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RECENT RBI INITIATIVES IN THE FINANCIAL SYSTEM

- In-principle approval was given to certain businesses to create **Small Finance Banks and Payment Banks** to carry out the planned activities within the RBI's broad regulatory restrictions.
- Furthermore, at the presentation of the Union Budget for Fiscal Year 2016, the Finance Minister announced the **establishment of a refinance agency** Micro Units Development & Refinance Agency Ltd (**MUDRA)**.

SMALL FINANCE BANKS (SFBs)

- The committee on Financial Sector Reforms under the **Chairmanship of Dr. Raghuram G. Rajan in 2009 had examined the relevance of small banks** in the Indian context.
- In the union budget 2014-15 the union finance minister announced the intention to put a structure in place for continuous authorisation of universal banks and create a framework for **licensing small banks and differentiated banks serving niche interests, local area banks, payment banks etc. to meet the credit and remittance needs of small business, unorganised sector, low income households, farmers and migrant work force.**

GUIDELINES FOR LICENSING OF SMALL FINANCE BANKS IN THE PRIVATE SECTOR AS ISSUED ON NOVEMBER 27, 2014:

a) **Objectives:** To further financial inclusion by provision of **savings vehicles, supply of credit to small business units, small marginal farmers, micro and small industries; and other unorganised sector entities** through **low cost** high technology operation.

b) **Eligible promoters:** Resident individuals/professionals with **10 years of experience in banking and finance; companies and societies owned by resident individuals will be eligible** to set up small finance banks.

- Existing **NBCs, MFIs, Local Area Banks (LAB) owned by resident Indians can opt for conversion subject to promoter/ promoter groups** having a sound track **record for at least five years of running their business** on sound lines and be fit and proper'.

c) **Capital Requirements:** Minimum paid up capital of ₹100 crore. Promoter's minimum initial contribution shall be **at least 40% of the paid-up equity capital** and gradually brought down to **26% within 12 years from the date of commencement of the business of the bank.** Foreign shareholding will be as per FDI policy for private sector banks as amended from time to time.

d) **Prudential Norms:** As applicable to commercial banks including maintenance of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) **75%** of its Adjusted Net Bank Credit to be extended to sectors eligible for classification as priority sector lending (PSL). 50% of the loan portfolio should constitute loans and advances up to **₹25 lakh.**

- RBI on September 16, 2015 has granted in-principle approval to 10 applicants to set up small finance banks .Selected applicants are:

a) Au Financiers (India) Ltd., Jaipur
b) Capital Local Area Bank Ltd., Jalandhar
c) Disha Microfin Ltd. Ahmedabad
d) Equitas Holding Private Ltd. Chennai
e) ESAF Microfinance and Investments Private Limited
f) Janalakshmi Financial Services Private Limited.
g) RGVN (North East) Microfinance Limited Guwahati
h) Suryoday Micro Finance Private Limited, Navi Mumbai
i) Ujjivan Financial Services Private Ltd. Bengaluru
j) Utkarsh Micro Finance Private Ltd. Varanasi

Para-banking Activities

a) SFBs will **not be permitted to undertake any para-banking activity** except that allowed as per the licensing guidelines and the related FAQs issued by RBI.

b) SFBs will be **permitted to use Interest Rate Futures (IRFs)** for the purpose of proprietary hedging. Regarding foreign exchange business, SFBs will be permitted to use derivatives for proprietary hedging only as applicable to AD Category II Licence holder.

Regulations on Business Correspondents

- SFBs may engage all **permitted entities including the companies owned by their business partners and own group companies** on arm's length basis as BCs.
- SFBs will be **exempted from the requirement of having a base branch for a certain number of BCs/access points managed by BCs** as currently stipulated in the RBI guidelines for scheduled commercial banks.

Financial Inclusion and development

- SFBs are encouraged to **lend to Self Help Groups (SHGs).**
- Provisions of Para 10 of Licensing guidelines pertaining to grandfathering of borrowings **will apply to cases where existing NBCs/MFIs set up a small finance banks and transfer its business to the SFB as well**, apart from conversion cases.
- The first audited balance sheet as of March 31st after the SFB's start-up would serve as the foundation for the SFB's first PSL target (for the following year).

Foreign Exchange Business

- Small Finance Banks shall comply with all the conditions attached with the AD
- Category II license that will be issued by the Foreign Exchange Department, RBI.

Customer Education and Protection

SFBs will be governed by the Banking Ombudsman (BO) Scheme.

