# Section 1
# Overview

## Chapter 1.1
## Preface

Providing access to financial services to low-income households and small businesses is not a new goal for India. Policy makers are also well aware of its importance and have been very willing to learn from the successful experiences of other countries and to experiment with new ideas. However, the record of progress on this front has left a great deal to be desired. On both Financial Inclusion (defined as the spread of financial institutions and financial services across the country) and Financial Depth (defined as the percentage of credit to GDP at various levels of the economy) the overall situation remains very poor and, on a regional and sectoral basis, very uneven. An estimate suggests that close to 90 per cent[1] of small businesses have no links with formal financial institutions and 60 per cent[2] of the rural and urban population do not even have a functional bank account. And, while the bank credit to GDP ratio in the country as a whole is a modest 70 per cent, in a large state such as Bihar, it is even lower at a mere 16 per cent[3]. This has left a large part of the economy dependent on the informal sector for meeting its credit needs. On the savings front, difficulties of access combined with an absence of a positive real return on financial savings, has accelerated the move away from financial assets to physical assets and unregulated providers. RBI's June 2013 Financial Stability Report notes that savings as a proportion to GDP has fallen from 36.8 per cent in 2007-08 to 30.8 per cent in 2011-12 and the financial savings of households have declined from 11.6 per cent of GDP to 8 per cent during the same period. It is clear that the demand for high-quality formal financial services is not a constraint – there is robust and visible demand for a wide range of financial services by small businesses and low-income households combined with a willingness to pay for them. The challenge is clearly the ability of the formal financial system to mount a strong supply response, which needs to be strengthened considerably.

As one examines the financial inclusion landscape in India, the sheer energy that has been put behind the effort and the seriousness with which providers and regulators have pursued this goal is impressive. However, it is possible that it is this very energy that has been its key weakness as well, because it has propelled highly engaged regulators and policy makers to move from one big idea to another, each time convinced that they have finally found the key to financial inclusion, whether it be cooperative banks, nationalisation of banks, self-help groups, regional rural banks, or business correspondents. While there is no question that there is a continuing need to explore new ideas; learn from the experiences of other nations; and benefit from new technologies; perhaps it is not the best regulatory strategy to centrally pick one approach no matter how convincing it may seem and to push the entire system in that particular direction to the exclusion of all others. A better approach may instead be to articulate a clear vision; establish a set of design principles; and then to permit all strategies, new and old, to flourish or to die out based on their inherent strengths and weaknesses. India is a very large and a very diverse country and no one strategy, however well designed, can ever hope to serve the entire country.

And, while there is no doubt that the goals of comprehensive financial access are very important, given their sheer magnitude, they need to be pursued in manner that does not end up threatening the stability of the financial system by building up high levels of non-performing assets or impairing the profitability of the financial institutions engaged in these tasks. For example, there is a concern that the current approach which is exclusively reliant on full-service, national level, scheduled commercial banks using their own branches and a network of mostly informal agents, while potentially a very good idea for some banks and for some regions of the country, for several banks and several regions is building up an extremely high risk portfolio of assets, and a high cost infrastructure but is not doing much by way of building comprehensive access to finance for low-income

households and small businesses. Priority Sector Lending (PSL) guidelines require banks to allocate 40 per cent of their lending book to it, and how they are implemented by the bank has a significant impact on its performance as a whole. However, whenever financial inclusion goals are generally specified and strategies articulated, there is little acknowledgement of risk and cost-to-serve considerations. This has had a severe impact and, despite the loan waivers that took place a few years ago, more than half the total NPAs on their books are attributable to this sector with an NPA ratio that is close to double that of the rest of the asset book. Unless these issues are integrated in discussions on financial inclusion, banks will always be reluctant participants. Given this important background, this Report overall makes a conscious effort to redress this imbalance and issues of risks and costs have been kept at the very centre of the discussions of each of the strategies for providing better access to financial services to small businesses and low-income households.

With this perspective in view and in accordance with the Terms of Reference given to it, in its deliberations, the Committee focussed its attention on:

1. Framing a clear and detailed vision for financial inclusion and financial deepening in India.

2. Articulating a set of design principles that will guide the development of institutional frameworks and regulation for achieving financial inclusion and financial deepening, including approaches to prudential regulation, consumer protection, and systemic risk management for institutions involved in financial inclusion and deepening, so that the eventual design: (a) provides a complete suite of suitable financial services to each and every small business and low-income household in a flexible, convenient, reliable, and continuous manner; (b) is highly cost effective; (c) ensures a high degree of customer protection, and enhancement of financial wellbeing; and (d) enhances systemic stability.

3. In the light of the detailed vision and the design principles, carefully reviewing each existing channel and suggesting how its performance may be improved based on both domestic and global experiences.

4. Where necessary, recommending new ideas for consideration by the RBI and other policy makers, in order to address specific barriers to progress and to encourage participants to work swiftly towards the full achievement of the vision in a manner that is consistent with the design principles.

5. Developing a comprehensive monitoring framework to track the progress of the financial inclusion and deepening efforts on a nationwide basis.

At the end of its deliberations the Committee finds that each of the channels, be they large National Banks, regional cooperative banks, or Non-Banking Financial Companies (NBFCs) have a great deal of continuing value to add. However, the entire approach would need to markedly change from one in which all the players become clones of each other because they are all required to adhere to one centrally designed blue-print, to one that would permit each one to focus on its own differentiated capabilities and accomplish the national goals of financial inclusion by partnering with others that bring complementary capabilities to bear on the problem. In such a structure systemic stability would be preserved by ensuring that each participant is required to transparently reveal the risks that it is exposed to and to have an adequate level of capability and financial capital to assume those risks. The best possible outcomes on outreach, pricing, and services would

be achieved by ensuring that each participant is treated in a neutral manner so that it is not operating in an environment that is either biased in its favour or against it and that it survives or fails based entirely on its inherent strengths and the efficacy of its strategies. The regulator, while paying close attention to the achievement of financial inclusion goals of the system as a whole would allow each participant to exercise significant autonomy to chart its own path. It would also exercise constant vigilance in order to ensure that key design principles such as systemic Stability, complete Transparency of balance sheets, Neutrality of regulatory stance towards different types of participants, and the need to protect customers, are not violated.

