III POLICY ENVIRONMENT

Reviving growth and mitigating effects of COVID-19 have assumed centre stage in the Reserve Bank's policy agenda and it acted swiftly with aggressive policy rate cuts, massive system-level and targeted liquidity infusion, moratorium and time-bound resolution for specified sectors. The Reserve Bank's regulatory ambit was reinforced by legislative amendments, giving it greater powers over co-operative banks, non-banking financial companies (NBFCs) and housing finance companies (HFCs) to improve their quality of management and governance.

1. Introduction

III.1 This Report is being issued in an environment in which the Indian economy, the Reserve Bank, and the banking and financial system are confronting the most testing challenge of more than a 100 years. Reviving growth and mitigating the effects of COVID-19 have assumed centre stage in the Reserve Bank's policy agenda in this unprecedented situation. The Reserve Bank responded to the pandemic with aggressive policy rate cuts, massive liquidity infusion, both system-level and targeted to distressed sectors, institutions and instruments, moratorium as a temporary relief to borrowers, and a time bound window for restructuring of assets. Providentially, this period has coincided with the regulatory ambit of the Reserve Bank being reinforced by legislative amendments, giving it greater powers over co-operative banks, non-banking financial companies (NBFCs), and housing finance companies (HFCs).

III.2 Against this backdrop, this chapter begins with an account of monetary policy and liquidity management measures in Section 2. This is followed by an overview of the regulatory policy developments relating commercial banks during the period under review (2019-20 and 2020-21 so far) in Section 3, followed by policy initiatives in respect of regional rural banks (RRBs) and small finance banks (SFBs) in Sections 4 and 5, respectively. Supervisory strategies for commercial banks are summarised in Section 6, followed by policies for co-operative banks and NBFCs in Sections 7 and 8, respectively. Credit delivery and financial inclusion initiatives, and foreign exchange policies are reported in Sections 9 and 10, respectively. Section 11 reviews policies undertaken to ensure customer education and protection, followed by policies for payment and settlement systems in Section 12. Section 13 concludes with an overall assessment and perspectives for the way forward.

2. Monetary Policy and Liquidity Management

III.3 In order to address the challenges posed by the COVID-19 pandemic, the monetary policy committee (MPC) met off-cycle in March and May 2020 and voted for a cumulative policy rate reduction of 115 basis points (bps), bringing the repo rate down to its lowest ever level of 4 per cent. Thus, the policy repo rate under the liquidity adjustment facility (LAF) was reduced cumulatively by 250 bps in the easing cycle that began in February 2019. In order to engender easy financial conditions and to encourage banks to deploy their surplus funds in investments and loans in productive sectors of the economy, the reverse repo rate under the LAF was reduced cumulatively by 155 bps to 3.35 per cent.

III.4 Ahead of the outbreak of the pandemic, the MPC had changed its stance from neutral to accommodative in June 2019 in order to address the cyclical slowdown in growth that commenced in the first quarter of 2018-19. The MPC reduced the policy rate in four consecutive meetings since April 2019. In the fifth and sixth bi-monthly meetings in December 2019 and February 2020, it took note of the elevated trajectory of inflation on account of the supply disruptions caused by COVID-19 and voted to keep the policy repo rate unchanged.

III.5 In its August, October and December 2020 meetings, elevated and persisting price pressures induced the MPC to keep the policy rate unchanged. It noted, however, that supporting the economic recovery remained its priority. Accordingly, its resolutions reflected further accommodation in its stance, which it decided to continue at least during the financial year 2020-21 and into the next financial year to revive growth on a durable basis and mitigate the impact of COVID-19 on the economy, while ensuring that inflation remains within the target going forward.

Liquidity Management

III.6 During 2019-20, primary liquidity expansion more than offset the leakage of liquidity from the banking system due to higher currency demand. System-level liquidity, which was in deficit mode during April and May 2019, turned into surplus from June and progressively increased during the year.

III.7 Liquidity amounting to ₹1.37 lakh crore was injected through variable rate repos of maturities ranging from overnight to 16 days in addition to the regular 14-day repos. Surplus liquidity of ₹284.4 lakh crore was absorbed through reverse repos of maturities ranging from overnight to 63 days during the year. The Reserve Bank also injected durable liquidity of ₹1.1 lakh crore through purchase of securities under open market operations (OMOs) during the year. Effective from February 14, 2020, a new liquidity management framework was operationalised that refined the Reserve Bank's liquidity management operation, clearly communicated the objectives thereof and set out toolkit for liquidity management with a view to enhancing transparency, informing and stabilising market expectations.

III.8 The Reserve Bank conducted a USD/INR buy/sell swap auction of US$ 5 billion (₹34,874 crore) for a tenor of 3 years in April 2019 and two OMO purchase auctions in May 2019 amounting to ₹25,000 crore in order to inject durable liquidity into the system. In June 2019, the Reserve Bank conducted two OMO purchase auctions amounting to ₹27,500 crore.

III.9 During the year, the Reserve Bank expanded its liquidity management toolkit by conducting four longer term reverse repo auctions in November 2019 – two of 21 days and one each of 42 days and 35 days tenor –absorbing ₹78,934 crore. Four operation twists *i.e.*, simultaneous purchase and sale of securities under special OMOs were also conducted between December 23, 2019 and January 23, 2020.

III.10 At the time of the outbreak of COVID-19, net average daily absorption of surplus liquidity under the LAF reverse repo amounted to ₹4.72 lakh crore in Q1:2020-21. Despite large currency expansion draining liquidity, the various measures undertaken in the wake of COVID-19 kept financial markets and institutions functioning normally, financial conditions easy and supportive and calmed pandemic-induced liquidity stress in various parts of the financial system (Annex III.1).

III.11 These liquidity-augmenting measures, amounting to ₹12.8 lakh crore (6.3 per cent of 2019-20 nominal GDP), resulted in the lowest financial markets borrowing costs in a decade, with yields on instruments like the 3-month Treasury bill, commercial paper (CP) and certificates of deposit (CDs) trading closer to the lower bound of the policy rate corridor in the secondary market. This in turn led to record primary market issuance of corporate bonds of ₹4.4 lakh crore during April-October 2020 as compared to ₹3.5 lakh crore during the same period last year. With illiquidity premia dissipating under the impact of Operation Twist and liquidity enhancing measures, spreads of 3-year AAA, AA+, AA- (AA minus) corporate bonds over government securities (G-secs) of similar tenor have declined by over 200 bps from March 26, 2020 to November 27, 2020. Even for the lowest investment grade corporate bonds (BBB-), spreads have come down by 158 bps as on November 27, 2020. These targeted policy measures also helped stabilise the market financing conditions for NBFCs as spreads for 3-year NBFC bonds across the rating spectrum narrowed in the range of 287 bps for AAA rated and 112 bps for A+ rated bonds over G-secs of similar tenor during the same period. The special liquidity facility for mutual funds (SLF-MF) helped stabilise the sector with assets under management (AUM) of debt MFs recovering and improving to ₹15.1 lakh crore as on November 30, 2020 from ₹12.20 lakh crore as on April 29, 2020.

3. Regulatory Policies for Commercial Banks

III.12 The Reserve Bank complemented monetary and liquidity measures with regulatory policy support. Measures such as moratorium on payment of instalments are aimed at giving respite to businesses and households affected by the lockdown. An option to realign debt was also provided to firms as well as individual borrowers through a resolution framework based on revised cash flow expectations.

III.13 As on August 31, 2020 customers accounting for 40 per cent of outstanding bank loans availed the benefit of moratorium allowed by the Reserve Bank for borrowers affected by the COVID-19 pandemic. Most sectors reported lower outstanding loans under moratorium in August 2020 compared to April 2020[1]; however, Micro, Small and Medium Enterprises (MSMEs) registered a marginal increase and the number of MSMEs customers availing moratorium increased to 78 per cent in August 2020, reflecting the stress in the sector. The distribution of moratorium sought in MSME loans indicate that urban co-operative banks (UCBs) bore the brunt of incipient stress, followed by PSBs and NBFCs. In the case of moratorium availed for individual loans outstanding, the share of SFBs is the highest, followed by UCBs and NBFCs. Nearly two-thirds of the total customers of PSBs and half of the total customers of PVBs exercised the option to defer payments in April 2020. As on August 31, 2020 this reversed, with PVBs accounting for a larger customer base under moratorium than other categories of lenders, mainly due to a four-fold increase in their MSME customers availing the benefit, and with sizeable customer base across categories (majorly individuals) opting out of moratorium in case of PSBs (Table III.1).

3.1 Prudential Framework for Resolution of Stressed Assets

III.14 The prudential framework for resolution of stressed assets was issued on June 7, 2019

[1] Financial Stability Report, issue No. 21, July 2020, Table 1.4, available at https://www.rbi.org.in.