Existing provisions as applicable to scheduled commercial banks will be applicable to small finance banks also such as-

a) Investment classification and valuation norms
b) Restrictions on loans and advances (including lending to NBFCs) including regulatory limits.
c) Income recognition, asset classification and provisioning norms on advances including that for restructuring of credit facilities
d) CRR, SLR, disclosures and statutory/regulatory reports
e) KYC requirements
f) Currency distribution (covering detection of forged and counterfeit notes, currency chest facilities, facilities for exchange of notes)
g) Credit information reporting
h) Outsourcing of operations, internet banking and mobile banking
i) Implementation of Ind AS
j) Bank deposits
k) Bank charges, lockers, nominations, facilities to disabled persons, etc.
l) Marginal Cost of Funds based Lending Rate (MCLR), other related regulations on interest rates and fair practice code for lenders
m) Branch authorization policy (SFBs are required to have **25% of their branches in unbanked rural centres** within 1 year from the date of commencement of operations.)
n) Constitution and functioning of committees of the board, management level committees, remuneration policies
o) Risk management.

PAYMENTS BANKS

- The Committee on Comprehensive Financial Services for Small Business and Low Households under the **Chairmanship of Dr. Nachiket Mor** in its report released in January 2014 examined the issues relevant to an **ubiquitous payment network and universal access to savings and recommended the licensing of payments banks to offer financial services** to the hitherto excluded segments of the population.
- In the Union Budget 2014-15, the finance minister announced that **RBI will create a framework for licensing small banks and differentiated banks.**
- Accordingly RBI formulated the guidelines for licensing of payments banks and released it on November 27, 2014

Objectives: To further financial inclusion by providing small savings accounts, payment/remittance services to migrant labour workforce, low income households, small businesses, other unorganised sector entities and other users.

Eligible Promoters

a) Existing non-bank pre-paid payment instrument (PPI) issuers, NBFCs, corporate Business Correspondents (BCs), mobile telephone operators, super-market chains, companies, real sector co-operatives that are **owned and controlled by residents, individuals, professionals and public sector entities.**

b) A **promoter/group can have a joint venture with an existing scheduled commercial bank** to set up a payment bank, subject to equity stake of the commercial bank in the payments bank to the extent as permitted under section 19(2) of the Banking Regulation Act, 1949

c) They should have 'fit and proper credentials with sound track record of professional experience or running the business for at least 5 Years on sound lines.

Scope of Activities

a) Acceptance of demand deposits, subject to holding a maximum balance of 1 lakh per individual customer.

b) Issuance of ATM/debit cards. No credit cards can be issued by the payment banks.

c) Payment and remittance services through various channels.

d) Acting as BC of another bank subject to RBI guidelines.

e) Distribution of non-risk sharing simple financial products like mutual fund units, insurance products etc

Deployment of funds

a) Payments banks **cannot undertake lending activities**

b) Payments banks are required to maintain CRR on its outside demand and time liabilities, they will be required to invest minimum **75%** of their demand deposit balances in SLR in eligible government securities/treasury bills with maturity up to one year and hold **maximum 25% in current and time/fixed deposits with other scheduled commercial banks for operational purposes and liquidity management.**

Capital Requirements: Minimum paid up equity capital to be ₹100 crore, leverage ratio of not less than 3%.

Promoter's Contribution: Initial contribution shall at least be 40% for the first 5 years from the commencement of its business.

Foreign Shareholding: As per FDI policy for private sector banks as amended from time to time.

Other Conditions: The operations of the bank should be fully networked and technology driven from the beginning. The bank should have a high powered Customer Grievance Cell to handle customer complaints.

Procedure for RBI decisions

a) The decision of RBI to issue an in-principle approval will be final.
b) Validity of the in-principle **approval will be for 18 months.**
RBI on August 19, 2015 has granted in-principle approval to the following 11 applicants to set up payments banks under the guidelines issued by them on November 27, 2014 :

1) Aditya Birla Nuvo Limited
2) Airtel M Commerce Services Limited
3) Cholamandalam Distribution Services Limited
4) Department of Posts
5) Fino Pay Tech Limited
6) National Securities Depository Limited

7) Reliance Industries Limited
8) Shri Dilip Shantilal Shanghyi
9) Sri Vijay Sekhar Sharma
10) Tech Mahindra Limited
11) Vodafone m-pesa Limited

Para-Banking Activities

PBs will not be permitted to undertake any para-banking activity except those allowed as per the Licensing guidelines and the related FAQs issued.

Bank Deposits

PBs can accept only savings and current deposits. The aggregate limit per customer shall not exceed ₹1,00,000 as provided in the licensing guidelines. All RBI and BR Act provisions and RBI Directions relating to minimum balance, inoperative accounts, unclaimed deposits including transfer of such deposits to the Depositors Education and Awareness Fund maintained by RBI on regular basis, nominations, cheques, drafts etc. will be applicable to the PBs.

