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ho2099@sib.co.in

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Theme 289

PAYMENT BANKS AND SMALL BANKS

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Email: sibcorporate@sib.co.in | CIN : L65191KL1929PLC001017

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DECEMBER 2015

Theme No: 289: PAYMENT BANKS AND SMALL BANKS

A well informed customer will make the policy makers as well as organisations which produce goods and services more responsive to the customer needs. This will also result in healthy competition among organisations and improve the quality of goods and services produced. The "SIB Students' Economic Forum" is designed to kindle interest in economic affairs in the minds of our younger generation. RBI used to issue only universal bank licenses till recently. But now central bank has taken a different step and gave in principle sanction to open payment banks and small banks. This month we discuss about Payment banks and small banks.

Briefly explain the background of payment banks?

RBI, on 27th August 2013, on its website published a policy discussion paper, banking structure in India-the way forward. Publication identified the need for differentiated banking in India as a good alternative for development of banking and growth of different sectors of economy.

Nachiket Mor Committee conducted a detailed study about this issue and recommended for the payment bank license. Finance Minister Arun Jaittley in union budget presentation of 2014-15 stressed the need for differentiated banks -payment banks, small banks etc. to cater the need of small businessmen, unorganized sectors, lower income households, farmers, migrant workers etc.

On 17-07-2014, RBI released the draft licensing directions for public opinion. The final guidelines were issued on 27-10-2014. 144 queries were raised and on 01-01-2015 RBI gave the clarifications. RBI released the list of 41 organizations which had applied for payment banks and on 19th August the final list of organizations which are given "in principle" sanction for payment banks.

Which are the 11 organizations that received "in principle" sanction for payment bank?

1. Vodafone 2. Airtel 3. Cholar mandalam distributor's Ltd 4. Reliance Industries 5. Aditya Birla 6. Paytm 7. Sun Pharmaceuticals 8. Department of post 9. Fino Paytec 10. Tech Mahindra 11. National Securities Depository Limited

What are the important licensing, registration and regulations for payment banks?

The validity period of 'in- principle' is 18 months. The payment banks should satisfy all the conditions/requirements within that period. They should not engage in banking activities during this period.

Major Regulations for Payment banks

1. Fully networked systems from the very beginning.
2. Atleast 40% promoter stake for first 5 years.
3. FDI allowed subject to rules for private banks.
4. Rs 100 Crores –minimum capital required.
5. Lending activities not allowed.
6. No subsidiaries allowed for undertaking non-banking activities.
7. Rs. 1 lakh per customer cap for deposits initially, but may be raised by RBI based on performance.
8. Appointment of directors- as per RBI guidelines independent directors should have the majority.
9. Shareholder voting rights- capped at 10% which can be raised to 26% by RBI
10. Voting right-Regulated by banking regulation act, 1949.
11. Atleast 25% of branches in under banked rural areas.
12. The bank should be registered under companies act, 2013, as a public limited company.
13. To differentiate from other banks, ‘payment bank’ to be used as a part of it’s title.

What is the primary objective of setting up of payment banks?

Financial inclusion is the primary objective of setting up of payment banks. They should help the financial inclusion by

a. Opening of small savings account
b. Smooth and easy payment/remittance services to migrant labourers, small business people, other unorganized entities etc.
c. Technology driven environment

Briefly describe the scope of payment bank?

Payment banks are allowed only certain restricted activities under the banking regulation act, 1949

1. Acceptance of demand deposit**:-**Payment banks can accept current/savings deposits from the individuals, small business and other entities. Non Resident Indian (NRI) deposits should not be accepted. There will be deposit insurance and credit Guarantee Corporation of India (DICGCI) cover for the deposits. Simplified KYC/AML norms will be applicable to such accounts.
2. Payment banks can issue ATM/Debit card but they are not allowed to issue credit card.
3. As per the instructions issued from time to time, they can issue pre-paid payment instruments (PPIs).
4. Payment banks can offer internet banking and they are excepted to leverage technology to offer low cost banking solution.
5. A payment bank can act as a business correspondent (BC) of another bank subject to RBI guidelines on BCs.
6. Payments banks can accept remittances to be sent to or receive remittances from multiple banks under a payment mechanism approved by RBI such as RTGS/

NEFT/IMPS.

