III POLICY ENVIRONMENT

During 2022-23 and 2023-24 so far, the Reserve Bank's policy focused on withdrawal of accommodation while supporting growth amidst high domestic inflation. The Reserve Bank made concerted efforts to encourage innovation while retaining focus on consumer convenience and protection. The regulatory and supervisory policies of the Reserve Bank aimed at enhancing ease of doing business for regulated entities and ensuring financial stability.

1. Introduction

III.1 The Indian financial system has exhibited resilience, supported by strong macroeconomic fundamentals, and effective regulatory and supervisory oversight that primarily focused on creating a level playing field for all regulated entities (REs), improving governance practices, expanding the reach and quality of financial services and enhancing the adoption of digital banking while ensuring that customer interests are protected and the financial sector is well-cushioned with capital and liquidity buffers.

III.2 Against this backdrop, the chapter begins with Section 2, which delineates key policy developments that had a bearing on financial conditions in the economy. Regulatory and supervisory initiatives undertaken by the Reserve Bank during the period under review are presented in Section 3. Policies pertaining to green initiatives are discussed in Section 4, while those related to the various technological innovations are covered in Section 5. Sections 6, 7 and 8 review the policies related to financial markets and foreign exchange, credit delivery and financial inclusion, and consumer protection, respectively. The Reserve Bank's initiatives for enhancing the scope and reach of the payments ecosystem are set out in Section 9. The chapter concludes with an overall assessment in Section 10.

2. The Macroeconomic Policy Setting

III.3 The policy environment in India in 2022-23 was dominated by unrelenting inflationary pressures induced by the conflict in Ukraine, the consequent surge in global commodity prices and the volatility in global financial markets. Accordingly, alongside ongoing fiscal consolidation and the deployment of supply-side measures to address food and fuel price shocks, monetary policy moved into tightening mode. The Monetary Policy Committee (MPC) raised the policy repo rate cumulatively by 250 basis points (bps) from 4 per cent to 6.5 per cent during the year[1]. The policy stance shifted in a calibrated manner from the pandemic-phase 'accommodation' to 'withdrawal of accommodation to ensure that inflation progressively aligns to the target while supporting growth'.

III.4 During 2022-23, the cash reserve ratio (CRR) was increased by 50 bps to 4.50 per cent (effective fortnight beginning May 21, 2022), withdrawing about ₹87,000 crore of primary liquidity from the banking system. To strengthen liquidity management, a standing deposit facility

[1] The MPC raised the policy repo rate by 40 bps in an off-cycle meeting in May 2022, followed by increases of 50 bps each in June 2022, August 2022 and September 2022, 35 bps in December 2022, and 25 bps in February 2023.

(SDF) was instituted in April 2022 as the floor of the liquidity adjustment facility (LAF) corridor, replacing the fixed rate reverse repo (FRRR). The SDF rate, which is applicable on uncollateralised overnight deposits, was set at 25 bps below the policy repo rate, which restored the pre-pandemic symmetry of the LAF corridor. By removing the binding collateral constraint, the SDF strengthened the operating framework of monetary policy, besides acting as a financial stability tool.

III.5 In the second half of 2022-23, transient liquidity pressures surfaced, in response to which the Reserve Bank conducted one fine-tuning variable rate repo (VRR) auction along with two 14-day VRR auctions. An additional amount of ₹5,000 crore was made available to standalone primary dealers (SPDs) under the standing liquidity facility (SLF) on March 31, 2023 at the prevailing repo rate to assuage year-end tightness in liquidity.

III.6 During 2023-24 (up to December 2023), the MPC kept the policy repo rate unchanged at 6.5 per cent in all its meetings, taking into consideration the policy transmission lags. In its December 2023 meeting, the MPC observed that recurring food price shocks are impeding the disinflation process and headline inflation remains volatile, with possible implications for the anchoring of expectations. The MPC also indicated preparedness to undertake appropriate and timely policy actions, should the situation so warrant. The MPC noted that it will remain resolute in its commitment to aligning inflation to the target.

III.7 Liquidity conditions eased in May-June 2023 due to the withdrawal of ₹2,000 banknotes from circulation, higher Government spending and the Reserve Bank's market operations. To ensure liquidity conditions are in sync with the monetary policy stance, the Reserve Bank – as a temporary measure – imposed an incremental cash reserve ratio (I-CRR) of 10 per cent on the increase in scheduled commercial banks' (SCBs') net demand and time liabilities (NDTL) between May 19, 2023 and July 28, 2023, with effect from the fortnight beginning August 12, 2023. This impounded about ₹1.1 lakh crore from the banking system. The I-CRR was reviewed on September 8, 2023 and was discontinued in a phased manner, ending October 7, 2023. The borrowings by banks under the MSF increased from an average of ₹6,702 crore in July 2023 to ₹1,27,355 crore in November 2023 but moderated to ₹85,697 crore in December 2023 (up to December 19). At the same time, substantial funds were deposited under the SDF, symptomatic of skewed liquidity distribution in the banking system. The weighted average call rate (WACR) firmed up from 6.48 per cent in July 2023 to 6.65 per cent in September 2023. It was 6.74 per cent in December 2023 (up to December 19).

III.8 In order to enable better fund management by banks, it was decided to allow reversal of liquidity facilities under both the SDF and the MSF, even during weekends and holidays, with effect from December 30, 2023. A review of this measure will be undertaken after six months or earlier, if required.

III.9 The Reserve Bank enhanced the held to maturity (HTM) limit for government securities from 22 per cent to 23 per cent of NDTL during 2022-23 to enable banks to better manage their investment portfolio. Banks were allowed to include eligible statutory liquidity ratio (SLR) securities acquired between September 1, 2020 and March 31, 2024 under this enhanced limit. The HTM limits are set to be restored from 23 per cent to 19.5 per cent in a phased manner starting from the quarter ending June 30, 2024. As part of the calibrated move towards normal liquidity operations, market hours, which were truncated during the pandemic, were restored for the call/notice/term money, commercial paper, certificates of deposit, repo in corporate bond segments of the money market as well as for rupee interest rate derivatives in December 2022, and for the government securities market in February 2023.