Table III.1: Loan Moratorium

(Availed as on August 31, 2020)

Sector	Corporate		MSME		Individual		Others		Total	
	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding	% of total Customers	% of total outstanding
PSBs*	24.96	36.70	64.11	75.42	36.28	34.51	30.58	39.08	34.80	41.33
PVBs*	16.37	23.19	83.38	62.99	50.25	33.60	47.90	54.00	54.88	33.96
FBs*	27.46	14.81	52.89	47.38	8.66	27.81	9.03	9.28	9.05	20.53
SFBs*	36.94	34.13	80.29	66.90	81.48	69.39	86.34	80.90	82.47	68.18
UCBs*	43.13	90.15	47.08	89.60	47.50	57.64	32.81	46.93	43.45	64.09
NBFCs*	42.65	37.15	68.76	67.01	23.11	56.51	50.21	33.20	26.58	44.94
SCBs	18.02	30.44	77.19	68.07	43.65	33.89	35.62	39.11	43.75	37.91
System	31.31	34.28	77.50	69.29	42.62	41.00	45.40	42.12	45.62	40.43

Note: *Total data of PSBs=12, PVBs=21, FBs=42, UCBs=39, SFBs= 10, and NBFCs=73.
Source: RBI Supervisory Returns.

for banks, All India Financial Institutions (AIFIs), Non-Deposit taking Systemically Important NBFCs (NBFCs-ND-SI) and Deposit taking NBFCs (NBFCs-D) to resolve stressed accounts. The prudential framework aims at entrenching early recognition and reporting as well as time-bound resolution of stressed assets, while providing strong disincentives for delays in implementation of resolution plans (RPs) in the form of additional provisioning. The framework also provides incentives for filing application for corporate insolvency resolution process (CIRP) under the Insolvency and Bankruptcy Code (IBC) by allowing half the additional provisions to be reversed on filing an insolvency application and the remaining additional provisions may be reversed upon admission of the borrower into the IBC's insolvency resolution process. A window was provided under the prudential framework in the wake of COVID-19 pandemic to enable the lenders to implement a resolution plan in respect of eligible corporate exposures without change in ownership, and personal loans, subject to specified conditions (Box III.1).

3.2 Changes in Risk Weights

III.15 Consumer credit, including personal loans and credit card receivables but excluding educational loans, earlier attracted a risk weight of 125 per cent or higher. This was reduced to 100 per cent effective September 12, 2019 although the relaxation is not applicable to credit card receivables.

III.16 Currently, exposures included in the regulatory retail portfolio of banks are assigned a risk weight of 75 per cent, subject to the fulfilment of criteria including a maximum exposure of ₹5 crore to one counterparty. The threshold limit of ₹5 crore for aggregate retail exposure to a counterparty was increased to ₹7.5 crore for all fresh as well as incremental qualifying exposures on October 12, 2020 in order to reduce the cost of credit for this segment and also to harmonise with the Basel guidelines.

III.17 As a countercyclical measure, on October 16, 2020 risk weights on individual housing loans were rationalised, irrespective of the amount of loan. Henceforth, the risk weights for all new housing loans to be sanctioned upto March 31,

Box: III.1: Resolution of COVID-19 Related Stress

The resolution window for COVID-19 related stress is applicable to those borrowers who are in financial difficulties due to the outbreak of the pandemic but were performing satisfactorily otherwise. Therefore, eligibility for resolution is prescribed as loan accounts which were classified as standard and had not been in default for more than 30 days as on March 1, 2020 to ensure that the benefit of resolution only accrues to borrowers genuinely distressed by COVID-19. The borrowers should continue to be classified as standard till the date of invocation of the resolution framework. Loans to financial service providers, central and state governments and local government bodies are not covered under this framework. As another framework governing resolution of MSMEs where banks and NBFCs have exposure of up to ₹25 crore is already operational, they have also been excluded from the ambit of this framework.

An Expert Committee constituted by the Reserve Bank (Chairman: Shri K V Kamath) recommended five financial parameters *viz,* total outside liability / adjusted tangible net worth; total debt / EBIDTA; current ratio; debt service coverage ratio (DSCR); and average debt service coverage ratio (ADSCR) to be factored into the assumptions underpinning resolution plans implemented under the resolution framework[1]. The Expert Committee also recommended sector-specific thresholds for these ratios to act like floors or ceilings in respect of 26 sectors, identified based on the outstanding and severity of impact of the pandemic, including power, iron and steel, construction, and real estate. For sectors where the specific thresholds have not been specified, lending institutions can make their own internal assessments of solvency. However, the current ratio and DSCR in all cases shall be 1.0 and above, and ADSCR shall be 1.2 and above.

Resolution Process

The lenders have been given time till end December 2020 to invoke the resolution framework. After invocation, lenders have 90 days to implement a resolution plan for personal loans, and 180 days for other loans.

In the case of personal loans, the RP may provide for steps such as rescheduling of payments or granting of a moratorium subject to a maximum of 2 years. For corporate loans with multiple lenders, the resolution process will be treated as invoked if the lenders representing at least 75 per cent by value of the total outstanding credit facilities and 60 per cent by number agree to invoke the resolution process. Once agreed, an inter creditor agreement (ICA) is required to be signed by all the lenders within 30 days from the date of invocation. A RP may involve any action, including but not limited to sale of exposure to other entities; change in ownership and restructuring; extension of the residual tenor of the facility, with or without payment moratorium, by a period of not more than 2 years; conversion of a portion of the debt into equity or other marketable, non-convertible debt securities; and sanctioning of additional loans to the borrower. The requirements for a RP to be treated as implemented have also been clearly specified.

Asset Classification and Provisioning

Accounts which may have become NPA between the period of invocation of the RP and its implementation may be upgraded as standard upon implementation of the RP. If an interim additional loan is granted to a borrower, it may be classified as standard till the implementation of the RP. Post implementation of a RP, lenders must keep a minimum provision of 10 per cent of re-negotiated debt exposure or as required under IRAC norms, whichever is higher. A lender not party to the ICA will be required to keep provisions of at least 20 per cent of the carrying debt on its books or as per IRAC norms, whichever is higher, in case of corporate exposures. For both personal loans and other exposures, half of the provisions may be written back upon the borrower paying at least 20 per cent of the residual debt without slipping into NPA and the remaining half may be written back upon the borrower paying another 10 per cent of the residual debt without slipping into NPA subsequently.

Default by the borrower with any of the ICA signatories during the monitoring period will trigger a review period of 30 days. If the borrower remains in default at the end of the 30-day review period, its asset classification will be downgraded to NPA for all lenders, including the non-ICA signatories.

An independent credit evaluation is required for RPs involving aggregate exposure of ₹100 crore and above by all lenders. Any RP in respect of borrowers to whom the aggregate exposure of lenders is greater than ₹1,500 crore as on the date of invocation needs to be independently verified by the Expert Committee for compliance with the required processes. Lenders are also required to make necessary disclosures in their financial statement of accounts where a RP is implemented.

[1] In respect of eligible borrowers under Part B of the Annex to the Resolution Framework.

2022 will be 35 per cent for loan to value (LTV) ratio less than or equal to 80 per cent, and 50 per cent for LTV ratio greater than 80 per cent but less than or equal to 90 per cent.

3.3 Large Exposures Framework (LEF)

III.18 Banks were given the option, through revised guidelines on large exposures issued on June 03, 2019, to recognise exposure either on the Credit Risk Mitigation (CRM) instrument provider or the original counterparty depending on the exposure on which the risk weights are used for capital adequacy purpose. On March 23, 2020 the Reserve Bank issued a clarification to the banks that even if the original counterparty was a person resident outside India, exposure can be shifted from the CRM provider to the original counterparty if CRM benefits like shifting of exposure/risk weights are not derived by that bank. Exposures shifted to a person resident outside India will attract a minimum risk weight of 150 per cent. The applicability of LEF on non-centrally cleared derivatives (NCCDs) exposure has been deferred till April 1, 2021.

3.4 Subordinate Debt for Stressed MSMEs

III.19 Under the Distressed Assets Fund Scheme for providing subordinate debt for stressed MSMEs, the Government of India (GoI) announced that banks will provide 15 per cent of the promoter's contribution or ₹75 lakh, whichever is lower, as fresh loans to promoters to be infused as equity/quasi equity. The scheme envisages 90 per cent guarantee coverage of the subordinate debt facility from the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) and the remaining 10 per cent guarantee from promoters. The guarantee cover would be uncapped, unconditional and irrevocable. On July 1, 2020 the Reserve Bank permitted banks to reckon the funds infused by the promoters in their MSME units through loans availed under the above scheme as equity/ quasi equity from promoters for debt-equity computation.

