III POLICY ENVIRONMENT

In India, the monetary policy stance was changed from 'withdrawal of accommodation' to 'neutral' in October 2024. The regulatory and supervisory policies of the Reserve Bank focused on strengthening risk management practices, harmonisation of prudential guidelines and addressing emerging risks. The Reserve Bank continued its efforts to improve customer awareness and financial inclusion, while enhancing emphasis on good governance and transparency.

1. Introduction

III.1 The Indian financial system demonstrated sustained resilience during 2023-24 and 2024-25 against the backdrop of formidable global headwinds, benefitting from a stable macroeconomic environment and an agile regulatory and supervisory framework. The Reserve Bank remained vigilant about emerging risks in the financial sector while being mindful of the need to encourage innovations in the sector. Regulatory initiatives to address climate-related risks were strengthened. The Reserve Bank has been increasingly harnessing technology to improve cyber-resilience and reporting efficiency of regulated entities (REs).

III.2 Against this backdrop, the chapter briefly chronicles monetary and liquidity management measures of the Reserve Bank during 2023-24 and 2024-25 in Section 2, followed by an overview of regulatory and supervisory policy developments in Section 3. Policies pertaining to various technological innovations are covered in Section 4, while those related to financial markets are discussed in Section 5. Sections 6 and 7 review the policies related to consumer protection and credit delivery and financial inclusion, respectively. Initiatives for enhancing the scope and reach of the payments ecosystem in a safe and secure environment are set out in Section 8. The chapter concludes with an overall assessment in Section 9.

2. The Macroeconomic Policy Setting

III.3 Mindful of the persistence of inflation above the target, the monetary policy committee (MPC) kept the policy repo rate unchanged at 6.50 per cent during 2023-24 and 2024-25 (up to December 2024) after a cumulative hike of 250 basis points (bps) during 2022-23. On October 9, 2024, the MPC decided to change the monetary policy stance from 'withdrawal of accommodation' to 'neutral' based on its assessment of the evolving inflation-growth dynamics. Further, on December 6, 2024, to ease potential liquidity stress, and consistent with the neutral policy stance, the Reserve Bank decided to reduce the cash reserve ratio (CRR) of all banks to 4.0 per cent of net demand and time liabilities (NDTL) in two equal tranches of 25 bps each, effective fortnight beginning December 14 and December 28, 2024. CRR was, thus, restored to the level prevailing before the commencement of the policy tightening cycle in April 2022.

Developments during 2023-24

III.4 In sync with the monetary policy stance, system liquidity turned from surplus to deficit in 2023-24. The average daily net injection under the liquidity adjustment facility (LAF) stood at ₹485 crore in 2023-24 as against an average daily net absorption of ₹1.9 lakh crore in 2022-23. During 2023-24, average absorption under the standing deposit facility (SDF) at ₹0.90 lakh crore constituted 78 per cent of the average daily total absorption (₹1.16 lakh crore) under the LAF, while the remaining 22 per cent was absorbed through variable rate reverse repo (VRRR) auctions – both main and fine-tuning operations. Banks' recourse to the marginal standing facility (MSF) increased, with average daily borrowing of ₹0.50 lakh crore during 2023-24 as compared with ₹0.06 lakh crore during 2022-23.

III.5 The reversal of liquidity facilities under both SDF and MSF was allowed even during weekends and holidays, effective December 30, 2023 to provide banks greater flexibility in their operations. The incremental CRR (I-CRR) of 10 per cent on the increase in scheduled commercial banks' (SCBs') NDTL between May 19, 2023 and July 28, 2023, with effect from the fortnight beginning August 12, 2023, was discontinued in a phased manner to ensure that system liquidity was not subjected to sudden shocks and money markets functioned in an orderly manner.

III.6 The weighted average call rate (WACR) – the operating target of monetary policy – averaged 6.63 per cent in 2023-24 as compared with 5.39 per cent in 2022-23, reflecting the increase in the policy repo rate and the evolving liquidity conditions. Overnight rates in the collateralised segment moved in tandem with the WACR. In the term money segment, yields on 3-month commercial papers (CPs) for non-banking financial companies (NBFCs) firmed up, reflecting, *inter alia,* the regulatory measures announced by the Reserve Bank on November 16, 2023. Amidst sustained double-digit growth in bank credit, banks resorted to issuances of certificates of deposit (CDs). The yield on 3-month treasury bills (T-bills) remained stable in 2023-24. Medium to long-term bond yields, however, eased from their March 2023 levels, taking cues from domestic developments, notwithstanding the hardening of US treasury yields. On June 8, 2023 the Reserve Bank allowed SCBs [excluding small finance banks (SFBs) and payments banks (PBs)] greater flexibility in money market operations by permitting them to set their own limits for borrowings in the call and notice money markets within the prescribed prudential limits for interbank liabilities, with the approval of their internal boards.

Developments during 2024-25

III.7 The average daily net absorption under the LAF stood at ₹0.65 lakh crore during 2024-25 (up to December 17, 2024). While average daily absorption under the SDF and reverse repos was ₹1.3 lakh crore, the recourse under the MSF averaged ₹0.07 lakh crore.

III.8 The WACR remained aligned to the repo rate, averaging 6.54 per cent in 2024-25 (up to December 17, 2024), with overnight rates in collateralised segments moving in tandem. In the term money segment, the yield on 3-month T-bills softened due to improved liquidity in the banking system amidst lower market borrowing requirements. The yields on CPs issued by NBFCs and that on CDs remained relatively stable during 2024-25. Domestic bond yields eased further in 2024-25, reflecting positive sentiment following the inclusion of Indian government securities (G-secs) in the global bond index and reduced market borrowing requirements budgeted by the central government for 2024-25. Global factors like easing of US treasury yields and decline in crude oil prices also contributed to the easing of domestic yields.