3. Regulatory and Supervisory Policies

3.1 Scheduled Commercial Banks

Regulatory Measures towards Consumer Credit and Bank Credit to NBFCs

III.10 Post-COVID, consumer credit, especially the unsecured portfolio, has accelerated substantially. Further, increasing dependency of non-banking finance companies (NBFCs) on bank borrowings was leading to regulatory concerns. Although their asset quality did not exhibit any major signs of stress, the consistent high credit growth in these two segments warranted a prudential intervention. Accordingly, the Reserve Bank on November 16, 2023 announced various measures, including increasing the risk weights of bank loans to NBFCs and commercial banks' and NBFCs' exposure to consumer credit and credit card receivables. These guidelines came into effect immediately. Furthermore, REs were advised to review their exposure limits for consumer credit and put in place Board-approved limits for its various sub-segments, specifically unsecured consumer credit exposures, by February 29, 2024.

Framework for Compromise Settlements and Technical Write-offs

III.11 The Reserve Bank issued a framework for compromise settlements and technical write-offs on June 8, 2023 to provide further impetus to the resolution of stressed assets in the system. The framework tightens some of the extant regulatory provisions, ensures greater transparency, and is applicable to all REs, including NBFCs and co-operative banks. Under the framework, REs are required to put in place a Board-approved policy that comprehensively lays down the process to be followed. It vests the power for approval of settlements with an authority which is at least one level higher in hierarchy than the credit-sanctioning authority. For compromise settlements with borrowers classified as fraud or wilful defaulters, the penal measures currently applicable would continue.

Minimum Capital Requirements for Operational Risk

III.12 On June 26, 2023 the Reserve Bank prescribed a new methodology for determining the minimum capital requirement for operational risk in order to secure greater convergence with the revised Basel standards. The new standardised approach is slated to replace all the approaches used presently *viz.*, the basic indicator approach (BIA), the standardised approach (TSA)/ alternative standardised approach (ASA), and the advanced measurement approach (AMA), for measuring minimum operational risk capital requirements. Under the new standardised approach, banks are required to consider a financial statement-based business indicator component (BIC), along with loss data-based internal loss multiplier (ILM) (for larger banks) in their operational risk regulatory capital calculation. The effective date of implementation would be communicated separately.

Master Direction and Guidelines on Acquisition and Holding of Shares or Voting Rights in Banking Companies

III.13 On January 16, 2023 the Reserve Bank issued the Master Direction and Guidelines

Table III.1: Limits on Shareholding

	Type of Shareholder	Shareholding Limit (percentage of paid-up share capital or voting rights of the banking company)
Non-promoter	Natural persons, non-financial institutions, financial institutions directly or indirectly connected with large industrial houses, and financial institutions that are owned to the extent of 50 per cent or more or controlled by individuals (including the relatives and persons acting in concert)	10 per cent
	Other financial institutions, supranational institutions, public sector undertakings and central/ state governments	15 per cent
Promoter	After completion of 15 years from commencement of business of the banking company	26 per cent
	Before completion of 15 years from commencement of business of the banking company	May be allowed to hold a higher percentage as part of the licensing conditions or the approved shareholding dilution plan.

Source: RBI.

on shareholding and voting rights in banking companies to ensure that their ownership and control are well-diversified, and that the major shareholders are continuously monitored for a change in 'fit and proper' status. Limits on permissible shareholding by different categories of shareholders have been updated (Table III.1).

Internet Banking Facility by Regional Rural Banks (RRBs)

III.14 On November 01, 2022 the Reserve Bank revised the eligibility criteria applicable to RRBs for offering internet banking with transactional facility to their customers to promote spread of digital banking in rural areas. The rationalised criteria provide various relaxations in the financial conditions while maintaining the extant non-financial conditions (Table III.2).

Table III.2: Eligibility Criteria for Offering Internet Banking Facility by RRBs

	Previous Financial Criteria	Revised Financial Criteria
Minimum CRAR	10 per cent	Minimum prescribed CRAR (currently 9 per cent)
Minimum net worth	₹100 crore or more as on March 31 of the previous financial year	₹50 crore or more as on March 31 of the previous financial year
Asset quality	GNPA ratio less than 7 per cent and NNPA ratio not more than 3 per cent	NNPA ratio not more than 5 per cent as on March 31 of the previous financial year
Profitability	Net profit in the immediately preceding financial year and net profit in at least three out of four preceding financial years	Net profit in two immediately preceding financial years
Accumulated losses	The bank should not have accumulated losses	–

Source: RBI.

Classification, Valuation and Operation of Investment Portfolio

III.15 In September 2023 the Reserve Bank revised the norms on classification and operation of investments, taking into account significant developments in global standards, linkages with the capital adequacy framework as well as the state of development of domestic financial markets. The revised framework updates the regulatory guidelines while introducing a principle-based classification of investment portfolios and a symmetric treatment of fair value gains and losses. The revised guidelines specify the criterion for identifying the trading book under held for trading (HFT), and remove the 90-day ceiling on holding period under HFT and the ceilings on the HTM category. Banks will be required to formulate a Board-approved policy to classify their investment under HTM, available for sale (AFS), and fair value through profit and loss (FVTPL) (with HFT as a subcategory of FVTPL) and provide more detailed disclosures on the investment portfolios. The FVTPL category will comprise securities that do not qualify for inclusion in HTM or AFS, including, *inter alia,* convertible instruments, those that have loss-absorbency features such as Additional Tier 1 and Tier 2 bonds, preference and equity shares, mutual fund investments, and securitisation notes representing the equity tranche. The guidelines will be applicable from April 1, 2024.

Interest Rate Risk in Banking Book (IRRBB)

III.16 IRRBB refers to the current or prospective risk to banks' capital and earnings arising from adverse movements in interest rates. In February 2023 the Reserve Bank issued guidelines requiring banks to measure, monitor, and disclose exposure to IRRBB[2]. The guidelines place the responsibility for understanding the nature and level of banks' IRRBB exposure on the banks' Boards, which have to approve broad business strategies as well as overall policies in this regard, set appropriate limits, and put in place comprehensive IRRBB reporting and review processes. Banks are also expected to develop and implement an effective stress testing framework for IRRBB as part of their broader risk management and governance frameworks commensurate with the nature, size and complexity of business activities and overall risk profile.

Outsourcing of Information Technology (IT) Services

III.17 REs often outsource a substantial portion of their IT activities to third parties, which exposes them to significant financial, operational and reputational risks. In April 2023, the Reserve Bank issued Master Directions to REs to ensure that such outsourcing-related risks are managed through adequate checks and oversight. The Directions, *inter alia*, provide definition of outsourcing and an indicative list of IT services thereof; necessary principles, standards, controls, and procedures for IT related outsourcing to ensure appropriate governance structures and risk management framework; due diligence requirements to assess the capability of the service provider; provisions to allow the RE to retain adequate control over the outsourced activity; and the right to intervene with appropriate measures to meet legal and regulatory obligations.