Payments Banks

- Need **not issue pass books** for deposit accounts
- May provide statement of accounts in paper form on chargeable basis or otherwise
- May provide account information through multiple user friendly moves such as SMS and/or internet banking
- Should provide electronic confirmation through SMS/e-mail/printed proof for each account transaction

Customer education and protection

PBs will be covered by the **Banking Ombudsman (BO) Scheme.**

Existing provisions/guidelines issued by RBI for commercial banks will be applicable to payment banks also in respect of the following

a) CRR, SLR, disclosures and statutory/regulatory reports
b) Market risk management
c) Operational risk management
d) Liquidity risk management
e) Strategic and reputational risk management
f) Internal controls, audit and compliance, with suitable enhancements to take care of the ICT related aspects and operations through agents.
g) Constitution and functioning of board of directors
h) Constitution and functioning of committees of the board, management level committees, remuneration policies
i) Bank charges, lockers, nominations, facilities to disabled persons, etc.
j) KYC requirements
k) Outsourcing of operations, internet banking and mobile banking

MICRO UNITS DEVELOPMENT & REFINANCE AGENCY LIMITED (MUDRA)

- The Union Budget presented by the Hon'ble Finance Minister, for FY 2015-16, announced the formation of MUDRA Bank. Accordingly **MUDRA was registered as a Company in March 2015 under the**

Companies Act 2013 and **as a Non-Banking Finance Institution with the RBI on 7 April 2015.**

- MUDRA was founded as a **wholly owned subsidiary of the Small Industries Development Bank of India (SIDBI)**, with SIDBI contributing 100% of the capital. MUDRA's authorised capital is **currently ₹1000 crores**, while its **paid-up capital is ₹750 crores**, entirely subscribed by SIDBI.
- MUDRA has been tasked with **growing and refinancing the micro-enterprise sector by assisting financial institutions that lend to micro/small business entities engaged in manufacturing, commerce, and service activities**.
- MUDRA will collaborate with banks, MFIs, and other lending institutions at the state and regional levels to offer microfinance support to the country's microenterprise sector.
- The RBI established a **MUDRA refinancing fund of ₹20,000 crore,** which was designated from the banks' priority sector lending deficit.
- MUDRA enrolled **160 Institutions**--including 88 banks (**27 public sector banks, 17 private sector banks, 31 regional rural banks (RRBs) and 13 state/urban cooperatives banks**). 46 MFIs and 26 NBCs as 'partners' for refinancing against their lending to micro entrepreneurs.

Role and Responsibilities :

- MUDRA was established with the primary purpose of expanding the country's micro enterprise sector by providing different sorts of assistance, including financial assistance in the form of refinancing, in order to meet the goal of "funding the unfunded."

- In addition to refinancing, MUDRA has been tasked with monitoring Pradhan Mantri Mudra Yojana (PMMY) data via **maintaining the online platform, as well as facilitating the issuing of guarantees for loans provided under PMMY**, a plan to disburse loans to micro firms.
- During 2015-16, PMMY made a significant contribution by extending credit **of ₹1.33 lakh crore to nearly ₹3.48 crore borrowers.**
- The programme also helped in extending financial support to the **weaker sections of the society**, viz., SC/ST/ OBC/women entrepreneurs, in large numbers.
- The programme has also facilitated the inclusion of nearly ₹1.25 crore new entrepreneurs in the formal credit system. MUDRA on the other hand, has made a steady beginning by extending nearly ₹3,300 crore of refinance to different financial institutions, for extending funding support to this vulnerable sector. MUDRA also introduced a new working capital instrument entitled "MUDRA Card". It started securitisation, a new area of business, with a view to enable credit access at reasonable cost to the borrowers.
- The PMMY was setup with the objective of fulfilling loan requirements up to **₹10 lakh for such enterprises to start or expand their business activities**.
- Up to March 31, 2016, an aggregate credit of **₹1,32,954 crore was extended to ₹34.88 million loan applicants**. RRBs can avail refinance for the loans extended to MUDRA borrowers with up to **3.5% interest margin.**

- As on March 31, 2016, the outstanding refinance portfolio of MUDRA stood at ₹3,291.66 crore. (Source Annual Report of MUDRA 2015-16)

Pradhan Mantri Mudra Yojana (PMMY)