3. Regulatory and Supervisory Policies

3.1 Operational Risk Management and Operational Resilience

III.9 On April 30, 2024 the Reserve Bank issued a guidance note on operational risk management and operational resilience to align with principles of the Basel Committee on Banking Supervision (BCBS). It provides overarching guidance to REs to strengthen their operational risk management framework and enhance their operational resilience to enable them to conduct critical operations even during disruption. The guidance note has been built on three pillars *viz.*, prepare and protect; build resilience; and learn and adapt. Across these three pillars, the note contains 17 principles. The guidance note has addressed areas such as three lines of defence, change management, mapping of interconnections and interdependencies, third party dependencies and information and communication technology (ICT) risk while explicating the concept of operational resilience. The earlier guidance was applicable to SCBs only, while the latest guidance covers all commercial banks, certain co-operative banks, all India financial institutions (AIFIs) and all NBFCs, including housing finance companies (HFCs).

3.2 Fraud Risk Management

III.10 On July 15, 2024 the Reserve Bank issued master directions on fraud risk management for REs[1]. The revised directions are principle-based and strengthen the role of the board in overall governance and oversight of fraud risk management. The framework on early warning signals (EWS) and red flagged accounts (RFAs) has further been strengthened for early detection and prevention of frauds, and timely reporting to law enforcement agencies (LEAs) and supervisors. The directions now expressly require REs to ensure compliance with the principles of natural justice in a time-bound manner.

3.3 Management of Model Risks in Credit

III.11 On August 5, 2024 the Reserve Bank issued a draft circular to ensure prudence and robustness in the use of various models by REs in their credit management. While the application of technology in the models facilitates faster decision-making, it adds complexity to the model risk management framework. As per the draft circular, the models used by REs may either be developed internally or sourced from external third-party suppliers or can be a mix of both as per the provisions of the policy. REs need to adhere to broad principles including, *inter alia*, clarity in objectives, robust assumptions, detailed documentation, scalability and flexibility of models, and consistent and

[1] Commercial banks (including regional rural banks) and all India financial institutions; co-operative banks (urban co-operative banks, state co-operative banks and district central co-operative banks); and all non-banking finance companies in the upper layer, middle layer and base layer (with asset size of ₹500 crore and above), including housing finance companies.

verifiable outcomes. REs will be ultimately responsible and accountable for the integrity and outcomes of the outsourced models. Further, REs will be required to put in place a model vetting / validation process, independent of model development / selection, for assessing the robustness of models developed in-house or otherwise.

3.4 Regulatory Measures towards Consumer Credit and Bank Credit to NBFCs

III.12 Post-COVID, growth in consumer credit, especially the unsecured portfolio, accelerated substantially. The increasing dependency of NBFCs on bank borrowings was enhancing the interconnectedness. Although these loan categories did not exhibit any major signs of stress, persistent high growth in these segments warranted prudential intervention. Accordingly, the Reserve Bank increased the risk weights by 25 percentage points on consumer credit exposure of commercial banks and NBFCs, credit card receivables of SCBs and exposures of SCBs to NBFCs, excluding core investment companies, on November 16, 2023. Furthermore, REs were advised to review their exposure limits for consumer credit and put in place board-approved limits for the various sub-segments, specifically unsecured consumer credit exposures, by February 29, 2024.

3.5 Bulk Deposits

III.13 On June 07, 2024 the Reserve Bank revised the definition of bulk deposits to single Rupee term deposits of ₹3 crore and above for SFBs and SCBs [excluding regional rural banks (RRBs)]; and single Rupee term deposits of ₹1 crore and above for local area banks (LABs) and RRBs. Earlier, on January 1, 2024 the Reserve Bank had also enhanced the bulk deposit limit for Tier 3 and 4 scheduled urban co-operative banks (UCBs) to ₹1 crore and above from ₹15 lakh and above.

3.6 Voluntary Transition of Small Finance Banks to Universal Banks

III.14 On April 26, 2024 the Reserve Bank issued eligibility criteria for SFBs to transition into universal banks. The eligibility criteria require SFBs to have scheduled status with a satisfactory track record of performance for a minimum period of five years. Further, SFBs' shares should be listed on a recognised stock exchange. These SFBs are also required to have a minimum net worth of ₹1,000 crore at end of the previous quarter and meet their prescribed capital to risk-weighted assets ratio (CRAR) of 15 per cent. Moreover, they are mandated to have net profits in the preceding two financial years with gross non-performing assets (GNPA) and net non-performing assets (NNPA) ratios of less than or equal to 3 percent and 1 per cent, respectively. The eligible SFBs are also required to furnish a detailed rationale for the transition.

3.7 Credit Card and Debit Card

III.15 On March 07, 2024 the Reserve Bank amended its master direction on credit and debit cards to align the extant regulations governing the issue of credit and debit cards with the fast -changing card ecosystem. General permission has been provided to all banks and NBFCs[2] registered with the Reserve Bank to become co-

[2] NBFCs- investment and credit companies (NBFC-ICC), housing finance companies (HFCs) , NBFCs-Factors, NBFCs- micro finance institution (NBFC-MFI) and NBFCs-infrastructure finance companies (NBFC-IFCs).

branding partners (CBPs) of card-issuers. Other changes, *inter alia*, include permission to issue form factors[3] for credit cards, mandating card issuers to display the modes authorised by them for accepting payments towards credit card dues, and to monitor the end use of funds for business credit cards. The extant regulations have also been strengthened in respect of wrongful billing, sharing of customer information, and advising card issuers to ensure that any debit to the credit card account is as per the authentication framework prescribed by the Reserve Bank.