3.2 Non-Banking Finance Companies

III.18 Under the scale based regulatory (SBR) framework, the threshold asset size for being classified in the middle layer (NBFC-ML) is specified at ₹1,000 crore. In October 2022, the Reserve Bank advised that if the consolidated asset size of a group is ₹1,000 crore and above, then each NBFC in the group will be classified as an NBFC-ML, irrespective of individual asset size, and consequently, regulations as applicable to the middle layer shall be applicable to it.

Credit Concentration Norms - NBFC-ML and NBFC-Base Layer (NBFC-BL)

III.19 Extant guidelines on the large exposure framework (LEF) for NBFC-upper layer (NBFC-UL) permit exposures to the original counterparty to be offset with certain credit risk transfer instruments. To harmonise regulations across NBFCs, on October 6, 2023 the Reserve Bank announced that NBFCs in the ML and BL may offset their exposures with eligible credit risk transfer instruments.

[2] The date of implementation is yet to be communicated.

Regulatory Framework for Infrastructure Debt Fund-NBFCs (IDF-NBFCs)

III.20 A review of the extant regulatory framework for IDF-NBFCs was undertaken in August 2023 to enable them to play a greater role in financing the infrastructure sector and to move towards greater harmonisation of regulations applicable to various categories of NBFCs (Box III.1).

Operations of Indian Banks and AIFIs in Foreign Jurisdictions and IFSCs

III.21 In December 2022, the Reserve Bank permitted branches and subsidiaries of Indian banks and all-India financial institutions (AIFIs) operating in foreign jurisdictions and international financial services centres (IFSCs) to deal in financial products that are not available or are not permitted by the Reserve Bank in the domestic market without its prior approval.

Box III.1: Review of Regulatory Framework for IDF-NBFCs

The Union Budget 2011-12 had announced the setting up of Infrastructure Debt Funds (IDFs). Subsequently, a broad structure of IDFs was issued by the Government of India. A trust-based IDF is registered as an IDF-mutual fund (IDF-MF) and is regulated by the Securities and Exchange Board of India (SEBI), whereas a company-based IDF is registered as an IDF-NBFC and is regulated by the Reserve Bank. Currently, there are two categories of NBFCs catering specifically to the infrastructure sector *viz.*, NBFC-Infrastructure Finance Companies (NBFC-IFCs) and IDF-NBFCs. While the former was created in February 2010 and is required to deploy a minimum of 75 per cent of its total assets in the infrastructure sector, the latter was created in November 2011 as low-risk entities dealing in brown-field infrastructure refinancing projects.

The regulatory framework for IDF-NBFCs was revised in August 2023 to induce efficient utilisation of their resources while preserving their low-risk character. The salient aspects of the revised framework are as follows:

- Under the earlier guidelines, an IDF-NBFC was required to be sponsored either by a bank or by an NBFC-IFC; this requirement was withdrawn and the shareholders of IDF-NBFCs are now subjected to scrutiny as applicable to other NBFCs.
- The toll operate transfer (TOT) projects, being operational in nature, do not have the construction risk associated with green-field ventures; in view of their low-risk nature, IDF-NBFCs are allowed to be direct lenders for such projects.
- Earlier, IDF-NBFCs were permitted to raise funds through the bond route only, both domestically as well as under external commercial borrowings (ECBs); the revised framework allows them to raise funds through the loan route under ECBs, subject to a minimum tenor of five years, excluding loans sourced from foreign branches of Indian banks.
- IDF-NBFCs were earlier required to enter into a tripartite agreement with the concessionaire and the project authority for investments in the public-private partnership infrastructure projects; this requirement has been made optional.
- The Tier I capital requirement of IDF-NBFCs was increased to 10 per cent from 7.5 per cent, within the overall regulatory capital requirement of 15 per cent, aligning their capital requirements with NBFC-IFCs and NBFC-Investment and Credit Companies (NBFC-ICCs) in the middle layer.
- Under the SBR framework, IDF-NBFCs are in the middle layer, with their exposure limits harmonised with those prescribed for NBFC-IFCs in the middle layer and infrastructure exposures of NBFC-ICCs — 30 per cent and 50 per cent of Tier I capital for single borrower and single group of borrowers, respectively.

These regulatory measures are expected to enable the IDF-NBFCs to diversify avenues for raising capital, funding resources and deployment of funds. Besides achieving the regulatory objective of harmonisation of regulations applicable to various categories of NBFCs, strengthening of prudential norms shall further mitigate risks associated with IDF-NBFCs.

Revised Regulatory Framework for AIFIs

III.22 On September 21, 2023 the Reserve Bank issued a revised regulatory framework for AIFIs to strengthen their prudential regulations and make their risk management systems more robust, while aligning it with banks[3]. The revised framework makes Basel III capital regulations applicable to AIFIs, replacing the currently applicable Basel I capital regulations, which includes, *inter alia*, raising capital standards, improving recognition of credit risk based on external ratings, applicability of LEF, and efficient capturing of their off-balance sheet exposures under the leverage ratio framework. The revised guidelines will be applicable latest with effect from April 1, 2024.

Regulatory Framework for Asset Reconstruction Companies (ARCs)

III.23 In April 2021, an external committee was set up by the Reserve Bank to review the existing legal and regulatory framework applicable to ARCs and recommend measures to enhance their efficacy. Based on the committee's recommendations and feedback from the stakeholders, the Reserve Bank reviewed the prescribed regulatory framework for ARCs on October 11, 2022 to (i) strengthen corporate governance framework by ensuring separation of ownership and management, requiring ARCs to constitute audit committees and nomination and remuneration committees of the Board; (ii) enhance transparency by increasing disclosure requirements; (iii) strengthen prudential guidelines by, *inter alia*, increasing the minimum net owned fund requirement; and (iv) facilitate their role in resolution of stressed assets by suitable regulatory enablement.

Diversification of Activities of Standalone Primary Dealers (SPDs)

III.24 On October 11, 2022 the Reserve Bank permitted SPDs to offer all foreign exchange market-making facilities as currently permitted to category-I authorised dealers (AD-1) to strengthen the role of SPDs as market makers. This will provide a broader spectrum of market makers to forex customers for managing currency risk, and a wider market presence will improve the ability of SPDs to support their core activities.

