Small Finance Bank

Meaning

- Small Finance Banks are the financial institutions which provide financial services to the unserved and unbanked region of the country.
- They are registered as a public limited company under the Companies Act, 2013.

Objective

- **Access to financial services:** The main purpose behind having small finance banks is to expand access to financial services in rural and semi-urban areas. These banks can do almost everything that a normal commercial bank can do but at a much smaller scale.
- **Basic banking services:** It will offer basic banking services, accept deposits and lend to underserved sections of customers, including small business units, small and marginal farmers, micro and small industries, and even entities in the unorganised sector.
- **Alternative institution:** Small finance banks have the potential to provide an alternative to some of the existing institutions with their mandated focus on small and medium businesses, the informal sector, small and marginal farmers and thus on increasing financial inclusion and serving a variety of unserved clients in the hinterland and tier three and four cities and towns.

Regulation

- **Small Finance Banks** are governed by the provisions of the:
    - Banking Regulation Act, 1949;
    - **Reserve Bank of India Act, 1934**;
    - Foreign Exchange Management Act, 1999;
    - Payment and Settlement Systems Act, 2007;
    - Credit Information Companies (Regulation) Act, 2005;
    - Deposit Insurance and Credit Guarantee Corporation Act, 1961;
    - Other relevant Statutes and the Directives, Prudential Regulations and other Guidelines/Instructions issued by Reserve Bank of India (RBI) and other regulators from time to time.
- SFBs will be given scheduled bank status once they commence their operations, and found suitable as per Section 42 of the Reserve Bank of India Act, 1934.

Eligible promoters

- **Eligibility Criteria:**
    - **Resident individuals/professionals, singly or jointly,** each having at least **10 years of experience** in banking and finance at a senior level and Companies and Societies in the private sector, that are owned and controlled by residents and having successful track record of running their businesses for at least a period of **five years,** will be eligible as promoters to set up small finance banks.
    - **Existing Non-Banking Finance Companies (NBFCs), Micro Finance Institutions (MFIs), and Local Area Banks (LABs)** in the private sector, that are controlled by

residents and having a successful track record of running their businesses for at least a period of five years, can also opt for conversion into small finance banks.

        - However, joint ventures by different promoter groups for the purpose of setting up small finance banks are not permitted.
    - **Primary (Urban) Co-operative Banks (UCBs):** These are desirous of voluntarily converting into small finance banks, may voluntarily transform from Urban Co-operative Bank into a Small Finance Bank.
    - The minimum net worth of such small finance banks shall be **Rs. 100 crore** from the date of commencement of business. However, they will have to increase their minimum net worth to **Rs. 200 crore within five years** from the date of commencement of business.
- **'Fit and Proper' criteria**
    - Promoters/Promoter Groups should be 'fit and proper' in order to be eligible to promote small finance banks.
    - RBI assesses the 'fit and proper' status of the applicants on the basis of their:
        - Past record of sound credentials and integrity;
        - Financial soundness and successful track record of professional experience or of running their businesses, etc. for at least a period of five years.
- **Corporate Structure:**
    - The promoters/promoter group may choose to set up the small finance bank either as a standalone entity or under a holding company, which shall act as the promoting entity of the bank.
    - **Intermediate company:** However, if there is an intermediate company between the small finance bank and its promoting entity, it should be a Non-Operative Financial Holding Company (NOFHC).
        - If the promoters desire to set up the small finance bank under a holding company structure, without an NOFHC, the holding company/the promoting entity shall be registered as an NBFC – CIC with the Reserve Bank.

Scope of activities

- The small finance bank shall primarily undertake basic banking activities of **acceptance of deposits** and **lending to unserved and underserved sections** including small business units, small and marginal farmers, micro and small industries and unorganised sector entities.
- It can also undertake other **non-risk sharing simple financial services activities,** not requiring any commitment of own funds, such as the distribution of mutual fund units, insurance products, pension products, etc.
    - With the prior approval of the RBI and after complying with the requirements of the sectoral regulator for such products.
    - After three years from the date of commencement of operations of the bank, the requirement for prior approval from the Reserve Bank will no longer apply and the bank will be governed by the extant norms as applicable to scheduled commercial banks.
- The small finance bank can also become an **Authorised Dealer** in foreign exchange business for its clients' requirements.
- **Open banking outlets:** Small finance banks will have general permission to open banking outlets from the date of commencement of business subject to the condition that the requirement of opening at least 25 percent of its banking outlets in unbanked rural centres (population up to 9,999 as per the latest census).
- **Restriction in the area of operations:** There will not be any restriction in the area of operations of small finance banks; however, preference will be given to those applicants who, in the initial phase, set up the bank in a cluster of under-banked States/districts, such as in the North-East, East and Central regions of the country.
    - These applicants will not have any hindrance to expand to other regions in due course.

    - It is expected that the small finance bank should primarily be responsive to local needs. After the initial stabilization period of five years, and after a review, RBI may liberalize the scope of activities of the small finance banks.
- The other financial and non-financial services activities of the promoters, if any, should be kept distinctly ring-fenced and not commingled with the banking business.

Capital Requirement

- The minimum paid-up voting equity capital for small finance banks shall be Rs.200 crore, except for such small finance banks which are converted from UCBs.
- In view of the inherent risk of a small finance bank, it shall be required to maintain a minimum capital adequacy ratio of 15 percent of its risk-weighted assets (RWA) on a continuous basis, subject to any higher percentage as may be prescribed by RBI from time to time.

Foreign Shareholding

- The foreign shareholding in SFBs would be as per the Foreign Direct Investment (FDI) policy for private sector banks as amended from time to time.
- Currently, the aggregate FDI in a private sector bank from all sources will be allowed up to a maximum of 74% of the paid-up capital of the bank.
- In the case of Foreign Institutional Investors (FIIs)/Foreign Portfolio Investors (FPIs), individual FII/FPI holding is restricted to below 10% of the total paid-up capital.
- The aggregate limit for all FIIs/FPIs/Qualified Foreign Investors (QFIs) cannot exceed 24% of the total paid-up capital. This can be raised to 49% of the total paid-up capital by the bank concerned through a resolution by its Board of Directors followed by a special resolution to that effect by its General Body.

Other Key Points

- SFBs need to maintain a Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR).
- They are required to extend 75% of its Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending by the Reserve Bank of India. At least 50% of its loan portfolio should constitute loans and advances of up to Rs. 25 lakh.
- SFBs can also transit to a universal bank, subject to fulfilling minimum paid-up capital/net worth requirements as applicable to universal banks.
- They cannot be a Business Correspondent (BC) for another bank. However, they can have their own BC network.