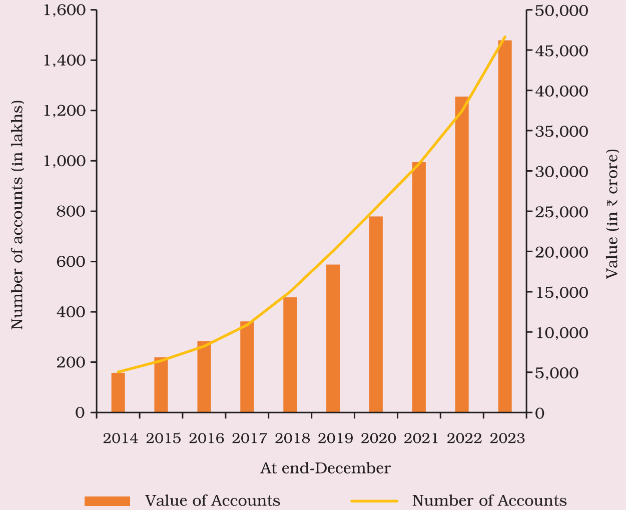
3.8 Arrangements with Card Networks for issue of Credit Cards

III.16 The authorised card networks tie-up with banks/non-banks for issuance of credit cards. It was observed that some of these exclusive tie-ups constrained choices of network for the customers. On March 06, 2024 therefore, the Reserve Bank directed that card issuers should not enter into any arrangement or agreement with card networks that restrain them from availing the services of other card networks. Card issuers with more than 10 lakh active cards should provide an option to their eligible customers to choose from multiple card networks at the time of issue.

3.9 Unclaimed Deposits in Banks

III.17 As per the extant instructions, the credit balance in any deposit account maintained with banks which has not been operated upon for ten years or more or any amount remaining unclaimed for ten years or more, is required to be transferred by banks to the Depositor Education and Awareness (DEA) Fund maintained by the Reserve Bank. Since 2014, the volume of unclaimed deposits has been increasing continuously (Chart III.1). To reduce the quantum of unclaimed deposits in the banking system and return such deposits to their rightful owners or claimants, comprehensive revised guidelines for inoperative accounts/ unclaimed deposits in banks were issued on January 1, 2024. The major changes made in the revised instructions include, *inter alia*, video-customer identification process for activating inoperative accounts, considering certain non-financial transactions and know your customer (KYC) updation as customer induced transaction for keeping the account active, facility of activating inoperative account in all branches including non-home branches in a time-bound manner and prohibiting debit transactions in inoperative accounts unless there is a customer induced activation. In this regard, launch of Unclaimed Deposits – Gateway to Access inforMation (UDGAM) portal by the Reserve Bank has

Chart III.1: Unclaimed Deposits with Scheduled Commercial Banks



Note: Data include regional rural banks.
Source: Statistical Tables Relating to Banks in India, RBI.

[3] Form factor is a physical or virtual instrument that can be used in place of a card to undertake a payment or banking transaction.

been bringing significant traction in assisting customers[4].

3.10 Interest Rate Ceilings on Foreign Currency Non-Resident (Bank) [FCNR(B)] Deposits

III.18 On December 6, 2024, the Reserve Bank increased the interest rate ceilings on FCNR(B) deposits in order to attract more capital inflows. Banks have been permitted to raise fresh FCNR(B) deposits of one year to less than three years maturity at rates not exceeding the ceiling of overnight alternative reference rate (ARR) plus 400 bps as against 250 bps earlier. For deposits of three to five years maturity, the ceiling has been increased to overnight ARR plus 500 bps as against 350 bps earlier. This relaxation has been made available till March 31, 2025[5].

3.11 Forms of Business and Prudential Regulation for Investments

III.19 On October 4, 2024, the Reserve Bank issued draft regulations on forms of business by banks to ringfence their core business from other risk bearing non-core businesses. As per the regulations, only a single entity within a bank group would be allowed to undertake a particular form of permissible business. Multiple entities within a bank group will not be allowed to undertake the same business. Further, no overlap in the lending activities undertaken by the bank and its group entities would be permitted. NBFC subsidiaries of banks will have to comply with scale-based regulations applicable to upper layer NBFCs and will be subject to regulatory and other restrictions on loans and advances applicable to banks. Additionally, it has been reiterated that a group entity shall not be used to circumvent regulations/guidelines applicable to the parent bank or other group entity to carry on any business activity which is not permitted otherwise.

3.12 Classification, Valuation and Operation of Investment Portfolios of Commercial Banks

III.20 In view of significant developments in the global standards on classification, measurement and valuation of investments, their implications on the capital adequacy framework as well as progress in the domestic financial markets, the prudential norms for the investment portfolios of banks were reviewed on September 12, 2023. The updated norms include principle-based classification of investment portfolios; tightening of regulations around transfers to/from the held to maturity (HTM) category and sales out of HTM; inclusion of non-statutory liquidity ratio (SLR) securities in HTM subject to fulfilment of certain conditions; removal of ceilings on HTM; symmetric treatment of fair value gains and losses; a clearly identifiable trading book under held for trading (HFT); removing the 90-day ceiling on the holding period under HFT; and more detailed disclosures of the investment portfolio. An analysis of investment portfolio composition of banks pursuant to the implementation of the new guidelines reveals that while the HTM portfolio remains largely unchanged, there has been an increase in the HFT portfolio and a reduction in the available for sale (AFS) portfolio (Box III.1).

4 The Reserve Bank launched a centralised web portal – UDGAM on August 17, 2023 for the public to facilitate searching of their unclaimed deposits across multiple banks at one place.