3.3 Co-operative Banks

III.25 Given the heterogeneity in the co-operative banking sector, a four-tiered regulatory framework was adopted for urban co-operative banks (UCBs) to balance the spirit of mutuality and co-operation of smaller UCBs *vis-à-vis* the growth ambitions of large-sized UCBs. The corresponding framework for net worth and capital adequacy came into effect from March 31, 2023[4]. Additionally, revaluation reserves were permitted for inclusion in Tier I capital subject to certain conditions. The guidelines are designed to bolster the capital structure and resilience of UCBs, enabling them to effectively address risks in proportion to their scale.

[3] At end-November 2023, there were five AIFIs in India *viz.*, Export-Import Bank of India (EXIM Bank), National Bank for Agriculture and Rural Development (NABARD), National Bank for Financing Infrastructure and Development (NaBFID), National Housing Bank (NHB) and Small Industries Development Bank of India (SIDBI).

[4] Tier 1 UCBs operating in a single district and all other UCBs (of all tiers) should maintain a minimum net worth of ₹2 crore and ₹5 crore, respectively. Tier 1 UCBs should maintain, as hitherto, a minimum CRAR of 9 per cent while Tier 2 to 4 UCBs should maintain a minimum CRAR of 12 per cent. UCBs are provided with glide paths till March 31, 2026 and March 31, 2028 to meet the minimum CRAR and net worth requirements, respectively.

Classification of UCBs as Financially Sound and Well Managed (FSWM)

III.26 The criteria for declaring a UCB as FSWM was first introduced in 2010. Over the years, the Reserve Bank has been fine-tuning them while also imparting operational autonomy to UCBs. The norms for determining the FSWM status of a UCB were revised on December 01, 2022 which emphasised on, *inter alia*, higher capital buffers, better asset quality as well as profitability of the entity. UCB Boards were empowered to decide their eligibility to be treated as FSWM, based on assessed financials and findings of the Reserve Bank inspection reports or audited financial statements, whichever is latest. This process is subject to supervisory review. UCBs may review the compliance with FSWM criteria every year at their Board levels.

Priority Sector Lending (PSL) by UCBs

III.27 PSL targets and sub-targets for UCBs were revised in 2020. With a view to ease the implementation challenges faced by them, the phase-in time for achievement of the PSL target and sub-target for weaker sections was extended on June 08, 2023 by two years, *i.e.*, up to March 31, 2026 (Table III.3).

Table III.3: Priority Sector Lending Targets and Sub-targets for UCBs

Financial Year ended	Overall PSL Target (as a percentage of ANBC or CEOBE, whichever is higher) *	Sub-target for Advances to Weaker Sections (as a percentage of ANBC or CEOBE, whichever is higher) *
March 31, 2024	60	11.5
March 31, 2025	65	11.75
March 31, 2026	75	12

Notes: 1. The targets for March 31, 2023 (60 per cent for overall PSL and 11.5 per cent for weaker sections) shall continue till March 31, 2024.
2. *: ANBC refers to adjusted net bank credit, while CEOBE refers to credit equivalent amount of off-balance sheet exposure.

Source: RBI.

III.28 UCBs are now required to contribute to the rural infrastructure development fund (RIDF) or other eligible funds in lieu of shortfalls in PSL targets/ sub-targets with effect from March 31, 2023 instead of March 31, 2021. Contribution made by a UCB for shortfalls during 2020-21 and/ or 2021-22 can be used to offset shortfalls that may have occurred during 2022-23 and excess deposits, if any, after offsetting the shortfall, will be refunded.

III.29 To incentivise UCBs to meet PSL targets, the Reserve Bank increased the monetary ceiling of gold loans that can be granted under the bullet repayment scheme from ₹2 lakh to ₹4 lakh on October 6, 2023 for UCBs that met the overall PSL target and sub-targets as on March 31, 2023 and continue to meet the same as per the revised schedule.

Provisioning for Standard Assets

III.30 On April 24, 2023 the Reserve Bank harmonised the provisioning norms for 'standard' assets applicable to all categories of UCBs, irrespective of their tier in the revised framework. Direct advances to agriculture and small and medium enterprise (SME) sectors will attract a uniform provisioning requirement of 0.25 per cent, while the provisioning requirement for advances to the commercial real estate (CRE) sector, commercial real estate - residential housing (CRE-RH), and 'all other standard advances' will be 1 per cent, 0.75 per cent and 0.4 per cent, respectively. Tier 1 UCBs, which were maintaining 0.25 per cent provisions on 'all other standard advances', were permitted to achieve the requirement of 0.40 per cent in a staggered manner by March 31, 2025.

Permission to Rural Co-operative Banks (RCBs) to Lend to CRE-RH Sector

III.31 RCBs, *i.e.,* state co-operative banks (StCBs) and district central co-operative banks

(DCCBs), were hitherto not allowed to finance CRE. Considering the growing need for affordable housing and to realise their potential in providing credit facilities to the housing sector, the Reserve Bank on June 8, 2022 permitted RCBs to extend finance to CRE-RH sector within the existing aggregate housing finance limit of five per cent of their total assets. RCBs are required to have a Board-approved policy for financing the CRE-RH sector. The performance of the CRE-RH portfolio should be reviewed by the Board at least on a half-yearly basis.

Individual Housing Loans - Enhancement in Limits for UCBs and RCBs

III.32 Taking into account the rise in housing prices and considering the customer needs, the Reserve Bank increased the limits on individual housing loans on June 08, 2022 for RCBs and UCBs. For RCBs with assessed net worth less than ₹100 crore, the limit was increased from ₹20 lakh to ₹50 lakh, while for other RCBs, it was raised from ₹30 lakh to ₹75 lakh. For Tier 1 UCBs, the limit was increased from ₹30 lakh to ₹60 lakh and for Tier 2 UCBs, it was raised from ₹70 lakh to ₹140 lakh. Consequent upon categorisation of UCBs under four tiers in the revised regulatory framework, the limits on housing loans sanctioned by UCBs to individual borrowers were respecified as ₹60 lakh for Tier 1 UCBs and ₹140 lakh for UCBs categorised in Tiers 2 to 4, with effect from December 30, 2022.

Issue and Regulation of Share Capital and Securities for RCBs

III.33 The extant instructions on issue and regulation of capital funds for StCBs and DCCBs were reviewed in April 2022 in light of the Banking Regulation (Amendment) Act, 2020. The new guidelines allow RCBs to issue preference shares, establish a minimum maturity period of 10 years for all regulatory capital instruments, and permit them to refund the share capital to their members (or nominees), subject to the CRAR remaining above 9 per cent.