Such an environment however, also needs the development of mechanisms for an active transfer of assets, liabilities, and risks between financial markets participants and a movement away from a structure where each player is required to raise its own liquidity; originate all of its own risks and assets; and then necessarily hold them to maturity. The presence of such mechanisms, not merely good governance, has for example ensured the continued success of the Sparkassens (the German version of Regional Banks) and their absence was directly responsible for the demise of the Development Finance Institutions (DFIs) in India (the Indian version of Wholesale Banks). Fortunately India already has most of the enablers necessary for a vibrant risk-transfer mechanism to come about but a number of concrete steps would need to be taken to ensure the development of such mechanisms in India. It would for example require central institutions such as National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), and National Housing Bank (NHB) to considerably strengthen their own risk assessment capabilities and instead of using their balance sheets to absorb these risks, become actively involved in helping to create markets for risk and liquidity transfers between market participants. It would also need the development and strengthening of several pieces of complementary infrastructure such as credit bureaus, weather stations, commodity markets, and warehouses.

The last few years have seen dramatic improvements on several fronts linked to supply-side infrastructure. The Unique Identification (UID) project has already covered 50 crore Indians and expects to complete the task of issuing a UID to the rest of the country by 2016. By linking UID numbers to Know Your Customer (KYC) norms, RBI has already paved the way for universalising bank accounts, thus removing one of the most important barriers to financial access. Through the Bharat Broadband Network, the Government is laying out the National Optical Fibre Network to all the Gram Panchayats in the country and expects to complete this task by 2014. Against only 3 crore fixed line subscribers, telecommunications companies now have over 87 crore[4] mobile phone subscribers of whom over 35 crore are based in rural areas and, while the urban number has stabilised, the rural number continues to grow at an annualised rate of 10 per cent. If these opportunities are used well, paradoxically, it is even possible that poor historic progress on financial inclusion may actually present India with an opportunity to leap-frog over the rest of the world and may prove to be an advantage just as the absence of copper-wire allowed India to move directly to mobile telephony. The Committee explores a number of ways that this can be done, benefitting from the early experiences of developing countries such as Kenya, Brazil, and South Africa as well as that of the European Union which has transformed its payment landscape in recent years.

India already has all the elements for success in place – a wide range of institutional types, well-developed financial markets, a good regulatory framework, and large scale and high quality authentication and transaction platforms. The Committee is therefore optimistic that with a concerted effort it should be possible to ensure the achievement of several key goals such as universal access to a bank account; a ubiquitous payments infrastructure; and a base level access to all the other financial products such as credit and insurance within a relatively short period of time.

## Chapter 1.2
## Executive Summary and List of Recommendations

**Section 1** introduces the Report.
**Section 2** provides the vision statements, current data on access, design principles and a theoretical framework to examine various banking system designs.

The six vision statements are:

1. Universal Electronic Bank Account (UEBA): By January 1, 2016 each Indian resident, above the age of eighteen years, would have an individual, full-service, safe, and secure electronic bank account.

2. Ubiquitous Access to Payment Services and Deposit Products at Reasonable Charges: By January 1, 2016, the number and distribution of electronic payment access points would be such that every single resident would be within a fifteen minute walking distance from such a point anywhere in the country. Each such point would allow residents to deposit and withdraw cash to and from their bank accounts and transfer balances from one bank account to another, in a secure environment, for both very small and very large amounts, and pay "reasonable" charges for all of these services. At least one of the deposit products accessible to every resident through the payment access points would offer a positive real rate of return over the consumer price index.

3. Sufficient Access to Affordable Formal Credit: By January 1, 2016, each low-income household and small-business would have "convenient" access to formally regulated lenders that have the ability to assess and meet their credit needs, and offer them a full-range of "suitable" credit products, at an "affordable" price. By that date, each District and every "significant" sector (and sub-sector) of the economy would have a Credit to GDP ratio of at least 10 per cent. This ratio would increase every year by 10 per cent with the goal that it reaches 50 per cent by January 1, 2020.

4. Universal Access to a Range of Deposit and Investment Products at Reasonable Charges: By January 1, 2016, each low-income household and small-business would have "convenient" access to providers that have the ability to offer them "suitable" investment and deposit products, and pay "reasonable" charges for their services. By that date, each District would have a Total Deposits and Investments to GDP ratio of at least 15 per cent. This ratio would increase every year by 12.5 per cent with the goal that it reaches 65 per cent by January 1, 2020.

5. Universal Access to a Range of Insurance and Risk Management Products at Reasonable Charges: By January 1, 2016, each low-income household and small business would have "convenient" access to providers that have the ability to offer them "suitable" insurance and risk management products which, at a minimum allow them to manage risks related to: (a) commodity price movements; (b) longevity, disability, and death of human beings; (c) death of livestock; (d) rainfall; and (e) damage to property, and pay "reasonable" charges for their services. By that date, each District would have a Total Term Life Insurance Sum Assured to GDP ratio of at least 30 per cent. This ratio would increase every year by 12.5 per cent with the goal that it reaches 80 per cent by January 1, 2020.

6. Right to Suitability: Each low-income household and small-business would have a legally protected right to be offered only "suitable" financial services. While the customer will be required to give "informed consent" she will have the right to seek

legal redress if she feels that due process to establish Suitability was not followed or that there was gross negligence.

The four design principles that would inform financial inclusion and deepening strategies discussed in the Report are: Systemic Stability, Balance-sheet Transparency, Institutional Neutrality, and Responsibility towards the Customer.