3.5 Scheme for Grant of Ex-gratia Payment of Difference in Interest

III.20 On October 23, 2020 the GoI announced a scheme for grant of *ex-gratia* payment of difference between compound interest and simple interest for six months to borrowers in specified loan accounts for the period between March 1, 2020 to August 31, 2020. On October 26, 2020 the Reserve Bank advised all lending institutions to adhere to the provisions of the scheme within the stipulated timeline.

3.6 Enabling Video-Based KYC

III.21 Video-based Customer Identification Process (V-CIP) for individuals was introduced by the Reserve Bank on January 9, 2020 to facilitate digital on-boarding of customers and improve customer convenience. The use of Aadhaar authentication / offline verification and the mandatory Permanent Account Number (PAN) requirement is expected to mitigate the risks associated with this process of on-boarding customers remotely. Further, the live location capturing of the customer (Geotagging) will ensure that customer is physically present in India.

4. Regional Rural Banks

III.22 RRBs are facing capital adequacy issues due to increasing level of NPAs, while their liquidity position is also weakened. During 2019-20, the Cabinet Committee on Economic Affairs (CCEA) had approved the continuation of the scheme of recapitalisation of RRBs upto 2020-21 for those RRBs which are unable to maintain minimum capital to risk-weighted assets ratio (CRAR) of 9 per cent. An amount of ₹670 crore towards GoI's share of recapitalisation has been sanctioned (*i.e.*, 50 per cent of the total recapitalisation support of ₹1,340 crore).

4.1 Policies for Liquidity Management

III.23 RRBs have been permitted conditional access to the LAF and marginal standing facility (MSF) of the Reserve Bank. Effective December 4, 2020, they were also allowed to participate in the call/notice/term money markets to facilitate more efficient liquidity management. Extension of liquidity facilities to RRBs will be contingent upon meeting certain eligibility criteria, such as implementation of Core Banking Solution and maintaining minimum CRAR of nine per cent.

4.2 Branch Authorisation Policies for RRBs

III.24 On May 31, 2019 the Reserve Bank introduced the concept of banking outlet (BO) for RRBs. A BO is a fixed-point service delivery unit, manned by either the bank's staff or its business correspondent, where acceptance of deposits, encashment of cheques/ cash withdrawal or lending of money are provided for a minimum of four hours per day for at least five days a week. RRBs are required to obtain prior approval of the Reserve Bank for opening brick and mortar branches in Tier 1 to 4 centres (as per Census 2011). For Tier 5 and 6 centres, RRBs have general permission for opening BO with *post facto* reporting. Furthermore, they are also required to open at least 25 per cent of the new BOs in unbanked rural centres every year.

4.3 Capital Raising through Perpetual Debt Instruments (PDI)

III.25 On November 1, 2019 RRBs were allowed to issue PDIs eligible for inclusion as Tier 1 capital. This will serve as an additional option to these banks for augmenting regulatory capital.

4.4 Amortisation of Pension Liabilities

III.26 Following the implementation of Regional Rural Bank (Employees') Pension Scheme 2018, the Reserve Bank permitted RRBs in December 2019 to amortise their total pension liability over a period of five years from 2018-19, subject to a minimum of 20 per cent of the pension liability assessed every year.

4.5 Guidelines on Merchant Acquiring Business

III.27 On February 6, 2020 RRBs were permitted to act as merchant acquiring banks using Aadhaar Pay – BHIM app and POS terminals, by employing digital banking for cost-effective and user-friendly solutions to their customers, subject to adequate IT systems and infrastructure for application development, and customer grievance redressal mechanisms.

5. Small Finance Banks

III.28 The primary objective of setting up of SFBs has been to further financial inclusion by provision of savings vehicles mainly to unserved and underserved sections of the population, through high technology-low cost operations. During the year, the Reserve Bank initiated several measures to expand the reach of these niche banks.

5.1 Guidelines for 'On-tap' Licensing

III.29 On December 5, 2019 the Reserve Bank issued guidelines for on-tap licensing of SFBs, with minimum paid-up voting equity capital / net worth requirement of ₹200 crore. For Primary (Urban) Co-operative Banks desirous of voluntarily transiting into SFBs, the initial requirement of net worth has been set at ₹100 crore, which will have to be increased to ₹200 crore within five years from the date of commencement of business. SFBs will be given scheduled bank status immediately and will have general permission to open banking outlets upon commencement of operations. All eligible payments banks (PBs) can apply for conversion into SFB after five years of operations.

5.2 Harmonisation of Branch Expansion Policy

III.30 The 2014 guidelines on the annual branch expansion plans of SFBs required prior approval of the Reserve Bank for the initial five years. On March 28, 2020 the requirement of prior approval of the Reserve Bank was done away with. Now, the SFBs set up under 2014 guidelines also have general permission to open banking outlets, subject to the condition that at least 25 per cent of their BOs are in unbanked rural centres.

5.3 Non-risk Sharing Financial Services Activities

III.31 On March 28, 2020 all existing SFBs were exempted from seeking prior approval of the Reserve Bank for undertaking non-risk sharing simple financial service activities, which do not require any commitment of own funds after three years of commencement of business.

6. Supervisory Policies

III.32 The thrust of the Reserve Bank's supervisory policies has been on identifying root causes of weaknesses in banks (*viz.*, poor compliance culture, inconsistencies between risk appetite and business strategy, deficiencies in internal assurance functions, among others) and taking suitable measures towards their mitigation. The Board for Financial Supervision (BFS) is the guiding force in these initiatives. In the 13 meetings held during the year (July 2019-November 2020), the Board deliberated on major issues including, *inter alia*, guidelines on compensation to whole time directors/ chief executive officers/ material risk takers and control function staff; review of instructions on opening of current account by banks, and measures taken by the Reserve Bank to ensure continuity of banking operations in an uninterrupted manner due to COVID-19 disruptions. Several supervisory policy measures were also initiated during the year with a focus on ensuring financial stability (Box III.2).

Box III.2: Bolstering the Supervisory Framework of the Reserve Bank

Few entity-related adverse events witnessed since mid-2018 raised some concerns about financial system soundness. Internalising the learnings from these episodes, the Reserve Bank initiated a series of measures to strengthen its supervisory framework over SCBs, UCBs as well as NBFCs, which are broadly outlined below:

Early Identification of Risks and Vulnerabilities

The Reserve Bank has developed a system for early identification of vulnerabilities to take timely and proactive action. It has been deploying advances in data analytics to quarterly offsite returns to provide sharper and more comprehensive inputs to onsite supervisory teams. An early warning framework—which tracks macroeconomic variables, and market and banking indicators—complements the analysis. Bank-wise as well as system-wide supervisory stress testing add a forward-looking dimension for identification of vulnerable areas.

Root Cause Analysis of Vulnerabilities

Effective governance is key to avoiding fragilities and frauds in a financial entity. Therefore, the thrust of the Reserve Bank's supervision is now more on root causes of vulnerabilities rather than dealing with symptoms. Structured frameworks are being put in place to assess the governance standard in Supervised Entities (SEs), robustness of their business model and efficacy of their internal assurance functions such as risk management, compliance and internal audit. This will buttress internal defences of SEs to identify current and emerging risks at an early stage and help in initiating remedial measures by themselves.

Framework for Early, Effective and Consistent Supervisory Action

In line with BCBS recommendations[1], the supervisory assessment framework is complemented by a graded

[1] Basel Committee on Banking Supervision (March 2018), *Frameworks for Early Supervisory Intervention*, available at www.bis.org.

(Contd.)

intervention framework aimed at initiating early and effective corrective actions, that are consistent across all SEs. This will help in influencing the behaviour of SEs in key areas (such as governance, risk appetite, risk and financial management and, where appropriate, strategy) to enhance their own safety and soundness while also contributing to the overall financial stability.

Harmonised and Consolidated Supervision

The supervisory functions pertaining to SCBs, UCBs and NBFCs are now integrated, with the objective of harmonising the supervisory approach based on the activities / size of the SEs. Steps are also being taken to progressively harmonise instructions issued, *albeit* with proper grading, so that supervisory arbitrage is reduced. Like SCBs, senior supervisory managers (SSM) are being appointed in all other SEs for continuous monitoring. Further, entities belonging to a group / conglomerate have a single point of supervision through the SSM, which is expected to reduce any potential supervisory arbitrage.

Specialised Structure for KYC/AML Risk

A risk based supervision framework focussing on KYC/AML risk has been created, in line with the principles of BCBS and Financial Action Task Force (FATF) requirements for prudential supervision.

Leveraging SupTech

Fintech are being embraced in the form of innovative technologies for regulation (RegTech) and supervision (SupTech). An Integrated Compliance Management and Tracking System (ICMTS) and a Centralised Information Management System (CIMS) are two major SupTech initiatives being implemented for seamless reporting between SEs and the Reserve Bank and for enhancing data management and data analytics capabilities, respectively.

