

# Draft Guidelines for Licensing of 'Small Banks' and 'Payments Banks'

22 July 2014

## In brief

The Reserve Bank of India (RBI), recently released the much awaited draft guidelines for 'Small Banks' and 'Payments Banks' to be licensed as differentiated or restricted banks. The RBI has invited comments and suggestions on the draft guidelines to be submitted by 28 August 2014. Key highlights of the draft guidelines are summarised in tabular fashion below.

## In detail

Small Banks	Payments Banks
Eligible Entities	
<ul style="list-style-type: none"> <li>Resident individuals/ professionals with 10 years of experience in banking and finance, Companies and Societies will be eligible as promoters to set up small banks.</li> <li>Existing NBFCs, MFIs and LABs<sup>1</sup> may opt for conversion into small banks after complying with the necessary legal and regulatory requirements.</li> <li>Promoter/ Promoter Groups<sup>2</sup> should meet "Fit and Proper"<sup>3</sup> criteria</li> <li>RBI will examine applicants on the basis of their past record of sound credentials and integrity; financial soundness and successful track record of running their businesses etc. for at least a period of five years.</li> <li>Local focus and the ability to serve smaller customers will be a key criterion in licensing such banks.</li> </ul>	<ul style="list-style-type: none"> <li>Entities eligible to set up Payments Bank are:               <ul style="list-style-type: none"> <li>Existing authorised non-bank Prepaid Payment Instruments (PPI) issuers</li> <li>NBFCs</li> <li>Corporate Business Correspondents (BCs)</li> <li>Mobile telephone companies</li> <li>Super-market chains</li> <li>Real sector co-operatives</li> <li>Public sector entities</li> <li>Companies</li> </ul> </li> <li>Other banks can take an equity stake in a Payments Bank (in terms of Section 19(2) of the Banking Regulation Act, 1949).</li> <li>Entities and their promoters/promoter groups to be 'fit and proper' - on the basis of past record of sound credentials and integrity; financial soundness, and successful track record of at least 5 years in running their businesses.</li> </ul>

<sup>1</sup> NBFC – Non-Banking Financial Company; MFI – Micro Finance Institution; LAB – Local Area Bank

<sup>2</sup> Promoter / Promoter Group defined as defined in SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2009

<sup>3</sup> Promoter/ Promoter Group should have a past record of sound credentials and integrity, be financially sound with a successful track record of running their business for atleast 5 years.

Small Banks	Payments Banks
<b>Capital Requirement</b>	
<ul style="list-style-type: none"> <li>Minimum paid up voting equity capital INR 100 crore.</li> <li>An existing NBFC/MFI/LAB compliant with these guidelines may convert itself into a small bank and will be required to have a minimum net worth of INR 100 crore</li> </ul>	Minimum paid-up voting equity capital set at INR 100 crores; maintain a positive net worth of INR 100 crores at all times.
<b>Promoter's Contribution and Ring-Fencing</b>	
<ul style="list-style-type: none"> <li>At least 40 per cent of the paid up capital should be held by the Promoter, which shall be locked in for five years from the date of commencement of business.</li> <li>Shareholding in excess of 40 per cent should be brought down to 40 per cent within three years, to 30 per cent within 10 years and to 26 per cent within 12 years.</li> <li>The other financial and non-financial services activities of the promoters, if any, should be ring-fenced and not co-mingled with the banking business.</li> </ul>	<ul style="list-style-type: none"> <li>At least 40 per cent of the paid up capital should be held by the Promoter which shall be locked in for five years from the date of commencement of business.</li> <li>Shareholding in excess of 40 per cent should be brought down to 40 per cent within three years, to 30 per cent within 10 years and to 26 per cent within 12 years.</li> <li>The other financial and non-financial services activities of the promoters, if any, should be ring-fenced and not co-mingled with the payments bank products.</li> </ul>
<b>Foreign Shareholding</b>	
Foreign shareholding in the bank would be as per extant FDI policy.	Foreign shareholding in the bank would be as per extant FDI policy.
<b>Voting Rights and Transfer/ Acquisition of Shares</b>	
<ul style="list-style-type: none"> <li>The voting rights for small banks will be as per norms for private sector banks and will be capped at 10 per cent, which can be raised to 26 per cent in a phased manner by the RBI<sup>4</sup> and any acquisition or transfer of 5 per cent or more of voting equity shares in a small bank will require prior RBI approval.</li> <li>Entities other than the promoters will not be permitted to have shareholding in excess of 10 per cent of the voting equity capital of the bank.</li> </ul>	<ul style="list-style-type: none"> <li>The voting rights for payments banks will be as per norms for private sector banks and will be capped at 10 per cent, which can be raised to 26 per cent in a phased manner by the RBI and any acquisition or transfer of 5 per cent or more of voting equity shares in a payments bank will require prior RBI approval.</li> <li>Entities other than the promoters will not be permitted to have shareholding in excess of 10 per cent of the voting equity capital of the bank.</li> </ul>
<b>SLR, CRR and Capital Adequacy</b>	
<ul style="list-style-type: none"> <li>Small Banks shall be required to maintain a minimum capital adequacy ratio (CAR) of 15 per cent 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 - CRAR will be computed under simplified Basel I standards.</li> <li>Small banks will be subject to all prudential norms and regulations of RBI as applicable to existing commercial banks including requirement of</li> </ul>	<ul style="list-style-type: none"> <li>Meet standard CRR requirements applicable to Scheduled Commercial Banks.</li> <li>All balances after CRR and minimum requirement for operational activities to be invested in government securities with maturity up to one year recognised as eligible securities for maintenance of SLR.</li> <li>Maintain minimum CAR of 15 per cent on RWA on a continuous basis; subject to any higher percentage prescribed by RBI from time to time and to be</li> </ul>