The framework to understand various types of banking system designs uses the functional building blocks of payments, deposits and credit and constructs two broad designs. These are the Horizontally Differentiated Banking System (HDBS) and the Vertically Differentiated Banking System (VDBS). Across these, ten existing and potential banking designs were identified. These are: National Bank with Branches, National Bank with Agents, Regional Bank, National Consumer Bank, National Wholesale Bank, National Infrastructure Bank, Payments Network Operator, Payments Bank, Wholesale Consumer Bank, and Wholesale Investment Bank. Subsequent chapters build on this framework for detailed discussions.

**Section 3** examines issues relevant to the goal of a ubiquitous payments network and universal access to savings. The following recommendations are made in this section:

3.1 Every resident should be issued a Universal Electronic Bank Account (UEBA) automatically at the time of receiving their Aadhaar number by a high quality, national, full-service bank. An instruction to open the bank account should be initiated by UIDAI upon the issuance of an Aadhaar number to an individual over the age of 18. The bank would need to be designated by the customer from amongst the list of banks that have indicated to UIDAI that they would be willing to open such an account with the understanding that it would attract no account opening fee but that the bank would be free to charge for all transactions, including balance enquiry with the understanding that such transactions' charges would provide the host banks with adequate compensation. The Bank would be required to send the customer a letter communicating details of the account thus opened. The Committee recommends that the RBI issue a circular indicating that no bank can refuse to open an account for a customer who has adequate KYC which specifically includes Aadhaar. [Identical to Recommendation 5.1]

3.2 RBI should require a strong Proof of Identity (POI) for each and every customer and a documentary proof of one national address but waive the requirement of documentary proof for the current address, for the purpose of opening a full-service bank account. It should instead enjoin upon banks to carry out careful tracking of usage and transactions patterns to ascertain the risk levels of the customer and take necessary action based upon risk-based surveillance processes developed internally by each bank. [Identical to Recommendation 5.2]

3.3 Under the existing rural branching mandate, a qualifying branch may be understood to have specified features regarding minimum services available, minimum hours of operation, nature of employment of staff, minimum infrastructure configuration, nature of ownership of infrastructure and premises, and minimum customer protection. In addition, this mandate is to be reviewed regularly and be phased out once the goals specified in the vision statement for payments services and deposit products have been achieved.

3.4 Aadhaar is the key piece of infrastructure to enable a customer to be identified and authenticated so that repudiation and fraud risks are minimised and therefore should become the universal basis for authentication. However, with slow enrolment in some areas and low penetration of biometric devices and internet

network connectivity in many areas, intermediate authentication methods such as PIN numbers and OTP could be used. State Governments need to coordinate more closely with UIDAI, NPR, and BBNL to ensure rapid coverage of their states for both Aadhaar and broadband.

3.5 Restore the permission of ND-NBFCs to act as BCs of a bank. Concerns around commingling can be effectively handled through technology-based solutions such that all settlements happen on an intra-day basis. In addition, eliminate the distance criteria between the BC and the nearest branch of the sponsor bank. Allow Banks to decide operational criteria.

3.6 The Taskforce on Aadhaar Enabled Unified Payment Infrastructure recommended that State Governments pay a fee of 3.14 per cent (subject to a cap of Rs. 15.71 per transaction) for Direct Benefit Transfer (DBT) payments originating from governments. RBI should enjoin upon State Governments to implement the same.

3.7 In order to address contagion risk concerns, instead of requiring White Label ATMs to access the settlement systems in a “nested” manner through a sponsor bank, provide them direct access to the settlement system subject to certain prudential conditions, to mitigate operation risk.

3.8 In order to ensure that the BC infrastructure that is established is utilised in an optimal manner and shared by multiple banks, which may each have account holders in a specific geography, allow high-quality White Label BCs to emerge with direct access to settlement systems subject to certain prudential conditions. This would be similar to Recommendation 3.7 vis-à-vis mitigating operations risk in the White Label ATM network.

3.9 Given the difficulties being faced by PPIs and the underlying prudential concerns associated with this model, the existing and new PPI applicants should instead be required to apply for a Payments Bank licence or become Business Correspondents. No additional PPI licences should be granted.

3.10 Under the Banking Regulation Act, a set of banks may be licensed which may be referred to as Payments Banks with the following characteristics:

a. Given that their primary role is to provide payment services and deposit products to small businesses and low-income households, they will be restricted to holding a maximum balance of Rs. 50,000 per customer.

b. They will be required to meet the CRR requirements applicable to all the Scheduled Commercial Banks.

c. They will be required to deposit the balance proceeds in approved SLR securities with a duration of no more than three months and will not be permitted to assume any kind of credit risks.

d. In view of the fact that they will therefore have a near-zero risk of default, the minimum entry capital requirement for them will be Rs. 50 crore compared to the Rs. 500 crore required for full-service SCBs.

e. They will be required to comply with all other RBI guidelines relevant for SCBs and will be granted all the other rights and privileges that come with that licence.

f. Existing SCBs should be permitted to create a Payments Bank as a subsidiary.

3.11 RBI to work with TRAI to ensure that all mobile phone companies, including those with Payments Bank subsidiaries, be mandated to provide USSD connectivity as per recent TRAI regulations with the price cap of Rs. 1.5 per 5 interactive sessions and to categorise all SMSs related to banking and financial transactions as Priority SMS services with reasonable rates and to be made available to the banking system.