4. Green Initiatives

III.34 With climate change being recognised as the most critical challenge, the Reserve Bank has been playing a key role in nudging banks towards mobilising green resources for green activities and projects.

Acceptance of Green Deposits

III.35 The Reserve Bank issued a framework for acceptance of green deposits on April 11, 2023 to encourage REs to offer green deposits to customers, protect depositors' interest, address greenwashing risks and help augment the flow of credit to green activities/ projects. Eligible REs[5] will have to allocate the funds raised from green deposits to (i) renewable energy sector; (ii) energy efficiency; (iii) clean transportation; (iv) climate change adaptation; (v) sustainable water and waste management; (vi) pollution prevention and control; (vii) green buildings; (viii) sustainable management of living natural resources and land use; or (ix) terrestrial and aquatic biodiversity conservation. The allocation of funds raised through green deposits will also be subject to annual independent third-party verification/assurance. This would not, however, absolve the RE of its responsibility regarding the end-use of funds, for which internal checks and balances will have to be followed.

[5] The framework is applicable to all scheduled commercial banks, including small finance banks (excluding regional rural banks, local area banks and payments banks) and all deposit taking non-banking financial companies, including housing finance companies.

Sovereign Green Bonds

III.36 During 2022-23, sovereign green bonds (SGrBs) spread over two tranches of ₹8,000 crore each were issued on January 25, 2023 and February 9, 2023. They comprised 5-year and 10-year bonds of ₹4,000 crore in each tranche. During 2023-24, 5-year and 10-year SGrBs of ₹5,000 crore in each tranche were issued on November 10, 2023 and December 8, 2023, respectively. Auctions of 30-year SGrBs (two tranches of ₹5,000 crore each) are scheduled to be held in January-February 2024. SGrBs issued during 2022-23 and 2023-24 were notified as 'specified securities' under the fully accessible route (FAR) on January 23, 2023 and November 08, 2023, respectively, and non-residents were allowed to invest in these securities without any restrictions.

5. Technological Innovations

III.37 To keep pace with the dynamically changing landscape, the Reserve Bank continued with conscious efforts to facilitate innovations in the FinTech sector.

Digitalisation of Kisan Credit Cards (KCC)

III.38 In September 2022, the Reserve Bank, in association with the Reserve Bank Innovation Hub (RBIH), conceptualised an end-to-end digitalisation of the KCC process to reduce the turnaround time for loan processing from more than two-three weeks to a few minutes so as to contain operational expenses and opportunity costs by obviating the need for multiple visits to bank branches. A pilot of Digital KCC was launched in select districts of Madhya Pradesh and Tamil Nadu and was further scaled to other states *viz.*, Maharashtra, Karnataka, and Uttar Pradesh. Digitalisation was also extended to dairy entrepreneurs in Gujarat, where the quantum of finance is instantly decided on the basis of the milk pouring data obtained from milk co-operatives/societies.

Public Tech Platform for Frictionless Credit

III.39 Based on the learnings from the KCC and dairy pilots, the Reserve Bank, in association with the RBIH, launched a pilot of the Public Tech Platform on August 17, 2023. The open application programming interfaces (APIs) and standards embedded in the platform enable linkage with services such as Aadhaar electronic know your customer (e-KYC), land records from onboarded State Governments, milk pouring data, bank account verification, property search data, satellite data, permanent account number (PAN) validation, and account aggregation. It is expected to increase efficiency in the lending process by reducing costs and aiding quicker disbursement and scalability. Apart from KCC loans up to ₹1.6 lakh per borrower and dairy loans, the platform focuses on micro, small and medium enterprise (MSME) loans (without collateral), personal loans and home loans through participating banks. The scope and coverage of the platform will be expanded to include more products, data/ service providers and lenders based on the learnings and response from stakeholders.

Operationalisation of Central Bank Digital Currency

III.40 The e₹ is a tokenised version of the Indian rupee. The Reserve Bank commenced the pilot for the wholesale segment (e₹-W) on November 1, 2022, for settlement of secondary market transactions in government securities with the participation of select banks. It is expected to reduce transaction costs by pre-empting the need for settlement guarantee infrastructure or for collateral to mitigate settlement risk. The scope of e₹-W was subsequently expanded to include inter-bank lending and borrowing transactions.

III.41 The pilot for the retail segment (e₹-R) was launched on December 01, 2022, covering select locations in a closed user group (CUG), comprising participating customers and merchants. Users can make both person-to-person (P2P) and person-to-merchant (P2M) transactions with e₹-R through a digital wallet offered by participating banks and stored on mobile phones. It offers trust, safety, and settlement finality, does not earn any interest and can be converted to other forms of money. The pilot started with four banks and four cities and is currently operational through thirteen banks. It is being expanded to cover more banks and locations across the country. Based on the learnings from the pilot, the Reserve Bank made Unified Payments Interface (UPI) and CBDC interoperable to leverage the almost universal UPI acceptance infrastructure. The scope of the pilots is gradually being expanded to cover various use cases, designs, and technological considerations.

Digital Lending

III.42 Based on the inputs received from various stakeholders on the recommendations of the Working Group on Digital Lending (WGDL), the Reserve Bank released a regulatory framework on August 10, 2022. It is based on the principle that lending business can be carried out either by entities that are regulated by the Reserve Bank or entities permitted to do so under any other law. The detailed guidelines were issued on September 2, 2022 and focus on addressing concerns arising out of unchecked engagement of lending service providers (LSPs) in various lending activities, mis-selling, breach of data privacy, customer grievance redressal, unfair business conduct and unethical recovery practices. The guidelines support orderly growth of credit delivery through digital lending methods while making the lending process transparent and fair by mandating several upfront disclosures to the borrowers.

Default Loss Guarantee (DLG) in Digital Lending

III.43 DLG arrangements involve a contractual arrangement between an RE and an LSP operating within an outsourcing arrangement under which the latter guarantees to compensate the former upfront specified loss due to default up to a certain percentage of the loan portfolio of the RE. Considering the need to strike a balance between prudence and innovation, on June 08, 2023, the Reserve Bank permitted DLG arrangements with suitable regulatory guardrails. REs need to ensure that the total amount of DLG cover does not exceed five per cent of the loan portfolio, and is offered only in the form of cash, fixed deposit or bank guarantee. The recognition of non-performing assets (NPAs) and consequent provisioning is the responsibility of the RE to ensure that credit appraisal standards are not diluted. Also, REs are required to ensure disclosure of DLG on the website of LSPs to promote transparency.

