RBI Guidelines on Small Finance Banks

Why in news?

The Reserve Bank of India (RBI) recently announced the final guidelines for on-tap licensing of private sector SFBs (small finance banks).

What do SFBs, PBs, 'on-tap licensing' mean?

- Small Finance Banks (SFBs) offer basic banking services.
- These include accepting deposits and lending to un-served and underserved sections.
- It offers for small businesses, small and marginal farmers, micro and small industries, and the unorganized sector.
- Payment banks (PBs), on the other hand, as per the existing rules, are not allowed to lend.
- Also, their deposits are capped at Rs. 1 lakh per customer.
- An 'on-tap' facility would mean that the RBI would accept applications and grant license for banks throughout the year.

What are the key guidelines?

- **Payments banks** can apply for conversion into small finance banks (SFBs) after 5 years of operation, provided they meet the eligibility criteria.
- The promoter of a payments bank is eligible to set up an SFB.
- This is permissible, provided that both banks come under the non-operating financial holding company (*NOFHC*) structure.
- **SFBs Capital** - The RBI has also raised the minimum paid-up capital requirement for SFBs from Rs. 100 crore to Rs. 200 crore.
- It said the promoter should hold a minimum of 40% of the paid-up voting equity capital for 5 years.
- If the initial promoter shareholding is above 40%, it should be brought down to 40% within a period of 5 years, 30% within 10 years, and 15% in 15 years.
- **Schedules bank status** - SFBs should be listed within 3 years of reaching a

net worth of Rs. 500 crore.

- They will be given the scheduled bank status immediately upon commencement of operations.
- They will also have general permission to open banking outlets from the date of commencement of operations.
- **Urban cooperative banks** - The RBI also allowed primary urban cooperative banks to convert into SFBs.
- This is, provided they comply with the on-tap licensing guidelines.
- The minimum net worth of such SFBs will be Rs. 100 crore.
- This has to be increased to Rs. 200 crore within 5 years from commencement of business.

What is the rationale?

- In September 2015, RBI had granted in-principle approval to 10 applicants to set up SFBs.
- The small finance banks have largely achieved their priority sector targets.
- They have thus attained the mandate for furthering financial inclusion, building a strong case for the entry of more players.
- The RBI has thus issued the final guidelines for licensing such banks throughout the year.
- Small finance banks have the potential to provide an alternative to some of the existing institutions.
- It can contribute to increasing financial inclusion and serving a variety of unserved clients in the hinterland and tier three and four cities and towns.

What are the benefits?

- If payment banks get the licence of small finance banks, it will give them access to more deposits.
- This will boost their profitability, which is at present under pressure.

- The RoE is likely to decline during the initial years of the transition to SFB.
- [Return on equity (ROE) is a measure of profitability of a business, calculated by dividing net income by shareholders' equity.]
- However, the move may prompt many NBFCs to explore the SFB model to address the liabilities issue.
- This is because there is liquidity tightness over the last one year and risk aversion to NBFCs.
- So, a good response for SFB licences can be expected.
- Given that licensing is on on-tap basis, NBFCs can finalize their business plans, organization structure, systems and processes before applying for the licence to ensure a better success rate.

- Small finance banks could thus occupy the space being gradually vacated by some of the bigger banks.
- Their success will, however, be dependent on asset quality, the trust they are able to build progressively, the level and standards of governance and regulatory oversight.

Source: Indian Express, Livemint

Quick Facts

NOFHC

- The NOFHC is a category of non-banking finance company (NBFC), registered as an NBFC with the RBI.
- It is governed by a separate set of directions issued by RBI.
- The objective is to separate several financial activities carried out by the same holding company.