RBI RELAXES PSL TO HELP SMALL FINANCE BANKS: ECONOMY

NEWS: RBI relaxes PSL norms to help SFBs de-risk, diversify loan portfolio

WHAT'S IN THE NEWS?

The Reserve Bank of India (RBI) has announced a relaxation of priority sector lending (PSL) norms specifically for Small Finance Banks (SFBs), with the changes effective from the current financial year.

About Priority Sector Lending (PSL)

- PSL is an RBI-mandated framework that requires banks to allocate a fixed portion of their lending to key sectors of the economy that typically face credit shortages.
- It aims to promote inclusive growth by channeling credit to sectors like agriculture, micro, small and medium enterprises (MSMEs), export credit, education, housing, social infrastructure, renewable energy, and weaker sections.
- In March 2025, RBI revised PSL guidelines, including enhanced limits for housing and education loans, while reducing the PSL target for urban cooperative banks (UCBs) from 75% to 60%.

Small Finance Banks (SFBs)

- ***Regulation and Governance****:* SFBs are regulated by the RBI and governed by the Banking Regulations Act, 1949, RBI Act, 1934, and registered as public limited companies under the Companies Act, 2013.
- ***Oversight:*** They are under the RBI's prudential norms applicable to commercial banks, including requirements for maintaining Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). They also come under the purview of the Banking Ombudsman Scheme.
- ***Objectives:*** SFBs were set up with the specific goal of providing credit and savings facilities to underserved segments of the population such as small businesses, farmers, micro-industries, and the unorganized sector. They are expected to operate cost-effectively, leveraging technology-driven delivery channels.
- ***Eligibility:*** Promoters can include resident individuals with at least 10 years of experience in banking/finance, resident-owned companies/societies, and existing entities such as Non-Banking Financial Companies (NBFCs), Microfinance Institutions (MFIs), and Local Area Banks (LABs). Promoters must demonstrate a strong track record of at least 5 years.
- ***Scope of Services:*** SFBs can provide basic banking products such as savings accounts, current accounts, fixed deposits, recurring deposits, and loans.
- ***Capital Requirements****:* Minimum paid-up equity capital required is ₹100 crore. Promoters must initially hold at least 40% stake (to be brought down to 26% within 12 years). Foreign shareholding is governed by FDI policy applicable to private sector banks.

Key Changes Announced by RBI

- ***Lowered PSL Target:***
    - The overall PSL target for SFBs has been reduced from 75% to 60% of their adjusted net bank credit (ANBC) or credit equivalent of off-balance sheet exposures (CEOBE), whichever is higher.
    - This change takes effect from the current financial year.
- ***Revised Additional Component:***
    - Previously, SFBs were required to allocate an additional 35% of ANBC/CEOBE to priority sector segments over and above the mandatory 40%.
    - Now, this additional component has been reduced to 20%, making the overall PSL target 60% from FY2025-26 onwards.
- ***Distribution of PSL Targets:***
    - SFBs must continue to allocate at least 40% of ANBC/CEOBE to different sub-sectors under PSL, as per existing guidelines.
    - The remaining 20% can be allocated flexibly to one or more PSL sub-sectors where the SFB has a competitive advantage or strategic focus.

Significance of the Changes

- This move acknowledges the unique operating challenges faced by SFBs and provides them with greater flexibility in allocating credit while maintaining focus on the priority sectors.
- It is expected to help SFBs improve efficiency, deploy capital strategically, and expand financial inclusion without being overly constrained by rigid lending targets.
- The adjustments balance the need for regulatory support with the continued emphasis on directing credit toward sectors crucial for inclusive growth and development.

Source: https://www.business-standard.com/industry/banking/rbi-psl-norms-relaxation-to-help-sfbs-diversify-and-de-risk-loans-125062301238_1.html