7. Payment bank can undertake other non-risk sharing simple financial service activities not requiring any commitment of their own funds such as distribution of mutual fund units, insurance products, pension product etc. with prior approval of RBI and after due compliance.
8. The payment bank can undertake utility bill payments on behalf of its customers and general public.
9. The payment banks cannot setup subsidiaries to undertake non banking financial service activities. The other financial and non financial service activities of the promoters, if any, should be kept distinctly ring-fenced and not involved with the banking and financial service business of the bank.
10. Payment banks will be permitted to handle international fund transfer in the nature of personal payments or remittances in the current account. All facilities/approvals for such transactions are subject to RBI approval.

Can the payment banks undertake lending activities?

The payment bank CANNOT undertake lending activities. They have to invest minimum 75% of 'demand deposit balances' in statutory liquidity ratio (SLR) eligible government securities\treasury bills with maturity up to 1 year and maximum 25% demand deposit balances can be held in current and time/fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.

What is the minimum capital adequacy ratio to be maintained by the payment banks?

Payment banks are required to maintain a minimum capital adequacy ratio of 15% of its risk weighed assets (RWA) on a continuous basis, subject to RBI guidelines issued from time to time. Tier1 capital should be at least 7.5% of RWAs. Tier2 capital should be limited to a maximum of 100% of total tier1 capital.

What is the system suggested to deal with customer compliant?

To deal with customer complaint/grievances, payment banks should have a high powered customer grievances cell.

SMALL FINANCE BANK

How many entities are given in principle sanction for small finance bank and which are the entities that are given in the principle sanction by RBI?

RBI has given in principle sanction for 10 organizations (out of 72 applicants) for starting small finance banks. They are 1.Au Financiers (India) Jaipur 2.Capital Local Area Bank Jalandher3.Disha MicroFin, Ahembadabad 4.Equitas Holdings, Chennai, 5.Esaf Microfinance Investment, Chennai 6.Financial Services, Bengaluru 7.RGVN (North East) MicroFinance, Guhatti 8.Suryoday MicroFinance, Navimumbai 9.Ujjivan Financial Services, Bengaluru 10.Utkarsh MicroFinance, Varanasi

What is the minimum capital requirement for small banks?

The minimum paid up equity capital for small finance banks is Rs 100 crore. They have to maintain a capital adequacy ratio of 15% of its risk weighed assets (RWA) on continuous basis subject to RBI instructions issued from time to time. At least 7.5% of RWAs should be tier 1 capital. Tier 2 capitals should be limited to a maximum of 100% of total tier 1 capital. Basel committee's standardized approach will be applied for the calculation of capital adequacy ratio.

What are the objectives of small finance banks?

1. Servicing the unserved and underserved sections of the people.
2. Through high technology-low cost operations to provide credit to small business units, small and marginal farmers, micro and small industries etc.

Describe briefly the prudential norms to be followed by small finance banks?

1. All prudential norms and regulations of the RBI which are applicable to the existing commercial banks (including SLR and CRR requirements) are applicable to small finance banks.
2. Priority sector advances should be 75% of Adjusted Net Bank Credit (ANBC) of small finance banks
3. At least 50% of small finance banks loan portfolio should be loans and advances up to Rs 25 Lakhs

Can small finance banks do foreign exchange business?

Small finance banks can become category 2 Authorized Foreign Exchange Dealer. It cannot setup subsidiaries to undertake non banking financial services activities.

What are the conditions for branch expansion for small finance banks?

For the first 5 years RBI approval is required for the branch expansion. The expansion plan should be in compliance with the requirement of opening at least 25% of its branches in unbanked rural centers (population up to 9999 as per the latest census)

Is it mandatory to use the words 'small finance bank' in its name?

Yes, it is required to use the word 'small finance banks' in its name. The objective is to differentiate from other banks.

What are the condition regarding promoters contribution?

The initial minimum promoter contribution towards paid up equity should be at least 40%, which can be brought down to 26% within 12 years from the date of commencement of business of the bank. Foreign share holding will be possible as per the Foreign Direct Investment (FDI) policy and amendments made from time to time.

Is it possible to convert the small finance banks to a universal bank?

Transition from a small finance bank to a Universal bank will not be automatic. It should be subject to fulfilling of minimum paid-up capital, net worth requirements etc. which are applicable to universal banks. It should have sufficient satisfactory track record as small finance bank. Reserve Bank will conduct the due diligence exercise. Subject to above conditions RBI may consider the transition from small finance banks to universal banks.

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