5 Reserve Bank of India (2024). Statement on Developmental and Regulatory Policies, December 6.

Box III.1: New Investment Guidelines: Analysis of the Investment Portfolio of Banks

The average share of the HTM category in the total investment portfolios of select SCBs [12 public sectors banks (PSBs); 14 private sector banks (PVBs); and 5 foreign banks (FBs)] during Q3:2022-23 to Q4: 2023-24 was 64.5 per cent. Since the adoption of the new guidelines, it has largely remained in the same range – 63.6 per cent at end-June 2024. On the other hand, the share of AFS, which was the residual category as per the old guidelines and had an average share of 33.7 per cent, has reduced to 22.8 per cent, mainly reflecting clarity on classification in the revised guidelines. The share of HFT category has increased from an average of 1.8 per cent under the old regime to 9 per cent under the new guidelines, which may be attributed to securities moving into HFT category due to the removal of 90-day holding ceiling, and better capturing of hedging benefits *via* derivatives (Chart III.1.1 a). Across bank groups, the share of AFS category has reduced as banks reallocated their portfolios to HTM and HFT categories. The increase in the share of HFT category was substantially higher in the case of PVBs and FBs than PSBs, partly reflecting differences in risk appetite and business practices (Chart III.1.1 b, c and d).

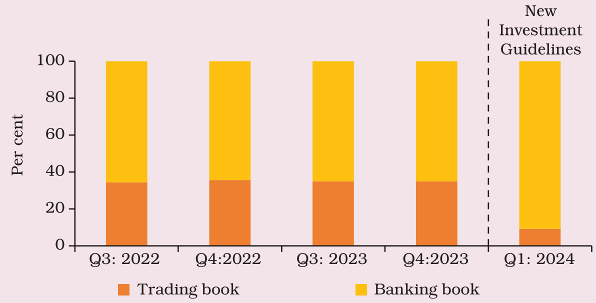
Chart III.1.1: Investment Portfolio of Banks

Source: RBI.

Banking Book and Trading Book for the Purpose of Capital Adequacy

Concomitant with the implementation of the revised investment norms from April 1, 2024, the definition of trading book for the purpose of computing capital charge for market risks was also revised in line with the BCBS standards[6]. With the AFS portfolio now being considered a part of the banking book along with the HTM portfolio for the purpose of computing the capital charge, the size of the banking book for capital adequacy computation purpose (HTM+AFS) has increased (Chart III.1.2).

Chart III.1.2: Comparison of Banking Book *vis-á-vis* Trading Book



Source: RBI.

[6] The trading book for computation of capital charge for market risk which comprised of both AFS and HFT earlier has now been revised to include only HFT.

Box III.2: Disclosure Framework on Climate-related Financial Risks

Climate-related disclosures by REs are an important enabler for assessment and mitigation of climate-related risks. Currently, REs are required to disclose information on material risks as a part of their Pillar 3 disclosures. The draft framework aligns the disclosure standards to internationally accepted standards[7]. It requires REs to disclose information on various aspects of climate-related financial risks and opportunities based on four thematic pillars, *viz.*, governance; strategy; risk management; and metrics and targets. Some areas needed to be covered by REs under the four thematic pillars are outlined below:

Governance

- Board's oversight of climate-related risks and opportunities.
- Senior management's role in assessing and managing climate-related risks and opportunities.

Strategy

- Climate-related risks and opportunities over short, medium, and long term.
- Impact of climate-related risks and opportunities on REs' businesses, strategy, and financial planning.
- Resilience of REs' strategy, taking into consideration different climate scenarios.

Risk Management

- Processes and related policies to identify, assess, prioritise, monitor and manage climate-related financial risks.
- Integration of climate risk management with traditional risk management.

Metrics and Targets

- Metrics and targets used to assess climate-related financial risks and opportunities in line with their strategy and risk management processes.
- Scope 1, scope 2 and scope 3 greenhouse gas (GHG) emissions and the related risks.

As the disclosures are envisaged to develop alongside the overall ecosystem, a leeway in applicability and timeline for implementation has been provided. The disclosures are also required to be subjected to appropriate internal control assessments and reviewed by the board of directors or a committee of the board.

3.13 Disclosure Framework on Climate-related Financial Risks

III.21 Climate-related risks are envisaged to significantly impact REs, with implications for financial stability. A detailed, consistent and comparable disclosure framework for REs is crucial to develop competencies and structures for assessment and mitigation of climate change risks. On February 28, 2024 the Reserve Bank released a draft disclosure framework on climate-related financial risks to obtain comments or feedback from the stakeholders (Box III.2).

Non- Banking Financial Companies

3.14 Prudential Guidelines for Deposit taking Housing Finance Companies (HFCs-D)

III.22 HFCs-D were subject to relaxed prudential parameters on deposit acceptance as compared to NBFCs. Since the regulatory concerns associated with deposit acceptance are same across all categories of NBFCs, revised regulations were issued on August 12, 2024 to align the guidelines for HFCs with NBFCs. The minimum liquid assets which HFCs-D are required to maintain against public deposits, have been raised to 15 per cent from 13 per cent. The ceiling on quantum of public deposits held by HFCs-D has been reduced from 3 times to 1.5 times of their net owned funds. Further, HFCs-D holding deposits in excess of the revised limit will not be allowed to accept fresh public deposits or renew existing deposits till they conform to the revised limit. Existing excess deposits will be allowed to run off till maturity. The maximum term of public deposits of HFCs-D has also been reduced to 60 months

[7] Internationally accepted standards such as the International Financial Reporting Standard S2 climate-related disclosures and the BCBS's climate disclosure consultative document.

from 120 months and existing deposits with maturities above 60 months are required to be repaid as per their existing repayment profile. Additionally, through a separate circular, the risk weights applicable for some assets of HFCs were also reviewed and revised.