**Section 4** examines issues relevant to the goal of sufficient access to affordable, formal credit. The following recommendations are made in this section:

4.1 In order to encourage banks to actively manage their exposures to various sectors, including priority sectors, a number of steps would have to be taken:

a. Banks must be required to disclose their concentration levels to each segment in their financial statements.

b. Credit facilities documented as bonds or Pass-Through Certificates (PTC), whether originated directly or purchased in the secondary markets should be permitted to be held in the “banking book” of a bank based on declared intent and not merely based on source or legal documentation. [Identical to Recommendations 4.10 and 4.30]

c. RBI must represent to the MoF to restore the tax-free status of securitisation SPVs as pass-through vehicles for tax treatment pointing out the role it would play in ensuring efficient risk transmission. [Identical to Recommendations 4.11 and 4.38]

d. Banks must be permitted to purchase portfolio level protection against all forms of rainfall and commodity price risks, including through the use of financial futures and options bought either within India or globally.

4.2 Universal reporting to credit bureaus should be mandated for all loans, both individual and SME, but in particular SHG loans, Kisan Credit Card, and General Credit Card. [Identical to Recommendation 4.43]

4.3 In view of the fact that banks may choose to focus their priority sector strategies on different customer segments and asset classes, it is recommended that the regulator provide specific guidance on differential provisioning norms at the level of each asset class. A bank’s overall NPA Coverage Ratio would therefore be a function of its overall portfolio asset mix. On standard assets, provisioning levels as well as asset classification guidelines specified by RBI would need to reflect the underlying level of riskiness of each asset class (combination of customer segment, product design, and collateral) and not be uniform across all the asset classes. Additionally, different customer-asset combinations behave very differently from each other and it is recommended that the regulator mandate NPA recognition rules at the level of each asset-class and require that all banks conform to these mandates. [Identical to Recommendation 4.21 for NBFCs]

4.4 All banks should be required to publicly disclose the results of their stress tests both at an overall balance sheet level as well as at a segmental level at least annually. [Identical to Recommendation 4.22 for NBFCs]

4.5 From the perspective of Stability that entails sustainable pricing, banks must be required to freely price farm loans based on their risk models and any subventions and waivers deemed necessary by the government should be transferred directly to the farmers and not through interest subsidies or loan waivers. The permission to

price farm loans below the base rate should be withdrawn. [Also see Recommendation 4.34]

4.6 Banks are already permitted to set up specialised subsidiaries upon getting specific approvals from the RBI. However, no approvals have been granted; potentially due to concerns around circumvention of branch licensing guidelines. In light of the recent relaxation of branch licensing guidelines and the capability carry to out consolidated supervision, the requirement of prior approvals may be removed for the purpose of creating dedicated subsidiaries for financial inclusion.

4.7 The decision on the manner in which risk sharing and credit approval arrangements need to be structured between banks and their agents can be left to the judgment of banks. Outsourcing guidelines should be amended to permit this.

4.8 There is a need to develop a robust legal and regulatory framework around customer data generated in various transactions (credit and payments, digital and off-line), with the objective of customer ownership of their own transactions data and its use, among others, for signalling credit-worthiness. RBI should constitute a Working Group comprising TRAI, CERC, and Credit Information Companies to develop a framework for sharing of data between telecom companies, electrical utilities, and credit bureaus. This framework should be in keeping with the FSLRC's draft Indian Financial Code which recommends the creation of regulations on the collection, storage, modification and protection of personal information by financial services providers; and establishment of mechanisms to ensure that consumers have access to, and are given an effective opportunity to seek modifications to, their personal information. [Identical to Recommendation 4.42]

4.9 The stipulation that the all-inclusive interest charged to the ultimate borrower by the originating entity should not exceed the Base Rate of the purchasing bank plus 8 per cent per annum should be removed. [Identical to Recommendation 4.37]

4.10 Credit facilities documented as bonds or Pass-Through Certificates (PTC), whether originated directly or purchased in the secondary markets should be permitted to be held in the "banking book" of a bank based on declared intent and not merely based on source or legal documentation. [Identical to Recommendations 4.1(b) and 4.30]

4.11 RBI should also represent to the Government of India to restore the tax-free status of securitisation SPVs as pass-through vehicles for tax treatment so as to create pathways for Wholesale Banks to provide liquidity to other Banks and Financial Institutions directly originating assets in priority sectors. [Identical to Recommendations 4.1(c) and 4.38]

4.12 Reorient the focus of NABARD, CGTMSE, SIDBI, and NHB to be market makers and providers of risk-based credit enhancements rather than providers of direct finance, automatic refinance, or automatic credit guarantees for National Banks.

4.13 Regional Banks continue to have a strong appeal for inclusion but low demonstrated stability in the Indian context. Robust solutions are required vis-à-vis regulation, supervision, risk management, and governance of the existing Regional Banks before any new ones are created.

4.14 In a manner similar to National Banks, for Regional Banks as well, refinance by NABARD or credit guarantee support by CGTMSE should be designed as risk-based guarantees and not available automatically. [Similar to Recommendation 4.12]

4.15 While the Risk Based Supervision process has been designed for the larger and more complex institutions, a similar effort could be conceived of for the Regional Banks allowing supervisors to direct scarce on-site supervision resources to higher-risk institutions. The help of commercial ratings agencies could also be taken to formally rate these Regional Banks and provide the ratings to the depositors on a regular basis – thus including them more directly into the risk-containment process.

4.16 Since DICGC offers deposit insurance to these banks, the Agreement between DICGC and the bank provides an additional opportunity to both ensure that the bank is run well on an on-going basis and resolved quickly in the event that it turns insolvent. Such an Agreement would provide for risk-based pricing of deposit insurance; the right to carry out both on-site and off-site inspections; and to take possession of the bank in the event that it goes into liquidation.

4.17 A State Finance Regulatory Commission (SFRC) could be created into which all the existing State Government-level regulators could be merged and functions like the regulation of NGO-MFIs and local Money Services Business could be added on. In some states, the SFRC could be created by upgrading existing Institutional Finance Cells. There is also value in bringing the regulatory function close to the enforcement function under the Economic Offences Wing (EOW), so as to ensure that they are working closely together. The RBI must be closely involved over a longer time frame in training the commissioners and licensing and accrediting the Commission itself. The local regional directors of the RBI could, for example, be ex-officio Chairs of the Commission's Board of Governors while the Commissioner could be a senior State level appointee drawn from the local Banking community. The District Magistrates would also play an important role in their respective districts.