6. Financial Markets and Foreign Exchange Policies

LIBOR Transition

III.44 In view of the planned phase out of the London Interbank Offered Rate (LIBOR) and the cessation of its publication after June 30, 2023, the Reserve Bank had been sensitising REs about the need to completely transition away from it to other benchmarks from July 1, 2023. On May 12, 2023, the Reserve Bank advised REs to (i) ensure that no new transaction undertaken by them or their customers rely on the USD LIBOR or its linked domestic benchmark, the Mumbai Interbank Forward Outright Rate (MIFOR); and (ii) ensure insertion of fallbacks in all remaining legacy financial contracts that reference USD LIBOR or MIFOR, at the earliest. The list of ‘significant benchmarks’ was accordingly updated to include the modified MIFOR (MMIFOR) and exclude MIFOR.

Non-Deliverable Derivative Contracts (NDDCs)

III.45 With a view to develop the onshore INR NDDC market and to provide residents with the flexibility to efficiently design their hedging programmes, the Reserve Bank on June 6, 2023 permitted banks with IFSC Banking Units (IBUs) to offer INR NDDCs to resident non-retail users in the onshore market for hedging foreign exchange risk. These banks were provided with the flexibility of settling their NDDC transactions with non-residents and with each other in foreign currency or in INR, while transactions with residents were to be mandatorily settled in INR.

Limits in Call and Notice Money Markets

III.46 On June 8, 2023 the Reserve Bank permitted SCBs (excluding small finance banks (SFBs) and payments banks) to set their own internal Board-approved limits for borrowing in the call and notice money markets within the prudential limits for inter-bank liabilities prescribed by the Reserve Bank to provide greater flexibility for managing their money market borrowings. Earlier, borrowings by SCBs in the call and notice money markets were subject to prudential limits.

7. Credit Delivery and Financial Inclusion

III.47 The vision for financial inclusion in India has been set by the National Strategy for Financial Inclusion (NSFI) 2019-24. In consonance, significant strides were made during the year under review to further strengthen the financial inclusion landscape, leveraging digital infrastructure.

New Interest Subvention Scheme for Women SHGs under DAY-NRLM

III.48 The Government of India introduced a new interest subvention scheme for women self-help groups (SHGs) under the *Deendayal Antyodaya Yojana* - National Rural Livelihoods Mission (DAY-NRLM) in July 2022 (Table III.4).

Table III.4: Interest Subvention Scheme for Women SHGs

Loan Amount	Interest Rate	Interest Subvention
Up to ₹3 lakh	7 per cent	4.5 per cent
₹3 lakh to ₹5 lakh	One-year marginal cost of funds-based lending rate, any other external benchmark-based lending rate or 10 per cent per annum, whichever is lower	5 per cent

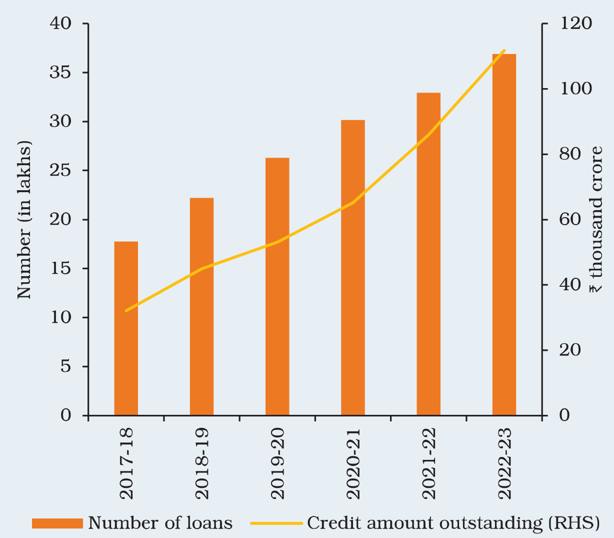
Source: RBI.

III.49 Women SHGs promoted by other agencies following the DAY-NRLM protocols are also eligible for the subvention scheme. The scheme is being implemented through a nodal bank selected by the Ministry of Rural Development (MoRD). During 2022-23, the number of loans and amount outstanding to women SHGs under DAY-NRLM increased by 12.0 per cent and 30.1 per cent, respectively (Chart III.1).

Modified Interest Subvention Scheme for Short-Term KCC Loans

III.50 The interest subvention scheme for short-term loans for agriculture and allied activities

Chart III.1: Women SHGs under DAY-NRLM



Source: RBI.

availed through KCC was extended for 2021-22 on April 28, 2022, and for 2022-23 and 2023-24 on November 23, 2022, with some modifications (Table III.5). The scheme, which earlier covered only public sector banks (PSBs) and private sector banks (PVBs) (in respect of loans given by their rural and semi-urban branches only), was extended to SFBs and computerised primary agricultural co-operative societies (PACS) which have been ceded with SCBs on use of their own resources. The benefit of concessional credit for agricultural and allied activities was, thus, sought to be made available to a larger set of borrowers.

Formalisation of Informal Micro Enterprises (IMEs) on Udyam Assist Platform

III.51 As per the new criteria for defining MSMEs, all lenders were advised to obtain *Udyam* Registration Certificates (URCs) from entrepreneurs. However, many enterprises were facing difficulties in registering on the portal due to the compulsory requirement of PAN/ goods and services tax (GST) documents, leading to a significant decline in the number of MSME accounts. The Ministry of MSMEs introduced the *Udyam* Assist Portal (UAP) to streamline the formalisation process for IMEs, and assist in their registration and issuance of *Udyam* Registration Numbers (URN) and *Udyam* Assist Certificates (UAC). On May 9, 2023 the Reserve Bank notified that UACs will be considered equivalent to URCs, and IMEs that possess a UAC will be recognised as micro enterprises for the purpose of PSL classification.

Table III.5: Modified Interest Subvention Scheme for Short Term KCC Loans

(Per cent)

Financial Year	Lending Rate to Farmers	Rate of Interest Subvention to Lending Institutions	Prompt Repayment Incentive for farmers
2021-22	7	2	3
2022-23	7	1.5	3
2023-24	7	1.5	3

Source: RBI.

8. Consumer Protection

III.52 The Reserve Bank has been undertaking various policy measures to strengthen the complaint redressal mechanism *viz.*, the internal grievance redressal (IGR) for REs and the alternate grievance redressal (AGR) framework by leveraging technology to enhance efficiency[6]. In addition, focused customer awareness programmes like Ombudsman Speak, Talkathon and Nationwide Intensive Awareness Program were conducted during 2022-23 across the country to educate customers on safe banking practices using innovative ways.