3.15 Wilful and Large Defaulters

III.23 The existing instructions on wilful and large defaulters were reviewed, and final master directions were issued on July 30, 2024. In addition to SCBs, scheduled UCBs, HFCs and AIFIs, the framework has been extended to NBFC-middle and above layers, non-scheduled urban co-operative banks (UCBs) in Tier 3 and 4, LABs and RRBs. The process of classification of wilful defaulters has been refined by introducing disclosure of all material and information on which the show cause notice is based, provision for written representation to a review committee against the order of identification committee, and provision for personal hearing for the borrower by the review committee. For early detection and identification of wilful default, a review of all NPA accounts with outstanding amount of ₹25 lakh and above within six months of their classification as NPA has been prescribed. The directions also provide clarity on the treatment of wilful default accounts after undergoing resolution under the insolvency and bankruptcy code (IBC) process or on loan assignment.

3.16 Harmonisation of Concentration Norms for NBFCs

III.24 Guidelines on the large exposures framework (LEF) are applicable to upper layer NBFCs (NBFC-UL). NBFCs in the middle layer (NBFC-ML) are, however, governed by credit or investment concentration norms. To ensure uniformity and consistency in computation of concentration norms among NBFCs, an amendment to the extant concentration norms was issued on January 15, 2024. In addition to the currently allowed credit default swaps (CDSs), the amendments allow use of additional instruments by NBFC-ML to offset the aggregate exposure[8]. NBFC-base layer (NBFC-BL) will now be required to put in place a board-approved internal policy for credit/investment concentration limits.

3.17 Information submission by Asset Reconstruction Companies (ARCs) to Credit Information Companies (CICs)

III.25 As per earlier guidelines, ARCs were stipulated to become a member of at least one CIC and provide credit information to the CIC of which they were a member. After a comprehensive review of the CIC-related guidelines applicable to ARCs, the Reserve Bank issued a circular regarding the submission of information to CICs by ARCs on October 10, 2024. This was done in order to align the CIC-related guidelines for ARCs with guidelines applicable for banks and NBFCs and to maintain a track of borrowers' credit history after loan transfers from banks and NBFCs to ARCs. The salient features of the circular include; (i) advising ARCs to become members of all four CICs; (ii) stipulating the submission of data by ARCs to CICs on a

[8] These include: a) cash margin/caution money/security deposit held as collateral on behalf of the borrower against the advances for which right to set off is available; b) central government guaranteed claims which attract 0 per cent risk weight for capital computation; c) state government guaranteed claims which attract 20 per cent risk weight for capital computation; d) guarantees issued under the Credit Guarantee Schemes of Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE), Credit Risk Guarantee Fund Trust for Low Income Housing (CRGFTLIH) and individual schemes under National Credit Guarantee Trustee Company Ltd (NCGTC) subject to meeting certain conditions.

fortnightly basis or shorter intervals as agreed between the ARC and the CICs; (iii) prescription for rectification of rejected data within 7 days of receipt of rejected data from CICs; and (iv) extension of best practices regarding regular submission/ updation of data and customer grievance redressal to ARCs.

Co-operative Banks

3.18 Prompt Corrective Action (PCA) Framework for Primary (Urban) Co-operative Banks

III.26 On July 26, 2024 the Reserve Bank introduced a prompt corrective action (PCA) framework for UCBs, replacing the extant supervisory action framework (SAF). The framework, effective from April 1, 2025 will be applicable to all UCBs under Tier 2, Tier 3 and Tier 4 categories except UCBs under all-inclusive directions. Tier 1 UCBs, though not covered under the PCA framework, will be subjected to enhanced monitoring under the extant supervisory framework. The framework requires financially weak UCBs to initiate and implement remedial measures in a timely manner to restore their financial health. The first risk thresholds for initiating corrective action under the framework include CRAR below the regulatory requirement (up to 250 bps); NNPA ratio above 6.0 per cent but below 9.0 per cent; and net losses during two consecutive years.

3.19 Prudential Treatment of Bad and Doubtful Debt Reserve

III.27 Several co-operative banks have created bad and doubtful debt reserves (BDDRs) under the provisions of the respective State Co-operative Societies Acts or on prudential consideration, either by recognising an expense in the profit and loss (P&L) account or through appropriations from net profits. In case of appropriations from net profits, the same when used to net off NPAs is in contravention of the applicable accounting standards. Further, the treatment of BDDR varies across banks, and in many cases, has been found to be at variance with applicable regulatory norms. Accordingly, with a view to bringing uniformity in the treatment, revised instructions on BDDR were issued, which stipulated that with effect from financial year 2024-25, all regulatory provisions shall mandatorily be charged as an expense to the P&L account. Further, a revised treatment of the BDDR created till end-March 2024 out of appropriation from net profits, but which actually represents regulatory provisions, has also been specified as a one-time measure to facilitate transition to an accounting standard compliant approach.

3.20 Eligibility Norms for Inclusion of UCBs in the Second Schedule of the Reserve Bank of India Act, 1934

III.28 On January 17, 2024 the Reserve Bank revised eligibility norms for inclusion of UCBs in the second schedule of the Reserve Bank of India Act, 1934. In addition to the criteria specified by the Government of India in 2023, UCBs which have CRAR of at least 3 per cent more than the minimum regulatory requirement and no major regulatory and supervisory concerns will be considered for inclusion in the second schedule.