Non-Banking Finance Companies

4.18 The Committee recognises that a partial convergence of NBFC and Bank regulations may be desirable. It recommends the following:

| Regulations | Banks | NBFC | Recommendation |
|---|---|---|---|
| Minimum Capital Adequacy | 9% | 15% | No case for convergence. |
| Cash Reserve Ratio | 4% | N.A | CRR applicable on bank deposits, shift to exclude time deposits recommended. |
| Statutory Liquidity Ratio | 23% | 15% for D-NBFCs on their deposits | Complete elimination recommended. |
| Duration to qualify for NPA | Non-repayment for 90 days | Non-repayment for 180 days | Case for convergence. Risk-based approaches to be followed for both types of institutions. |
| Definition for sub-standard asset | NPA for a period not exceeding 12 months | NPA for a period not exceeding 18 months | Case for convergence. Risk-based approaches to be followed for both types of institutions. |

| Definition for doubtful assets | Remaining sub-standard asset for a period of 12 months | Remaining sub-standard asset for a period exceeding 18 months | Case for convergence. Risk-based approaches to be followed for both types of institutions. |
|---|---|---|---|
| Quantum of provisioning for Standard Assets | Direct advances to agricultural and Small and Micro Enterprises (SMEs) sectors at 0.25% | 0.25% | Case for convergence. Risk-based approaches to be followed for both types of institutions. For agricultural advances, this would imply at least 0.40%. |
| Priority Sector | 40% of ANBC | NIL | No case for convergence. |
| Deposit Insurance | YES | NO for D-NBFCs | No case for convergence. |
| SARFAESI eligibility | YES | NO | Case for convergence subject to strong customer protection guidelines. |
| Lender of Last Resort | YES | NO | No case for convergence. |
| Risk Weights | Differential | 100% for all assets | No case for convergence. |
| Entry Capital Requirement | Rs. 500 crore | Rs. 2-5 crore | No case for convergence. |

4.19 Multiple NBFC definitions should be consolidated into two categories: a distinct category for Core Investment Companies (CIC) and another category for all other NBFCs. Benefits that were previously available to specific NBFC types, such as tax benefits, bank limits, and priority sector benefits should continue to be available even after consolidation, on a pro-rata asset basis.

4.20 The Committee recommends addressing wholesale funding constraints faced by NBFCs in a systematic manner. The following are the specific recommendations in this regard:

a. A clear framework to be developed by RBI and SEBI for Qualified Institutional Buyers and Accredited Individual Investors who may participate in debt market issuances of NBFCs.

b. Benefit of ‘shelf prospectus’ should be available for one year to all issuers including NBFCs.

c. Permit ECB in Rupees for all institutions.

d. For ECB not in Rupees, eligibility should be linked to size and capacity to absorb foreign exchange risk rather than specific NBFC categories.

e. The nature of activity, rather than institution type, must be made the criterion for availing refinance from NABARD, NHB, SIDBI and credit guarantee facilities.

f. Current capitalisation slabs on foreign equity funding should be relaxed and money laundering concerns should be mitigated by instituting additional reporting requirements on Banks/Authorised Dealers (AD).

4.21 In a manner similar to banks, different customer-asset combinations behave very differently from each other and it is recommended that the regulator specify NPA recognition and provisioning rules, including for standard assets, at the level of each asset-class and require that all NBFCs conform to these mandates. [Identical to Recommendation 4.3 for National Banks]

4.22 Require all NBFCs to have better on-going risk measures. These include disclosure of their stress test results both at an overall balance sheet level as well as at a segmental level at least annually. All NBFCs must adopt core banking systems so that this can enable better off-site supervision. [Identical to Recommendation 4.4 for National Banks]

4.23 Enable better benchmarking by requiring all NBFC-MFIs to disclose their operating costs (direct and indirect) of a mature branch to the RBI or MFIN once it becomes an SRO.

4.24 The regulatory focus must be on total indebtedness of the small borrower in relation to their debt-servicing capacity and not just indebtedness per se or merely from NBFC-MFIs. Keeping this in mind, the total borrowing limit for the small borrower segment may be increased immediately to Rs. 100,000 across all lenders, including bank-lending to this segment. In order to implement this, all lenders to this segment will need to be mandated to report to the credit bureau as has been the case with NBFC-MFIs. If total indebtedness is being tracked adequately, the stipulation of a maximum number of lenders appears redundant and can be gradually removed as this would also help in creating intensified price competition.

4.25 All policy biases against consumption finance need to be removed. An example of this is restricting the proportion of consumption finance that is permitted for NBFC-MFIs.

4.26 In order to enable the gradual transition of eligible and interested NBFCs to Wholesale Consumer Banks or Wholesale Investment Banks or National Banks, the Committee recommends a re-examination of PSL definitions [also see Recommendation 4.41], creating an active market for PSL assets, assessment of the relevance of SLR in light of capital adequacy norms, and application of CRR on time liabilities.

4.27 Under the Banking Regulation Act, a set of banks may be licensed which may be referred to as Wholesale Banks with the following characteristics:

a. Given that their primary role is lending and not the provision of retail deposit services, they will only be permitted to accept deposits larger than Rs. 5 crore.

b. Since they could expect to borrow large amounts from other banks, net liabilities from the banking system will be permitted to be deducted from their NDTL computation for the purposes of ascertaining their SLR obligations on par with the treatment currently given for CRR.

c. Since other banks are expected to lend large amounts to Wholesale Banks, those other banks will be permitted to deduct their net assets to the banking system from the computation of their ANBC (the amounts on which PSL requirements are to be applied).

d. In view of the fact that they will not take retail deposits, the minimum entry capital requirement for them will be Rs. 50 crore compared to the Rs. 500 crore required for full-service SCBs.

e. If the institution has fewer than twenty branches through which it operates, it will not be required to meet the 25 per cent branching requirement. Institutions with twenty or fewer branches could be referred to as Wholesale Investment Banks while those with a larger branch network could be referred to as Wholesale Consumer Banks.

f. Wholesale Consumer Banks should be permitted to act as BCs for other full service Banks.