Strengthening Cyber Security Resilience

Key cyber risk indicators were introduced for all SCBs since June 2019. A comprehensive cyber security framework on a graded approach for UCBs and instructions on cyber security controls for third party ATM switch providers for all SEs were released in December 2019. Further, a certification / awareness programme on cyber security was made mandatory for members of the Board, senior management and CXOs in August 2018, which has been attended to by more than 2,500 bank officials till date.

Regular Deep-dive into Areas of Concern through Thematic Studies

A number of thematic studies on areas such as unsecured retail credit, aviation sector, loan pricing, CD ratio and liabilities profile of PVBs, business practices of digital lenders, component analysis of income of banks, transmission of policy rates and net interest margin were conducted to provide inputs to top management for proactive policy interventions.

Other initiatives include setting up of a college of supervisors for capacity development and skilling of the Reserve Bank's supervisory staff.

Notwithstanding improvements being made, it is recognised that enhancing the supervisory framework is a continuous process, and the Reserve Bank will strive to continually advance and refine the supervisory approach and methodology to improve the resilience of the SEs.

6.1 Merger of PSBs

III.33 Vijaya Bank and Dena Bank were merged with the Bank of Baroda with effect from April 1, 2019, to reap thebenefits of economies of scale and resulting synergies. With effect from April 1, 2020, 10 PSBs were merged into 4 entities. Oriental Bank of Commerce and United Bank of India have been merged with Punjab National Bank to form the country's second-largest public-sector lender. Syndicate Bank and Canara Bank merged to create the fourth largest PSB. Andhra Bank and Corporation Bank have been merged into the Union Bank of India, forming the country's fifth largest PSB. Allahabad Bank was merged into Indian Bank.

6.2 Prompt Corrective Action (PCA) Framework

III.34 The infusion of capital in banks during 2018-19 by the central government led to five PSBs coming out of the PCA framework. Additionally, the only private sector PCA bank during that period *viz.* Dhanlaxmi Bank, was also allowed to restart normal business activities. The Reserve Bank initiated PCA for Lakshmi Vilas Bank in September 2019 due to the high level of bad loans, lack of sufficient capital and negative return on assets[2]. Currently, there are 3 PSBs[3] and 1 PVB[4] under the PCA framework.

[2] The Lakshmi Vilas Bank was amalgamated with DBS India Pvt. Ltd on November 27, 2020.
[3] Indian Overseas Bank, Central Bank, UCO Bank
[4] IDBI Bank.

6.3 Yes Bank Reconstruction

III.35 On March 5, 2020 the central government, based on the application of the Reserve Bank, placed Yes Bank under moratorium. On March 6, 2020 the Reserve Bank placed a draft 'Yes Bank Ltd. Reconstruction Scheme, 2020' on its website for public comments. Following the sanction and notification of the Scheme by the central government on March 13, 2020, the moratorium was lifted effective March 18, 2020. The resolution plan was characterised by the unique public-private partnership comprising leading financial entities which infused capital into Yes Bank. Since implementation of the Scheme, the financial position and other parameters of the bank have improved.

6.4 Amalgamation of The Lakshmi Vilas Bank

III.36 The Reserve Bank announced the draft scheme of amalgamation of the Lakshmi Vilas Bank Ltd. with DBS Bank India Ltd. on November 17, 2020, along with a month-long order of moratorium on the former. Following the sanction of 'The Lakshmi Vilas Bank Ltd. (Amalgamation with DBS Bank India Ltd.) Scheme, 2020' by the central government, the amalgamation came into force on November 27, 2020, with the moratorium order ceasing to be effective and all branches of the Lakshmi Vilas Bank functioning as branches of DBS Bank.

6.5 Integration of Supervisory Function

III.37 The supervisory function within the Reserve Bank was integrated by merging its Department of Banking Supervision (DBS), the Department of Co-operative Banking Supervision (DCBS) and the Department of Non-Banking Supervision (DNBS) into a Department of Supervision (DoS), with effect from November 1, 2019. This holistic approach to supervision is expected to address growing complexities of size and inter-connectedness, potential systemic risks from supervisory arbitrage and information asymmetry, while establishing a more effective consolidated supervision of financial conglomerates. The supervisory approach is being fine-tuned to focus on root causes of vulnerabilities in the banking system, *viz.*, governance issues, processes, and sub-optimal risk and compliance culture.

7. Co-operative Banking

III.38 The co-operative banking sector plays an important role in financial inclusion at the grass-root level. In a landmark development, the Reserve Bank was given regulatory powers to improve the quality of management and governance in co-operative banks and to ensure more effective regulation and supervision to strengthen the co-operative banking sector. The Reserve Bank is initiating measures to improve standards of corporate governance in UCB sector, even while strengthening cybersecurity and improving reporting standards for UCBs.

7.1 Amendments to the Banking Regulation (BR) Act, 1949

III.39 On June 26, 2020 Banking Regulation (Amendment) Ordinance, 2020 was promulgated amending the BR Act, 1949, bringing additional areas of functioning of cooperative banks under the regulatory purview of the Reserve Bank. The major provisions pertain to areas such as governance and management of co-operative banks, prior approval of the Reserve Bank for appointment or removal of statutory auditors (SAs), time allowed for disposal of non-banking assets, providing additional avenues for raising capital, voluntary/compulsory amalgamation, preparation of scheme of reconstruction and winding up by the concerned High Court at the instance of the Reserve Bank. The Act is not applicable to certain types of credit societies, including Primary Agricultural Credit Societies.

On September 29, 2020 the Banking Regulation (Amendment) Act, 2020, which replaced the Ordinance, was notified by the GoI, and all the provisions of the amended Act came into force for UCBs with effect from June 29, 2020 [Box V.1].

7.2 Board of Management Guidelines

III.40 Under the extant legal framework, the Board of Directors of UCBs perform both executive and supervisory roles, with the responsibility to oversee the functioning of the UCBs as a cooperative society as well as a bank. On December 31, 2019 UCBs with deposits of ₹100 crore and above (except all Salary Earners' Banks) were advised to constitute Board of Management (BoM) comprising members with special knowledge or practical experience in one or more fields, *viz.* accounting, banking, finance, and co-operation, among others. The BoM will facilitate professional management and focussed attention on banking-related activities of UCBs and, thus, protect the interests of depositors.

7.3 Review of Supervisory Action Framework (SAF) for UCBs

III.41 On January 6, 2020 the Reserve Bank issued revised guidelines on SAF for UCBs to initiate corrective action by the banks themselves and/or supervisory action by the Reserve Bank at an early stage on breach of specified thresholds (triggers) in respect of asset quality, profitability and capital position. The guidelines intend to make SAF more effective in bringing about improvement in weak but viable UCBs and resolving non-viable UCBs in an expeditious manner.

7.4 Reporting of Large Exposures to CRILC

III.42 SCBs, SFBs, All India Financial Institutions (AIFIs), NBFCs-ND-SI, NBFCs-D and Non-Banking Financial Company in Factoring Services (NBFC-Factors) were required to report credit exposures of ₹5 crore and above on Central Repository of Information on Large Credits (CRILC). In addition, UCBs with assets of ₹500 crore and above were brought under the CRILC reporting framework from the quarter ending December 31, 2019.

7.5 Prudential Exposure Limits

III.43 On March 13, 2020, the prudential exposure limits for UCBs for a single borrower/ party and a group of connected borrowers/ parties were reduced from the existing 15 per cent and 40 per cent of their capital funds to15 per cent and 25 per cent, respectively, of their tier-I capital. A suitable glide path has been given to UCBs for bringing down their existing exposures within the aforesaid revised limits by March 31, 2023. Moreover, 50 per cent of the loan portfolio of UCBs should comprise loans of upto ₹25 lakh or 0.2 per cent of Tier I capital, whichever is higher, subject to a maximum of ₹1 crore per borrower or party by March 31, 2024.

8. Non-Banking Financial Companies

III.44 The NBFC segment has been struggling to cope with liquidity stress and risk aversion of lenders since issues relating to IL&FS emerged in the second half of 2018. While measures taken by the Reserve Bank and the government helped in containing the systemic implications of this stress event, their credit growth remained anaemic. During 2019-20 and 2020-21 so far, the Reserve Bank continued to take calibrated regulatory measures to make available sufficient liquidity to the sector.

8.1 Special Liquidity Scheme for NBFCs/HFCs

III.45 The GoI announced the Special Liquidity Scheme (SLS) of ₹30,000 crore under which a Special Purpose Vehicle (SPV) will purchase investment grade CPs/ non-convertible debentures (NCDs) of residual maturity upto

90 days issued by NBFCs/HFCs to provide them liquidity support. On July 1, 2020 the Reserve Bank specified the eligibility criteria and other operational details for NBFCs/HFCs under the scheme, which are required to use the proceeds received solely for the purpose of extinguishing existing liabilities. The facility was available for any paper issued on or before September 30, 2020, while the SPV is required to recover all dues by December 31, 2020.