4. Technological Innovations

III.29 Central banks face a delicate balancing act of encouraging technological advancements in financial institutions while safeguarding them from vulnerabilities. To foster responsible innovation in financial services, promote efficiency and benefit consumers, the Reserve

Bank has established regulatory sandbox (RS), which allows live testing of new products or services in a controlled regulatory environment. So far, four cohorts – on themes retail payments, cross-border payments, MSME lending and prevention and mitigation of financial frauds– have been completed, wherein 90 products were tested, of which 19 products successfully exited the RS. The Reserve Bank also organises a long form global hackathon annually, called HaRBInger, to encourage development of technology driven innovative solutions for the existing challenges in financial sector. HaRBInger on 'Zero Financial Frauds' and 'Being Divyang Friendly' is currently ongoing.

4.1 FinTech and EmTech Repositories

III.30 On May 28, 2024 the Reserve Bank launched the FinTech repository, aimed at capturing essential information about FinTech entities, their activities and technology usage. Both regulated and unregulated FinTech entities are encouraged to contribute to the repository. An EmTech repository was also launched on the same day, which is focused on capturing information on adoption of emerging technologies [like artificial intelligence (AI), machine learning (ML), cloud computing, distributed ledger technology and quantum technology] by various REs. These repositories will enable a better understanding of developments in the FinTech ecosystem and support appropriate policy approach.

4.2 Self-regulatory Organisation (SRO) Framework for FinTechs

III.31 To encourage self-regulation in the FinTech sector, the Reserve Bank announced a framework for recognising self–regulatory organisations in FinTech sector (SRO-FT) on May 30, 2024. SROs will be responsible for formulating codes of conduct, monitoring compliance, and addressing grievances. The framework outlines the criteria for industry associations to be recognised as an SRO-FT, their scope of activities, responsibilities towards the Reserve Bank, and governance requirements. The framework also mandates SROs' functions, including standard-setting and developmental activities. FinTech Association for Consumer Empowerment has been recognised as an SRO-FT.

4.3 Platform for Regulatory Application, Validation And AutHorisation (PRAVAAH)

III.32 The Platform for Regulatory Application, Validation And AutHorisation (PRAVAAH) was launched on May 28, 2024. It is a secure and centralised web-based portal for any individual or entity to seek authorisation, licence or regulatory approval on any reference made by it to the Reserve Bank. It facilitates ease of doing business for REs and will reduce the turnaround time for processing, thereby bringing efficiency in regulatory processes.

4.4 Retail Direct Mobile Application

III.33 The RBI Retail Direct Scheme, launched in November 2021, enables individual investors to maintain gilt accounts with the Reserve Bank and invest in G-secs. To further improve ease of access and convenience for retail investors in G-secs market, an 'RBI Retail Direct' mobile application was launched on May 28, 2024. The mobile app has several user-friendly features including single sign-on facility that enables seamless navigation between primary and secondary market using single login credential.

5. Financial Markets

III.34 Financial markets support growth and development of an economy by facilitating efficient allocation of resources and sharing of risks. Developing safe and stable financial markets is a key policy objective of the Reserve Bank. The measures undertaken by the Reserve Bank during the period under consideration included, *inter alia*, rationalisation of directions on money market products; review of regulatory framework for hedging foreign exchange risks; mandating exchange of initial margin for non-centrally cleared derivative (NCCD) transactions; and putting in place a framework for recognition of SROs in financial markets. Additionally, direct access to the Negotiated Dealing System – Order Matching (NDS-OM) platform was expanded to include a larger set of REs.

5.1 Commercial Paper and Non-Convertible Debentures (NCDs) of Original or Initial Maturity up to One Year

III.35 The extant directions on CPs and NCDs of original or initial maturity up to one year were reviewed. The master directions, which came into force with effect from April 1, 2024, *inter alia,* rationalised the default handling procedures, standardised the issuance process and strengthened the disclosure requirement for CPs and NCDs. These revisions are expected to bring consistency across different money market products, benefitting issuers, investors and other participants.

5.2 Hedging of Foreign Exchange Risks

III.36 The regulatory framework for hedging of foreign exchange risks was revised in January 2024 which, *inter alia,* expanded the suite of permitted forex (FX) derivative products, refined the user classification framework, and consolidated the previous instructions in respect of all types of FX transactions – over-the-counter (OTC) and exchange traded – under a single master direction. This will enhance operational efficiency and ease access to foreign exchange derivatives, especially for users with small exposures. It will also enable a larger set of users with the necessary risk management capabilities to efficiently manage their risks.

5.3 Margin for Derivative Contracts

III.37 The extant directions allowed posting and collection of margins for permitted derivative contracts between a person resident in India and a person resident outside India. The directions were revised on May 8, 2024, to permit, *inter alia,* exchange of margins in India and outside India by applicable entities to enable implementation of the OTC derivative reforms on margin requirements for NCCDs. This aligns the Indian framework with global best practices. Indian banks are also permitted to post and collect margins for derivative transactions of their overseas branches and IFSC banking units (IBUs).

5.4 Reporting of FX Cash/Tom/Spot Transactions to Trade Repository

III.38 Authorised dealers are mandated to report all OTC foreign exchange derivative contracts and foreign currency interest rate derivative contracts, undertaken by them directly or through their overseas entities to the trade repository (TR) of Clearing Corporation of India Ltd. (CCIL). To ensure completeness of transactions data in TR for all foreign exchange instruments, the Reserve Bank on November 8, 2024 expanded the reporting requirement to include foreign exchange cash/tom/spot trades, in a phased manner. This measure will facilitate greater transparency and effective oversight of the foreign exchange markets.

6. Consumer Protection

III.39 The Reserve Bank's policy initiatives on consumer protection are aimed at protection of customers' rights, enhancing the quality of customer service, spreading awareness, and strengthening the grievance redress mechanism in banks and in the Reserve Bank. As a part of the consumer awareness initiatives, the Reserve Bank has been undertaking several initiatives, including publishing posters and short films, spreading awareness through financial literacy weeks and setting up Centres for Financial Literacy (CFLs) and Financial Literacy Centres (FLCs). Continuing the booklet series, the Reserve Bank published 'The Alert Family' in 2024, which unlike the earlier booklets, goes beyond financial frauds and provides guidance to the public on dealing with various banking services and facilities.