<sup>4</sup> As per Section 12(2) of the Banking Regulation Act, 1949

Small Banks	Payments Banks
maintenance of CRR and SLR.	<p>calculated under simplified Basel I standards.</p> <ul style="list-style-type: none"> <li>Additionally, to have a leverage ratio of not less than 5 per cent (outside liabilities not to exceed 20 times its net worth/paid-up capital and reserves).</li> </ul>
Priority Sector Lending and Rural Branches Requirements	
<ul style="list-style-type: none"> <li>Small Banks shall comply with the PSL targets as applicable to existing domestic banks. The bank should build its PSL portfolio from commencement of business.</li> <li>Small banks shall plan to open at least 25 per cent of its branches in unbanked rural centres (population up to 9,999 as per the latest census)</li> </ul>	<p>No requirement for rural branches, however, requirement of 25 per cent access points in under-banked rural areas (population up to 9,999 as per latest census), either through own branch network or BCs or through networks provided by others.</p>
Prudential Norms	
<ul style="list-style-type: none"> <li>The maximum loan size and investment limit exposure to single/ group borrowers/ issuers would be restricted to 15 per cent of its capital funds.</li> <li>At least 50 per cent of its loan portfolio should constitute loans and advances of size up to INR 25 lakh in order to extend loans primarily to micro-enterprises.</li> <li>Restrictions placed on banks' loans and advances to its directors and the companies in which its directors are interested will apply.</li> <li>Small banks are prohibited from having any exposure to its promoters, major shareholders (who have shareholding of 10 per cent of voting equity shares in the bank), the relatives<sup>5</sup> of the promoters as also the entities in which they have significant influence or control<sup>6</sup>.</li> </ul>	<ul style="list-style-type: none"> <li>Allowed access to inter-bank uncollateralised call money market and the Collateralised Borrowing and Lending Obligation (CBLO) market for temporary liquidity management.</li> <li>To follow RBI guidelines of liquidity risk management.</li> <li>Establish a robust operational risk management system.</li> </ul>
Corporate Governance	
<ul style="list-style-type: none"> <li>The Board of the Small Bank should have a majority of independent Directors.</li> <li>Small Bank should comply with the corporate governance guidelines including 'fit and proper' criteria for Directors as issued by RBI from time to time.</li> </ul>	<ul style="list-style-type: none"> <li>The Board of the Payments Bank should have majority of independent directors.</li> <li>Payments Bank to comply with the corporate governance guidelines including 'fit and proper' criteria for Directors as issued by the RBI from time to time.</li> </ul>
Branch Presence/ Expansion	
<ul style="list-style-type: none"> <li>The area of operations of the small bank will be restricted to contiguous districts in a homogenous cluster of States/ Union Territories – however, if considered necessary, the bank will be allowed to expand its area of operations beyond contiguous districts in one or more States with reasonable geographical proximity.</li> <li>Its branch expansion plan for the initial three years</li> </ul>	<ul style="list-style-type: none"> <li>Payments bank is envisioned to operate in remote areas through BCs and other networks, hence no mandate of 25 per cent rural bank branches.</li> <li>Expected to adopt technological solutions to lower costs and extend network.</li> </ul>