8.2 Review of Guidelines for Core Investment Companies (CICs)

III.46 Based on the recommendations of the Working Group (WG) to Review the Regulatory and Supervisory Framework for CICs (Chairman: Shri Tapan Ray) and inputs received from stakeholders, the guidelines for CICs were revised on August 13, 2020. Under the revisions, any direct or indirect capital contribution made by one CIC in another exceeding 10 per cent of owned funds of the investing CIC has to be deducted while computing the adjusted net worth. The number of layers of CICs within a group have been restricted to two to address the complexity in group structures. The parent CIC in a group has to constitute a Group Risk Management Committee, which will be tasked with risk management. CICs with asset size more than ₹5,000 crore are required to appoint a Chief Risk Officer with clearly specified responsibilities. Corporate governance requirements and consolidation of financial statements have to be done as per provisions of Companies Act, 2013 in order to achieve higher standards of governance and disclosure.

8.3 Review of Regulatory framework for HFCs

III.47 With the intention of transiting to a new framework in a non-disruptive manner, a comprehensive review of the extant regulatory framework applicable to HFCs was undertaken. On October 22, 2020 the Reserve Bank issued a revised regulatory framework for HFCs which defined principal business and housing finance and increased the net owned fund requirement for HFCs to ₹20 crore. Regulations applicable to NBFCs on liquidity risk management framework, LCR, implementation of Ind-AS, securitisation transactions, outsourcing guidelines, lending against shares, and lending against gold jewellery were also extended to HFCs. Further, regulations on lending to group companies engaged in real estate business; and exempting HFCs from the provisions of Sec 45-IB and 45-IC of the RBI Act, 1934 in addition to Section 45-IA were issued.

8.4 Resolution of NBFCs

III.48 The Reserve Bank received additional powers for resolution of erring or insolvent NBFCs (including HFCs) following amendments to the RBI Act. The government notified Insolvency and Bankruptcy (Insolvency and Liquidation Proceedings of Financial Service Providers and Application to Adjudicating Authority) Rules in November 2019. These rules empowered the Reserve Bank to make application for initiating Corporate Insolvency Resolution Proceedings (CIRP) under IBC for NBFCs (including HFCs) having total assets of ₹500 crore or more, which are in default.

8.5 Fair Practices Code (FPC) for Asset Reconstruction Companies (ARCs)

III.49 The guidelines on FPC for ARCs issued by the Reserve Bank on July 16, 2020 aim to achieve transparency and fairness in dealing with stakeholders. While providing the minimum regulatory expectation, the guidelines also grant freedom to the boards of ARCs to enhance its scope and coverage. Non-discriminatory practices in both acquisition of financial assets and sale of secured assets, ensuring reasonable fees and expenses charged by ARCs, and confidentiality of borrower information are other objectives of the FPC. Matters pertaining to grievance redressal, outsourcing of activities and use of recovery agents by ARCs are also covered.

8.6 Implementation of Indian Accounting Standards (Ind-AS) for NBFCs and ARCs

III.50 In order to promote high quality and consistent implementation of Ind-AS, as also to facilitate comparison, the Reserve Bank issued instructions to NBFCs and ARCs implementing Ind-AS on March 13, 2020. The guidelines cover governance framework, a prudential floor for expected credit losses including impairment reserve and principles for computation of regulatory capital and regulatory ratios.

8.7 Adherence to Fair Practices Code and Outsourcing Guidelines for Loans Sourced Over Digital Lending Platforms

III.51 All SCBs (excluding RRBs) and NBFCs (including HFCs) were advised to adhere to FPC and Outsourcing Guidelines for loans sourced over digital lending platforms either through their own or under an outsourcing arrangement. Lending institutions were mandated to, *inter alia*, disclose names of digital lending platforms engaged as agents on their websites, direct the digital lending platforms to upfront disclose the name of actual lender to borrowers, issue sanction letter to borrowers on their letter head, furnish a copy of agreement to borrowers and take steps towards creating awareness about the grievance redressal mechanism and ensure effective monitoring of digital lending platforms.

8.8 NBFCs as Financial Institutions under SARFAESI Act, 2002

III.52 Earlier, NBFCs with asset size of ₹500 crore and above were treated as Financial Institutions under the SARFAESI Act, 2002 and these could take recourse to the SARFAESI Act for enforcement of security interest in secured debts of ₹100 lakh and above. On February 24, 2020 the GoI notified NBFCs with asset size of ₹100 crore and above as Financial Institutions under the SARFAESI Act, 2002. Eligible NBFCs can now take recourse to the SARFAESI Act for enforcement of security interest in secured debts of ₹50 lakh and above.

9. Foreign Exchange Policies

III.53 The foreign exchange related policies of the Reserve Bank are aimed at facilitating external trade by enhancing the ease and scope of transactions with ease of doing business. During 2019-20 and 2020-21 so far, further measures were taken to rationalise regulations to facilitate external trade and payments.

9.1 Rationalisation of ECB End-use Provisions

III.54 On July 30, 2019 end-use restrictions relating to external commercial borrowings (ECBs) were relaxed for working capital requirements, general corporate purposes and repayment of rupee loans. Eligible borrowers were permitted to raise ECBs with a minimum average maturity period (MAMP) of 10 years for working capital purposes, general corporate purposes, and repayment of Rupee loans availed domestically for purposes other than capital expenditure, and 7 years for repayment of rupee loans availed domestically for capital expenditure. Borrowing by NBFCs for on-lending for these purposes was also permitted. ECB as given above can be availed from all recognised lenders, except foreign branches/ overseas subsidiaries of Indian banks.

III.55 ECBs can be raised for repayment of rupee loans availed domestically for capital expenditure in manufacturing and infrastructure sectors if classified as SMA-2 or NPA, under any one-time settlement with lenders. Lender banks are also permitted to sell through assignment such loans to eligible ECB lenders, except foreign branches/ overseas subsidiaries of Indian banks, provided the resultant ECB complies with all-in-cost, MAMP and other relevant norms of the ECB framework.

9.2 Participation of Banks in Offshore Non-Deliverable Rupee Derivative Markets

III.56 On March 27, 2020 banks in India having an AD Category-1 license under Foreign Exchange Management Act (FEMA) 1999, and operating IFSC Banking Units (IBUs), were made eligible to offer non-deliverable foreign exchange derivative contracts involving the Rupee, or otherwise, to persons not resident in India. Banks can undertake such transactions through their branches in India, through their IBUs or through their foreign branches (in case of foreign banks operating in India, through any branch of the parent bank).

9.3 Review of Trade Guidelines

III.57 On January 23, 2020 the Reserve Bank revised the Merchanting Trade Transactions (MTT) guidelines, which enhanced the limit of the import advance without SBLC/ bank guarantee to USD 0.5 million. Third party payments and issuance of Letter of Undertaking (LoU)/ Letter of Comfort (LoC) for supplier's/ buyer's credit is prohibited. Write-off of unrealised export leg of MTT in certain circumstances and payment of agency commission under exceptional circumstances has been allowed.

9.4 Inclusion of Japanese Yen in the Asian Clearing Union (ACU) Settlement Mechanism

III.58 The Foreign Exchange Management (Manner of Receipt and Payment) Regulations, 2016 were amended on March 4, 2020 to include Japanese Yen as the currency of settlement under the ACU mechanism.

9.5 Enhancement of Scope of Special Non-Resident Rupee Account

III.59 The scope of Special Non-resident Rupee (SNRR) account was enhanced in November 2019 to promote the usage of Indian Rupee products by persons residing outside India. Several activities, including ECBs, trade credits, export and import invoicing and business-related transactions outside the International Financial Service Centre, can be now carried out by persons resident outside India in Indian rupees. In June 2020, investment in investment vehicles was also permitted through SNRR Accounts.

10. Credit Delivery and Financial Inclusion

III.60 The Reserve Bank has been playing an active role in financial inclusion by developing policies that ensure availability of affordable banking services to vulnerable sections of society, who have hitherto been left outside the scope of formal financial services. Recognising that education can prove to be a powerful lever for diffusion of financial inclusion, the National Strategy for Financial Education 2020-25 was formulated. Furthermore, the National Strategy for Financial Inclusion 2019-24 laid down the specific action plans for stakeholders that may help in achieving the objective of universal access to financial services.

10.1 Priority Sector Lending (PSL) Guidelines

III.61 The PSL guidelines, which were last reviewed for SCBs in April 2015, were revised by the Reserve Bank on September 4, 2020 to align it with emerging national priorities and bring sharper focus on inclusive development. Credit penetration to credit deficient districts is now encouraged through assignment of higher weightage to identified districts where priority sector credit flow is comparatively low. Along with the introduction of some new categories to be financed under priority sector, the targets for certain existing categories are also being increased in a phased manner. The credit limit for sectors such as renewable energy, health infrastructure and certain categories of farm credit have been increased.