Committee for Review of Customer Service Standards

III.53 In recent years, the financial landscape in India has been witnessing a rapid transformation in terms of a rising customer base and number of service providers, advent of new technology and digital products and an increase in volume of digital transactions emerging from innovations in payment systems. Against this backdrop, the Reserve Bank set up the 'Committee for Review of Customer Service Standards in RBI Regulated Entities (REs)' on May 23, 2022. The Committee submitted its report on April 24, 2023 (Box III.2).

[6] The Reserve Bank in its statement on developmental and regulatory policies on October 6, 2023 announced that it will issue a consolidated master direction to harmonise the guidelines on internal ombudsman (IO) framework across various categories of REs.

Box III.2: Review of Customer Service Standards

The Committee for review of customer service standards was formed under the Chairmanship of Shri B.P. Kanungo to evaluate and review the quality of customer service, examine evolving needs, identify best practices, and suggest measures for bringing about improvements in quality of customer service and grievance redressal mechanism in REs.

The committee conducted a survey of 5,016 customers of REs in July 2022 to identify lacunae in services extended to them (Chart III.2.1). A survey of 861 employees of REs was also conducted to identify the issues hindering better customer service at branches (Chart III.2.2).

The key recommendations made by the Committee included:

Strengthening Regulation by the Reserve Bank

- Developing and publishing a system-level index to capture the standards and quality of customer service/ protection in a single score.
- Empowering the RBI Ombudsmen (RBIOs) to issue directions to REs based on complaint/s received.

Enhancing Regulatory Compliance by REs

- Putting in place a suitable structure of incentives and disincentives aimed at enterprise-wide improvements in customer service.
- Creating a fund for direct compensation to the Internal Ombudsmen (IOs) appointed in REs to address conflicts of interest.

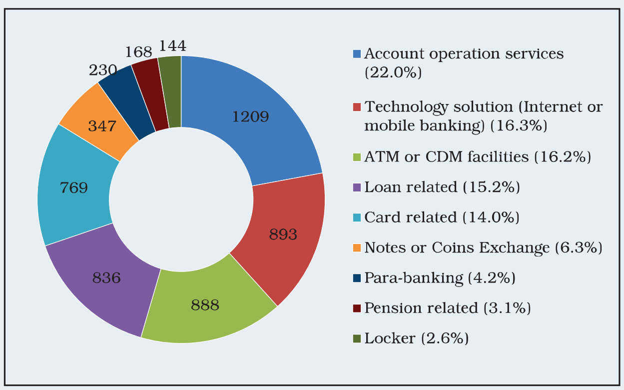
Leveraging Technology

- REs may leverage contextual data and artificial intelligence (AI) to integrate and personalise their interfaces for the benefit of customers.
- Designing and deploying safer means of second factor authentication mechanisms by REs to counter the misuse of one-time passwords (OTPs).
- Standardisation of automated teller machine (ATM) interface and ensuring minimum set of functionalities for all ATMs.

Improving Customer Service in REs

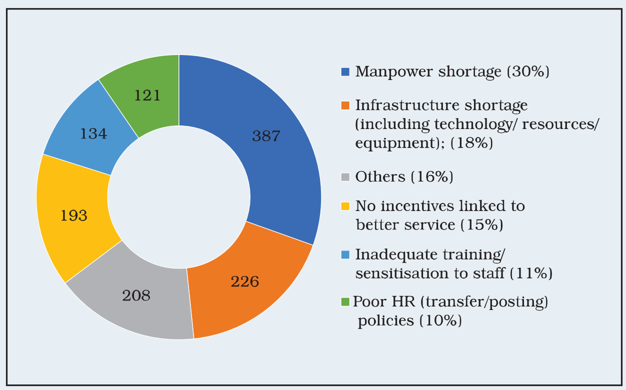
- Ensuring hassle-free and speedy settlement of claims through online portals in cases of deceased account holders to obviate the need for physical visits by nominees.
- Establishing a centralised database of KYC documents of all customers of REs linked to customer information files to avoid repeated submissions for each new facility availed.
- Ensuring timely return of property documents to borrowers and suitable compensation for delays / losses.

Chart III.2.1: Areas of Concern: Customer Survey



Note: Sum may not add up to 5,016 as multiple options were allowed.

Chart III.2.2: Issues Hindering Better Customer Service



Note: Sum may not add up to 861 as multiple options were allowed.

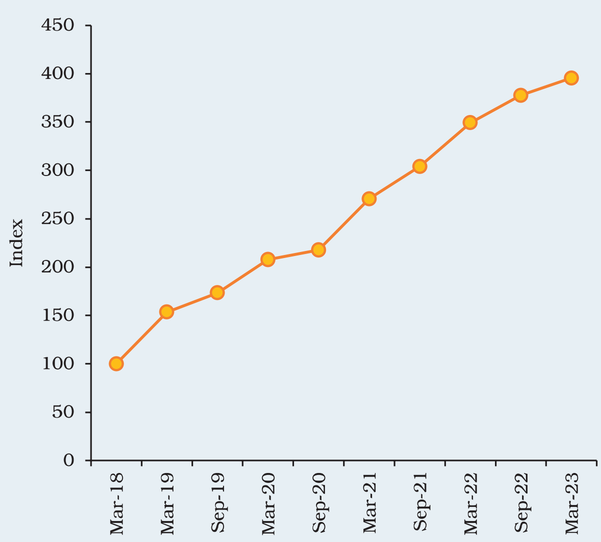
9. Payments and Settlement Systems

III.54 In the recent years, India's digital payments ecosystem has emerged as a role model not only for other emerging market economies (EMEs), but also for many advanced economies (AEs). The inherent safety features, robust infrastructure and supportive policy initiatives have led to a transformation and a shift away from cash-based transactions. The progression in Reserve Bank's Digital Payments Index (RBI-DPI) bears a testimony to this phenomenon (Chart III.2).

Bharat Bill Payment System (BBPS)

III.55 BBPS, an interoperable platform for bill payments, has witnessed a quantum leap, both in the volume of transactions as well as the number of onboarded billers. To enhance the participation of non-bank Bharat Bill Payment Operating Units (BBPOUs), the Reserve Bank reduced the net worth requirement for their authorisation from ₹100 crore to ₹25 crore on May 26, 2022.

