Small finance banks may continue to offer higher FD rates but face pressure on margins, say bankers

FD rates offered by SFBs are in the range of 7-7.5 percent but are still lower than the 8 percent to 9 percent they were offering in 2018

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Representative image.

Small finance banks (SFBs), which do not have a bigger cushion of cheaper current account, saving account (CASA) deposits, are

offering higher rates to mobilise fixed deposits (FDs) to raise funds to meet credit demand.
However, they face stress on margins as the rise in their deposit rates is higher than lending rates.

SFBs will have to continue to offer high FD rates as interest rates are rising and liquidity in the banking system is drying up, bankers and analysts told Moneycontrol.

"With the reduction in system-level liquidity and the RBI increasing the repo rate since May, smaller banks like us will need to continue providing higher FD rates over well-established larger banks," said Rishi Dhariwal, Group Head, Liability, **AU Small Finance Bank**.

SFBs will need to continue paying a premium to attract deposits for the "foreseeable future" and this is similar to what large private banks have to pay over public sector banks like **State Bank of India**, added Dhariwal.

"Primarily aimed at financial inclusion, SFBs often pay higher returns on deposits in savings accounts compared to commercial banks," said Keyur Doshi, chief financial officer at **Fincare Small Finance Bank**. "These deposits are utilised for offering loans to mostly sub-prime customer segments, priced higher and according to the risk profile of the customer profile and other factors such as nature (unsecured versus secured) and tenure of the loans."

SFBs are a niche category within the banking system, having created a formidable deposits franchise. From that perspective, the rates offered on deposits and savings account shall continue to be attractive and higher as compared to the mainstream commercial banks, he said.

FD INTEREST RATES

Bank	<1 year	1 to 2 years	2 to 3 years	3 to 5 years	w.e.f
AU Small Finance Bank	5.35	6.6	6.9	6.9	Jun 24
Equitas Small Finance Bank	5.25	6.6	7	6	Jun 27
Fincare Small Finance Bank	5.4	7	7.25	7.5	Aug 21
Jana Small Finance Bank	5.5	7.25	7.25	7.35	Jun 15
Suryoday Small Finance Bank	5.75	6.5	7.49	6.75	Jun 06
Ujjivan Small Finance Bank	6.5	7.5	7.5	7.2	Aug 09

Value: In %; Data as on respective banks' website on Sep 2, 2022. For each year range, the maximum offered interest rate is considered; interest rate is for a normal fixed deposit amount below Rs 1 crore.

Source: BankBazaar.com

moneycontrol

How the rates are stacked up

The top six SFBs in India – AU Small Finance Bank, Equitas Small Finance Bank, Fincare Small Finance Bank, Jana Finance Bank, Suryoday Small Finance Bank and Ujjivan Small Finance Bank – offer FD rates for deposits less than one year and below Rs 1 crore in the range of 5.25 percent to 6.50 percent. Deposits over three years and up to five years attract an interest rate between 6 percent and 7.5 percent, according to Bankbazaar.com data.

Within these, Fincare, Ujjivan and Jana offer the most lucrative interest rates. Suryoday offers 7.49 percent interest on FDs of Rs 1 lakh for an investment tenor of 999 days. Equitas offers 7.32 percent on FDs of Rs 1 lakh. The investment tenor is 888 days.

In comparison, FD rates offered by top banks like SBI, HDFC Bank, Kotak Mahindra Bank, Axis Bank and IDFC FIRST Bank for tenures from 7 days to 10 years range between 2.50 percent and 6.90 percent for general citizens.

“Even as SFBs are increasing FD rates, they are in the range of 7 percent to 7.5 percent. This is still lower than in 2018, when SFBs were offering rates as high as 8 percent to 9 percent,” according to Aditya Acharekar, associate director at CareEdge.

“SFBs have a deposit market share of less than 1 percent, with a lot of scope to grow their deposit base. However, to remain competitive, they will continue to offer higher rates, said Acharekar.

The **Reserve Bank of India**'s (RBI) **Monetary Policy Committee** has increased rates by 140 basis points (bps) since May to quell inflationary pressures in the economy. One bps equals one-hundredth of a percentage point. Typically, when interest rates go up and liquidity dries up, banks have to increase their deposit base by offering higher rates on deposits. In a monetary tightening scenario and when credit growth is picking up, the need to mobilise deposits is high.

Faster deposit mobilisation to continue

According to bankers and analysts, FD rates of SFBs could inch higher in the coming days as the repo rate is likely to be hiked further. Most economists expect the repo rate to be hiked to 6 percent in this financial year from 5.40 percent currently as the RBI prioritises taming inflation.

“Small finance banks’ target audience is the low-income segment that can be wooed with a sachet level product suite,” said Paul Thomas, managing director and chief executive officer at ESAF Small Finance Bank. “Unlike NBFCs (non-banking finance companies), which expand horizontally with a special focus product, SFBs have a chance to expand vertically and horizontally.”

Paul added that it is difficult for SFBs to compete with public sector banks in low-cost deposit mobilisation as the people in the low-income segment trust banks more to park their money.

Margins under pressure

Gaurav Aggarwal, senior director at Paisabazaar.com, said that the focus segments of these banks are usually underserved by major banks. This allows SFBs to charge higher rates for loans and thereby sustain their net interest margins.

However, a continued rise in rates and aggressiveness of individual players to offer competitive rates may impact SFBs' margins going forward, according to bankers.

"Deposit rate hikes will reduce bank margins," said R Baskar Babu, managing director and chief executive officer at **Suryoday Small Finance** Bank.

Babu elaborated that even though the lending rates are rising along with deposit rates, the rise in deposit rates is comparatively higher. This may stress margins, he said.

'Tread with caution'

For depositors, FDs offer liquidity and assured interest income at regular intervals. Thanks to the ample liquidity they promise, FDs can be useful while building an emergency corpus. A higher FD rate in SFBs could easily lure depositors to park their life savings in such FDs. While this could fetch good returns over a period, depositors should tread with caution to keep their deposits safe, said experts.

For one, depositors should spread their investments across all asset classes and not put all eggs in one basket. Another important aspect is to monitor the banks' financials, especially the non-performing assets (NPAs), profitability and capital adequacy, said experts. This could avoid the spillover risk on depositors in the event of a bank failure, they added.

"If we look at data from September 2021, some of these SFBs were paying interest in the low to mid sixes. Now, expectedly, with the rates rising, they are paying in the mid-sevens. Depositors would welcome this since we've been through a long period of negative real returns on deposits," said Adhil Shetty, chief executive officer at BankBazaar.com.

Shetty said that the general advice for depositors and investors is that with high returns come higher risks.

“Make an effort to know your bank’s financials if you’re parking large volumes of cash there. NPAs are down to a multi-year low, but some banks have higher NPAs than others. So caution is required,” added Shetty.