10.2 Co-Lending by Banks and NBFCs to Priority Sector

III.62 The co-lending model (CLM), introduced by the Reserve Bank on November 5, 2020 is a revised version of the co-origination scheme for priority sector lending. The co-origination scheme entailed joint contribution of credit as well as sharing of risks and rewards between banks and NBFCs. While the earlier scheme allowed banks to partner with only NBFCs-ND-SI, the revised scheme allows co-lending with all registered NBFCs (including HFCs), based on a prior agreement. While NBFCs are required to retain a minimum of 20 per cent share of the individual loans on their books, greater operational flexibility has been allowed under the revised model. CLM guidelines permit the banks to claim priority sector status in respect of their share of credit while adhering to the specified conditions. Banks and NBFCs are required to formulate Board-approved policies for entering into the CLM with the objective to make available funds to the ultimate beneficiary at an affordable cost and place the approved policies on their websites.

10.3 Priority Sector Lending by NBFCs

III.63 On August 13, 2019 the Reserve Bank allowed bank credit to registered NBFCs (other than micro finance institutions (MFIs)) for on-lending to agriculture and micro and small enterprises (MSEs) to be treated as priority sector lending, subject to certain conditions. Only fresh loans sanctioned by NBFCs can be classified as priority sector lending by the banks. Furthermore, on-lending by NBFCs for the term-lending component under agriculture is allowed upto ₹10 lakh per borrower and upto ₹20 lakh per borrower to MSEs. These guidelines, after a review on March 2020, have been made applicable upto March 31, 2021, and will be reviewed thereafter. The limit for on-lending to HFCs for housing loans was enhanced to ₹20 lakh per borrower as against the earlier limit of ₹10 lakh, to qualify for priority sector lending.

10.4 Priority Sector Lending Target for UCBs

III.64 On March 13, 2020 the target for lending to priority sector for UCBs was increased from the existing 40 per cent to 75 per cent of adjusted net bank credit (ANBC) or credit equivalent amount of off-balance sheet exposure (CEOBSE), whichever is higher, to strengthen the role of UCBs in financial inclusion. A suitable glide path has been provided to achieve the target by March 31, 2024. On April 24, 2020 the Reserve Bank mandated that UCBs should contribute to the Rural Infrastructure Development Fund (RIDF) with NABARD and other funds with NABARD/NHB/Small Industries Development Bank of India (SIDBI)/Micro Units Development and Refinance Agency (MUDRA) Ltd. against the shortfall in their achievement of priority sector lending targets with effect from March 31, 2021, thereby harmonising the guidelines in this regard with those for SCBs.

10.5 New Criteria for Classification of MSMEs

III.65 Effective July 1, 2020, the GoI changed the classification criterion of MSMEs. With this, the investment only criterion that was used since 2006 is now based on composite criteria of investment and turnover. In line with the changed criteria, the GoI has defined micro enterprises as those where investment in plant and machinery or equipment does not exceed ₹1 crore and turnover does not exceed ₹5 crore. Similar criteria for small enterprises is investment upto ₹10 crore and turnover upto ₹50 crore while that for medium enterprises is ₹50 crore and ₹250 crore, respectively.

10.6 One-Time Restructuring of Loans to MSMEs

III.66 A one-time restructuring of existing loans to MSMEs that were in default but 'standard' as on January 1, 2019, was permitted without an asset classification downgrade. The restructuring was required to be implemented by March 31, 2020. The scheme was made available to MSMEs that qualify in terms of criteria such as a cap of ₹25 crore on total borrowings from banks and NBFCs and being GST-registered before implementation of the restructuring package. Additional provisioning of 5 per cent was specified for accounts restructured under the scheme.

III.67 Since then the scheme has been extended twice with the latest restructuring applicable to MSME accounts that were in default but 'standard' as on March 1, 2020. This restructuring is required to be implemented by March 31, 2021.

10.7 Interest Subvention Scheme for MSMEs

III.68 The Interest Subvention Scheme for MSMEs 2018 was announced by the GoI on November 2, 2018 for SCBs for a period of two financial years *viz,* 2018-19 and 2019-20. The scheme, which was later extended to 2020-21, provides for an interest relief of two per cent per annum to eligible MSMEs on their outstanding fresh/incremental term loan/working capital during the period of its validity. The coverage of the Scheme is limited to all term loans / working capital to the extent of ₹100 lakh. With effect from March 3, 2020 the Government made co-operative banks eligible lending institutions under this scheme. The Reserve Bank issued guidelines in this regard on October 7, 2020.

10.8 Classification of Exports under Priority Sector

III.69 On September 20, 2019, the Reserve Bank enhanced the sanctioned limit to be eligible under priority sector norms in order to boost credit to the export sector from ₹25 crore to ₹40 crore per borrower. Furthermore, the existing criterion of units with turnover of upto ₹100 crore was removed.

10.9 Interest Subsidy on Export Credit

III.70 The GoI increased the interest subsidy on post and pre-shipment export credit from 3 per cent to 5 per cent to provide a boost to MSME sector exports, effective from November 2, 2018. On May 13, 2020 the scheme, which was valid upto March 31, 2020, was extended with same scope and coverage, for a period of one year, *i.e.,* upto March 31, 2021.

10.10 Guidelines on Doorstep Banking

III.71 The Reserve Bank had issued instructions on providing doorstep banking facility for senior citizens and differently abled persons on November 9, 2017. Reviewing its progress, the Reserve Bank observed that the services as envisaged by the policy were either yet to be offered by banks or were restricted to select branches. To improve effectiveness of the policy, the Reserve Bank on March 31, 2020 advised banks to offer these services on pan-India basis. Banks are also required to develop a Board approved framework for determining the nature of branches where these services will be provided mandatorily and those where it will be provided on a best effort basis. Banks were also advised to update the list of branches offering such services on their website regularly and publicise on the availability of such services in their awareness campaigns.

11. Consumer Protection

III.72 Even before the COVID-19 pandemic started affecting Indian businesses and households, the Reserve Bank's consumer protection initiatives ensured that digital transactions are safe and efficient, and people of the country have trust in the system. These proactive policy measures—including limiting the liability of customers in fraudulent digital transactions, digitisation and strengthening grievance redressal through the roll-out of Complaint Management System (CMS) and ombudsman schemes for digital transactions, and enhancing consumer education, especially about digital banking, through awareness initiatives—came in handy as the lockdown period coincided with greater reliance on and higher spread of digital transactions.

11.1 Enhancement in Deposit Insurance

III.73 Deposit Insurance and Credit Guarantee Corporation (DICGC) raised the limit of insurance cover for depositors in insured banks to ₹5 lakh from the earlier level of ₹1 lakh with effect from February 4, 2020 with the approval of the GoI.[5] With effect from April 1, 2020 the premium was also increased by DICGC from 10 paise to 12 paise per annum per ₹100 of assessable deposits, with the approval of the Reserve Bank, to mitigate the impact of the hike in insurance cover on the Deposit Insurance Fund (DIF) in case of failure of banks. Further, DICGC is also examining the implementation of risk-based premium based on the recommendations of an internal committee (Chairman: Shri V.G. Venkata Chalapathy).

11.2 Dissolution of the Banking Codes and Standards Board of India

III.74 The Banking Codes and Standards Board of India (BCSBI) was set up by the Reserve Bank in February 2006 as an independent and autonomous body to formulate codes of conduct to be adopted by banks voluntarily for ensuring fair treatment of customers and MSEs. Following the setting up of a dedicated department for consumer protection in the Reserve Bank, issue of the Charter of Customer Rights (CoCR) and considerable strengthening of the Ombudsman mechanism to enhance consumer protection, it was decided to dissolve BCSBI in 2019.

11.3 Online Dispute Resolution (ODR) System for Digital Payments

III.75 On August 6, 2020 the Reserve Bank directed all Payment System Operators (PSOs) and Payment System Participants (PSPs) to implement a transparent, rule-based, system-driven, user-friendly and unbiased ODR system for disputes and grievances related to failed transactions in their respective payment systems by January 1, 2021. Any entity setting up a payment system in India or participating therein is required to make available the ODR system at the commencement of its operations. Based on experience gained, ODR arrangement would be extended to cover disputes and grievances other than those related to failed transactions.

11.4 Internal Ombudsman Scheme for Non-Bank Pre-Paid Payment Instruments Issuers

III.76 The Internal ombudsman (IO) scheme envisages creation of an apex independent authority within the regulated entity for strengthening the grievance redressal within the entity or organisation. In October 2019, the scheme was extended to cover non-bank issuers with more than one crore outstanding pre-paid payment instruments (PPIs). Customer complaints that are partly or wholly rejected by

[5] Union Budget Speech 2020-21, available at https://www.indiabudget.gov.in/doc/Budget_Speech.pdf.

the issuer are referred to the IO for a final decision before being conveyed to the complainants.