Chart III.2: RBI-Digital Payments Index



Source: RBI.

III.56 Since September 2022, BBPS has been enabled to process foreign inward remittances received under the Rupee Drawing Arrangement (RDA)[7]. Such payments can now be transferred to the KYC compliant bank account of the biller (beneficiary). In December 2022, the scope of BBPS was further extended to include all categories of payments and collections, both recurring and non-recurring, to enable more billers to be onboarded on BBPS.

Storage and Tokenisation of Actual Card Data

III.57 On June 24, 2022 the Reserve Bank extended the timeline for storing Card-on-File (CoF) data by three months, *i.e.*, till September 30, 2022. This was done to resolve outstanding issues around storage of actual card data in the digital payments ecosystem. With effect from October 1, 2022, no entity in the payment chain other than the card issuer or card network is allowed to store CoF data. Any such data previously stored has to be purged. On July 28, 2022 the merchant or its payment aggregator (PA) involved has been allowed to save the CoF data for a maximum period of T+4 days ('T' being the transaction date) or till the settlement date, whichever is earlier, for transactions where cardholders decide to enter the card details manually (commonly referred to as 'guest checkout transactions'). As per the guidelines, these data shall be used only for the settlement of such transactions and must be purged thereafter. The acquiring banks have been allowed to continue to store guest check-out transaction data until January 31, 2024 for

[7] RDA is a channel to receive cross-border remittances from overseas jurisdictions wherein the authorised category-I banks enter into tie-ups with the non-resident exchange houses in the financial action task force (FATF) compliant countries to open and maintain their vostro account.

handling other post-transaction activities. All previously stored CoF data has to be purged after 180 days of the transaction.

III.58 So far, over 64 crore tokens have been created on which transactions with value of over ₹6 lakh crore have been undertaken. Tokenisation has improved transaction security and transaction approval rates. Earlier, CoF tokens could only be created through merchants' applications or webpages. In October 2023 the Reserve Bank proposed to introduce CoF token creation facilities directly at the issuer bank - level to enhance convenience for cardholders.

Expanding the Scope of Trade Receivables Discounting System (TReDS)

III.59 Guidelines on the TReDS were issued in December 2014 to help MSMEs convert their trade receivables into liquid funds. Recognising that financiers are generally not inclined to bid for payables of low-rated buyers, the Reserve Bank permitted insurance facility for TReDS transactions in June 2023. The permission for insurance companies to enter the ecosystem consisting of MSME sellers, buyers and financiers would aid financiers to hedge default risk. The Reserve Bank also took measures to expand the pool of financiers and to enable a secondary market for factoring units.

Extending UPI to Inbound Travellers to India

III.60 Till recently, foreign nationals and non-resident Indians (NRIs) visiting India had to rely on cash or foreign exchange payment instruments that required availability of point-of-sale (PoS) terminals to meet their payment needs. Recognising that UPI QR codes are widely used in India, the Reserve Bank on February 10, 2023 allowed them to make local payments using UPI while they are in India. The facility involves issuance of prepaid payment instruments (PPIs) in the form of wallets that could be linked to UPI and loaded with INR by converting foreign currency. The facility, first made available to delegates from G-20 countries on select airports to begin with, will be extended to other entry points and visitors from other countries in due course.

Enhancements to UPI

III.61 On May 19, 2022 the Reserve Bank mandated banks, ATM networks and white label ATM operators to provide an interoperable card-less cash withdrawal (ICCW) facility. The use of UPI has been permitted for customer authorisation in such transactions, with settlement of transactions through the ATM network. In June 2022 the Reserve Bank expanded the scope of UPI by allowing linking of credit cards to the UPI network, with the initial facilitation planned for RuPay credit cards. On September 3, 2023 the Reserve Bank enabled UPI transactions from pre-sanctioned credit lines with prior consent of the individual customer.

Regulation of Payment Aggregator – Cross Border (PA - Cross Border)

III.62 On October 31, 2023 the Reserve Bank issued guidelines on regulation of PA - Cross Border with the aim of bringing all entities, including online export-import facilitators (OEIFs), online payment gateway service providers (OPGSPs), and Reserve Bank approved collection agent arrangements, that facilitate processing and settlement of cross-border payment transactions for import and export of goods and services under direct regulation of the Reserve Bank.

Internationalisation of Payment Systems

III.63 The Reserve Bank has been working towards expanding the global footprint of UPI and RuPay cards through collaboration with various countries. In February 2023, the Reserve Bank and the Monetary Authority of Singapore (MAS) operationalised linkage of their respective fast payment systems (FPS), *i.e.* UPI and PayNow. The linkage has enabled users of the two systems to make instant and low-cost cross-border peer-to-peer (P2P) payments on a reciprocal basis. In July 2023, the Reserve Bank and the Central Bank of the UAE (CBUAE) signed an MoU for linking UPI with the Instant Payment Platform (IPP) of the UAE; and linking their respective card switches (RuPay switch and UAESWITCH). Acceptance of UPI through QR codes has been enabled in Bhutan, Singapore, and the UAE. Indian tourists travelling to these countries can use their UPI apps to make payments at merchant locations. Arrangements have been made with Bhutan, Nepal, Singapore, and the UAE to accept RuPay cards without co-branding with other international card schemes. Issuance of RuPay cards in other countries is also being examined.

Extension of Payments Infrastructure Development Fund (PIDF) Scheme

III.64 The PIDF scheme was operationalised by the Reserve Bank in January 2021 for three years to incentivise the deployment of payment acceptance infrastructure in Tier 3 to Tier 6 centres, north-eastern states and union territories of Jammu & Kashmir and Ladakh. In October 2023, the Reserve Bank extended the PIDF Scheme by two years, *i.e.,* up to December 31, 2025. To provide a fillip to efforts towards promoting digital transactions at the grassroot level, the beneficiaries of PM *Vishwakarma* Scheme were also included under the PIDF Scheme.

10. Overall Assessment

III.65 During 2022-23 and 2023-24, the Reserve Bank created an enabling environment for REs to improve ease of doing business, while maintaining their focus on customer protection. The strides taken in digital finance infrastructure have made finance more inclusive, competitive, and robust, while setting a global benchmark. In the highly uncertain geopolitical environment, REs will have to keep their focus on identifying and mitigating incipient stress, maintaining soundness and public confidence, and meeting the financing requirements of the country's developmental aspirations. The Reserve Bank remains committed to preserving financial stability while enhancing efficiency in the financial system.