6.1 Internal Ombudsman (IO) for Regulated Entities

III.40 On December 29, 2023 the Reserve Bank issued master direction harmonising the instructions applicable to various REs in the IO mechanism. This has brought uniformity in matters like timeline for escalation of complaints to the IO, exclusions from escalating complaints to the IO, temporary absence of the IO, minimum qualifications for appointing the IO and updation of reporting formats, in addition to introduction of the post of Deputy Internal Ombudsman. These instructions are expected to further strengthen the mechanism by enabling a review by an apex level authority within the RE before rejection of customer complaints, besides providing ease of compliance.

7. Credit Delivery and Financial Inclusion

III.41 The National Strategy for Financial Inclusion (NSFI) 2019-24 outlines the vision and primary goals of India's financial inclusion and financial literacy policies, aiming to broaden their impact while maintaining momentum through comprehensive collaboration among all stakeholders in the financial sector. Over the five years, the strategy has catalysed deepening of financial inclusion for individuals and enterprises in the country with increased emphasis on proliferation and adoption of digital financial services.

7.1 Lending to Micro and Small Enterprises (MSEs)

III.42 On June 11, 2024 the Reserve Bank updated master directions on lending to micro, small and medium enterprises (MSMEs), mandating that the time taken for credit decisions for loans up to ₹25 lakh to MSE borrowers should not be more than 14 working days. For loans above this limit, the timelines shall be as per the board-approved sanction time norms.

III.43 Further, the MSE clusters have now been defined as those identified by the Ministry of MSME, Government of India or respective state governments. The guidelines provide an indicative list of activities that constitute credit linkage such as assessing the credit needs of MSE units within these clusters and either directly meeting their credit requirements or facilitating their linkage with other banks in the area for credit proposals.

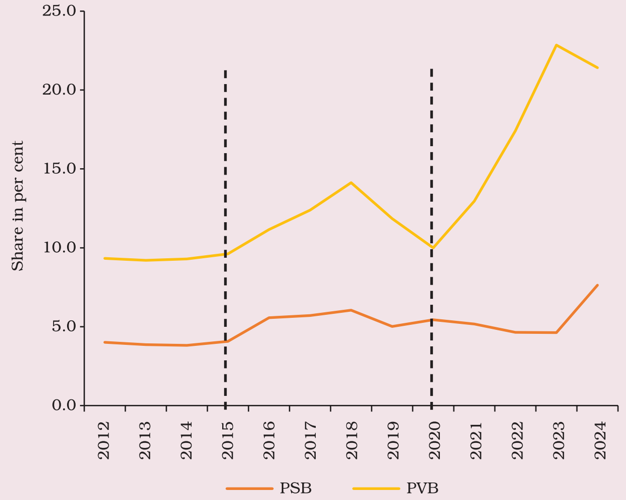
7.2 Collateral-free Agriculture Loan – Enhancement of Limit

III.44 Keeping in view the rise in agricultural input costs and overall inflation, the Reserve Bank, on December 6, 2024, announced an increase in the limit for collateral-free agriculture loans from ₹1.6 lakh to ₹2 lakh per borrower to further enhance credit availability for small and marginal farmers.

7.3 Priority Sector Lending (PSL)

III.45 On July 1, 2015 the Reserve Bank had expanded the ambit of PSL norms to include loans up to ₹15 crore to borrowers for purposes like solar-based power generators, biomass-based power generators, wind mills, micro-hydel plants and for non-conventional energy (NCE) based public utilities, *viz.*, street lighting systems, and remote village electrification. The limit was subsequently raised from ₹15 crore to ₹30 crore per borrower on September 4, 2020. These policy interventions, in conjunction with other policies, have boosted lending to the NCE sector (Chart III.2 and Box III.3).

Chart III.2: Share of Credit to NCE Sector in Total Credit to Energy (Electricity, Gas, and Water)



Note: Data pertain to end-March.
Source: Basic Statistical Returns, RBI.

Box III.3: Bank Lending to the Non-Conventional Energy Sector

An impact analysis of the Reserve Bank's policy initiatives in the NCE sector is carried out in a panel regression framework using bank-wise quarterly data from December 2014 to December 2023.

$$Y_{it} = \beta_0 + \beta_1 Y_{it-1} + \beta_2\, GNPA_{NCE\,it-1} + \beta_3\, Policy_t + \beta_4\,(Policy_t * Bank\ Group_{it}) + \beta_5\, CDR_{it} + \beta_6 GDPgrowthrate_{t-1} + \epsilon_{it}$$

where the dependent variable (Y_{it}) is the share of bank *i's* credit to NCE in total credit to the energy sector in quarter *t*; $GNPA_{NCE\,it-1}$ is bank *i's* GNPA ratio in the NCE sector in quarter *t-1*; the dummy variable $Policy\,2015_t$ takes value 1 for Q2: 2015-16 to Q1:2020-21 and zero otherwise; the dummy variable $Policy\,2020_t$ takes the value 1 for Q2:2020-21 to Q3: 2023-24 and zero otherwise; $Policy_t * Bank\ Group_{it}$ is the interaction term between the policy dummies and bank group dummy (0 for PSBs, 1 for PVBs); CDR_{it} is bank *i's* credit-to-deposit ratio in quarter *t*; $GDPgrowthrate_{t-1}$ is one quarter lagged nominal GDP growth rate, which is included as a macroeconomic control.