<sup>5</sup> As defined in Section 2 (77) of the Companies Act, 2013 and rules

<sup>6</sup> As defined in AS 21 and AS 23

Small Banks	Payments Banks
would need prior approval of RBI after which period, based on experience, the RBI may consider relaxing this condition.	
Scope of Activities	
<ul style="list-style-type: none"> <li>Small Banks shall primarily undertake basic banking activities of acceptance of deposits and lending to small farmers, small businesses, micro and small industries and unorganised sector entities in the initial five years – post this period, after a review, RBI may liberalize the scope of activity of small banks.</li> <li>Small banks will be required to have a well-diversified portfolio of loans and advances spread over its area of operations.</li> <li>It can also undertake other simple financial services activities with the prior approval of the RBI.</li> <li>It cannot set up subsidiaries to undertake non-banking financial services activities.</li> </ul>	<p>The Payments Bank will be permitted to undertake only certain restricted activities as described below:</p> <ul style="list-style-type: none"> <li><b>Deposits</b> <ul style="list-style-type: none"> <li>Acceptance of demand deposits: current deposits, savings bank deposits.</li> <li>Deposits initially be restricted to a maximum balance of INR 1,00,000 per customer; limit can be increased after review of the bank's performance by the RBI.</li> <li>Deposits to be covered under the Deposit Insurance Scheme of the Deposit Insurance Credit Guarantee Corporation of India (DICGC)</li> <li>If transactions in the account conform to 'Small Account' (Basic Savings Bank Deposit Account (BSBDA)- Small), simplified Know your customer (KYC)/ Anti-Money Laundering (AML)/ Combating the Financing of Terrorism (CFT) norms will be applicable.</li> </ul> </li> <li><b>Payments &amp; Remittances</b> <ul style="list-style-type: none"> <li>Offer payment and remittance services through various channels including BCs, branches, Automated Teller Machines (ATMs) and mobile banking.</li> <li>Offer PPIs as per instructions under the Payment and Settlement Systems Act (PSS) Act</li> <li>Cash out permitted as per extant guidelines of the PSS Act; cash out via Point of Sale (PoS) terminals also permitted up to INR 1,000 per day</li> <li>Function as BC of other banks for credit and other restricted products</li> <li>Provide internet banking services to customers by leveraging technology and meeting existing standards</li> </ul> </li> </ul> <p>It cannot set up subsidiaries to undertake non-banking financial services activities.</p>
Other Conditions	
<ul style="list-style-type: none"> <li>The operations of the bank should be technology driven from the beginning.</li> <li>The bank should have a high powered Customer Grievances Cell to handle customer complaints.</li> <li>Any non-compliance with terms and conditions laid</li> </ul>	<ul style="list-style-type: none"> <li>Required to use the word 'payments' in its name.</li> <li>The operations of the bank should be fully networked and technology driven from the beginning.</li> <li>The bank should have a high powered Customer</li> </ul>

Small Banks	Payments Banks
<p>down by RBI will attract penal measures including cancellation of license of the bank.</p> <ul style="list-style-type: none"> <li>Registration, licensing and regulations - The Small Bank shall be registered as a public limited company under the Companies Act, 2013. It will be licensed under Section 22 of the Banking Regulation Act, 1949 and 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, other relevant regulations/guidelines issued by the RBI and other regulators, SEBI regulations regarding public issues and other guidelines applicable to listed banking companies etc.</li> </ul>	<p>Grievances Cell to handle customer complaints.</p> <ul style="list-style-type: none"> <li>Any non-compliance with terms and conditions laid down by RBI will attract penal measures including cancellation of license of the bank.</li> <li>Registration, licensing and regulations - The payments bank shall be registered as a public limited company under the Companies Act, 2013. It will be licensed under Section 22 of the Banking Regulation Act, 1949 and 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, other relevant regulations/guidelines issued by the RBI and other regulators, SEBI regulations regarding public issues and other guidelines applicable to listed banking companies etc.</li> </ul>
Application Process – Business Plan	
<ul style="list-style-type: none"> <li>The applicants for Small Bank licenses will be required to furnish their business plans along with project reports with their applications.</li> <li>The business plan should be realistic and viable and will have to address how the bank proposes to achieve the objectives behind setting up of small banks i.e. play an important role in the supply of credit to micro and small enterprises, agriculture and banking services in unbanked and under-banked regions in the country.</li> <li>In case of deviation from the stated business plan after issue of license, RBI may consider restricting the bank's expansion, effecting change in management and imposing other penal measures as may be necessary.</li> </ul>	<ul style="list-style-type: none"> <li>Business plan to address the objectives of setting up payments banks i.e. <ul style="list-style-type: none"> <li>Providing small savings accounts</li> <li>Providing payments/remittance services to migrant labour workforce, low income households, small businesses, unorganized sector entities and other users.</li> </ul> </li> <li>Preference will be given to Applicants who: <ul style="list-style-type: none"> <li>Primarily propose to set up access points in under-banked states/districts in the North-East, East &amp; Central regions of the country.</li> <li>Diversified shareholding and a time frame for listing will be preferred.</li> </ul> </li> <li>In case of deviation from the stated business plan after issue of license, RBI may consider restricting the bank's expansion, effecting change in management and imposing other penal measures as may be necessary.</li> </ul>
Application Procedure	
<ul style="list-style-type: none"> <li>Applications shall be submitted in the prescribed form (Form III) in terms of Rule 11 of the Banking Regulation (Companies) Rules 1949</li> <li>In addition, the applicants should furnish the details on shareholding pattern in the proposed bank, financial statements, income tax returns and credit reports for last three years, names and addresses of banks from which credit facilities are availed, etc.</li> <li>Application for license to be submitted along with business plan, shareholding pattern in proposed bank, financial statements, income tax returns and credit reports for the last three years, names and addresses of banks from whom credit has been availed etc.</li> <li>The applications will be screened and evaluated by an Expert Advisory Committee comprising of eminent professionals like bankers, chartered accountants, finance professionals etc.</li> <li>In-principle approvals granted will be valid for one year, during which time the payments/ small bank must be set up.</li> </ul>	

## **Let's talk**

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