11.5 Ombudsman for NBFCs

III.77 The ombudsman scheme for NBFCs was initially operationalised for all NBFCs-D. In April 2019, the scheme was further extended to NBFCs-ND, with asset size of ₹100 crore or above and having customer interface.

11.6 Harmonisation of Turn Around Time for Failed Transactions

III.78 A large number of customer complaints originate on account of unsuccessful or 'failed' transactions due to, *inter alia*, disruption of communication links, non-availability of cash in ATMs and time-out of sessions, which may not be directly assignable to the customer. Moreover, the process of rectification and amount of compensation to the customer for these 'failed' transactions were not uniform.

III.79 Accordingly, the Reserve Bank introduced a framework on Turn Around Time (TAT) for resolution of customer complaints and compensation for failed transactions across all authorised payment systems on September 20, 2019. This framework aims to provide prompt and efficient customer service in all electronic payment systems. Under the framework, TAT for failed transactions and compensation was finalised to improve consumer confidence and bring consistency in processing of the failed transactions.

11.7 IVRS for online support to complainant

III.80 During 2019-20, the Interactive Voice Response System (IVRS) under the aegis of the CMS was established as an on-tap source of information for consumers of financial services. Any person can dial 14440 and obtain basic guidance on a variety of issues, *inter alia*, the ombudsman scheme; consumer protection regulations such as limited liability of customer in fraudulent electronic transactions; and basic savings bank deposit accounts.

12. Payment and Settlement Systems

III.81 India has been at the forefront of new innovations in payment and settlement systems, with the Reserve Bank creating the enabling environment. Aided by cutting edge technology, payment systems have ensured faster, cheaper and more convenient payment transactions. The focus is on adding newer services as well as expanding the reach and spread of existing services to unleash their full potential, rationalising the cost of transactions, and protecting the interests of the customers. Concomitantly, being mindful of the risks involved in unbridled growth of these services, the Reserve Bank has been proactive in effectively regulating them.

12.1 Availability of NEFT on a 24x7x365 Basis

III.82 The National Electronic Funds Transfer (NEFT) is a retail system with half-hourly settlement batches and prescribes no floor or ceiling on the amount that can be transferred. In a milestone achievement, NEFT, which was operating in 23 half-hourly batches earlier, was made available 24x7x365 with effect from December 16, 2019. The system now operates in 48 half-hourly batches with the first batch of the day starting at 00:30 hours and the last batch of the day ending at 24:00 hours.

12.2 Increase in Operating Hours of RTGS

III.83 In view of increasing customer demand, the timings for customer transactions in the Real Time Gross Settlement (RTGS) system had been extended and the RTGS system was made available from 7:00 am to 6:00 pm with effect from August 6, 2019. The Reserve Bank has subsequently made available the RTGS system on 24x7 basis on all days with effect from December 14, 2020. Round the clock availability of RTGS system will facilitate India's efforts to develop international financial centres and provide wider payment flexibility to domestic corporates and institutions.

12.3 Waiver of Charges in RTGS and NEFT systems

III.84 With effect from July 01, 2019 the Reserve Bank waived processing charges and time varying charges, levied by it on banks for outward transactions undertaken using the RTGS system as also the processing charges levied by it for transactions processed in the NEFT system to provide an impetus to the digital funds movement. Banks were advised to pass on this benefit to their customers.

III.85 Furthermore, member banks were directed to not levy any charges on their savings bank account holders for online-initiated funds transfers (through internet banking and/or mobile apps of the banks) done through NEFT system, effective January 01, 2020.

12.4 Positive Pay System for Cheque Truncation System

III.86 The mechanism of positive pay, which involves reconfirming key details of cheques of value of ₹50,000 and above, was announced on September 25, 2020 to be implemented from January 1, 2021. While the positive pay system is optional for customers, banks may consider making it mandatory for cheques of ₹5,00,000 and above.

12.5 Introduction of PPIs solely for purchase of goods and services

III.87 In December 2019, the Reserve Bank introduced a new type of semi-closed PPI aimed at enhancing ease of small value transactions. Such instruments, which can be loaded or re-loaded only from a bank account and/or a credit card, can be used only for purchase of goods and services and not for funds transfer. Other features of the PPI include issuance only after obtaining minimum details from the customer, limits for amount loaded during any month and the amount outstanding at any point of time, and the option to close the instrument and transfer funds 'back to source'.

12.6 Cash Withdrawal using Point of Sale (PoS) Terminals

III.88 Earlier, banks were required to obtain one-time permission from the Reserve Bank for offering the facility of cash withdrawal at PoS terminals deployed by them. On January 31, 2020 the Reserve Bank dispensed with this requirement and directed banks to provide cash withdrawal facility at PoS terminals, based on the approval of their Board. The designated merchant establishments are required to clearly display the availability of this facility along with the charges, if any, payable by the customer.

12.7 On-tap Authorisation of Payment Systems

III.89 In order to diversify risk and to encourage innovation and competition in payment systems, the Reserve Bank issued instructions for providing on-tap authorisation to desirous entities on October 15, 2019. The authorisation is subject to criteria such as merits of the proposal, capital and KYC requirements, and the interoperability among different retail payment systems. So far, issuance of PPIs; Bharat Bill Payment Operating Units (BBPOU); Trade Receivables Discounting Systems (TReDS); and White Label ATMs (WLAs) have been offered on-tap authorisation.

12.8 Self-Regulatory Organisation (SRO) for Payment System Operators

III.90 An SRO is a non-governmental organisation that sets and enforces rules and standards relating to the conduct of member entities in the industry, with the aim of protecting the customer and promoting ethical and professional standards. On October 22, 2020 the Reserve Bank put in place a framework for recognition of SRO for PSOs to promote industry-wide smooth operations and ecosystem development. Under the framework, eligibility criteria, management guidelines, functions and responsibilities of the SRO have been laid down.

12.9 Streamlining QR Code Infrastructure

III.91 On October 22, 2020 the Reserve Bank decided to continue with the two interoperable Quick Response (QR) codes in India *viz.* UPI QR and Bharat QR based on the recommendations of the Committee for Analysis of QR Codes (Chairman: Prof Deepak Phatak) and feedback received from stakeholders. PSOs that use proprietary QR codes were advised to shift to one or more interoperable QR codes by March 31, 2022, and the launch of new proprietary QR codes by any PSO was prohibited.

12.10 Pilot Scheme for Offline Retail Payments

III.92 On August 6, 2020 the Reserve Bank announced a pilot scheme to be conducted for a limited period under which authorised PSOs will be able to provide offline payment solutions using cards, wallets or mobile devices for remote or proximity payments till March 31, 2021. A decision regarding formalising such a system will be taken subject to fulfilment of conditions and based on the experience gained.

12.11 Regulatory Sandbox for Financial Service Providers

III.93 On November 4, 2019 the Reserve Bank announced the opening of the first cohort under the regulatory sandbox (RS) for financial service providers, with retail payments as its theme. It is expected to spur innovation in the digital payments space and offer payment services to the unserved and underserved segment of the population. A total of 32 applications were received for the cohort, covering a range of products which included innovative use of Near Field Communication (NFC), Unified Payments Interface (UPI) architecture, offline payments through PPIs and feature phones to effect payments using voice, and Unstructured Supplementary Service Data (USSD) and mobile network. The RS framework provides for a five-stage sandbox process, including preliminary screening, test design, application assessment, testing and evaluation. The test design stage was completed for products of the selected 6 applicants and two entities commenced testing their products from November 16, 2020. Other entities are expected to start the test phase shortly. The Reserve Bank has also subsequently announced the second cohort with cross-border payments as the theme.

12.12 National Electronic Toll Collection (NETC) System

III.94 In December 2019, the Reserve Bank permitted all authorised payment systems and instruments (non-bank PPIs, cards and UPI) to link with FASTags to broad base the NETC system as well as to foster competition among the system participants by allowing a bouquet of payment choices for customers. These passive tags, affixed on a vehicle's windscreen, use radio frequency identification technology (RFIT) to pay toll fares directly from a pre-paid account to the toll plaza, thus saving fuel and time. These instruments can also be enabled for payment of parking fees and filling of fuel.