They will be required to comply with all other RBI guidelines relevant for SCBs and will be granted all the other rights and privileges that come with that licence.

Priority Sector Lending

4.28 All loans given to landless labourers and small and marginal farmers should be counted as a part of Direct Agriculture and not merely the wages component of a loan given to a farmer for financing her agricultural production.

4.29 Investment by banks in bonds of institutions must qualify for PSL where wholesale lending to the same institutions already qualifies under PSL.

4.30 Credit facilities documented as bonds or Pass-Through Certificates (PTC), whether originated directly or purchased in the secondary markets should be permitted to be held in the “banking book” of a bank based on declared intent and not merely based on source or legal documentation. [Identical to Recommendations 4.1(b) and 4.10]

4.31 Investment by banks in the form of non-fund based limits (such as guarantees) should qualify for PSL to the extent of the credit equivalent amount of the off-balance sheet facility where loans to these categories qualify for PSL. ANBC should also be adjusted to include such PSL-linked, non-fund based limits.

4.32 Equity investments by banks in complementary infrastructure within the purview of PSL guidelines, such as rural warehouses, market yards, godowns, silos, and NBFCs in low financial depth districts. These equity investments should be eligible for contribution to the overall priority sector lending targets. They should be permitted where debt already qualifies for PSL but with a multiplier of four, to reflect the higher risk and the illiquid character of these investments. The benefit must accrue as long as the equity investment is held by the Bank. This list of eligible equity investments may be varied from time-to-time. [Identical to Recommendation 4.44]

4.33 PSL targets should be applicable on the last reporting Friday during the last month of each quarter in exactly the same manner as it is currently applicable in the month of March, so as to ensure more timely and continuous credit flow into

priority sectors. In order to ensure administrative ease, requirements such as investment into RIDF can continue to be levied on an annual basis and computed on the basis of the average of the quarterly requirements.

4.34 If the government does desire to provide relief in any form to the small farmer, it would be best carried out as a direct benefit transfer (DBT) to the bank account of the farmer and not through the mechanism of either interest subvention or debt waiver. This would ensure that the banking system is able to price loans in a sustainable manner and also protect credit discipline amongst its borrowers. Adding a universal requirement to report all defaults to credit bureaus would ensure that the borrower also builds a strong interest in protecting his credit history, even if he is a recipient of DBTs. [Similar to Recommendations 4.2 and 4.43]

4.35 In order to guard against large scale defaults resulting from catastrophic events, banks should be permitted to work closely with insurance companies to purchase bank-wide portfolio level insurance against events such as large scale rainfall failure on a regional or national basis, instead of having an expectation that relief would be provided from national or state budgets.

4.36 For the provision of food-credit, Food Corporation of India (FCI) and State Governments should be required to originate warehouse receipts and raise low-cost funds in the market against these receipts instead of being reliant only on bank credit. [Identical to Recommendation 4.46]

4.37 The stipulation that the all-inclusive interest charged to the ultimate borrower by the originating entity should not exceed the Base Rate of the purchasing bank plus 8 per cent per annum should be removed. [Identical to Recommendation 4.9]

4.38 The RBI should represent to the Government of India to restore the tax-free status of securitisation SPVs as pass-through vehicles for tax treatment so as to create pathways for Wholesale Banks to provide liquidity to other Banks and Financial Institutions directly originating assets in priority sectors. [Identical to Recommendation 4.11]

4.39 While a market that trades PSL assets will be of critical importance, regulation should additionally enable the use of risk-free PSL Certificates as a means to achieving PSL compliance amongst banks that wish to do so.

4.40 In order to enable greater regional and sectoral specialisation among Banks, the Committee recommends that the RBI revise the PSL targets and require banks to meet an Adjusted PSL target of 50 per cent against the current requirement of 40 per cent. Districts and sectors are weighted based on the difficulty in lending to them, and a Bank lending to a difficult sector in a difficult to reach district can benefit from a multiplier value based on the specific sector and district. Every sector-district combination has a weight associated with it and the Bank will have to reach an adjusted PSL value of 50% taking these weightages into account.

4.41 The Committee recommends that RBI seriously examine moving to a new framework in which two parameters: District level credit depth, and sector and sub-sector level credit depth be used to determine the sector, sub-sector, and regional weights which are published every three years. Using these weights banks would be required to reach an Adjusted PSL target of 150 per cent of ANBC.

4.42 There is a need to develop a robust legal and regulatory framework around customer data generated in various transactions (payments and credit, digital and off-line), with the objective of customer ownership of their own transactions data and its use, among others, for signalling credit-worthiness. RBI should constitute a Working Group comprising TRAI, CERC, and Credit Information Companies to develop a framework for sharing of data between telecom companies, electrical utilities, and credit bureaus. This framework should be in keeping with the FSLRC's draft Indian Financial Code which recommends the creation of regulations on the collection, storage, modification and protection of personal information by financial services providers; and establishment of mechanisms to ensure that consumers have access to, and are given an effective opportunity to seek modifications to, their personal information. [Identical to Recommendation 4.8]

4.43 Universal reporting to credit bureaus should be mandated for all loans, both individual and SME, but in particular SHG loans, Kisan Credit Card, and General Credit Card. [Identical to Recommendation 4.2]