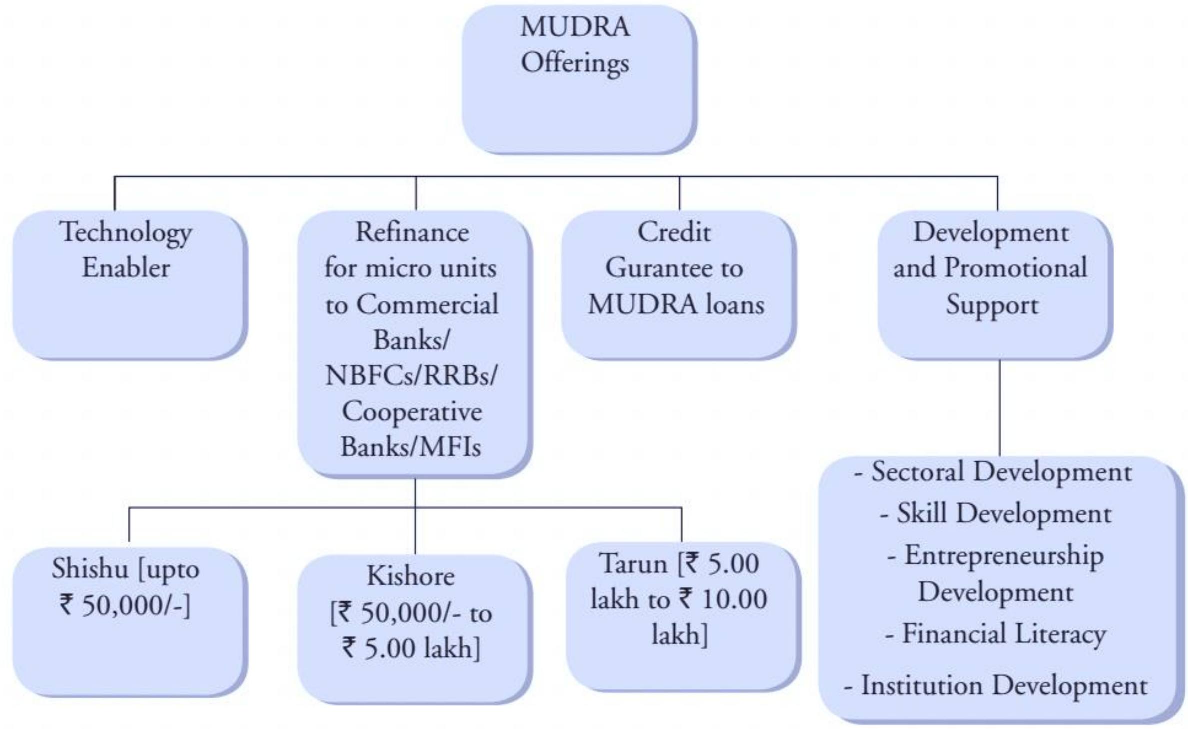
a) The Mudra loan plan, as it is commonly called, seeks not only to bridge the financial gap for micro firms, but **also to build the confidence of first generation entrepreneurs and support existing small businesses in expanding their operations.**

b) PMMY intends to make Mudra loans of up to **₹10 lakh rupees to income-generating micro companies involved in manufacturing, commerce, and services.**

c) The MUDRA loans are divided into three categories based on the business life-cycle that the loanee enterprise currently is in. **These three categories signify the growth, development and funding needs of the beneficiaries.**

- Shishu: Loans up to 50,000
- Kishore: Loans from 50,001 to 5,00,000
- Tarun: Loans from 5,00,001 to 10,00,000

Product/Offerings of MUDRA



Credit Guarantee Fund for Micro Units

- As announced by the Hon'ble Finance Minister in the budget for FY 2015-16, a separate credit guarantee fund was created for MUDRA loans, **with an initial corpus of ₹3,000 crore.**
- National Credit Guarantee Trustee Company (NCGTC). a subsidiary of SIDBI managing various credit guarantee funds, is the implementing agency for MUDRA Credit Guarantee Scheme.
- The fund was constituted during **2015-16 and the schemes were notified on April 18, 2016** through a GoI gazette notification.

Scheme for guarantee coverage to eligible Non-Banking Finance Companies (NBFCs)

Eligibility-

a) Systemically Important NBFCs registered with RBI and meeting specified prudential norms.
b) Should be in **profit for last three years**. Credit rating for long term bank credit not lower than BBB.
c) Lending to Micro and Small Enterprises (MSEs)

- Experience of **minimum 5 years** to establish their lending and recovery track record (could be relaxed to 3 years).
- Should have **minimum ₹100 crore** MSE loan portfolio.
- **NPA level less than 5%** for MSE portfolio as per the latest audited results.
- Average recovery ratio for the MSE portfolio for the **last three years should be over 90%.** May be relaxed in deserving cases.

Coverage of loans: Loans above ₹10 lakh and up to ₹200 lakh sanctioned after signing of agreement with CGTMSE to new as well as existing MSEs in manufacturing as well as service sector carrying out activities as currently permitted for coverage by CGTMSE.

Formalities to become a member - Eligible NBFCs have to approach **CGTMSE for completing the formalities as a Member Lending Institution, signing of agreement and submission of information**

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Other important Conditions

- **No collateral security or third party guarantee** shall be stipulated.
- NBFC will be **responsible for due diligence of the credit proposal and its further follow up and recovery of all loan amounts.**
- Entry of the units under MSME databank of Government of India will be necessary for coverage under CGTMSE.