13. Overall Assessment

III.95 During 2019-20, as the banking system showed distinct signs of resilience with recapitalisation and mergers, the Reserve Bank's regulatory focus was on strengthening the resolution process and aligning the standards with the global benchmarks. In the wake of a severe and unprecedented macroeconomic shock caused by the COVID-19 pandemic, the Reserve Bank's actions veered towards providing a stimulus to the economy while ensuring financial stability. The troika of policy rate cuts and liquidity infusion; regulatory forbearance; and time-bound resolution with additional provisions was employed to ease immediate concerns emanating from the pandemic as well as aid the economic revival going forward. Improvement in the health of the banking sector henceforth hinges around the pace and shape of economic recovery. The challenge is to rewind various relaxations in a timely manner, reining in loan impairment and adequate capital infusion for a healthy banking sector.

Annex III.1: Reserve Bank's Response to the COVID- 19 Disruptions

In the face of COVID-19 related disruptions, the Reserve Bank acted swiftly with several conventional and unconventional policy measures aimed at enabling normal functioning of financial markets and institutions, facilitating and incentivising bank credit flows, supporting monetary transmission and easing of financial stress in specific sectors and markets and increasing the systemic liquidity.

Monetary and liquidity measures

- Infusion of ₹1.25 lakh crore through long-term repo operations (LTROs) to reduce the cost of funds of banks and facilitate monetary transmission;
- Provision of US dollar liquidity of US $ 2.7 billion through two 6-month USD/INR sell/buy swap auctions;
- Exemption to banks from maintaining CRR on deposits for the amount equivalent of incremental credit disbursed by them as retail loans to automobiles, residential housing, and loans to MSMEs;
- Temporary enhancement in the standing liquidity facility (SLF) available to standalone primary dealers (SPDs) from ₹2,800 crore to ₹10,000 crore;
- Reduction of the cash reserve ratio (CRR) by 100 bps (from 4.0 per cent of net demand and time liabilities (NDTL) to 3.0 per cent), thereby augmenting primary liquidity in the banking system by about ₹1.37 lakh crore;
- Reduction of the minimum daily CRR balance requirement from 90 per cent to 80 per cent of the prescribed CRR (dispensation allowed upto September 25, 2020);
- Enhancement of banks' marginal standing facility (MSF) borrowing limit by dipping into their Statutory Liquidity Ratio (SLR) to 3 per cent of NDTL from 2 per cent earlier, allowing the banking system to potentially avail an additional ₹1.37 lakh crore of liquidity;
- Provision of special refinance facilities for a total amount of ₹60,000 crore at the policy repo rate to NABARD; SIDBI; and NHB to meet sectoral credit requirements (Table III.a); extending a line of credit of ₹15,000 crore to the EXIM Bank for a period of 90 days (with rollover up to one year) to enable it to avail a US dollar swap facility;
- Injection of ₹1.12 lakh crore through targeted long-term repo operations (TLTRO 1.0) for investment in corporate bonds, commercial paper, and non-convertible debentures and through TLTRO 2.0 auctions for investment in investment grade bonds, commercial paper, and non-convertible debentures of NBFCs, with at least 50 per cent of the total amount availed going to small and mid-sized NBFCs and micro finance institutions (MFIs);
- Introduction of a special liquidity facility for mutual funds (SLF-MF) of ₹50,000 crore;
- Injection of durable liquidity of ₹40,000 crore cumulatively through three OMO purchase auctions in March and ₹2.27 lakh crore during 2020-21 so far (up to December 18, 2020);

Table III.a: Institution-wise Loan Availment as on December 4, 2020

(₹ crore)

Loans Extended to	SLF availed By AIFIs	Loan disbursed By AIFIs
Co-operative banks	16,300	16,300
Regional Rural Banks	6,700	6,700
Microfinance Institutions	3,350	4,278
Small Finance Banks	3,587	3,772
MSMEs	6,155	9,806
Housing Finance Companies	9,999	10,425
Total	**46,091**	**51,281**

Source: Weekly report submitted by NHB, NABARD, SIBDI.

Annex III.1: Reserve Bank's Response to the COVID- 19 Disruptions *(Continued)*

- Conduct of eleven auctions of special OMOs for ₹10,000 crore each aimed at reducing the term premium (up to December 18, 2020);
- Announcement of on tap TLTRO of up to 3 years for a total amount of ₹1,00,000 crores at a floating rate for investment in corporate bonds, commercial paper and non-convertible debentures issued by the entities in specific sectors.

Regulatory Measures

- Deferment of the last tranche of 0.625 per cent of the capital conservation buffer (CCB) to April 1, 2021;
- Deferment in the implementation of net stable funding ratio (NSFR) by six months from April 1, 2020 to October 1, 2020 and further to April 1, 2021;
- Six-month moratorium on payment of instalments in respect of all term loans outstanding as on March 1, 2020, without resulting in an asset classification downgrade;
- Lending institutions permitted to allow a deferment of six months on payment of interest in respect of working capital facilities sanctioned in the form of cash credit/overdraft outstanding as on March 1, 2020. Lending institutions were permitted, at their discretion, to convert the accumulated interest on such working capital facilities over the deferment period (up to August 31, 2020) into a funded interest term loan to be repayable not later than March 31, 2021;
- Lending institutions permitted to recalculate drawing power by reducing margins for working capital till August 31, 2020, and to review the sanctioned limits upto March 31, 2021;
- Moratorium or deferment period, in respect of all accounts classified as standard, wherever granted, to be excluded by the lending institutions from the number of days past-due for the purpose of asset classification as well as determination of 'out of order' status in respect of term loans and working capital facilities sanctioned as cash credit/overdraft, respectively;
- In respect of borrowers who were in default as on February 29, 2020 and have availed of moratorium and the consequent asset classification benefit, lenders were required to maintain provisions of not less than 10 per cent. Lenders were allowed to adjust these provisions later on against the provisioning requirements for actual slippages in such account;
- Period between March 1, 2020 and August 31, 2020 was allowed to be excluded from the 30-day Review Period calculation or the 180-day Resolution Period under the Prudential Framework on Resolution of Stressed Assets dated June 7, 2019, if the Review/Resolution Period had not expired as on March 1, 2020;
- Banks were advised to not make any dividend payouts from their profits pertaining to the financial year ended March 31, 2020 to conserve capital;
- Reduction in liquidity coverage ratio (LCR) requirement for SCBs from 100 per cent to 80 per cent which would be gradually restored back in two phases – 90 per cent by October 1, 2020 and 100 per cent by April 1, 2021;
- The limit for bank's exposure to a group of connected counterparties was increased from 25 per cent to 30 per cent of the eligible capital base of the bank up to June 30, 2021;

Annex III.1: Reserve Bank's Response to the COVID- 19 Disruptions *(Concluded)*

- The Reserve Bank permitted member lending institutions (SCBs (including scheduled RRBs), NBFCs (including HFCs as eligible under the scheme) and AIFIs) to apply zero per cent risk weight on the credit facilities to the extent of guarantee coverage under the Emergency Credit Line Guarantee Scheme guaranteed by the National Credit Guarantee Trustee Company (NCGTC) and backed by an unconditional and irrevocable guarantee provided by GoI;
- Foreign portfolio investors (FPIs) under the voluntary retention route (VRR) were allowed additional three months' time to invest 75 per cent of limits allotted;
- Permissible loan-to-value (LTV) for loans against pledge of gold ornaments and jewellery for non-agricultural purposes increased from 75 per cent to 90 per cent till March 31, 2021;
- Special window under the prudential framework provided with the intent to facilitate revival of real sector activity [Refer to Box III.1];
- Increase in the limit of securities held to maturity (HTM) to 22 per cent of NDTL from the earlier limit of 19.5 per cent up to March 31, 2021, which was further extended up to March 31, 2022. Only SLR securities acquired between September 1, 2020 and March 31, 2021 qualify to be included in the increased limit. The limit will be restored to 19.5 per cent in a phased manner, beginning from the quarter ending June 2022.

Supervisory Measures

- All supervised entities (SEs) were directed to implement their operational and business continuity plans for smooth conduct of business processes in the wake of the COVID-19 pandemic.
- Special advisories were issued for management of cyber security risks with a focus on securing sensitive data like customers' data and payment system, among others.
- Reduction of compliance burden for brief period by granting flexibility in audit coverage and in furnishing supervisory data.
- All SEs were also advised to conduct stress tests to quantify and estimate the impact of COVID-19 on their financial projections so as to strengthen their capital adequacy positions accordingly.

Credit Delivery and Financial Inclusion

- Extension in the period of realisation and repatriation of export proceeds to India from nine months to 15 months in respect of exports made up to or on July 31, 2020;
- Extension in the time period for completion of remittances against normal imports into India from six months to twelve months from the date of shipment for such imports made on or before July 31, 2020;
- Increase in the maximum permissible period of pre-shipment and post-shipment export credit sanctioned by banks from one year to 15 months for disbursements made up to July 31, 2020;
- Interest subvention (IS) and prompt repayment incentive (PRI) for short term loans for agriculture including animal husbandry, dairy and fisheries extended during the moratorium period till August 31, 2020.