4.44 Equity investments by banks in complementary infrastructure within the purview of PSL guidelines, such as rural warehouses, market yards, godowns, silos, and NBFCs in low financial depth districts. These equity investments should be eligible for contribution to the overall priority sector lending targets. They should be permitted where debt already qualifies for PSL but with a multiplier of four, to reflect the higher risk and the illiquid character of these investments. The benefit must accrue as long as the equity investment is held by the Bank. This list of eligible equity investments may be varied from time-to-time. [Identical to Recommendation 4.32]

4.45 For the provision of food-credit, Food Corporation of India (FCI) and State Governments should be required to originate warehouse receipts and raise low-cost funds in the market against these receipts instead of being reliant only on bank credit. [Identical to Recommendation 4.36]

4.46 RBI needs to write to each of the State Governments expressing its support for the recommendations of both the PLATINUM Group and the Rajan Committee (2009) and urge them to implement those ideas by pointing out the potential benefits to the expansion of banking and financial activity in their respective states.

4.47 Banks and Financial Institutions should be required to verify the land records of their clients at the time of making loans and in those states where this is possible, to insist that transfers take place before a loan can be renewed for a second time.

4.48 Equity investments by banks in private companies engaged in the task of installing and operating weather stations, or in creating markets for second-hand assets should be eligible for PSL treatment. These investments should also get a multiplier of four, to reflect the higher risk and the illiquid character of these investments. [Also see Recommendation 4.44]

**Section 5** examines issues relevant to the goal of universal access to investment and risk management products. The following recommendations are made in this section:

5.1 Every resident should be issued a Universal Electronic Bank Account (UEBA) automatically at the time of receiving their Aadhaar number by a high quality, national, full-service bank. An instruction to open the bank account should be initiated by UIDAI upon the issuance of an Aadhaar number to an individual over the age of 18. The bank would need to be designated by the customer from

amongst the list of banks that have indicated to UIDAI that they would be willing to open such an account with the understanding that it would attract no account opening fee but that the bank would be free to charge for all transactions, including balance enquiry with the understanding that such transactions' charges would provide the host banks with adequate compensation. The Bank would be required to send the customer a letter communicating details of the account thus opened. The Committee recommends that the RBI issue a circular indicating that no bank can refuse to open an account for a customer who has adequate KYC which specifically includes Aadhaar. [Identical to Recommendation 3.1]

5.2 RBI should require a strong Proof of Identity (POI) for each and every customer and a documentary proof of one national address but waive the requirement of documentary proof for the current address, for the purpose of opening a full-service bank account. It should instead enjoin upon banks to carry out careful tracking of usage and transactions patterns to ascertain the risk levels of the customer and take necessary action based upon risk-based surveillance processes developed internally by each bank. RBI must take the lead in developing this as a convergent approach to KYC across all regulators for their respective products. [Identical to Recommendation 3.2]

5.3 In keeping with the goal of creating integrated providers for financial services delivery, RBI should publish a guideline towards the appointment of entities regulated by it, including National Banks, Regional Banks, or NBFCs, as agents. This guideline should set out the following eligibility criteria for agents:

a. The Agent must not have been subjected to any disciplinary proceedings under the rules, regulations and bye-laws of a stock exchange, SEBI, RBI, IRDA, FMC, or any other regulator with respect to the business involving either organisation, partners, directors, or employees;

b. All Agents must be required to commit some capital against operating risks and customer protection risks for the business that they are engaged in. While the minimum amount may be structured as a Rs. 5 lakh security deposit from the agent, the amount may vary depending on the number of customers and volume of transactions;

c. There must be suitable limits on cash holding as also limits on individual customer payments and receipts;

d. Transactions should be accounted for and reflected in the Principal's books by end of day or next working day. Where the transfer of money from agent to Principal happens on the next working day, there should also be a stipulation that the agent should transfer the day's collections to a non-operative pooled collections account on the same day itself. To ensure this, the Agent has to maintain the account with a bank which has online fund transfer facility with standing instructions to transfer the funds to the designated pool account at the end of each day. This ensures that the clients' funds are secure even if the agent goes bankrupt;

e. To counter the risk of repudiation of transactions, RBI should insist that every transaction be initiated by the customer. Biometric authentication can help achieve this. The log of each transaction must be maintained at the agent level. Each transaction must carry a transaction number and customer must receive the transaction receipt at the time of the transaction;

f. The Agent must have trained staff that can communicate with the clients about the details of the products and take full responsibility for communicating with the clients. The Agent must have a comprehensive human resource policy, including an incentive plan for staff that not only encourages them to achieve the business objectives but more importantly prevents mis-selling;

g. The Agent should adopt the Suitability principles of the RBI as well as those of the Principal's regulator. The Agent should also have a mechanism to address queries and grievance of the customer about the services rendered by it and publicise it widely through electronic and print media. All customer grievances should be addressed within a defined time frame.

RBI could then request each regulator to follow this integrated approach to Agent appointment for its respective products.

**Section 6** examines issues in customer protection. The following recommendations are made in this section:

6.1 The RBI should issue regulations on Suitability, applicable specifically for individuals and small businesses, to all regulated entities within its purview, i.e., banks, NBFCs and payment institutions (under Sections 35 A of the BR Act, Section 45 JA of the RBI Act and Section 38 (2) of the Payments and Settlement System Act, 2007); so that the violation of such regulations would result in penal action for the institution as contemplated under the aforesaid statutes through a variety of measures, including fines, cease-and-desist orders, and modification and cancellation of licences. These regulations should be applicable specifically for individuals and small businesses defined under the term "retail customer" by FSLRC. FSLRC defines a retail customer as "an individual or an eligible enterprise, if the value of the financial product or service does not exceed the limit specified by the regulator in relation to that product or service." Further, an eligible enterprise is defined as "an enterprise that has less than a specified level of net asset value or has less than a specified level of turnover." All financial firms regulated by the RBI would be required to have an internal process to assess Suitability of products prior to advising clients with regard to them. The RBI would provide the following guidance with regard to the internal compliance requirements for firms regarding Suitability:

a. The Board should approve and oversee the procedures put in place for Suitability on an annual basis and attempt to detect and correct any deviations from procedure.

