India) framework encourages foreign participation in sectors that enhance domestic capacity. Banking is treated similarly – open selectively to foreign capital that contributes to resilience rather than mere portfolio gains.

Each case approved by the RBI to permit controlling stake seems to have been done on selective strategic considerations. We examine the unique features of these:

Catholic Syrian Bank: The Private Equity Experiment

The CSB, headquartered in Thrissur, Kerala, had long been a regional private bank with strong community roots but limited growth. Its modest scale, outdated technology and rising non-performing assets made it a candidate for external capital infusion. In 2018, the FIHC obtained the RBI's approval to acquire up to 51 per cent in the CSB. The deal was unprecedented, the first of its kind: a foreign-controlled PE-style investment in a small Indian bank. The FIHC committed long-term capital and managerial expertise, promising to modernise the bank. While the transaction strengthened the CSB's capital base, it triggered local political debate in Kerala about external control of a heritage institution. Over time, the FIHC partially exited its holding to comply with RBI norms and portfolio diversification.

In terms of its policy shift the CSB-FIHC episode demonstrated:

- a. The RBI's trust in credible global financial sponsors.
- b. The utility of fit-and-proper criteria and lock-in requirements to regulate PE participation.
- c. The persistence of regional sensitivities, highlighting the need for communication and social acceptance in ownership transitions.

This case validated the feasibility of PE participation in smaller banks under a carefully supervised framework.

Lakshmi Vilas Bank: Foreign Control as Resolution

A century-old Tamil Nadu-based private bank, LVB suffered from years of weak management, poor asset quality and a shrinking capital base. By 2020, it was on the verge of insolvency. Several attempts at domestic mergers failed, leaving the RBI to search for a strategic solution. In November 2020, the RBI announced the amalgamation of LVB with DBS Bank India, a wholly owned subsidiary of Singapore's DBS Bank. The key features of this amalgamation were:

- i. All deposits and branches of LVB were transferred to DBS India.
- ii. DBS Bank infused S\$365 million of fresh capital to support the merged entity.
- iii. Shareholders of LVB lost their equity, while depositors were fully protected.

This was the first instance where a foreign bank acquired a failing Indian private bank under the RBI's supervision. The transaction represented:

- i. A strong vote of confidence in foreign ownership as a stabilisation measure.
- ii. A demonstration of the RBI's ability to exercise its resolution powers decisively.
- iii. Assurance that depositor protection and continuity of service override ownership concerns.

The LVB-DBS Bank precedence paved the way for future foreign-led rescues, signalling that the RBI's door to global strategic participation would remain ajar – but only under conditions that ensured systemic benefit.

Yes Bank: A Domestic Rescue followed by Foreign Equity Infusion

Founded in 2004, Yes Bank quickly became one of India's fastest-growing private sector banks. However, between 2017 and 2019, the bank faced severe asset-quality deterioration, exposure to risky corporate loans and governance failures. By early 2020, it was on the brink

of collapse, prompting a moratorium by the RBI. In March 2020, the RBI announced a reconstruction scheme for Yes Bank where a consortium led by the SBI were directed to inject capital. In the process shareholders faced dilution and the new investors were subject to a three-year lock-in and a reconstituted board and governance overhaul were mandated. After the bank gained stability, the infusion by SMBC was permitted.

Yes Bank's reconstruction, though domestically led, set an important precedence:

- The RBI demonstrated readiness to invite external capital post-stabilisation.
- It introduced mechanisms to ensure governance reform before allowing new investors.
- The approach balanced systemic stability with market openness – a hallmark of selective liberalisation.

While foreign or PE ownership was not central to the rescue, the episode reinforced the regulator's confidence in structured capital infusion as a viable stability tool.

RBL Bank: Strengthen Governance and Capital Adequacy

RBL Bank, originally founded in 1943 as Ratnakar Bank in Kolhapur, Maharashtra, began as a small regional lender serving traders and small businesses. Following its transformation in 2010 under new management and significant PE investment, it evolved into a modern private sector bank with a strong focus on retail. However, in recent years, RBL Bank faced challenges related to asset quality, management transitions and regulatory scrutiny, prompting the need for renewed capital support and strategic alignment with a credible global banking partner.

In October 2025, ENBD was permitted to take a 60 per cent stake in RBL Bank signalling:

- A desire to strengthen governance and capital adequacy
- Confidence in regulatory safeguards and
- A broader aim to integrate Indian banks with global financial systems.

This has been done while still maintaining oversight to prevent systemic risks and ensure stability in a sensitive sector.

Broader Policy and Market Implications

For the banking system, the selective opening has improved sectoral resilience, attracted long-term capital and encouraged better governance practices. However, it also introduces complexity in supervision as the RBI must monitor diversified ownership structures.

For foreign investors, the Indian market remains attractive but challenging. Investors must be prepared for extensive due diligence and fit-and-proper scrutiny, long-term commitments due to lock-ins and potential political sensitivities in regional markets.

For PE firms, the RBI's acceptance of the FIHC's model suggests room for PE involvement, but only in niche or mid-sized banks. PE investors will need to demonstrate strategic commitment, not merely financial engineering.

For policymakers, the evolving approach supports India's aspiration to create a handful of globally competitive banks. Controlled foreign participation can strengthen capital buffers, risk management and technology adoption.

The Road Ahead

Looking ahead, India's banking sector faces several intersecting trends:

- i. Consolidation and Scale: The government and the RBI are expected to encourage mergers that create globally competitive banks. The discussion with the SBI is already on.
- ii. Digital Transformation: Foreign partnerships could accelerate technological upgrading, especially in payments, credit scoring and cybersecurity.
- iii. Capital Market Linkages: As Indian banks access global capital markets, the presence of credible foreign shareholders may improve transparency and investor confidence.
- iv. Potential Expansion of Licensing: The RBI may consider new categories of differentiated banks where foreign participation could be more liberal.

Selective liberalisation is, therefore, likely to deepen – not by sweeping reforms, but through carefully curated transactions aligning with India's developmental and stability goals.

Conclusion

The evolution of India's banking sector policy reflects the RBI's enduring balancing act – openness without vulnerability. The regulator's willingness to selectively open the sector to foreign banks and PE investors stems from necessity rather than ideology. It is a pragmatic response to capital shortages, governance failures and the need for consolidation.

Each of the four cases discussed above represents a distinct expression of the same philosophy – calibrated liberalisation under vigilant supervision. The RBI's selective approach ensures that India benefits from global capital and expertise while preserving financial sovereignty and depositor trust.

As India's economy advances toward the US\$5-trillion (S\$6.75-trillion) mark, its banking system will require levels of capital, technology and risk-management expertise that far

exceed what domestic resources alone can provide. The selective opening, which has been cautious, conditional and case-driven, is thus not merely a regulatory stance but a strategic blueprint for the next phase of Indian banking.

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