Positive and statistically significant coefficients of dummy variables across specifications suggest that both the policy interventions were associated with an increase in the share of credit to the NCE sector in total credit for energy (Table III.3.1). The 2015 policy intervention was effective for PSBs, whereas the 2020 policy helped in

Table III.3.1: Regression Results

	Dependent variable (Y) = Share of Bank Credit to Non-Conventional Energy Sector in Total Energy Sector Credit (NCE / TEC)		
Variables	(1)	(2)	(3)
NCE /TEC (L1)	0.825***	0.802***	0.801***
	(0.0613)	(0.0536)	(0.0541)
NCE GNPA Ratio (L1)	-0.0139	-0.0255	-0.0249
	(0.0281)	(0.0297)	(0.0293)
Policy 2015	0.0079	0.0069**	0.0069**
	(0.0064)	(0.0029)	(0.0029)
Policy 2020	0.0219**	0.0007	0.0011
	(0.0090)	(0.0050)	(0.0047)
Policy 2015 * PVB		0.0045	0.0044
		(0.0100)	(0.0100)
Policy 2020 * PVB		0.0406**	0.0406**
		(0.0158)	(0.0158)
Credit to Deposit Ratio		0.0007	0.0007
		(0.0008)	(0.0008)
GDP Growth Rate (L1)			0.0002
			(0.0003)
Constant	0.0202*	-0.0298	-0.0317
	(0.0114)	(0.0678)	(0.0659)
Observations	1,095	1,095	1,095
R-squared	0.688	0.693	0.693
Number of Banks	33	33	33
Bank Fixed Effects	Yes	Yes	Yes

Notes: 1) Robust standard errors in parentheses.
2) *** p<0.01, ** p<0.05, * p<0.1
3) In models 2 and 3, PSB is the base category; the coefficients of policy variables (*viz.*, Policy 2015 and Policy 2020), therefore, represent the policy impact on PSBs' credit to the NCE sector.
Source: RBI staff estimates.

(Contd.)

increasing PVBs' lending to the NCE sector (Model 2). The regression results remain robust even after controlling for macroeconomic influences (Model 3). Thus, the priority sector policy modulations have encouraged credit flows to the NCE sector. It, however, needs to be recognised that this phase also saw significant policies and incentives by the government to promote green energy sources. The results reflect the combined impact of various policy measures and incentives.

Reference:

Polzin, F., Migendt, M., Täube, F. A., and von Flotow, P. (2015). Public Policy Influence on Renewable Energy Investments—A Panel Data Study across OECD Countries. *Energy Policy*, Vol. 80, 98-111.

8. Payment and Settlement Systems

III.46 The Reserve Bank has been a pioneer in establishing various technology-based solutions for improvement of the payment and settlement system infrastructure, coupled with the introduction of innovative payment products. The global reach of unified payments interface (UPI), India's fast payment system (FPS), is steadily growing through partnerships with various countries.

8.1 Cyber Resilience and Digital Payment Security Controls for Non-Bank Payment System Operators (PSOs)

III.47 On July 30, 2024 the Reserve Bank issued directions to non-bank PSOs, aimed at enhancing their information security preparedness and cyber resilience. The directions will be applicable to all authorised non-bank PSOs and will be implemented in a phased manner, starting with large entities effective April 1, 2025.

8.2 Bharat Bill Payment System (BBPS)

III.48 BBPS, an integrated bill payment system, offers interoperable and convenient payment services to customers. In view of the evolving payment ecosystem, the Reserve Bank issued a revised regulatory framework on February 29, 2024. Some of the key changes include, *inter alia*, expanding the participation criteria to all authorised non-bank payment aggregators; measures to enhance interoperability; customer protection measures and requirement of escrow account for non-bank Bharat Bill Payment Operating Units (BBPOUs).

8.3 Framework on Alternative Authentication Mechanisms for Digital Payment Transactions

III.49 On July 31, 2024 the Reserve Bank released draft framework on alternative authentication mechanisms for digital payment transactions. As per the framework, all digital payment transactions shall be authenticated with additional factor/s of authentication (AFA), wherein one of the factors of authentication should be dynamically created[9]. Additionally, to decide the appropriate AFA for a transaction, a risk-based approach needs to be adopted based on factors like the risk profile of the customer and / or beneficiary, transaction value and channel of origination.

8.4 Pre-sanctioned Credit Lines through UPI

III.50 In September 2023 the Reserve Bank had allowed pre-sanctioned credit lines to be linked through UPI and be used as a funding account by SCBs excluding PBs, SFBs and RRBs. On December 6, 2024, the Reserve

[9] A dynamically created factor is generated after initiation of payment, is specific to the transaction and cannot be reused.

Bank announced that SFBs would also be permitted to extend this facility. This will further deepen financial inclusion and enhance formal credit, particularly for 'new to credit' customers.

9. Overall Assessment

III.51 The financial landscape is witnessing a dramatic transformation, globally as well as in India, driven by technological innovations, changing consumer preferences and emergence of alternative business models. While these developments have fostered competition and collaboration, they also raise concerns about customer security and adequate regulatory oversight. During 2023-24 and 2024-25, the Reserve Bank continued to pursue proactive and prudent regulatory and supervisory policies with focus on strengthening resilience of REs, consumer protection, grievance redress mechanisms, financial inclusion, mitigation of climate risks, digitalisation and promoting innovation. The robust financial health of REs enabled them to fund productive activities of the economy, while embracing technology. The Reserve Bank remains committed to preserving financial stability and enhancing financial sector efficiency, while adopting a consultative approach in its regulatory frameworks and aligning Indian banking practices with international standards. The objective is to shape a resilient financial sector through a flexible and robust regulatory architecture so as to foster growth with stability.