b. The firm would have to carry out a limited due diligence of the customer and put in place a process to assess the appropriateness of any product offered to a customer based on the results of the diligence. With respect to credit, for instance, the firm could be obliged to check the borrower's information from credit bureaus to determine the current level of indebtedness, make reasonable attempts to determine the current and projected income of the borrower, financial capacity, objectives and risk tolerance of the borrower, to determine the repayment capacity of the borrower. The lender should seek appropriate documentation to evaluate income and the ability of the borrower to repay given the increasing interest rates of the loan.

c. The requirement to conduct a due diligence should include the requirement to obtain relevant information about the customer's personal circumstances and

give advice or recommendations based on due consideration of the relevant personal circumstances. If the financial firm finds that the information is inaccurate or incomplete, the customer must be warned.

d. Any product may be offered to customers upon establishing its Suitability, except “globally unsuitable” products discussed in (m).

e. In the event a customer chooses to purchase a product considered unsuitable to the customer, the financial services provider should consider providing written advice to the customer and seeking acknowledgement from the customer. This should however, not be misused by the financial services provider.

f. The firm’s internal rules relating to compensation packages of staff should not create incentives or otherwise promote inappropriate behaviour. In addition, requirements relating to Suitability and appropriateness should be embedded into compensation packages. Accordingly, the compensation packages and incentive structures should not be based solely on numerical targets but should include qualitative aspects such as offering appropriate products and services to customers and complying with requirements of the internal policy relating to Suitability etc.

g. The firms should have internal processes to track compliance with Suitability and an internal process to detect and correct any deviations from the policy, including potential disciplinary action and sanctions for the staff for any deviations. This could include a customer audit committee which reports to the board that is responsible for determining compliance with the Suitability process and other customer protection initiatives of the financial services provider.

h. The firm must have internal grievance redressal mechanisms for non-compliance with process and this should be required to be communicated to customers as well. The customers, should however be made aware that it is the process that is guaranteed and not the outcome. An internal grievance redressal process would not, however, preclude a customer from proceeding against the firm in any other forum.

i. The internal policy and procedure of the board should be communicated across the organisation and appropriate training programs should be put in place for the staff- both the client facing and the control staff. Such communication should articulate inter alia (a) the business benefits of having Suitability requirements, (b) the firm’s commitment to a zero-tolerance approach to follow the process, and (c) the consequences for the breach.

j. The firms should have a paper trail and record keeping procedures to demonstrate compliance with its internal procedures which should be available for inspection by the RBI.

k. Additionally, if gross negligence, fraud or wilful misconduct can be established on the part of the financial services provider, the adherence to the process will not be sufficient and the firm would be liable to be penalised regardless of the process.

l. The regulations should additionally protect the firm from penal action in a situation where the customer may have deliberately misled or misrepresented to

the firm, or if despite reasonable attempts the firm was unable to assess Suitability.

m. In addition, specific products may be deemed as “globally unsuitable” and would not be eligible to be offered to households or businesses below a certain income threshold or net worth or individuals above a certain age. Such products should be prescribed by the RBI and could be amended from time to time based on feedback from customers and financial services providers.

n. There is a specific set of de minimis products, the offer of which is to be subjected to a limited application of the Suitability requirements - basic bank accounts, the universal electronic bank account recommended in the Report and credit below Rs. 5000 subject to ascertaining the income and repayment capacity of the borrower. However, the Suitability process should definitely apply if an insurance, investment or derivative product is being offered to a customer, whether on a standalone basis or bundled along with credit.

6.2 The Committee recommends that a unified Financial Redress Agency (FRA) be created by the Ministry of Finance as a unified agency for customer grievance redress across all financial products and services which will in turn coordinate with the respective regulator. The FRA should have a presence in every district in the country and customers should be able to register complaints over the phone, using text messages, internet, and with the financial services provider directly, who should then be required to forward the complaint to the redressal agency. The customers should have their complaints resolved within 30 days of registration of the complaint with the FRA.

6.3 The RBI should create a system using which any customer can effortlessly check whether a financial firm is registered with or regulated by RBI. Customers should be able to access this service by phone, through text-messages or on the internet. Once the FRA comes into being, this system should be subsumed under the FRA and be available for firms registered under all regulators.

**Section 7** examines issues relevant to measurement and monitoring of comprehensive access to financial services. The following recommendations are made in this section:

7.1 RBI should mandate all formal providers of financial services to households and small businesses to report data on a quarterly basis at the level of each one of their access points such as branches, outlets, BCs, ATMs, and POS terminals, as applicable. This includes data on geo-spatial location, access, services offered, quantum of transactions, depth of penetration, and application of Suitability process. This data should be verified periodically by the RBI using standardised quality control and follow up visits conducted by trained enumeration field teams within randomly selected sub samples.

7.2 In order to measure access, usage, and affordability of financial services, RBI should mandate two surveys of consumers to gain a more accurate picture of progress towards achieving the desired outcomes outlined by the vision statements. The Financial Access & Usage Survey should be a nationally representative survey of consumers undertaken annually to collect data on access and usage of financial services and can be incorporated as additional modules in nationally representative surveys that are being undertaken for other purposes by institutions such as the National Sample Survey Organisation (NSSO) and the Centre for Monitoring Indian Economy (CMIE). The Cost & Return Survey should be a nationally representative

survey of consumers undertaken triennially to collect data on costs of credit, insurance and investment products, as well as returns on deposits and investment products. For this survey, RBI should commission institutions which have appropriate capacity and expertise in conducting such nationally representative surveys with the required academic rigour.