To, 6th April, 2016

Dr. Saurabh Garg, I.A.S.
Joint Secretary (Currency & Investment),
Department of Economic Affairs,
Ministry of Finance,
Room No. 39B, North Block,
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Dear Dr. Garg,

Sub: Permission for Domestic Venture Capital Funds (DVCFs) to invest in Small Finance Banks (SFBs)

1. RBI has given "in-principle" licence to set up small finances banks (SFBs) to certain entities - majority of which are microfinance and Non Banking Financial Institutions mainly to provide basic banking services like accepting deposits and lending to the unbanked sections such as small farmers, micro business enterprises, micro and small industries and unorganised sector entities.

2. The "in-principle" approval will be valid for 18 months to enable the applicants to comply with the conditions attached to it and get the final licence to convert themselves in to SFBs.

3. In order to fulfil domestic shareholding norm to comply with RBI guidelines, these NBFC need to raise Rupee equity capital from institutional investors and other alternative investment vehicles like DVCFs etc to reduce their foreign holding to 49%.

4. DVCFs registered under SEBI VCF Regulations 1996 and which satisfy the criteria of "Fit & Proper" Person would like to invest in the NBFCs that have received an "in principle" approval for setting up SFBs

5. Existing VCF Regulations permit investments in NBFCs which operate only as "Banking Companies" and "Asset Finance Companies" even though they are NBFCs.

6. **Hence DVCFs should be allowed to invest in these NBFCs who have obtained an "in-principle" approval to enable their transition in to SFBs.**

7. **The objective of DVCF is only to invest in Banking Companies and not in an NBFC. Therefore investment made by DVCFs in these NBFCs, who have obtained in-principle banking licence, should be construed as investment in Bank and not in an NBFC.**

RBI has provided a window of 18 months to these NBFCs to comply with the conditions before they get the final license to operate as SFBs. Since their in-principle eligibility itself was based on their ability to raise the minimum initial capital, control by residents and ownership status etc., most of these NBFCs are well positioned themselves in terms of fund raise and other regulatory compliance to comply with the conditions before the stipulated time.

Hence DVCFs should be allowed to invest in those NBFCs which have obtained in-principle approval to set up SFBs.

In case these NBFCs are unable to comply with the conditions and convert themselves into SFBs within RBI stipulated time, DVCFs will disinvest the investments made in these NBFCs within a stipulated period in order to comply with SEBI VCF Regulations. The investment by DVCFs in NBFCs will be subject to such conditions to enable the DVCFs to call back the investment if these NBFCs could not convert themselves into SFB within RBI stipulated time
It is also pointed out that as per RBI guidelines these SFBs are not permitted to set up subsidiaries to undertake non-banking financial activities which indirectly implies that these SFBs are not considered as NBFCs.

In view of the fact that there is dearth of Rupee Capital in the country, the permission to DVCF to invest rupee funds in the form of equity capital in such SFBs will greatly help such institutions to comply with the capital adequacy requirements and also where applicable comply with FDI regulations for such sector and obtain permanent license to operate as Small Finance Bank

Thank you very much.

Respectfully,

Arvind Mathur
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